Econsult Investments and Advisory Services (Pvt) Ltd

Market Watch ^ Cross Talk

August 2015-Vol-1

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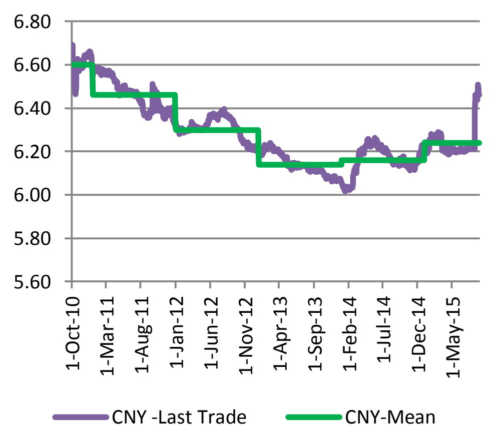
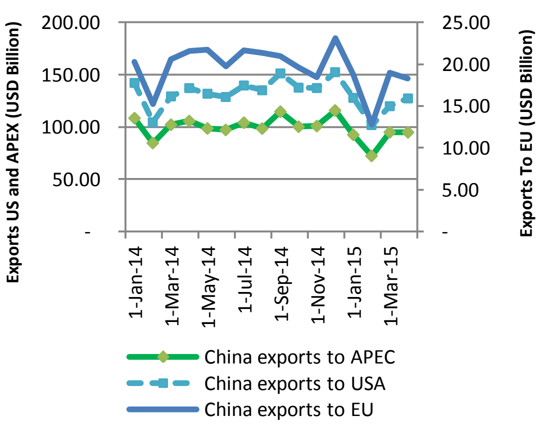
Market Watch

Figutre-1-Chinese Yuan Off Shore Performance 2010-2015



Source: Thomsonreuters

Figure-2-Chinese Exports to APEC,US and EU from 2014-2015



Source: Thomsonreuters

The currency overvaluation during the past two years has impeded exports and increased risks to the Chinese real economy, as GDP estimates indicate a that growth has been revised lower to 6.9% growth for 2015 from 7.3%. The slowdown in Chinese exports triggers a timely response by Monetary Authorities.

<u>China Shock Wave to Global Markets</u>!

- The "*Wealth of Nations*" rest on 'Competitive Advantage' and not 'Comparative Advantage' this adage has been proved once again by the Chinese Yuan depreciation.
- The Yuan depreciation (Figure-1) was prompted by the sharp drop in 1Q 2015 exports (predominantly Industrial and high value added). Raising concerns of China's adherence to USA in maintaining an overvalued Chinese Yuan since 2010 (Figure-1). Data shows that it does not help China's objectives. Comparing 1Q 2015 with 1Q 2014 export values to EU and APEC tells us that exports declined by 10.2% for EU to USD 50.5 billion from USD 58.9 billion. The APEC region too showed similar results with export revenues declining by 12.0% to USD 259.6 billion from USD 296.1 billion . On the other hand exports to the USA improved to USD 89.7 billion from USD 80.6 billion (Figure-2).
- Therefore the devaluation was a timely measure to restore Trade Supremacy and sustain Chinese corporate earnings. Thereby preventing any further cooling off or freezing of the real economy.
- The currency depreciation and monetary stimulus by the worlds second economy, China, also trigged fears of a *domino theory* type effect on the Global economy. Raising renewed concerns that Global GDP could head southward into another *Juglar cycle(i.e. investment cycle).* Econsult expects that another *correction* is still possible and is very much on the horizion.
- Steep declines in stock markets of both the US and Europe raised alarm bells that the fragile US and EU recoveries would now be seriously impacted. The gains achieved by persuasive and other political support packages designed to progress in the competitive exports goods markets would now be reversed, thereby negatively impacting corporate profits. Initial assessment of the depreciation is that *New Age Trade Supremacy* between US and China is very much at play.
- It also set opens now up countries to re-think their trade and exchange rate policies. For China has taught the World that there is "No Free Trade"!.

Cross Talk

IMF and Sri Lanka BOP Assistance ?

- Sri Lanka government had approached the IMF for a *standby credit facility (SCF)* to stabilize its so called Balance of Payment (BOP) crisis. The sharp decline in year on year export earnings, loss of foreign exchange due to defending of the rupee, along with selling off of treasury bills and bonds by foreign inventors brought about this need during the last 9 months.
- During the period of November 2014 to August 2015 Sri Lanka had lost circa USD 2.3 billion in foreign reserves . Or in other words our foreign reserves is sufficient for 3.5 months as opposed to 5.4 months seen in November 2014. The loss of reserves has resulted in further exacerbating downward pressure on the rupee depreciation against the US dollar.
- Ironically what Sri Lanka does not seem to realize is that the standby facility is only made available to low-income countries (LIC) for periods of 12–24 months at ¼ percent interest rate. SCF also has a grace period of 4 years, and a final maturity of 8 years. As the SCF is intended to address exceptional short-term needs and not BOP situations of middle income countries, such as Sri Lanka.
- The very fact that Sri Lanka has approached IMF also raised questions of the countries significant vulnerability to Global melt downs with the possibility of another recession re-emerging.
- In this situation Sri Lanka faces multiple challenges a) to revive its primitive agriculture dominated export base on relatively elastic global prices, which continue to slump, b) manage its import consumption and exposure to the growing needs of high crude oil consumption. For crude consist of 25% of total imports or circa USD 5, 000.0 million, c) protect its depleting external finances, as there are serious concern of country's Debt stock and GDP growth due to the economic data conundrum and lack of institutional confidence created by the handing over of government

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