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## WTC Attack and Capital Flows

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A high volatility and a high volume of trading on the equity market characterized NYSE's re-opening after the terrorist attack of the 11<sup>th</sup> of September. The market proceeded to the reallocation of capital according to the new situation characterized by economic and politic uncertainty. We believe that the conjunction of the US economy downturn and the terrorist attack may have the following impact on capital flows of the developed countries. The potential capital flows are analyzed from 3 points of views:

1. Vehicle wise,
2. Business sector wise,
3. Geographic region wise.

### **Inter-vehicle capital flows**

*Still waiting for the "flight to quality"*

The expected "flight to quality" (intensive capital flows from stocks to bonds) is still not happening; on the contrary the capital flows have reduced in Japan (historic narrowed daily variations of the Nikkei Index on the 26<sup>th</sup> of September) as the investors are waiting for new elements to take any large-scale investment decisions.

*Increasing liquidity or increasing stock exposure?*

At the moment it seems difficult to know whether investors in Japan will look for more liquidity or, on the contrary, as stocks are plunging, will see there an opportunity to increase their exposure to stocks.

*Speculation on REITs*

Before the re-opening, some investors were expecting an increase in share prices of REIT that own office buildings in and around Manhattan because available space were expected to be gobbled rapidly by displaced tenants. This movement effectively occurred on the 19<sup>th</sup> of September especially for SL Green Realty Corp (+5.5%), Cali Realty Corp. (6.6%) and Reckson Associate Realty Corp (+4.3%).

The rise of Cali Realty Corp and Reckson stocks were confirmed on the 27<sup>th</sup> of September while SL Green Realty Corp had already plunged again under the quote prevailing before the attack. Nevertheless, the positive effect of the attack on the first two REITs may not persist for the

following reasons:

- They are almost fully occupied and have little development in the pipeline,
- The costs of insurance and energy are likely to rise,
- Movements of financial institutions outside NY City may be difficult to reverse.

### **Inter-sector capital flows**

#### *Winners*

As investors should flock to companies with earnings that are not dependent on the economy, allocations should increase for:

- Shares of drug-makers,
- Share of beverage and food companies.

In Japan some pension funds are also observing capital flows towards life insurance companies whose interest rates (1.5%) became attractive in today economic situation.

#### *Losers*

On the contrary, investors may reduce their allocations to:

- Airline companies stocks,
- Property and casualty insurers stocks.

This negative impact will be partially offset in the US by companies buying their own shares to prop up the market further to the easing of restrictions on company repurchases by the SEC. This will probably result in a reduction of the investments of these sectors.

#### *Impact on Japanese banks*

Even if the losses of core Japanese banks like Mizuho Holdings, UFJ Holdings or Mitsubishi Tokyo Financial Group were expected before September (due to the decline in the value of their stockholdings), the WTC attack has certainly worsened their results, which results in lowering the amount of bad debts they can deal with. Another indirect effect of the WTC impact is that investors are beginning to doubt that Japanese government can, at the same time, be involved in the new potential conflict in Afghanistan and in the resolution of the domestic problem of NPL. This event could contribute to the weakening of the Japanese banking system and urge capital demand side to rely more and more on securitization.

### **International capital flows**

The increase of the risk premium of American assets has resulted in a relative plunge of US stock prices. A Market correction to the extreme concentration of investors' funds in the US and a disruptive shift in the international flows of funds are expected.

This phenomenon could also spread to countries whose economies are most correlated to US (Japan, UK, and Germany). Japan is more particularly exposed as it is in great part relying on a US recovery to rescue its economic performance.

As a consequence, continental Europe could benefit from this shift as, at the same time, the reduction of the investors' position in emergent markets accelerates.

NREIM would like to extend our deepest sympathies and prayers to all the people affected in this attack.