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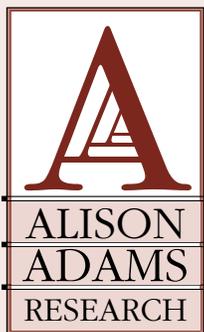
Week 40: October 7, 2010

Frozen trade war: Countervailing duties and anti-dumping under the WTO. *The U.S.*

continues to lead the world in cases in the WTO—it has filed the most and has also been the respondent in the most cases in the organization. There are over 100 complaints against the U.S. for WTO violations. There are only 19 complaints against China for WTO violations.

It seems as if we are in a fairy tale, where it took Brazil's Finance Minister to declare what we all saw but failed to name—a currency war. Are we waiting for a Smoot-Hawley moment for a trade war to be declared? I would argue that we are already in one. But the United States is the most active violator of WTO principles and continues to be the single most litigious member of the WTO. (The United States has well over one hundred active complaints in the WTO.) The EU has around 80 (31 of which are actually against the U.S. and only 4 against China). China has 7 cases where it is the complainant and only 19 where it is a respondent. The United States is the country with the largest number of complaints against it for unfair trade practices. Although some EM countries are looking to use anti-dumping mechanisms, the United States continues to be the leading trade activist in the WTO.

Is it ironic or tragic that the Fed's extremely loose monetary policy forced EM exporters to prop up their export sector in the first place? Joseph Stiglitz recently made the same argument in reference to the currency wars. In an interview with Reuters, he stated that “ultra-loose monetary



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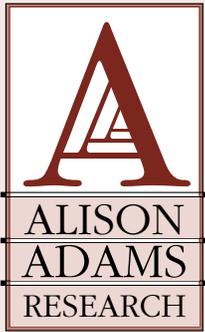
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policy” is creating chaos around the world rather than repairing economic growth at home. “The irony is that the Fed is creating all this liquidity with the hope that it will revive the American economy . . . It’s doing nothing for the American economy but it’s causing chaos over the rest of the world. It’s a very strange policy that we are pursuing.”

Is a Fully Convertible RmB a 2013 Problem? *Demand for yuan-denominated assets is exceedingly strong and yuan full convertibility could be a reality sooner than we think. Do you really want to be holding a U.S. treasury the day the yuan floats?*

Could China float its currency in 5 years? The pace at which new yuan-denominated products are becoming available warrants some time and thought. If it’s possible, it should be in your models by 2013 at the latest. Are the pundits missing the point with this currency war and strategic cooperation with the BOJ? The single most important currency pair in the world is not traded. But China is marching very quickly towards building a yield curve with currency swap agreements across emerging markets; instituting trade settlement agreements; permitting McDonald’s to issue RmB-denominated bonds; and pushing to have the RmB as part of the IMF SDR basket, which would effectively put the yuan in every IMF member country’s central bank. The SDR as a global currency basket would help facilitate the pricing of the yuan in global markets. The European Union cannot wait to give up 2 of its IMF board seats if it can get China to commit to “responsible” yuan management. (The translation is please, please don’t float your



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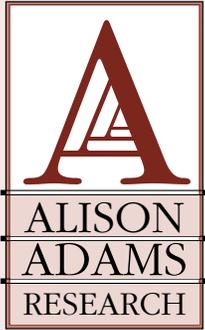
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currency—just appreciate it slowly—preferably until we are all retired and invested in yuan-denominated assets ourselves.)

And now the Hong Kong stock exchange expects to list its first yuan-denominated listing by next year. Charles Li, the chief executive of the HKex indicated that competition for yuan-denominated listings and offerings is fierce and that there are many players in HK ramping up capacity. The capacity of corresponding banks and the regulatory hurdles are the only constraint. Demand is extremely high. The *South China Morning Post* ran an article enumerating the ways to play the RmB appreciation as part of its “money” section. Given global demand for EM assets, this process is happening much more quickly than I would have thought.

As I am writing this, it occurs to me that the U.S. Congress really ought to be thanking China for keeping its currency pegged. It gives me little pleasure to point out the perennially obvious, that our leaders on Capitol Hill are afraid of the wrong thing and crippled by short-term thinking. Sure a slightly stronger yuan can give the appearance of progress, but the last thing the U.S. dollar or economy needs is a fully convertible yuan. The current arrangement means that the U.S. can continue to keep its profligate, anti-industrial, budget-deficit consumer culture going through the 2012 presidential elections.



