Αρχείο

Μύστ αλέξα μέχρι 6/9/2010

WEEKLY ECONOMIC AND MONETARY REPORT

29 January 2010

Most of the key issues of the day have been discussed extensively at this week's meeting of the World Economic Forum in Davos – which is taking place at just the right time to have an unusual impact. There have been drop-outs (Brazil's Lula, and Afghanistan's Karzai, in particular), but many key players are there.

The tone for the meeting was set by French President Sarkozy's opening speech – which was a fairly naked attack on free-market capitalism. He argued for a return to a Bretton Woods-type regime of fixed exchange rates, and an end to "monetary dumping". He supported a transaction tax on banks as a kind of insurance levy, and he demanded that remuneration in the financial sector should reflect "utility and merit". He also attacked China's policy of pegging the renminbi to the US dollar, and talked of a "crisis of globalisation itself".

Much of this was just rhetoric. But France holds the Chairmanship of the G20 next year, and this is a good indication of its likely agenda.

It also reflected a theme of the meeting: the apparent failure of "Anglo-Saxon" capitalism, and the need to find an alternative if we are not to face what the Forum's founder, Klaus Schwab, warned would be a catastrophic social crisis. The new buzzword appears to be "cohesive capitalism" – capitalism without losers. Whether it is achievable, however, is rather doubtful.

I BANKING

It has been reported today that the heads of Bank of America, Deutsche Bank, and UBS are currently meeting privately in a side-room at the WEF, in preparation for a showdown meeting with regulators (including Barney Frank, Chairman of the US House Banking Committee) on January 30. Given the large number of top-level bankers present in Davos, and the enormous amount that is apparently being spent by the banks on lobbying against Obama's proposals to break up the big US banks, this meeting could well be very important.

However, for the moment, the tide of public and political opinion is still running in favour of Obama – even if press reaction to his proposals has been sceptical. The problem is the absence of detail – particularly on just what a (tightly regulated) retail bank can do. The assumption seems to be that utility banks will be able to offer a full array of investment banking services – provided that those services are for retail and commercial clients only. In other words, the only restriction would be on a bank using Federally-guaranteed deposits to fund its own "proprietary" trading. That may be correct, but most people who know Paul Volcker believe that he has something more radical in mind.

The key may be whether Volcker retains the influence he has suddenly achieved with Obama. If his star wanes, and those of Treasury Secretary Geithner and NEC Director Summer rise, then bank lobbying will have worked, and structural changes to the financial industry will be marginal at best. That is quite likely; however, Geithner got a very tough time when he testified to Congress this week on the bailout of AIG.

It is not much different in Europe. Indeed, in the UK, it was reported this week that the Conservative Opposition (still very likely to form the next government) has broadly endorsed Obama's approach to the banks – putting the (center-left) Labour government in the bizarre situation of defending UK banks against attack from (right-wing) Tories. It was also reported that the Labour government is considering an independent review of the investment banking industry – and of what impact its shrinking would have on the UK economy.

The possibility of regulatory "fragmentation", as a result of the crisis, is already being exploited by lobbyists as a reason for the US not to press ahead with major regulatory reforms. On Tuesday, the IIF, for instance, published a report in which the US was urged not "to go it alone"; that seems likely to be the theme for all banks opposed to the "Volcker rule".

The other significant banking issue this week is the Swiss Federal Administrative Court's ruling that UBS may not give the US tax authorities more than around 250 of

the 4,450 names that the US alleges represent illegal tax evasion by US citizens. The names it can give are (apparently) those of US citizens for whom there is a *prima facie* case of tax evasion and/or money laundering. For the rest, Swiss Parliamentary approval much be obtained – and it is unlikely to be forthcoming. As a result, the Swiss and Americans are again at loggerheads.

Finally, there is a major international push to write off Haiti's external debt – which totals just over US$1 billion. Last July, the Paris Club agreed to cancel around US$215 million, and the World Bank and IMF approved US$1.2 billion of debt relief. However, Haiti also owes US$440 million to the Interamerican Development Bank, US$295 million to Venezuela and US$90 million to Taiwan. There was a preliminary meeting of donors this week in Montreal, ahead of a full donors' conference.

