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*The OECD business and finance outlook:
Why investors need to take note*

Tuesday 28 July - Sydney



THE BUSINESS & FINANCE OUTLOOK OF
THE OECD: WHY INVESTORS SHOULD
TAKE NOTICE

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Directorate. The views expressed here are my own, and do
not reflect the views of OECD member countries.





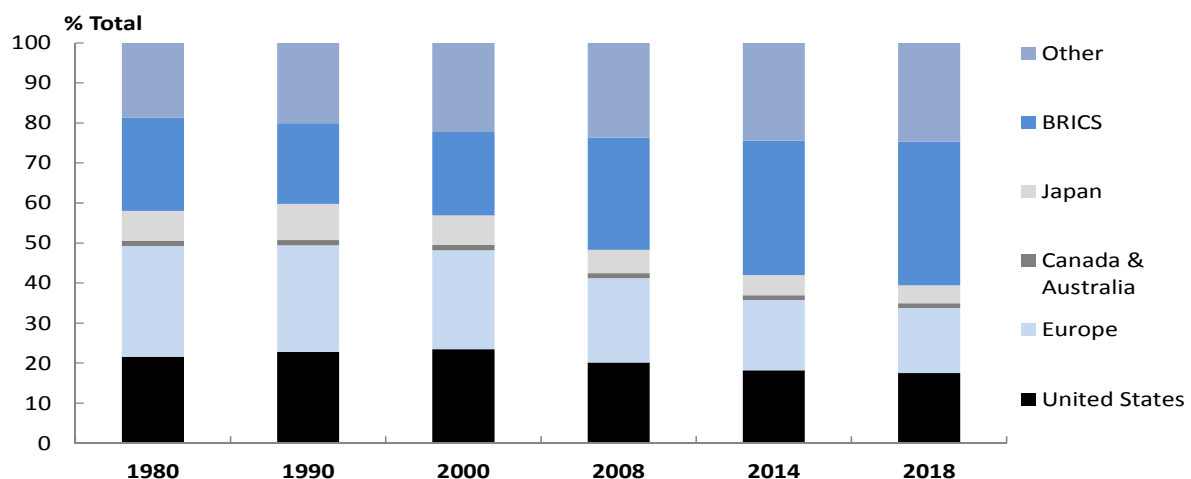
Glenn Stevens Question in Basel

- *“Since the crisis why is it that financial markets see so little risk, while companies that invest in the real economy appear to see so much risk” [i.e. they are not investing].*
- Indeed!
- This is the very issue that the OECD Business and Finance Outlook addresses.

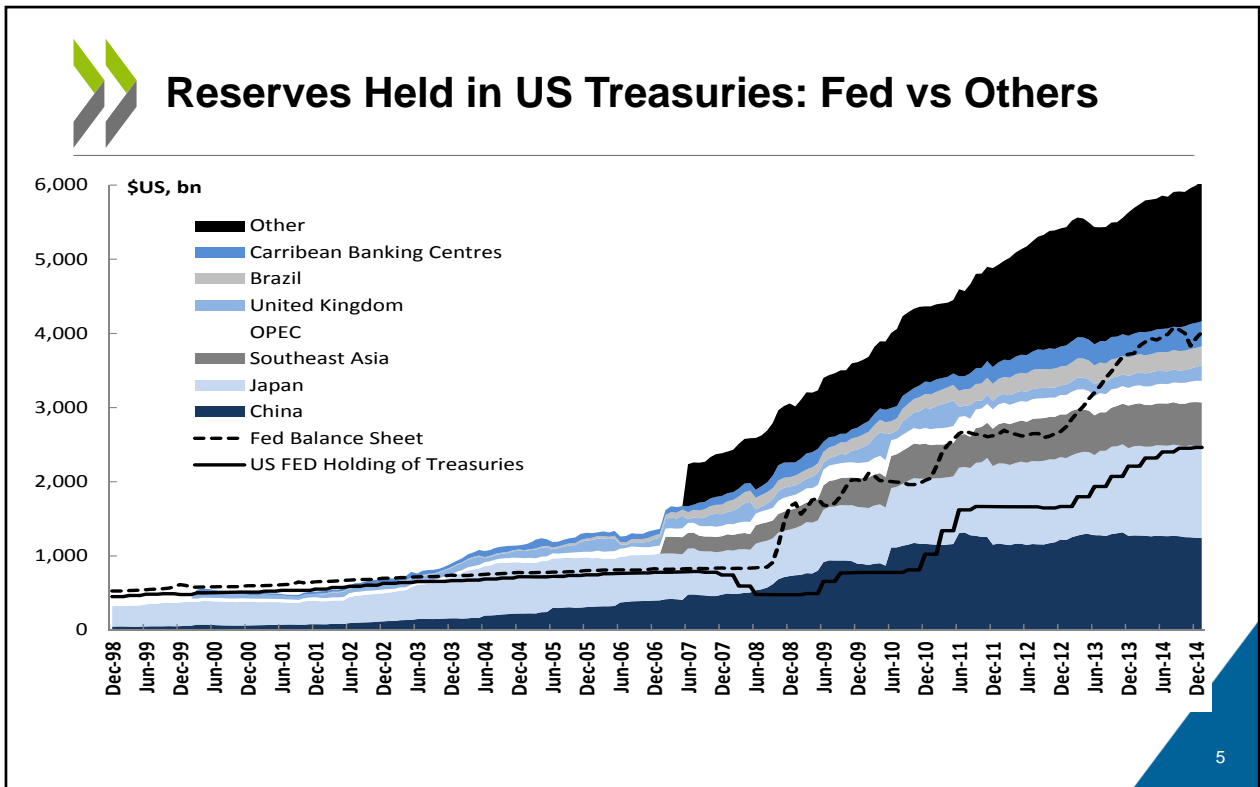
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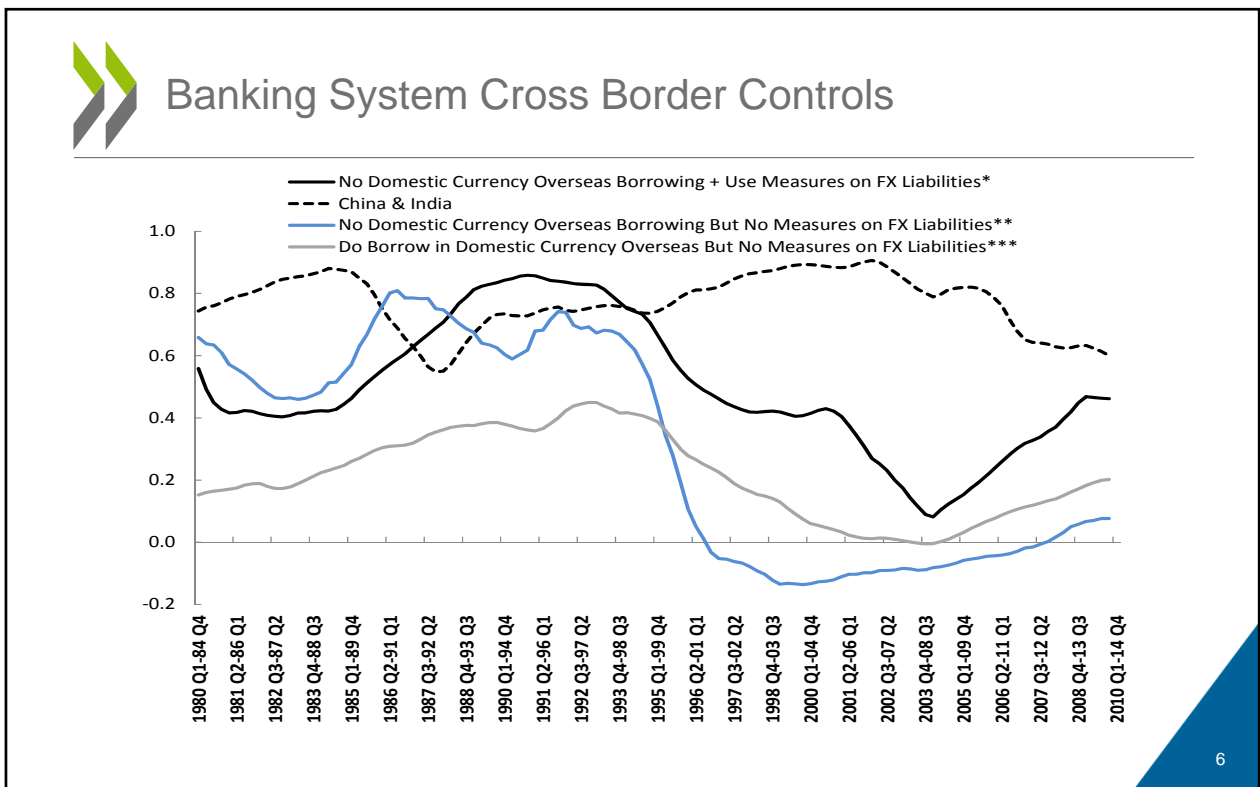
Europe Making Way for Emerging Markets



