

EDITORIAL

EU tax ruling on Apple in Ireland puts focus back on taxation of MNCs

THERE has been jubilation among free marketeers over the ruling that the European Commission (EC) – the competition watchdog of the European Union (EU) – had failed to prove that US tech giant Apple had been granted special economic advantage and, by extension, state aid to the tune of 13 billion euros (\$20.7 billion) from Ireland.

The ruling by the EU's second highest court, the General Court, goes back to 2016, when the EC had ordered Apple to pay the sum for underpayment of taxes on profits across the EU from 2003 to 2014. It was claimed that Apple had used two shell companies incorporated in Ireland to reduce its tax burden to a fraction of 1 per cent.

The American corporate tax lobby sees the court's ruling as a victory against Euro-protectionism. The EC's charges against Apple and Ireland and another case against Google were viewed as a broad EU attack on US tech giants because the Europeans, allegedly unable to compete, sought to hobble those companies dominating their technological landscapes. Further, it was alleged, the EC's move was part of the EU's offensive against its smaller member states that dangle low tax rates to attract multinational corporations (MNCs) to their shores – which runs counter to the interests of high-tax members such as France and Germany.

But equally, this case can be viewed as a way in which MNCs shift profits from higher- to lower-tax jurisdictions. In the EU, MNCs can pay taxes on their revenue across all 27 member countries in the one EU country where they have their regional headquarters. For Apple and many other MNCs, that is one of three countries: Ireland, the Netherlands or Luxembourg. Clearly then, these smaller EU nations do use their low tax regimes to draw in international businesses, ready to forego some tax revenue for the jobs created. Apple employs some 6,000 people in its factory in Ireland. But the reality is that it and other MNCs pay very low rates of tax, measured against the scale of their profits in the EU.

Since the 2008 global financial crisis, revenue-starved EU governments have been scouring for new sources of tax revenue, and have become critical of members with low taxes. And now there is the added urgency of the Covid-19 pandemic and subsequent economic carnage. So the court's ruling is not the end of the story. Brussels is now moving to crack down on tax deals that the low-tax nations have entered into with big companies. While taxation rates will remain under the authority of members, the plan is to ensure a level playing field among the 27 nations. Ultra-low tax deals with MNCs will come under sharp scrutiny. Further, a previously unused instrument in the EU treaty that could curb MNCs' tax minimisation strategies is being explored. It says something about its determination that Brussels is prepared to use tools it has never used before, such as voting – as opposed to seeking consensus – on changes to the corporate tax structure in the EU. So, unlike ordinary tax legislation, the push is to find a way that would require the backing of a majority of EU members, as opposed to unanimous support of all treaty members. No one can veto proposals under this treaty provision.

It remains to be seen if anything will come out of it. It is also likely that the Apple-in-Ireland ruling will be appealed to the European Court of Justice, its highest court. But whatever happens on that front, unless there is a global agreement on taxing multinationals, they will continue to be targeted for their tax minimisation schemes.



As Singapore emerges from an election that clears the decks for a fresh term of government, Singapore stocks are a top pick within Asean. The Singapore dollar is stable and the government has ample resources to support economic and employment growth. BT FILE PHOTO

Global market rally may not be irrational

Markets are constantly looking to the future and if they expect a global economic recovery, then the rally is rational even if it diverges from the overall economic outlook. BY ANTHONY RAZA

ECONOMIC activity over the past few months has plummeted to levels we have not seen in my lifetime, both in Singapore and globally.

Despite this, the global stock markets are in the midst of a remarkable rally. For the first time in history, a bear market, defined as a 20 per cent or larger fall, was followed by a bull market, a 20 per cent or larger rise, in consecutive months. This happened in March and April.

Since then, stock markets have continued climbing steadily, even as everyone agreed that the world was entering its worst recession since the Great Depression. In Singapore, the Straits Times Index has risen more than 400 points from a nadir of around 2,200 points at end-March.

The stunning divergence between the global economic and stock market trajectories presents strong challenges to our understanding of how financial markets work. We are used to economic numbers, corporate performance and stock prices moving in a broadly similar direction. Many investors now believe the market rally that began in April was fundamentally irrational. Was it?

This is an important question, because if the rally had no rational basis, then prices could plummet again at any moment, even with no material change to market expectations.

