

# The Word from Hansard

Good afternoon,

General Motors Corp, the world's largest car manufacturer for 77 years, will file for bankruptcy today (Monday), and emerge with majority ownership by taxpayers and liabilities reduced by more than 50%, the US government said. The "new GM" will get USD 30.1 billion in bankruptcy financing from the government, and the Treasury "does not anticipate providing any additional assistance" after that, the Obama administration said in a statement yesterday. The federal government will have a 60% equity stake in the retooled carmaker, and 12% will be held by the Canadian government, which is lending USD 9.5 billion to the company.

For all the hand-wringing over the dollar's slide, the expanding US deficit and the nation's AAA credit rating, the bond market shows international demand for American financial assets is as high as ever. The Federal Reserve's holdings of Treasuries on behalf of central banks and institutions from China to Norway rose by USD 68.8 billion, or 3.3%, in May, the third most on record, data compiled by Bloomberg show. The Treasury said bidding from foreigners was above average at its USD 101 billion of note auctions last week. US government securities have fallen 4.3% so far this year, the worst performance since Merrill Lynch & Co began tracking returns in 1978, as so-called bond vigilantes drove up yields to punish President Obama for quadrupling the budget shortfall to USD 1.85 trillion. The purchases by foreigners show that, at least for now, there's little chance of buyers abandoning the US or threatening the dollar's status as the world's reserve currency.

China's manufacturing expanded for a third month, adding to evidence that its economy is on the road to recovery. The official Purchasing Manager's index was at a seasonally adjusted 53.1 in May after registering 53.5 in April, the Federation of Logistics and Purchasing said on Monday in Beijing. A reading above 50 indicates an expansion. "The Chinese economy is well on track for recovery and economic growth is picking up steam," said Lu Ting, an economist at Merrill Lynch & Co in Hong Kong. "The PMI may trigger a rally for asset prices, especially commodity prices."

China's manufacturing expansion has helped drive oil to its highest price since November as it signals that fuel demand in the world's second-biggest energy consumer will increase. Oil climbed as much as 1.8% after the US dollar fell to its lowest against the euro since December, heightening the need for commodities to hedge against inflation. "All the attention is on the weaker dollar and macroeconomic sentiment," said Christopher Bellew, senior broker at Bache Commodities Ltd in London. "The market has advanced a long way on flimsy fundamentals and may pause for a breath or see a setback now." Crude oil for July delivery rose as much as USD 1.98, or 3%, to USD 68.29 a barrel on the New York Mercantile Exchange. Crude had its biggest monthly gain in a decade in May, surging 30%, after OPEC left output unchanged on signs the global economy is recovering and fuel demand will increase.

Poland posted the European Union's second-fastest economic growth for the first quarter so far as investments in buildings and machinery and household spending kept the nation from slipping into eastern Europe's recession. Gross domestic product expanded an annual 0.8%, the Central Statistical Office said in a preliminary estimate last week in Warsaw, the second-best result of the 20 EU countries that have reported first-quarter GDP, behind Cyprus. The 16-member euro zone contracted 4.6% in the period.

Zimbabwe may begin using the South African rand as its currency this year, the Johannesburg-based Times newspaper reported, citing Finance Minister Tendai Biti. The southern African nation is considering joining the rand monetary union, continuing with the regime of multiple currencies, or resuming use of the Zimbabwean dollar and redenominating it either with either the rand or the US dollar.

### **Spotlight on the euro fixed income market**

The release of the gross domestic product data for the first quarter of 2009 showed the eurozone's largest contraction on record at 2.5%, with the region's more export-orientated economies exhibiting particular weakness. In Germany, for example, growth slowed by 3.8%, the sharpest downturn since reunification in 1989. Meanwhile, inflation remains well below the European Central Bank's (ECB) 2% target. The consumer has remained under pressure and the unemployment rate has escalated, reaching 8.9% in March, with Spain showing particular weakness.

Growth is now forecast to contract by around 0.1% in 2010 and inflation to remain well below 2%. More recent indicators seem to suggest business confidence may be improving with purchasing manager indices indicating some recovery in manufacturing orders. Nevertheless, we are still in the early stages of the downturn in Europe.

The ECB acknowledges the labour market will continue to deteriorate for quite some time. In spite of the ECB's gradualist approach and clear concerns over how low interest rates can go, further policy easing is likely. In addition, the ECB has announced it will be embarking on unconventional stimulus measures, to be detailed at its June meeting.

Intra-euro country performance has remained a key theme so far this year. Countries such as Austria have come under heightened pressure in this environment due to concerns over exposure to the banking sector in eastern Europe. Ireland traded at particularly wide levels due to concerns surrounding the outlook for growth and public finances. In addition, the market has been affected by anticipation of downgrading activity that emerged at the end of the first quarter when S&P downgraded Ireland to AA+ with a negative outlook. Overall, country spreads reached levels that began to price in the modest probability of a break up of the European Monetary Union, thereby creating buying opportunities among the stronger credits. However, the overshoot has partly corrected since then, with spreads being much tighter.

With little evidence of a significant turnaround in growth outlook or a medium-term inflation threat, investors should maintain a positive outlook on the euro fixed income market according to Michael Krautzberger, co-head of European fixed income at BlackRock. Looking forward, credit is expected to be a key source of positive performance for portfolios.

"While bank disintermediation is likely to increase supply, and a prolonged economic slowdown will result in a higher level of defaults, corporate bonds are pricing at an excessively pessimistic economic outlook and elevated levels of default risk," said Krautzberger. He continues, "It is true we are now entering a period where defaults may pose a potentially higher risk for investors. However, the additional return investors derive from corporate bonds more than adequately compensates for that risk, particularly when in some cases they are earning 8% or 10% as a yield-to-maturity. In addition, when you look at the period since 1970, average lev-

els of default for investment grade bonds have been very low, at around 0.8% over any five-year period."

Krautzberger adds that areas of the market investors should look to are government guaranteed financials and utilities. As governments take the necessary steps to guarantee liquidity, replenish capital and restore confidence there is potential for a recovery in financial corporates and value is likely to emerge in selected names, particularly in the senior debt and lower tier-II areas. In a securitised area, investors should look at high-quality asset-backed securities and commercial mortgage-backed securities, focusing on names where there is greater cash-flow clarity.

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