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CMMB Emerging Markets Weekly

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2008 – A Year in History

In less than three (3) weeks, 2008 will be over but undoubtedly, the wave of events that unfolded during the year has safely secured it a place in history. Certainly, the past year will remain etched in the minds of investors as the year Wall Street collapsed; when fundamental trading took a back seat to widespread speculation; when the ill effects of globalisation were felt with full force; when commodity prices reached highs never envisioned. Indeed, the financial crisis of 2008 will be characterised as the worst since the Great Depression. Whilst the impact has been manifested in various ways, the fundamental problem can be traced to undermined confidence in the market.

Global Economy

Prior to the current crisis, the global economy boomed on the backdrop of a broad based surge in the emerging and developing economies recording sustained growth at an average rate of 5% for the few years up until 2007. Momentum in the global economy soon started to fade in light of the sub-prime mortgage crisis in the United States (US) that erupted just over a year ago. This crisis has now evolved into a full-blown global financial crisis not seen since the early 1930's. As confidence fell off the radar and global demand slowed, we witnessed the world's most advanced and wealthiest economies either slip into a recession or head towards that direction. It therefore came as no surprise that these economies switched their focus from containing inflation (in light of easing global commodity prices), to boosting growth by slashing their key policy interest rates as seen in Table 1.

Table 1: Advanced economies' key policy interest rates

Central Bank	Last Policy Decision	Current Target Rate
Bank of Japan	unchanged	0.30%
Federal Reserve	-50 bps	1.00%
European Central Bank	-75 bps	2.50%
Bank of Canada	-75 bps	1.75%
Bank of England	-100 bps	2.00%
Swiss National Bank	-100 bps	1.00%
Reserve Bank of Australia	-100 bps	4.25%
Reserve Bank of New Zealand	-150 bps	5.00%

Source: Bloomberg

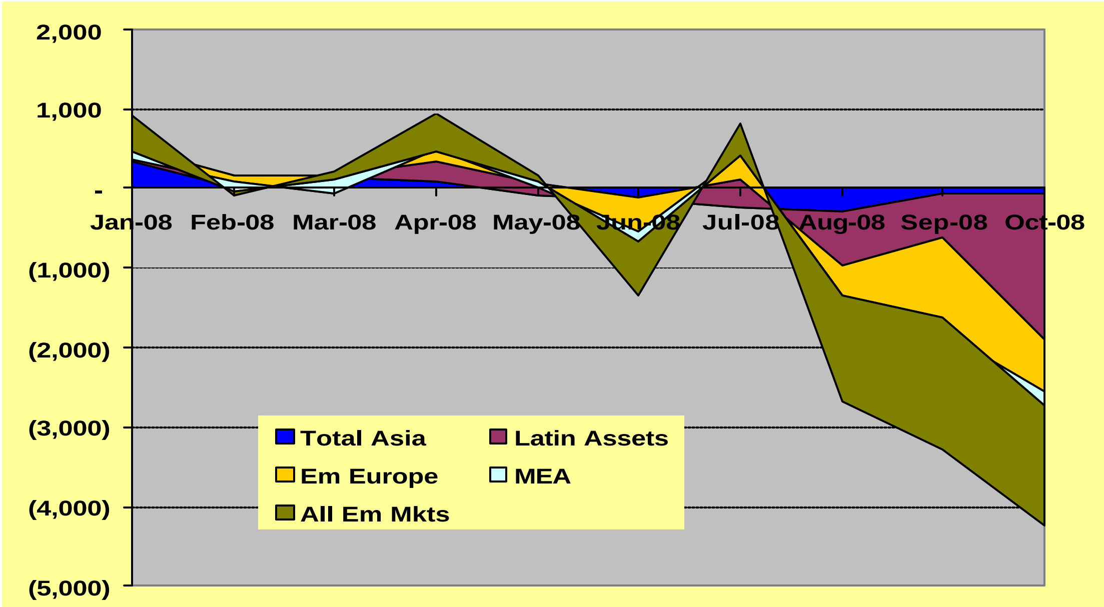
Despite these efforts, the world economy has entered a major downturn and is expected to sink further in 2009. With the current situation extremely uncertain and subject to significant downside risks, the idea of recovery seems farfetched and is expected to be a gradual process. According to the International Monetary Fund (IMF), this gradual recovery is expected to emerge in the latter part of 2009, as a result of the following key factors: commodity prices are expected to stabilise; the slump in the US housing sector is expected to bottom out; whilst the emerging markets are expected to still provide a key source of resilience. Although to some extent I agree with the first two (2) factors, the outlook for the emerging markets in the coming year is anything but resilient.

Emerging Markets

Emerging markets' resilience has constantly been tested throughout history but over the past year, this has been even more profound. While favourable global economic conditions paved the way for buoyancy, these conditions have been drastically reversed, making this year a bitter-sweet one for emerging markets throughout the world. Although the series of credit ratings upgrades boosted investor confidence in the first half of 2008, the wave of credit ratings downgrades and revised negative outlooks witnessed in the second half eroded confidence in the emerging markets significantly. As testament to this, Figure 2 shows the breakdown of bond fund flows in the emerging markets by region, since the beginning of 2008. As at the end of October 2008, there were net bond outflows amounting to USD1,521 million compared to the net bond inflows of USD407 million as at the end of July 2008.