II RECENT ECONOMIC AND MARKET DEVELOPOMENTS

A INTERNATIONAL ORGANIZATIONS: Ahead of Davos, the IMF released an update of its *World Economic Outlook* – showing a surprising improvement in the outlook for growth. At the global level, for instance, growth this year is now put at 3.9%, up from 3.1% in October. For the US, it is 2.7%, up from 1.5%:

WEO: GDP Growth Forecasts

	2010	2011
US	2.7%	2.4%
Japan	1.8%	2.2%
Eurozone	1.0%	1.6%
UK	1.3%	2.7%
China	10.0%	9.5%
Emerging Asia	8.4%	8.4%
World	3.9%	4.3%

The EBRD also released new forecasts for emerging Europe. Thanks to stronger than expected growth in Poland, Turkey, Russia and Kazakhstan, GDP growth for the region in 2011 is now put at 3.3%, up from an earlier forecast of 2.5%.

There have also been new estimates of global trade volumes.

According to the World Bank, for instance, global trade fell 14.4% by volume last year. This year, however, the trade performance is likely to be a good deal better. According to the Dutch CPB institute, the volume of world trade was up 1.1% year-on-year in November, and, for 2010, it is predicting an increase of 3.9%.

However, there remains one major problem – something that has also been a major concern in Davos. The banks are still not lending. According to the BIS, international bank lending fell by US$235 billion in the third quarter of 2009. For the first nine months of the year, it was down over US$3 trillion, or 10%.

B **THE US:** Today's US GDP data was (for once) a pleasant surprise.

The 5.7% annualized rate of growth in the fourth quarter was higher than expected, and was also the US economy's best performance in six years. However, it is worth noting that almost two-thirds of this growth came from re-stocking, and it is therefore unlikely to be repeated unless consumption picks up very sharply. Nevertheless, it is a rare piece of good news.

Other that that, economic releases this week have been mixed, at best. Home resales, for instance, were down a hefty 16.7% month-on-month in December, and the Case-Schiller index for November saw house prices down 0.2% month-on-month and 5.3% year-on-year. Durable goods orders for December were also disappointing – up just 0.3% after a 0.4% drop in the previous month. On the other hand, however, initial jobless claims fell 8,000 in the latest week, and the Conference Board's index of consumer confidence rose from 53.6 to 55.9 last month.

More important was the Congressional Budget's office's 2010 Annual Report. This forecasts a budget deficit for this fiscal year of US$1.35 trillion – and of over US$6 trillion in the next decade.

That has cast Fed policy into doubt. However, for the moment, the FOMC (which met on Wednesday) is still able to hold US interest rates close to zero – and to insist (as it has done for some months) that it intends to keep them "exceptionally low" for an "extended period".

What of Obama's State of the Union speech, on Wednesday evening?

In some ways, it was overshadowed by the likely failure of the Administration's plans for health care reform – though the President continued to urge the Senate (where the Democrats have now lost their veto-proof majority) to pass the bill that has already been approved by the House. As far as the US economy is concerned, the emphasis was on job creation: "Jobs must be our number one focus." However, Obama also pledged to freeze public spending for three years from FY2011 – something that may be very hard to do without a withdrawal from Afghanistan.

So far, none of this has impressed the markets. Last week, the DJIA was down 4.5%, the S&P500 was down 4.2% and the Nasdaq was off 3.9%. Through early trade today (and despite the GDP data), the DJIA is off 0.5% for the week, the S&P is down 0.6% and Nasdaq is down 1.2%. However, interest rates on US government paper remain low, with the yield on the benchmark 10-year Treasury just 3.65%.

C **EUROPE:** The issue of Greece will not go away – and it now probably poses the biggest threat to the integrity of the eurozone and the value of the euro since the single currency was set up ten years ago.

This week started off well for Athens – which managed to sell €8 billion of five year government bonds on Monday at around 6.22%, "only" 350 basis points higher than equivalent German *bunds*. There was also talk that China would buy up to €25 billion of the bonds – which would, more or less, have covered Greece's refinancing requirements through May-June. Since then, however, things have got worse. So far, the Chinese haven't come through, and spreads vis-à-vis *bunds* have widened, peaking at around 415 bp. Moreover, Brussels, Frankfurt and Berlin have been sending very mixed messages on whether or not Greece can expect any kind of support.

