

# EU failing to find consensus on IMF chief to succeed Lagarde



Paris: EU members have so far been unable to reach a consensus on a candidate to succeed Christine Lagarde as head of the International Monetary Fund and may yet need a vote to break the deadlock, officials said Thursday.

EU states had given themselves a deadline of the end of July to find a candidate to head the Washington-based global lender, which by tradition – but not rule – is led by a European.

But reflecting tensions all too familiar in Brussels, the process to replace Lagarde, who is to become head of the European Central Bank, has been mired in disputes between northern and southern EU member states.

“At this stage, although some candidates’ names gather more support than others, there is not yet a full consensus around one name,” said an official from France’s finance ministry, asking not to be identified by name.

French Finance Minister Bruno Le Maire, who is leading the talks on finding a European candidate, has spoken to “all his colleagues” over the last few days and in particular his German counterpart Olaf Scholz.

Sources say that five candidates are currently in contention – from southern Europe Spain’s Finance Minister Nadia Calvino and her Portuguese counterpart Mario Centeno, and from northern Europe, former Dutch finance minister Jeroen Dijsselbloem and Bank of Finland chief Olli Rehn.

The fifth candidate – from central Europe and a possible compromise figure – is Kristalina Georgieva, the current number two at the World Bank.

Southern EU states fear that Rehn and Dijsselbloem, who enjoys German backing, excessively favour economic austerity which risks harming growth.

Southern countries have particularly long memories of Dijsselbloem because of his tough stance against southern nations like Greece when he headed the group of EU finance ministers.

“I can’t spend all my money on drinks and women and then ask for help,” he said in one particularly notorious comment in 2017. But northern countries are also underwhelmed with the southern European candidates, with Calvino in particular seen as having insufficient experience.

“This situation shows the splits between the north and the south and the difficulties for the Europeans in agreeing on a solid candidate,” a source close to the talks told AFP.

The ECB's outgoing chief Mario Draghi said last week that he was "not available" for the position. At 71, he is too old to hold the post, according to IMF rules, which state that the managing director must be under 65 when appointed.

This leaves Georgieva – but the snag is that she will soon be 66, above the age limit of 65. "The other members of the fund will need to make an exception for her, and that it is not a given," one source said.

Adding to the uncertainty, Le Maire has allowed Britain, after its government shake-up last month, one more day to present a candidate, source said. This could allow a candidacy by Canadian-born Bank of England governor Mark Carney, who holds Canadian, British and Irish nationality.

Sources said a vote by ministers is a possible way to break the impasse, adding that Le Maire has raised this as an option. But this would also have the disadvantage of exposing to the world the inability of Europeans to unite around a single top-level candidate, the sources said.

The IMF says any of the fund's 189 members can nominate a candidate between July 29 and September 6, after which the board will announce its shortlist of up to three names. But with the US and Europe having the biggest voting blocs in the IMF, it would be difficult for an outside candidate to upset the tradition whereby they divvy up the IMF and World Bank jobs between them.

The convention has nonetheless come under strain in recent years, with developing economies demanding a greater say at the Washington-based institutions. US Treasury Secretary Steven Mnuchin emphasised at a meeting of G7 ministers last month that naming a European to head the IMF was a convention, "not an official policy".

Possible non-European candidates could include the general manager of the Bank of International Settlements and former

Bank of Mexico governor Agustin Carstens, and Lesetja Kganyago, the governor of the central bank of South Africa. The IMF plans to select its new leader by October 4.

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## France's EDF fined nearly 2 mn euros for not paying bills on time



Forgot to pay your bills? Don't worry. So did your electricity provider.

France's state energy giant EDF has been fined 1.8 million euros (\$2 million) for not paying its bills on time, a record amount that aims to dissuade big businesses from starving small suppliers by putting off payment for as long as possible.

Junior economy minister Agnes Pannier-Runacher said Thursday

the government wanted to “hit companies in the wallet” to force a change in their thinking on paying bills, currently treated by many as “a minor administrative issue”.

France, like many European countries, has been getting tougher on late payers, blamed for sometimes bankrupting small companies by failing to settle their bills on time.

In 2016, the socialist government of then president Francois Hollande increased the maximum fine for late payments from 375,000 euros to 2 million euros.

President Emmanuel Macron has continued on the same track, pushing through a UK-inspired law that allows the government to publicly name and shame offenders for the first time.