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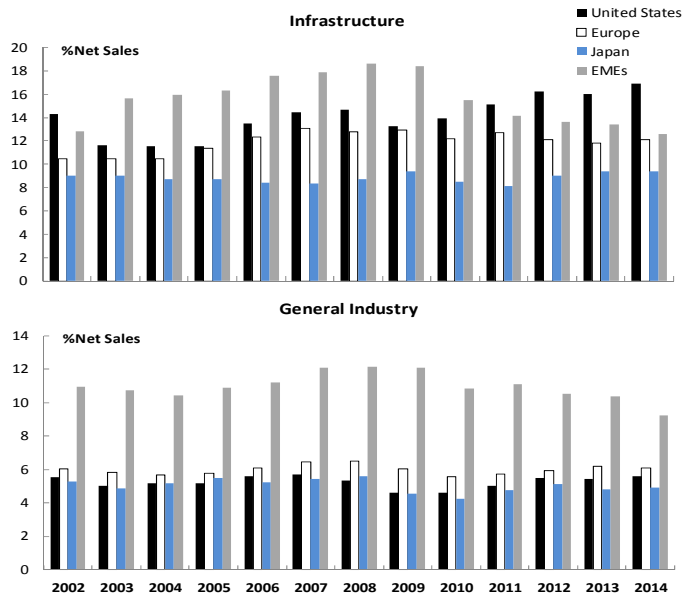
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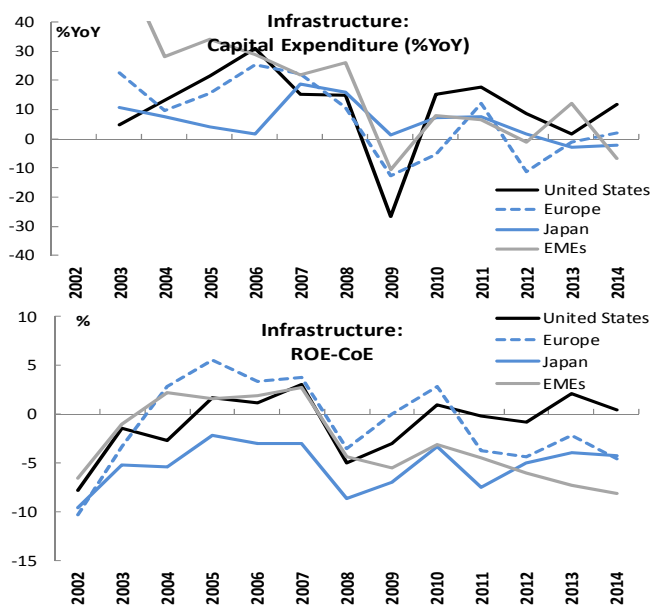
Emerging MNE's Almost Double the CAPEX Rate of Advanced Countries (10,000 of the world's largest listed companies in 75 countries)



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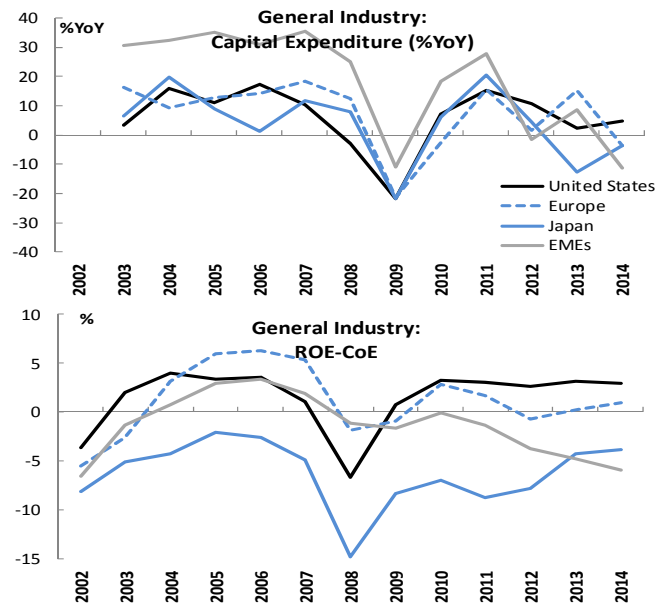
Infrastructure CAPEX & ROE vs COE



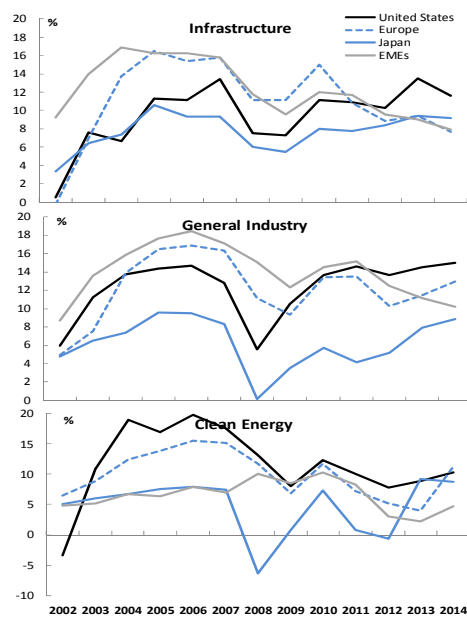
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General Industry CAPEX & ROE-COE

