Ten Seconds Into The Future: Greece. China. Singapore. Other Stuff.

When markets rise, the media quickly approach bulls to interview and feature. When markets fall, they seek bears.

In June, July this year all eyes were on Greece. Every bit of news about Greece was analyzed and scrutinized and markets reacted to these developments as if Greece was larger than the 2% it is of Eurozone output. Soon, the media and markets tired of Greece and despite lack of a credible and durable agreement, Greece was deemed problem solved and off the front page. There remains no credible solution to the Greek's solvency or liquidity, only a temporary reprieve, if that. The apparent solution features more austerity than the Greek economy can withstand, than the electorate had elected Syriza to negotiate for, and Syriza in its entirety stood for. It threatens to fracture Syriza and result in new elections. The IMF has also recognized that the current plan is commercially not viable. Beware, once media and markets have tired of China, and struggle to find or manufacture a fresh crisis, Greece may be back on the table, despite its de minimis impact on Europe and the world.

Earlier this week the PBOC changed the way the Yuan exchange rate was determined by admitting prior closing prices (which introduce serial correlation to add stationarity to the price generation process), demand and supply and the price movements of other major currencies (which introduce market forces), into the way market makers submit their contributions to the fixing. One of the corollaries, probably a bullet point three and not bullet point one, was that the current fixing would be 2% lower, which is inside the bid offer at your local Bureau de Change. Markets and media tire of details and content but instead focus on the easy bullet point: PBOC devalues RMB 2%, in flashing red LED. News is amplified in transmission and soon RMB is falling a full 5% by day 2.

With a slowing economy in China, RMB faces natural weakness. The prior stability masked central bank operations to shore up the currency, not weaken it as some US politicians believe.

– In an open economy, weak growth weakens currency improving terms of trade in a somewhat self-correcting mechanism. China’s trade numbers have been weak.

-China is intelligent enough to realize that the structure of the world economy today renders competitive devaluation less effective on exports.

-China was probably responding to the IMF’s requirement for a more market determined exchange rate for including RMB in the SDR, something that will be considered in October.

-Now some speculation; either China is aware or believes that the Fed will raise interest rates in September and seeks to insulate the economy from potential acute USD strength dragging up RMB, or China did not factor this into their decision to loosen the reigns on the currency and the resultant relative strength of USD transfers probability of a rate hike from September to December.

-And finally something that we are sure we still do not know: what are the precise mechanics for the determination of the RMB reference exchange rate. We don’t know how many market makers there are and we don’t know what constitutes an outlier (which is excluded from the calculation) and how the previous day’s spot rate, demand and supply, and other major crosses feature in the calculation.

Trouble in paradise:

Singapore will never make international headlines but then you never know. What if the Fed r aises rates in September, oil rebounds to 60, equity markets rise steadily and bonds recover? There might be little else for the media and markets to fret over but a little island state turning 50 and about ripe for a mid-life crisis. The long ruling party, the PAP began to lose ground in the 2011 elections and face a new election sometime soon. The passing of the country’s first prime minister, the celebrations at the nation’s 50th birthday coincide to provide the PAP with the strongest circumstances to contest an election. Every silver lining, however, has a slowing economy, or a weakening currency, or rising interest rates, a discontented people unhappy with the high cost of living, significant wealth inequality, overcrowding and the influx of foreign labour at all strata of society. A strong USD is putting gentle but inexorable pressure on interest rates to rise which increases the debt service costs of a nation obsessed with property ownership and funded by adjustable rate mortgages with favorable teaser rates, a significant portion of which threaten to reset. This increased debt service is eroding disposable income and consumption and slowing an economy already burdened with trading with China, whose economy is itself slowing significantly, and Malaysia, an energy and resource driven economy currently in the process of self-mutilation. Some of Singapore's ruling party's veterans are calling it a day as they find the pressure of managing the country beyond the generous monetary rewards of government; and why not? Like a successful private equity partner on Fund VIII, the prospect of cashing out is not all that bad. Singapore's fortunes were built in adversity as it was evicted from Malaysia. Absent adversity and desperation, what will temper the next generation of leaders who have to find a way through the next half century? Is adversity a condition precedent for the next leg of prosperity? The world is a smaller place, and yet a less friendly place, not just for small island states but for everyone. What does a country where trade is more than twice its GDP do as countries become more insular and less cooperative?

Then there are some troublesome questions which many daren't seek the answers to.

Greece exposes a structural inefficiency in the euro mechanism. Is it sufficient that Greece is resolved or should the Eurozone examine underlying causes and seek to stave off future potential crises? A currency union without fiscal union and indeed structural and institutional union extending to labor and commercial laws among other things is fragile.

Global debt levels are another concern. How we regard debt at an ideological level and how we deal with its repayment and servicing are questions we have decided to seek but partial answers to. Central banks of indebted countries could be seen as having lost their independence in how they police or intervene in markets. Most are creditors to their sovereigns begging the question of what does a consolidated sovereign balance sheet look like? What are a country's assets and liabilities? At a more prosaic but no less concerning level, how does a central bank roll back quantitative easing. The US Fed is the most advanced along the line and will serve as an example to the world's other major central banks. One hopes the Fed knows what it is doing. And that its example is replicable by countries without the luxury of the world's most trusted IOU, the USD.

Inequality. In world where it is patently clear resources are amply sufficient for the planet, why must one person starve while another basks in luxury. Widespread poverty defers such question as much as robust growth. Slow growth and a growing middle class cast rich and poor in vivid relief. Social media and technology bring rich and poor into close virtual proximity, surely an incendiary environment. Delve deeper and questions about the value of capitalism and socialism and how we organize our economy and society arise.

But markets and media do not concern themselves with problems as intractable as these. They seek more tangible problems, problems which have an immediate or short term price impact.

Here is one. The US is sanguine about a strong USD, but only because it has never been much of an exporter, on a net basis at least. It has now achieved some semblance of energy independence. It is the most stable and robust large economy. It is even considering raising interest rates in the near future. This creates a natural, gentle upward pressure on the currency. But a rising USD changes the calculus for emerging market bonds. Bond yields which appear to be generous in places like Brazil or Indonesia are tempered by the need and cost of hedging the currency exposure. Sometimes, as in Brazil and Indonesia, the cost of hedging makes the investment less attractive than buying a lower yielding US treasury note or bond. A strong USD and an improving trade balance can happen if a structural phenomenon such as reshoring gains ground and manufacturing is repatriated to automation heavy factories. This combination not only raises local currency borrowing costs but USD borrowing costs internationally. The Fed doesn’t just tighten policy for the US, it tightens policy for the world.