Several big companies have been outed as late payers in recent months, including US online retail giant Amazon, China’s Huawei and France’s own cosmetics chain Sephora as well as the national postal service.

But the fine imposed on EDF dwarfs all previous sanctions, with the stiffest to date – 670,000 euros – going to a subsidiary of German industrial giant HeidelbergCement in May.

As further punishment for EDF, in which the state has a 83.7-percent stake, the company will also be stripped of a label it earned in 2015 for its “balanced relations” with suppliers.

The government audited over 130,000 bills received by the company between March and August 2017.

It found that 3,452 suppliers who sent bills totalling 38.4 million euros had not been paid on time.

EDF said Thursday that it had “taken note” of the fine and vowed to “continue reinforcing internal procedures...so that procedures allowing bills to be paid on time are understood and followed” by staff.

In France, companies have 30 days to pay their bills unless otherwise stated in the contract, which can give creditors up to 60 days to pay up.

But big groups regularly disregard the deadlines, with fewer than one in two settling their bills within 60 days, according to a 2018 report from the Banque de France's monitoring centre.

The centres blamed late payers for robbing small companies of 19 billion euros in cashflow.

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## **Siemens Is Latest Casualty of European Manufacturing Slowdown**



German industrial giant Siemens AG became the latest casualty of Europe's economic slowdown, warning a sharp deterioration in some markets hurt quarterly profit and has put financial

goals at risk.

The shares dropped as much as 5.9% on Thursday, the most in more than three years, after the region's largest engineering company reported a disappointing set of results, joining ArcelorMittal, Rheinmetall AG and BMW AG in providing evidence of the gathering storm.

The earnings are a sign that a deepening slump in the global car industry and a more general economic malaise are reaching further into corporate Europe. Until now, Siemens was able to rely on its digital industries division supplying factories with equipment to automate to make up for a protracted slump in the power and gas sector. In the latest quarter, even orders and sales at that unit dropped.

"It is difficult to reconcile owning Siemens for its world-class automation, software franchise when this is driving negative earnings," Morgan Stanley analyst Ben Uglow wrote in a note.

## **Downbeat Figures**

Manufacturing in the euro area shrank for a sixth month at the start of the third quarter, dragged down by Germany's worst slump in seven years. The downbeat figures come in the wake of reports showing slower economic growth in France, Spain and the euro area, with Italy stagnating. While part of the weakness is linked to troubles in the automotive industry, a continued downturn could spell more trouble.

Behind the economic statistics, an increasing number of companies like Siemens are also sounding the alarm. The German company is in the midst of an overhaul and is already shedding thousands of jobs. During the latest reporting period, profit declined a worse-than-expected 12% and the company said a target for sales growth will be harder to reach and another for profit margin will be at the lower end of a range.

