

UK Economy: Darkness before Dawn




Microscope

Although the British Chambers of Commerce said it expected the economy to grow by 1.1% next year which showed almost a double of what was predicted in June, keeping the recovery process going would be very difficult and there could be high risks of relapse. For example, unemployment rate could hit just above 3 million in coming months. In addition, the problem of debt, already amassed while battling the recession could become a real challenge to sustaining the recovery. Last week, a major corporation cast a vote of censure. HSBC Holdings Plc announced that it is moving Chief Executive Officer to Hong Kong from London as Europe's biggest bank increases its focus on emerging markets. Although HSBC will still be domiciled in the UK, it is strong evidence that there's a shift of gravity going from West to East. It is in no doubt that HSBC plans to expand in emerging markets, like China, India and Brazil, to take advantage of increasing demand for banking services. But the move certainly signals the upcoming investment trend. To counteract this trend, Prime Minister needs to repair the public finances once growth rebounds. 

The pound fell to its lowest level in almost six months against the euro after the Newcastle Journal cited Bank of England Governor Mervyn King as saying the pound's weakness was helpful. Policy makers said there may be false dawns in the recovery, according to the minutes of their most recent meeting released last week. The central bank began the so-called quantitative-easing policy in March in an effort to lower borrowing costs as the UK grappled with its worst recession since World War II. During the last week's G20 meeting, central banks around the world signaled this week that the economic recovery may not be robust enough to justify the withdrawal of stimulus measures. It is widely expected the Bank of England favors a weaker currency to help revive the economy. With regard to other monetary policy, UK has planned to sell as much as 5 billion pounds of bonds through

banks. The sale is part of a record 22 billion pounds the Treasury aims to raise this year to finance the budget deficit. In fact, the UK faces a fiscal deficit never before seen in peacetime, yet the war between political parties is not resulting in any proper answers as to how this will be addressed. Whichever political party wins the next election needs to secure a mandate for radical action. Recently, reports indicated the recession was showing some signs of easing. Manufacturing output rose and services industries expanded for the first time in a year, while house prices had stabilized since. The Royal Institution of Chartered Surveyors said UK homebuyers are clinching smaller discounts on property prices as the housing market stabilizes. At the same time, the unprecedented 22% drop of UK house prices to date has definitely sparked interest

amongst prospective home buyers to venture out into the warm summer months after having held off from purchasing since last summer. As a result, the UK housing market is now seeing liquid buyers return to the market which should have been reflected in rising house prices during the summer months that undoubtedly will increasingly be taken by the mainstream press to conclude that the house prices have bottomed. On the other hand, the number of repossessions is forecast to hit a high of 75,000 this year, matching the early 1990's peak of 75,000, however this masks the impact of all of the government initiatives and bank arm twisting measures in an attempt to artificially keep people in their homes by a variety of means such as the "Mortgage Rescue Scheme" in the run up to the 2010 general election, according to Bloomberg. 

MARKET BRIEFING


YTD % (local curr)

US DJ	9,665 (10.1%)
Nasdaq	2,090 (32.6%)
Euro Stoxx 50	2,831 (15.5%)
HSI	21,024 (46.1%)
Japan NK225	10,265 (15.9%)
China Shanghai Composite	2,838 (55.9%)
Singapore	2,662 (51.2%)
India BSE30	16,693 (73.0%)
Brazil BOVESPA	60,355 (60.7%)
Aus All Ord	4,714 (28.8%)
US-10yr Bond	Yield 3.32%


As at 25/09/09

Insight: "Leading Indicators"

Leading indicators, in economic context, signal changes before the economy has changed. Examples of leading indicators include production workweek, building permits, unemployment insurance claims, money supply, inventory changes, stock prices and yield curve. One of the powerful indicators is yield curve. Historically, the 10-year Treasury bond yield has averaged approximately two percentage points above that of 2-year bond yield. In situations when this gap increases, that is to say, 10-year Treasury yield rises higher than the 2-year Treasury yield, the economy is expected to improve quickly

in the future. This type of curve can be seen at the beginning of an economic expansion, or after the deep recession. During this period, economic stagnation will have depressed short-term interest rates. However, rates begin to rise once the demand for capital is re-established by growing economic activity. In May, the gap between yields on 10-year Treasury notes and 2-year notes widened to 2.75% points, its highest ever. Nevertheless, no indicator can perfectly predict the future. Right now, the US government continues its stimulus program to sell nearly \$2 trillion in US Treasury bonds in 2009, which led investors to fear that demand for government debt would be insufficient, which would lower bond prices and raise the government's borrowing costs. To conclude, the yield spread can be induced by other factors at the same time. 

A-Z Financial Tools

Macaroni Defense is a tactic used by a corporation that is the target of a hostile takeover bid. The defense is adopted because the corporation which lists on the exchanges and tries to avoid to be taken over. Accordingly, the defense involves the issue of a large number of bonds that must be redeemed at a higher value if the company is taken over. 



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