Philequity Corner (September 8, 2008)
By Valentino Sy

Stocks fall on global slowdown fears

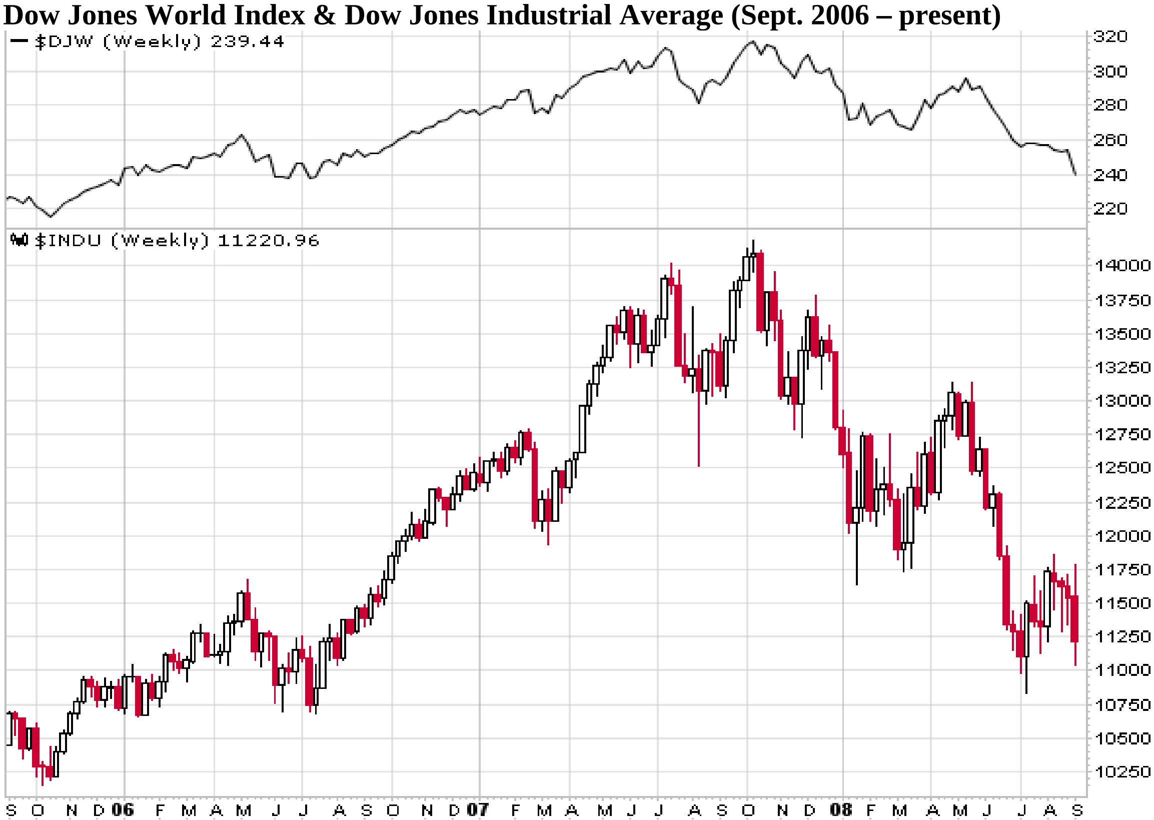
Global equities reentered precarious territory last week led by the US market which threatened to test its lows established last July. Concerns over a US-led global economic slowdown have supplanted inflation angst as the primary driver of the decline.

These worries were reinforced after data on Wednesday showed the first ever quarterly contraction in the Eurozone from April to June. That weakness is coming off the release of 2Q2008 GDP numbers from Japan which fell -0.6% quarter-on-quarter and -2.4 percent year-on-year.

Despite the strong 3.3 percent growth in the US in 2Q2008 (thanks to the tax rebates), recession fears were reignited when unemployment data showed a larger-than-expected 6.1 percent figure in August as employers shed jobs for the eight consecutive month and revised numbers for earlier months.

As a result, Dow Jones Industrial Average (bottom pane) closed at 11,220.96 on Friday, down 2.8 percent week-on-week and merely 3.6 percent away from a two-year low of 10,827.71 set in July. Meanwhile, the rest of the world fared worst with the Dow Jones World Index (top pane) already breaking down from its July low.

Dow Jones World Index & Dow Jones Industrial Average (Sept. 2006 – present)



Source: Stockcharts.com

Still no US recovery in sight

Latest figures from the Conference Board's US leading economic indicator showed a decline in July, providing a fresh reminder that the slowdown is far from over. Massive policy easing and fiscal stimulus have not been sufficient to offset the drags on the housing slump and the squeeze on consumption.

The S&P/Case-Shiller Index confirms that US house prices continue to fall sharply. In June, the index experienced its greatest ever year-on-year drop at -15.9 percent. Mortgage rates remain elevated (despite the decline in Fed policy rates) and inventories of existing homes are stuck at record highs. Moreover, the rising unemployment rate means that the uptrend in foreclosure rates will spread beyond the sub-prime market.