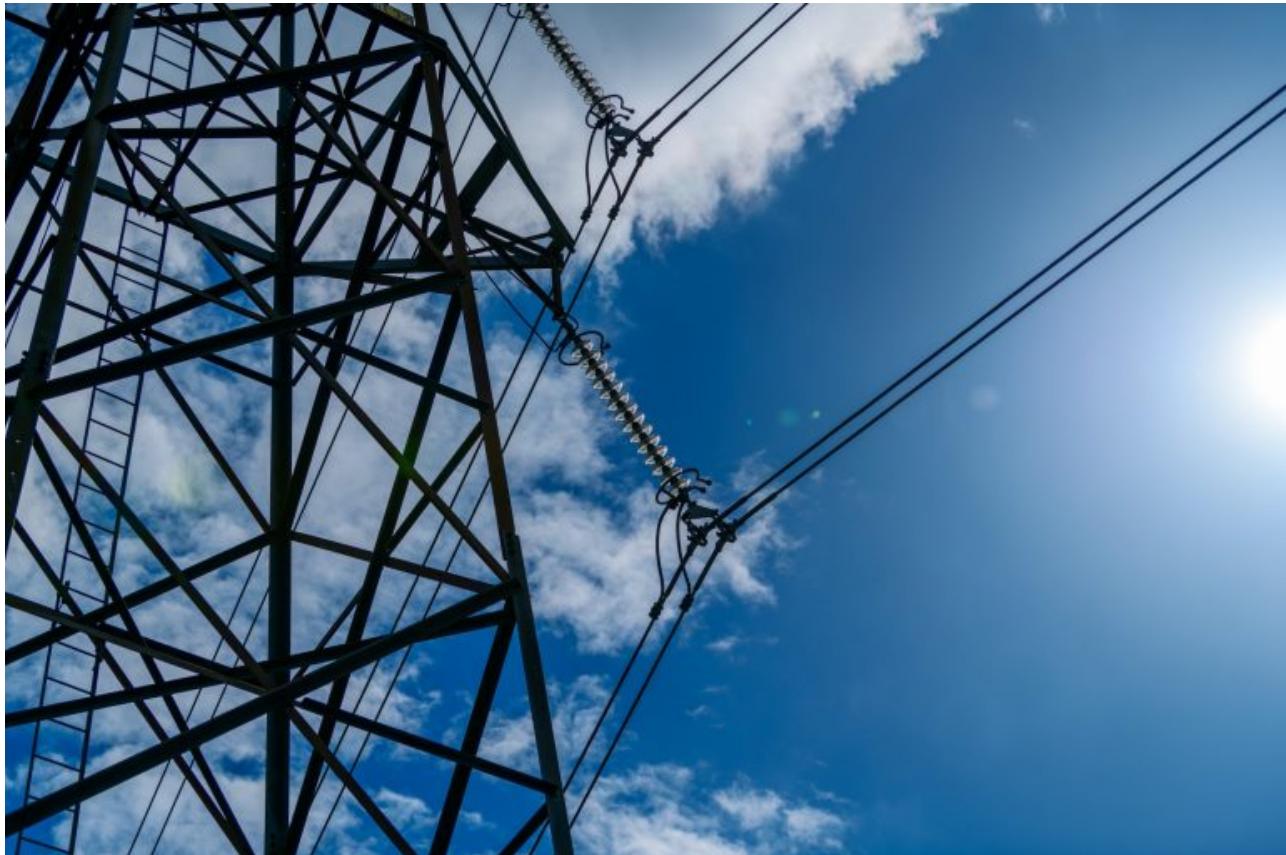
"The assumptions we made in the first two quarters about the economic and political environment are no longer true," Siemens Chief Financial Officer Ralf Thomas said, adding that the auto sector won't improve for at least three quarters. "We're taking countermeasures to secure our business's profitability to the greatest extent possible."

Chief Executive Officer Joe Kaeser has supervised a large-scale breakup of Siemens's conglomerate structure, starting with a merger of the wind turbine division and a listing of the health-care division. The planned spinoff of the gas and power unit will be completed in 2020. The German executive also tried and failed to merge the train-making operation with that of rival Alstom SA. The move was partly motivated by the fate of rival conglomerate General Electric Co., which is showing signs of emerging from a troubled period.

Siemens's new structure has greatly reduced the company's need for people in central operations, where 2,500 job cuts are planned. In total, the company plans to cut more than 10,000 jobs, although Kaeser has said company also plans to hire about 20,000 in the same time.

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## **Sweden's Biggest Cities Face Power Shortage After Fuel-Tax Hike**



Sweden's introduction on Thursday of a tax aimed at phasing out the nation's last remaining coal and gas plants to curb global warming comes with an unintended consequence for some of its biggest cities.

Hiking threefold a levy on fossil fuels used at local power plants will make such facilities unprofitable and utilities from Stockholm Exergi AB to EON SE have said they will halt or cut power production.

The move means that grids in the capital and Malmo won't be able to hook up new facilities including homes, transport links and factories. While Sweden doesn't have a shortage of power, there's not enough cables to ship it to the biggest cities.

"We don't have a problem with generating enough power in Sweden, we have a problem with getting it to where its needed," Magnus Hall, chief executive officer of state-owned utility Vattenfall AB, said in an interview. "This law was added with short notice and I am not sure a proper analysis of

it was made."

The tax was introduced in January in a budget deal between the Center Party, Liberals, Social Democrats and the Greens after record long 18 weeks of negotiations. As only one of 73 points hashed out between the political fractions to reach a compromise, time for thorough analysis was probably slim.

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## **Qatar's fiscal balance/GDP set to rise to 4.6% in 2023: FocusEconomics**



Qatar's fiscal balance as a percentage of GDP is set to rise to 4.6% in 2023 from an estimated 1.3% this year, FocusEconomics said.

