AMG FINANCIAL GROUP 安柏

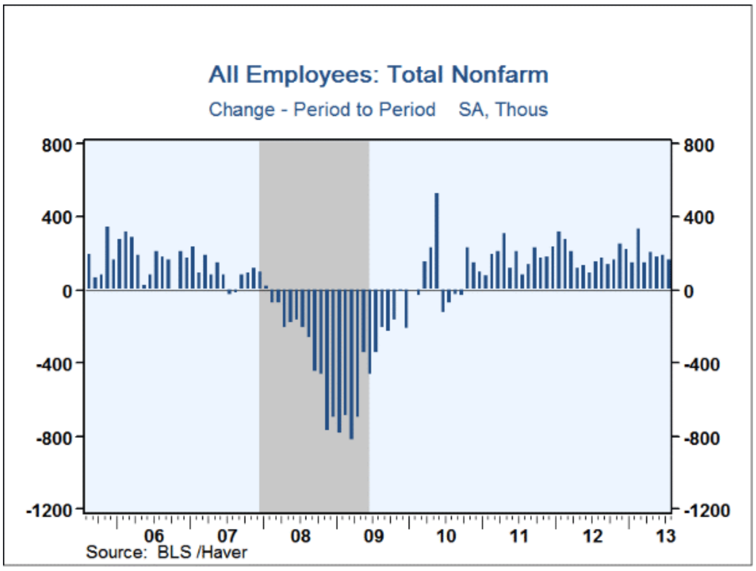
AMG Market Commentary

August 2013

U.S. Labour Market Snippets

It's been often said that "a picture speaks a thousand words". Regular readers of our Commentary could attest our preference of showing charts and using these to help explain/support our views. However, it is important to look closely to see what exactly a picture is trying to tell you. At the same time, it is important that one try to view a picture from various angles as the way a view is framed could present vastly different messages. Labour market data from the U.S. are good cases in point.

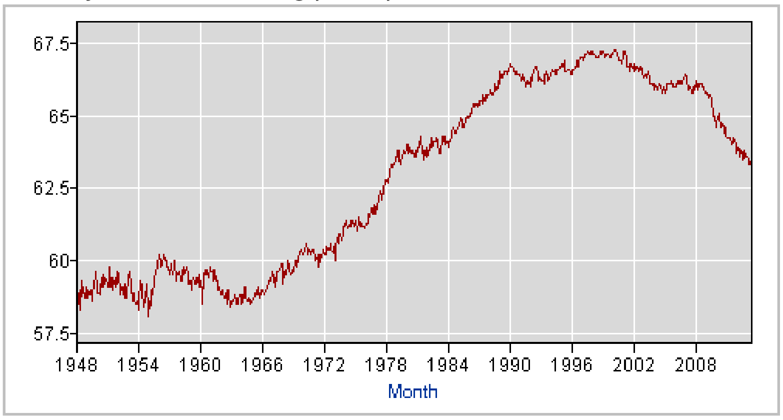
The first Friday of every month is a busy day for the Bureau of Labor Statistics (or BLS for short) in the U.S. because it is set to release a host of data revealing health of the country's labor market. It is also a high-wire day for Wall Street traders and money managers because positive surprise or disappointment versus consensus expectations could prompt sharp and outsized moves in financial markets.



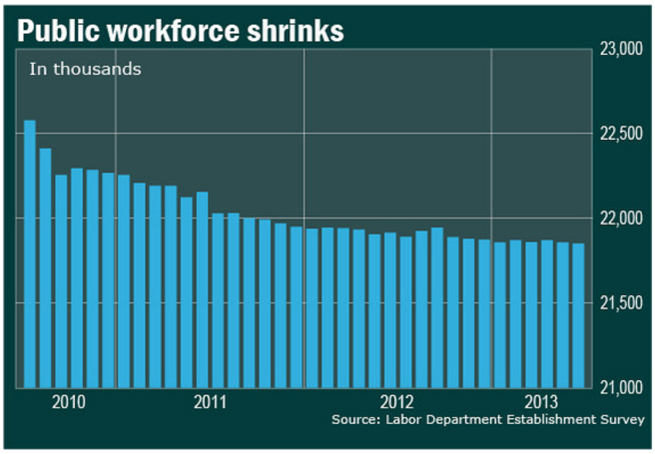
For this month, which fell on August 2, it's been a rather placid day. While the total non-farm payroll added came in below expectations, the unemployment rate dipped to post-recovery low of 7.4%. Albeit the unemployment rate remains far higher than 5.8% for the month that was just preceded the collapse of Lehman Brothers (which in turn triggered the financial tsunami), it has come a long way from the 10% recorded at the nadir of the Great Recession. Moreover, looking at the above chart which shows monthly changes in total non-farm payroll, it seems to suggest the U.S. economy has been able to create new jobs at a steady and healthy pace over the past three years.

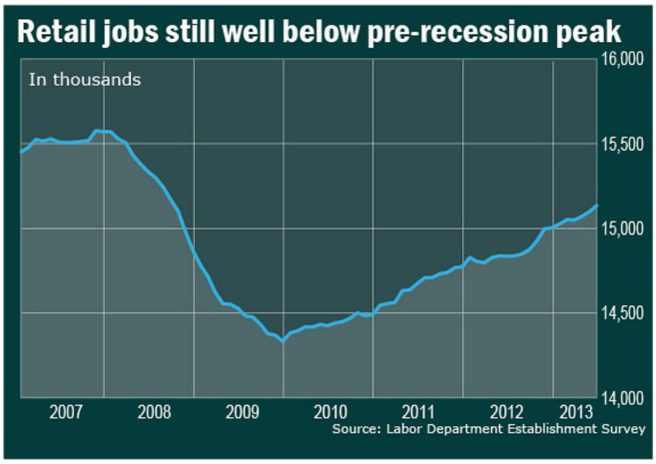
The picture looks less bright when we examine the total number of people currently being employed. As can be seen from the right-hand chart, despite the U.S. economy creating jobs month after month since early-2010 there are fewer people working today than before the financial crisis. In other words, the economy has yet to made up with all the jobs that were lost during the last recession.

