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The lex column

Italy: game on for super Mario

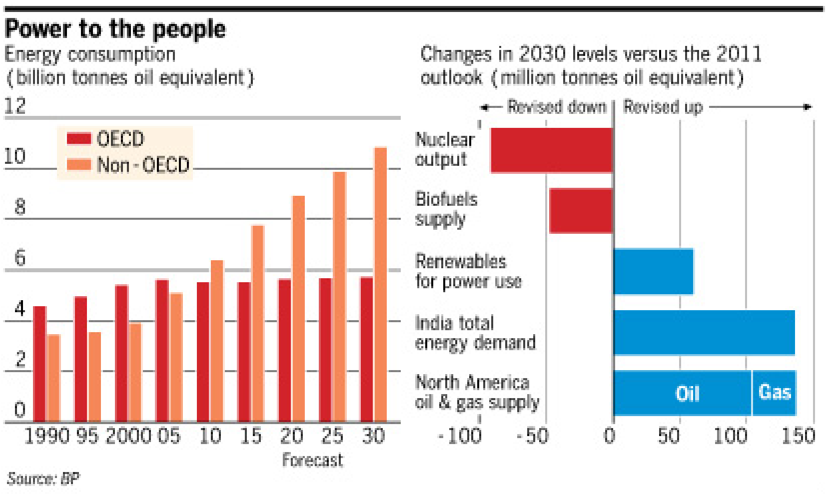
Good news from Rome: serious people are running Italy. After a decade of government-as-cabaret-act under Silvio Berlusconi, the era of Mario Monti should be more like one of those classic 1970s Italian movies that had subtitles and dealt with matters of life and death. He has made a good start; pension reform is in place and he is starting to tackle entrenched rigidities in the economy. Mr Monti's efforts are not reflected in bond markets, though. Italy's 10-year bond yield, at 6.4 per cent, remains higher than Spain's.

Holders of Italian bonds tend to fall into three categories – optimists, pessimists and pessimists (or optimists) who want to be optimists (or pessimists). For a country that, in the past six months, has voted through some €80bn of spending cuts and revenue measures to target a primary surplus of 5 per cent of gross domestic product next year, the optimists ought to be on top. But they are not, mostly because Italy's fiscal position remains precarious. After last week's downgrade, it now has the second lowest credit rating (triple B plus) in the eurozone bar Cyprus and the three bail-out countries. That is a slender limb on which to undertake a €650bn gross funding requirement up to 2014.

Italy's 10-year bond yield is below the 7.5 per cent hit last November. But Spain can borrow at 5 per cent. Rome could reduce funding costs by borrowing at the shorter end – two-year money can be had at 4 per cent. But that would shorten the maturity profile, which, at about seven years, is one of the few reassuring things about Italy's €1.9tn of net sovereign debt.

If Italy wants to convert those pessimists who want to be optimists, it is not enough to meet exalted expectations. Mr Monti should target a positive surprise, such as higher steady-state economic growth (how about 3 per cent, from today's zero?). Only then will Italy's borrowing costs really come back to earth.

Energy: think outside the barrel



In hindsight, BP's much-ridiculed "beyond petroleum" campaign may merely have come a decade too early. The company's annual long-term energy forecast, one of the most detailed and insightful reports of its kind, expects oil to lose its starring role in the world's fuel mix over the next couple of decades.

Indeed, if it were not for the developing world then there would be hardly any growth in energy consumption period and an outright decline in oil use, reckon BP's economists. Some 96 per cent of energy demand growth will come from non-OECD countries while per capita energy consumption in the developed world falls. Coal will do better, but not by much. The only bright spot for traditional fossil fuels will be natural gas, spurred by liquefaction and hydrofracturing.

The latter technology will usher in big changes, helping North America to become a net exporter of fossil fuels by 2030. By contrast, China, India and even Europe ex-Russia will become far more dependent than they are today.

Aside from these shifting fortunes, BP sees renewables making even larger inroads than before, stealing much of the growth it had earlier seen going to nuclear energy (the Fukushima disaster occurred after its last report). Within renewables, though, proportionally more will be delivered through the power grid rather than under the bonnet as the sustainability of biofuels crimps their growth outlook.

It is easy to quibble with individual forecasts, which look very different from just a few years ago courtesy of new technologies and Japan's tragedy, but the report makes some insights that could stand the test of time. One is a convergence in energy-intensity around the world as emerging markets begin to look much more like the west. Another is that the absolute growth in non-fossil fuels is, for the first time in BP's survey, seen growing more than any single fossil fuel.