The current account balance (as a percentage of the country's GDP) will be 6.6% in 2023 compared with 6.7% in 2019.

Qatar's merchandise trade balance, FocusEconomics said in its latest economic update, will be \$55.1bn in 2023. This year, it will account for \$46.7bn.

Qatar's gross domestic product is expected to reach \$239bn by 2023, it said. By the year-end, Qatar's GDP may total \$196bn.

Qatar's economic growth in terms of nominal GDP will reach 5.2% in 2023 from 2.3% by the year-end.

The researcher said Qatar's public debt will fall gradually until 2023, and is estimated to be 51.7% this year, 48.4% (in 2020), 45.3% (in 2021), 42.7% (in 2022) and 40% (in 2023).

International reserves may exceed \$43bn in 2023, from the current \$37.7bn; FocusEconomics estimated and noted it will cover 12.1 months of country's imports.

The country's inflation, the report noted, will be 2.1% in 2023 and 0.1% this year.

Qatar's unemployment rate (as a percentage of active population) will remain a meagre 0.2% in 2023, unchanged from this year.

According to FocusEconomics, the economy posted a "modest acceleration" to 0.9% year-on-year growth in the first quarter (Q1) after a "weak" 0.5% out-turn in Q4 last year.

Q1's expansion was driven by the mining and quarrying sector's return to growth for the first time since Q4, 2017.

Meanwhile, the manufacturing sector also posted a "solid" turnaround.

"The economy should gather momentum this year, driven mainly by a recovery in the energy sector and stronger government consumption growth.

"Consumer prices fell 0.4% in annual terms in June (May -0.7% year-on-year). Going forward, inflation should return later this year on stronger economic activity and a supportive base effect, but remain anaemic nonetheless."

FocusEconomics panellists expect inflation to average 0.1% in 2019, which is down 0.5 percentage points from last month's forecast, and 2.3% in 2020.

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## **Alumina market roller coaster spins price to two-year lows**



By Andy Home

LONDON, July 30 (Reuters) – The alumina market has collapsed over the last three months with both Chinese and Western prices now at their lowest levels in two years.

The action in China has been particularly brutal. Spot prices surged to a six-month high of 3,170 yuan per tonne in May as production in the province of Shanxi was disrupted by environmental closures.

So violent has been the subsequent sell-off to below 2,500 yuan that producers are now voluntarily cutting output to try to support prices.

Since alumina is the key metallic input to the aluminium smelting process, bombed-out alumina prices are bad news for an aluminium market that is itself treading heavy water right now.

The London Metal Exchange (LME) three-month aluminium price is currently trading just above the \$1,800 per tonne level after

touching an 18 month low of \$1,745 in June.

Lower alumina prices serve to lower the aluminium production cost-curve, the break-even point for smelters that helps define the market's downside.

Global smelter profitability is once again beholden to the gyrations of the alumina price with still little evidence that such volatility is being hedged in either the CME Group's or LME's new futures contracts.

## THE RETURN OF ALUNORTE

The CME alumina price, tellingly, never reacted to the May spike in the Chinese price but rather kept grinding lower to today's \$305 per tonne, a level last visited in June 2017.

The core driver has been the return of the giant 6.3-million tonne per year capacity Alunorte plant in Brazil.

Alunorte had been operating at half capacity since February 2018 under a court order related to allegations of run-offs from a tailings dam holding the "red mud" generated in the refining process.

Operator Hydro was given clearance to resume full output in May this year and Alunorte was already running at 80-85% capacity in June, the company said in its Q2 results. That should rise to 85-95% in the fourth quarter.

Alunorte's return closes a supply gap in the Western market which had to be filled by Chinese exports, an unusual occurrence in the alumina market.

Chinese exports mushroomed to 1.5 million tonnes last year from just 56,000 tonnes in 2017.

The tide has since turned. Exports have dropped off sharply and the country has returned to being a net importer since January.

The extra supply is no longer needed thanks to the return of Alunorte, the continuing ramp-up of new capacity by Emirates Global Aluminium and stagnant aluminium production.

Metal output outside of China was down by 0.6% in the first half of 2019, according to the International Aluminium Institute.

## CHINESE BOOM AND BUST

Chinese alumina prices have boomed and bust in the space of just three months.

Environmental closures in May, triggered by a “red mud” leak at Xinfia Group’s Jiaokou alumina refinery in Shanxi, spooked the local supply chain.

