

# “What does the **Eurozone Sovereign Debt Crisis** mean for the Isle of Man?”

27 October 2011

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Maitland

# Who is Maitland and what do we do?

- Maitland is a privately-owned firm offering wealth management services to private and institutional services
- Maitland is like a large family office:
  - **Legal tax advisors** - offer international cross-jurisdictional tax advice to private clients
  - **Fiduciary capability** - utilise offshore trusts and company structures
  - **Investment Services** - portfolio advice and management
  - **Fund services and administration** – for external fund providers
- Founded in 1976, we now employ 550+ people in 11 offices across Europe, the Caribbean and South Africa
- Maitland has \$125bn assets under administration
- Investment Services have \$700m+ under management and advice
- Isle of Man office manages our ‘international’ client bank, ~80% of total



# Eurozone headlines

- **Mervyn King** “the aim of the measures to be introduced over the next few days is to create a year or possibly two years’ breathing space. The underlying problems still have to be resolved.”
- **President Sarkozy:** “the whole construction of Europe since 1945 is at stake.”
- A European Union official said the Commission had yet to receive the 15-page letter in which **Silvio Berlusconi**, Italy’s embattled prime minister, was to outline his government’s response to demands for concrete economic reforms to stabilise the country’s finances.

Wednesday October 26 2011 | [thetimes.co.uk](http://thetimes.co.uk) | No 70400

Max 15C, min 4C



St Paul's, 11.12pm: just one protest tent is occupied



The glow in this image shows that most protesters choose to quit the camp at right here, pages 4, 5 Photograph: Richard Wallace of T1 Thermal Imaging for The Times

**Doubt cast on breast cancer screening**

Chris Smyth Health Correspondent

The national breast cancer screening programme is being reviewed after concerns that thousands of women every year are wrongly told that they have life-threatening cancer. The country's most senior cancer expert has promised to examine whether it is still justifiable to invite two million women a year for mammography checks. The move comes after pressure from a succession of specialists who say that some women are being treated unnecessarily. Regular breast screening is recommended for all women aged between 50 and 70, on the basis of estimates that it saves 1,400 lives each year by picking up cancer early. But some experts have accused the national programme of misleading women over the benefits.

**'They let me believe it would have killed me'**  
News, pages 8, 9

## Europe at mercy of the markets as Italy teeters

Summit to save eurozone is in trouble before it begins

Charles Bremner, David Charter and Sam Coates

A comprehensive package to save the currency from collapse was unveiled last night, putting the single currency once again at the mercy of the markets. The Italian Government of Silvio Berlusconi appeared days from disintegrating after a deadlock over austerity measures demanded by Europe raised the prospect of another ailing economy coming under siege. Hopes were fading, meanwhile, that

an emergency summit tonight could deliver the "comprehensive solution" that European leaders had promised would rescue the euro. Two of the three main elements of the salvage plan remain unresolved, prompting the abrupt cancellation of a meeting of finance ministers, including George Osborne, which had been due to approve the detail. One European diplomat told The Times that they were not certain how the economic, political and economic difficulties could be resolved. Sir Mervyn King, the Governor of the Bank

of England, gave a similar assessment to the Commons Treasury Select Committee. "The aim of the measures to be introduced over the next few days is to create a year or possibly two years' breathing space. The underlying problems still have to be resolved," he told MPs. David Cameron will still join his 26

colleague leaders for talks in Brussels this evening, but Downing Street emphasised that this was now an "informal" meeting and he would leave for a planned trip to Australia whatever the outcome. European officials conceded that the EU eurozone countries had yet to reach final agreement on how to reduce Greece's huge debts, and still had no clear way of boosting the firepower of the bailout fund. A third summit in eight days may now be staged this weekend, to try to

over since Danish researchers said that tests could also find benign abnormalities and that thousands of women were being put through grueling treatment they did not need. Officials dispute the numbers, but doctors have criticised the programme and its official publicity material for failing to inform women of the potential harms. Professor Sir Mike Richards, the national cancer director, has promised an analysis of the evidence underpinning breast screening. "Should the independent review conclude that the balance of harms outweighs the benefits of breast screening, I will have no hesitation in referring the findings to the UK National Screening Committee and their ministers," he wrote in a letter to the British Medical Journal. The leaflet sent to women invited to screening, which has been criticised for not fully explaining the harms, will also be revised, only a year after it was rewritten. More than 48,000 women are told that they have breast cancer every year, with about half of cases occurring in 50 to 70 age group and many being detected by screening. Although survival rates have improved since 1980, it is still a leading cause of cancer death.

IN THE NEWS					INSIDE TODAY	
<b>Quake baby rescued</b> A 15-day-old girl was pulled alive from rubble more than 46 hours after the earthquake in eastern Turkey. <a href="#">News, page 5</a>	<b>Sentencing reform</b> Kenneth Clarke is to scrap the Labour policy of indefinite jail terms for dangerous violent or sexual offenders. <a href="#">News, page 6</a>	<b>SAS man's Eta role</b> An ex-SAS member struggled to explain his role in the 1974 IRA bombing of a pub in London. <a href="#">World, page 12</a>	<b>King's challenge</b> Sir Mervyn King told MPs that it was up to the Treasury to lead attempts to boost lending to businesses. <a href="#">Business, page 42</a>	<b>Terry faces inquiry</b> The FA has started an investigation into claims of racism against Julian Terry, the England captain. <a href="#">Sport, page 84</a>	<b>Sarah Vine</b> <b>Sarkozy's New Baby syndrome</b> <a href="#">Times2, page 3</a>	

# The European Union

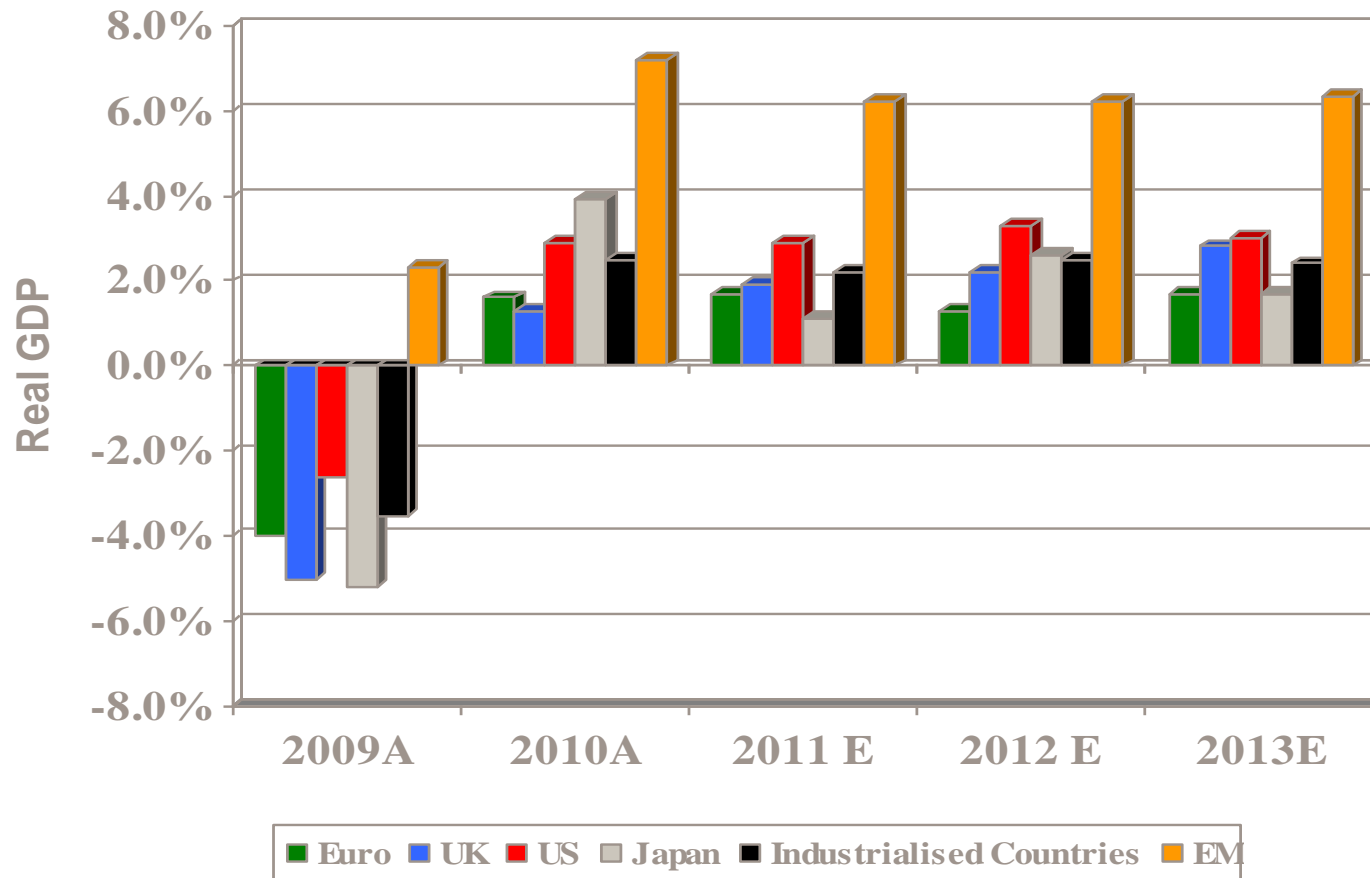


Source: Nationsonline

# Euro (Maastricht) Convergence Criteria

- **1. Inflation rates:** No more than 1.5 percentage points higher than the average of the three best performing member states of the EU
- **2. Government finance:**
  - **Annual government deficit:** The ratio of the annual government deficit to GDP must not exceed 3% at the end of the preceding fiscal year. If not it is at least required to reach a level close to 3%. Only exceptional and temporary excesses would be granted for exceptional cases
  - **Government debt:** The ratio of gross government debt to GDP must not exceed 60% at the end of the preceding fiscal year. Even if the target cannot be achieved due to the specific conditions, the ratio must have sufficiently diminished and must be approaching the reference value at a satisfactory pace
- **3. Exchange rate:** Applicant countries should have joined the exchange rate mechanism (ERM) under the European Monetary System (EMS) for two consecutive years and should not have devalued its currency during the period
- **4. Long-term interest rates:** The nominal long-term interest rate must not be more than 2 percentage points higher than in the three lowest inflation member states

# Economic Growth Estimates



Source: Citi Research, March 2011

# Eurozone deficit vs. surplus nations

Table 1: Deficit Bloc

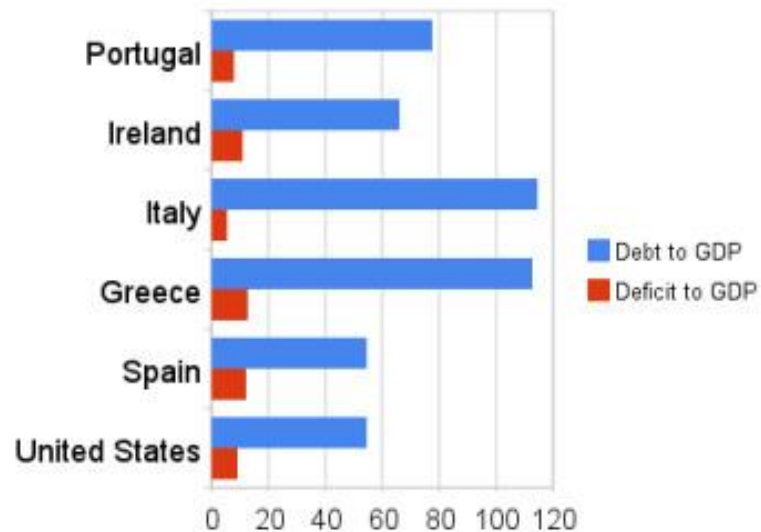
	Current Account Balance (in % of GDP, 2010)	Public Deficit (in % of GDP, 2010)	GDP Growth 2010 (in %)	GDP Growth 2001-2010 (in %)	Share of Euro-Zone GDP (in %)
Greece	- 10.6	- 9.6	- 4.2	2.3	2.5
Ireland	- 1.1	- 32.3	- 0.2	2.6	1.7
Italy	- 3.2	- 5.0	1.1	0.2	16.8
Portugal	-10.7	- 7.3	1.3	0.6	1.9
Spain	- 4.8	- 9.3	- 0.2	2.1	11.5
Slovakia	- 2.9	- 8.2	4.1	4.8	0.7
Slovenia	- 0.7	- 5.8	1.1	2.7	0.4
France	- 3.3	- 7.7	1.6	1.2	21.2
<b>Average</b>	<b>- 4.7</b>	<b>- 10.7</b>	<b>0.6</b>	<b>2.7</b>	<b>Total: 56.8</b>