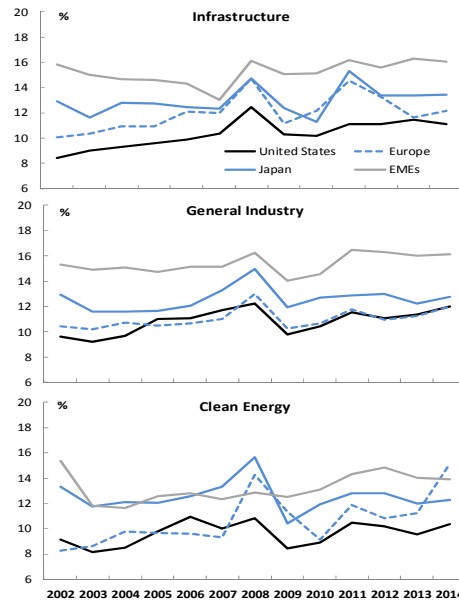


ROE's Declining in EME's and Europe

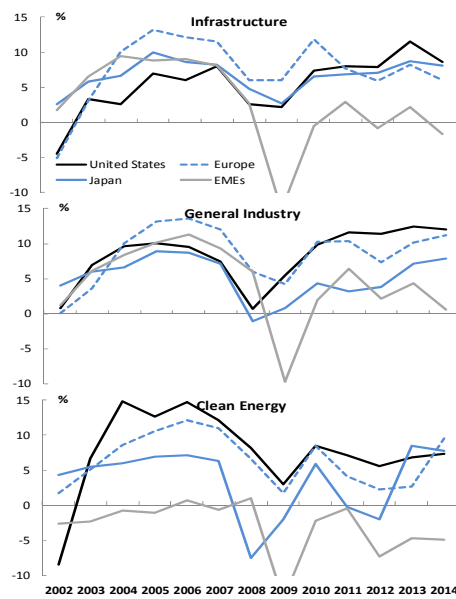




Cost of Equity Higher in EME's



ROE's versus the Cost of Debt Look Better, But are Still Low in EME's





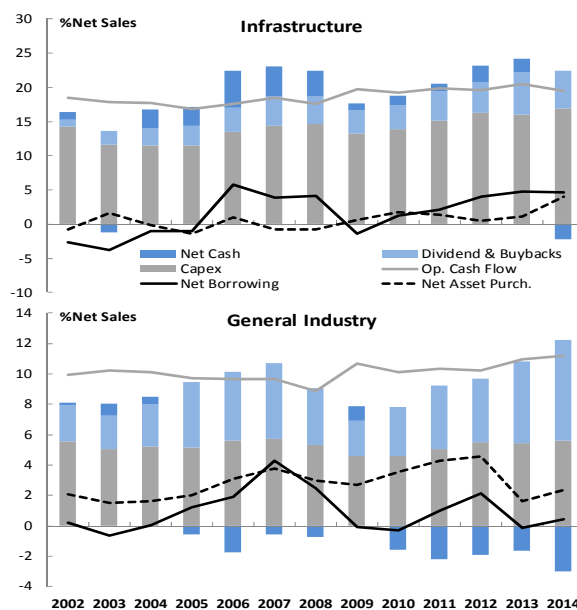
Which Market Investment Strategy Outperformed? Uncertainty? Remuneration CEO's? Tax? Intellectual Property?

Infrastructure & General Industry
(buying the bottom quartile of companies CAPEX / (CAPEX + DIV & BUYBACKS) index and selling the top quartile)

	2009	2010	2011	2012	2013	2014	Cumulative
United States	0.56	1.70	16.18	11.98	3.84	15.55	49.82
Europe	-2.36	3.80	13.84	8.73	9.74	13.47	47.22
Japan	-7.27	0.45	9.63	9.29	2.17	-2.62	11.65
EMEs	-3.71	8.70	10.22	10.74	0.97	-5.52	21.40

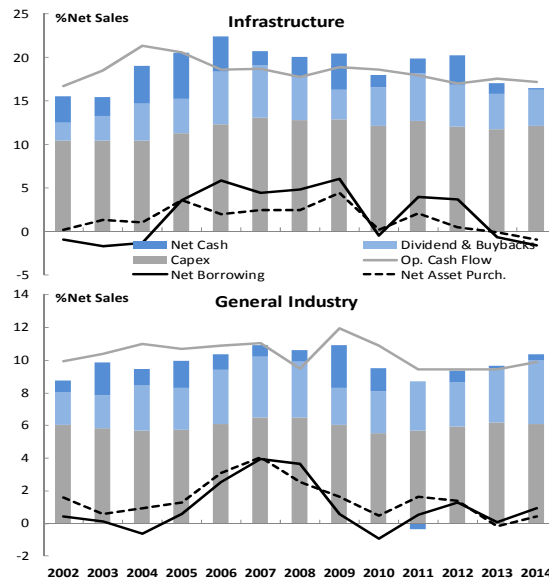


US Companies: Operating Cash Rising & Huge in Buybacks





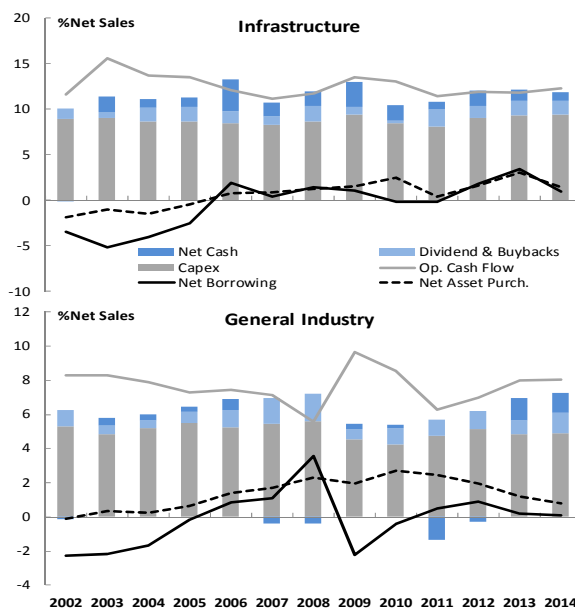
Europe: Operating Cash Enough to do it All



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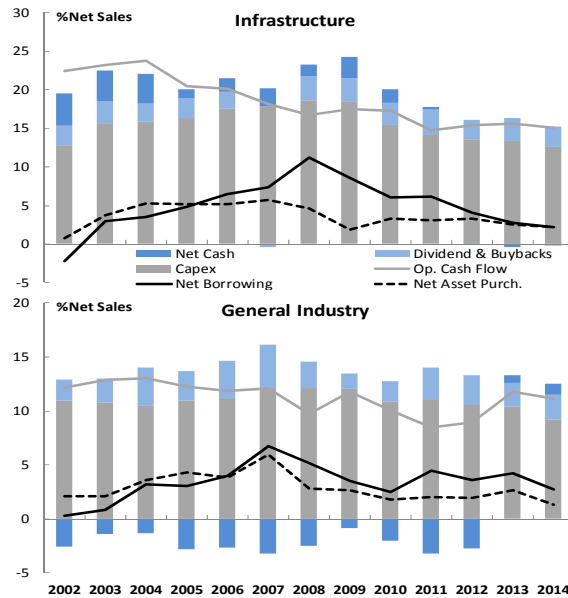
Japan: Operating Cash More than Enough but not all for Investment



