



Key News

- [Thailand rules out capital controls as baht rises](#) (Reuters via Forbes.com)
- [Indonesia central bank wants banks to lower lending rates](#) (Alibaba.com)
- [China Q4 GDP growth could hit 10 pct](#) (Reuters via Forbes.com)
- BRDO PRI KRANJU, Slovenia, Nov 13 (Reuters) - Credit activity in the euro zone and globally will remain low because economic recovery is also expected to be slow, Andrej Rant, deputy governor of the Slovenian central bank said on Friday.

"Recovery will be slow in 2010 and if recovery is on the level of 1 to 2 percentage points, it is difficult to expect strong credit activity," Rant told Reuters in an interview on the sidelines of a banking conference.

Rant, whose governor, Marko Kranjec, sits on the European Central Bank's Governing Council, said banks were reluctant to extend loans because of high uncertainty on the market and not because they did not have enough money.

"There are no obstacles regarding credits on the supply side, obstacles are on the side of demand because economy is not improving in the way we would want," Rant said.

Quotable

"QE created a surge in excess reserves: In September 2008, central banks opened up liquidity facilities to alleviate the stress from frozen fixed income markets. These operations resulted in the build-up of 'excess reserves' (ER) and an expansion in central banks' balance sheets. In the past, such a build-up in ER would have been 'sterilised' by central banks by selling government securities. This time around, however, that was not done for two reasons. First, we have argued that central banks have pursued QE with the intention of increasing the growth of money, given near-zero policy rates, while more ER would push overnight rates lower. Second, the sheer size of the increase in ER relative to the size of government securities held by or available to the Fed that could be used to drain reserves was at least partly responsible for central banks not being able to drain excess reserves (see Keister & McAndrews (2009), Haubrich & Lindner (2009)). Under these extenuating circumstances, the Fed even turned to the Treasury for assistance and the Supplemental Financing Program was created to help drain ER (see Appendix for details on how the SFP worked and how its wind-down will push up excess reserves).

But why have excess reserves *stayed* so high? Could be a supply-side issue...
Tautologically, commercial banks are holding on to excess reserves because they cannot put the funds to better use. However, this does not help us in identifying whether

supply or demand is the source of the problem. While reserves may be higher than required by regulators, banks may not consider them 'excessive' in an economic sense, as argued by Friedman and Schwartz (1963). Commercial banks could be hoarding this cash with a 'precautionary motive', much as consumers increase savings when uncertainty around their income stream increases. This would be a problem on the supply side of the loanable funds market."

Manoj Pradhan

FX Trading – Video Edit: The Global Stimulus and Emerging Markets Show

REWIND:

The latest G-20 communiqué said nothing new. You know ... where the leaders told us they're not yet ready to rein in the stimulus they've provided to their respective economies.

FAST-FORWARD:

Dominique Strauss-Kahn, head of the International Monetary Fund, is spewing all kinds of commentary this morning.

On one hand, he's affirming the position taken by the G-20 to remain supportive till a legitimate recovery ensues.

On the other hand he's stressing the fact that there should be a coordinated effort to peel back stimulus amidst a firm recovery.

Back to the one hand, he admits the global recovery remains fragile.

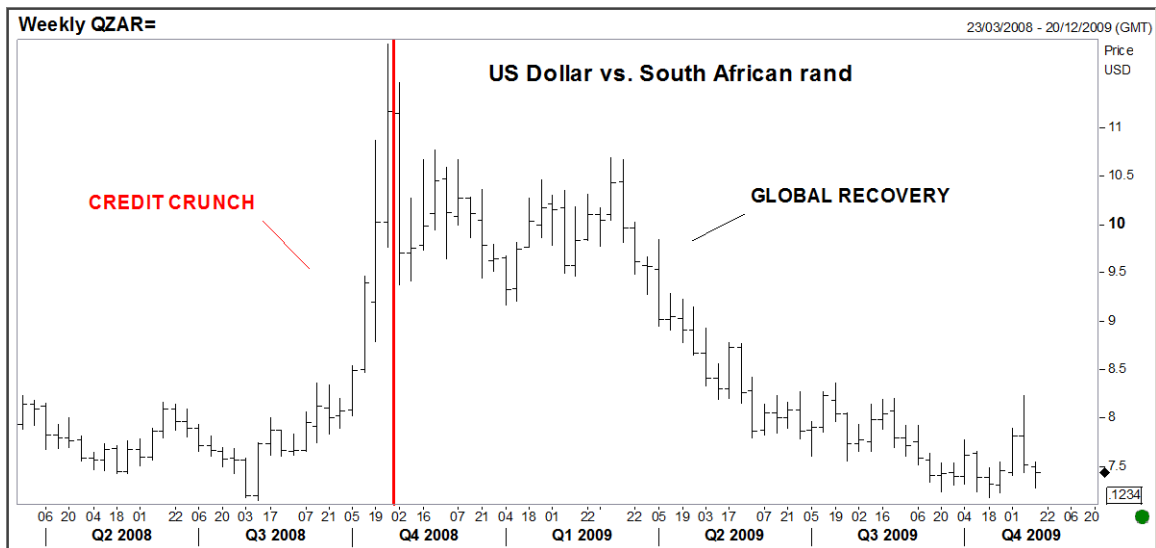
But back to the other hand, he warns that hot money flowing into emerging markets threatens adverse currency moves and asset bubbles; thus forming exit strategies is necessary.

