Current Stern Issues Fussing Financial Markets

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Abstract. Purpose — The purpose of this paper is to evaluate the current ability and prospects of the financial economy to respond to the newest challenges of the world economy with the special orientation to the emerging markets.
Design/methodology/approach — The paper revisits the crisis as it is moving from an acute to a chronic phase. Meaning no new recession is thinkable top priority today is the euro zone crisis and China change.
Findings — The euro zone is afflicted by three ills: a banking crisis, a sovereign-debt crisis and a growth crisis. Dealing with one often makes the others worse. Whatever the issue it is not simplifying but aggravating the behavior of the financial markets participants, viz. institutional investors. In case of China which economic role is expanding and plummeting simultaneously the expectations are even more controversial. Research Limitations/Implications — The author's ability to decipher what went wrong in the financial economy could not translate fully into how to fix them. It easier to point out the flaws in a system than to correct them. Practical Implications — Some additional snags protrude out of the fact that main economic players have no trust in Chinese statistics.
Originality/value — The paper talks broadly about a more balanced economy and adds insight into the present and the future of international financial markets.
Keywords: Eurozone; Chinese growth; financial market; hedge funds.

Ажиотаж на финансовых рынках из-за краткосрочных проблем

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Аннотация. Целью данной статьи является оценка актуальных возможностей и перспектив финансового сектора ответить на вызовы новой мировой экономики с особенным учетом развивающихся рынков. Автор статьи заново рассматривает кризис в его переходе от острой фазы к хронической. Особое внимание уделено кризису Еврозоны и изменениям в Китае. Что касается Еврозоны, то здесь наблюдаются три «болезни»: банковский кризис, кризис суверенных долгов и кризис экономического роста. Попытки «лечить» один из недугов приводят к ухудшению состояния остальных. Тем более что решение вопросов не только не помогает, но даже ухудшает поведение участников финансовых рынков, а именно институциональных инвесторов. Относительно Китая, экономическая роль растет и падает одновременно, вопрос становится еще более сложным. В статье отражен взгляд автора на более сбалансированную экономику, а также на текущее состояние и будущее международных финансовых рынков.
Ключевые слова: Еврозона; экономический рост Китая; финансовый рынок; хедж-фонды.

INTRODUCTION

Among the minor debates like when the crisis began, viz. was it 2006, when America's housing market peaked; 2007, when money-market liquidity froze; or 2008, when Lehman Brothers collapsed the contemporary financial world is pondering about several quite serious issues.

The crisis has highlighted specific areas of difficulty. Among them are problems with judging the sophistication of a client. Then real and potential costs are devastating. Property is the world's biggest asset class. It took 25 years for American stocks to regain their 1929 highs and Japanese stocks have never made it back to their peak. British households' property wealth, in today's prices, is around £500 billion ($785 billion) short of its peak; American households have lost a whopping $9.2 trillion. Measured by real GDP per person a third of the 184 countries the IMF collects data for are poorer than they were in 2007. These 61 countries have each lost at least five years.

It becomes clear that the crisis is, in effect, moving from an acute to a chronic phase. Of 34 advanced economies, 28 had lower GDP per head in 2011 than they did in 2007. Japan's household-saving rate has fallen from 14% of disposable income in the early 1990s to only 2% in the past couple of years. Its net debt-to-GDP ratio — more than 130% in 2011—is second only to that of Greece. There is no easy settlement to this. Cut the deficit too aggressively, in other words, and the negative impact on growth and the rise in the cost of debt service from higher spreads could result in a higher, not lower, debt-to-GDP ratio. Decreasing debt is a marathon, not a sprint (Blanchard, 2012).

There is a big difference between the business cycle, which typically lasts five to eight years, and a long-term (long wave) debt cycle, which can last 50–70 years. A business cycle usually ends in a recession, because the central bank raises the interest rate, reducing borrowing and demand. The debt cycle ends in deleveraging because there is a shortage of capable providers of capital and/or a shortage of capable recipients of capital (borrowers and sellers of equity) that cannot be rectified by the central bank changing the cost of money. An ordinary recession can be ended by the central bank lowering the interest rate again. A deleveraging is much harder to end. It usually requires some combination of debt restructurings and write-offs, austerity, wealth transfers from rich to poor and money-printing (Taber, 2012).

In this study, I use comprehensive analysis of the newest trends to investigate the relative ability of different market participants and specific country events to influence potential growth in the financial industry. I take the performance as reflected in Europe, USA, and Asian countries. I also investigate, which types of adjustments of the international financial markets, would improve wobbling world economy.

Previous empirical research provides contradictory and sometimes ambiguous evidence on the value relevance of the actual state of affairs disclosures promulgated in different countries. Thus, present study using comprehensive analysis of the financial market data shed more lights on the issue.

