

South Korea : Aggressive rate cut ahead!



South Korea's central bank surprised the market last week by cutting the base interest rate for the first time since 2009. The central bank lowered the seven-day repurchase rate by 25 basis points to 3%. Only two of 16 economists surveyed by Bloomberg News predicted the BOK rate cut. The move was widely interpreted as a response to signs that South Korea's economic growth was slowing significantly. South Korea's government bonds jumped, driving yields to record lows, and the won weakened afterwards. Amid the current economic situation, this cut is unlikely to be the last and a second is likely to come sooner rather than later. The country's economy grew by 2.8% in the first quarter, the weakest level in two and a half years. Exports have been shrinking for much of this year, prompting economists to slash their growth forecasts. Exports rose 1.3% in June, but sales to Europe fell by a fifth, with exports to the US and

Japan also down. Foreign sales had fallen in four of the previous five months, with exports to China, the biggest trade partner, coming under pressure. In addition, manufacturing sentiment had turned negative according to a survey of purchasing managers last week, and employment figures for June were the weakest for nine months. According to the statement released by the central bank, the monetary policy committee anticipated that the domestic economy would sustain a negative output gap for a considerable time going forward, due mostly to the increase in euro area risks and the sluggish economies of its major trading partners. Furthermore, it is expected that South Korea's relatively small population limits its domestic demand potential. The business community cautiously welcomed the move but some companies

said the impact of monetary policy was outweighed by international developments, with the largest companies carrying out most of their sales and manufacturing in other countries. Weaker demand may cap overseas sales at South Korea's largest companies, with Samsung Electronics Co. posting second-quarter sales that trailed estimates. Obviously, the central bank moved far faster than expected, reflecting a worsening global economic outlook. In response to the recent moves by major central banks around the world, policy makers opted for monetary easing rather than a supplementary budget as they believe a fiscal response is much more costly. Furthermore, consumer prices increased 2.2% in June from a year earlier, the slowest pace in 32 months. This paved the way for a further rate cut this year. **B**

Microscope

International Properties - "RICHARD"
The second factor affecting property market is interest rate. In many countries, people get used to use mortgage to finance their property purchase, maximizing the buying power. For example, homebuyers in HK need 30% downpayment in general. It requires 25% in UK while only 10% in Malaysia. As such, the gearing ratio can achieve 3 -10 times. Although the multiplier effect is similar to, say, future contracts, property gearing may be different in terms of mechanism and holding capacity. For example, when an investor makes investment with margin arrangement does not have enough cash to maintain his account, he will receive a margin call. If failing to deposit funding, the trading will be terminated. For property, however, homebuyers can still hold the property even there is a negative equity should he repay installment on time. Certainly, people should consider whether is rental yield greater than the borrowing cost. In HK, as the borrowing costs range from 1% to 2.5%, which are slightly lower than that of rental yield as mentioned. The property market is HK has still resilience because of the rental yield-cost gap. **B**

MARKET BRIEFING

YTD % (local curr)

US DJ	12,777 (4.6%)
Nasdaq	2,908 (11.6%)
Euro Stoxx 50	2,259 (-2.5%)
HSI	19,092 (3.6%)
Japan NK225	8,724 (3.2%)
China Shanghai Composite	2,185 (-0.6%)
Singapore	2,995 (13.2%)
India BSE30	17,213 (11.4%)
Brazil BOVESPA	54,330 (-4.3%)
Aus All Ord	4,118 (0.2%)
US 10yr Bond Yield	1.49%

As at 13/07/12

Insight: "High Yield Currencies"

There are few popular high yield currencies in the market, including Australia dollar, New Zealand dollar and pound sterling. With its high interest rate, the Australian dollar is viewed as an attractive high-yield currency. Hence, it has been favoured by Japanese investors who borrow cheaply in yen and earn high interest rates in Australian dollar deposits. This practice, known as "carry-trade", has not been fully abandoned by investors, although returns from such a strategy peaked a year ago. Four years ago, Australian dollars and other high yield currencies slumped against the US dollar because of the concern over

financial woes in credit market. In turn, investors' appetite for risk decreased. Now, investors may accumulate Australia's dollar again as the US government plan to stabilize financial markets, restoring demand for higher-yielding assets. The US is considering another round of QE to buy devalued mortgage-related securities from investment firms to keep the financial system from coming to a standstill. Stocks rallied globally recently, reviving appetite for buying Australian assets through carry trades funded with loans in Japan. Australian interest rates are about 4x of the US, compared with 0.5% in Japan, making the South Pacific nations' assets favorites with investors seeking higher returns for investments funded with Japanese loans. The risk in such trades is that currency market swings can erase profits. **B**

A-Z Financial Tools

Fisher Effect is a theory describing the long-run relationship between inflation and interest rates. The theory can explain the trend of interest rate movement, according a one equation. The equation tells us that, all things being equal, a rise in a country's expected inflation rate will eventually cause an equal rise in the interest rate (and vice versa). **B**



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