Table 2: Surplus Bloc

	Current Account Balance (in % of GDP, 2010)	Public Deficit (in % of GDP, 2010)	GDP Growth 2010 (in %)	GDP Growth 2001-2010 (in %)	Share of Euro-Zone GDP (in %)
Austria	3.0	- 4.3	2.0	1.5	3.1
Belgium	1.7	- 4.8	2.0	1.4	3.7
Denmark	4.5	- 5.1	2.3	0.7	2.5
Finland	1.3	- 3.1	2.9	1.8	1.9
Germany	4.8	- 3.7	3.7	0.9	27.1
Luxemburg	8.4	- 1.8	3.2	3.0	0.4
Netherlands	5.2	- 5.8	1.7	1.3	6.4
<b>Average</b>	<b>4.1</b>	<b>- 4.1</b>	<b>2.5</b>	<b>1.5</b>	<b>Total: 45.1</b>

Source: European Commission

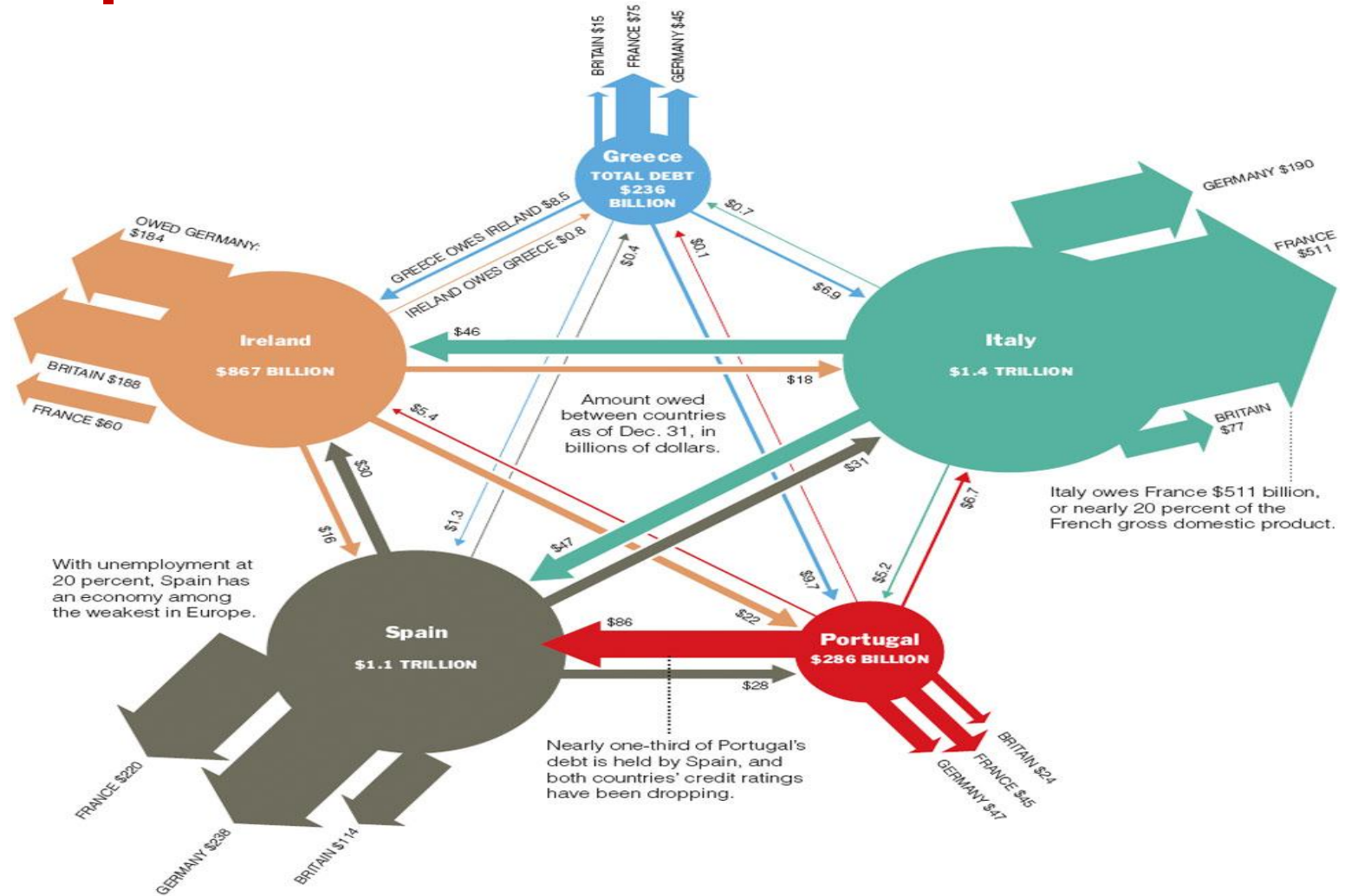
# The burden of debt



	Debt to GDP	Deficit to GDP
United States	54.6	8.8
Spain	54.3	12
Greece	113	12.5
Italy	114.6	5.3
Ireland	65.8	11
Portugal	77.4	8

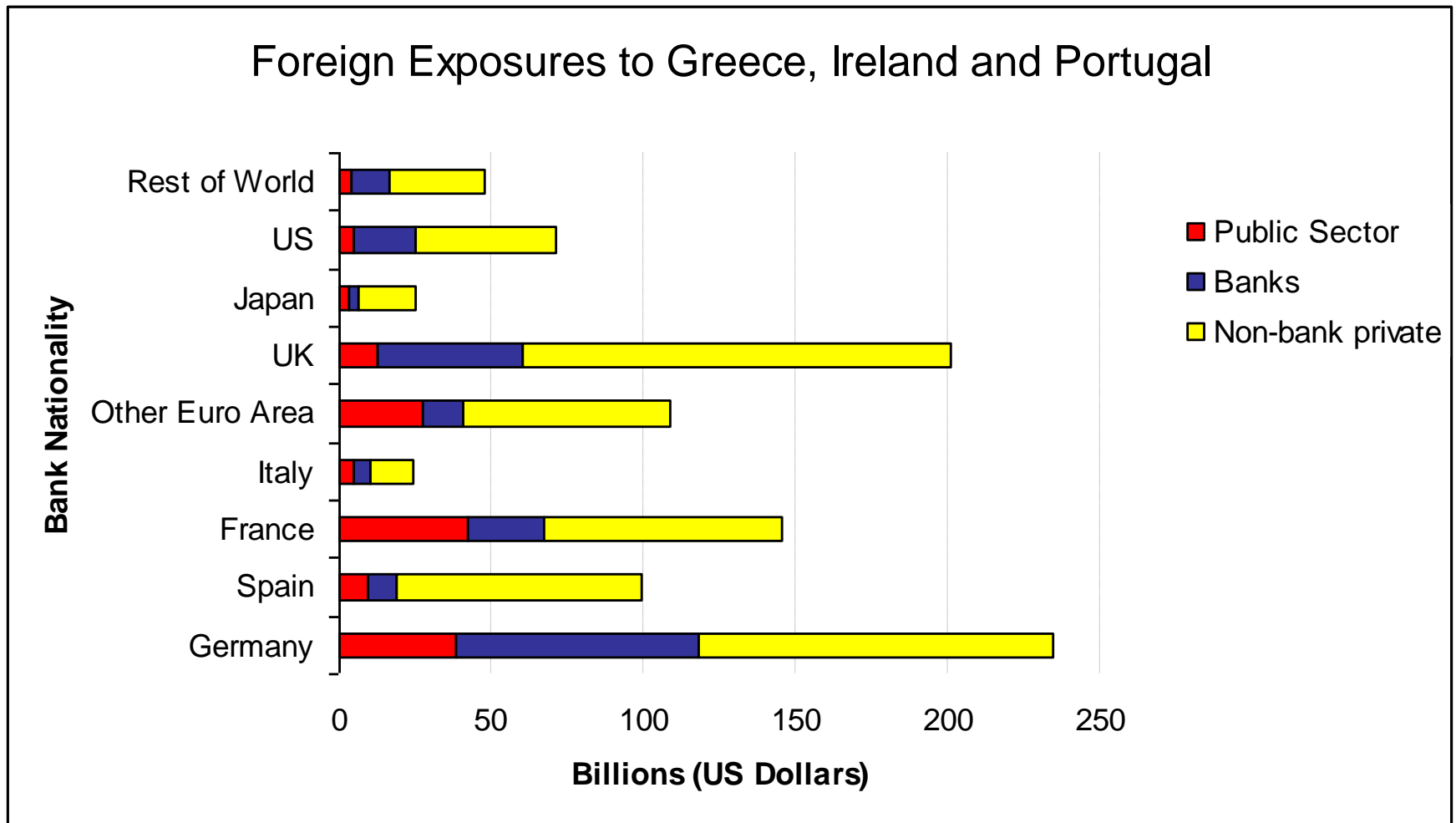
Source: Foreign Policy Website, February 2010

