

A global crisis of confidence

Even drastic measures may not be enough to improve confidence in the market and nudge the global economy towards positive, writes **Sachin Patki**.

It's a situation akin to Columbus discovering the New World, where the then established economies went through a sharp change due to the complete shift in the basis of their growth. Today, we stand at a similar fork in the road. Global finances, economies, regulatory bodies, laws and regulations, trade restrictions and government systems will change with the latest global events.

Will the concept of laissez-faire that drove the concept of a free economy in post-Keynesian economics now be a byword for greed at the cost of social development? Will governments be forced to put society ahead of individual profits? Will social economics make an unannounced entry? In the end, it's going to be all about confidence in governments – their policies and goals being for the benefit of all, their desires being to protect the weakest and make the future better than it is today.

There are big ramifications in a world where governments own financial institutions and don't just regulate them; where government bodies own real estate and don't just sponsor and fund institutions to provide the framework for a large mortgage market; where indirectly the credit to corporations is balanced with the government's long-term objectives of growth for the greater good.

The currency market, along with the commodity, bond and equity markets, works on the concept of all prices being reflective of the market-agreed value of the supply and demand forces at that point in time. This model has now changed with the new global economic matrix. One of the biggest victims of this situation may be the global tariff barrier system, which needs more protectionism by each political body to ensure that its constituents are least impacted.

The current strength of the US dollar has been partly based on it being the most used currency in the world. At present, many are looking to maintain the value of their funds by buying gold and keeping cash positions. The exit from many of the corporate credit issuances around the world and from the region has led to a sharp drop in bond prices at a time when the US yield curve clearly reflects market perception of an economic slowdown this year. The US unemployment rate rose to 7.6 per cent in January and is expected to touch 10 per cent this year, with the GDP expected to contract by around two per cent. Positive growth is expected only in 2010.

The retail level impact of the new stimulus package from President Obama is a key factor in improving the confidence of the market. The opportunity lies towards the end of the year for the US dollar to find buyers again, with the interim period seeing a corrective phase. If the impact of the tax cuts, tax incentives, waiver of levies, Medicaid benefits and public spending projects are enough to nudge the economy towards

the positive, then we may see the rally in the US equity market and see asset-backed and corporate bonds take the US dollar higher.

The Eurozone is also on the defensive, with the usually inflation-vigilant European Central Bank (ECB) now looking to bring interest rates to new lows as a solution to the falling growth rate across the region. Many of the countries within the group have already slipped into a recession, with the month-on-month inflation rate going negative last December. The unemployment rate has already hit eight per cent, and the consumer confidence index dipped to -31 in January 2009.

The market has already priced in a further cut in interest rates and sees the ECB having to push member governments to undertake fiscal measures to drive growth, akin to President Obama's just-approved stimulus package. The euro has slipped into a trading range between 1.3200 and 1.2500, and we may see continued weakness up to the lower end of the range. A clear break on a weekly close below the 1.2500 level sees the potential to go back to the previous low of 1.2350, last seen in October 2008. The euro/yen has tested the lows near 112.20 and now looks to test the 121.40 levels again; a failure to break this level will indicate continued range trading, while a clear break indicates a move towards 125.80.

Of all the developed economies, the most susceptible seems to be the UK economy, where growth has largely been driven by cheap credit terms, ebullient real estate prices and high levels of consumer credit. The economy is now officially in a recession with a consumer confidence index rating of -37. Although the UK Chancellor of the Exchequer was the first to take measures of public funding to rescue financial institutions and corporations, enough has not yet been done to reverse the negative sentiment of retail level consumers. Unless they see the future getting better, they are not going to spend and the economy is not going to grow out of a recession.

Tax breaks, public spending and increased money supply (literally printing notes) may be some drastic measures needed for a turnaround, as interest rates are at their lowest since 1693. However, such measures are not seen as doing enough to support growth. The sterling has recently attempted to rise from the lows at 1.3550 to 1.4970, but this has not held up, as the sterling has slipped to the 1.4350 area. Another attempt at 1.3550 seems possible, and if this level holds, we may see the currency make another attempt towards 1.4650, 1.4785 and 1.5010. A break of 1.5010 would mean the currency is not ready to test 1.5360 and 1.5785 on the upside.

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Views expressed are his own and not necessarily those of Mashreq. Data and comments are as of February 15, 2009.