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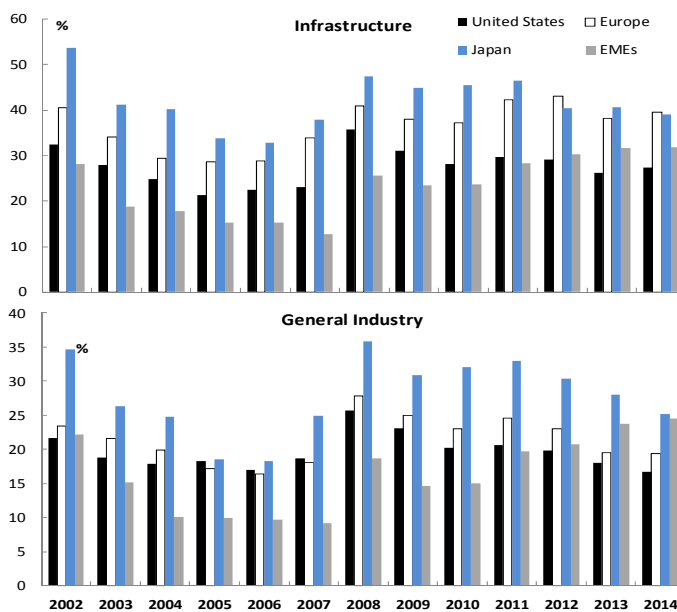
EMEs: Operating Cash No Room for Buybacks



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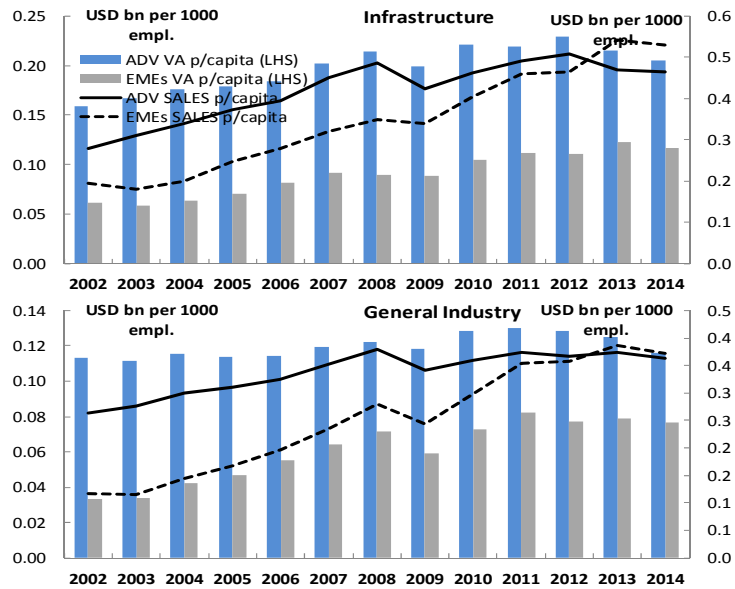
Debt-to-Enterprise-Value Ratios



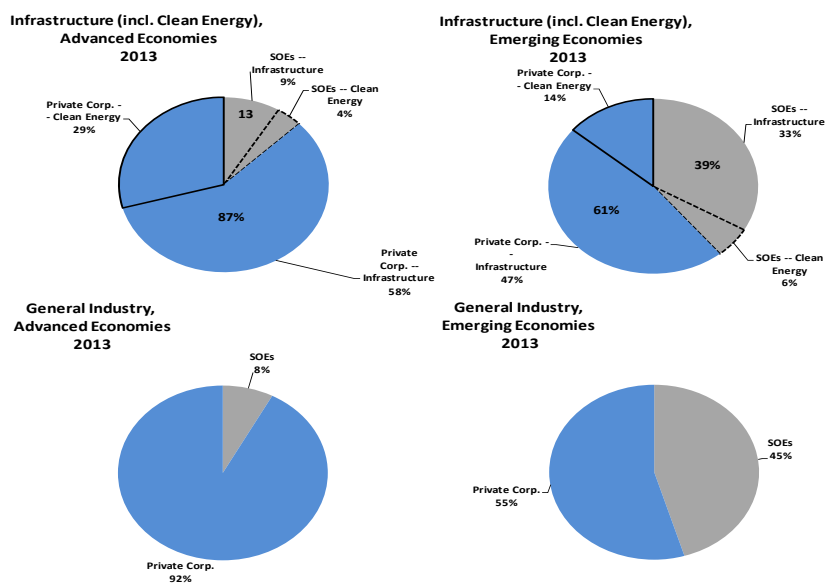
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The MNE Global Productivity Catch-Up: Sales Only



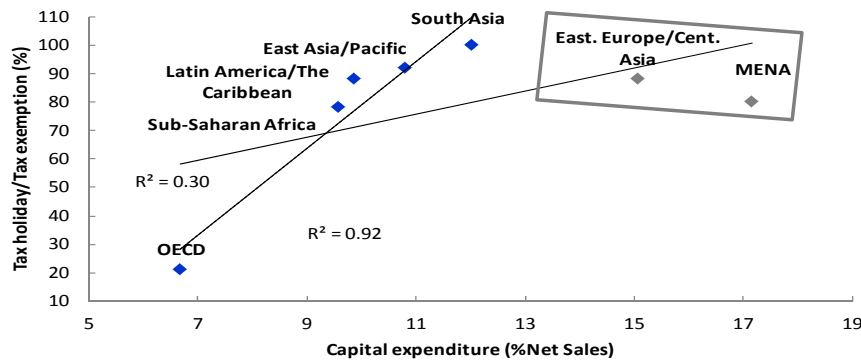
SOE's Proliferate in Emerging Industries (2013)



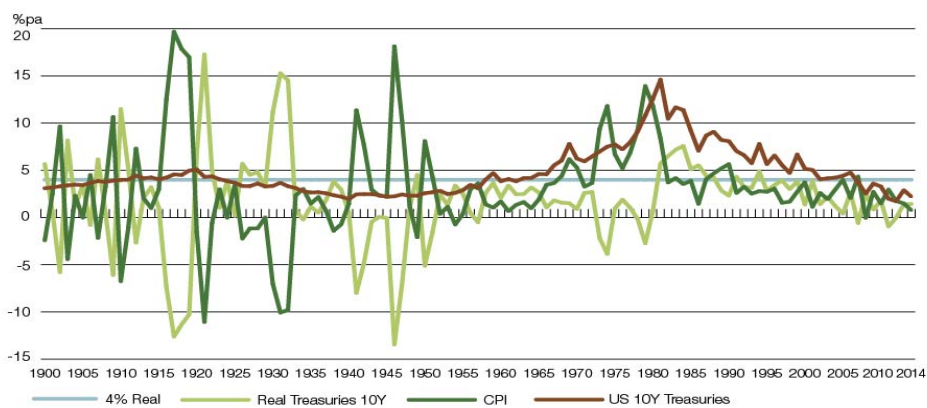


Asia Strong on Tax Holidays to Boost Investment

	Number of Countries Surveyed	Tax holiday/Tax exemption	Capex(%Net Sales)
East Asia/Pacific	7	92	11
Latin America/The Caribbean	25	88	10
OECD	33	21	7
South Asia	12	100	12
Sub-Saharan Africa	45	78	10
East. Europe/Cent. Asia	16	88	15
Middle East/North Africa	15	80	17