In this research, I am going to investigate the current position of the financial economy with the distinct accent on the activity of the main market makers countries and companies included.

The top priority of the study is the euro zone crisis.

PREVIOUS RESEARCH

The Great recession 2007–09 was excessively researched by economists and academics, many famous ones including. D. Acemoglu (2009) looks into the structural lessons of the crises. Akerlof, G. and Shiller, R. (2009) discover psychology drives in its nature. Brunnermeier, M. (2009) tried to decipher the credit crunch. As a relevant and very popular became a relatively old research by H. Minsky (1977). The recession was scrutinized from different points of economic view by Ohanian (2010). Reinhart, C. and Rogoff, K. (2009) published a kind of bestseller akin to manifesto simply saying that this time it was defferent.

Nikolson (2008) recognized that financial crisis which initiated in United States has become global phenomenon. This crisis apart from affecting the developed economies has distressed the economy of such a country like Russia as well; in May 2008, Russian stock market was fallen by 50% and the Russian central bank had to buy ruble in massive amount to prevent the severe falling against US Dollar and Euro (Erkkilä, 2008).

About the cause of current crisis Bartlett (2008) said that crisis was started with the downfall of US sub-prime mortgage industry, the intensity of this collapse was significant. He further stated that it is "The largest financial loss in history", as compared to Japan's banking crisis in 1990 about $780 billion, losses stemming from the Asian crisis of 1997–98 approximately $420 billion and the $380 billion savings and loan crisis of U.S itself in 1986–95.

lmaz (2008) charged U.S subprime mortgage industry to be the major reason of current global financial crisis, he also stated that the total loses estimated initially up to $300 to $600 billion are now considered to be around $1 trillion.

While enlightening the factors that why this US sub-prime mortgage crisis turn into global banking crisis, Khatiwada and McGirr (2008) stated "Many of these sub-prime mortgages actually never made it on the balance sheets of the lending institutions that originated them"; and they were made attractive to foreign banks by high investment grading, "when sub-prime borrowers failed to repay their mortgages, the originating institution needed to finance the foreclosure with their own money, bringing the asset back on its balance sheet. This left many banks in a financially unfeasible situation, in a rather short, out of hand timeframe".

However Hyun-Soo (2008) argues that it was the "Trust Crisis" which caused this global predicament. DeBoer (2008) believes that it was series of events that caused the crisis; it begins with the collapse of currencies in East Asia in 1997 and became edgy due to the financial crisis of Russia in 1998. Next, in USA was the "dot-com" stock collapse in 2001, and the final stroke was again in USA, when after a swift decline in housing prices and "rapid contraction in credit, it fell into recession.

Rasmus (2008) has the same thoughts; he, while discussing the reasons of economic recession of U.S said "The 'real' ailments afflicting the US economy for more than a quarter-century now include sharply rising income inequality, a decades-long real pay freeze for 91 million non-supervisory workers, the accelerating collapse of the US postwar retirement and healthcare systems, the export of the US economy's manufacturing base, the near-demise of its labor unions, the lack of full time permanent employment for 40 per cent of the workforce, the diversion of massive amount s of tax revenues to offshore shelters, the growing ineffectiveness of traditional monetary and fiscal policy, and the progressive decline of the US dollar in international markets."

EUROZONE HITCHES AND FUTURE

The euro zone is afflicted by three ills: a banking crisis, a sovereign-debt crisis and a growth crisis. Dealing with one often makes the others worse.

A big problem is that the euro zone is only partly integrated. Its members have given up economic tools, such as currency devaluation and monetary policy, yet lack "federal" instruments to cope with shocks. So redressing the imbalances must come through "internal devaluation": bringing down real wages and prices relative to competitors.

The deeper roots of the euro-zone crisis lie with the loss of competitiveness in the region's trouble spots.

Although the euro might still survive in the core countries like Germany and the Netherlands, the prospect of a stronger euro shorn of its weakest links would take years to materialise.

Important problems stand out. One is the scale of European public spending. If America is a defence superpower, spending almost as much on defence as the rest of the world combined, Europe is a "lifestyle superpower", spending more than the rest of the world put together on social protection. Ageing will add to the burden. Europeans can still choose to work shorter days and take longer holidays than Americans, but they can no longer afford to retire early.

The Germans know what they do not want: no transfer union, no Eurobonds and no transformation of the European Central Bank into a lender of last resort.

The Spanish illness might harm the euro zone's convalescence. Portugal and Ireland are in recession, and may need second bail-outs; Greece will probably require a third rescue (and the restructuring of official debt). 20% of the productivity slowdown in Spanish manufacturing between could be pinned 1992 and 2005 on temporary work (Doladoy et al., 2012).