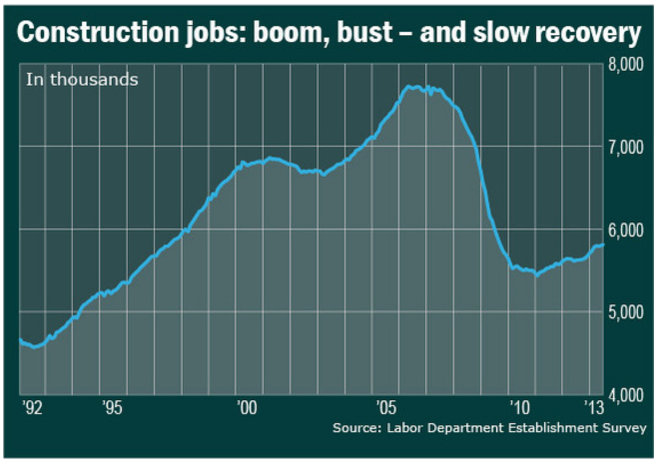
If the above chart looks disheartening, the picture turns downright abhor when we consider data on labor force participation rate. The chart to the right is composed by the BLS showing participation rate of civilian Americans who are 16 years & above. At 63.4%, the percentage of working Americans as a percentage of total population is at the lowest level since May 1979 – that's nearly thirty-four years ago. A simple way to sum up is that the pace of job creation over the past three decades has lagged behind the pace of population growth. When viewed from this angle, the U.S. job market doesn't look that good after all.

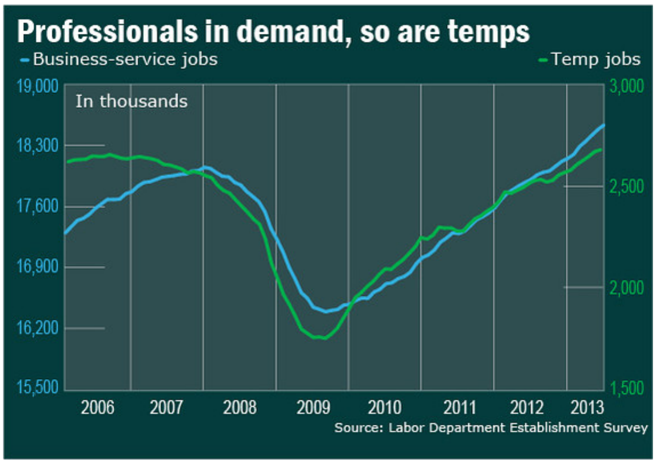


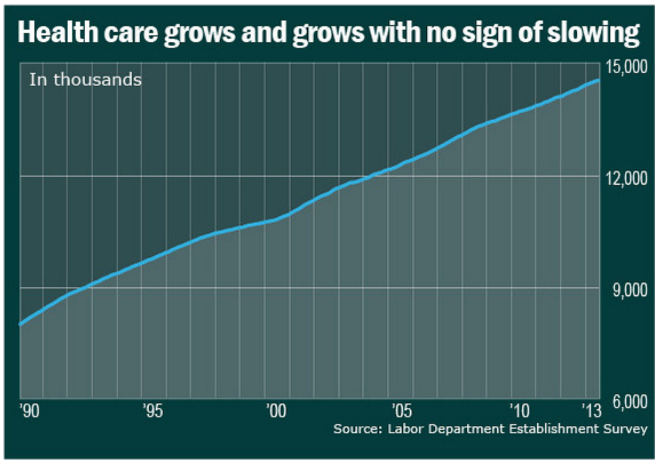
It is also important to distinguish what kind of jobs were created as not all jobs are equal. Below charts show total jobs in six sectors over time and as we can see the differences are significant.











For the leisure and hospitality, total jobs have surpassed levels prior to recession. For government sector, total jobs have been on a steady decline. To say that jobs gained in the former sector(s) offset jobs lost in the latter would be grossly misplaced as public jobs on average are higher paying than waiters and bus boys working in restaurants, and the same when compare to cleaning maids and bell boys in hotels.

For retail and construction related jobs, there are a lot of catching up that needs to be done. The problem though is that the lack of job creation in both sectors is structural in nature. While retail sales have been growing on robust personal consumption, more and more Americans are shopping via the internet rather than from bricks-and-mortar establishments. Online shopping websites make it easy to bargain-hunt and they typically offer lower prices that stores are difficult to match. In addition, goods are delivered right to one's doorstep which is a big bonus for bulk or bulky orders. For construction, while housing starts have seen strong rebound this is largely confined to residential whereas the commercial side (such as office, shopping malls and industrial buildings, etc) has seen scant activity.

More uplifting news can be found in professional and business services. The segment has created the most jobs since the recession ended. All in all, about 2.12 million jobs have been created for architects, engineers, scientists, managers, computer programmers, and so on. These are among the highest paying jobs in the market. Unfortunately, almost half of the new professional jobs since mid-2009 were of temporary nature than pay far less than full-time ones. Fact is, percentage of temporary works in private sectors has reached an all-time high.

