

Weekly Perspectives

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A Weekly View of Global Economies

16 August 2005

North America

Global activity has been picking up, and is running ahead of the moderate expectations formed earlier in the cycle. The primary reason is that growth in both the United States and China has surprised on the upside. And, of course, this has also underpinned demand-driven and event-susceptible oil prices, which have perked up instead of calmed down.

However while oil does not have the same impact on the economy that it did two decades ago, it is far from being a minor factor. At current levels, it is likely to sap some of the vigour of the higher-growth spurt presently underway.

Europe

UK consumer inflation jumped in July - - above consensus expectations, and also breaching the rate that the Bank of England targets. Higher oil prices were partly to blame for the headline number. Unfortunately, core inflation, also spiked higher. The data has firmly dampened expectations of further interest rate cuts by the Bank. There are also indications that consumer spending may be past its point of greatest weakness, which we witnessed earlier in the year. Meanwhile, house prices are falling at a slower pace, allaying fears of sharper declines.

Asia/Pacific

Oil remains a strategic resource in the longer run. At any rate, until serious alternatives are found to replace fossil fuels. Not surprisingly, energy security is a factor in the geopolitical positioning of the great powers, and the US presence in Iraq and central Asia is partly due to America's concern about losing influence in the region.

Their main rival is of course China, which has surprised the Americans with the speed of its economic advance and its growing political clout. The Chinese are making headway in economic and political terms all over Asia, including the Middle East. And, as far as the oil-producing countries are concerned China, unlike the US, does not have to overcome a long history of policy mistakes.

There are other strategic moves underway on the chessboard. The US is moving closer to India and has recently agreed to increase its cooperation on nuclear technology with that country. Clearly, they are trying to help India develop, and serve as a counterweight to China's potential hegemony in Asia.

Russia is another Asian power, but primarily in military terms. Its economy is smaller than the other two, and embarrassingly so. Like the oil-exporting countries, it is largely a raw material producer.

As for Japan, it is being overshadowed by China's growing political influence. Japanese foreign policy has followed the American line for decades, resulting in a lack of credibility as an independent voice. And the Chinese leadership is keen to keep Japan marginalised as a political force. In line with this goal, they vehemently opposed Japan's proposed membership of the United Nations Security Council.

Meanwhile, Europe isn't a big player in the Asian arena. The European Union is far from being a cohesive political entity. It is still true, as Henry Kissinger said many years ago, that when he picks up the phone he doesn't know who to call in Europe. Some European countries have

aligned themselves with the United States, while others aren't averse to witnessing China's rising power, as a force to counterbalance America's global hegemony.

Asia plays a big part in the process of globalisation, and accounts for a significant portion of world trade growth. It has a major role in the rationalisation of global production and the trend towards outsourcing.

Manufacturing capacity and industrial production is growing rapidly, providing competitive challenges to developed-country firms, and dampening wage and employment growth in the tradable goods sectors in Europe and North America. This also introduces a deflationary bias in the global economy.

The advances being made are primarily in the production of goods, though there are notable exceptions such as the success of software firms in India. In the more advanced Asian countries there is also rapid progress towards producing ever more technologically complex goods. Let's just note that China has a sophisticated and ambitious space programme.

In addition, many countries have large balance of payments surpluses and sizable foreign exchange reserves. This gives them the potential to have a major impact on global interest rates and currency movements.

Given all the above factors, it is likely that Asia, from Russia to Japan - - and everything in between - - will be at centre stage in global economic and political developments in the future. That's the way the US administration sees it too, both in its actions and in shifting NATO's focus eastward. The hackneyed phrase "the Asian century" has a ring of truth.

Bonds

Headline consumer inflation in the US was higher in July. But this number was boosted by oil prices and wasn't too far out of line with consensus expectations. Also, core inflation is still well contained. At the same time, there are a few doubts about how long the current global growth spurt will continue. Accordingly, the benchmark ten-year Treasury note yield moved lower, continuing a correction from recent highs. But the CPI data may not convince the Fed that inflationary pressures have dissipated. They are likely to maintain their tightening stance until domestic demand softens.

Currencies

The greenback has been losing ground against the euro this month, on renewed concern about the twin-deficit problem in the US, namely the budget shortfall and the current account gap. More recently, traders have focussed on the better cyclical picture in the States, breaking the dollar's weakening trend.

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