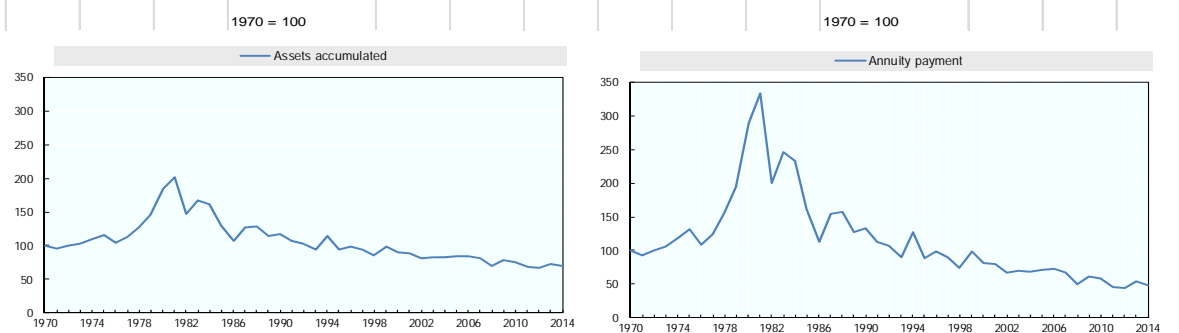
Low interest rates could persist for a long time (3.1)





Pensions & Annuities With Low Rates

Figure 4.12. Changes in retirement income as interest rates change



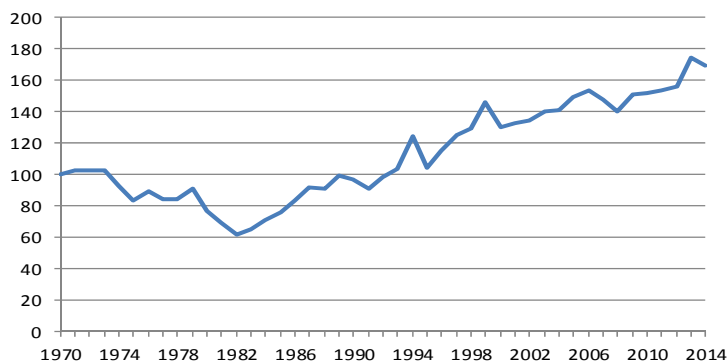
Note: Assets accumulated and annuity payments are calculated for the same hypothetical individual contributing 10% of wages over a 40 year period and retiring at different periods. The assets are invested in a portfolio comprising 60% of variable income and 40% of fixed income. The return on both asset classes used is 4.5% for the former and the historical yields for 10-yr government bonds, kept to maturity, for the latter. The assets accumulated are used at retirement to buy an annuity with a life expectancy of 20 years at age 65 and using the actual government bond yields for calculating the annuity premium. The only variable evolving over time is the yield on government bonds set equal to actual data. Therefore, the evolution of both variables represents the impact of interest rates trending downwards since the 1970.

Source: OECD Secretariat calculations.



Promise Payable Present Value as Rates Fall

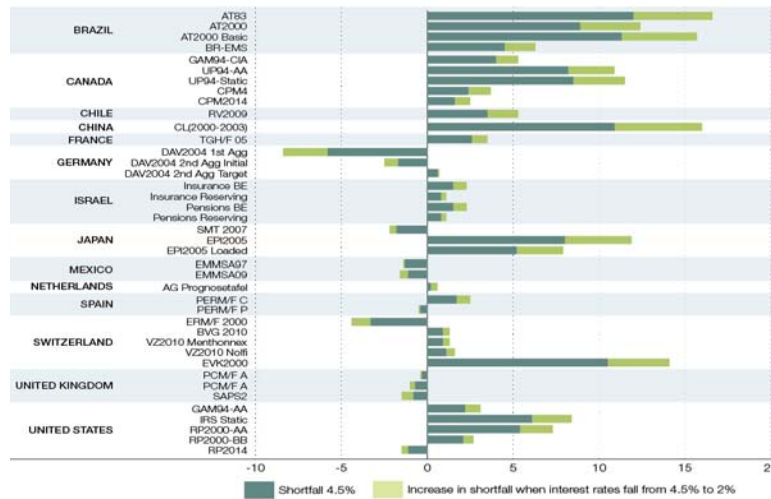
Figure 4.13. Evolution of the present value of a hypothetical fixed cash flow promise payable over 20 years when interest rates fall
(First year present value = 100)



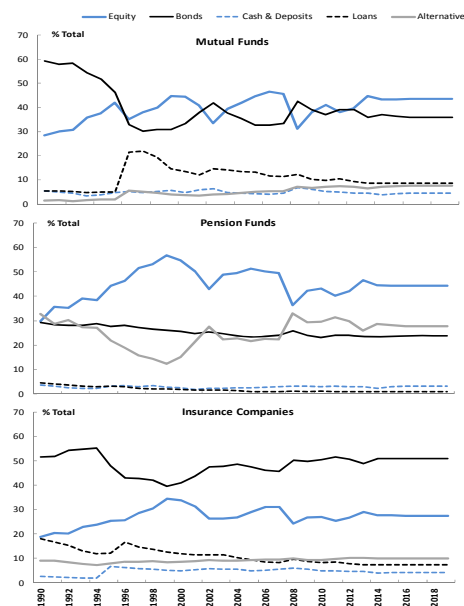
Note: The historical long-term US government bond yield is used to discount the cash flows. The yield in 1970 is used for the present value of the first year. The yield for 2014 is used for calculating the present value of the last year.

Source: OECD Secretariat calculations.

Drop in interest rates increases exposure to longevity risk of mortality tables across countries – average shortfall for women over 65 (4.18)

