Weekly Perspectives

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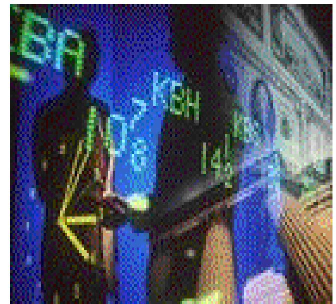

A Weekly View of Global Economies

31 August 2004

North America
The Republicans are convening in New York, and those of the Wall Street crowd, who aren't already on vacation, have jumped at the chance to vamoose out of the Big Apple. As a result, trading volumes have plunged on the New York Stock Exchange. It's not that they have taken a sudden dislike to President Bush, who would surely get a bigger score on the Street than the 50% approval rating he is getting at the national level. But who wants to face the hassles caused by a big convention and the security clampdown that goes with it.

Free-market policies are popular among business types. And that's what the Republican Party is supposed to stand for. But in recent years the Party has also attracted many groups with a very conservative social agenda on things like abortion, religious issues and so on, that doesn't go down too well with sections of the broader electorate.

Bush needs to satisfy his conservative base without frightening off others, who have a more liberal outlook on social choice. At the same time, the economy isn't really a strong selling point. The earlier pickup in employment growth appears to be waning and, taking the presidential term as a whole, the record on job creation is hardly impressive. So Bush's trump card will be security - - which is clearly why the Republican organisers chose the city that was the main target in the 9/11 terrorist attacks for their convention.

The security issue has been drilled into American consciousness in the past few years and it doesn't take much to fan subliminal worries. President Bush's strategists will play this theme with zeal, in order to put Kerry on the defensive. Sure, the Iraqi situation can be a discomforting subject matter, but the rules of political discourse will prevent the challenger from being too hard on the president. Kerry can't really go for the jugular, without damaging his own credibility as an opponent of terrorism. The boundaries of what can be discussed and criticised have already been set - - and that favours Bush.

The situation in Iraq is unlikely to improve in the next few months. There are a good many well-armed and ill-intentioned factions loose in the country: disgruntled Sunnis, former Baathists, Al-Qaeda operatives, radical Shia militia, and common criminal gangs. Even to optimists, it must be obvious that they are more interested in grabbing power and creating chaos than in participating in democratic polls and sharing power. Progress will be slow.

But this isn't going to sabotage Bush's electoral chances, as long as the violence continues at a "normal" level rather than being ratcheted up. And, as far as we know, the insurgents in Iraq have expressed no particular preference for one or other of the presidential candidates. Bush's standing outside the United States - - if we are to believe the polls - - is probably lower than that of any president, in a very long while. But these malcontents don't have a say in who gets elected in the US, and American voters aren't particularly mindful of foreign opinion.

Democratic Party strategists think that the current situation is reminiscent of the Carter-Reagan campaign, when support for Carter melted away as the election approached. But that contest was influenced by particular factors that are absent in the current situation.
So, unless an untoward event takes place between now and the November elections, the balance of forces seems to favour Bush retaining the initiative and remaining in the White House for another four-year term.

In the past, academics have conducted studies indicating that the stock market generally does better under Democratic presidents than under Republican ones. And, the data-set extends over a very long period. Unfortunately, one can't really apply the results to the future, with any measure of confidence. The economic and market conditions, geopolitical factors and risks - - not to speak of political agendas and party coalitions - - are sufficiently different now, compared with the past, that we can rule out any simple generalisation based on previous experience.

Europe
Given the downside risks to the growth outlook in the Eurozone, it looks like the European Central Bank is still on hold, regarding interest rate hikes. Meanwhile, consistent with forward economic slowdown, corporate earnings momentum is probably past its peak. In such a context, value stocks are expected to outperform growth. At the same time, some defensive sectors have probably been overbought and are no longer cheap.

Asia/Pacific
In China, investment spending has moderated as a result of earlier administrative tightening measures that were implemented by the authorities. Meanwhile, consumption and exports are strong enough to prevent a rapid deceleration of the economy. At the same time, inflation may have already peaked. So, it looks like policymakers may achieve a soft, if bumpy landing, as earlier fears of a nastier outcome have receded.

Bonds
The core PCE (personal consumption expenditure) deflator came in at 1.5%, the same value it has had for the past 5 months. This was interpreted as bond friendly by fixed-income investors who pushed Treasury yields lower. Meanwhile, the outlook for job growth remains a key issue - - for the market, as well as for the Fed. Going forward, employment creation is likely to clock in at less than 200, 000 a month, on average, which will put a constraint on consumer purchasing power. However, given the volatility that this series is subject to, we cannot rule out a monthly jump in the reported figures.

Currencies
US economic data were lacklustre last week. The revised second-quarter GDP numbers were uninspiring and July durable goods orders - - less the volatile transportation component - - came in weaker than expected. So there was little reason for traders to push the euro through the 1.20 level. It has bounced off that floor and it will take strong ISM and payroll numbers in the US, this week, to cause a reversal of the euro's rebound and a continuation of the dollar rally below 1.20.

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