ANTICIPATING ECONOMIC RECOVERY

Markets are by nature forward-looking. In an economic recession, market participants not only want to know how drastic the fall will be but also when they can expect a recovery.

The answers can be difficult to figure out. But at the moment, there is a surprising level of consensus, with even fairly conservative economists saying the global economy should return to pre-Covid levels by the end of 2021.

This expectation is founded in part on the most aggressive fiscal and monetary response to any crisis in history by governments and central banks around the world, which has so far forestalled massive unemployment.

The prospect of a vaccine being discovered by the first half of 2021 also underpins recovery expectations. Leading health authorities such as Anthony Fauci, the US government's top infectious diseases expert, say that on vaccines, the question is no longer if one will be found, but when.

Most scientists are encouraged that humans develop neutralising antibodies that help patients stay naturally immune for some time after being infected with Covid-19. The chances of finding a vaccine that replicates this process is high.

Scientists also believe it is possible to fast track large-scale human trials – the phase that usually takes the longest. One way is by conducting them in an outbreak hotspot, instead of waiting for trial participants to be naturally exposed to the virus in an area with fewer infections.

In anticipating the end-point of the crisis, we are in effect rationalising that if the surf is eventually going to be up, we should all make an early move by swimming towards it now.

Given that equities have historically earned a return of 7 to 10 per cent per year, stock markets globally may have simply priced in that rate of return in their recent rally. That is, if stock prices continue to rise at the annual rate of 7 to 10 per cent between now and the end of 2021, they will approximately recover to pre-Covid-19 levels.

In other words, if we are sure about the end-point of an economic downturn, how we get there – whether it is through a U-shaped or some-other-shaped recovery – becomes less critical.

In line with this account of how markets are constantly looking to the future, we think that the global rally in stocks is rational, even if it diverges from the overall economic outlook.

A SQUARE-ROOT RECOVERY?

To be sure, many risks lie ahead. The virus appears to be receding in Europe, but in the United States and in many emerging economies – including Brazil, Russia, India and South Africa – it has not come under control. Within emerging markets, if the virus outbreak leads to more lockdowns, the economic impact may cause investors to lose confidence, which could, in the worst case scenario, snowball into a more serious currency crisis.

As the US approaches a presidential election in November, the global economy also faces the lingering threat of US-China trade tensions. That said, the financial markets are likely to conclude that both President Donald Trump and his opponent, the former vice-president Joe Biden, are reasonably market-friendly. Mr Trump has provided corporate tax cuts that the

markets like, while Mr Biden can point to the stellar performance of the markets during both of the Obama-Biden terms.

In view of the unknowns that remain on the pandemic's trajectory and global trade relations, a W-shaped recovery in the stock markets, involving another sharp fall in stock prices, is possible. Our take, however, is that a square-root-shaped recovery is more likely. Equities rebounded steeply in April and have since been experiencing a drawn-out period of mediocre growth, similar to the near-flat or gently-sloping top of a square-root sign.

With limits on how much further stocks can rally, investment-grade corporate bonds are looking more attractive, as their prices are expected to normalise in the coming months, not unlike how the stock market has recovered since April.

In contrast, cash, which was "king" during bouts of panic among investors, no longer holds such clear advantages over other stable assets, such as gold.

As Singapore emerges from an election that clears the decks for a fresh term of government, Singapore stocks are a top pick within Asean. The Singapore dollar is also stable compared with other regional currencies and the government here has ample resources to support economic and employment growth.

RALLY WITH RATIONAL JUSTIFICATIONS

There is a fine line between resilience and delusion. Market behaviour is not always reasonable and level-headed – as we learned during the dot-com bubble of the late 1990s, when then-US Federal Reserve chairman Alan Greenspan coined the now-popular phrase, "irrational exuberance".

Still, the rational justifications for today's market rally are persuasive. This by no means guarantees that the journey ahead will not be choppy and uncertain for both the economy and the financial markets. However, appreciating the logic underlying recent market movements is important, because it can help us allocate resources and investments accordingly and avoid an unnecessarily despondent outlook.

Having a clearer understanding of today's situation will be useful to individuals, companies and governments as we make plans and take considered, if guarded, steps into the future.

