THE SHORT CUT
with ROGER MONTGOMERY

Between debt devil and the Black Sea

IT'S official. European consumer prices fell by an annualised 0.2 per cent in December 2014.

European Central Bank President Mario Draghi continues to "do whatever it takes" with last week's announcement of the €1.1 trillion ($1.41 trillion) bond purchase program over 2015 and 2016.

Draghi thinks this will steer the euro area away from deflation by convincing investors his latest strategy is audacious enough to stimulate their relatively fragile economy.

With the plunging oil price and the hard left Syriza Party likely to take government in Greece this week, Draghi seems a little bit trapped to me. For example, the average 10-year sovereign bond yield for France, Germany, Italy, Portugal, Spain and The Netherlands is 1.2 per cent, well below the US 10-year bond yield of 1.8 per cent.

While Draghi thinks the lower the bond yield for these major economies, the better the outlook, all that seems to be happening is the decline of the euro/US dollar exchange rate to an 11-year low. And this is after six years of quantitative easing.

The European Union 28-member state, according to German Chancellor Angela Merkel, accounts for 7 per cent of the world's population — 25 per cent of the world's GDP but 50 per cent of the world's social spending. Demographics are challenging with more people in the 65 years and older category than in the under 15-year category, while the 500 odd million population is forecast to remain steady long-term.

Academics Carmen Reinhart and Kenneth Rogoff claim if a country's external debt-to-GDP ratio exceeds 30 per cent, there is a material risk of a credit default. Based on information from Joint External Debt Hub, there are 25 countries believed to have exceeded this ratio, and interestingly 19 of them are based in Eastern or Southern Europe, with Greece easily winning gold with a gross external debt-to-GDP ratio of 210 per cent.

Any crisis in Eastern Europe will have negative ramifications for the EU. Countries such as Romania, Ukraine, Poland, Belarus and Turkey have high current account deficits along with high external indebtedness.

AND any exchange rate devaluation would increase pressure to service more foreign currency debt, not unlike the Swiss Loans, which was pumped into Aussie farmers in the mid-1980s. At least the external debt of Greece, Latvia, Slovenia, Estonia and Slovakia is predominantly denominated in euros.

Meanwhile, the Russian Federation is suffering from the oil price crash and international sanctions. Moody's Investors Services just lowered Russia to Baa 3, the lowest investment grade, and it is understood Standard & Poor's is weighing up whether to cut their sovereign credit rating to junk status.

One in every five distressed corporate bonds worldwide originates from Russia, and with the central bank hiking the cash rate from 10.5 per cent to 17 per cent in late-2014, the sixth increase in a year, we believe a serious recession in 2015 is likely. Furthermore, the tension between the Ukraine and Russia and the threat to bypass the Ukraine for Russia's gas exports, which supplies about a third of Europe's needs, seems to be escalating.

Roger Montgomery is the founder of Montgomery Investments

Iron out the GST

Fix tax anomalies: survey

COLIN BRINSDEN
TAX

IT'S a political hot potato but Australian businesses are open to changes to the GST.

That's the findings of a new survey, although any increase or broadening of the consumption tax must be tied to the abolition of state taxes, including stamp duty and payroll tax.

There is also a clear message in the 2015 Tax Reform Survey by accountancy firm BDO: just get on with it.

"More than 90 per cent of respondents agreed or strongly agreed that there has been too much talk and not enough action on genuine tax reform," BDO national tax director Lance Cunningham said.

"One of the major concerns for small to medium businesses is the additional paperwork and red tape required to deal with the multitude of state and federal taxes."

The Federal Government's timetable for its tax reform white paper suggests there is unlikely to be any material change until 2017 at the earliest, assuming it wins the next election.

Two-thirds of respondents agreed that all GST exemptions — such as on fresh food, education and health — should be abolished to help simplify the tax system.

Almost as many disagreed that the GST should never exceed 10 per cent.

Half of respondents, primarily from the business community, supported the 1.5 per cent cut in the corporate tax rate that is pencilled in for July 1. However, more than 70 per cent disagreed with the 1.5 per cent levy that will be imposed for the government's controversial paid parental leave scheme.

Mr Cunningham said any changes needed to make the tax system simpler.

The survey will be formally launched today.

AAP

Mattel chief Bryan Stockton (above) and youngsters Tahlia, Madeline and Madison in Barbie-inspired dresses at Target.