# European debt – who owes how much



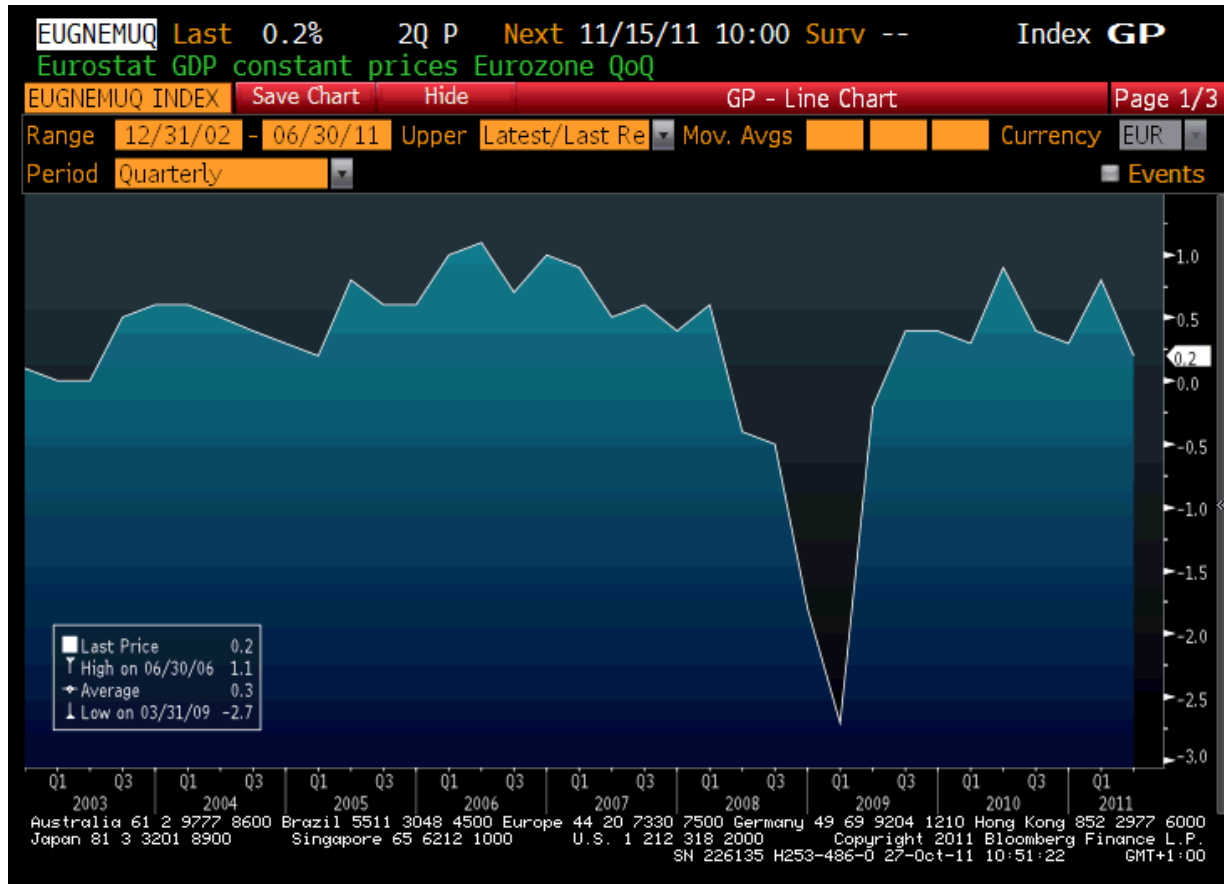
Source: The Bank for International Settlements (BIS)

