

#UkrFinForum17

Day 1. Keynote panel

Global finance and the world economy: EU after potential Brexit, US, and China. How sustainable is the global recovery?

Jonathan David Ostry, Deputy Director Research Department, IMF

dedicated his opening remarks to rising inequality, and ways to create a foundation for sustainable growth. In his view, inequality is a robust determinant both of the pace of medium-term growth and of the duration of growth periods. Ostry emphasized that redistribution of income can help improve the situation with inequality and that on average, across countries and over time, unless extreme, governments' efforts to redistribute do not lead to bad outcomes for growth. He pointed out that globalization does not work well for all. Some periods of capital-account liberalization were followed by increased inequality, which increased volatility and constrained growth. Ostry stressed that austerity can be costly, as episodes of fiscal consolidation hurt growth in the short run, and increased inequality. At the same time, paying debt rapidly can be costlier than living with it. In Ostry's view, financial inclusion and redistribution can mute the impacts of inequality. The question is how to make financial globalization more inclusive, and the prosperity it generates spread more evenly.

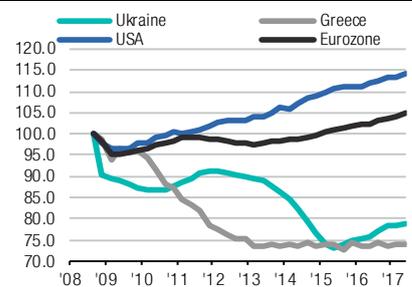
Yanis Varoufakis, former Finance Minister of Greece pointed out that both the Eurozone and global economy require deeper reforms than currently are underway. He stressed that the modern world is full of uncertainty that cannot be explained. Nobody has an answer for the question: what happened to inflation and cheap money? Varoufakis divides the postwar period into three phases: 1) a period of growth characterized by surplus capital in the US, 2) financial deregulation that began in the 1970s after the US lost its status as a surplus country, 3) the period since the 2008 crisis. He describes the current period as "unbalanced equilibrium." The world has returned to surplus economies, but capital flows do not change. He explains, "Previously, capital was used to create new companies and jobs, but today companies buy back their own shares, which results in a lack of investment." In addition to worldwide underinvestment, except for China, Varoufakis highlights other global issues such as rising public and private debt, and increasing poverty. He emphasizes that at first glance, the world is in a state of recovery, but in reality, it is in a slow-burning crisis. In his view, the global financial architecture needs to be recalibrated, as it was in 1944.

Markus Brunnermeier, Professor of Economics, Princeton University

In his opening remarks, Brunnermeier said that if Ukraine wants to join the EU in the future, it must understand its internal policies. He pointed out the differences in Germany and France's policy-making. Brunnermeier distinguishes several key differences between them: 1) Germany bases its policies on strict rules, and the crisis in Greece is an example. Germany approved the debt restructuring because it believed that Greece should fulfill its obligations. France is more flexible: it agreed to receive other benefits instead of debt repayment; for example, control over the banking system of Greece. 2) Responsibility for actions: Germany

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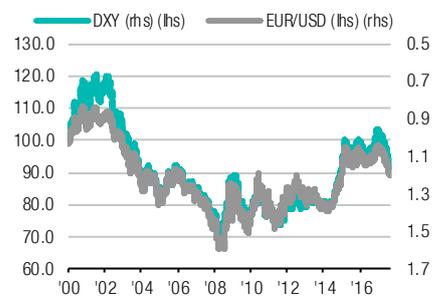
Real GDP performance: quarterly history from 3Q08 through 2Q17



Source: Bloomberg, ICU.

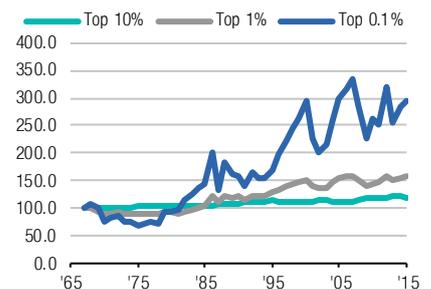
Note: real GDP data rebased at 100 points as of 3Q08.

EUR/USD pair versus DXY



Source: Bloomberg, ICU.

Growth in share of all US income going to each quantile



Source: The World Wealth and Income Database.