There are good reasons for the mixed message – not least, the strong probability that any deal put together for Greece will be the base negotiating position for Portugal,

which (with a budget deficit close to 10%of GDP) is now clearly next in line. But, for Greek PM Papandreou – who already faces major demonstrations from farmers – the delay is very damaging. According to the *Financial Times,* the Commission is working on a rescue plan, and the Socialist leader of the European Parliament, Martin Schulz, has said that Greece must not be "abandoned to the markets". On the other hand, Commissioner Almunia continues to say that there are no bailout talks taking place, and German Economics Minister Brüderle insists that there must be no bailout at all – and no moves towards a "European economic government". In the meantime, Papandreou gave an interview in Davos, in which he claimed that Greece is being targeted "by those with an ulterior motive" – presumably by anti-Europeans who want to bring the euro down.

There is a European Summit scheduled for February 11 in Brussels. However, that may be too late for a deal. The general feeling is that Greece needs help quickly if it is to avoid a default – and that the government does not have the political clout, by itself, to impose the savage public spending cuts/tax increases that are necessary. One option is a big structural readjustment loan from the EIB; that would be similar to IMF involvement, but it would be less politically unpalatable. Perhaps the final word (for the moment) should go to Nouriel Roubini (also in Davos): "If Greece goes under, that's a problem; if Spain goes under, it's a disaster."

As discussed below, Greece's problems have undermined the euro in FX markets this week. It has also not been helped by news that eurozone unemployment hit 10% last month. However, there was some good news, in that it was also reported that eurozone consumer confidence rose again in January, for the tenth straight month, from 94.1 to 95.7. Plus, in Germany, the government has revised its 2010 GDP growth forecast from 1.2% to 1.4%, largely because of an anticipated 5.1% increase in exports.

Two political developments within the eurozone are worth noting:

- In Germany, the founder/leader of the (hard) Left party, Oskar Lafontaine, has been forced to quit politics as a result of prostate cancer. Since the party has no other figure of remotely comparable standing, that leaves a huge hole in

German politics. The Left had won 11.9% of the vote in the September Federal elections – and the SPD will fight very hard to get it back.

- In France, former PM Villepin has (rather unexpectedly) been acquitted of slandering President Sarkozy in a case that dates from when both were challenging to succeed Chirac. Villepin now re-emerges as a political threat to the President, though, at the moment, he has only limited support within the ruling UMP.

Outside the eurozone, the UK appears to be limping out of the recession. Fourth quarter GDP growth was reported to be just 0.1% - rather lower than expected – despite strong automobile sales and a good Christmas season. Given the end of the so-called "scrappage" scheme for cars, there is a fair chance of a so-called "double-dip" recession – this time, with rising inflation.

Will it happen? Well, on the positive side, the GFK/NOP confidence index rose this month from -19 to -17, and the Nationwide's house price index rose 1.2% month-on-month. On the other hand, however, the CBI's distributive trades index fell from +13 to -8 in January. Moreover, in a major blow, S&P yesterday announced that it has downgraded the stability of the UK banking system; it is now lumped together with banks in Chile and Portugal.

One other warning, PIMCO's Bill Gross (who has been consistently negative on the UK) warned on Tuesday that he would not buy UK gilts because of the budget deficit. As he put it, the UK economy is sitting "on a bed on nitro-glycerine", which could blow up at any stage. With that kind of mood in the markets, and with Britain's triple-A rating under threat, the consensus is that the BofE's policy of Quantitative Easing must be coming to an end.

D **JAPAN:** Another bad week for the Nikkei-225. After a fall of 3.8% last week, the index has dropped a further 3.7%. In part, that reflects the unexpected problems of Toyota, which is facing a massive global recall of several of its popular models because of a malfunctioning accelerator. However, it also reflects a warning from S&P that, if Japan does not cut its budget deficit, it faces its first ratings downgrade in over eight years.

The problem is that, thanks to the economic slowdown, tax revenues are down 26% year-on-year. There are signs of economic recovery. Industrial production, for instance, was up 2.2% month-on-month in December, and household spending was up 2.1% year-on-year. Unemployment may also be improving; the economy generated 130,000 new jobs in December, and the jobless rate fell from 5.2% to 5.1%. On the other hand, however:

- retail sales are still weak, falling 0.3% year-on-year in December; and
- housing starts in 2009 were at their lowest level since 1964.