In the U.S., there is one sector that has witnessed an unabated string of job growth since the Labor Department began gathering such data in 1990. This is the healthcare industry. Average pay for healthcare-related jobs is pretty good and comparably to that of mechanic and construction jobs, though below full-time professional and business services jobs. With more and more Baby Boomers retiring in coming years and a general aging population, this industry is destined for further growth. At the same time though, the industry is seeing rising percentage of contract workers from abroad. It is not uncommon to see nursing homes and rehabilitation centres staffed by people from the Phillippines, India, China, and Africa on working visas. Hence, not all the wages earned in this sector stay in the U.S.

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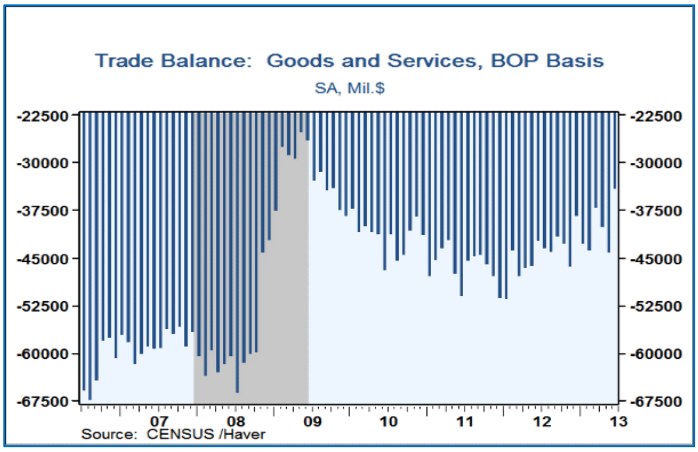
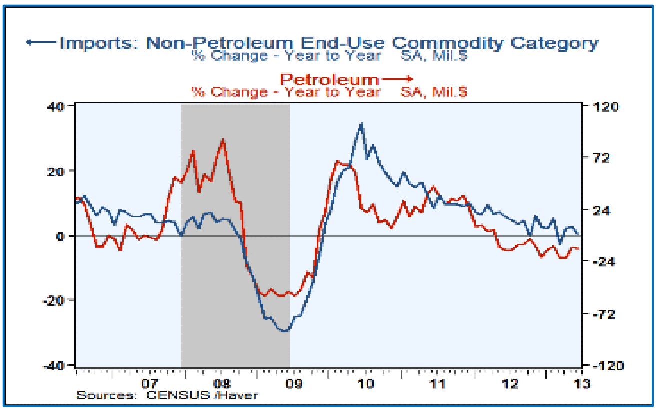
Market Review & Outlook

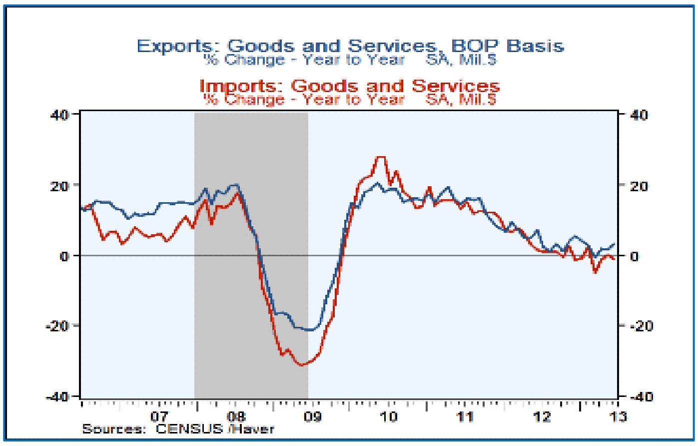
U.S.: Neutral

The U.S. foreign trade deficit fell sharply during June to its shallowest level since October 2009. The $34.3 billion deficit compared to a revised $44.1 billion in May, initially reported as $45.0 billion. A $43.5 billion deficit had been expected in the Action Economics survey. The 2.2% jump (3.2% y/y) in exports led the deficit's improvement after a 0.3% May slip. Imports, conversely, slumped 2.5% (-1.0% y/y) after a 1.5% rise. In chained 2009 dollars, the deficit in goods shrank to $43.1 billion. Real exports gained 3.2% (1.9% y/y) while real imports fell 3.0% (-0.7% y/y).



By country, the June trade deficit in goods with mainland China eased to $26.6 billion. Exports to China gained 8.3% y/y while U.S. imports slipped 0.3% 4.9% y/y. With Japan, the deficit deepened slightly to $5.5 billion. U.S. exports fell 5.4% y/y while imports were off a greater 6.8% y/y. The deficit with the European Union declined sharply to $7.1 billion, its least since February 2012. U.S. exports fell 1.7% y/y while





imports were off 5.2% y/y.