Any impact from those closures, however, has been fleeting. National output dipped appreciably in May but has since bounced back to 6.41 million tonnes in June, the highest monthly run-rate since May 2017.

Cumulative alumina output rose by 3% in the first half of the year and with China’s own aluminium production also flat-lining this year, analysts at Morgan Stanley calculate a 200,000-300,000 tonne surplus in the country. (“Stopping alumina’s slide”, July 29, 2019).

Previous fears of a supply shortfall have been rapidly dialled back and spot prices are now at a level where higher-cost producers in northern regions are suffering “serious losses”, according to Antaike, the research arm of the China Nonferrous Metals Industry Association.

Producers have announced a collective temporary curtailment of 1.5 million tonnes, Antaike says.

As ever with such coordinated announcements by Chinese producers, there’s an element of window-dressing previously

scheduled maintenance work, but the real significance is what it says about the margin pain occasioned by falling prices.

Higher-cost producers have in the past been able collectively to support prices around \$300 per tonne but with alumina's own input costs falling, it remains to be seen how disciplined supply will be this time around.

There is growing speculation among analysts that China's alumina sector is heading for the same sort of structural reform treatment already imposed on the smelter segment of the production chain.

That might be a source of long-term support to the alumina price but for now it's down to whether Chinese producers can curtail output sufficiently to balance the domestic market.

## **RIDING THE ROLLER COASTER**

Alumina has been on a high-tempo, high-volatility price trajectory over the last couple of years.

It was above \$600 per tonne as recently as September 2018 before crashing to its current producer pain levels.

The price of alumina was once linked to that of aluminium. Producers embraced spot trading several years ago, arguing that alumina supply-demand fundamentals were different from those of the metallic product.

They have turned out to be right, although not perhaps in the way they imagined. Alumina has turned out to be a much more volatile package of drivers than aluminium.

What's curious is that all this volatility hasn't inspired much interest in using the paper market to hedge price risk.

The LME's newly-launched alumina contract didn't trade at all through June. CME's contract, which started trading in 2016, has seen only sporadic volumes since inception. Activity this

year has almost totally dried up with just 240 contracts traded in January-June.

The Shanghai Futures Exchange (ShFE) is undeterred and has promised its own contract later this year.

It's possible that last year's high prices actively deterred producer hedging interest but with the outlook increasingly bearish, that might change.

#### ADVERTISEMENT

Morgan Stanley sees "near term price support around \$300 per tonne, with risk to the downside".

However, given the excitement of the last two years, you wouldn't bet against a few more spins of what Antaikaike calls the alumina "roller coaster".

(\$1 = 6.8876 yuan)

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**Centrica CEO to quit after first dividend cut in years**



Bloomberg/London

Centrica said its chief executive officer will step down after a tumultuous five-year run at Britain's largest energy supplier, which has lost two-thirds of its value and millions of customers during his term.

Iain Conn, 56, announced his departure along with Centrica's first dividend cut since 2015. He will leave the board in 2020 after he finishes an effort to fortify the utility against increasing competition and a government cap on what it can charge for its electricity and natural gas.

Centrica shares fell as much as 13% in London to the lowest since 1997, the year the utility was spun out of the state-owned British Gas. Conn inherited a company that had under his predecessors diversified into oil and gas production and nuclear energy, businesses that Centrica now intends to sell.

In more recent years, smaller rivals have lured away tens of thousands of customers from Britain's Big Six utilities. Centrica earnings were also hit in the first half as warm weather and operational issues cut its electricity supply by 4%.

Conn said his departure was a mutual decision with the board and the result of months of discussions. Conn is seeking to

hand over a smaller entity focused on customer-facing businesses supplying power and energy services. The board will name a successor later.

While the company's share price plunged to new lows, Conn said the company was on the right track and seeing the beginning of stabilisation. He said the earnings outlook is brighter for the rest of the year.

"This set of steps is a fundamental re-positioning of the company and is the end of a journey we began in 2015," Conn said on a call with reporters yesterday. "We haven't changed our strategy. We've made some adjustments, but the board has confirmed we need to keep going toward the customer."

Unions were quick to criticise Conn's plan to maintain the pace of job cuts he announced in February and step up a cost savings target.

