

Global Outlook, October 2008

The collapse of Lehman Brothers and AIG, the sell-off of Merrill Lynch to Bank of America and Washington Mutual to JPMorgan Chase, the public bail-out of mortgage giants Freddie Mac and Fannie Mae, are seen as indicators of more insidious problems with the US financial market. The US\$700 Billion bail-out package passed last week may help stem the losses to Wall Street Investors but will further undermine the external value of US debt driving the dollar lower and increasing commodity prices. The cure may only be a band-aid that helps the US limp along if inflation and unemployment also escalate. Consumer spending, already slowing, has dropped off sharply further acerbating the fears of a recession. The Bush Administration has consistently chanted a mantra of free trade and laissez-faire market policy yet removed most regulatory and supervisory safeguards from the market. The bail-out package is in effect the nationalizing of Wall Street's bad debt with none of the potential benefits. Wall Street's being offered a "do over" while China, Japan, among others are expected to finance this "corporate socialism".

The proposed Federal Budget for 2009 contains a US\$482 Billion deficit while freezing or cutting domestic spending programs. Nor does this budget account for the appropriations for Iraq or Afghanistan. If this bail-out is passed, the US will be expected to borrow over US\$1.3 Trillion just to meet it stated goals. The slowing economy and the latest round of corporate subsidies and tax credits mean there will be decline in revenue in 2009. Investigations into the collapse of the investment banking, mortgage, and insurance markets will further siphon off resources while looking into fraud and seeking blame but in the end will do little to recover lost assets or defray the costs of the initial bail-out package or its uncertain ramifications. The US may indeed need to borrow significantly more than the US\$1.3 Trillion. International trade and commodities may come under real pressure to shift to another hard currency. The US is exporting its inflation to countries in the Middle East, Africa, and other large trading partners. As long as foreign capital pours into the US, there will be a floor to the dollar but this may be prolonging the inevitable crash and be spreading the pain to other nations as well.

The Japanese economic collapse of the early 90s should be a lesson to leaders in Washington. Japanese government intervention prolonged the pain actually causing a deflationary spiral that Japan has yet to fully recover from. Increasing the already mind-boggling amount of US debt will only undermine the currency further as well as erode what is left of the US's economic authority. Due to trends since the mid-1990s, the US has increased its exposure to imported goods. Food products account for over 15% and will continue to become more expensive as the dollar declines in value until new domestic sources come online assuming financing is available to increase domestic production. Consumers will be the hardest hit by a declining dollar as they watch goods in discount stores such as Wal-Mart and Target which depend heavily on imported

products, go up in price. In an economic downturn, consumers shift from normal goods to inferior goods, but what happens when the inferior goods become too expensive? Discretionary spending is cut and savings should increase however the US has for many years shown a negative savings rate. Discretionary spending may not be enough to meet the need for investment funds further worsening the credit crisis.

Many countries are now rethinking their currency pegs in light of US policies. The issue is that their primary relationship is with the US economy and therefore revaluing their currencies will reduce their competitiveness with the US. The main trade off at present is the increase in the cost of non-US dollar denominated goods and domestic inflation. There is a balance to be sought, and foreign investors must be careful to adequately weigh the risks and profits of a business venture with the exposure posed by inflation and possible further devaluation of the US dollar. Banks, Financial Institutions and investors are conservative by nature and capital has dried up because of it.

and for Euroasian?

Euroasian is looking to make smart investments and we carefully craft our facilities to minimize risk and to seize the opportunities of the changing global market place. Neither Euroasian nor its funding sources invested in the instruments and/or the syndicated sale of those instruments, which are at the core of the current financial meltdown in the US. Even Euroasian has seen a slow-down in demand for our products as a direct result of the lack of confidence that has hit the financial markets.

We continue nevertheless, to lend throughout this crisis.