# Who owns the debt?



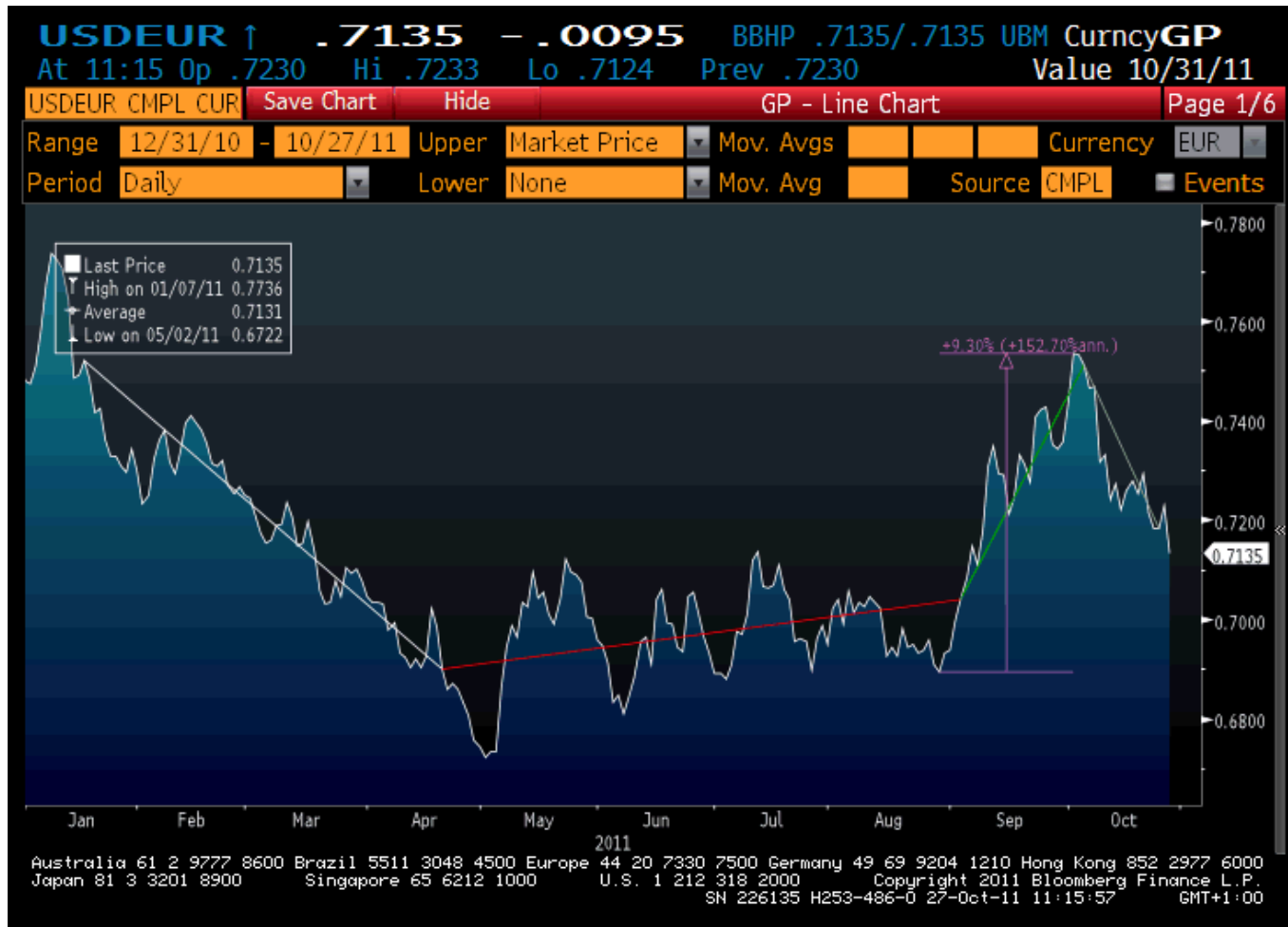
Source: BIS, March 2011

# Eurozone GDP growth facing possible further recession



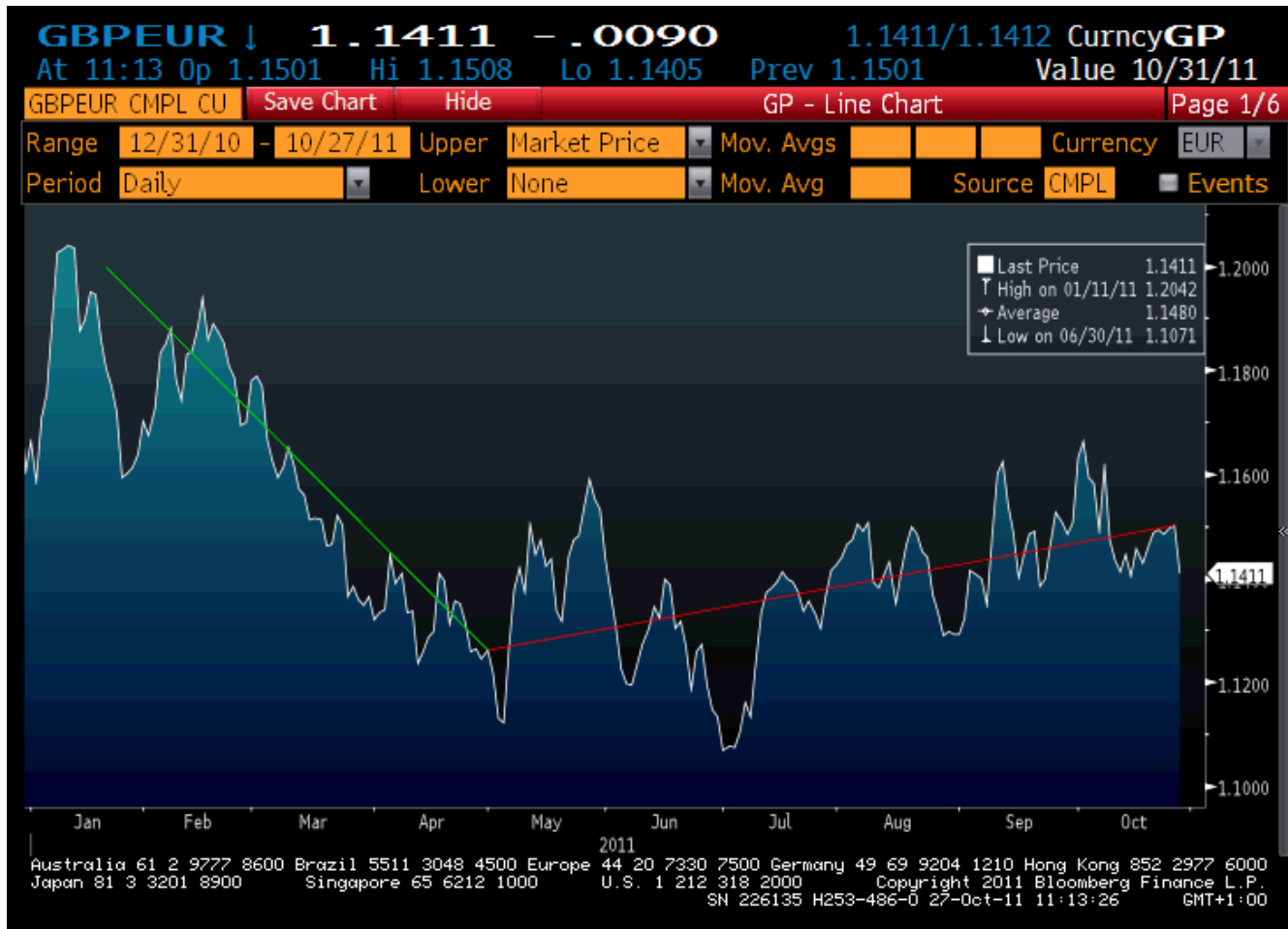
Source: Bloomberg

# The USD/EUR has been volatile



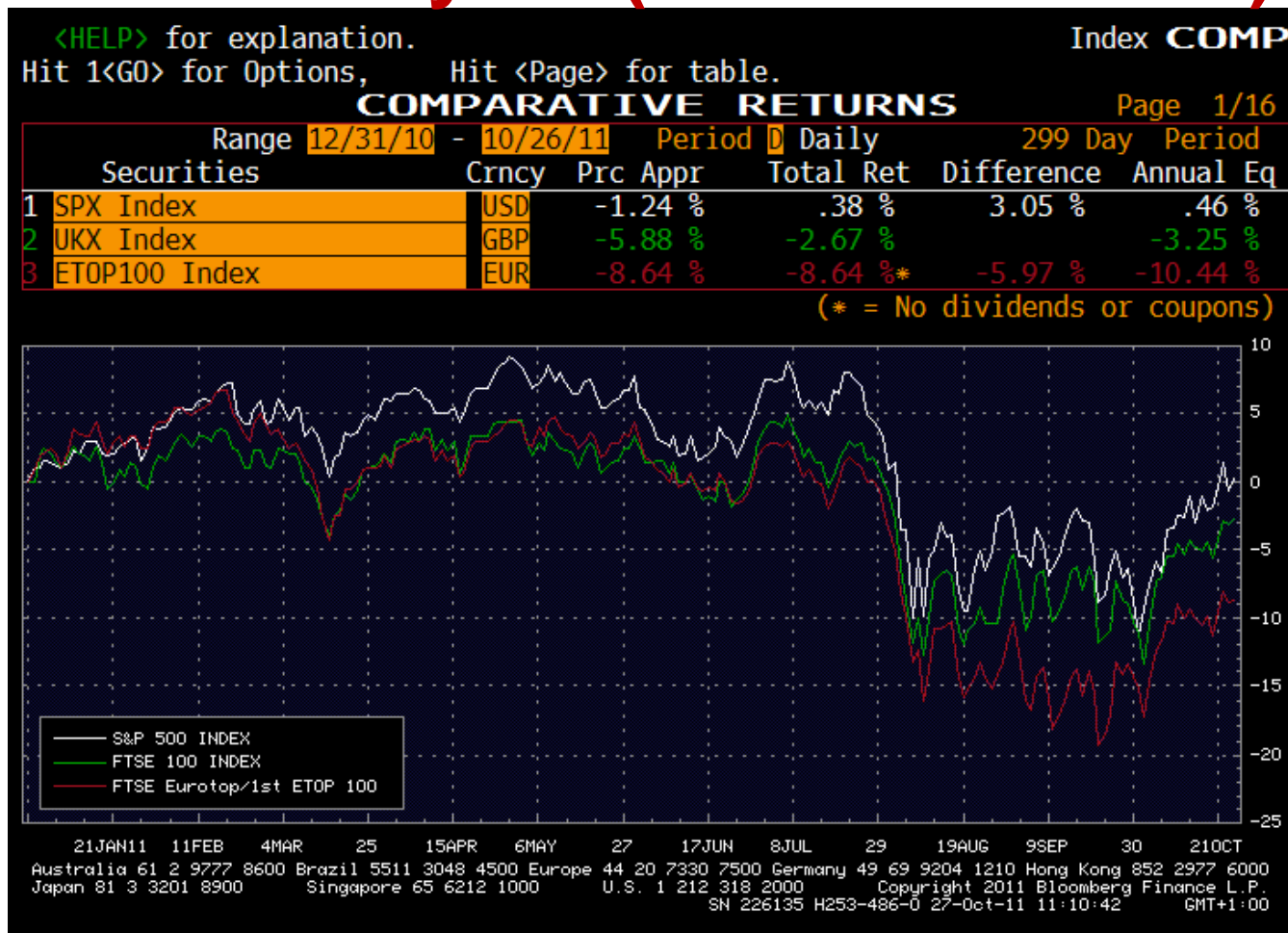
Source: Bloomberg

# As has GBP/EUR



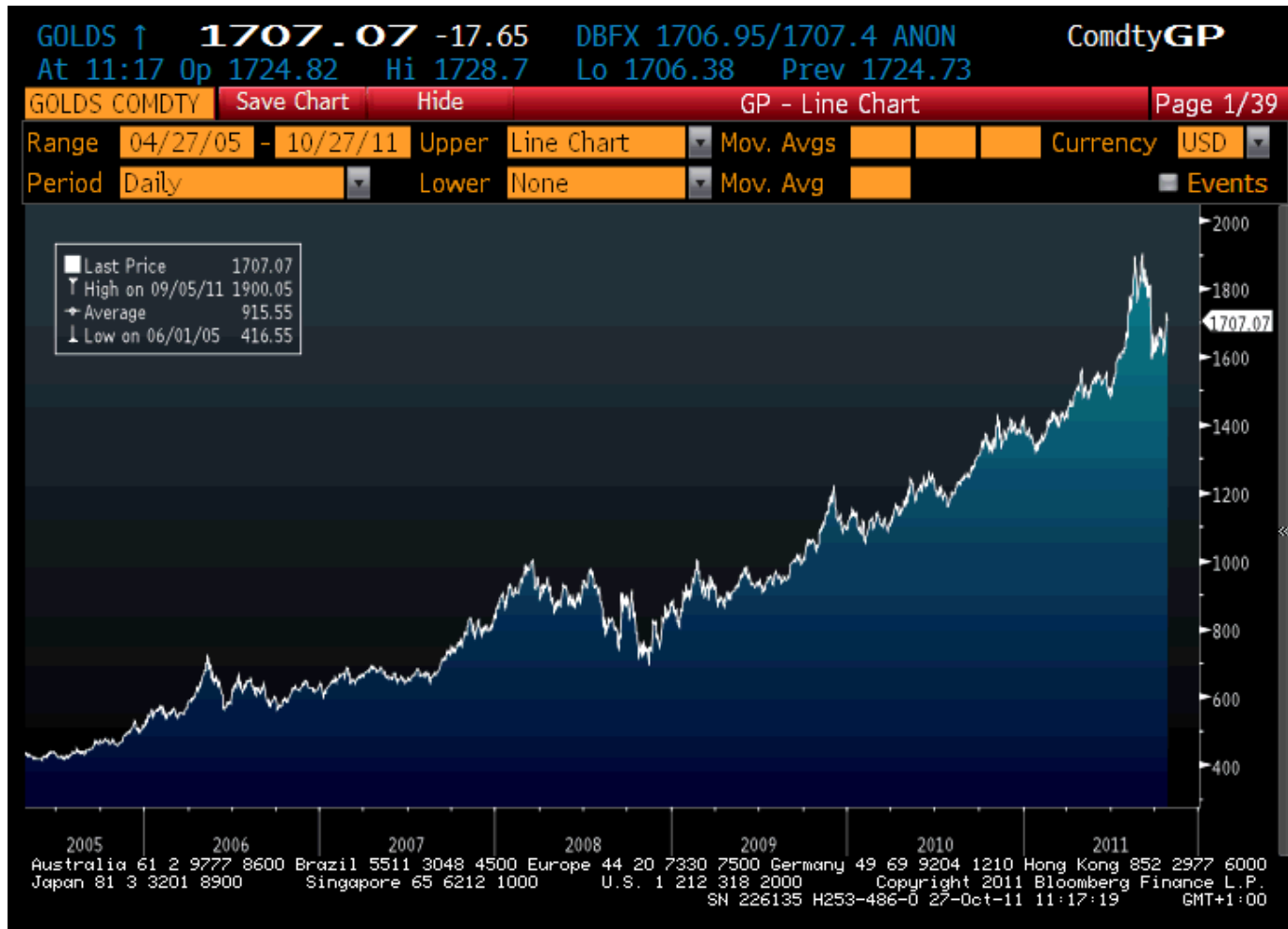
Source: Bloomberg

# Major developed equity markets have had a turbulent year (own currencies)



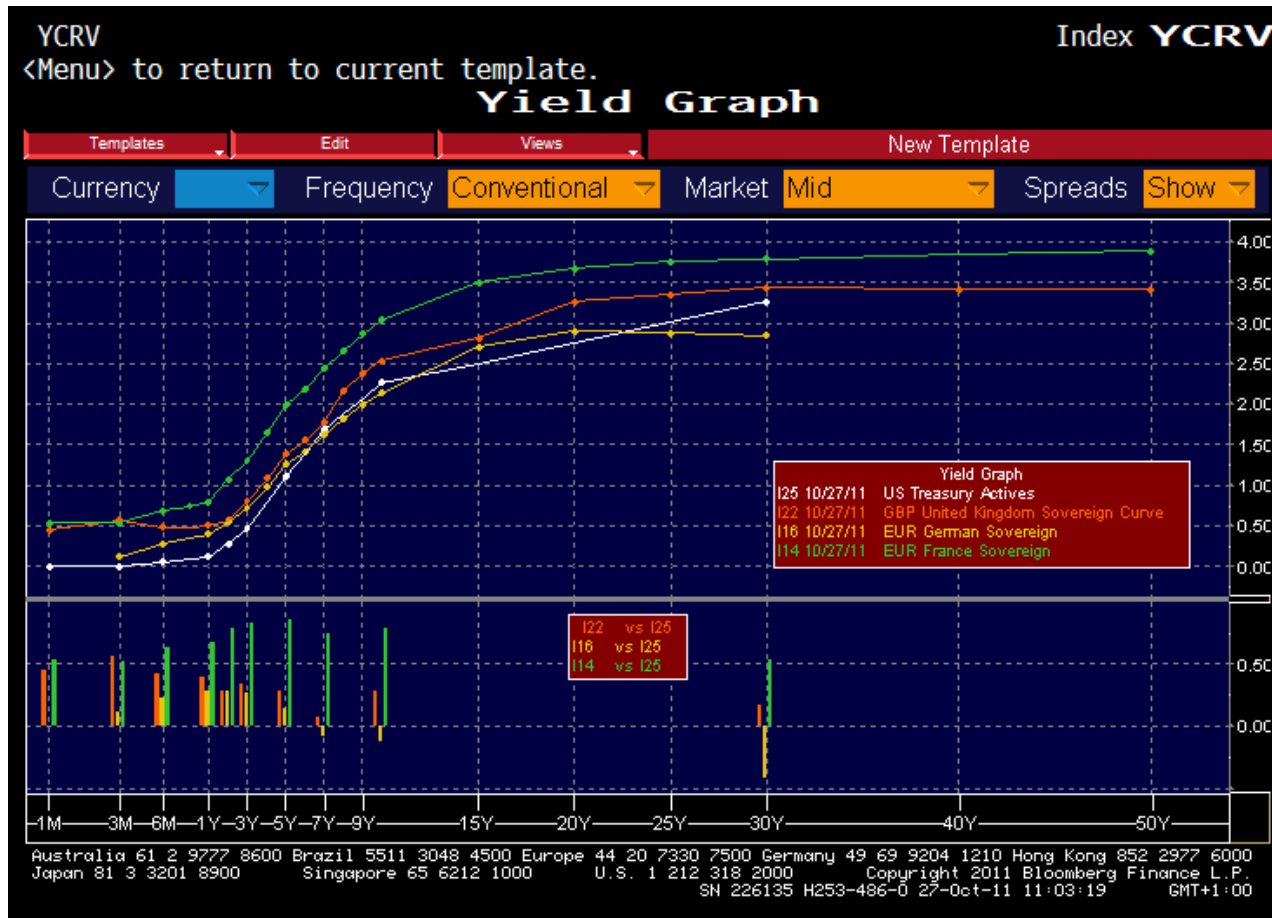
Source: Bloomberg

# Gold keeps on going....



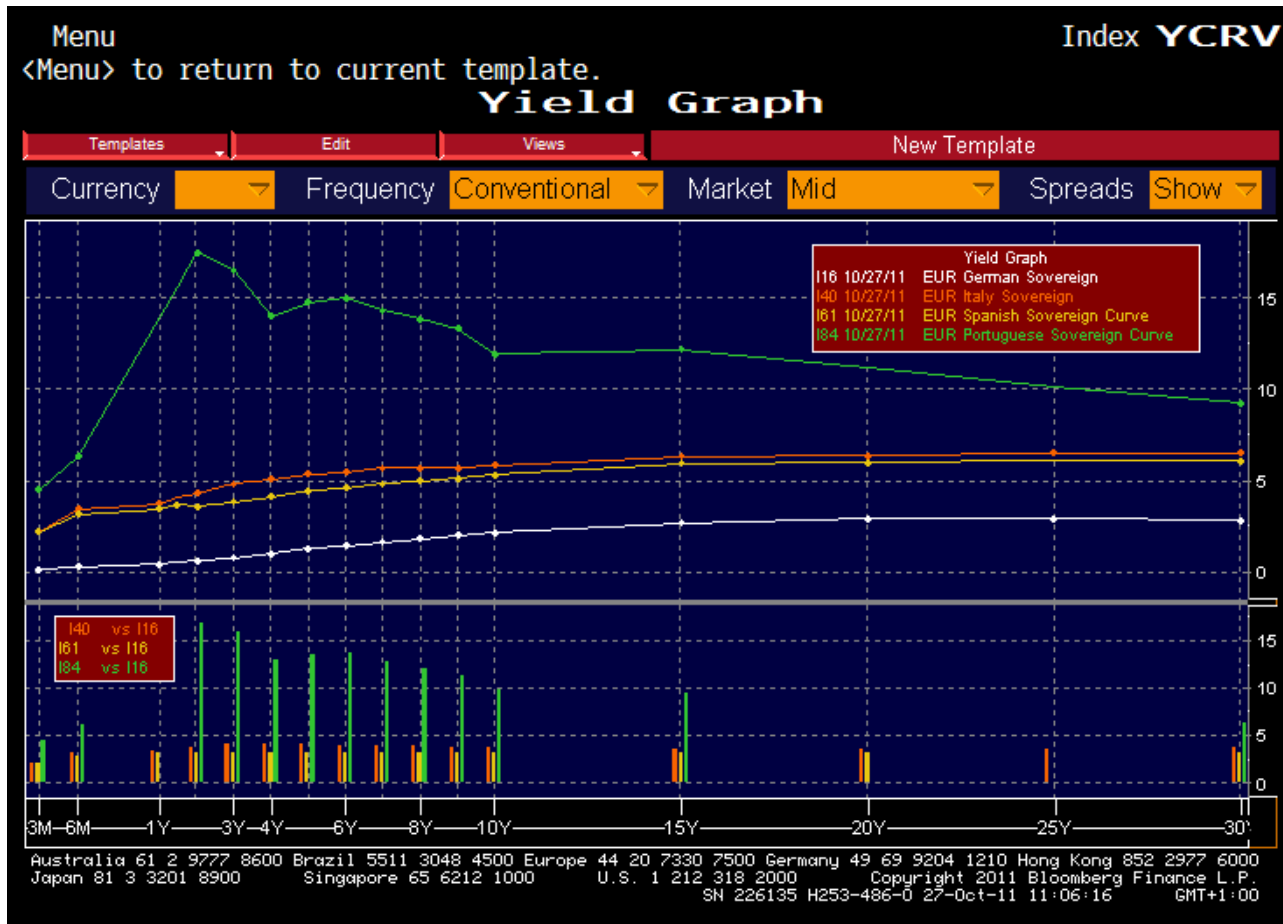
Source: Bloomberg

# Some comparative yield curve charts



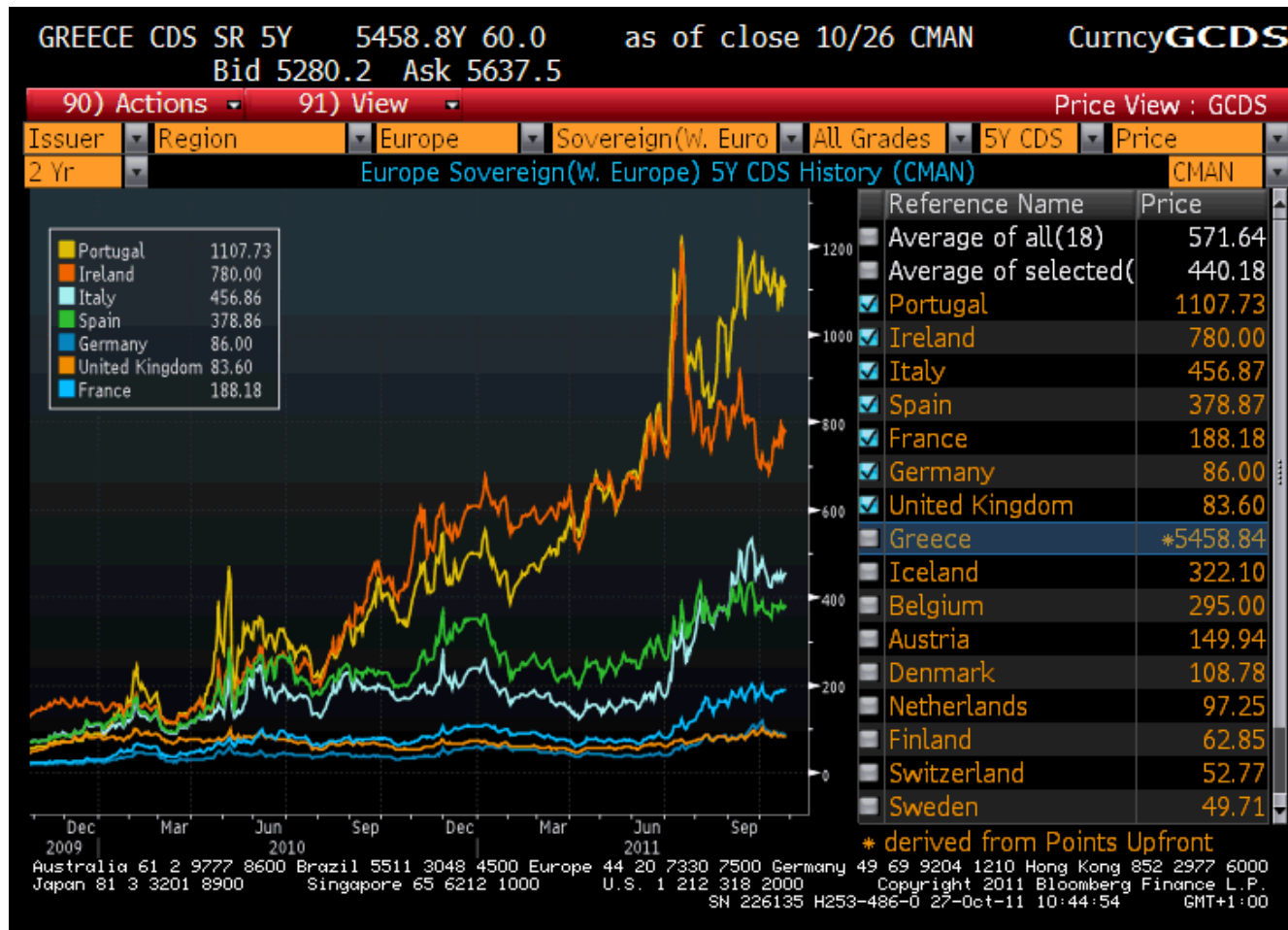
Source: Bloomberg

# The 'peripherals' are not so pretty...



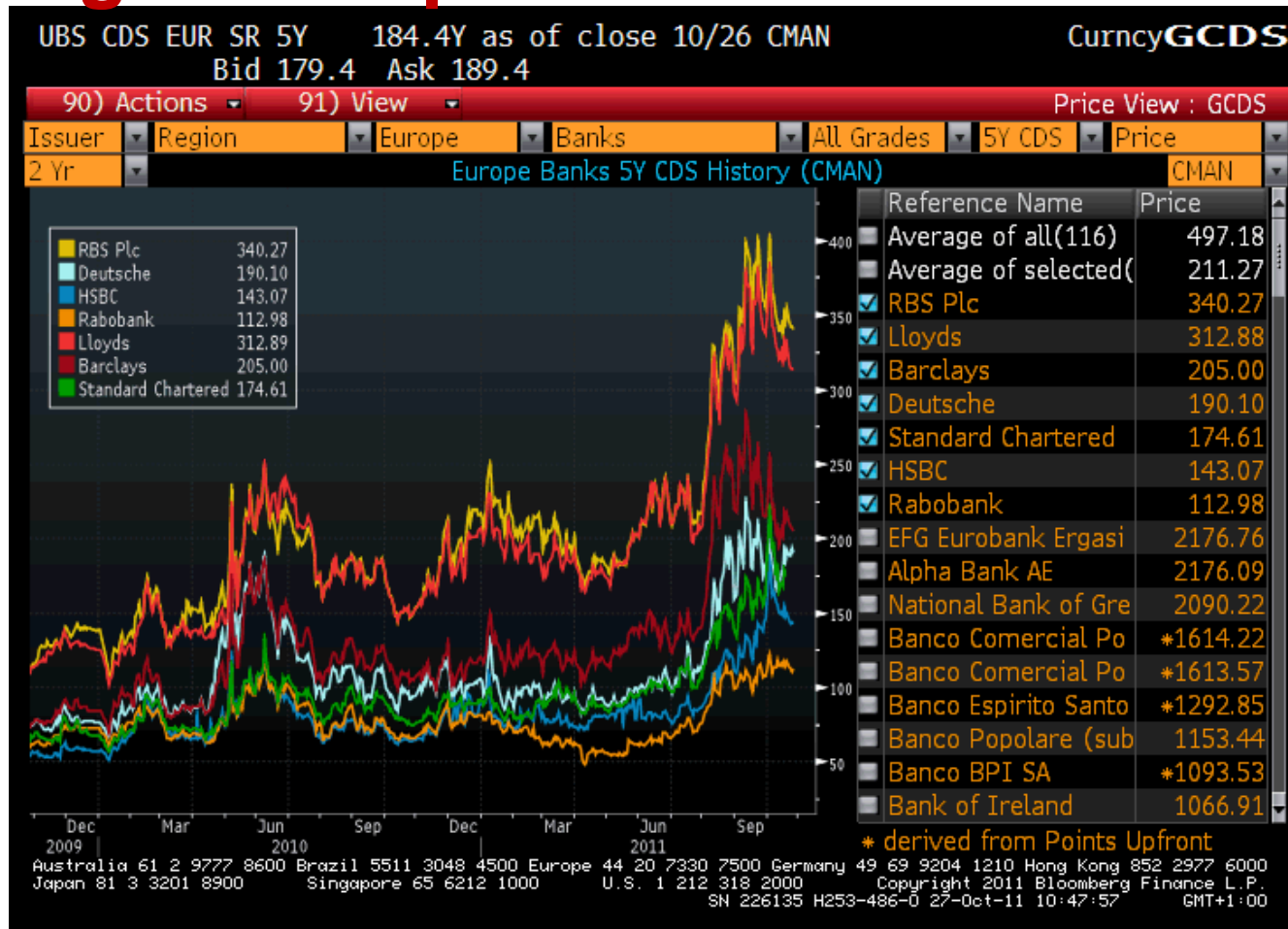
Source: Bloomberg

# Europe sovereign debt credit default swaps (cost of insuring their debt)



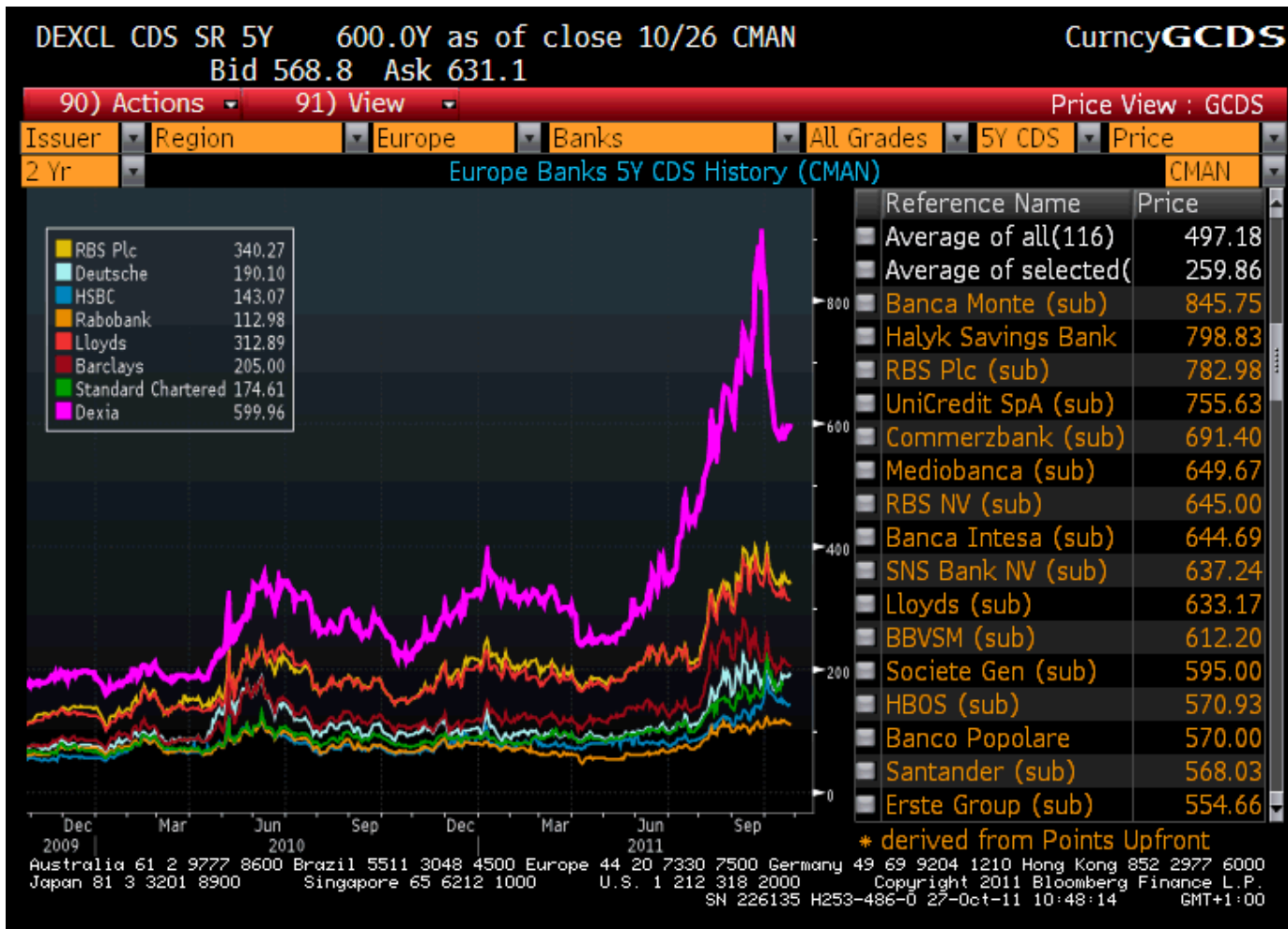
Source: Bloomberg

# Sovereign debt problem becomes a banking sector problem



Source: Bloomberg

# ...including Dexia (now nationalised)



Source: Bloomberg