Foreign Trade (Current Dollars)	Jun	May	Apr	Y/Y	2012	2011	2010
U.S. Trade Deficit	$-34.3B	$-44.1B	$40.1B	$42.4B (6/12)	$534.7B	$556.8B	$499.4B
Exports (%)	2.2	-0.3	1.3	3.2	4.6	14.5	16.9
Imports	-2.5	1.5	2.4	-1.0	2.8	13.9	19.5
Petroleum	-6.3	4.3	-1.5	-12.6	-5.6	30.7	32.5
Nonpetroleum goods	-2.5	1.6	3.5	0.4	5.2	12.1	20.8

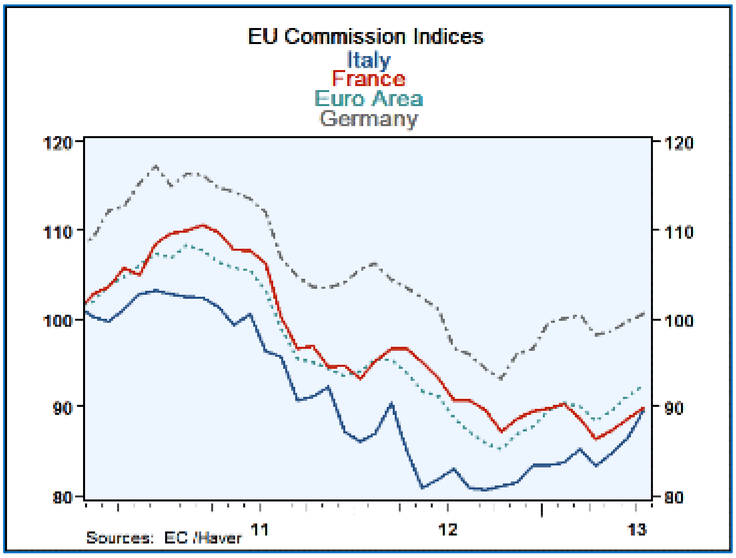
Europe: Neutral

EU Sectors and Country level Overall Sentiment											By Queue	% Avg
EU	Jul-13	Jun-13	May-13	Apr-13	Percentile	Rank	Max	Min	Range	Mean	rank%	Level is:
Overall Index	**95**	**92.6**	**90.9**	**89.7**	**55.8**	**245**	**117**	**67**	**50**	**101**	26.6%	94.1
Industrial	-10	-11.3	-12.2	-12.8	62.1	229	8	-39	46	-6	31.4%	
Consumer Confid	-14.8	-17.5	-20.2	-20.4	51.5	245	2	-32	34	-12	26.6%	
Retail	-7	-10.3	-11.9	-13.7	57.4	201	8	-27	34	-6	39.8%	
Construction	-31	-31	-32	-33	26.9	259	7	-45	52	-18	22.5%	
Services	-4.5	-6.1	-7.9	-10.6	43.0	144	31	-31	62	6	22.2%	
	% m/m			Jul-13	Based on Level		Level					% Avg
EMU	1.3%	2.0%	1.0%	92.5	46.8	281	118	70	48	101	15.9%	91.9
Germany	0.7%	1.1%	0.6%	100.5	59.4	200	119	73	46	101	40.1%	99.5
France	1.4%	1.5%	1.2%	89.9	35.9	277	117	75	43	100	17.1%	89.5
Italy	3.3%	2.0%	1.8%	89.5	32.6	289	121	75	46	101	13.5%	88.9
Spain	1.3%	2.8%	0.1%	93.5	48.0	239	116	73	43	100	28.4%	93.0
Greece	-1.9%	-0.3%	5.2%	91.7	39.1	280	119	74	44	100	16.2%	91.4
Portugal	-0.1%	1.3%	2.2%	85.2	20.9	283	126	75	51	101	15.3%	84.1
Austria	1.4%	-1.1%	0.4%	92.4	45.7	274	119	70	48	100	18.0%	92.0
Belgium	2.4%	1.1%	1.5%	92.9	48.5	261	116	71	45	100	21.9%	93.0
Finland	0.3%	1.7%	-0.2%	94.4	45.1	248	120	73	47	100	25.7%	94.1
Netherlands	-2.2%	1.0%	1.4%	87.5	39.6	297	117	68	49	100	11.1%	87.6
Memo:UK	7.1%	-0.7%	1.9%	104.2	61.7	145	129	64	65	102	56.6%	102.2
All since Jul 1985			334	-Count	Services:	185	-Count					
Sentiment is an index, sector readings are net balance diffusion measures												

The EU index in July rose to 95 from 92.6, a relatively large jump the ranks 20th out of about the last 250 observations; that places it in the top 11% of all monthly changes over that period. Consumer confidence made a particular large increase in the month rising to -14.8 from -17.5, a spurt that ranks it as the 10th largest monthly rise among the last 250 observations.

Retailing improved to -7 from -10.3 also a relatively substantial jump. The services sector improved to -4.5 from -6.1. The industrial sector improved to -10 from -11.3. Construction was flat on the month at -31.

Monetary policy in EMU was neither tailored for the strength in Germany nor for the weakness in southern Europe.



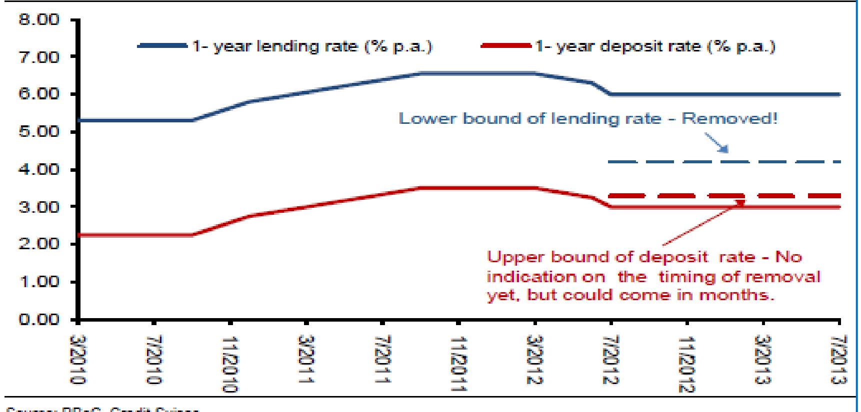
While the European central bank did what it could to try to address local circumstances the Germans largely tried to prevent it from engaging in too many regional policies arguing that they were outside of its mandate and not approved by The Treaty.