All of this poses very tricky questions for PM Hatoyama and Finance Ministers Kan.

E **CHINA:** Here, the problem is the growing fear of economic overheating – and of what Beijing might be forced to do to counteract it. It was reported this week that both the Bank of China and the China Construction Bank are restricting new loans and mortgages – prompting a sharp sell-off on the Shanghai exchange.

III FOREIGN EXCHANGE MARKET DEVELOPMENTS

Today's stronger than expected US GDP data has given the dollar a further boost – pushing it to a six-month high against the euro. It has also risen against the yen – though the strength of the yen on a trade-weighted basis and the growing problems of the Japanese economy have caused FM Kan to appeal to the BoJ to intervene in the markets.

The big problem at the moment is the euro - which is being dragged down by Greece's problems and by the outside chance that a local crisis could become a crisis for the whole eurozone. It fell sharply last week, and – although it bounced a bit on Monday – it has fallen again this week. Following the US growth figures, the euro is currently trading at US$1.391 – down 1.9% since the close last Friday.

Sterling has also been hit – by fears of a "double dip" recession and by S&P's warnings about the impact of the UK's debt position on the banking sector. It is currently trading at US$1.604/US$ - down 0.6% for the week.

As noted, the yen has benefited from this – in part as a result of its safe haven role. Although it has weakened 0.8% against the dollar, it has risen this week from Y127.47/€ to Y126.06. However, its future depends very much on whether the DPJ government can press the BoJ to intervene.

Given the problems of Greece, most observers are still bearish on the euro – at least in the short term. Rumours out of Germany that funds are "fleeing" Greece (though denied) cannot help.

IV OIL

Today's unexpectedly strong US GDP data has given oil prices a boost. Nevertheless, both front-month Brent and WTI still look like ending modestly down for the week:

- March WTI lost 4.2% last week, closing on Friday at US$74.54 a barrel – the lowest price for marker crude since December 23. It rose 72 cents on Monday, but then fell back to a low as US$73.64 at the close yesterday. In early trading today, it is up 51 cents at US$74.15 – but that is still down 0.5% for the week.
- March Brent closed at US$72.83 a barrel last Friday – having fallen for 11 out of 15 trading days in January. It, too, recovered on Monday, but then fell back to close at US$72.13 yesterday. It is currently trading at US$72.68 – down just 0.2% for the week.

It is perhaps surprising that oil prices were as weak as they were prior to today's US GDP data. After all, it was also reported this week that US crude stocks (usually an important determinant of prices) were down 3.9 million barrels in the latest week – much MORE than the 1.4 million barrel increase that had been expected. True, gasoline stocks were up 2 million and distillate stocks rose 400,000 barrels. But imports into the US were down 673,000 b/d because of fog in the Houston Channel – which normally boosts prices.

In addition, Chinese imports have been strong, and it was reported that China's economic planning agency is now working on the assumption of an average price of US$80 a barrel this year. Plus, according to the CFTC, net long positions in the paper trading market are near record levels.

There has been a lot of bullish talk about oil in Davos. BP's CEO, for instance, forecast that emerging markets' demands for oil will add another 15 million b/d to global consumption over the next 20 years. And the CEO of Shell insisted that the industry needs to spend another US$27 trillion over the same period – which will be impossible without a substantial real price increase.

So, why has the price eased? One reason is a general softening of commodity prices. The R/J CRB index, for instance, has fallen this week from 275.1 to 268.5, and George Soros used Davos to call gold "the ultimate bubble". Beyond that, however, there is clearly little faith in the strength of global economic recovery.

V NEXT WEEK

Next week is a big week for US economic releases. The most important is clearly non-farm payrolls for January, expected to be up 50,000 (after a fall of 85,000 in December).

Other important releases include:

- personal income and consumption for December, expected to be up 0.3% and 0.2% respectively;
- construction spending for December, expected to be down 0.3%;
- automobile sales for January;
- the ISM (purchasing managers) index for January, expected to be up; and
- factory orders for December, expected to be up 1.5%.

Elsewhere, the most significant releases are likely to be:

- purchasing managers indices for the eurozone;
- leading indicators for Japan; and
- industrial production for Germany.

Both the ECB and the BoE also meet next week on interest rates.

Regards,
GISE AG