ALISON ADAMS RESEARCH

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Week 35: September 2, 2010

Currency, the G20, and the PBoC diversification: *France has the presidency of the G20 this fall. And currency manipulation will be on the agenda. We are already beginning to see the possible ramifications of China's RmB liberalization and diversification away from the dollar. It's worth thinking about the possibilities of a new sort of Bretton Woods coordination in the G20 down the line.*

The economist Barry Eichengreen has made it clear that countries are most likely to invoke trade barriers in response to mismatched currencies. Trade flows and trade wars follow currency competitiveness. The rise in the yen will only accelerate the exodus of fixed-asset investment in Japan as it moves to Thailand and India and Vietnam. South Korea could also find its export model threatened. Or South Korea will be forced to buy more dollars to actively manage its currency competitiveness. China might let the RmB appreciate against the dollar, but against its regional competitors the RMB and cheap labor continue to demonstrate competitive advantages. The PBoC's diversification away from the dollar and into its trade partner's currencies could be part of the reason why Japan and Korea are seeing the currencies appreciate. To give an idea of the distortion, though trade between Japan and China was $136bn in the 1H2010 and Japan has invested at least $70bn in China over the years, China's FDI in Japan totals $670 million.

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Even Malaysia is worried about the impact of newer, cheaper Asian tigers as annual FDI has collapsed to only 3.8% of the region's total for 2010.

President Sarkozy wants the G20 to fix the currency troubles facing global trade. Although the hyperactive president is too often dismissed, France has been able to achieve a great deal through the G20 and the EU. Its wish list of reforms from Detroit has been largely addressed. It's possible that Sarkozy owes much of France's success to his able Minister of Finance Christine Lagarde. The IMF's Lipsky is on the warpath about global imbalances and excessive reserves in exporting countries. Self-insurance through massive reserves is the offspring of competitive currency and export-led growth policies. The IMF will focus on developing preemptive liquidity facilities for qualifying countries to reduce the need for self-insurance. Certainly the IMF plans to make greater use of the SDRs (special drawing rights) and has proposed more frequent allocations. The SDRs are based on a basket of currencies—which could include the RmB in the next rebalancing. The IMF hopes that central banks looking to diversify their currency reserves will start to use the SDRs because they represent a liquid and internationally guaranteed security.

The attractiveness of a cheap currency can be readily appreciated. Germany's dithering about the PIIGs tanked the euro and German business cleaned up. Thanks to Merkel's foot dragging, Germany could qualify as the world's newest "Eu/Asian Tiger." But European farmers,

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winemakers, and manufacturers are all enjoying the same windfall. Meanwhile the U.S. is importing more and exporting less.

None of this is new, but the stakes are high. China's moves to liberalize its currency will be shifting trade and currency flows considerably. With the likes of HSBC offering RmB trade settlement facilities, and foreign purchases of Chinese corporate and government bonds, the shift from the dollar will put even more pressure on Asian and Latin American currencies. With banks trading an estimated $4tr a day in currency, we should not dismiss Sarkozy's agenda out-of-hand. If not adequately addressed, currency wars could seriously impact international relations.

Venezuela: Just what is PDVSA going to do with all that money? *PDVSA is issuing dollar debt and selling its share of German refining to Rosneft, but the funds raised will hardly cover its arrears.*

It's not the love of the people that keeps Chavez afloat, it's PDVSA. The central bank bought $1.4bn of the reopened 2014 bonds. PDVSA issued another $3bn 2022 bonds. And the company is now in negotiations to sell its share of refining operations in Germany to Rosneft for $1–2bn. The Russian oil company is currently in discussions to buy 50% in the joint venture between BP and PDVSA in Germany, Ruhr Oel.

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PDVSA has been propping up Chavez’s Bolivarian state for some time. The company is raising dollars to pay off creditors and help satisfy domestic demand (huge, desperate domestic demand for dollars). Late last week, Venezuela agreed to pay part of its considerable $800m debt to Colombian exporters for its imports. After great difficulties, the Bolivarian Revolutionary government agreed to pay the weary Colombian businessmen $200m of the $800m owing. A good part of the debt is for foodstuffs imported by the Venezuelan government because domestic production is collapsing.

Another debt to be paid? PDVSA owes its service operators between $3–4bn dollars. Will they get paid all their outstanding debts? It’s possible that they will have to wait like the Colombians, though they should get more than 25%. Chavez always has more plans for PDVSA cash.

Nigeria: *Politics are heating up ahead of the controversial 2011 presidential elections. Can all the reform proposals for the energy sector hold up? Negotiations between political bosses are intensifying and promised energy and petroleum reforms could be derailed in the political horse-trading ahead.*

All in all, Nigeria looks to be on the right track. The World Bank has just given the financial system a clean bill of health. The country’s banks appear to be sound. But that is because they do very little lending into the actual economy and most of their business seems to revolve around

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margin loans to the capital markets. The power sector reform and privatization seems promising as well. Even the political signals around the much-anticipated Petroleum Reform Bill seem friendly enough. But in politics the negotiations among the power economic elites and their attendant cadres has begun in earnest.