BP's old slogan sums up its conclusion nicely: "It's time to think outside the barrel."

Goldman and pay

The investment adage that you're better off working for a bank than owning shares in one is mostly true. Indices of global banks, including sexy developing-world lenders, have gone exactly nowhere over the past decade. Ditto the stock price of the mighty Goldman Sachs, which released full-year results on Wednesday. Over shorter periods, bank returns are uglier still.

Yet Goldman, for example, has paid its employees $125bn during the past 10 years (doubling along the way), twice what it made in net profits. Hence, some hope that a possible route to boosting low bank returns on equity is a structural cut to industry compensation ratios. At Goldman, again, lowering 2011's full-year wage bill by a third would have increased its ROE from 7 to 12 per cent, all other things being equal.

But is that realistic? Bankers, of course, talk about the war for talent and the potentially devastating effect on morale and top-line growth if compensation and/or headcount are slashed. It is true that most bankers have next to no loyalty, especially the really well-paid ones, who, to be fair, mostly earn their keep. What is more, flush shadow banking institutions, such as hedge funds, are also constantly circling.

The reality, however, is that banks also support a thick layer of second tier executives, as well as legions of pen-pushing, meeting-loving, middle- and back-office workers who are paid multiples of their worth and contribution, especially compared with other industries. And market dynamics matter. If the whole financial sector started paying less, the bargaining power would fall for even star employees. Perhaps such a change is happening. Goldman reduced its compensation bill by a fifth in 2012, and global headcount by 2,300. Yet those remaining are hardly queueing for the exits, nor will the thousands of graduates who apply every year think twice.

Reliance Industries: buy-back backlash

"I don't believe in not taking opportunities," Mukesh Ambani, billionaire boss of Indian conglomerate Reliance Industries, once reportedly said. What a pity that the latest opportunity he has spotted is no more ambitious than a share buy-back (a board meeting on Friday may approve one). Buy-backs superficially boost earnings per share, but the economic impact for shareholders is zero (excluding local tax arrangements). Still, shares in Reliance added 5 per cent on Wednesday. The question, however, is whether this is the best use of shareholders' cash.

Reliance has been hurt by a dramatic fall in gas output as well as lower regional refining margins. Its return on equity has dwindled by a third since before the financial crisis. Over the past year, equity investors have lost one-fifth of their investment, 8 percentage points below the return on the Sensex.

The company's net cash position of about $1bn certainly gives it options. It could invest in expanding its gasfields to offset falling output, or more aggressively pursue acquisitions abroad. Talks with Dutch petrochemicals group LyondellBasell in 2010 were one attempt, but they fell through as the price was not distressed enough for Mr Ambani to part with his cash.

No clue has been given to the size of the buy-back. But even if Reliance spends, say, $1bn on the exercise, it would improve earnings per share less than 2 per cent compared with consensus earnings for 2012. At the very least Reliance must hope that the move will bolster investors' confidence, particularly given this Friday's quarterly earnings release is again expected to be lacklustre. Reliance's investors know the company is too big to repeat its historical growth. But the rate of decline has them agitated. And it will take more than a share buy-back to appease them.

SGX/China Sky: investors come first

When regulators ask companies to explain their accounts, most jump to it, at least publicly. Not so China Sky Chemical Fibre, the latest in a line of overseas-listed Chinese groups with questionable books. This week the Singapore stock exchange geared up for its first court action to enforce a special audit demand, an action it has now dropped.

The fact that SGX initiated the action is to be welcomed. The exchange first asked for a special audit of China Sky in November, having raised questionsabout related party transactions, land acquisitions and unusually high, one-off maintenance costs. China Sky, which has a market value of $64m, claims to have explained the issues to the exchange. SGX says it has not done so. Unfortunately, this is not a one-off case. In addition to China Sky, 17 companies on the SGX, most of them Chinese, have undergone special audits since 2009. Investigators have encountered some novel problems. Sino Techfibre claimed last year that its accounting records were largely lost in an office fire. Two years previously, China Sun Bio-chem Technology said it lost its records in a lorry that was stolen.

Any company that can even contemplate dog-ate-my-homework excuses has no business offering shares to the public. And stock exchanges have no business allowing these companies to list, or remain listed. Investors get it. In the past six months, the volume of Chinese shares traded on SGX (S-chips) has fallen by nearly two-fifths year on year; that of non-Chinese shares fell by just over one-fifth. The combined market value of S-chips has also dropped by more than two-fifths – nearly three times the non-Chinese stocks' decline.

The Singapore exchange should pursue this matter further. It needs to protect its own reputation and ensure that the interests of investors come first.