Even if almost all of Greece's private creditors agreed to write off half of what they are owed, its debt would still be about 120% of GDP by 2020. More likely, participation in any write-off would be lower than that, leaving debt above 145% of GDP in 2020. That implies new debt restructurings would be needed. And since Greece's economic news has been worse than expected of late, even these numbers are optimistic. The European

Central Bank (ECB) is now thought to be Greece's biggest bondholder.

Far from stable is the economic situation in France. Public debt stands at 90% of GDP and rising. Public spending, at 56% of GDP, gobbles up a bigger chunk of output than in any other euro-zone country — more even than in Sweden. France now has the euro zone's largest current-account deficit in nominal terms.

Between the third quarter of 2009 and the same period 2011, the euro's share of central-bank reserves fell from 27.9% to 25.7% and the dollar's proportion nudged up slightly from 61.5% to 61.7%. It is probable that the European Central Bank will eventually be forced to adopt quantitative easing (QE) as the only way of helping the region out of its debt crisis (the provision of three-year liquidity to the banks is a step along that road).

It is hard to be sure whether quantitative easing in Europe would be bullish or bearish for the currency. The conventional assumption is that creating more currency is bad for its value: QE in America is generally agreed to have been negative for the dollar. But if QE is perceived to stabilise the European economy, it could end up being positive for the euro, at least in the short term.

One can fix the value of money internally, via a gold standard, or externally, via a fixed exchange rate. The point is that, neither fixing nor floating the currency is a panacea; countries still need to keep themselves competitive.

Back in 2008 the monetary base of the euro zone (in effect notes and coins plus reserves held at the region's central banks) was around 10% of GDP; the equivalent figures for the Federal Reserve and the Bank of England were in the 4–6% range. Now the monetary base in all three places is between 16% and 18% of GDP.

A crisis for some is an opportunity for others. The decline in short-term rates is not surprising, given the excess liquidity washing around the euro-zone banking system: banks have almost €500 billion on overnight deposit with the ECB earning interest of 0.25%.

FINANCIAL INDUSTRY AND THE MARKET

Finance is a very specific and an industry out of the ordinary.

For example, in a global ranking of firms assigned patents in America in 2011 the first financial firm in the list was American Express — only in joint 259th place (Hardman, 2012).

Finance is at its most dangerous when it is perceived to be safe. Securitisation is an important source of credit to the real economy. Scale is what makes finance worrying. When products or techniques become systemic, everyone has a stake in ensuring that they are well managed.

Financial industry literally seizes the world economy. Take for instance LIBOR that was developed in the 1980s to simplify the pricing of interest-rate derivatives and syndicated loans. Accurate benchmarks are vital if risk is to be correctly priced. Contracts worth around $360 trillion, five times global GDP, are based on LIBOR.

LIBOR rates are needed, every day, for 15 different borrowing maturities in ten different currencies. But hard data on banks' borrowing costs are not available every day, and this is the root of the LIBOR problem. Suspicions that something was wrong with LIBOR were aroused in 2008 when financial risks began to pick up but the benchmark, which ought to have ticked upwards too, did not move. That same year a group of American academics circulated a paper showing that banks' individual estimates of their borrowing costs were surprisingly close, given their different levels of risk.

Studies have shown that institutions that are seen as too big to fail pay lower prices for funding (although post-crisis efforts to ensure that institutions can be resolved in case of failure are meant to remove that subsidy).

Generally financial landscape is full of oddities. Quite possible is the prospect of America being paid interest by its creditors when its national debt is rocketing. The Treasury recently disclosed it is exploring how to let investors enter negative yields when bidding at debt auctions. Clearly, demand for American government debt is driven by much more than a hunger for returns. Financial-market participants use Treasury bonds and bills as collateral to secure lending, for instance. And for risk-averse investors such as foreign central banks, money-market funds and retirees, America's debt is uniquely suited to storing savings without much due diligence. In short, its government debt is a lot like money. That is analogous to the dollar's role as reserve currency, which obliges America to issue debt securities in which foreigners can invest those dollars.

Politicians seem to have three main beefs with the financial sector. The first is that bankers earn too much. The second is that banks take reckless risks and then need rescuing by governments. And the third complaint is that investors in financial markets have undue influence over an economy through their ability to affect bond yields and equity prices.

Rather a big issue affecting financial market potentials with big social component embraces the bankers pay.

Pay at the top grew by over 300% between 1998 and 2010. At the same time, the median British worker's real wage has been pretty stagnant. These trends mean the ratio of executive to average pay at FTSE100 firms jumped from 47 to 120 times in 12 years. Bosses' pay has gone up not because corporate governance is failing but because of globalization. Getting and keeping a good boss matters more to a firm's owners than how much he or she is paid; and they invest internationally, so they know how much good bosses need to be paid. This looks more like a market rate than a market failure.