# Default jargon explained

- **‘Credit restructuring’** to change the pre-agreed legal terms of the loan
  - **‘Maturity re-profiling’** to demand more time to pay the loan off
  - **‘Controlled default’** IMF/ECB maintain they are in control
  - **‘Technical default’** historically difficult to avoid in some way, one for the technicians: coupon changes (UK 1932), repayment collateral (USA 1933)
  - **‘Selective default’** to default on selective bond issues in an ‘orderly manner’
  - **‘Debt Repudiation’** to default by another name
  - **‘Disorderly default’** sudden and unexpected non-payment: Latin America (1980’s), Russia (1998)
- 
- **‘To take a Haircut’** to pay the lender a lower rate of interest or a lower capital price for the principal on redemption or exchange – with their pre-agreed approval

Source: Ollie Stones, Quilter

# Some Debt Default questions answered

**Q: Has the UK ever not been Aaa /AAA rated?**

*Not since the Agencies were set up in the 1960s (but after USA - watch this space)*

**Q: Has the UK ever defaulted?**

*Yes, a few times (depending on the default definition). For example, in 1932 on WW1 debt to USA (however linked to unpaid German war reparations so considered an 'excusable' or 'technical default'), then again in 1932 when the War Loan (issued in 1917) with a coupon of 5% was reduced to 3.5%. The Sterling devaluations in periods of 'fixed exchange rates' between 1948 – 1967*

**Q: So who has never defaulted?**

*NZ, Australia, Thailand, Denmark, Canada and Malta (amongst a short list )*

**Q: Is there a Debt/GDP level where default is inevitable?**

*No, Ecuador has defaulted with a debt/GDP level of just 20%*

**Q: Officially how many EUR millionaires live in Greece according to Greek Tax Authorities?**

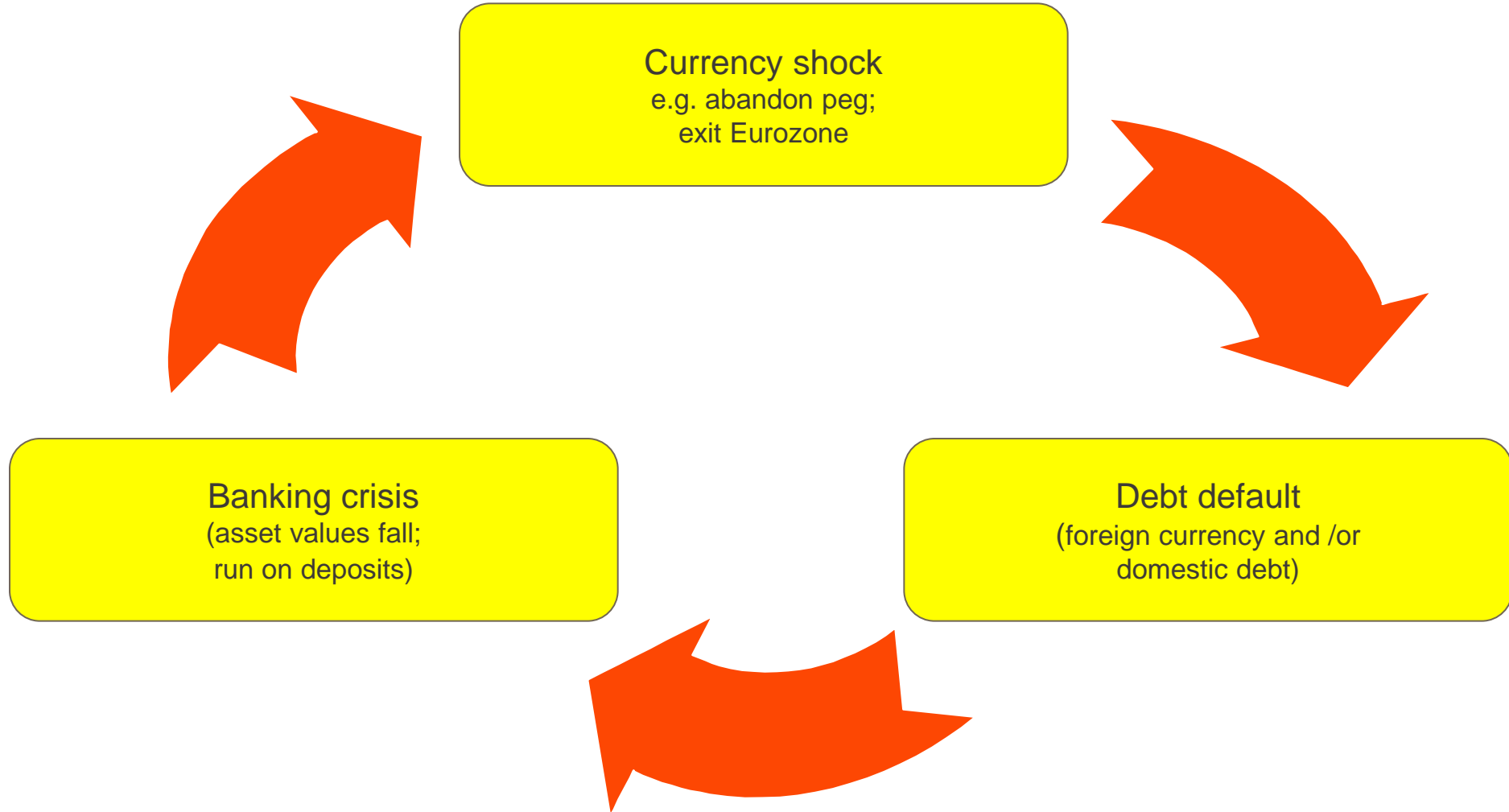
*Six*

**Q: Who does Italy owe over \$ 500 billion to?**

*France*

Source: Ollie Stones, Quilter

# Triple crisis schematic



Source: Invesco, for illustrative purposes only

# Eurozone deal agreed (27 Oct 11)

- **Indicative terms** released:
  - Private banks and insurers will accept a 'voluntary' **50%** loss on Greek sovereign debt holdings
    - Not a technical default since a voluntary write-down
    - Enables Greece's debt to be reduced from 160% of GDP to 120% by 2020