What's worse is that the positive effects of the tax rebates - which were supposed to stimulate consumption until August - are fading earlier than expected. While retail sales, real personal spending and consumption recovered in April and May, they fell again in June and July. This suggests that consumers restrained consumption in spite of the tax rebates. Thus, real consumption will likely fall in 3Q2008 and may continue to fall for a while into the middle of 2009.

The only silver lining in this dark cloud is the bailout of Fannie Mae and Freddie Mac which was leaked out last Friday. This could provide the much needed capital to finance housing transactions. Despite this, however, there will be no quick fix to the US housing market, and it appears that the slump has at least another year to run.

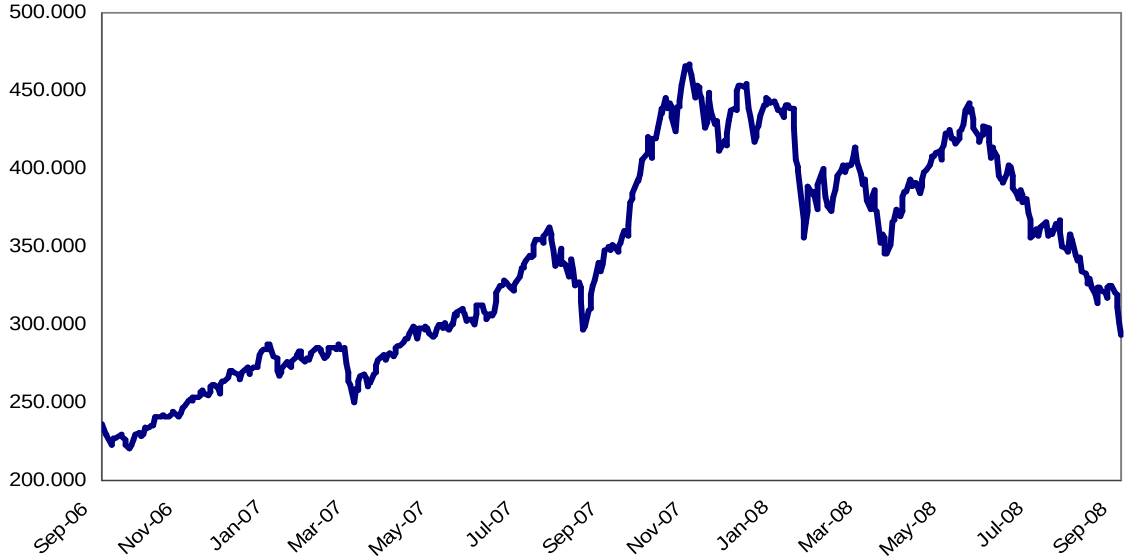
The rest of the world follows

The global economy is in a difficult spot, caught between sharply slowing demand in many advanced economies and rising inflation everywhere, notably in emerging and developed economies. Global growth is expected to decelerate significantly in the 2nd half of 2008, before recovering gradually in 2009, according to IMF's World Economic Outlook Update last July.

Economic activity in the emerging and developing economies is also expected to lose steam. Investors are now realizing that growth in the economies of China, India, Brazil and Russia will not be enough to offset what looks like a world economic contraction. India expanded 7.9 percent, its slowest pace since 2004. Meanwhile, China grew 10.1 percent in 2Q2008 after a recent high of 12.7 percent in 2Q2007. Chinese authorities are now trying to avoid what Morgan Stanley economist Stephen Jen calls the "Olympic curse." According to a study by Mr. Jen, 10 of 11 summer Olympic host nations suffered growth and investment slump in the year following the games. Tax cuts and a public-works spending spree are said to be in the pipeline.

Nevertheless, one cannot argue the substantial slowdown that is being anticipated by the markets. In fact, the MSCI BRIC (Brazil, Russia, India, China) Index is down 36.8 percent from its high registered in October last year. Since equities markets function as an efficient forward discounting mechanism, it is very likely that growth in these emerging economies will decelerate sharply in the quarters to come.

MSCI BRIC (Brazil, Russia, India, China) Index



Source: MSCI

Philippines in a bottoming-out process

Meanwhile, the Philippine market performed creditably well over the last two months compared to the US and more so against commodity- & oil-driven markets like Australia, Canada, Russia and Brazil. In fact, we have noted this divergence and pointed out a possible bottom in Philippine equities in "*Drop in Commodities Saves the Philippines* (see August 11, 2008 issue of **The Philippine Star**). Rightly so, since the slowdown here in the Philippines (2Q2008 GDP growth of 4.6 percent) is not as pronounced as that in the developed economies and most other emerging markets. OFW remittances continue to come in, shielding the Philippines from the global economic slowdown.

Inflation is actually the bigger problem for the Philippines because we are an oil importer. Thus, the drop in oil and other commodities is actually helping the Philippines withstand the global slump.

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