Going forward, the picture is just as gloomy. Recently, the outlook for emerging markets worsened as the advanced nations continue to protect their banking sectors leaving global investors and lenders less likely to invest in countries perceived as risky. In this regard, speculation has risen as to which countries' outlook will be revised negatively or credit rating downgraded. This perceived riskiness in emerging markets is clearly captured in the JP Morgan EMBI+ index, which tracks the returns for traded external debt instruments in emerging markets. At the time of writing, the index stood at 723 basis points, widening by 474 bps since the start of 2008.

Figure 1: Monthly Bond Fund Flows – Net Buy/ (Sell) (USD, millions) by Region



Source: EPFR Global

Commodities

Before drastically easing since mid-July 2008, commodity prices surged to record highs over the past year and a half. In fact, these large increases came on top of persistent price increases during the 2003-2006 period making this commodity boom very similar to the boom witnessed in the early 1970s in terms of magnitude. Fuel and food prices have doubled since mid-July 2007 on the backdrop of strong global growth, low inventory coupled with spare capacity and supply constraints. This consequently gave rise to the notion of a 'supercycle', characterized as a period with secular trend increases in commodity prices because of the need for a substantial buildup in capacity, according to the IMF. Even though this phenomenon was expected to become a new way of life for many market players, recent developments in the commodity markets proved otherwise.

The recent retreat in oil prices has been attributable to: data that continues to signal a slowdown in oil demand from the US; the reality of a global recession; as well as less supportive financial conditions. While no one would have forecasted the past year's extreme volatility in oil prices, many would now strongly say the commodity boom is over. Looking ahead, oil prices will remain vulnerable to slowing global demand and the continuation of recent production increases by OPEC that are expected to loosen market conditions to some extent.

Parallel to the oil boom, the food price boom intensified in the beginning of 2008 and was primarily driven by six food commodities; corn, wheat, rice, soybeans, rapeseed oil and palm oil. Like the oil boom, low inventory levels coupled with supply constraints set the stage for this spiral of food prices. Indeed, according to the IMF, the current food boom has already exceeded the length of the average food boom by 12 months and any further easing will be limited by permanent factors such as low inventories.

Despite the recent decline in commodity prices and the clear shift in focus from inflation to growth, as evidenced by the more accommodating monetary policy stance adopted by central banks throughout the world, ongoing monitoring of inflationary pressures should be continued going into 2009. In fact, concerns have increased about second-round effects as domestic price pressures are expected to persist for some time.

Financial Markets

What began as financial turmoil in the US in mid-July 2007 has now mutated into a full-blown global crisis that has altered the landscape of the global financial markets. As a result of this, over the past year, we witnessed a wave of emergency resolutions as solvency concerns intensified. While it is too early to say whether or not these efforts will indeed aid in stabilizing the fragile global financial markets, the extreme measures taken by US and European authorities over the past year are testament to their commitment to overcome this crisis sooner than later.

While the successive collapse of many large banks in the US and Europe no longer appear imminent, it is too soon to say that financial panic has eased. In fact, with investor's confidence in banks and financial institutions drastically eroded amid heightened risk aversion over the past year, this crisis is expected to be prolonged with estimates within the range of 2-3 years. On an even more fightening note, as the current crisis has considerably weakened economic activity, the US Labour Department has reported a total job loss of 1.91 million since January 2008 to date. At this level, job losses in the US alone are well above the entire population of Trinidad and Tobago!

The current crisis has taken a toll worldwide and is crippling economic activity everywhere. With confidence the key to restoring stability in the global economy, policy makers around the world face the difficult task of containing inflationary pressures and sustaining growth while simultaneously attempting to nurse the financial markets back to health. The events that unfolded over the past year proved that uncertainty is the only certainty in this world and in this regard, buckle your seat belts because 2009 is expected to be a long and bumpy road.

FINANCIAL & ECONOMIC INDICATORS

As at 11 December, 2008

Exchange Rate/US$	Closing Value	Previous Week
Yen	91.45	92.23
Euro	1.36	1.28
Jamaica	79.68	77.45
Guyana	204.20	203.90

Commodity Prices	Closing Value	Previous Week
Crude oil (US$/bbl)	47.98	43.67
Natural Gas (US$/mmbtu)	5.87	6.56
Gold (US$/Troy Ounce)	821.35	767

Eurobond Indices (As at 11-December-08)	
Lehman Brothers Global Aggregate Index (Return % YTD)	1.37
JP Morgan EMBI+ (Basis points)	728
JP Morgan Central America and Caribbean Index (CACI) (YTD return %)	-21.47

Policy Interest Rates (%)	Closing Value	Previous Week
United States	1.00	1.00
Euro Zone	2.50	2.75
Japan	0.28	0.28
Brazil	13.75	13.75
Trinidad	8.75	8.75
Jamaica	13.50	13.50
Barbados	4.00	4.00

Market Interest Rates (%)	Closing Value	Previous Week
US 90-day T-Bill	0.02	0.02
US 10-Yr Treasury	2.60	2.55
3-month UK Libor	3.22	3.72
Japan 90-day T-Bill	0.48	0.48
Brazil 90-day T-Bill	13.93	14.30
TT 90-day T-Bill	7.17	7.04
Jamaica 90-day T-Bill	16.92	16.92
Barbados 90-day T-Bill	4.60	4.60

Sources: Bloomberg, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com