

China: Cooling off!



Microscope

Although China's commitment to reduce dependence on exports and investment may be challenged as the world's third-largest economy slows more than estimated, the figures signal a diminishing risk of economic overheating and give Premier Wen Jiabao more room to scale back restrictions on bank lending or property purchases by year-end. So far, the government has cooled the economy by targeting a 22% reduction in new loans this year to 7.5 trillion yuan, raising lenders' reserve requirements and selling bills to soak up cash. The Shanghai Composite Index of stocks slid the most in two weeks, leading declines across Asia as weaker growth in China added to European budget cuts and limited American job gains in clouding prospects for the world recovery. As a result, policy makers may loosen some real-estate curbs and approve more infrastructure and investment projects in the fourth quarter as growth slows toward 7% before picking up into 2011. According to Bloomberg, China's economy will overtake Japan's as the world's second biggest this year and the OECD said in March that it may account for a third of global growth.

Stocks in China tumbled last week amid the fact that China's economic expansion eased to 10.3% in the second quarter and industrial production cooled more than forecast in June, signaling a deeper second-half slowdown that may add to risks for the global economy. Stocks in Asia have retreated the past two months in part on concern that Chinese tightening measures, including guidance to banks to curb lending and tougher mortgage lending rules, may be excessive. The gain in GDP was less than an 11.9% increase in January-March from a year earlier. Inflation cooled to 2.9% in June, the statistics bureau also reported. On the hand, industrial output rose 13.7%, less than all but one of 27 forecasts in a Bloomberg News survey. Figure-wise, urban fixed-asset investment gained 25.5% in the first six months of 2010 from a year earlier. The pace compares with a 33.6% increase in the first half of 2009, when a 4 trillion yuan

fiscal stimulus program was kicking in. Industrial output growth was the weakest since September excluding January and February numbers distorted by a Lunar New Year holiday. However, fears of a sharp slowdown are vastly overstated as infrastructure projects started under the stimulus program expiring this year will take three to five years to complete. On the contrary, the concern over that overheating risks have eased. A leading economic index for China rose 0.8% to 145.8 in May, according to the Conference Board. In fact, the indicator signals solid but less robust growth in the second half. Although China's export gains may have prevented a deeper slowdown, a support that may wane as the nation's currency strengthens, European policy makers implement budget cuts and America's unemployment rate hovers near 10%. China last

month eliminated the yuan's peg to the dollar, allowing gains for the first time since July 2008. Statistics bureau spokesman also said that property curbs have yet to affect the real economy and indicated that Europe's debt crisis may have a bigger effect on exports in the second half. Consequently, some analysts forecast that the government may by year-end move to bolster spending by loosening quotas limiting bank lending. As a matter of fact, China's central bank sold three-year bills at a lower yield for the first time in six weeks today, suggesting that officials favor policies to support the economy as growth slows. With regard to consumption, retail sales rose 18.3% in June from a year earlier, the bureau said. This indicated that the domestic consumption might drive the economy in the second half.



MARKET BRIEFING

YTD % (local curr)

| | |
|---------------------------------|----------------|
| US DJ | 10,097 (-3.2%) |
| Nasdaq | 2,179 (-4.0%) |
| Euro Stoxx 50 | 2,645 (-10.8%) |
| HSI | 20,250 (-7.4%) |
| Japan NK225 | 9,408 (-10.8%) |
| China Shanghai Composite | 2,424 (-26.0%) |
| Singapore | 2,957 (2.1%) |
| India BSE30 | 17,955 (2.8%) |
| Brazil BOVESPA | 62,339 (-9.1%) |
| Aus All Ord | 4,437 (-9.1%) |
| US-10yr Bond | Yield 2.92% |

As at 16/07/10

Insight:

"Fight Against Inflation"

There is a conventional wisdom of investing in the stock market and the importance of portfolio diversification. But during the period of inflation or even stagflation, have you ever considered investing in gold to act as hedging tool? While stocks tend to perform extra well during periods of political and economic stability, due to its intrinsic value gold tends to be more desirable and perform better during periods of bank turmoil, falling interest rates, and times of political crisis or war. In addition, gold has been regarded and used throughout history. Gold price hit a new record high price recently. Had you purchased one ounce of

pure gold on Jan. 21, 1980, you would have paid over \$847 for it; in 1980 dollars, or, according to the Wall Street Journal, an astounding \$2,268.6 in inflation adjusted 2008 dollars. Therefore if you had sold

on July 16, 2010, the one ounce of pure gold, which you purchased on January 21, 1980, you would have lost in 2008 dollars the sum of \$2,268.6 minus \$1,188.2, which equals \$1,080.4. Therefore, buying the real thing to hedge inflation may not be the most effective way. Another roundabout way to invest in gold is to buy stock in a company that mines gold. Besides benefiting from the rising gold prices, investors might get extra profit margin from profitable mining operations. Certainly, to avoid the risk of single investment, mutual funds could offer exposure as well as some semblance of diversification.

Financial "In & Out"

IN: High yield currencies may continue their bull run amid the optimism that Asian countries illustrate the sustainable growth in Asia and the rising risk appetite for risky assets, including high yield currencies.

OUT: USD will face profit-taking pressure in recent bull run due to concerns over the slow economic growth in the coming year.



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Next Insight

"Use of Structured Product"