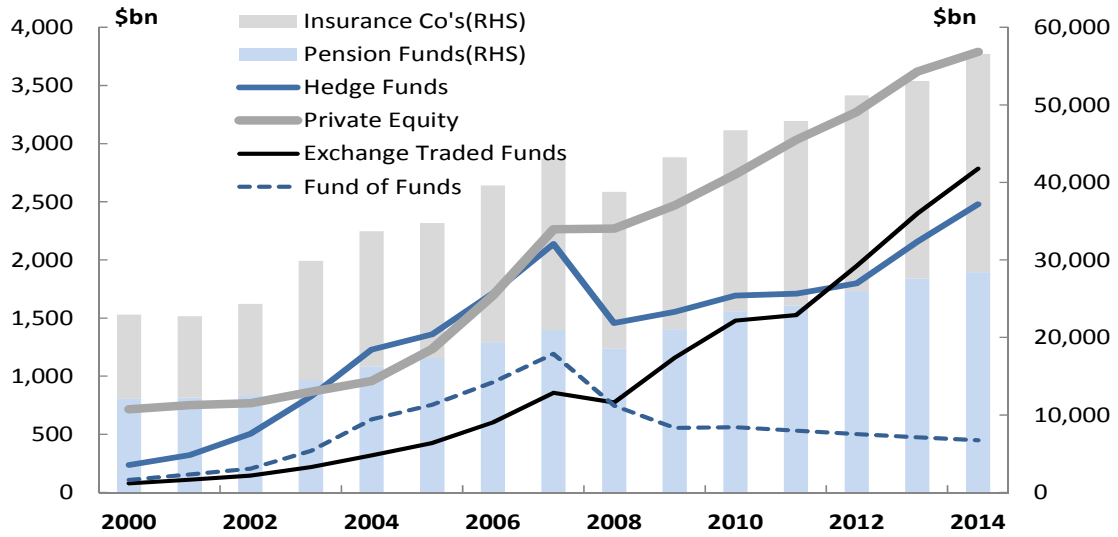


Asset Allocation

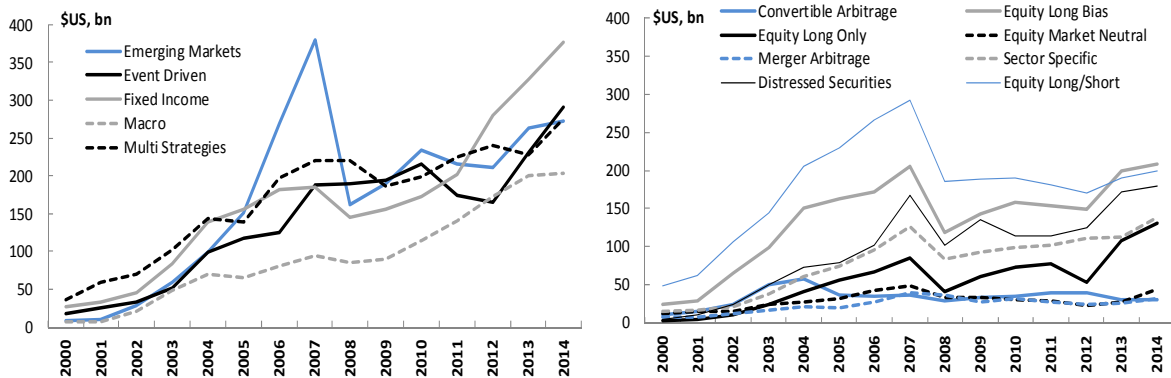




Shadow Banking Assets

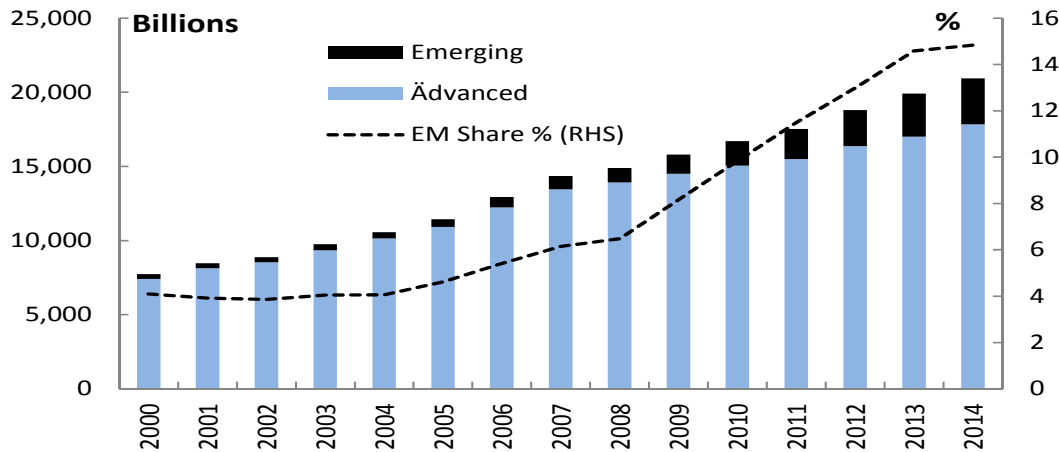


Hedge Funds Adapting





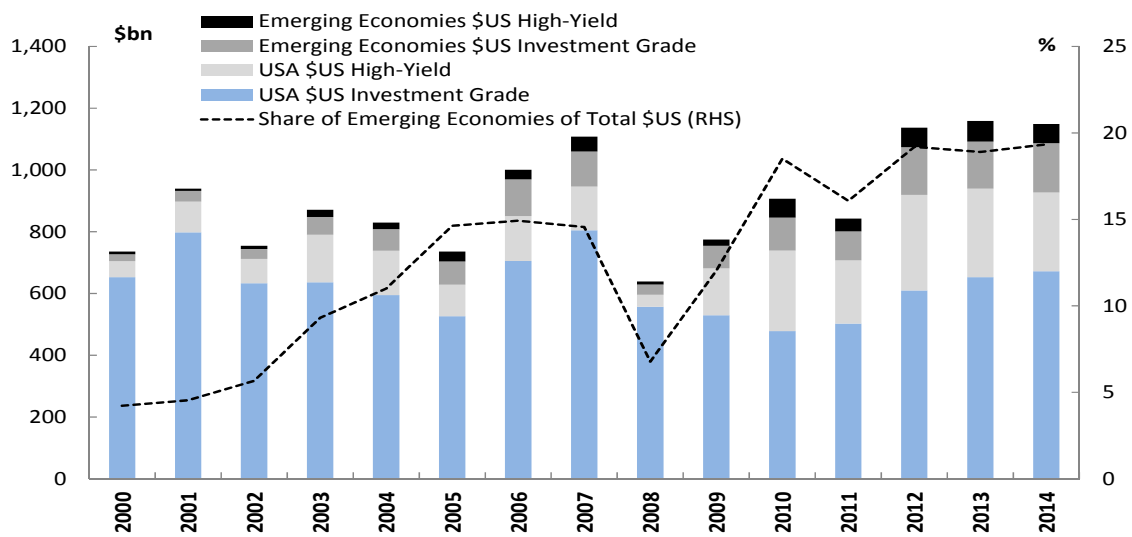
Outstanding Corporate Bonds



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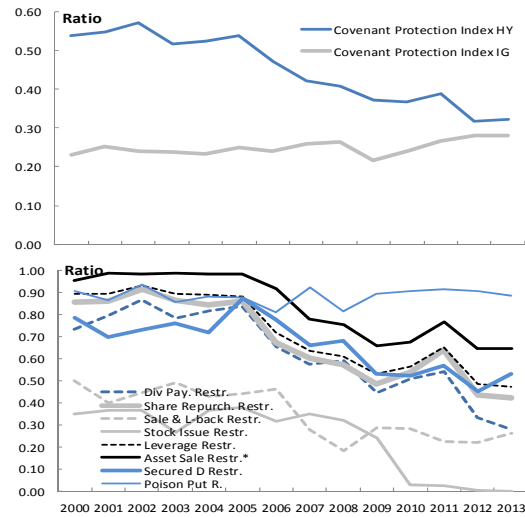
Capital Market Connection to EME Corporate Debt



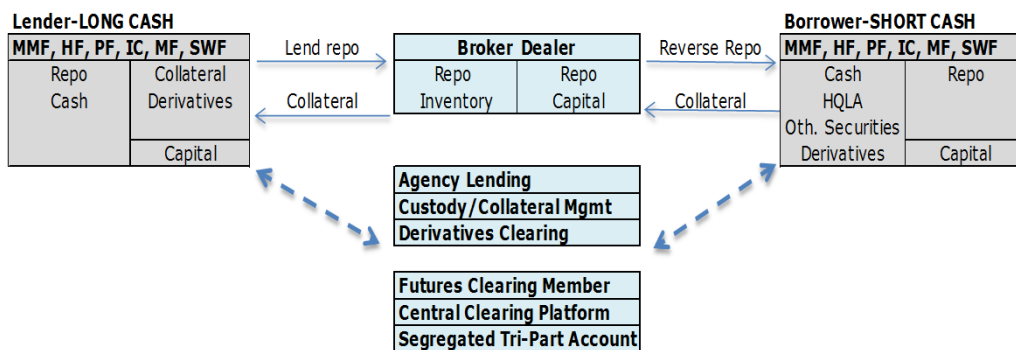
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Covenant Protection High-Yield Bonds Declining