Germany was concerned that too much localism could undermine the general thrust of monetary policy in the monetary union while it was the lack of localism the made the bite of austerity so much more severe in countries are forced to pursue it.

China: Neutral

The PBoC announced one more step in interest rate liberalization with three changes that took effect on 20 July: 1) it removed the lower bound of financial institutions' lending rate; 2) it abolished the control on the interest rate of discount bills; and, 3) it lifted the upper bound of Rural Credit Cooperatives' lending rate.

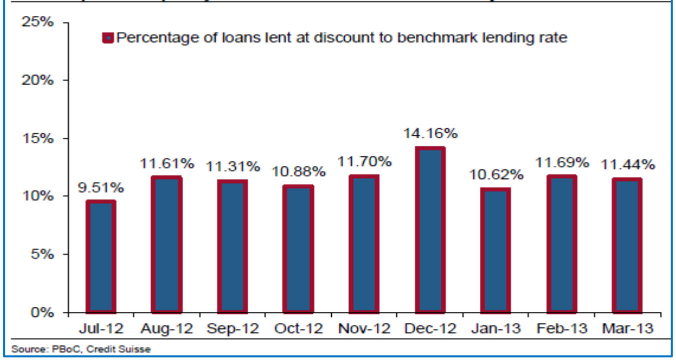
Exhibit 1: Interest rate liberalisation has started



Source: PBoC, Credit Suisse

The most important change is the removal of the lower bound of the lending rate, however, the actual impact to the economy will likely be limited, at least in the new future. The problem in the current environment is that those whom banks prefer to lend do not have much appetite to borrow, while those who are interested in receiving credit are those whom banks are cautious about lending. This is nothing unusual when the economy is in a down cycle.

Exhibit 3: Loans made at a discount to benchmark were limited, even the PBoC's previous policy allowed for a 30% downward adjustment



Source: PBoC, Credit Suisse

Removing the deposit rate ceiling would be more significant to the economy and banking sector than removing the floor to the lending rate. The government has given no indication about the timing of deposit rate liberalization but we think this could happen in the coming months.

India: Neutral

An increase in external vulnerability, less policy space to ease, and a weaker funding outlook make investors bearish on the India market outlook. Although there is still a gradual improvement in the investment cycle as the government unclogs bottlenecks, especially on the infrastructure front. It is expected a continued improvement in exports, due to better external demand conditions in 2014 compared to 2013.

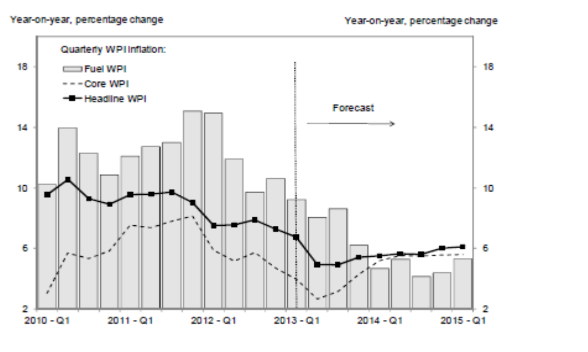
Exhibit 5: Recent policy initiatives by the government on infrastructure could help

Reforms / measures	Potential impact
Government plans ~ Rs1.15 tn project awards in the Infrastructure sector through the PPP model by FY14 end	Increased order inflow
Coal Minister announced that the government would allocate 14 coal blocks to state-run firms within a week	Increased coal availability for power sector
CCEA approves an increase in domestic natural gas prices to US$8.4/mmbtu from current US$4.2/mmbtu mechanism.	Flexible gas allocation and possible increase in E&P activity-related orders
New special cell in cabinet secretariat takes up 122 of total 200-odd stalled projects	Increased order inflow and faster project execution
CCEA allows road concessionaires to sell out by diluting equity in favour of an interested company	Faster completion of projects
CCEA allowed power companies to pass on the cost of imported coal to customers	To benefit power plants facing coal shortage
Proposal approved to allow a committee headed by Road secretary to clear highway projects of less than Rs5 bn	Increased order inflow in roads segment
Cabinet Committee on Infrastructure (CCI) cleared projects worth US$18 bn.	Unclogs project backlog and delays

Source: Government of India, GS Global ECS Research estimates.

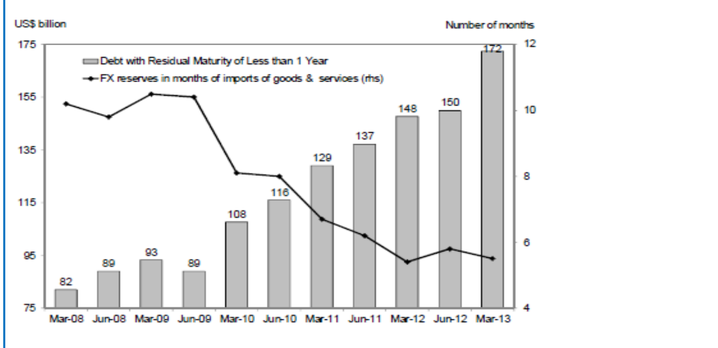
India is well known for its high inflation rate, but the situation might be alleviated in the near future due to weaker domestic demand, a good agricultural crop restraining food prices, and weak commodity prices in FY14. The INR depreciation to date could add close to 60 bp to headline inflation.