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THE BUSINESS TIMES

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THE BOTTOM LINE

Pandemic inadvertently helps Opec win market battle

By Mriganka Jaipuriyar

COVID-19 continues to take an economic and emotional toll globally, but it has also inadvertently helped the Organization of the Petroleum Exporting Countries (Opec) finally win its long-drawn battle for oil market share and influence.

Opec began losing market share in 2016 with the rise of US shale and lifting of an export ban on US crude in December 2015, and has since been playing tug of war between balancing supply and demand as well as reclaiming market share.

But the pandemic-led demand destruction, which in the second quarter saw close to 16.5 million barrels per day (b/d) of oil demand wiped out, left prices floundering in the low double digits and forced several non-Opec producers, led by US shale, to rein in output and even drove some to bankruptcy. S&P Global Platts physical sweet crude benchmark Dated Brent tumbled to US\$13.62 per barrel on April 27, its lowest level since March 1999.

Data from S&P Global Platts Analytics shows that some 2 million b/d of US crude production was voluntarily shut in at its peak. As prices have risen to the level of US\$40 per barrel, some of this lost output is coming back online, but overall US crude oil production is still expected

to average 11.74 million in 2020, down from 12.24 million b/d in 2019, and will fall further to 10.17 million b/d in 2021.

As non-Opec supply slows, demand for Opec crude is rising. In its July monthly oil report, the Paris-based International Energy Agency (IEA) revised upward its estimates for the call on Opec's crude this year to 24.2 million b/d. In 2021, the IEA estimates demand for Opec's crude will average 28.7 million b/d.

OPEC PUMPS IT UP

Against a backdrop of rising demand as economies emerge from lockdowns and falling non-Opec supply, Opec+ decided on July 15 to ease their record production cuts from Aug 1.

The 23-country Opec+ coalition enacted a 9.7 million b/d production cut accord starting in May in response to the Covid-19 crisis, but will roll the deal back to 7.7 million b/d in August until the end of the year.

However, the actual output increase could be lower, since countries that exceeded their quotas in May and June have agreed to make extra compensation cuts in the third quarter. This volume amounts to around 840,000 b/d and will offset a significant chunk of the coalition's scheduled production increase.

"The increase signals an Opec+ desire to

keep the market somewhat tight amid rising domestic consumption (not adding much to exports), but not pushing prices too far or ceding share as non-Opec shut-ins return," said Shin Kim, S&P Global Platts Analytics' head of supply and production.

Platts Analytics expects Opec production to average 23.26 million b/d in Q4 2020 – lower than the IEA's estimated demand for the cartel's crude, implying that the group together with its key coalition partner Russia has ample ammunition to influence prices.

ASIAN BUYERS UNMOVED

Opec+ may have decided to pump additional oil, but buyers in Asia – a key market for Middle East crude – told S&P Global Platts that this does not mean they will buy more. Asian oil refiners see the demand recovery as extremely fragile and are in no rush to crank up operating rates at their plants. Uncertainty also continues to surround the pace at which regional demand for transportation fuels is set to recover in North-east Asia, especially in the face of a potential second wave of Covid-19 cases, as has been witnessed in China and Japan.

China's appetite to buy more crude has also dampened as it grapples with high stocks. China imported nearly 13 million b/d of crude

oil in June – a record high – as the country rushed to buy cheap crudes since late March. But the focus in the next few months will be on destocking.

Global oil demand recovery continued in June with a month-on-month growth of some 4.2 million b/d, a little higher than the gains of 3.9 million b/d in May, but July's month-on-month increase will ease to 2.9 million b/d, said Platts Analytics. Meanwhile, crude and key refined product stocks have built almost one billion barrels since January.

"Oil balances have been tightening with demand improving from April lows just as the supply response kicked in. But headwinds are plenty with weak refinery margins, an expected slowdown in Chinese crude buying, a strong supply recovery, growing anxiety on the development of Covid-19, on top of bloated global oil inventories," Chris Midgley, global director of Platts Analytics said in a note.

Platts Analytics expects Dated Brent prices to struggle to maintain US\$40 per barrel in Q3 and is forecast at US\$35-40 per barrel for the rest of the year, with a price closer to US\$40 per barrel towards year-end as onshore crude stocks drop materially by then.

■ The writer is head of News-Asia at S&P Global Platts

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