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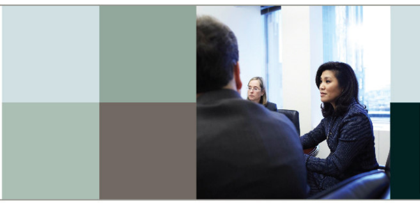

June 2012
For Investment Professionals

Relief in a Time of Austerity - Impact on Bonds and Equities

In anticipation of a positive outcome from the Greece's election, Euro, Singapore dollar and stock markets had rallied in the last few days. New Democracy, a pro-austerity and pro-European party, has managed to claim 128 seats and secured about 30% of vote share versus 18.9% in the May election. New Democracy and Pasok, another pro-austerity party, secured a majority of 162 seats in total in the 300-member parliament. The New Democracy is expected to take the lead to form the next coalition government.

Notwithstanding the pain from the existing austerity program, about three quarters of Greeks have indicated their preference to stay in the Euro area as they understand the even greater negative impact and, therefore more agony for Greeks, if the country were to leave the monetary union.

While stock markets globally cheered on the outcome of the Greece's election, it will not be an easy path for the country and the new government. Syriza, the anti-austerity party, raised their vote share from 16.8% in May to 27.1% in this latest election.Syriza has the potential of catapulting Greece out of the Euro area and plunging the Euro area economy into a crisis. With stronger electoral support, they are likely to continue to oppose strongly against the pro-austerity new government. Therefore the tenure of the next Greek government may not be that long.

Looking beyond Greece, there are also positive developments in Spain. Last week, the European Union announced a Eur 100 billion bailout package for the ailing Spanish banks. This bailout package has ring-fenced the Spanish banking sector to prevent a melt-down. Similar to the large capital flight from the banking sector in Greece, the Spanish banking sector has been suffering from capital outflow in recent months.

However, the bailout for the banking sector could eventually lead to a full bailout of the Spanish sovereign.   Spain is suffering from high unemployment rate of close to 25% and negative growth outlook in the next 1 to 2 years. The bailout package would only add woes to the already debt-laden Spanish Government. This would eventually lead to more rating downgrades by rating agencies. Currently Spain is in the BBB category, just one rating category above the investment grade by major rating agencies. Bailing out of the Spanish government would aggravate the already weak European sovereign debt situation.

There are many issues to be resolved in the Euro area. But we expect the European Central Bank and the European Union to continue to implement policies to ensure the monetary union stays intact while taking time to resolve the issues.

Turning to the US and China, the slower growth momentum in these two countries in recent weeks are well within our expectations. We expect the Federal Reserve to continue to maintain easy monetary policies, and if need be, to introduce more easing measures to boost the economy. Chinese premier Wen Jia Bao has also given the strongest indication that the Chinese government would not be hesitant to take actions to boost the economy. In fact, the People's Bank of China announced a 25 basis points cut on both the commercial banks' benchmark lending and deposit rates on 8 June.

While uncertainties remain globally, easy monetary policies will continue to support the economy and prevent a downward spiral. Bond market will be well bid in this environment. We maintain our long-held view that fundamentals in Singapore are strong. Investors should expect volatility in the coming months, but take comfort in the strong long-term fundamentals of the Singapore economy and its stock market. For balance mandates, we are currently overweight the bond market and underweight the equity market.

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