Centrica is targeting £1bn (\$1.2bn) of annual cost savings from this year through 2022, up by £250mn since February. The company maintained its estimate that it will shed 1,500 to 2,000 jobs this year from the some 30,520 it had at the end of 2018. "More of the same, more job cuts on top of the thousands already gone and going, are panic measures, not a credible plan for recovery," said Justin Bowden, national secretary of the GMB union. "There must be a pause under a new CEO, investment and a new plan for growth."

The board proposed an interim dividend of 1.5 pence a share, down from 3.6 pence for the same period a year ago. For the full year, the dividend will be cut to 5 pence a share, down from 12 pence in the last four years.

"The departure of Centrica's CEO won't resolve all of its problems, in our view, as many are outside management's control," Elchin Mammadov, analyst at Bloomberg Intelligence, wrote in a note. "The new team at the helm will need to focus on delivering further cost cuts and growth in energy supply and services."

Customer numbers in Centrica's main energy supply and services business fell 2% to 23.6mn in the first half of the year.

Output from its 20% stake in Britain's nuclear plants fell 19% in the first half to 4.9 terawatt-hours, reflecting outages at the Dungeness B and Hunterston B power stations.

"Centrica faced an exceptionally challenging environment in the first half of 2019, which impacted earnings and cash flows," Conn said in a statement yesterday. "This major refocusing of our portfolio will unlock further efficiencies enabling us to be even more cost-competitive, as we focus on being a leading energy services and solutions provider." Looking Ahead Conn maintained guidance for full year earnings. Nuclear plant outages that hit earnings in the first half are likely to pass, and cost savings set to kick in.

Centrica expects growth in its consumer businesses. In its connected homes business, growth accelerated 49% to 1.5mn. In the months ahead, Centrica will work on selling its Spirit Energy unit, which produces oil and natural gas. It's already divesting its stake in nuclear power plants, although the statement yesterday said nothing new about that process. Conn said Centrica will exit Spirit via a trade sale and use proceeds to restructure the company.

"We are completing the shift we began in 2015 from a company ill-equipped to deal with changes in the energy systems to one in tune with moving toward a lower-carbon economy," Conn said. "Once we've made them, it is now time for me to hand over to a successor."

Along with its shift toward a more customer-facing business, the company also wants to make money off the expansion of electric vehicles. It announced a new partnership with Ford Motor Co yesterday to develop charging stations at hundreds of dealerships across the UK and Ireland as well as sell home charging equipment and electric vehicle tariffs.

The company is in talks with other car companies to expand further into this area, Sarwjit Sambhi, head of Centrica's consumer business, said on a call with reporters.

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# Italy to play low 2019 deficit card to avoid EU procedure



EU Commission threatened Rome with disciplinary steps; 2019 deficit could be 2% of GDP or lower, officials say; league economics chief says 1.8% is possible; coalition still undecided how to use savings emerging Reuters Rome Italian coalition officials say the country's public accounts are throwing up positive surprises this year, strengthening Rome's hand as it tries to ward off a possible European Union disciplinary procedure. Recent data suggest the deficit this year will not only be below the European Commission's forecast of 2.5% of gross domestic product (GDP) but could even be below the 2.04% agreed with Brussels in December, two senior

coalition members said. However, it remains to be seen how far the anti-austerity government will actually slash its current 2.4% target, because some in the 5-Star Movement, one of the two ruling coalition parties, want the savings that are emerging to be quickly spent on new expansionary measures.

The other ruling party, the League, is pushing for deep tax cuts, but only from 2020. It is also not certain that an unexpectedly low 2019 deficit would be enough to convince Brussels that Italy's finances are on a sustainable path. But the latest data at least give Rome fresh arguments – something that looked impossible a few months ago. The Commission on Wednesday paved the way to disciplinary steps against Italy, complaining that its debt had risen in 2018 instead of falling and would continue to do so. It said Rome had also not reined in its annual budget deficit as promised in 2018 and would continue to run excessive deficits this year and next. A disciplinary procedure, which could eventually end in fines, had already been averted at the last moment in December when Italy cut its original 2.4% deficit target for this year to 2.04%, with the agreement of the Commission. In April, Italy restored the original 2.4% target because of a slump in growth, while the Commission forecast 2.5%.

