News release

23 August 2011

Weekly Currency Team comment 23 August 2011

Where do safe havens find a safe haven?

What happens if regardless of the US downgrade by S&P markets upgrade US Treasuries? How to react when a currency is appreciating so quickly it affects export, such as in Singapore and in Norway? What about food inflation in Thailand?

If the current 'confidence crisis' is one of governments and policymakers, who of the current politicians still knows what the concept of Utilitarianism is, in particular during general election periods. The proper course of action is the one that maximizes the overall "good" of the society not one's political ambition. But what is the proper course of action? In our view the proper course of action starts by realizing the global effect (and in some cases the non effect) of any policy decision.

Despite efforts of the Swiss National Bank in the last weeks, the **Swiss** franc strengthened versus the euro and continued to advance against the **US** dollar as concern that the global economy is stalling boosted demand for safer assets. The franc has appreciated 18 percent versus the dollar this year. The rise of the Swiss franc continued after the SNB refrained from pegging the currency to the euro or adopting a target. In our view the Swiss adopting a target rate will be the last resort. In the short term, we believe they will continue to pump the market with liquidity.

The **British** Pound benefitted from its safe haven status rising nearly 2% versus the **US** dollar in less than a week, despite a weaker than expected labour market and increasing concern of the BOE about the recovery. The GBP accounts for just 4.6% of the world reserve currencies (versus 0.1% Swiss Franc) according to the latest quarterly IMF report figures. The USD can still be considered the reserve currency over 60%, but that percentage is steadily decreasing.

The run to safe havens also has collateral damage, as we can see in **Norway**. Like **Switzerland** it has one of the lowest unemployment rates and a sound economy but unlike Switzerland it has a relatively high interest rate with a benchmark interest rate of 2.25%. The attached graph shows the appreciation of the Norwegian Krone versus the price of crude oil. Historically they tend to move together but over recent months the divergence is visible, representing the safe haven status of the Norwegian Krone. Norway's Finance Minister released a statement to 'do what we can' to prevent further appreciation of the Norwegian Krone, which is negatively affecting export and growth potential.

The Phily Fed numbers on the 18th of August were simply shocking and markets spiralled down on Thursday and Friday as risk assets were sold across the board. These numbers indicate the direction of change in overall business activity by looking at employment, working hours, new and unfilled orders, shipment, inventories, delivery times, prices paid and prices received. In simple terms they measure the outlook for businesses. These numbers unexpectedly contracted by the most in two years which by markets was perceived as a confirmation of a significant slow down. As Bloomberg stated: "*The Federal Reserve Bank of Philadelphia's general economic index plunged to minus 30.7 this month, the lowest since March 2009. The August gauge exceeded the most pessimistic projection in a Bloomberg News survey. "*.

US Treasury yields reached historic lows, showing that the US might have gotten a downgrade from S&P but are still perceived a safe haven by investors.

In Asia, the **Japanese** Yen continued to soar as investor concerns continue about a double dip recession. The Yen is a top performer of Asian currencies although one with a bitter taste and new intervention is likely.

All eyes are on Jackson Hole this Friday. Ben Bernanke is in a very difficult position...he probably dreams of a safe haven as well.

Markets will need consolidated action by policymakers and awareness of the global effects of their decisions. The necessary confidence boost requires more than intervention like QE1 and QE2, which is worrying.

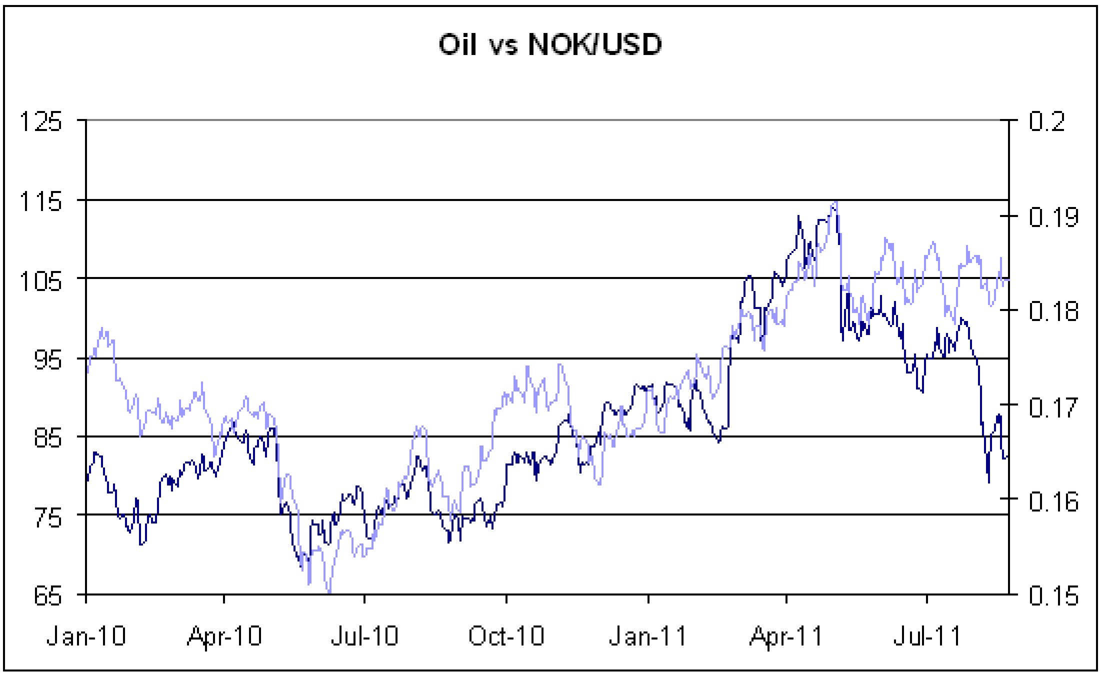
The lines between developed and emerging markets are fading with the growth numbers now also slowing in some emerging markets. Regardless of inflation numbers, markets now see limited room for hikes and even expect some surprise cuts.

The question remains how to deal with high inflation numbers. As food prices still account for a significant weight in an inflation index, the recent slide of some commodities might help, but is certainly not enough. In **Thailand**, rice will play an increasing role in the coming week as the Thai Prime Minister will be releasing her economic policy on the 24th of August. Markets fear she will push through her plan to increase rural income by lifting the rice price. Thailand is the world's biggest exporter of rice and this could effectively push inflation in Asia higher. The Bank of Thailand is also to decide on interest rates that same day. We have come to a level where such a policy decision will have an effect on the rest of the region and might actually have a negative effect on growth and inflation and will cause disruption in monetary policy decisions in the whole Asian region. As an indication, the price of Thai export rice has risen by more than 20% in a year.

Asian currencies performed well in the beginning of the week only to retreat later. However, it has to be said again, that as a block they held up quite well.

The **Singapore** Dollar, considered a safe haven for many (Asian) investors seemed without a direction, initially up in the beginning of the week, only to slip after weak July export data on Wednesday, which shrank 2.8 percent. The Singapore Dollar is the best performing Asian currency since the beginning of this year (with the exception of Japanese Yen obviously) but this now seems to have its effect on export growth. This is a concern in combination with the view that Singapore is seen as the gateway between the Western and the Eastern world and therefore is more vulnerable to the tail risk events in developed markets.

Markets ended the week in a strong risk off mode.



Important Information