The pay of bank bosses correlated well with returns on equity, but not with returns on assets — in other words, managers prospered by gearing up bank balance-sheets. That is now harder to pull off.

Mistrust of mainstream finance is all the rage. But lean economic times also make get-rich-quick schemes more tempting, and desperation breeds gullibility. As investors in Bernie Madoff's funds found out to their cost, frauds are more prone to exposure in a weak economy — when it becomes clear who has been swimming naked. The FBI is currently probing 1,000 cases of investment fraud, more than double the number in 2008. Meanwhile America's Securities and Exchange Commission filed more than twice as many Ponzi cases in 2010 as in 2008.

Though figures are notoriously hard to come by, the amount of fraud based on stolen card numbers in the United States is around $14 billion a year (Light of Bytes, 2012).

With the rest of the developed world having embraced more secure "smart cards" (or at least in the process of doing so), America remains the only major country that still relies on antiquated payment cards that encode their sensitive data in a magnetic stripe on the back. In security terms, that is about as safe as writing your account details on a post-card and sending it through the mail. Stolen credit-cards details are sold in bulk, ranging in price from ten cents to nearly a dollar per item. To date, more than 1.3 billion EMV cards have been issued globally, and some 21m point-of-sale terminals can now accept them. This represents nearly one out of two payment cards in use globally, and three out of four terminals on merchants premises around the world.

Tax evasion costs governments $3.1 trillion annually. Switzerland's banks house around $2.1 trillion, or 27%, of offshore wealth (Werdiger, 2011).

In some cases fraud spreading looks as a systemic one. Korea's Fair Trade Commission (FTC) detected over 3,500 cases of price-fixing in 2010, but only 66 led to fines.

I am far of blaming the role of financial innovations. The good society requires an effective financial sector, and the way to extend the good life to more people is not to shrink the sector nor restrain financial innovation but instead to release it.

Nevertheless it is easy to find some glaring negative events because of those innovations.

So, on February 3rd 2010, at 1.26.28 pm, an automated trading system operated by a high-frequency trader (HFT) called Infinium Capital Management malfunctioned. Over the next three seconds it entered 6,767 individual orders to buy light sweet crude oil futures on the New York Mercantile Exchange (NYMEX), which is run by the Chicago Mercantile Exchange (CME). Enough of those orders were filled to send the market jolting upwards.

But the fact that they happen at all feeds the perception that today's equity markets have turned into something more akin to science fiction than a device for the efficient allocation of capital. HFTs do not have clients but operate with their own capital. Now the complaints are about the milliseconds HFTs gain over ordinary investors by putting their servers right next to the exchanges' data centres; then they were about the monopolistic privileges of the specialists and the advantages of being on the floor. Meanwhile the industry itself pushes inexorably forward. That certainly entails greater speed: the industry used to think in terms of milliseconds (it takes you 300–400 of these to blink) but is now fast moving to microseconds, or millionths of a second. It also means smarter algorithms.

People have gone from trading in open-outcry pits to trading via screens to programming algorithms. The next stage could be self-learning systems, in which sentient algorithms mine the capital markets, spotting correlations that are too complex for humans to see and suggesting trading ideas as a result. Humans will still be needed to validate these ideas, he says reassuringly. Innovation is often triggered by a client coming to a bank with a specific headache. Software has a nasty habit of developing bugs.

The Chicago Mercantile Exchange, which launches over 400 new derivatives products a year, outlines a three-stage process for innovation: investigation, creation and validation.

It is a tradition among investors to assert that equities are the best asset for the long run. Buy a diversified portfolio, be patient and rewards will come. Holding cash or government bonds may offer safety in the short term but leaves the investor at risk from inflation over longer periods.

Such beliefs sit oddly with the performance of the Tokyo stockmarket, which peaked at the end of 1989 and is still 75% below its high. Over the 30 years ending in 2010, a "long run" by any standards, American equities beat government bonds by less than a percentage point a year. The data for 19 countries from 1900 to 2011 shows that the equity risk premium relative to Treasury bills (short-term government debt) ranged from just over two-and-a-half percentage points a year in Denmark to six-and-a-half points in Australia. In the period 1900–2011, the average world dividend yield was 4.1%; real dividend growth was just 0.8%; and the rerating of the market added 0.4%. Gold was the only asset that had a positive correlation with inflation.

Countries are specific in their attitude to the financial sphere. So unlike those in charge of public pension funds elsewhere, the Canadians prefer to run their portfolios internally and invest directly. They put more of their money into buy-outs, infrastructure and property, believing that these produce higher returns than publicly traded stocks and bonds. They are in some ways like depoliticized sovereign-wealth funds — a new brand of financial institution. Running assets internally costs a tenth of what it would if they were outsourced. Canadian pension funds have ensured their pay is competitive with Bay Street, Toronto's version of Wall Street.

