



Investment Alerts Archive

The Debt Deal

On 2nd August 2011, the bitterly fought US debt agreement was finally signed into law, ending the eminent threat of a US default. U.S. senate has approved to raise the debt ceiling up by US\$ 2.1 trillion in stages and cut spending by US\$ 2.4 trillion. While the world heaved a collective sigh of relief and provided the dollar with some rebound, the politics will continue with a new legislative committee tasked with finding ways to enact the bulk of the US\$2.4 trillion in cuts. Should they fail to slash US\$1.5 trillion by November, painful spending cuts will be automatically triggered on the Democrats' social programme and the Republicans' treasured defense expenses.

Fate of the U.S. Dollar

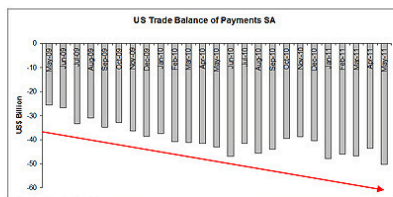
Despite reaching a consensus on the debt ceiling that saved the US from the brink of default, the country's AAA rating was not spared. On 5th August 2011, Standard & Poor's (S&P) downgraded US' credit rating by one notch to AA+. This was the first time US was downgraded since receiving AAA rating from Moody's and S&P in 1917 and 1941 respectively. While Moody's and Fitch have maintained US' AAA rating, they will continue to study the deficit plan to decide if US deserves to keep the coveted rating.

Already struggling from low interest rates and slow economic growth, the loss of AAA status could lead to further downside bias for the greenback over the medium term. Fundamental weakness and negative outlook will weigh on the dollar's status as a safe haven currency.

Sustainability of US Economic Recovery & the US Trade Deficit

The sustainability of US' economic recovery has been a major market concern. The latest US manufacturing ISM data slipped to the lowest level since mid 2009 while housing and employment sectors struggled to regain momentum, with unemployment hovering above 9%. The US economy also grew at a lower-than-forecasted rate in the 2Q at a tepid annualised quarterly growth of 1.3% after stalling at the start of the year. The recent spending cuts negotiated by the congress may further hit the faltering economy, pressuring the Fed to hold interest rates at near zero. All these fundamental factors point to a weaker USD.

Moreover, the US has been running a trade deficit that has widened further to US\$50.2 billion in May 2011. This represents added incentive for the US to keep the USD weak to support export growth, which in turn will reduce the trade deficit that can be detrimental to the US economy.



Source: Bloomberg

Possibility of QE3

With the debt ceiling saga resolved and an array of weak economic data piling up, the Fed is under close scrutiny for any indication of a possibility of a 3rd round of quantitative easing (QE3). QE2 has ended in June with little success and the Fed has since teased the idea of QE3 but subsequently maintained that they are 'not ready to take any new action'.

Nonetheless, the possibility of an economic slowdown is undeniable and the Fed may pursue yet another wave of policy easing should the present situation show no improvement. By flooding the market with liquidity, the value of USD will inevitably weaken. As shown in the graph below, the DXY embarked on a downturn throughout the period of QE2 from November 2010 to June 2011.



For the Investor

While the USD may see some support on the back of the debt ceiling extension, coupled with its status as a safe haven, our core view of a weaker USD still stays. With no positive catalysts on the horizon and given the reasons stated above, clients may wish to take advantage of any potential USD rally as opportunities to reduce their exposures accordingly. Diversification is still a key in all investment strategies and clients can consider Dual Currency Returns as a tool to pair with other currencies they are comfortable with or have potential needs for. Some currencies that can be considered are the higher yielding commodity currencies like AUD and NZD. Clients can at the same time earn substantially higher interest rates than traditional time deposits and have the opportunity to choose their own alternate currency, tenure and strike level.

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