Exhibit 6: Inflation is muted, but should gradually trend up after Q3 2013



Source: CEIC, GS Global ECS Research estimates.

Exhibit 7: Short-term debt has continued to trend up, and FX reserve cover has come down



Source: RBI, GS Global ECS Research estimates.

Given an external environment characterized by rising US yields, and pressures on capital inflows, a domestic milieu of weak balance of payments and a depreciating INR, and an economy skewed towards consumption rather than investment, the space to ease monetary policy is quite limited. Unless there is a large improvement in the current account deficit and/or a significant near-term appreciation of the INR, the RBI will be more conservative in its rate policy.

Asia Pacific: Mixed

Crude oil prices have been on a gradual upswing in recent weeks, triggered by market fears that the political upheaval in Egypt may spread to major oil-producing nations in the Middle East. If this is the case, oil prices could easily spike higher to US$120-125 per barrel.

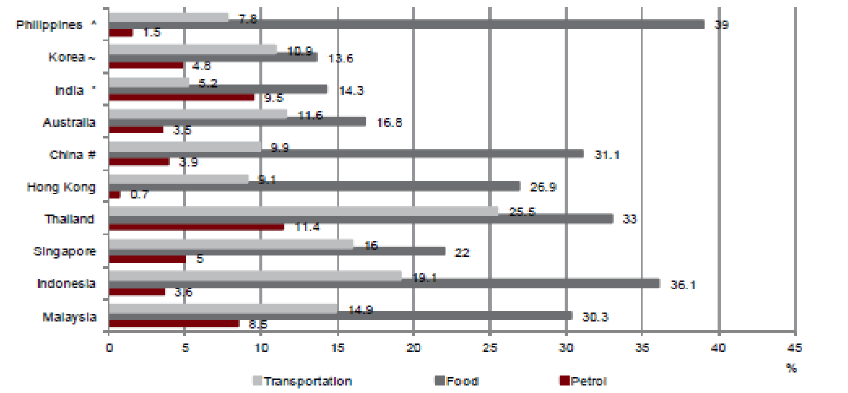
Figure 20: Fuel subsidies (% of GDP, % of government revenue)

	Malaysia		Indonesia		Thailand	
	% of GDP	% of Revenue	% of GDP	% of Revenue	% of GDP	% of Revenue
2008	2.3	11.0	2.8	14.2	n.a.	n.a.
2009	0.9	3.9	0.8	5.3	n.a.	n.a.
2010	1.2	6.0	1.3	8.3	n.a.	n.a.
2011	2.3	11.0	2.2	13.7	0.2	0.7
2012	3.0	13.4	2.6	15.6	n.a.	n.a.

SOURCES: NATIONAL SOURCES, IMF, CIMB RESEARCH

Rising oil prices undermine fiscal sustainability as outlays on fuel subsidies go up with the rising prices. The upshot is larger fiscal deficits, failing which government spending may have to be cut back. Policymakers in developing Asia implemented gradual fiscal reform of their fuel price policies to ensure a manageable impact on inflation and households' incomes. Higher oil prices' spillover effects on other industrial inputs will also affect the fiscal budget due to the rising cost of government projects.

Figure 23: Food, fuel and transport's weight in CPI basket (%)



Note: * = WPI weights were used for transportation and food; transportation consists of equipment and parts; CPI weight was used for petrol, which comprises fuel and light ^ = Petrol weight includes lubricants ~ = Petrol weight includes electricity, gas and other fuels # = Capital Economics' estimate as no detailed breakdown of CPI weights available from official sources

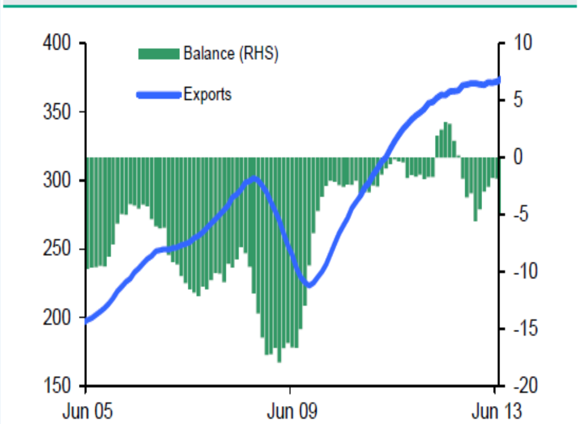
SOURCES: CEIC, CIMB RESEARCH

The governments of Indonesia and Malaysia primarily rely on budgetary operations to finance their subsidies.

Russia and Emerging Markets: Mixed

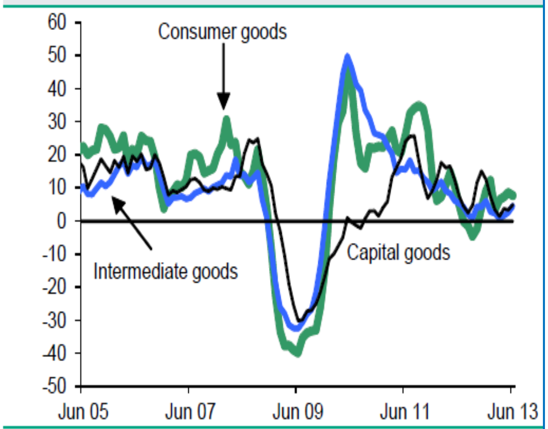
The trade balance of Mexico shifted from to a surplus of USD 855mn in June from deficits of USD 470mn and USD 1.3bn in May and April, respectively (Chart 1). The trade surplus was made possible by the fact that imports growth was slower than a weak growth in exports. Mexico had a trade deficit of USD 1.9bn in the first half of the year compared with a surplus of USD 3.1bn in H1 2012.