A mixture of social and financial returns is central to a burgeoning asset class known as "impact investing". In simple terms, finance lacks an "off" button. Most stock market bulls build their case on the trailing price-earnings ratio for the S&P 500, which stands at 16.

The capital market that is commonly thought to be the most developed in the world is in a mess. An average of 165 companies with less than $50m in inflation-adjusted annual sales went public in America each year between 1980 and 2000. In 2001–2011 the average fell by more than 80%.

Qualitative and quantitative changes have marked 2011 in other segments of the financial market. The insurance industry paid out some $110 billion for natural disasters last year. Their economic costs were $378 billion last year, breaking the previous record of $262 billion in 2005 (in constant 2011 dollars). Whether the economic toll of disasters is rising faster than global GDP is unclear, since a wealthier world naturally has more wealth at risk. Development by its nature also aggravates risks.

The mountain of over-the-counter (OTC) derivatives products, whose notional amounts outstanding, reckoned at around $700 trillion in June 2011, easily dwarf the $83 trillion of derivatives on exchanges. The notional amount of outstanding over-the-counter (OTC) derivatives declined to $648 trillion at the end of last year, after reaching a high of $707 trillion in June 2011.

Interest-rate contracts, which make up the majority of OTC derivatives traded, decreased by 9% to $504 trillion; credit-default swaps dropped by 12%; and other derivatives, including commodities and equity-linked contracts, fell by 9%—despite Australia and Spain reporting to the Bank for International Settlements for the first time in December 2011. However, gross market values, which measure the cost of replacing all existing contracts, increased by 40%, to $27.3 trillion, the biggest increase since the second half of 2008.

For less calamitous changes in the weather, derivatives are a better option. According to the Weather Risk Management Association, an industry body, the value of trades in the year to March 2011 totalled $11.8 billion, nearly 20% up on the previous year, though far below the peak reached before the financial crisis took the steam out of the business. In 2005–06 the value of contracts had hit $45 billion.

Weather derivatives had an inauspicious start: the first trade was done by Enron in 1997.

Mining and oil companies account for some 30% of the value of London's stockmarket, about twice the global weighting.

But just as the client base is shifting eastward, so is incorporation. A new big trend is the rise of the "mid-shore" financial centre, which incorporates elements of onshore and offshore. Two big examples are Hong Kong and Singapore. Both have offshore traits (low tax, secrecy) but also have strong legal systems and plenty of double-taxation treaties. This has helped Singapore, in particular, gain business that has fled the Channel Islands and other European jurisdictions.

The average year-on-year growth rate for cross-border bank credit to non-banks during the 2000–07 period was a sizzling 15.2%, compared with 6.7% for total bank credit. Since then cross-border credit has fizzled and looks likely to fall further.

European lenders were in the vanguard during the era of internationalization, and around a third of their assets are outside their home markets. In March 2012 the Reserve Bank of Australia revealed that the departure of European lenders, in particular French banks, had left an A$34 billion ($35 billion) funding gap in the syndicated-loan market for local companies. A big lesson of the crisis is that banks which are global in life are national in death. Bankruptcies of Lehman Brothers and MF Global showed regulators how assets could easily get trapped in foreign jurisdictions, leaving a bigger bill for taxpayers back home. Now a third revolution is under way. Manufacturing is going digital. Offshore production is increasingly moving back to rich countries not because Chinese wages are rising, but because companies now want to be closer to their customers so that they can respond more quickly to changes in demand. And they cling to a romantic belief that manufacturing is superior to services, let alone finance.

Financial industry was at birth of a very interesting sector of the world economy known as offshore business incorporation.

Up to 2m companies are set up in America each year. Britain creates some 300,000. These are the total numbers. At the same time around 250,000 are set up in offshore locations.

The British Virgin Islands (BVI) alone registered 59,000 new firms in 2010. It had 457,000 active companies as of last September — more than 16 companies for every one of its 28,000 people.

Firms may use them during mergers, to park assets during complicated transactions, or to fend off lawsuits in countries with predatory governments or corrupt courts. They can usefully protect trade secrets or safeguard directors from kidnappers or busybodies. Takeovers are usually lucrative for shareholders of the target firm: in America between 1990 and 2008, they have received a median premium of 35%.

They offer flexibility for entrepreneurs needing to move quickly. Many companies started out as a shell. Delaware's Division of Corporations registered 133,297 new corporate vehicles 2011.

Offshore formation agents seethe at this: they have tightened their standards under pressure from big countries that do not practice what they preach and (worse still) are now stealing their business.