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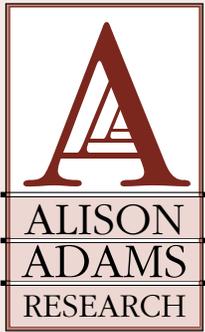
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But it could be that China has bigger plans than a slow bloodletting with a pegged currency, and our political system is not accustomed to having to earn our credit rating like most EM countries around the world.

Brazil: No real solution for the appreciating real. India says no, then possibly yes, to capital controls. *Brazil was the first BRIC to tax inflows. India seems to be worried but unclear on action.*

Within 24 hours of announcing the increase of the IOF tax for foreign investors on local currency debt, Minister of Finance Guido Mantega admitted to the press that the measure was not going to help with the appreciation of the real. The IOF tax for foreign investors was raised from 2% to 4% with the hope that it would hinder hot-money speculative money. But that money is a drop in the bucket compared to the Petrobras recent offering or FDI and flow of funds into equities. In part, Brazil's promotion to investment grade has only increased the demand for Brazil's assets. It is clear that the tax will do little to halt the wall of money hitting Brazil.

In India, the appreciating rupee is troubling the government and the central bank alike. Even as the RBI raised its benchmark rate, in spite of favorable inflation data, the rising current account deficit has tripled in recent months and stronger currency could exacerbate the troubles. India's MoF Pranab Mukherjee flatly rejected the notion of capital controls. The next day, Deputy Governor of the RBI Subir Gokam indicated that the RBI was indeed very concerned about the



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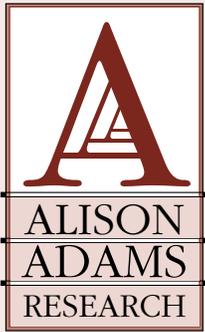
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disruptions caused by such strong capital inflows, and that they were considering ways to deal with these disruptions. Meanwhile, Indian corporations are continuing to take advantage of global risk appetite and are borrowing from foreign lenders and issuing dollar-denominated debt at a record pace.

Can Japan Really Recover? Not with more attractive investment destinations so close by.

Japan's national champions continue to move new investment offshore into direct investment in emerging Asia. Zero interest rates at home are not enough to stave off corporate flight.

The move by the Bank of Japan to add additional stimulus to help “weaken” the yen, has helped to galvanize PM Kan’s newly formed government. The bank earned public approbations from Kan’s cabinet and seems to have energized his government. But political cheering aside, the deflation demon continues to stalk Japan’s economy. And Japan’s national champions are doing little or nothing to help. What seems so complex for the dynamics between the U.S. and China seems simpler for Japan’s case. But it’s not. Although Japan has been demoted to the 3rd largest economy in the world, its national champions are growing like crazy. Nippon Steel, once the pride of Japan’s industry, is putting its money and time to work in India. The company is in talks with Tata to make auto-grade steel in India. But the comments from Tata seem to indicate that there are possibly other joint ventures down the road. The Bank of Japan can keep interest rates near zero and buy back government debt until the cows come home. But Japanese companies are taking their money and their efforts elsewhere. Vietnam, Thailand, China, and India are the



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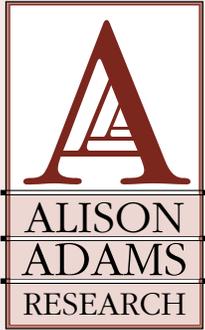
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beneficiaries of Japan's flight from home. The United States should be learning from the clear shortcomings of global shareholder capitalism.

Nigeria: Is production going offline soon? *The election delay and the lack of elite political consensus will encourage MEND to resume its hostilities; it has indicated that it plans more violence in the Delta.*

The political fallout of last week's MEND bombings in Abuja makes clear that the presidential race is vicious and will be troubled with further violence. There have been attempts by provocateurs to link the North's most likely presidential candidate, former general Ibrahim Babangida (IBB for short) to the car bombings in the capital last week. The rebel group MEND had to reconfirm its responsibility for the violence and publicly protect IBB and his camp from further linkages to the attacks. "We have already accepted responsibility," said the MEND.

Well, the MEND also seized the opportunity to declare the "amnesty" a sham process and stated that the government has not addressed its grievances. The MEND will continue its activities until these issues are resolved and denied any intended statement to the North regarding the presidential elections. The MEND also indicated that it was surprised that the government security forces did not heed its warning. It declined to offer assurances about further peace or attacks. But the MEND indicated that the military would be targeted in the Delta when hostilities resume. To sum up, the MEND is still alive and well and planning further violence.



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