

Shifting trends to drive movements

There is potential for an increased demand in commodities as the global economy recovers, while equity markets become volatile, writes **Sachin Patki**.

Initial signs of recovery snowballed into positive gains in some of the asset classes like equities and bonds over the year. The expectations of a low interest rate environment helped some of these rallies, while the debate on withdrawing or keeping the stimuli continues.

One of the most interesting changes we have seen in the changed world order is the emergence of China on the world stage. The stage is now set for China to be the second largest economy in the world, overtaking Japan. We have seen production rising by 16.1 per cent from a year before, while retail sales grew by 16.2 per cent in October. We have seen bank credit drop in volume in reaction to tightening in money supply by China, which is expected to go back to 10 per cent plus growth in 2010 from the fourth quarter of 2009 onwards. For a country that currently has US\$2.273 trillion in foreign currency reserves, this can only mean further growth. The US dependence on these funds for investing in government securities to fund its trade deficit shows its dependence on China. This does impact its leverage for negotiating with the Chinese authorities on revaluing the yuan, which still remains largely pegged, despite the huge growth

and savings within China over the last two decades.

With signs of global economic recovery, we see a potential for increased demand for commodities and volatile equity markets as PE ratios shift to adjust to the quarterly corporate performance announcements. The shifting trends in the source of funds and the new markets where they are going will drive the movements in global currencies. Some of these pressures were also felt in the region over two years ago as overseas funds looked for better value from better interest rate differentials and potential local currency appreciation. When it did not work out, the capital moved elsewhere for better opportunities.

Across in Europe, we see some signs of stabilisation in the economies in the Eurozone, with increased confidence in the manufacturing sector and consumer demand, which is expected to translate into a full-blown recovery in 2010. However, recent comments from the European Central Bank indicate that it does not see a longer-term risk emerging from the current inflation rates yet. Inflation has yet to reach a point of concern for the US Fed officials that have indicated their interest in looking at

employment and inflation together before making any call to reverse the current interest rates.

With unemployment at 10.2 per cent and inflation still below two per cent, it will take a while for interest rates to climb higher, though any rapid rise in inflation may trigger a tightening in the money supply, which still remains too high and has a risk of creating asset bubbles due to an overly liquid economy. Some of the commodity countries like Australia, Canada and New Zealand have seen their currencies rise sharply based on the market discounting future demand for their commodity exports as the global economy picks up in 2010. These economies are poised to do much better with higher demand for their exports; this may also trigger a rise in the central bank rates to dampen inflationary pressures.

The euro remains poised for one more attempt at its previous high at 1.6000, though it may need a lot more news to take it up there. Part of that reason would be the slide in the US dollar across all other currencies, something that is already attracting comment from EU officials. A weaker US dollar gives the US economy a much better chance of recovery due to a potentially higher order book of exports. Support remains at 1.4670, 1.4580 and 1.4310, with resistance at 1.5350, 1.5470, 1.5510, 1.5680 and 1.5825. The US dollar/yen has been inching towards the previous low at 87.20. A break would give us 86.70 and 85.90 with a lot of the long yen positions unwinding in this region. A reversal promises 89.00, 90.50, 92.10, 93.65 and 95.00. The sterling remains a little defensive, with top formation in place near 1.7010, now giving us 1.6430, 1.6280, 1.6115 and 1.6000. A break of 1.5850 would open up a whole new range with a low near 1.5520.

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Views expressed are the author's and not necessarily those of Mashreq. Data and comments are as of November 15, 2009.

