Weekly Perspectives

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A Weekly View of Global Economies

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North America
Supply fears are underpinning a high risk premium on oil prices. Problems keep on popping up in Iraq, Russia, Saudi Arabia, and further afield. At the same time, global demand is still pretty strong and speculators find oil an attractive market to play. So a further spike in prices isn't out of the question, but whether it will stick depends on a continuing dose of fear-inducing events.

At current levels, the average price is still not particularly high in real terms, when compared with historical experience. All the same, it will help to slow down the world economy which is already losing momentum. This will, in time, help to readjust the supply/demand discrepancy and lead to lower prices.

High oil prices and paltry US employment numbers have sent analysts scurrying to revise their growth forecasts in a downward direction. But the slowdown shouldn't be a big surprise to those who had noted the downturn in a number of leading indicators, months ago.

It also looks like Greenspan's previous forecast for US GDP growth is now at the more optimistic end of the range of consensus estimates. This should give him even more incentive to go easy on monetary tightening, provided the bond market's inflation fears remain quiescent.

Declining bond yields did not prevent a sharp fall in the stock market, last week. Normally, lower interest rates would make stocks look more attractive relative to bonds, on a risk-adjusted basis. But a weaker economy is also bad for earnings growth and investor expectations may now be undergoing a downward revision.

There is talk among some Wall Street types that the recent fall in stock prices has created bargains. However, this sort of contention is not easy to evaluate unless they clearly spell out their norms. One man's cheap stock may be too expensive for another man, depending on his valuation criteria - - remembering, too, that value investors are more difficult to please, in this respect, than growth investors.

Folks from the Buffett or Graham and Dodd school of thought, who look for stocks that are defined as good value if they fall below certain valuation hurdle rates, may have to search hard to find qualifiers. In the case of growth-stock aficionados, though, the focus of attention is momentum rather than value. They have to sort out whether the lack of momentum is temporary and will eventually pick up or whether they have a busted growth stock on their hands that is past its prime.

For the market as a whole - - picking a representative index, such as the S&P 500 - - falling prices may make the forward PE (the price to forward-earnings ratio) more attractive than it has looked in the recent past. But we should also note that the consensus forward earnings estimate is subject to revision, in line with economic strength or weakness.

Then again, the earnings figure that is normally used to calculate the PE is "operating earnings". And, many people regard it as being biased in an upward direction. In other words, it makes stocks look cheaper than they are if we use other earnings calculations. But it is this measure that is the primary focus of Wall Street attention.

Others may apply core earnings, which makes adjustments for a number of factors such as pension liabilities, restructuring costs and employee options expenses. This figure is normally lower than the one for operating earnings, sometimes by a good margin. Still others use average earnings over a number of past periods to get a smoothed version of the data that is considered to be more representative than a single year's figure. Both of these measures make stocks look more expensive than on an operating-earnings basis.

Europe
Just when people thought that rising UK house prices had been reigned in, we get another data release showing that inflation in this sector is still hot. The Bank of England's MPC (Monetary Policy Committee) introduced another rate hike just last week, and it looks very much like it has more work to do before the housing sector manages to cool down.

Consumer inflation is till below the MPC's 2% target rate. But fairly robust growth is reducing capacity, even as oil prices continue to rise. This puts upward pressure on prices and forces policymakers to be proactive in nipping inflation in the bud. The objective is to slow down activity without damaging the manufacturing sector or forcing highly indebted households to retrench sharply.

Asia/Pacific
Japan's dependence on oil imports has declined quite a bit over the past couple of decades, since the bad old days of oil shocks. Furthermore, current prices in real terms are a good deal lower than highs reached in the past. So, they are unlikely to sink the current expansion. Nevertheless, there has to be some impact on growth and corporate profitability if energy prices don't stabilise or, better still, edge lower.

Japanese authorities are upbeat about economic prospects and the latest data release on machinery orders (a leading indicator of trends in business spending) easily beat expectations. But investors don't appear to be sharing the optimism as the Nikkei 225 continues to lose ground. There are lingering doubts about the sustainability of the pace of growth and profitability.

Bonds
The US employment report has a proud tradition of producing nasty surprises for the Treasury market, and it happened again last Friday. Yields slid sharply as traders factored in a slower growth scenario. Expectations of future rate hikes by the Fed have now been scaled back.

Currencies
A falling Japanese stock market and rising oil prices have weighed on the yen, which is struggling versus the dollar. The greenback, of course, got whacked after the release of the lousy payroll numbers last week, falling sharply against a range of currencies. Traders are looking for some evidence of US economic out-performance if the dollar is to find favour.

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