Chart 1: Trade Balance and Exports (USDbn; 12m acc)



Source: INEGI, BNP Paribas

Chart 2: Imports Components (3m y/y)



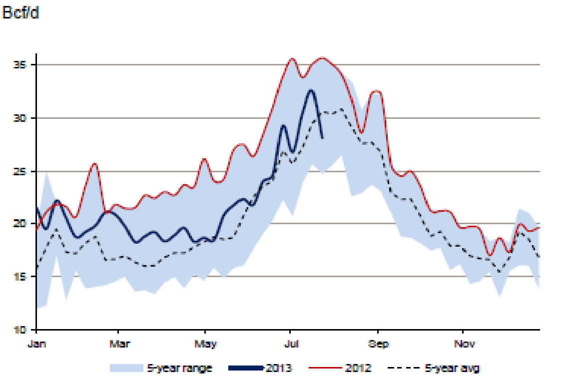
Source: INEGI, BNP Paribas

Imports increased 1.7% y/y in June on a 5.2% y/y rise in consumer goods imports and a 1.8% increase in intermediate goods imports. Demand for capital goods imports declined substantially (-3.3% y/y and -4.1% m/m, sa). This reflects the fact that the economy has large and increasing slack production capacity. Exports increased 2.5% y/y, chiefly on the strength of auto exports (+9.6% y/y) while non-auto manufacturing exports were broadly flat (0.2% y/y).

Seasonally adjusted data show continued weakness in domestic demand but strengthening external demand. In sequential terms, imports contracted 1.2% m/m, sa, in June while exports increased 0.8% m/m, sa. Exports growth was chiefly due to the strength of oil exports (+6.0% m/m) as manufacturing exports were broadly unchanged (-0.04% m/m, sa)

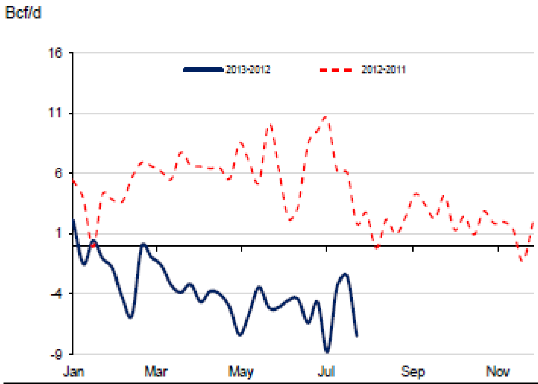
Commodities: Negative

Exhibit 25: Gas power demand fell below average



Source: Bentek Energy, Credit Suisse

Exhibit 26: ...and yoy switching remains weak

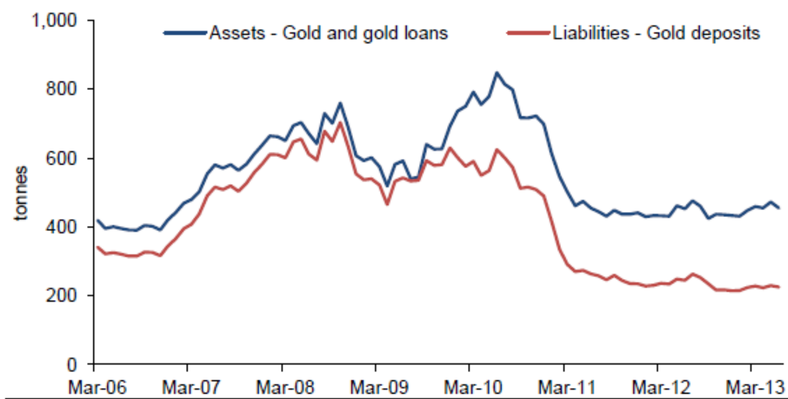


Source: Bentek Energy, Credit Suisse

While the close of the August contract of natural gas on Monday places prices at five-month lows, the price differential between gas and coal is the tightest since last year. However, further pain may be needed for the natural gas to overcome. With little fundamental market support in the near term outlook, prices may head lower, approaching levels where gas becomes competitive with PRB coals. That said, power plant gas consumption data indicate this “switch” response may be some way off.

Exhibit 30: BIS gold balance sheet has returned to pre-crisis norms

Tonnes, converted from prevailing month-end US$ gold price and SDR exchange rates



Source: Bank for International Settlements, the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Central banks that have previously bought large quantities have been absent on the buyside during the sell-off; the last sizeable declared purchase was that of South Korea (20 tonnes) in February. Brazil last made a purchase in November 2012, Mexico in March that year. To us that is not surprising – although purchasing mandates are not price driven they are likely to be influenced by price behavior in our view. Reserve asset managers are as unwilling to "catch a falling knife" as any other fund manager we think and, in general, are wary of spikes in volatility. The IMF data show that, contrary to what many bulls believed, neither a sharp fall in the price in gold nor a sharp rise in US Treasury yields enticed central banks back to the gold market.

