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G-20 Summit Review

The communiqué from the G-20 Summit in Toronto was largely a commitment to maintain progress on the policy framework laid out at the Pittsburgh meeting in September 2009, with the added dimension of a dedication to fiscal consolidation. We will have to wait until the Seoul Summit in November before new rules on capital requirements, liquidity and leverage ratios are defined in detail. The concluding theme of the Toronto G-20 meeting was that while countries agree on many major policy objectives, they also acknowledge that a one-size fit-all approach is not feasible. It remains to be seen if the same theme will be repeated on financial reform in Seoul. In the end, the Toronto Summit essentially laid out a broad range of issues where there was an agreement on assessments and principles.

Fiscal Consolidation

The substantive new development that came out of the Toronto Summit was that members outlined a specific framework for simultaneous fiscal adjustment. The communiqué noted that “advanced economies have committed to fiscal plans that will at least halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016”. In recognition of Japan’s high deficit and debt levels, Japan was an exception to the commitment, but there was still a dedication to fiscal consolidation. However, while formally recognizing a specific timetable was a new development for the G20, the focus on deficit cutting was not. A number of G-20 countries had already pledged or introduced new budgets to reduce their fiscal deficits which are in line with “halving” by 2013. For instance, Germany’s current budget pledges to achieve its Constitutional limit of 0.3% of GDP deficit by 2016. The United Kingdom has just released a new budget which reflects a decline in public sector net borrowing of 9.9 percentage points of GDP, from 11% of GDP in fiscal year 2009-10 to 1.1% of GDP in fiscal year 2015/16. Even the March budget proposal by the United States – a country that remains quite vocal about pursuing a go-slow approach to fiscal withdrawal – has budget projections for deficit-to-GDP to go from -10.3% in 2010 to -4.5% in 2013. So, the commitments made by many of the countries at the G-20 are the same promises made to their constituents. And, some of the improvement in fiscal balances will reflect the end of the temporary fiscal stimulus initiatives. The greater challenge is dealing with the structural deficits that have been accumulated.

In addition, the timeframe is merely guidance and not a hard target. The communication gives a nod that there isn’t a one-size-fits-all approach by stating that fiscal consolidation will be “differentiated to national circumstances”, and “those with serious fiscal challenges need to accelerate the pace of consolidation”.

The comment to stabilize the debt-to-GDP ratio by 2016 certainly has some ambiguity attached to it because stabilization could mean different things to different countries. Returning to the example of the United States, the Congressional Budget Office projects this ratio to steadily climb from 63% of GDP in 2010 to 90% in 2020 under Obama’s proposed budget in March. The

ratio, however, does rise at a slower and slower rate. Is this the minimum standard to which the US will be held accountable in the definition of “stabilization”? The answer is not clear. In contrast, Canada’s debt-to-GDP is expected to peak in 2011/12 at roughly 35% and edge down thereafter. Ultimately, it will be the financial markets that will dictate what deficit and debt levels can be tolerated from a country and – as we saw with Greece – markets will enforce discipline on those that stray beyond their comfort level.

Financial Reform

As expected, there were no specific guidelines defined on the financial reform, as final proposals by the Basel Committee on Banking Supervision and the Financial Stability Board are scheduled for the next G-20 Summit to be held in Seoul on November 11th and 12th. Regarding capital requirements, the communiqué states that “the amount of capital will be significantly higher and the quality of capital will be significantly improved when the new reforms are fully implemented. This will enable banks to withstand – without extraordinary government support – stresses of a magnitude associated with the recent financial crisis.” The implementation deadline remains end-2012. However, once again there was acknowledgment that one-size does not fit all, as “phase-in arrangements will reflect different national starting points and circumstances”. Reaching agreement on the specifics of a new capital framework, as well as calibration of new liquidity and leverage ratios should be accomplished at the time of the Seoul Summit. By that time, the Financial Stability Board should also “consider and develop concrete policy recommendations to effectively address problems associated with, and resolve, systemically important financial institutions”.

In the run-off to Toronto’s Summit, many countries (notably Germany and France) had been promoting the idea of financial institutions paying for any burdens associated with government interventions to repair the financial system. The G-20 leaders addressed the issue by recognizing that “there is a range of policy approaches. Some countries are pursuing a financial levy. Other countries are pursuing different approaches.” In other words, there will not be a universal bank tax, as was initially put forward by European members.

Global Imbalances

On the issue of global imbalances, G-20 leaders agreed that “advanced deficit countries should take actions to boost national savings while maintaining open markets and enhancing export competitiveness.” Meanwhile, “surplus economies will undertake reforms to reduce their reliance on external demand and focus more on domestic sources of growth”. However, they “recognize that these measures will need to be implemented at the national level and will need to be tailored to individual country circumstances.” Regarding the pending conclusion of the WTO Doha round, G-20 members reiterated their support for bringing it to a “balanced and ambitious conclusion as soon as possible, consistent with its mandate and based on the progress already made.” However, G-20 members missed the opportunity for setting a date for holding the concluding negotiations.

Concluding Remarks

The G-20 Toronto Summit provided little in the way of new developments to highlight, but re-confirmed the key policy areas that leaders are looking to make progress on and it acknowledged the importance of fiscal consolidation over the medium-term and global growth rebalancing. The Seoul Summit will be a tougher test for G-20 leaders because the expectation will be on achieving final agreement on financial regulation reform, and decisions will have to be

made on very specific issues that will not allow for vague statements. However, the fact that phase-in of new regulations will be conditioned to different national starting points and circumstances sets a worrisome precedent for the upcoming negotiations. Indeed, with the U.S. being on the verge of passing its own financial reform act stresses the prospects for individualistic approaches. The key risk is that an uncoordinated approach could fuel regulatory arbitrage, as firms adjust to the new regulatory environment.

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