WORKSHOP CHAIRED BY CLAUDIO COCCA – 1 NOVEMBER 2008

THE IMPACT OF THE CREDIT CRUNCH ON NATIONAL ECONOMIES OF GGI MEMBERS

Introduction

The meeting was chaired by Claudio Cocca following a request from a number of GGI members for GGI to address the business and economic issues that arose as a result of the disruption in the world's financial markets.

Claudio began the meeting by summarising his view of the financial, business and economic conditions currently prevailing and then asked participants to let the meeting have their view as to where the world's economy would be at the end of 2009.

Summary of Current State of Financial, Business and Economic Conditions

1. The world's economy has benefited from a long period of high liquidity and low interest rates.

2. There has been a boom in house ownership, particularly in the USA.

3. A substantial relaxation in the financial regulatory regime within the USA which encouraged the banking and financial industry to lend and invest substantial amounts of money in the housing market which was based on a supposition that house price inflation would continue indefinitely.

4. When banks capitalised on the opportunity to extend funding to the US housing market they then tried to lay off the risk by creating new financial products which were sold to other banks on an international basis.

5. During 2007 real estate prices in the USA began to fall.

6. From mid 2007 onwards the financial industry began to recognise there might be a liquidity problem and organisations such as BNP Paribas and Bearsterns closed two funds.

7. There then began a wholesale downturn in the liquidity in financial markets which passed over to the "real economy".

8. A recognition is developing that this recession, being initially based on financial services, could be radically different from other recessions which tended to be more industrial, commercial and "real economy" based and, as there is no previous recent example of this, there is no certainty as to what the outcome might be.

9. There is a suspicion that once the recession takes hold in the "real economy" there will then be a "boomerang effect" which will impact as a double dip on the banking and financial community which could exacerbate the effect of the recession.

10. We are now in a position where many international banks have very weak balance sheets and are undercapitalised relative to their debt.

11. It is not impossible that there could be some 700 or so insolvencies amongst banks and other financial institutions by the end of 2010.

12. The Baltic Dry Index is a measurement of the levels of activity being generated in international trade where some 90% of all goods are shipped. Currently, the Baltic Dry Index is running at around 75% less than the level of activity in August 2008 owing to, not only a drop in global demand for raw materials and goods, but also because of the difficulties in banks, customers and suppliers being able to obtain letters of credit. As the Baltic Exchange is a "real time measure" as opposed to a speculation as to where the markets might move to, it can be regarded as a real example of the downturn in global trade.

13. The consequence of the lower levels of activity through the Baltic Exchange means that by spring 2009, there could well be world wide shortages of goods and materials.

14. The outcome of the current recession is uncertain. On an optimistic front, the world may escape with a "soft landing" but GGI member firms should plan for a "hard landing" just in case the worse scenario is realised.

<u>What Action should GGI Member Firms take</u>

For many professional services firms, the issue is about "survival". In order to give firms the best prospect of riding through the current recession they should consider the following:

1. Implementing strict credit control and taking security from clients.

2. Not hesitating to cut staffing costs where work volumes show signs of drying up.

3. Undertaking due diligence of major customers and clients before embarking on substantial pieces of work.

4. Remaining "outward focused" by maintaining a profile without spending substantial amounts of money on marketing where the returns are likely to be minimal.

The meeting then invited member firms to give their view as to how their own national economies might develop:

Belgium: Philippe Gregoire. PG was of the view that the existence of a common currency, the Euro, was essential. Belgian debt is some 85% of GDP and Fortis bank was sold to BNP Paribas. As always, there will be opportunities of increased litigation for lawyers (!) but, in general, the outlook is not rosy.

Switzerland: Switzerland is no longer regarded as a safe haven because it depends so heavily on banking. UBS and Credit Suisse are substantial employers and contributors to its GDP. From a position of conservative stability, there is a view that Switzerland might now be too heavily reliant on financial services.

Uruguay: Commodity prices are falling. The USA was a major purchaser of raw materials and has disappeared from the market place. There is a confidence crisis as no-one trusts the banks and the danger of the national government of merely printing money could lead to inflation.

Dubai: Many investment products sold by USA financiers and banks were not authorised to be sold within the USA. These were often sold as "capital protected" products and were purchased by many European banks even though, in reality, the words "capital protection" might be open to interpretation. It is predicted that 50% of developments in Dubai will not be completed and many will go into liquidation. Currently the largest investors into Dubai are from Russia, Iran and India/Pakistan. There is, however, an opportunity for the Sovereign Wealth

Funds from the Gulf to acquire blue chip trophy assets from North America and Western Europe.

UK: The decline in house prices has followed the USA and it is not clear where this will end. The credit crunch arrived late in the UK (compared to Europe and North America) but its effects are being severely felt from autumn 2008 onwards. There is a difficulty in obtaining funding from banks and unemployment is rising. The outcome as to whether we would experience a soft or hard landing is unclear. Sales of safes and other security equipment in the UK has gone through the roof!

Austria: The banks in Austria do not appear to be as badly affected as in other GGI nations. Government guarantees have been given over the whole of the banking industry. Many business owners have taken cash out of companies and put it into personal accounts as bank cash is not covered within the government's guarantee. Austrian banks are heavily invested in Eastern Europe.

Slovenia: There is little collateral for loans. MBO's and other leverage transactions are virtually impossible to complete. Real estate values have fallen substantially and taxes will be likely to rise.

Luxembourg: 26% of employment within Luxembourg is based on banking and 80% of tax revenues come from the financial sector. The state is playing "doctor" to the banking industry and acting as a lender of the last resort. There will be opportunities in real estate and on the stock exchange when prices stabilise as much lower levels but clients need to check liquidity of customers on a continuous basis.

Conclusion

Claudio then summarised the feeling of the meeting which was that the whole of 2009 was likely to be extremely difficult. He believed there was a likelihood in the value of gold climbing substantially and that the desire by a number of national governments to print money as a way of adding liquidity to the market might lead to inflation and therefore a flight towards gold.

Ultimately it is a crisis of confidence and money. The world financial conference in the USA on 20th November (which may in some way resonate with the Bretton Woods meetings of 1946) could be crucially important.

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