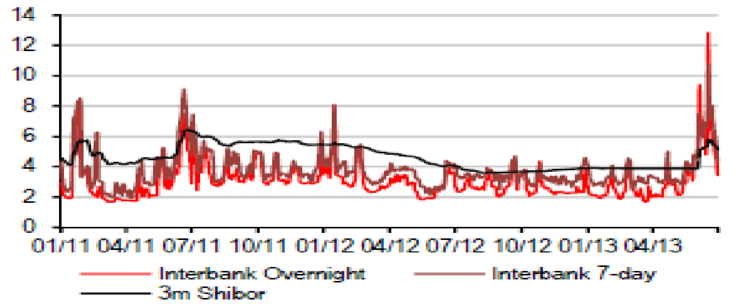
There are, of course, a number of central banks that do not report changes in gold reserves on a regular basis to the IMF. The largest of those is the People’s Bank of China, which in 2009 brought onto its books 454 tonnes of gold accumulated by the State Administration of Foreign Exchange.

One option for central banks that report to the IMF, but that do not want to acknowledge publicly purchases at the present time, would be for them to operate via an intermediary, and take ownership at a later date. The natural intermediary would be the Bank for International Settlements (BIS) but data from the institution suggest that its activity in the gold market has returned to pre-crisis levels.

Bonds: Mixed

China’s money market squeeze pushed overnight and 7-day repo rates to record levels (12.85% and 10.77% respectively on 20 June). This was a concern for investors in all asset classes around the world, especially in developed markets, as they had not anticipated the cash crunch in China and did not understand what was behind it.

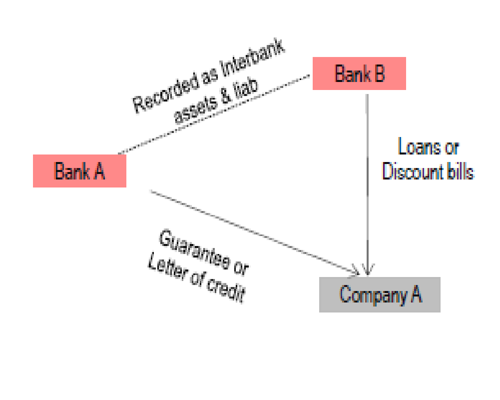
Fig.1 Money market squeeze in June 2013



Source: Bloomberg, HSBC

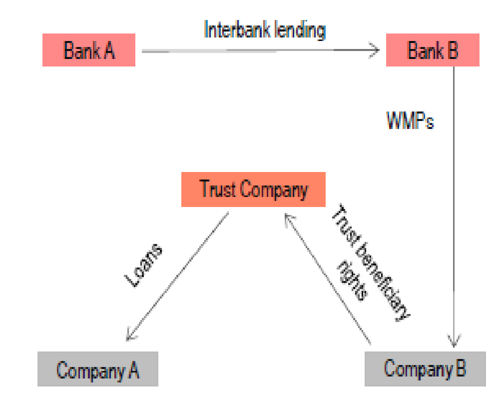
Essentially, there were three different factors at play: 1) fundamentals – slower FX inflows and banks' leveraged balance sheet; 2) seasonal factors – tax payments and the need to meet required reserve ratio regulatory targets; 3) the tightening stance by the PBoC.

Fig.2 Interbank entrusted payment



Source: HSBC

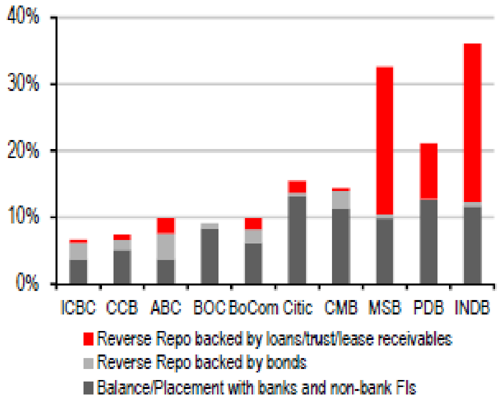
Fig.3 Corporate loans transformed to interbank lending



Source: Securities Times, HSBC

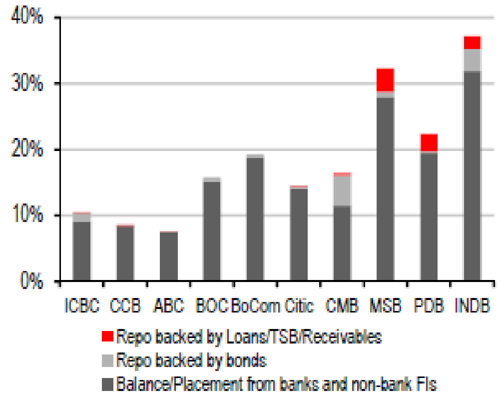
In China, the "interbank business" is quite different from developed markets. Apart from banks, market participants also include non-bank financial institutions such as trust companies, securities firms, credit cooperatives, financial leasing companies, insurance companies, asset management companies and the financial arms of companies.

Fig.4 Banks' interbank asset breakdown



Source: company reports, HSBC

Fig.5 Banks' interbank liability breakdown



Source: company reports, HSBC

Broadly, there are four types of interbank transactions: outright borrowing, pledged repo (backed by bonds), cooperation related to wealth management products (WMPs), and those backed by credit assets (e.g. discounted bills and trust beneficiary rights). The last category is mainly conducted over the counter (i.e. based on agreements between two parties), and has recently been the target of regulators due to potential risks (credit and liquidity) to the banking sector.

Transforming a credit asset into an interbank asset has several benefits. It helps banks escape the constraints of credit quotas and the loan-todeposit ratio, avoids having to make provisions, and saves as much as 80% capital. As companies borrowing through this process are mainly those with no access to normal bank lending, banks can charge a much higher interest rate.

* Unless otherwise stated, all figures and information are collected from WSJ, Bloomberg or Haver Analytics.

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