REWIND:

When the credit crunch hit in earnest, emerging market assets felt severe pain. Stocks were sold off; emerging currencies lost major ground to the US dollar.

The South African rand is one example:

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In less than two quarters at the end of 2008 the US dollar skyrocketed while the South African rand lost more than 55%. That’s a monster move in the currency world.

FAST FORWARD:

Since then there’s been a steady sentiment shift back into riskier assets. The rand epitomizes such risky assets and over the last year has erased the losses it suffered.

This is exactly the type of hot money flow that the IMF head hauncho is talking about: “The resurgence of capital flows to emerging markets, including several in Asia, is presenting policy challenges.”

With increasing confidence that the global economy is coming out of the mud, more and more money is moving into these emerging markets and emerging currencies.

PAUSE:

Keep in mind the potential scenarios, and potential risks, we might be dealing with.

Scenario #1: Pull the Stimulus Too Soon

This is probably the biggest concern right now. We continue to see improved numbers on the economic front ... in several different regions of the globe. But will national economies be able to sustain the recovery when global policy makers cut them off from stimulus money?

From Reuters:

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World Bank Chief Robert Zoellick told the "APEC CEO Summit" that consumer confidence was the key factor in deciding when to hand back to the private sector the primary role for stimulating growth.

"If you look at the U.S. stimulus programme, and many other stimulus packages, a lot of the money actually comes in late 2009, the start of 2010. But the question mark for everybody is whether the private sector will kick in by the middle of 2010 and that is partly an issue of confidence."

Scenario #2: Keep the Stimulus Coming

Oddly enough, there doesn't seem to be too much concern with keeping the money taps flowing freely. The most blatant risk seems to be a possible asset bubble from which bursts more pain than a shaky global economy won't easily be able to handle.

More from the IMF's Strauss/Kahn:

"While capital inflows are generally beneficial, they can raise risks of rapid and potentially destabilizing movements of currencies and asset prices."

"Policymakers should therefore keep supportive measures in place until a recovery is firmly established and conditions for unemployment to recede are in place. In some emerging markets, including a few in Asia, the recovery is further along, and crisis support policies may need to be unwound sooner rather than later."

PLAY:

Basically, policy-makers are having a sticky time balancing expectations, but boy oh boy are they getting good with the typical economist's multi-hand approach to markets.

As I see it, policy makers are going to err on the side of stimulus. At this stage in the game an asset bubble does not concern them. An asset bubble may concern market participants, but it does not concern policy makers looking to keep the globe afloat and prevent, at all costs, a double dip.

Get out your oven mitts!

The hot money is going to be around a while longer; but there are going to be some speed bumps getting in the way of these capital flows as we move along.

An area to key on is in the emerging markets – they embody the risk appetite mentality that drives markets right now. Over the next several months we will likely see a continued surge by emerging market currencies relative to the US dollar.

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But it won't be that simple, as concern about stimulus and/or asset bubbles will certainly spark some periods of shakedown.

It's possible that we see some countries enact capital controls as Brazil and Taiwan.

It's possible that we see some central banks move toward tightening monetary policy.

It's possible we see more emerging nations, e.g. Hungary, fail to live up to the stipulations of stimulus loans from the IMF and others.

Just make sure you've got your oven mitts on ... wouldn't want you to get burned.

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Get Your Emerging Markets Fix

All this week Jack and JR will be highlighting emerging markets and their respective currencies.

They plan to offer insight to the global macro perspective that's driving capital into, or in some cases out of, these lesser-developed nations. They'll also be offering a look inside some individual nations and their prospects for growth ... and the prospects for their currencies.

This series of emerging market commentary and analysis will culminate in a **FREE Emerging Markets Webinar** that will be held next Thursday, November 19th. Details on the webinar will be given in upcoming issue of Currency Currents. Or, feel free to contact us at info@blackswantrading.com for immediate details.

Jack and JR continue to spot excellent investment and trading opportunities in emerging market currencies. We offer a newsletter that expands upon the dynamics of these economies and seeks to exploit opportunities offered by powerful moves in emerging currencies.

[Click here to read more if you're interested.](#)

Thanks again for being a loyal reader,

David Newman
Black Swan Capital

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