Executive summary

Keeping promises in a low interest rate environment

The first issue of the *OECD Business and Finance Outlook* looks at the way in which companies, banks, shadow banking intermediaries and institutional investors are trying to deal with a climate of very low interest rates and structural change in the global economy. The 'promises' of growth, employment and retirement income are seen to be at risk in the absence of policy actions.

Corporate investment and the stagnation puzzle

Following the easy monetary policies brought on by the crisis, financial markets have rallied strongly while companies that undertake capital spending do not appear to see the same value creation opportunities. Despite historically low interest rates, economic growth is stagnating in many regions due in part to the lack of investment. This is true of companies in the general industry, infrastructure and clean energy sectors. Bottom-up data of 10 000 of the world's largest companies listed in the Bloomberg World Equity Index for both advanced and emerging countries are used to explore this puzzle, enabling capital spending and matching financial data to be used over the period 2002-2014.

Trends, developments and policy concerns in financial markets

Policies and regulatory responses to crises tend to roll financial excesses into other sectors or regions. The response to the 2008 crisis has rolled the risk into the shadow banking and corporate bond sectors. Shadow banks intermediate credit between cash-rich and cash-poor investors in their bid to reuse securities and to gain access directly or synthetically to higher-yield and lower-risk alternative products in a world of low interest rates and rising longevity risk. At the root of the problem are a number of implicit promises that have been made to investors that are unlikely to be met in the absence of structural change and better regulation.

In this regard the outlook for the solvency position of pension funds and life insurance companies is of concern. Insofar as their promises are linked to evolving parameters or can be adjusted to the new environment of low interest rates, low inflation and low growth, these institutions may be able to weather the situation. However, there is a very serious concern for the financial outlook should these institutions become heavily involved in an excessive 'search for yield' in order to fulfil any fixed guarantee promises they may have made when interest rates were higher. Regulators and policy makers should remain vigilant.

Small and medium-sized enterprises (SMEs) are essential for the economic recovery from the current economic and financial crisis. The crisis has reduced bank lending and affected SMEs in particular because credit sources tend to dry up more rapidly for small firms than for large companies during economic downturns. Bank lending gaps have opened up since the crisis, and are especially pertinent outside the United States. Therefore, a two-pronged approach to fostering SME financing (in as far as it is a supply problem) is proposed: first, restoring banks' health to improve bank lending; and second, supporting the development of a broad range of non-bank financing for SMEs in debt and equity markets, the latter being especially well-suited for small dynamic, innovation-oriented SMEs. Owing to the diversity of the SME sector, financing remains complex and requires a variety of instruments and approaches. Policy makers can help by providing regulatory support and assist in the improvement of data transparency, standardisation, and raising awareness about available financing options.

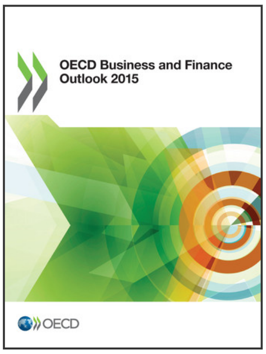
Recent trends in global and regional cross-border financial flows involving multinational enterprises are reviewed using data on international mergers and acquisitions and foreign direct investment. Three main factors that are shaping the outlook going forward are examined. These are; broader economic trends, the growing involvement of governments in the governance of the global economy, and the sustainability of MNE investment from emerging market economies.

Strengthening market-based financing of corporate investment

During the last ten years, corporations' use of capital markets has changed in a number of important ways. These changes have partly been driven by macroeconomic events that have affected traditional sources of funds and shifted some of the corporate debt from traditional bank lending to corporate bonds. They may have been influenced by regulatory changes that may have contributed to a decrease in the use of public equity markets by small and medium-sized enterprises. Profound changes have also occurred in the functioning of secondary equity markets and trading practices during the last decade which raise important policy issues with respect to ensuring a level playing field among investors and efficient price discovery. Finally, in a low interest rate environment, where institutional investors are pressed to meet their client obligations, corporations have also had to respond to investor campaigns for higher dividends and share buyback programmes.

Pro-competitive policy reform for investment and growth

Promoting competition was declared to be a priority by the G20 in 2014, recognising that it is market competition between firms that provides them with an incentive to reduce costs and develop new and better products. The economic evidence shows that some of the most effective structural reforms to promote growth are those increasing product market competition. On the other hand the most damaging restrictions on competition often arise from protected state-owned enterprises (SOEs) or from regulatory policies that unnecessarily limit competition. Since state ownership is becoming more significant in the world economy, it is increasingly important to ensure that SOEs face similar competitive conditions, on equal terms, as do private sector firms. Identifying and redesigning the most damaging regulations can be difficult and, in many cases, politically challenging. Quantification of benefits and accounts of other countries' experiences can help explain and gain political support for reforms. Some cases are described here.



Please cite this chapter as:

OECD (2015), “Executive summary”, in *OECD Business and Finance Outlook 2015*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264234291-4-en