Great financial influence on the world economy is contributed by remittances to poor countries. Since 1996 remittances to poor countries have been worth more than all overseas-development aid, and for most of the past decade more than private debt and portfolio equity inflows. In 2011 remittances to poor countries totaled $372 billion, according to the World Bank (total remittances, including to the rich world, came to $501 billion). That is not far off the total amount of foreign direct investment that flowed to poor countries. Given that cash is ferried home stuffed into socks as well as by wire transfer, the real total could be 50% higher.

Remittances are not just big, but growing — they have nearly quadrupled since the turn of the millennium — and resilient. In 2009, when economies around the world crashed, remittances to poor countries fell by a modest 5%, and by 2010 had bounced back to record levels. By contrast, foreign direct investment in poor countries fell by a third during the crisis, and portfolio inflows fell by more than half. In 1970 46% of recorded remittances were reckoned to originate in America. By 2010 America's share was just 17%. One big new player is the Gulf, which has sucked in migrant workers since the oil boom. Saudi Arabia is now the world's biggest sender of remittances after America, posting $27 billion in 2010, mostly to the families of South Asians and Africans who toil on its building sites and clean its homes. More than half of all remittances to South Asia come from the Gulf; worldwide, the region sends almost as many remittances to poor countries as Western Europe does.

Expensive oil has made Russia a big destination for immigrants, too. In 2000 it was only the 17th-biggest remitter in the world — indeed, it was a net receiver. But by 2010 it was the fourth-largest sender, dispatching nearly $19 billion, mostly to Central Asia. Remittances from Russia are worth more than a fifth of Tajikistan's economy. Stricter border controls keep migrants in as well as out, and the remittances flowing.

Despite world economic turmoil, global inflows of foreign direct investment (FDI) rose by 17% in 2011 to $1.5 trillion (SUNS, 2012).

Most buy-out firms now prefer the fluffy title of "alternative asset manager". There are 827 buy-out firms globally(Pensionprism, 2012). Private-equity buy-outs tend to increase productivity — by around 2%, on average (Lee, 2012).

Dynamic changes occur to hedge funds. Running a hedge fund today is three times as much work for a third of the fun, says one. But many are motivated by economics. Hedge funds typically get paid a 2% management fee on assets to cover expenses and a 20% performance fee on the returns they achieve for investors. Most funds do not earn performance fees unless they outperform their peak level or "high-water mark". At the end of 2011, 67% of hedge funds were below their high-water marks and 13% have not earned a performance fee since 2007 or earlier. 18% of hedge funds are more than 20% below their high-water marks (Durden, 2012).

Last year alone, Bridgewater Pure Alpha fund earned its investors $13.8 billion, taking its total gains since it opened in 1975 to $35.8 billion, more than any other hedge fund ever, including the previous record-holder, George Soros's Quantum Endowment Fund.

Around a third of all hedge funds own Apple's shares, including big names like SAC Capital and Greenlight. Some have made very big bets. Citadel's $5.1 billion stake in Apple (as of December 31st 2011) accounted for around 12% of its equity portfolio. Many hedge funds that have done well in the past year owe much to this single position.

Apple is larger than the American retail sector combined. It accounts for 4.5% of the S&P 500 and 1.1% of the global equity market.

CHINA DWINDLING AND EXPANDING ROLE

China foreign-exchange reserves fell in the fourth quarter 2011 for the first time since the height of the Asian financial crisis in 1998. The drop was small, from $3.2 trillion to $3.18 trillion, but also a little mysterious. China still exports more than it imports, and attracts more foreign direct investment than it undertakes. These two sources of foreign exchange must, then, have been offset by an unidentified drain. Last year about $185 billion might have passed from mainland China through the VIP rooms of Macau's casinos.

Each iPad sold in America adds $275, the total production cost, to America's trade deficit with China, yet the value of the actual work performed in China accounts for only $10. China's small contribution to total costs suggests that a Yuan appreciation would have little impact on its exports. A 20% rise in the Yuan would add less than 1% to the import price of an iPad.

But is China's currency still undervalued by the Senate's own definition? There are three IMF's methods to identify offending exchange rates. Referring to one IMF calculation the Yuan was undervalued by 23%. That estimate, made in September 2011, was based on the exchange rate required to bring the country's notorious current-account surplus into line with the "norm" for a country like China. The IMF has not said officially what that norm should be, but one study suggests it is about 2.9% of GDP.

The corollary of a cheap currency is a large current-account surplus. It is therefore notable that China's surplus narrowed to only 2.5% in the fourth quarter of 2011. It was the smallest surplus (relative to the size of China's economy) since 2002. Even in absolute terms, the $201 billion surplus was the smallest since 2005.

China's labour force is not, however, growing as quickly as it was. From 1991 to 2000, it swelled by 8.7m a year.