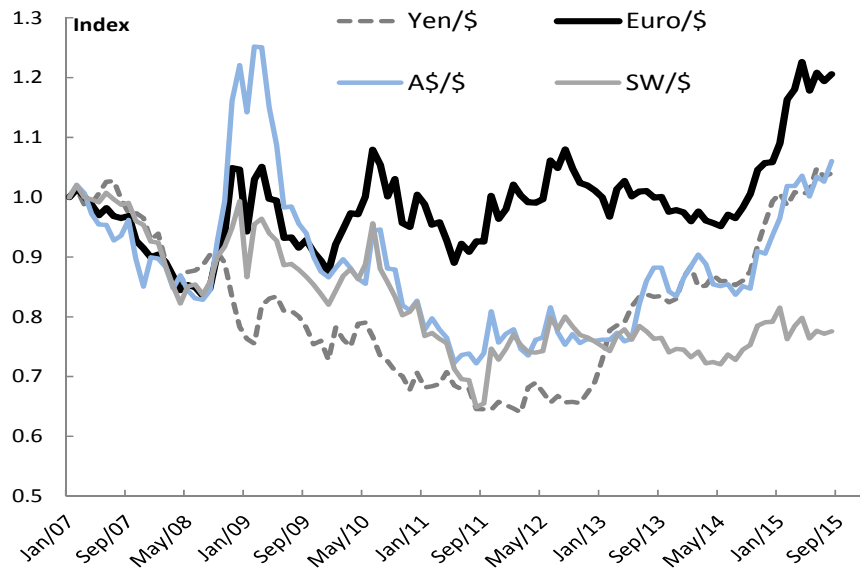


Shadow Banking and Shifting the Risks





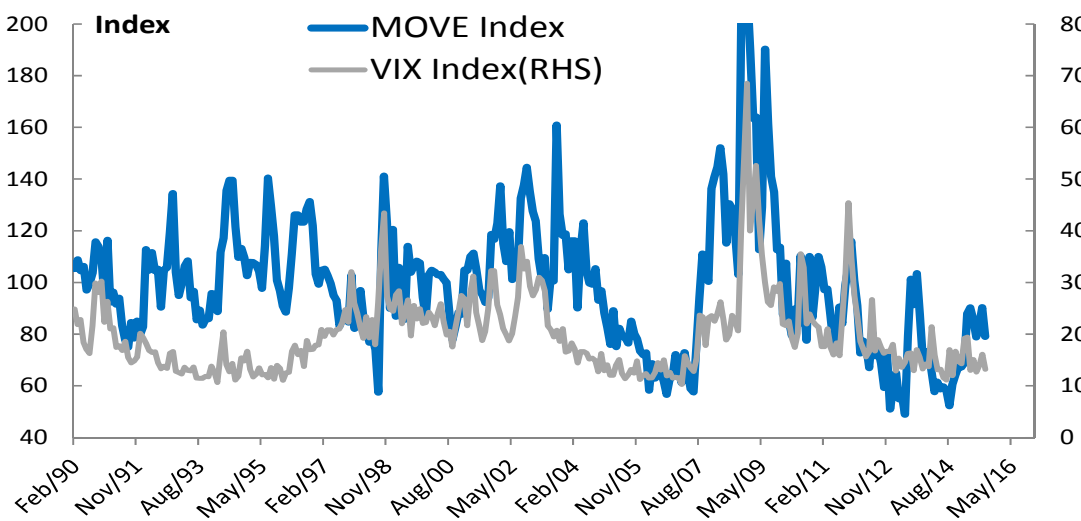
Currency—so far the euro is ok



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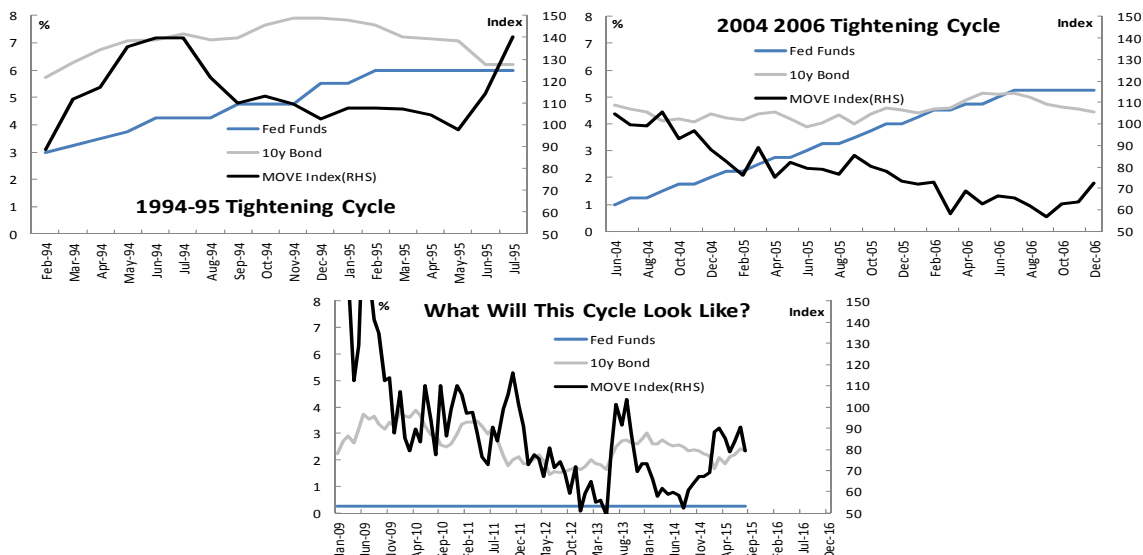
Bond versus Equity Market Mood (volatility)



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2 Tightening Cycles: What Will This Next One Look Like?



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The Drought of High Quality Bonds: What Happens in a Scramble for Quality?

