

Trade revival

But stock markets slide on the week

January 15, 2010 – Improvements in world trade figures released last week raised hopes that the flood of government “stimulus” and monetary easing over the past 18 months has kick-started the global economy. Trade figures from the US and China especially seemed to indicate a revival in domestic demand – the key to any sustainable recovery. The big question, of course, is just how “sustainable” the recovery will be once government handouts end and central banks turn off the printing presses.

In the US, the trade deficit widened to US\$36.4 billion, up US\$3 billion from the previous month. US domestic demand strengthened on growing business spending as inventories are re-stocked, and imports rose 2.6% in November as a consequence, outweighing a smaller increase in exports.

As encouraging as this is – after all, the US is still the world’s economic growth engine by a huge margin – China’s export surge in December was the big story. Exports rose an annualized 18% in December, while imports surged by 56%. Near-record imports of iron ore and the highest-ever imports of crude oil contributed to December’s export trade turnaround, the first month of growth after 13 months of decline. As a sidebar, Chinese exports posted their first yearly decline since 1983, falling 16%, to US\$1.2 trillion in 2009. Imports, meanwhile, dropped 11.2%, to US\$1 trillion in the year.

As China’s economy gets rolling again, ballooning trade surpluses with the rest of the world are once again becoming an issue. With its fourth-quarter trade surplus topping US\$196 billion, criticism is beginning to surface again, from the US, the European Union, and Japan, that China’s burgeoning export sector enjoys an unfair advantage because its currency, the yuan, is pegged to the US dollar at an artificially low level.

As China’s policymakers attempt to recalibrate the economy towards domestic demand, its voracious appetite for raw materials is exercising a strong gravitational pull on the prices of commodities ranging from oil to soybeans, wheat, and copper, all of which have seen sizable recent runups. In the process, the currencies of resource-supply economies like Canada and Australia are experiencing renewed strength as the US dollar resumes its decline.

This highlights again the growing potential for escalating trade tensions and currency imbalances, even as the global economy attempts to re-set following the devastation wrought on every domestic economy by the recession.

Canada's merchandise trade balance, meanwhile, slipped back into deficit in November, following a surplus recorded in October, according to Statistics Canada. Exports faded slightly in the month, led by a decline in auto exports, while imports rose, resulting in a \$344 million deficit for the month. Canada's trade surplus with the US narrowed slightly to \$3.2 billion, but the trade deficit with other countries widened to \$3.6 billion as sales to Europe and Japan stalled. However, the November trade deficit is likely to be anomalous, as inventory re-stocking in the US and growing world demand firms up support for Canada's export sector through December and into the first quarter of 2010.

Against this backdrop, the US Federal Reserve Board's "beige book" survey of regional economic conditions released last week showed modest improvement across the country. Even though it said the holiday shopping season was moderately better than 2008, retail sales posted an unexpected decline in December, according to a US Commerce Department release last week. Sales figures are volatile, however, and most observers believe that a firming trend is in place that's likely to continue accelerating in coming months.

Fourth-quarter US corporate earnings are expected to show improvement, especially in the all-important banking sector. Revenues are expected to rise 7.6% among S&P 500 companies, while operating earnings are expected to triple, on a year-over-year basis. President Barack Obama, meanwhile seems to be on a crusade against profits, especially bank profits, which he sees as "massive," along with bonuses, which he characterizes as "obscene."

Hoping to deflect growing criticism of his domestic policies, such as healthcare socialization, and widespread discontent over massive fiscal deficits, Mr. Obama last week proposed a 0.15% tax on the liabilities of all large financial institutions, whether they ever received government bailout money or not. The tax is expected to generate US\$90 billion over 10 years as a way to make up shortfalls in repayments of loans from the Troubled Asset Relief Program (TARP). The proposal, which is not yet law, provoked predictable yea/nay responses along party lines.

What was generally missed in all the political hot air is the fact that this is a new tax – in other words, a tax *increase*. Granted, it's a tax on some big banks, which currently are in the doghouse, rightly or wrongly, with most of the American public. A new corporate tax, and on banks no less, is not seen as any kind of a problem. However, anyone who believes that the proposed Obama bank tax is the end of the story is in for a rude awakening. It's the first of many, progressively more painful tax increases yet to come, which will not by any stretch of the imagination be limited to the big, bad corporations.

The same will eventually be true in Canada, though perhaps on a smaller scale. But not just yet. A possible spring election pretty much rules out any tax talk. Meanwhile,

though, Canada's booming housing market has raised fears of a developing asset bubble. However, Timothy Lane, the Deputy Governor of the Bank of Canada last week said that the BoC believes that rising house prices are not out of line with supply and demand fundamentals, that a real estate "bubble" is not in the making, and that any increase in the BoC's target overnight rate at this point would "in essence be dousing the entire Canadian economy with cold water just as it emerges from recession."

Similarly, the European Central Bank held its benchmark interest rate at 1% last week, as ECB President Jean-Claude Trichet warned that although economic activity expanded in the fourth quarter, "some of the factors supporting the growth in real GDP are of a temporary nature," adding that "the recovery process is likely to be uneven." The ECB continued to phase out extraordinary liquidity measures implemented over the past year, including ultra-low-rate loans to banks. And, tellingly, money supply shrank for the first time on record.

The S&P/TSX Composite Index had a rough week, as selling pressure on materials, energy, and, of course, bank stocks pushed Toronto's benchmark index to a 2.2% week-over-week loss.

On Wall Street, against a backdrop of soft retail sales and jobless claims data, as well as rising retail loan losses and a dividend freeze reported by JPMorgan Chase & Co., the Dow Jones Industrial Average missed breakeven on the week as weakness in telecommunications and materials led declining shares through a Friday plunge. The DJIA lost 0.1% on the week after touching a new 15-month high on Thursday. Similarly, the S&P 500 Composite Index lost 0.8% on the week. A sign of increasing investor nervousness is the 0.7% week-over-week advance in the consumer staples group, and a 0.8% gain in healthcare, the only two S&P groups to post gains – and the two groups that represent defensive stocks. ■

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