MATTEL CHIEF FROZEN OUT

THE chairman and chief of Barbie doll maker Mattel has resigned after the struggling toymaker reported preliminary December quarter profit results that fell far short of analyst expectations.

Bryan Stockton stepped down after Mattel, which also makes Hot Wheels cars and owns Lego competitor Mega Bloks, said net income tumbled 59 per cent to

BOARDROOM

$US149.9 million ($189.32 million) from $US369.2 million in the three months to December 31.

The company said board member Christopher A Sinclair will replace Mr Stockton as chairman and interim CEO.

On a per-share basis, Mattel earned US44c per share in the most recent quarter, or US52c not counting hits from taxes and costs tied to its acquisition of Mega Bloks owner Mega Brands.

Mattel will announce its full results on Friday.

The company has struggled for several quarters on the back of slumping Barbie sales, with the iconic doll latterly eclipsed by merchandise from hit Disney film, *Frozen*.

Slower sales no fun at all

TOYS

TOYS, sporting goods and confectionery distributor Funtastic says it expects to lodge a first-half loss, partly because of slower international sales.

Funtastic said its preliminary assessments indicate that revenues for the six months to January 31 would clock in at between $50 million-$54 million, with an earnings loss before interest, tax, depreciation and amortisation of between $2.5 million-$4.5 million.

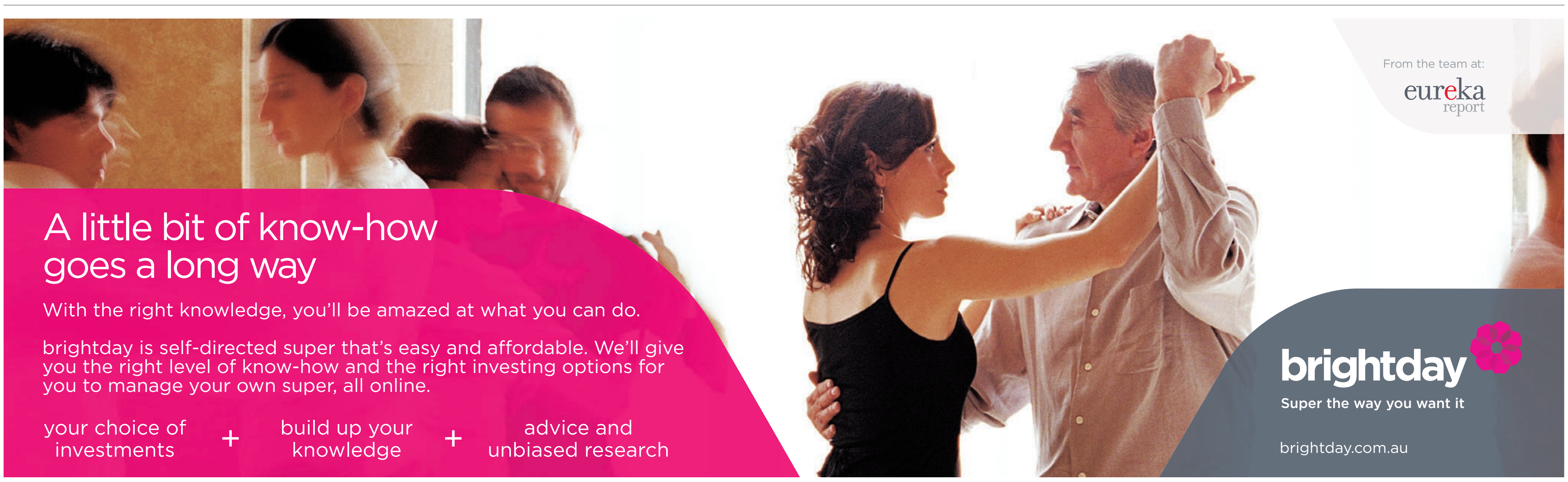
Funtastic said the estimates were not definitive.

"This expected loss is due to the deterioration in the company's second quarter performance which has primarily been driven by softer-than-expected international sales, lower domestic margins and additional one-off rationalisation costs," Funtastic said.

The company said it had taken steps to ensure a return to profitability in the second half of fiscal 2015.

Funtastic had secured a number of new products that would increase sales when launched in Australia and in key overseas markets.

Shares in Funtastic fell sharply yesterday before closing 0.4c lower at 2.6c.



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