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Fundamental | FX

Market Insight

The financial crisis goes on and on and on

The severe lack of credit around the globe and the unwillingness of banks to lend capital to their clients as well as each other have been dubbed the "credit crunch" by the media. The securitisation of sub-prime US mortgages and their subsequent re-sale and collateralisation has led to far reaching problems for the vast majority of businesses and investors around the world. If firms cannot obtain loans to be used for daily operations those firms will have problems staying solvent. This scenario has been increasingly prevalent in the US where several financials firms, regional banks, manufacturers and retailers have been forced to close as a result of necessary credit lines being cut or being made too costly.

In the broad marketplace fear and risk aversion is dominating sentiment and trading decisions which has led to some currencies getting more interest than others. Traditionally risk averse, low yielding currencies have acted as safe havens since the start of the crisis whilst risky high yielding currencies have been sold. The secondary effect of this trend is that many firms are being forced to convert assets which are already seeing lower values such as stocks, commodities and bonds into cash so that some value can still be preserved and to be able to meet necessary funding requirements for day-to-day operations. The net result in the short term has been significant increases in volatility and volume across all asset classes as firms, investors and speculators look to reposition their portfolios by selling devaluing assets in preference of holding bonds, gold or cash.

The economic situation has made FX a more attractive proposition for many investors because it appears more secure and transparent in comparison to other asset classes; this has helped to boost volumes. The FX market is a relative market where all currencies trade on relative values against others which makes FX as an asset class very attractive for risk mitigation purposes.

Over the longer term the important aspect to concentrate on is which currencies emerge as the least affected in relation to others considering that the economic crisis is global and has affected all countries to some extent. It is quite possible that currencies which have had the least bad news will actually be seen as the best

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currencies. So far the currencies that fall into this category are the JPY, CHF and EUR. The USD has remained strong despite being at the epicentre of the problems in global capital markets because the USD is still considered to be the world's reserve currency and the currency in which most international payments and transactions are done. Moreover, the USD has already digested and priced in a lot of negative sentiment that saw the EUR/USD reach a high of 1.6038 in July 2008. In addition, many US investors have been repatriating huge sums of USD back to the US in response to deteriorating conditions around the world, especially in emerging markets such as China, India, Russia and Eastern Europe.