

Credit Market: Unfreezing!



Microscope

Although the US mortgage rates have fallen sharply since last fall, the Federal Reserve acknowledged that the supply of mortgage credit was still relatively tight. It is noted that the mortgage activity remains heavily dependent on the support of government programs. Contrary to the recent credit market's phenomenon, the Fed's April survey of senior loan officers revealed that about 50% of domestic loan officers indicated they had tightened their lending standards on prime mortgages over the previous three months. While banks have been tightening credit standards for commercial and industrial loans to large- and middle-market firms for more than two years, the Fed's April survey also revealed that 37 of the 38 domestic banks that saw weaker demand for commercial and industrial loans indicated that a decrease in their customers' needs to finance investment in plant and equipment was an important reason for the change in loan demand. Business investment spending during the first quarter plunged at a 38% annual rate, by far the steepest quarterly descent during the 62 years that the US Commerce Department has compiled quarterly data. **IB**

By the end of May, the London Interbank Offered Rate (LIBOR) for three-month dollar loans between banks fell below 1%. LIBOR reached as high as 4.82% in October as credit markets across the globe threatened to collapse in the wake of the September bankruptcy of Lehman Brothers. There is no doubt that the credit market has been unfreezing. LIBOR is a benchmark interest rate that affects more than \$350 trillion in loans, including US adjustable-rate mortgages. Although the current LIBOR premium relative to the Fed's targeted overnight interest rate is still nearly four times higher than it was before the credit crisis began, the so-called TED spread, which measures the percentage-point difference between the three-month LIBOR and three-month Treasury bills, fell below 0.8 recently after peaking at 4.63 in October. The lowering spread more or less reflected the effort

made by global monetary authorities during the past few months. The convincing evidence indicating the credit market was approaching its normal behaviour is the normalization process of the LIBOR-Overnight Indexed Swap spread (LIBOR-OIS spread). The LIBOR-OIS spread measures the willingness of banks to make loans to each other for longer periods. From a peak of 3.65 percentage points in October, when banks were extremely reluctant to lend to each other because they worried about the borrower's solvency, the three-month LIBOR-OIS spread dipped below 0.8 last week. The improving trend in interbank lending rates and spreads suggests some further easing in bank balance sheet pressures as bank lending continues its recent sharply contracting trend. Another popular gauge of credit risk -- the CBOE's Volatility Index, or VIX earlier last week sank

to the level below 30 last seen in early September, just days before Lehman failed. To conclude, improvement in credit spreads, including the TED spread, reflects willingness for investors to take on risk again, in part because of government involvement. In fact, conditions in a number of financial markets have improved in recent weeks. But the real test will come when the government starts to unwind some programs like the Term Asset-backed Securities Loan Facility, or TALF, and it's up to private capital to decide how much a range of bonds are worth without government subsidies. In case consumers and companies are able to tap into relatively cheap credit for this moment, financial burden of individuals and corporate can ease. In turn, corporates' profits are likely to increase, driving the value of stockmarkets higher. **IB**

MARKET BRIEFING

YTD % (local curr)

US DJ	8,500 (-3.1%)
Nasdaq	1,774 (12.5%)
Euro Stoxx 50	2,451 (0.0%)
HSI	18,171 (26.3%)
Japan NK225	9,522 (7.5%)
China Shanghai Composite	2,632 (44.6%)
Singapore	2,329 (32.2%)
India BSE30	14,625 (51.6%)
Brazil BOVESPA	53,197 (41.7%)
Aus All Ord	3,813 (4.2%)
US-10yr Bond	Yield 3.46%

As at 29/05/09

Insight:

"Stagflation vs. Inflation"

While many analysts and experts are still debating whether the US economy will recover soon, there has been fear over recent government stimulus plan which could cause prices to sky rocket. However, rising unemployment is making it hard for the economy to climb out of recession. Consequently, someone called this as stagflation, which is composed of high inflation and slow economic growth. Usually, the misery index, a combination of unemployment and inflation rates, gauges the rate of stagflation. Based on the recent figure, total inflation is basically nonexistent at -0.4%. Now, policy makers around the globe

try to avoid stagflation at all costs. With stagflation, a country's citizens are affected by high rates of inflation and unemployment. High unemployment rates further contribute to the slowdown of a country's economy, causing the economic growth rate to fluctuate no more than a single percentage point above or below a zero growth rate. Recently, commodity prices, an important gauge of economic revival, saw strong gains, with oil prices going above \$66 a barrel in their biggest monthly jump in 10 years. Commodities ended the month up 14%, the biggest monthly jump since July 1974, according to the leading Reuters/Jefferies CRB index. At the same time, the US dollar fell against major currencies and commodities. These made inflation a reality in coming months. **IB**

A-Z Financial Tools

Value at Risk (VaR) is a measure of the risk of loss on a specific portfolio of financial assets over the given time horizon. For example, if a portfolio of stocks has a one-day 1% VaR of \$1 million, there is a 1% probability that the portfolio will fall in value by more than \$1 million over a one day period, assuming markets are normal and there is no trading. **IB**



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