Note: growth in share of all US income rebased at 100 points as of 1967

Germany and France influence EU policy from fundamentally different approaches. The ability to find compromise is key to deepening integration of the European Union

holds the position that everyone is responsible for the situation in which they find themselves, while France is inclined to share responsibility. This disagreement is clearly evident in the issue of Eurobond issuance, which Germany is against. 3) In times of crisis, Germany requires austerity and debt restructuring, while France sees insolvency as a lack of liquidity. 4) Time for reforms: France has a more economics-related approach to this issue, and believes that reforms must be carried out in good times, while Germany relies on the political component, and holds the view that reforms need to be introduced during the crisis. The approach of these two countries to policy-making are quite different. However, the ability to find compromises on important issues is the basis of EU unity and further integration.

Varoufakis believes that the world remains in crisis

During a **further discussion between Brunnermeier and Varoufakis**, Varoufakis stated that he doesn't see any signs of a recovery in the world economy. He highlighted the over dependence on credit of the Chinese economy, and the uncertainty surrounding Trump's reforms in the United States. He also noted that **demand in many European countries remains weak, and is supported only by increasing private debt**. Brunnermeier, by contrast, noted that although growth is fragile, he sees the situation as gradually improving. Commenting on inflation, he said that today, central banks have more means to fight it. Expert's views on possible Grexit are also divided. Varoufakis assumes Grexit, believing that in the medium term, this would give Greece more benefit. However, in his opinion, the **European Union would not survive Greece's exit from the economic union and the Eurozone**. Brunnermeier, on the contrary, supports preserving the European Union, and looks for greater integration.

Debt restructuring and tax cuts are key factors for economic recovery of Greece

Answering a question from ICU Managing Director Makar Paseniuk on the availability of additional tools for boosting growth besides debt write-down, Varoufakis emphasized that **debt restructuring should not be the ultimate goal. It should be accompanied by a reduction in taxes, which will create a powerful, positive stimulus for the economy**. The elimination of oligopolies, especially for major consumer products, is also paramount, along with reform of the state administration. Brunnermeier added that among the two options for restructuring Greece's debt—partial write-off or extending maturities and reducing interest rates—Germany tends to prefer the latter, because it opposes Greece's return to the private equity and debt markets. Brunnermeier pointed out that growth in the smaller economies of the European Union can be accelerated through capital controls, productivity, and structural reforms.

Varoufakis emphasized that Ukraine should not repeat the path of Greece: it is important not to play with insolvency. Greece's case is an example of how debt should not be restructured. Varoufakis pointed out that a **country cannot escape bankruptcy through new loans if conditions are such that it must shrink incomes, which weren't sufficient to repay the previous debt**.



11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kiev, 01030 Ukraine
Phone/Fax +38 044 2200120

WEB www.icu.ua



@ICU_UA

CORPORATE FINANCE

Makar Paseniuk, CFA, Managing Director
makar.paseniuk@icu.ua

Ivan Shvydanenko, Director
ivan.shvydanenko@icu.ua

Roman Nikitov, ACCA, Director
roman.nikitov@icu.ua

Yuriy Kamarytskyi, Vice President
yuriy.kamarytskyi@icu.ua

Ruslan Kilmukhametov, Director
ruslan.kilmukhametov@icu.ua

Ruslan Patlavsky, Director
ruslan.patlavsky@icu.ua

STRATEGY AND CORPORATE DEVELOPMENT

Vlad Sinani, Director
vlad.sinani@icu.ua

SALES AND TRADING

Konstantin Stetsenko 
Managing Director
konstantin.stetsenko@icu.ua

Liliya Kubytovych 
Asset Management Product Sales
liliya.kubytovych@icu.ua

Sergiy Byelyayev
Fixed-Income Trading
sergiy.byelyayev@icu.ua

Yevgeniya Gryshchenko
Fixed-Income Sales
yevgeniya.gryshchenko@icu.ua

Vitaliy Sivach 
Fixed-Income & FX Trading
vitaliy.sivach@icu.ua

Bogdan Vorotilin 
bogdan.vorotilin@icu.ua

RESEARCH

Alexander Valchyshen 
Head of Research
alexander.valchyshen@icu.ua

Alexander Martynenko 
Head of corporate research
alexander.martynenko@icu.ua

Taras Kotovych 
Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Mykhaylo Demkiv 
Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Lee Daniels, Rolfe Haas
Editors

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