

Global Economy: Liquidity is still welcome



Amid the optimism that global economy will record a rebound as a result of consecutive stimulus plans from major countries, investors are becoming more and more concerned about the upcoming "exit" strategies or monetary-reversal policies. All these may evaporate the recent rebound in commodities and stockmarkets. In fact, the world's third-biggest economy expanded 7.9% in the second quarter from a year earlier, accelerating from a 6.1 % pace in the first three months of 2009. Chinese bourse retreated from its recent high in response to the fear that Chinese authority will take action to prevent the formation of stockmarket bubble. However, the underlying economy still grew unbalanced. Exports fell for an eighth month in June as the global recession cut demand, highlighting the economy's dependence on stimulus spending to revive growth. In addition, Premier

Wen Jiabao said on Sunday that China would maintain its current macroeconomic policy stance aimed at bolstering domestic spending as the nation continues to experience fallout from the global recession. He added that the effect of some of China's stimulus policies would weaken over time, and the economy was still under pressure from declining demand for exports. Although there has been a 4 trillion yuan stimulus plan, he emphasized that China would be sticking to the proactive fiscal policy and moderately loose monetary policy because there were many difficulties and challenges. In fact, China's central bank has kept interest rates and reserve requirements for banks unchanged this year after cutting them in the final four months of last year to counter the effects of the global credit crisis. The People's Bank of China, in an Aug. 5 statement,

reiterated its pledge to keep the yuan stable at a "reasonable and balanced" level. On the other hand, England's Monetary Policy Committee said after its regular meeting that it expected the quantitative-easing program to take another three months to complete and would be "kept under review", instead of pausing the policy. The bank also left the key interest rate at a record low of 0.5 % last week. Although there is also sign of an economic recovery in the UK, for example, household and business confidence has picked up, albeit from the very low levels experienced in the wake of the financial crisis last autumn, there is still concern over that the threat from falling sales prices becoming entrenched clearly presents a bigger worry to the Bank of England than the market presently predicts. **E**

Microscope

Whatever governments around the globe do, it is quite certain that nobody would like to see a "W-shaped" recovery. That's why China or England will try hard to achieve a sustainable recovery. By the way, investors would be more concerned about the risk appetite. During recent months, investor demand for emerging-market bonds has been driving the cost of insuring against debt defaults below industrialized governments for the first time, indicating the widening risk appetite. The average cost of swaps for sovereign debt from 45 developing countries has declined to 314 basis points, the lowest since October, from 785 basis points five months ago, according to Bloomberg. Emerging-market bond funds held almost \$49 billion on July 31, the most since October, after their biggest weekly cash influx in a year. They've attracted more deposits than withdrawals every week since April 13, following eight months of declines, according to EPFR Global. Behind the condition that global liquidity remains intact, or becomes even loose, investors can take advantage of each pull-back of stockmarkets as entry point to capture the upcoming bull run. **E**

MARKET BRIEFING

YTD % (local curr)

US DJ	9,370 (6.8%)
Nasdaq	2,000 (26.8%)
Euro Stoxx 50	2,706 (10.4%)
HSI	20,375 (41.6%)
Japan NK225	10,412 (17.5%)
China Shanghai Composite	3,260 (79.1%)
Singapore	2,549 (44.7%)
India BSE30	15,160 (57.1%)
Brazil BOVESPA	56,329 (50.0%)
Aus All Ord	4,303 (17.6%)
US-10yr Bond	Yield 3.85%

As at 07/08/09

Insight: "Fund Flow Analysis"

International securities markets performed well in recent months as a result of rising risk appetite. Are there indicators showing that investors are still chasing high yield assets? One of these indicators is indicator of fund flows. However, no direct measurement can be adopted to identify the exact flow. Therefore, we can make use of the proxy - LIBOR. In fact, the decline in LIBOR is, to a certain extent, the function of increased flow of liquidity. However, the analysis over LIBOR should be in-depth. With respect to LIBOR, the fact that there is today more money than yesterday cannot alone explain LIBOR's drop. For example,

excess reserves ramped up way back in October, yet LIBOR was stubbornly high. One of the most important lessons of the credit crisis is that liquidity can be fleeting and that its existence cannot by itself alter the price of financial assets. The keepers of liquidity can withhold the money and do so in a moment's time, or they can release it just the same. In any case, the keepers of money will demand a high price when there are uncertainties, especially during the last quarter last year. LIBOR could not have fallen without the removal or reduction of uncertainties. But since the second quarter this year, the start of the "green shoots" phase has happened and it is subject to the laws of supply and demand and the cost of money is lowered, because the suppliers of inter-bank funds have released their reserves. **E**

A-Z Financial Tools

Fisher Effect is a theory describing the long-run relationship between inflation and interest rates. The theory can explain the trend of interest rate movement, according to a one equation. The equation tells us that, all things being equal, a rise in a country's expected inflation rate will eventually cause an equal rise in the interest rate (and vice versa). **E**



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