Prime Minister Giuseppe Conte surprised observers when he said on Wednesday, in response to the Commission, that a deficit of 2.1% was possible. But now, senior officials in the government of the right-wing League and the anti-establishment 5-Star say it could be even lower. Claudio Borghi, the League's economics chief, told Reuters 1.8% was possible if current trends continue. The main reason for the surprise trend is that two flagship government measures – an early retirement option and a new means-tested welfare benefit – are proving less popular, and therefore less costly than expected. Taken together, it now looks as if the combined cost of the two policies will be €4bn (\$3.4bn) less than was set aside in the 2019 budget, Borghi said.

This estimate was confirmed by a government member closely involved in economic policy, who asked not to be named. Borghi said tax amnesties allowing people to settle disputes with the authorities by paying a limited sum had yielded more than expected, as had measures against tax evasion. Among these, the requirement from January this year that a copy of virtually all transactions must be transmitted electronically to the taxman produced squeals of protest from companies but has bolstered sales tax revenues. State coffers have also been swelled by out-of-court settlements with several large multinationals accused of tax evasion, the largest of them a €1.3bn deal with Kering, the holding company of fashion house Gucci.

A senior Treasury official declined to confirm Borghi's 1.8% 2019 deficit projection but said it now looked "possible" that the deficit would be 2% or lower. Public finance data so far this year has been encouraging. The central government deficit for the first four months was just €1.5bn above last year's equivalent figure – below the trend projected in Rome's 2019 Stability Programme, which forecasts that the full-year deficit would rise by €16bn. Tax revenues through April were up 1.0% year-on-year despite a stagnant economy, compared with an official full-year target of 0.6% growth. In addition, dividend payments by the central bank and state-owned enterprises will also exceed the projections in the Stability Programme by more than 0.1% of GDP, the Treasury said in documents sent to Brussels this month.

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## **Can euro replace dollar as**

# world's dominant currency?



Reuters/ London

Should European countries want the euro to replace the dollar as the world's dominant reserve currency, the Sino-US trade war may offer a window of opportunity.

The souring of ties between the world's two largest economies will indicate the extent to which China can switch some of its giant reserve holdings to another hard currency and also point to the limitations the eurozone faces in providing a viable alternative.

In the post-World War Two era, no asset has ever fully matched US government bonds for size, liquidity and credit quality.

It is the closest any global security has come to being perceived as a cash-like, risk-free asset with over \$16tn worth of paper in circulation.

Yet, a year into a bitter tariff war, there are some signs of Beijing's discomfort at being both the United States' biggest trade adversary and one of its biggest creditors.

Recent data showed China sold more US Treasuries in March than it has in any month over the past 2-1/2 years.

If that proves to be more than a one-month quirk, speculation

will rise about where it is diverting those reserves, and the eurozone – the world's biggest trading bloc – tops the list of likely spots.

On size alone, eurozone government bonds appear to provide a credible landing pad: outstanding securities are almost two-thirds of the overall Treasury market.

There are signs already of greater Chinese interest in Europe – bankers attribute record Asian demand for recent Spanish, French and Belgian debt sales to Beijing.

And China has stepped up buying debt from Europe's quasi-sovereign entities, bankers told Reuters, in particular the European Stability Mechanism (ESM) a eurozone-guaranteed AAA/A1-rated bailout fund.

Asian investors snapped up 33% of the ESM's recent 2bn-euro 10-year bond, data from International Financing Review shows.

Asian takeup for ESM's euro issues last year was 4%-5%. But for Chinese reserve managers to shift hundreds of billions of dollars from Treasuries to Europe's single currency, the euro bloc needs to address key shortcomings.

"I find it hard to square the circle how such a huge Treasury holding can be diversified away, given the landscape we are in," said Salman Ahmed, chief investment strategist at Lombard Odier Investment Managers.

"In the eurozone there is not a big risk-free market...Twenty years down the line it may be different."

For Ahmed, the main issue is that credit risk in the bloc is not uniform.

The 19 members each run their own fiscal policies, budget rules are too loosely policed to ensure adherence, and euro exit remains a theoretical possibility.

So wealthier members such as Germany remain net savers that run balanced budgets or even surpluses, while others, mostly in southern Europe, are dogged by high debt.

The resulting mix of credit and political risks make it harder to see the aggregate eurozone bond market as a true mirror of the US Treasury universe.