So China is not about to hollow out. But if it is to keep growing fast, it must become more innovative. At present Chinese innovation is a mixed bag. China was once a dazzling innovator: think of printing, paper, gunpowder and the compass.

China can seem invincible. In 2010 it overtook America in terms of manufactured output, energy use and car sales. Shanghai reported fertility of just 0.6 in 2010—probably the lowest level anywhere in the world. In 1980 China's median (the age at which half the population is younger, half older) was 22. That is characteristic of a young developing country. It is now 34.5, more like a rich country and not very different from America's, which is 37. China set up a national pensions fund in 2000, but only about 365m people have a formal pension. And the system is in crisis. The country's unfunded pension liability is roughly 150% of GDP. AT ITS peak, of over 10% of GDP in 2007, China's current-account surplus offered firm proof that the Yuan was undervalued. The evidence is much less conclusive now. China's currency is 30% stronger in real trade-weighted terms than in 2005, when its peg to the dollar was scrapped. China's surplus with America rose to a record $202 billion, more than accounting for its total surplus (China ran a deficit with the rest of the world).

Between 2000 and 2010 China increased its consumption of oil more than any other country, by 4.3m b/d, a 90% jump. It now gets through more than 10% of the world's oil. More surprising is the country that increased its consumption by the second-largest increment: Saudi Arabia, which upped its oil-guzzling by 1.2m b/d. At some 2.8m b/d, it is now the world's sixth-largest consumer, getting through more than a quarter of its 10m b/d output. Air-conditioning units soak up half of all power generated at peak consumption periods (Savrieno, 2012).

Officials also almost tripled the amount of foreign investment allowed in China's capital markets, to $80 billion.

Emerging markets is a useful term precisely because it is imprecise. Coined for the convenience of investors looking for somewhere exciting to put their money, it covers a bewildering range of economies with little in common, except that they are not too rich, not too poor and not too closed to foreign capital. It is hard to say whether the shared success of emerging economies can continue.

Although the emerging markets have less room for easing now than they did in 2008, when they collectively ran a small surplus on their budgets, their average budget deficit last year was only 2% of GDP, against 8% in the G7 economies. And their general-government debt amounts on average to only 36% of GDP, compared with 119% of GDP in the rich world.

The ten largest economies in Asia now spend roughly $400 billion a year on research and development (R&D)—as much as America, and well ahead of Europe's $300 billion.

GDP per person measured at purchasing-power parity, which adjusts for differences in the cost of living in each country shows that Japan was overtaken by Singapore in 1993, by Hong Kong in 1997 and by Taiwan in 2010.

Previous colonial development has greatly influenced the economy of some of now emerging markets. Two countries which share a common language trade 42% more with each other than two otherwise identical countries that lack that bond. Two countries that once shared imperial ties trade a startling 188% more. Imperial ties affect trade patterns more than membership of a common currency (which boosts trade by only 114%). The ex-colonies' traffic with Britain with their traffic with the rest of the world shows that trade flows were 13% higher than you would expect, capital flows were 24% higher and the flows of people and information were a startling 93% higher.

STATE CAPITALISM

The defining battle of the 21st century will be not between capitalism and socialism but between different versions of capitalism. The rise of state capitalism in the East may encourage a trade war as liberal countries attack subsidies and state-capitalist countries retaliate. It introduces commercial criteria into political decisions and political decisions into commercial ones. And it removes an essential layer of scrutiny from central government.

The red tape in America is no laughing matter. The problem is not the rules that are self-evidently absurd. It is the ones that sound reasonable on their own but impose a huge burden collectively.

It costs companies an average of 95 man-days a year just to deal with trade bureaucracies. It takes longer and is more expensive to ship goods between two Middle Eastern ports than to send them from the Middle East to America. Such market fragmentation, the authors argue, is the consequence of the region's centralized, state-led economic policies.

When firms had to decide whether to do something in America or elsewhere, America lost two times out of three. About €350 billion of EU contracts are open to foreign bidders, twice as much as in America and 13 times as much as in Japan.

The Fed has "outperformed" the rest of America's financial industry put together for four years running. That might be a triumph in a state-controlled economy. In America, it is another cause for concern. 2011 already written off as a disaster.

Generally state companies show no signs of relinquishing the commanding heights, whether in major industries (the world's ten biggest oil-and-gas firms, measured by reserves, are all state-owned) or major markets (state-backed companies account for 80% of the value of China's stock market and 62% of Russia's). And it has been given an extra boost by the 2007–08 financial crises: in 2009 some 85% of China's $1.4 trillion in bank loans went to state companies.

In Russia, for example, the state has retained golden shares in 181 firms. In all, the world's sovereign-wealth funds control about $4.8 trillion in assets, a figure that is likely to rise to $10 trillion by the end of this decade.