Illustration of What is Happening Based on 2014 Data

	TOTAL Assets	Bonds	Ratio Bonds	Turnover	Need to stand still
Demand Interest Inelastic					
Pension Fund	28,398	6642	0.234	0.143	948.9
Insurance Company	28,192	14342	0.509	0.143	2048.9
International Reserves	10,065	10,065	1.000	0.143	1437.9
TOTAL Inelastic Demand for High Quality Just to Stand Still					4435.6

	Issuance (net of QE)
Supply of New Issues	
Invest Grade Corp	782
Invest Grade Sovereigns	917
HY Corp	238
TOTAL	1937

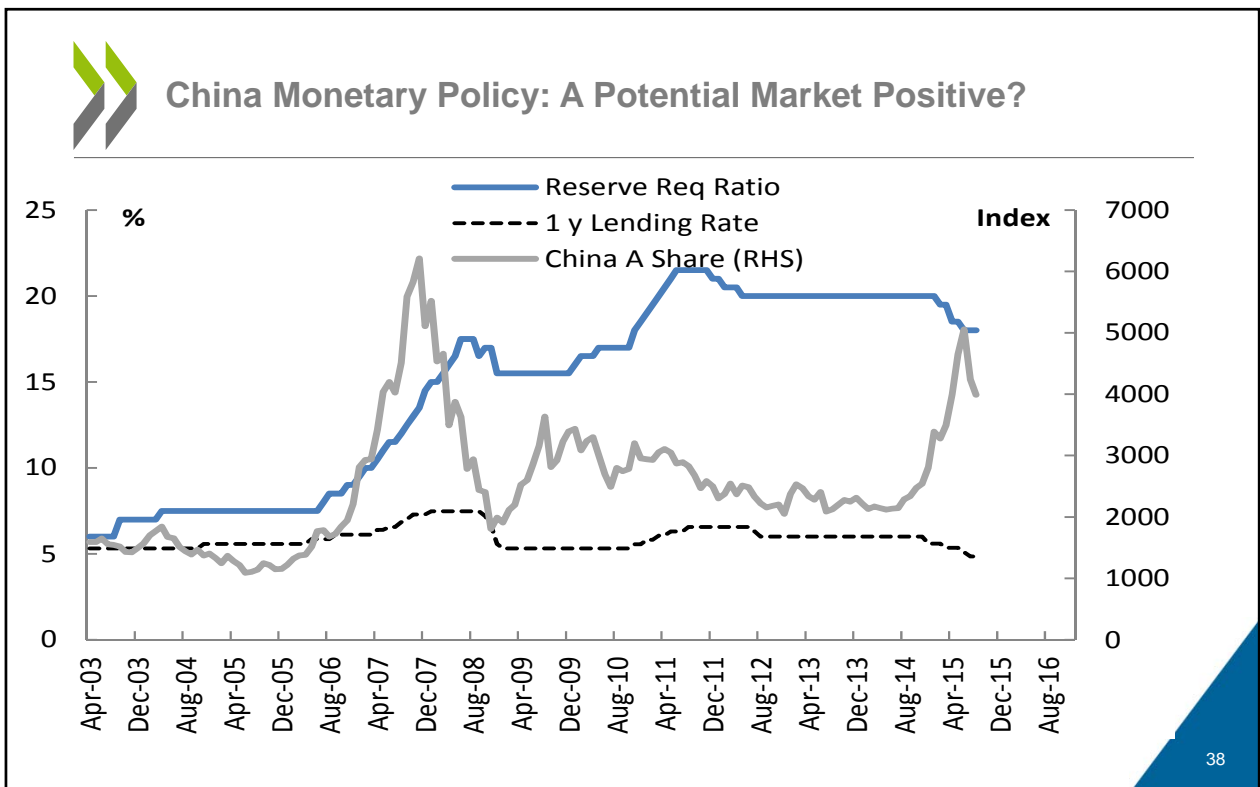
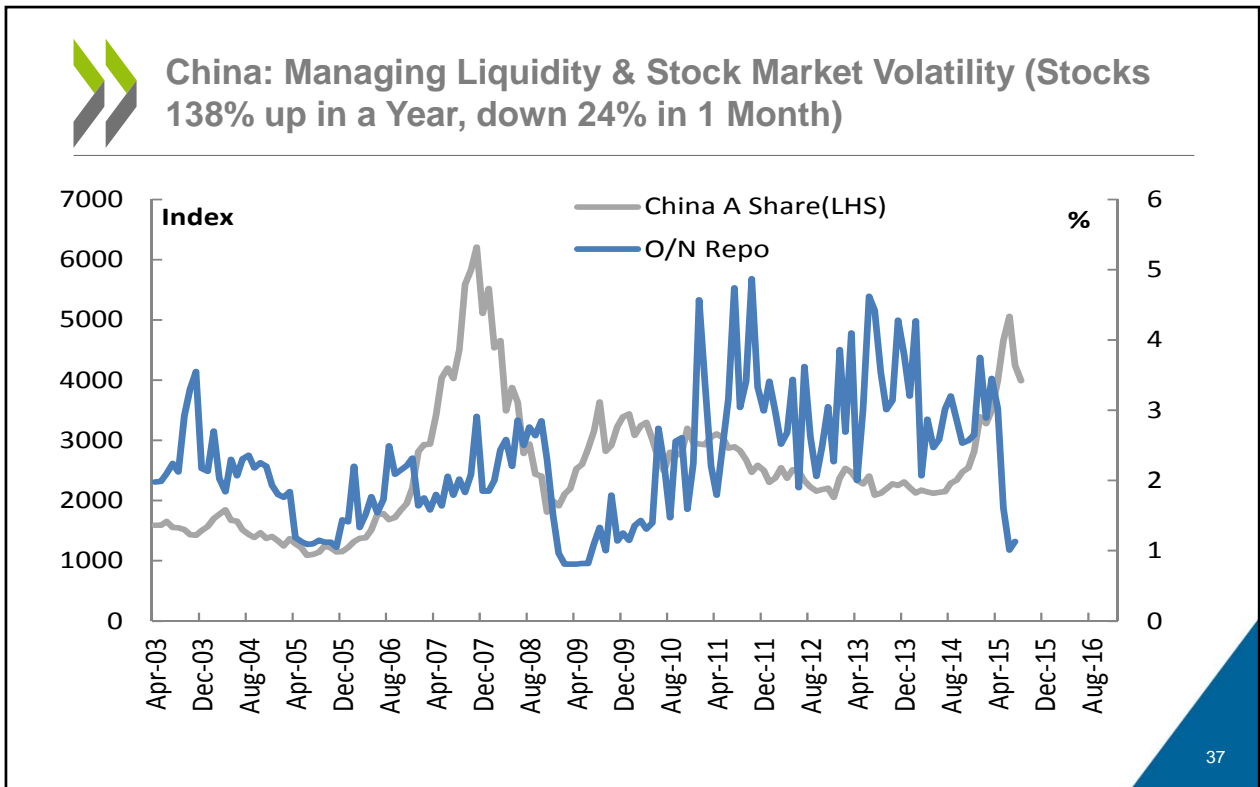
Inelastic Demand minus Supply of New Issues Sovereign and Investment Grade
 (Move into Alternative assets, High Yield & Equity by Pension & Insurance to This Amount) **2737**

In a Scramble for Quality this Group would Have to Sell to the Inelastic-But at What Price?

Demand Interest Elastic	TOTAL Assets	Bonds	Ratio Bonds	Turnover	Need to stand still
Mutual Funds	33,384	12389	0.370	0.143	1766.3
Hedge Funds	2,497	380	0.152	0.143	54.3

Supply to Come from QE Reversal **UNKNOWN**

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Is There a Case for a Positive Liquidity Scenario

- QE reversal releasing quality assets;
- Large companies are in better shape with balance sheets and digital awareness of their businesses, so that defaults will not exacerbate or trigger credit product redemption;
- Rate tightening will be gradual and well telegraphed—and the world is not correlated in GDP strength (that occurs when central banks are behind the curve).
- But against this is the large imbalances built up with years of low rates and QE.
- Gates? Longer redemption periods? Redemptions in kind? Better disclosure (securities lending, embedded leverage)? Cash buffers?