Ross Hutchison, a fund manager at Aberdeen Standard

Investments, says it boils down to the fact the United States "has a federal nature that the euro area hasn't got yet". Additionally, distortions stemming from years of bond buying stimulus by the European Central Bank mean available euro government bonds are far fewer than may appear.

While euro government debt outstanding is around \$9.5tn, the ECB is estimated to hold roughly a quarter.

And the kind of "safe" securities that reserve managers seek are even scarcer – AAA-rated debt from Germany, the Netherlands and Luxembourg totals around \$2.5tn, less if ECB holdings are discounted.

Debt from slightly lower-rated France, Belgium and Austria would add another \$3tn.

Italy on the other hand has the bloc's biggest government bond market, worth \$2.3tn.

But its poor debt-to-GDP ratio, sluggish economy and populist policies make its bonds riskier and its credit rating is a notch or two above junk.

So in times of stress, investors clamour for German bonds, while in Italy, yields spike, threatening to undermine local banks that hold these securities.

Italian 10-year yields are at 2.5%, versus Germany's minus 0.22%. Such risks have chipped away at the euro's fortunes as a reserve currency – International Monetary Fund data shows it comprises 20% of global central bank holdings, from 26% in 2009.

The decline is linked to the 2011 Greek debt crisis that then ravaged Spain, Italy, Portugal and Ireland, highlighting risks of default by a member state and redenomination of euro debt into a new currency.

European officials are keen to counter the dollar's hegemony, and at a conference last month they debated ways to win the euro a "stronger international role". But they made no mention of the one measure that could resolve the issue at a stroke – joint debt issuance via common eurozone bonds.

Such securities would pool the bloc's risks, and offer safer securities than those from most individual nations.

Olli Rehn, Bank of Finland governor and an ECB governing council member, said last week a safe asset would help enhance the euro's international role, offering hope the issue will be on the agenda of the new European Commission later this year. A common bond "would be more significant than the creation of another TLTRO in boosting demand for euros globally and reserve managers would be part of that story," said David Owen, chief European economist at Jefferies.

He was referring to the ECB's cheap multi-year loans.

"Maybe there will be more focus on pushing forward this agenda and taking advantage of the US and China having this trade spat," Owen added.

Others, however, note that wealthier states oppose any common bond programme, fearing they will end up footing the bill.

Also, across Europe populist and anti-establishment movements are on the rise, with the agenda of slowing integration and returning power to national capitals.

Such groups grabbed a greater share of the vote in EU parliamentary elections last month, albeit less than expected.

"If anything, the trend is towards decentralisation of power," Ahmed said.

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## **Bank of England to Hold Rates as Clouds Gather Over Outlook**



Bank of England officials will probably keep policy on hold next week as they acknowledge that the economic outlook has worsened materially since May.

All but one of the 24 economists surveyed by Bloomberg predict a unanimous vote to maintain the benchmark rate at 0.75%. The risk of a no-deal departure from the European Union under new Prime Minister Boris Johnson and an increasingly gloomy global outlook suggest that policy makers will be cautious.

Officials have scaled back their rate-hike rhetoric and investors are increasingly pricing in rate cuts as the risk of a disorderly Brexit grows.

But with a falling pound and stronger wage growth threatening to fuel inflation, officials potentially face a dilemma. Governor Mark Carney is expected to address the trade-off between growth and prices after the BOE publishes its quarterly Inflation Report, alongside the monetary-policy decision, at noon on Thursday.

Economists are virtually unanimous in predicting the BOE will cut its 2019 growth forecast, with around half predicting a downgrade to the following two years. Officials are also widely expected to hike their inflation projections.

Policy makers have softened their language about the possibility of interest-rate increases. Michael Saunders, who led the charge for the BOE's last two rate hikes, has suggested he's in no rush to begin another push, telling Bloomberg the economy right now is "clearly not overheating."

Chief Economist Andy Haldane, also considered among the more hawkish members of the Monetary Policy Committee, said in a speech this week that the case for keeping policy unchanged is strong and the group should proceed with caution on any loosening.

Carney has also warned that damage to the global economy from rising protectionism could be significant and require a major policy response.

While one economist sees a dissenter on the nine-member rate setting committee calling for an immediate cut, most recent comments point to unanimity.

Officials may try to address the discrepancy between their official forecasts and market expectations. Carney has said they will explore "how best to illustrate" the market "sensitivities."

Source: Bloomberg