Since 2000 the cumulative surpluses of oil exporters have come to over $4 trillion, twice as much as that of China.

One reason why this enormous stash has received much less attention than China's is that only a fraction of it has gone into official reserves. Most of it is in opaque government investment funds (Arezki and Hasanov, 2009).

The Bank of England is now a market mammoth, owning over 30% of the £940 billion ($1.5 trillion) pool of outstanding government bonds.

According to Bank of America Merrill Lynch, there were some $11 trillion-worth of government bonds in issue at the end of 2001; by the end of 2011, that figure had risen to more than $31 trillion. The reason was that central banks were pretty indifferent to low yields, being content to park their reserves in the relative safety and liquidity of Treasury bonds as a way to manage their currencies' level versus the dollar.

In Britain, data from the Debt Management Office show that banks and building societies owned just £26 billion-worth of gilts in the last quarter of 2008; by the end of 2011 they owned £131 billion, or around 10% of the total.

It is ensuring that the sovereign can borrow cheaply. But it is not enough. The simplest wheezes push spending into the future. Classic forms of deferred spending that do not show up on balance-sheets until later include pension promises and public-private partnerships, where governments pay companies for infrastructure after construction is done. America met a 1987 deficit target by simply delaying military pay and Medicare payments. Greece's debt figure shot up by 7.8% of GDP in 2010 when Eurostat, the EU's statistical agency, reclassified bus, railway and other public companies in the government accounts. Accounting measures should follow the movement of economic value, not cash, so that delaying pay packets until next year (or retirement) has no effect.

Government spending is in some cases in obvious excess. At 40% of GDP, public spending is already high for such a middle-income country like Russia. Mr Putin has made extravagant pre-election promises, adding up to as much as $160 billion to the budget, which will push this ratio even higher. His promises include large pay and pension increases for the armed forces, teachers and doctors. In 2012 alone he has pushed through a 33% rise in defence, security and police spending.

The result is huge economies of scale: the cost per container on an Asia-to-Europe trip has fallen from around $1,000 to below $300.

Singapore accounts for 4% of the world's total spending on arms imports. Its defence spending per head beats every country bar America, Israel and Kuwait. This year $9.7 billion, or 24% of the national budget, will go on defence.

American defence spending (which, as a share of GDP, is about three times the European NATO average.

Very impressive is America's Strategic Petroleum Reserve. The SPR holds 700m barrels of the black stuff in vast underground caverns strung along the Gulf of Mexico.

Higher temperatures make butane and other cheap and popular petrol additives evaporate, causing smog, so air-quality regulations prevent their usage during the summer. Americans may protest loudly, but their economic behavior indicates a remarkable indifference to the price of oil. If gas prices truly damage the quality of lives, Americans have done a remarkable job of hiding it.

We are living now in a world of general peculiar inflation affecting all the sides of economic, cultural and social life. So, airlines have been issuing so many miles (for spending on the ground as well as in the air) that the total stock is worth more than all the dollar notes and coins in circulation. In Britain the proportion of A-level students given "A" grades has risen from 9% to 27% over the past 25 years. Yet other tests find that children are no cleverer than they were. A study by Durham University concluded that an A grade today is the equivalent of a C in the 1980s. In American universities almost 45% of graduates now get the top grade, compared with 15% in 1960. Grade inflation makes students feel better about them, but because the highest grade is fixed, it also causes grade compression, which distorts relative prices. This is unfair to the brightest, whose grades are devalued against those of average students. It also makes it harder for employers to identify the best applicants. Job-title inflation, which has recently accelerated because a fancier-sounding title is cheaper than a pay rise. Inflation of all kinds devalues everything it infects. It obscures information and so distorts behaviour. It is true inflation is similar to toothpaste: easy to squeeze out of the tube, almost impossible to put back in.

SUMMARY AND CONCLUDING REMARKS

The Results of the study do not show that current economic and financial developments are the marks of a sustainable recovery. Moreover, it indicates on a real probability of a double dip recession. The same results prevailed at total sample of separate country situation with the feeble exclusion of the USA. The same is relevant to quite a few financial and industrial groups. In addition, the result of the analysis does not show the superiority of positive towards negative trends and developments for firm performance, based on stock market price.

The results show that in state companies China being a priority the current tendencies are far from perfect despite assertive rhetoric of certain government officials even in the developed part of the world.

In companies, active in the financial industry, I found no evidence of comprehensive change of their strategy towards more prudent one. This will not obviously reduce the international financial markets volatility.

I propose further study of the issue in another research with the same methodology applied in this research, except that, first, the estimation of the best models that fit the data to be done, and second, using the best competing models to investigate the potential threats to the world economy and financial industry, in particular.

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