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A Bear Market Rally as the G-20 Steps In

Amid a rapidly deteriorating global economic landscape, the Group of 20 (G-20) concluded its deliberations during the first week of April 2009. It was with great expectations that analysts and market players anticipated these discussions, with hopeful optimism that the heads of the world's richest countries would come to some consensus for a coordinated and convincing fight against the deepening global economic crisis. The primary outcome from the meeting was, as one author put it, 'an IMF band-aid', where the answer to the current problems of the global economy can be solved through increasing the size of the International Monetary Fund (IMF). But will this suffice to facilitate a global economic upturn?

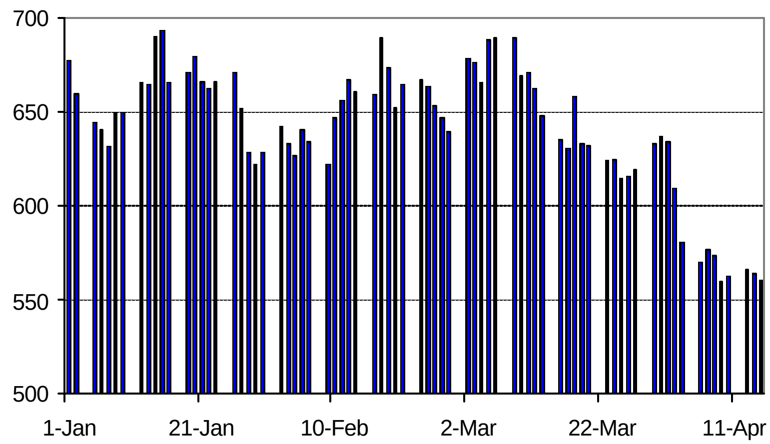
The global leaders agreed to fight back against the global crisis with US$1,100 billion in funding for the IMF, regional development banks and international trade finance; however, there was no discussion on new rounds of fiscal stimulus. In addition to the funding provision, the G-20 heads pledged to crack down on tax havens, extend regulation of the financial system to large hedge funds, set tougher pay rules in the financial services and oversee credit ratings agencies. US$750 billion will be provided to the IMF to support poorer nations those hit the hardest by the crisis, while US$250 billion will be allocated for trade finance and US$100 billion for multilateral development banks. The new IMF funding is likely to come from US$500 billion in loans from member countries and US$100 billion each would come from the EU and Japan and US$40 billion from China. The most vulnerable and poorest nations will also benefit from the sale of gold by the IMF.

The world economy is sinking deeper and deeper into what seems to be a protracted state of synchronized recession. The US economy contracted at a 6.3% annualized pace, the most since 1982, while the Euro region shrank 1.5% in fourth quarter of 2008. The IMF is forecasting global growth of 0.5% for 2009, which represents the weakest post-war pace and it highlights the strong likelihood that trade flows will remain depressed throughout the year. The Organization for Economic Cooperation and Development (OECD) is now forecasting that the industrialized countries will contract by more than 4% in 2009, which would mark their worst economic performance in the last 60 years. Indeed, it seems that the worse of the crisis is still left to be unraveled. The IMF estimates that the total losses to the global banking system from bad lending practices will amount to about US$2.3 trillion, which represents more than twice the losses that the banks have acknowledged to date.

While the efforts to boost the IMF's lending capacity are quite commendable on the part of the G-20 members, their deliberations did not include any measures to deal with the real issues affecting the global economy. Indeed, the fate of the global economy rests on the progress of recovery of the industrialized nations, and one can argue that the way to do this is to provide fiscal stimulus, which can be used at the very least, to limit the effects of falling asset prices on global household spending. As an indication of the severity of the decline in global equity and housing prices, the OECD now estimates that approximately US$50 trillion in global household wealth, or the equivalent of around 100% of world GDP, has been wiped out over the past year. Analysts also argue that the meeting failed to come up with any new initiatives that might adequately recapitalize the global financial system, another necessary condition for starting a sustainable global economic recovery. According to the IMF, a sustained economic recovery will not be possible until the financial sector's functionality is restored and credit markets are unclogged.

Despite the mixed reviews of the G-20 meeting, the markets reacted positively. Emerging market assets have since staged a daring rally. To be sure, the EMBI+ Index, which gives an indication of the riskiness of emerging market debt, tightened significantly by 76 basis points so far in April alone, and for the year so far, it has improved by over 100 basis points, suggesting that the market views the decisions by the G-20 heads to be positive for emerging markets. Figure 1 below shows the performance of the EMBI+ Index for the year so far.

Figure 1 – EMBI+ Index (year to date)



Despite this moderate rally in EM debt, these countries are faced with rising downside risks. EM economies continue to struggle against the backdrop of a frail global scenario, and the *recoupling* to the global recession continues apace. The weak performance is being attributed to falling export demand and financing, lower commodity prices and much tighter external financing constraints. As growth virtually slowed to a halt, policy makers sprung into action, aggressively slashing interest rates in an effort to shore up economic activity.

Will the assistance provided by the world's richest nations be sufficient to assuage the already immense impact upon the emerging markets? We witnessed renewed confidence in emerging markets over the past few weeks, which intensified during the first week in April. All Equity Funds tracked during 3-8 April received net inflows of US$3.5 billion while All Bond Funds received net contributions of US$1.3 billion, according to data from EPER Global. Is this rebound a reflection of expectations for a sustained economic recovery or just a bear market rally? Fundamentals remain too depressed for any sought of sustainable resurgence. Increasing the IMF's lending capacity is very much an admirable move, and it will temporarily allay some of the problems of the poorer, more vulnerable countries, but it really does not temper the unparalleled slump presently afflicting the world's industrialized countries. Until such time that firm signals of a recovery in the world's richest and most influential nations materialize, then emerging markets will continue to be under severe pressure. For any recovery to take place in the advanced countries, measures must be put in place to deal with falling asset prices and subsequent erosion of household wealth, as well as recapitalization of the global financial system. Until this happens, it is my opinion that the current *bear market rally* is by no means indicative of a bull market – for in a bull market you get to keep your profits!

FINANCIAL & ECONOMIC INDICATORS

As at 15 April, 2009

Exchange Rate/US$	Closing Value	Previous Week
Yen	99.37	100.44
Euro	1.32	1.32
Jamaica	89.01	88.86
Guyana	204.70	206.00

Commodity Prices	Closing Value	Previous Week
Crude oil (US$/bbl)	49.25	50.96
Natural Gas (US$/mmbtu)	3.60	3.51
Gold (US$/Troy Ounce)	891.05	881.62

Eurobond Indices (As at 15-April-09)	
Lehman Brothers Global Aggregate Index (Return % YTD)	-2.99
JP Morgan EMBI+ (Basis points)	563
JP Morgan Central America and Caribbean Index (CACI) (YTD return %)	8.40

Policy Interest Rates (%)	Closing Value	Previous Week
United States	0-0.25	0-0.25
Euro Zone	1.25	1.25
Japan	0.10	0.10
Brazil	11.25	11.25
Trinidad	8.50	8.50
Jamaica	17.00	17.00
Barbados	3.00	3.00

Market Interest Rates (%)	Closing Value	Previous Week
US 90-day T-Bill	0.14	0.18
US 10-Yr Treasury	2.77	2.92
3-month UK Libor	1.53	1.56
Japan 90-day T-Bill	0.38	0.38
Brazil 90-day T-Bill	9.95	10.54
TT 90-day T-Bill	2.56	3.28
Jamaica 90-day T-Bill	20.51	20.51
Barbados 90-day T-Bill	3.85	3.85

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