    - Bailout package valued at €130bn, an increase on the €109bn agreed in July
  - The European Financial Stability Fund leveraged up to **€1trn**
    - Insurance of bond sales
    - Creation of a special purpose investment vehicle
    - Further details to be agreed next month
  - European banks should increase their tier 1 capital ratio to **9%** by June 2012
    - European Banking Authority estimates €106bn re-capitalisation required
    - Greek, Spanish and Italian banks should provide 2/3 of this figure

# ... and how did the markets take it?

- **Good cheer:**
  - FTSE All-World equity index up 2.5%
  - Commodities higher (Brent Crude Oil up 2%)
  - Growth-focussed currencies (i.e. AUD) strongly up
  - EUR up 1% vs. USD
  - European banking sector equities up ~10%
    - Sovereign debt exposure can be contained
    - Capital raisings not as onerous as feared
  - Dollar index down 0.7%
  - 10 year US Treasury yield up 8 basis points to 2.29%
  - 10 year German Bund yield up 13 basis points to 2.16%
  - 10 year Italian debt down 12 basis points to 5.80%

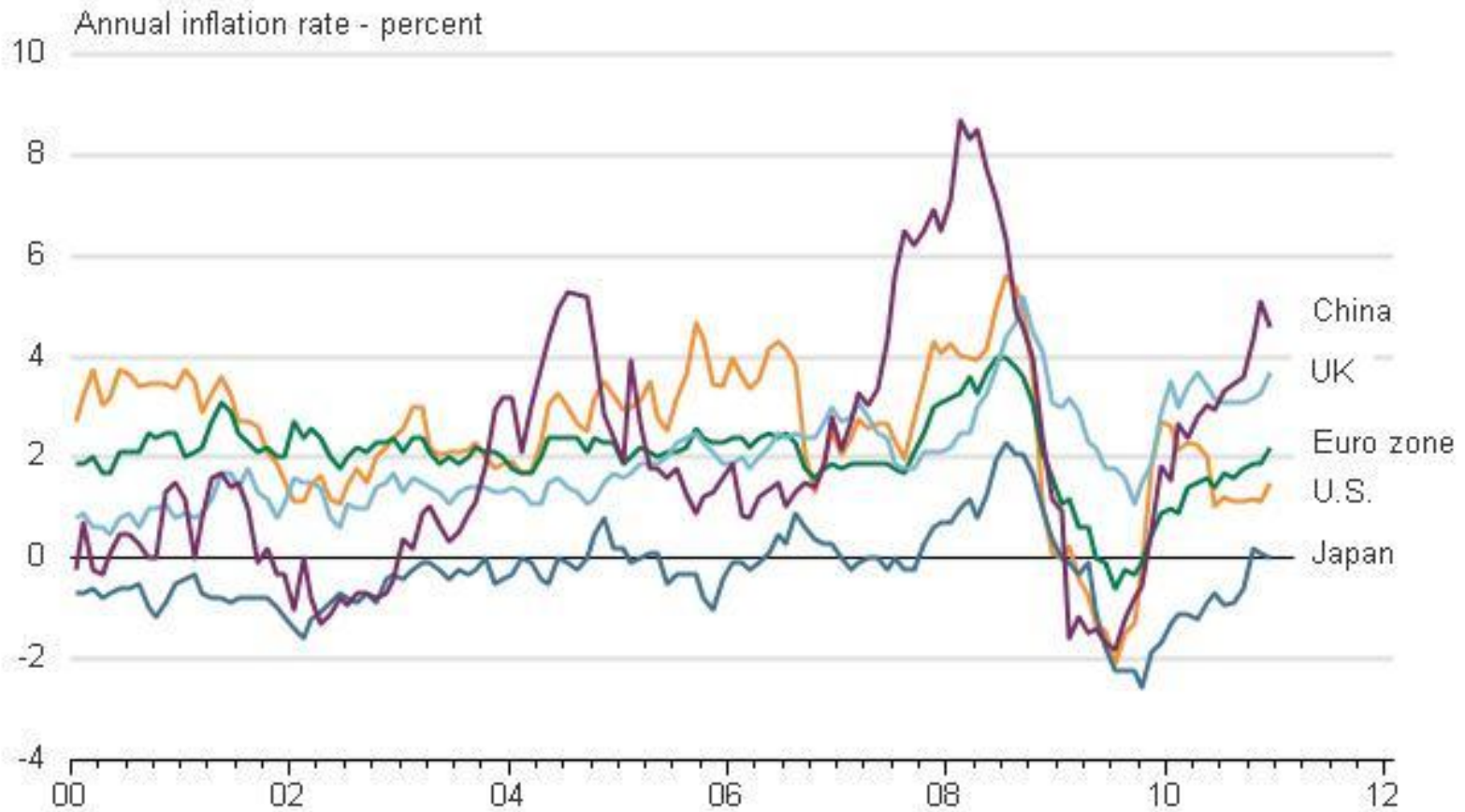
# So, where are we now?

