



China Red Flags the Greenback

After the crash of the equity markets there was a global “flight to quality” by investors. During the panic, government bonds were bid to preposterous levels where three month bills were yielding just 0.01% at one point, after briefly dipping into negative territory. Basically, investors were giving the government their money without expecting anything but their principal in return. Looking at the yield curve now, it appears as though Treasuries have been retreating off their peaks. The panic seems to be subsiding, and with it the quality premium investors were willing to pay to hold government bonds. TLT's (iShares Lehman 20+ Year ETF - a good proxy for 30-Year Treasuries) drop may spell the beginning of the return to normalcy. Treasuries seem to be winding down from an unprecedented bull rally. This can be a worrying situation for major holders of US debt. As a result, the US-dollar saw its biggest weekly slide since 1985 after the Federal Reserve's decision to buy long-term government debt raised the specter of an oversupply of dollars.

The prospect of ballooning US debt has recently incited calls by some of the world's leading emerging economies to dislodge the dollar as the dominant global reserve currency and the call is gaining momentum as a weakening dollar adds further urgency to the discussion. The push emphasizes growing concerns among emerging-market leaders about the long-term value of the dollar.

People's Bank of China Governor Zhou Xiaochuan indicated that he would like to see the dollar, which was installed as the reserve currency after World War II, be replaced by a different standard similar to that run by the International Monetary Fund (IMF). China, the top holder of US Treasury bonds with \$739.6 billion as of January, is concerned about its investments as the US battles a deep recession pushing for an overhaul of the global monetary system to allow for wider use of Special Drawing Rights (SDRs) allocated by the IMF. SDRs, which have a value based on a basket of key international currencies, also serve as the unit of account for the IMF and some other international organizations. The suggestion was made for the IMF's SDR to serve as a super-sovereign reserve currency as it would not be easily influenced by the policies of individual economies. These comments were made ahead of the G20 summit scheduled to begin 2 April in London, where world leaders and international organizations including the IMF are to discuss reforming the financial system.

This proposal by China came on the heels of the US plan to buy one trillion dollars of its own debt, diluting the value of China's dollar reserves via a depreciating greenback and thus raising fears of inflation. The Federal Reserve introduced a money-creation scheme, in which Central Bank would buy \$1.15 trillion in securities, including \$300 billion in long-term government debt. While this policy would ostensibly prop up the value of US Treasury notes, which will be a positive outcome for China, it does so by potentially diluting the value of the US dollar and thus China's holdings. Immediately after the Fed's announcement, the US dollar plunged, falling 4.5% against the euro in two days, and significantly against almost every other major currency.

Russia has also decided to put forward a formal proposal for the creation of a new reserve currency issued by international financial institutions at the G20 meeting in April. Russia is claiming the broad support of its fellow BRIC countries - Brazil, India and China - as well as South Korea and South Africa for its plan. Emerging economies, which are among the largest dollar holders in the world due to their strong export revenues, have sought to diversify their reserves away from the dollar. Russia possesses the world's third-largest store of foreign reserves, approximately half of which are in dollars.

As the world's main reserve currency, US dollars account for most governments' foreign exchange reserves and are used to set international market prices for oil, gold and other commodities. As issuer of the world's reserve currency, the US pays less for funding and borrows more easily as appetite for US debt has been almost insatiable. The US dollar replaced the British pound as the world's primary reserve currency after World War II, when Britain was struggling with the cost of fighting two world wars.

The Chinese authorities hold approximately \$2 trillion in foreign reserves, two thirds of which is placed in US assets. Any crisis of confidence in the US dollar threatens the value of Chinese holdings. It is suspected that US policy is coming into such sharp conflict with the interests of other countries, particularly China, compelling them to put forth calls for the new reserve currency despite the potential consequences to their own holdings.

In response to the financial crisis, the US has announced a series of massive bank bailouts; the most recent detailed by US Treasury Secretary Timothy Geithner. These bailouts of the financial companies will be funded through the issuance of debt, flooding world markets with hundreds of billions in US Treasuries.

The Chinese government is faced with a peculiar situation. In one instance, they are aware that the US policy is potentially inflationary, that the prospect of a massive dollar crisis is very real. It will be beneficial for them to reduce its dependence on US debt. On the other hand, any moves by the Chinese in this direction will result in similar moves by market participants and could spook the market and precipitate the very crisis it fears.

Adopting a super-sovereign reserve currency such as SDRs would reduce the global imbalances of recent years that allowed the United States to run up large twin budget and external deficits while export-oriented emerging economies accumulated dollar-denominated reserves. This global imbalance has been blamed for the cheap borrowing costs in the U.S. that contributed to subprime mortgage bust that triggered the global credit crunch.

The calls for the change in the reserve currency is also being addressed by a United Nations panel of experts who is recommending that the world changes the dollar as its reserve currency in favor of a shared basket and creates a currency similar to the old ECU -- or European currency unit -- as a hard-traded weighted basket.

The current global financial breakdown has threaded into uncharted territories for many nations and governments. The inherent vulnerabilities and systemic risks in the existing international monetary system were reflected in the financial crisis and its spillover to the entire world. China's current proposal is unlikely to attain significant ground because the SDR is not a currency system backed up by a government. The possibility of the new reserve currency in the future does exist but would require global acceptance, political determination and intricate assessment of the system.

Current Happenings in Local and International Markets:

- GHL seeks higher limit in share buyback
- GHL benefits from Clico's troubles
- Sagicor sending home 75 workers; Shipping Association trimming too
- Supreme Ventures bets on US\$ 'super lotto' - To launch game in Jamaica; Starting jackpot US\$2m
- Jamaica remittances fell 18.3 per cent in February
- U.S. Economy Contracts 6.3%, Profits Decline 16.5%
- Obama Seeks JPMorgan, Goldman, Citigroup Support on Bank Plan
- Consumer spending up for second straight month even though income drops due to layoffs
- Japan Heads for Deflation as Retail Sales Tumble 5.8%
- Brazil's Unemployment Rate Rises to a 10-Month High

Table 1: Regional Market Performance (as at 26 March 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	821.90	-0.53	-2.38	-2.50	-16.47
All Trinidad	1,122.02	-0.16	-2.60	-2.83	-9.47
JSE Index	79,312.50	-1.31	-4.28	-1.05	-23.99
JSE Select	1,643.58	-4.86	-11.13	-17.19	-44.71
All Jamaica	61,883.34	-3.06	-8.59	-16.37	-43.14
BSE Composite	864.25	-0.36	-5.14	-6.05	-15.20

Table 2: International Market Performance (as at 26 March 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	832.86	6.23	10.63	-7.79	-37.90
Nasdaq Composite	1,587.00	6.98	14.05	0.63	-31.72
Dow Jones Industrial	7,924.56	7.08	10.34	-9.71	-36.21
German Dax	4,259.37	5.34	8.03	-11.45	-34.36
FTSE 100	3,925.20	2.84	0.24	-11.48	-30.66
Nikkei 225	8,636.33	8.33	15.80	-1.27	-32.03
Hang Seng	14,108.98	7.45	9.41	-1.94	-37.62
DJ Eurostoxx	2,156.97	5.76	6.72	-12.01	-40.27

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