

Weekly Perspectives

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A Weekly View of Global Economies

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As we said previously, nominal wage increases in the United States are failing to keep up with inflation. There is underlying pressure for a rise in wages, but workers' bargaining power is too limited for them to make major gains. As a result, firms have managed to contain the increase in unit labour costs. Otherwise, we would have seen higher inflation and a bigger corporate margin squeeze than we have witnessed.

Globalisation and outsourcing have played a significant role in dissipating inflationary pressures. But this hasn't stopped inflation from edging up. Meanwhile, faced with a very competitive job market, worker frustration is being increasingly channelled towards supporting protectionism.

Politicians are under pressure to address some of their concerns. This is a trend that has to be closely monitored because if policymakers take steps towards implementing protectionist measures, it could have an impact on inflation and corporate profits; raising the former and lowering the latter.

An obvious target for the public and congressmen alike is, of course, China. However, once the protectionist bandwagon gets going it is likely to have a wider impact on trading relationships. In the current context, the Bush administration may not want to start a trade war with China, but it is feeling the political heat and will press for concessions from the Chinese authorities to calm sentiment in the US.

China's leaders are well aware of the political pressure, and are also better versed in how markets and economies work than their Western counterparts. So they have prepared a shopping list to try and reduce the large trade surplus with the United States. In addition, they have made some concessions by lifting several barriers to imports from the US. But the size of the gap is so large that their efforts are unlikely to make much of a dent.

Some of the goodies they have an eye on, in the tech and defence area, have been declared off limits by the Americans for "security reasons". So, to get a substantial adjustment in the trade balance would require a significant acceleration in Chinese consumer expenditure or a deceleration in American household spending. But that isn't likely to happen in the short run. The long-term plan in China is to promote domestic consumption relative to exports, which is going to be a slow process.

Another adjustment mechanism would be via a major revaluation of the renminbi. But China would prefer a gradual approach in revaluing its currency. A rapid revaluation would act as a shock to the economy. Also, they don't want to make a big move until they are sure that the financial system is in a position to handle it. In the long run, of course, the renminbi will have to become a fully-convertible floating currency, used in the foreign exchange reserves of other countries.

In the economic sphere there is obviously mutual dependence between the two major powers. Over-consumption in the United States is counterbalanced by over-production in China - - and elsewhere in Asia - - and the cycle is financed by Asians taking on US debt. Introducing punitive measures against Chinese imports will hurt their economy and have repercussions on the US too. But the politicians are becoming increasingly impatient.

China's economy is still expanding at a rapid rate, with the 10.2 percent growth registered in the first quarter beating consensus estimates. The fast pace of advance makes it easier to absorb new entrants into the labour

force and to reallocate workers among different activities, from declining to expanding sectors. But it also creates a divide between winners and losers. In this context, more often than not, poverty is relative rather than absolute. In other words, some groups may be better off than they were ten years ago but have been left far behind by the big winners.

This causes stresses, tensions and conflicts in society, opening up the potential for political instability. Chinese leaders are aware of these problems. Their speeches indicate the desire to address issues of "unbalanced" growth, including environmental concerns. The aim is to avert violent action from the disaffected, something that is already occurring sporadically all over China.

In the economic sphere, there is mutual dependence between the US and China, but in the political sphere there is rivalry. The Americans have identified China as the major threat to the primacy of their power in Asia. One of the primary goals of their activities in central Asia, the Middle East, India and elsewhere is to check the growth of China's power and influence.

The ongoing strategic game is fraught with uncertainty and may turn out to be expensive, financially. Iraq and Afghanistan look more like states teetering on the edge of chaos than budding democracies. As for the countries of the Caucasus and central Asia - - where Americans have established a presence - - they are mostly fragile states that were formed after the collapse of the Soviet Union. Their long-term viability is not assured.

Many political analysts regard American policies in the Middle East as being very damaging to US strategic interests. In the Far East, the alliance with South Korea is being questioned by the Koreans as to its value. Only Japan remains firmly in the American camp, possibly because of the ongoing campaign by China to marginalise Japan politically. The US relationship with India is relatively new and it is not clear what benefits it will bring. It hasn't stopped India from signing energy deals with Iran, despite strong US opposition. As for Russia, it is becoming increasingly assertive, as Putin consolidates power.

According to the Bush administration, selling the American ideology is proving to be difficult. This appears to be corroborated by polls, which indicate that there aren't too many buyers out there. If so, this is bad news because getting people to join your side through influence and persuasion is a lot cheaper and more effective than pointing guns at them. The trend may worry investors who would be concerned about the rising cost of military engagements. In particular, these factors are likely to weigh on the fortunes of the dollar.

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