## Major bloc interest rates

	Now	3 months	6 months	1 year
Bank of England	0.50%	0.50%	0.50%	0.50%
Euro Central Bank	1.50%	1.00%	1.00%	1.00%
US Federal Reserve	0.25%	0.25%	0.25%	0.25%

Source: Bloomberg, based on short-term interest rate futures market

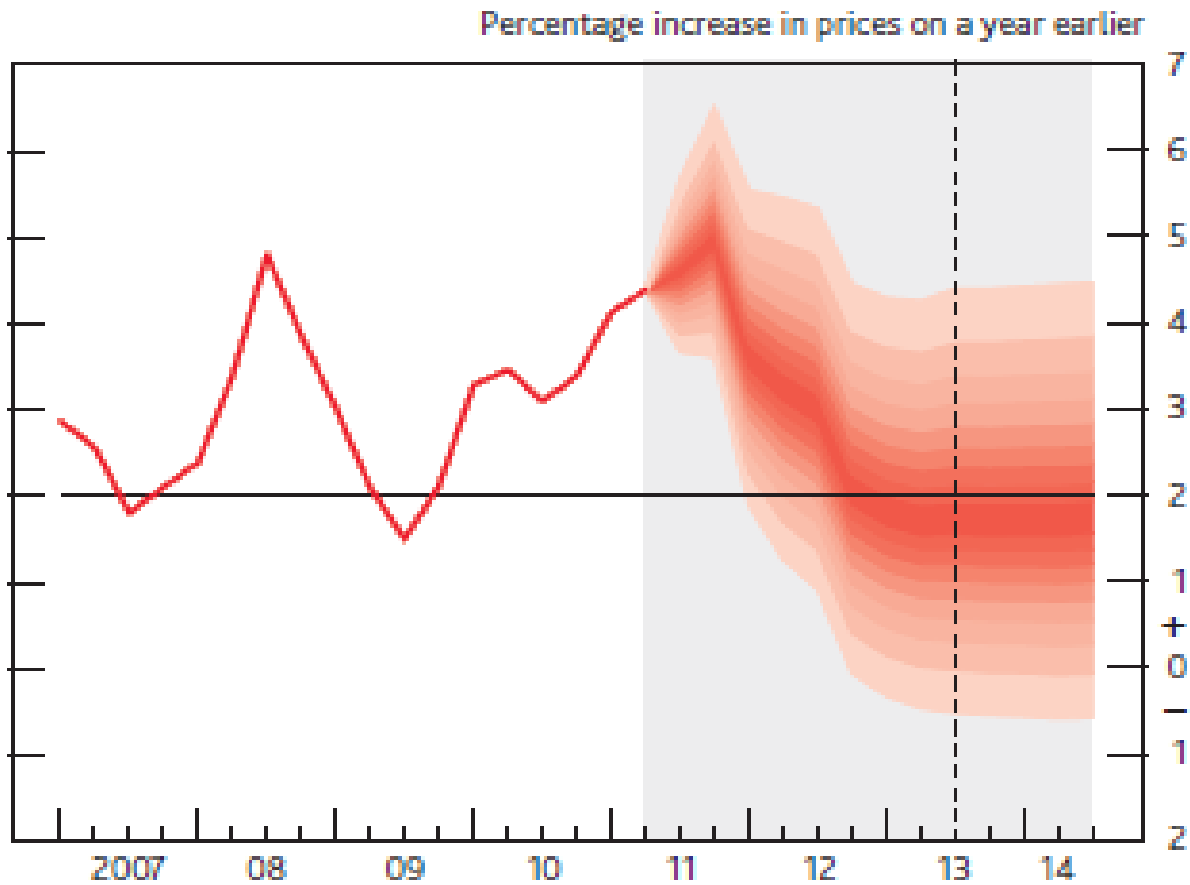
# Global inflation rates



Source: Thomson Reuters Datastream

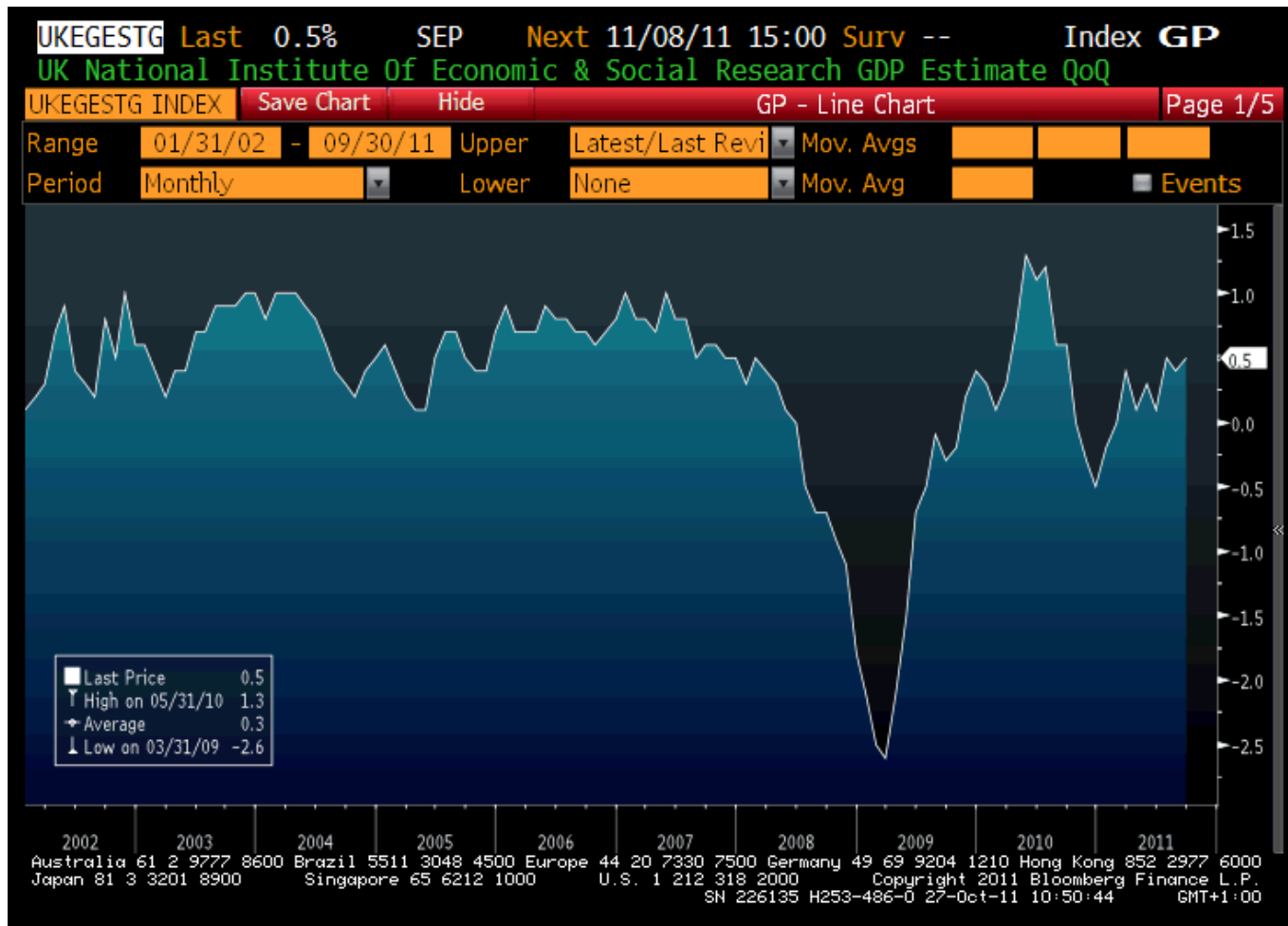
Reuters graphic/Scott Barber 01/02/2011

# UK inflation should start to ease...



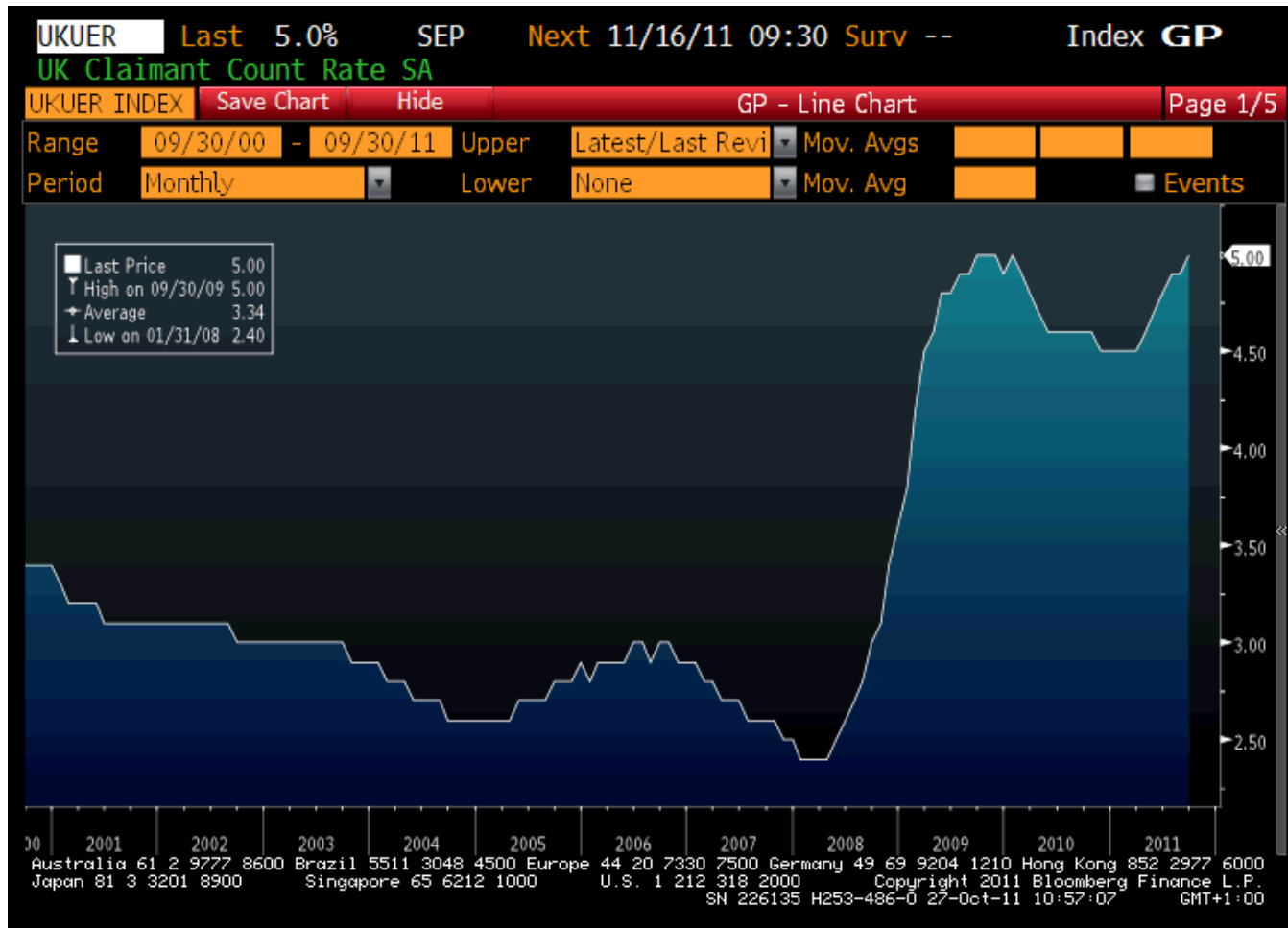
Source: Bank of England, Q2 2011

# UK GDP growth is wobbly



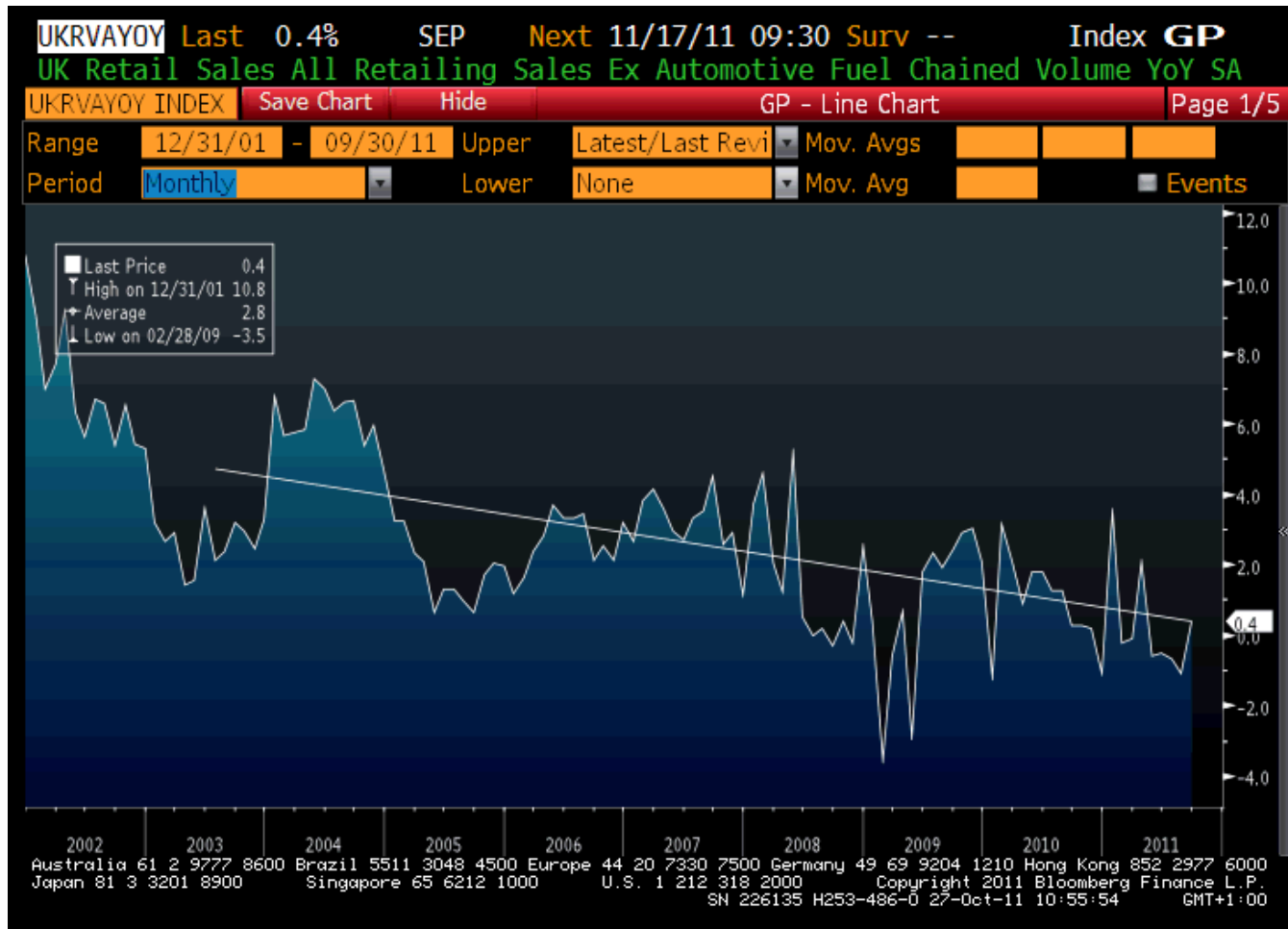
Source: Bloomberg

# Stickily high UK unemployment



Source: Bloomberg

# Slowing retail spending...

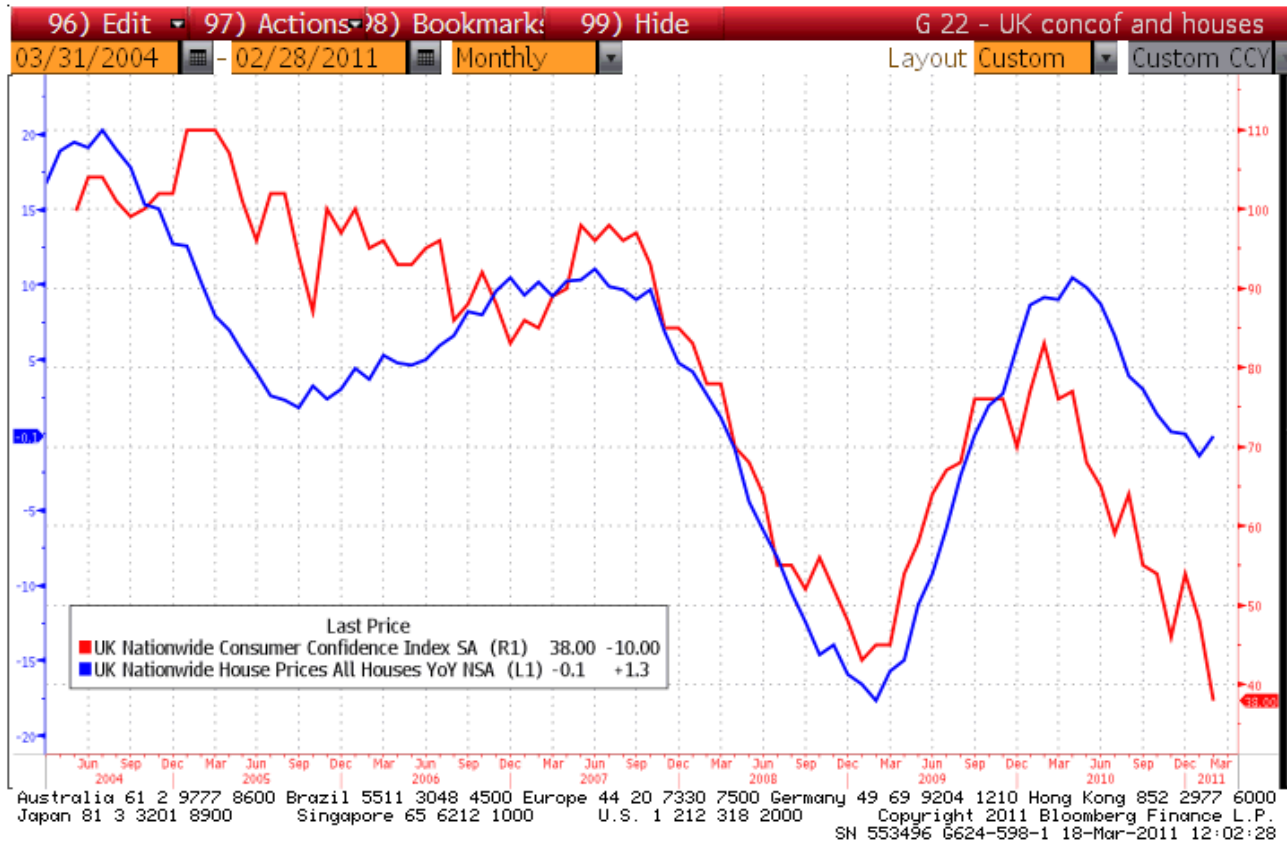


Source: Bloomberg

# ...and the only thing more depressed than UK house prices is the UK consumer!

<HELP> for explanation.

Index **G**



Source: Bloomberg

# UK Government spending cutbacks are starting to bite

- Increased **VAT to 20%** in January 2011
- Raise **£8 billion in taxes** (mostly by removing tax breaks and introducing moderate bank levy and oil company windfall profit tax)
- **Cut government department spending by average 25%** (redundancies)
- **Public sector pay freeze for 2 years** (£21,000 salary floor)
- **Recruitment freeze** in some departments
- **Cut 'Quangos'** (quasi non-governmental organisations) and **Consulting costs**
- **Cuts in benefits by £32 billion** (unemployment, health and housing)
- **Pension shake-up** (RPI to CPI indexation)



# UK north-south economic divide



Source: Daily Mail

# So, where does this leave the Isle of Man?



# So, where does this leave the Isle of Man?



**So, where does this  
leave the  
Isle of Man?**



# Strong historic position

- Isle of Man has historically positioned itself very successfully:
  - **Geographical location** is key being midway between UK and Ireland
    - Fishery
    - Lower import duties promoted contraband trade from continent into UK
    - Victorian tourism industry
    - Offshore finance
  - This location is **still important** today
    - Benefit of being one of the British Isles
    - OECD White List of 'good' offshore jurisdictions
    - Isle of Man only needs a small slice of international trade to survive
      - We need to do enough to retain access, but not too much to hinder competitiveness



# Key Isle of Man statistics

Number of <b>days annual rain</b> (2010)	173 days
<b>Average daily temperature</b> (2010)	9.4 degrees
<b>Highest recorded temperature</b> (2010)	21.5 degrees
<b>Total Population</b> (2006)	
Isle of Man	47.6%
England	37.2%
Wales & Scotland	4.6%

Source: Isle of Man Treasury, "Isle of Man Digest of Economic and Social Statistics 2011"

# ...and where are we now?

- Pro's

- Historically high levels of employment (~2%)
- Zero Government debt (excluding public service liabilities)
- National Reserves
- Stable democratic government
  
- Member of the British Isles
- English-speaking populace
- Regulatory compliant culture
  
- Open to international business
- Generally commonsensical and prudently-run business community



# ...and where are we now?

- **Con's**
  - Difficult government fiscal position
  - Continuing high public sector employment and spending
  - Finance-dominated economy
    - Concerted and co-ordinated international pressure on offshore finance
    - Reduced profitability and low-cost competition
  - Geographical location
    - UK now 'ex-growth', Emerging Markets are remote
  - Vulnerable to pressure from neighbours
  - Poor shopping and entertainment provision
  - Drift away of school and university leavers



# Conclusion

- The frog in the kettle
- A **short term answer to the Eurozone debt crisis** seems to have been found, but:
  - The can has been kicked further down the road
  - ‘Developed’ economies need to re-find their place in the world
  - Real structural growth is now happening elsewhere
- **Markets will remain sensitive to headlines** - portfolios should include many assets other than equities (or even gold!)
- The **Isle of Man is in a strong position** but faces **real potential threats**
  - Short term
  - Long term



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**Questions please...?**