In politics, asking for the impossible will sometimes merit crumbs from the table. The ruling party in Nigeria is in active pre-nomination party negotiations regarding the nomination for reelection of President Goodluck Jonathan. In the North, former President Babangida is pushing for the zone agreement of the PDP to be honored. According to the zone agreement, party presidents will alternate between the South and the North. In the North, there are plenty of political hard feelings about the current presidency being in the hands of President Jonathan— a southerner. It's the North's turn. Political elites think that the reelection of Jonathan and their cooperation should be negotiated. Moreover, if the northern political elites are to give way, they are definitely indicating that they should receive substantial political compensation.

So far, this is normal discourse for Nigerian politics. But there are other troubles afoot. Former President Obasanjo is actively endorsing President Jonathan for reelection. His notable presence in the recent political gathering of the PDP's Southwest Zone made clear that he has given himself the role of kingmaker. It seems that the powerful southern governors will endorse Jonathan. But Obasanjo's prominent involvement is likely to provoke internal party tensions.

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Apparently President Jonathan is actively engaging with former presidents and political bosses ahead of the 2011 elections himself. He met with former President and General Buhari and other prominent representatives from the northern elites including former VP Abubakar. President Jonathan has not formerly declared, but it looks like he is active in the power brokering that is happening behind the scenes.

Unions and rebels could look for opportunities to cash in on the political deal-making. Everyone will imagine a grievance that demands political compensation in the breakdown of the PDP zoning agreement. The unions in the state power-holding company are threatening strikes for fear of job losses. In Port Harcourt, a prominent leader of the MEND rebel group who was part of the general amnesty program was assassinated. It is not yet clear who was responsible. Local officials tried to blame gang violence but foreign press indicate that a political motive was more likely.

The $10bn in investment expected in the power sector from investors like Saudi Arabia and China could be delayed until next year. The Nigerian government has had a pattern in the past of over-estimating investor interest. With irascible unions and cagey political bosses, investment will be slow to materialize.

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Philippines: Reforms for Real? *The new government is rolling out reforms: 2G telecom operators will see significant fee increases, state-owned companies must look to self-finance or be axed, and local and state governments must publish all revenue and expenditure transactions within 30 days.*

Politicians reform only when it is absolutely necessary and unavoidable. In the Philippines, politicians have been able to put off meaningful reforms for longer than most. But the newly installed Aquino government looks like it is serious about political and financial reforms. The government has a budget shortfall of 3.9% of GDP. The Department of Budget and Management seems to be on a war path. The National Telecommunications Commission has seen its subsidies slashed and the NTC will be hiking 2G SUFs significantly. The government has made it clear that the operators have already recouped their costs and should pay more. State-owned and -controlled entities (GOCCs) have been ordered to create strategic plans and look for methods of self-finance. The order went out to the 158 SOEs and to over 600 water districts. The government has stated that those who fail to become self-sustaining will "face the chopping block."

China: How to sell trains with attractive financing. *Thailand and South Africa are to benefit from China's trains and financing.*

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China's exports are finding ready buyers in emerging markets. In Bangkok the high-speed electric trains joint venture between China's Maglev and Thailand's State Railway Company is likely to be approved. According to local press, the Thai government is in favor of the more affordable electric trains. The State Railway Company owns the land for the four proposed lines out of Bangkok. The Mass Rapid Transit Authority will also play a role. Thailand's Board of Investment is on a road show in China and looking for more deals and FDI.

China Railway Group has an MOU for a deal in South Africa. President Zuma's visit to China was well worth the political heat he endured on his return home. A major railway agreement could do a great deal to soothe South African labor unions' demands for more work. The deal could be worth $30bn for a high-speed rail between Johannesburg and Durban.

Russia: highways, petrol prices, and Putin. *Putin poses at the gas station, filling his Lada, after brokering deals with Asia. Does Russia need WTO? Car and petrol tariffs are the stuff of 2012 presidential elections.*

Among the iconic photographs of PM Putin, perhaps one of my favorites will be Putin pumping gas into a yellow Lada Kalima. Putin decided that the tour of Russia's Far East ought to include several items, such as the inauguration of the Russia-China pipeline to Daquin. But the pipeline is old news. The subject of the proposed petrol tariff increases and the desperate conditions of

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Russian roads has come to the forefront. A recent miscommunication between President Medvedev and PM Putin over the subject of deforestation and the construction of the new Khimki motorway between Moscow and St Petersburg had analysts atwitter about Kremlin infighting. Putin stated that the roadway was necessary, but subsequently refined his position to agree with Medvedev that the route ought to be investigated.

Now Putin, on his vacation road trip of the newly completed Amur Freeway and high-profile test drive of a Lada, has put another wrong foot forward in complaining about the high price of gasoline. He said road quality is poor and gasoline prices are high. Well, there will be little money for road repair and maintenance if the planned petrol tariffs are not enacted. MoF Kudrin has promised that Russian roads will meet EU standards in ten years. Those improvements will cost money. Kudrin and the Kremlin had planned that the petrol tariff would increase one ruble a year for the next three years. In 2011 alone the tariff increase was expected to raise $2.7bn in revenues. The *Moscow Times* has estimated that the tariff could provide RUB240bn over the next 3 years for road construction and improvements.

<u>The only trouble is that there will be a presidential election in 2012.</u> Roads and fuel prices are two big election issues. Who cares about transparency when there are potholes big enough to swallow the Lada that you can't afford to drive?

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