

Markets post New Year's advance *But fiscal, monetary, and currency problems loom*

January 8, 2010 – The good news is that the first week of the year saw news of an encouraging resumption of activity in global manufacturing through December. Both output and new orders at places that make stuff we all need and use rose just about everywhere. That gave the beleaguered Canadian manufacturing sector a small ray of hope that its long trial by fire might soon be coming to an end. No good deed goes unpunished, however, and those small hopeful signs of growing economic revival were offset by broad unemployment rates that remain stubbornly high and by growing concerns over deteriorating global fiscal and monetary conditions.

The JP Morgan Global Purchasing Managers Index, which surveys 20 countries, rose to 55.0, its highest level in over three and a half years. (Like all purchasing managers indexes, any reading above 50 indicates expansion in the sector.) New orders also rose, to their highest level in five and a half years.

In the US, the widely followed index of manufacturing published monthly by the Institute of Supply Management rose to 55.9 in December, matching a level last seen in April 2006. US Department of Commerce reported that new factory orders advanced 1.1% in November in response to freshening demand for everything from machinery to steel to chemicals to textiles. Orders for cars and planes lagged, however in the durables category.

European factories also resumed cranking out doodads at their fastest pace in 21 months. Markit Economics reported that its December purchasing managers index in the 16-nation euro area rose to 51.6 from 51.2 in November. So what's great about an increase of four tenths of a point? True, there's nothing much to crow about in absolute terms; in fact, it's pretty dismal. But what's significant here is that there's *any* increase at all, given the dismal results of most every other macroeconomic metric in Europe.

In Asia, the Chinese manufacturing sector saw its fastest growth in five years, as the HSBC/Markit Economics Chinese purchasing managers index rose to 56.1 in December. China is now the world's third-largest economy, and seems likely to supplant Japan in the number-two slot this year, as Japan sinks into what appears increasingly to be the second leg of a double-dip recession.

As for Canada, the Ivey Purchasing Managers Index dipped to 48.4 in December from a reading of 55.9 in November. The decline had been expected, because December usually

sees a drop in manufacturing purchasing intentions, but the index had been expected to stay in growth territory above 50. Alas, it was not to be, as Canadian manufacturers continue their struggle for survival against the forces of tight-fisted American consumers and renewed Canadian dollar strength against the US greenback.

If the generally improving global manufacturing sector is a harbinger of reviving economic growth worldwide, then the long shadow cast by still-dismal employment numbers and growing fiscal and monetary concerns can be said to be stunting that growth from its full potential.

Unemployment in the world's developed nations continues to weigh heavily on hopes for any quicker or more robust recovery. Indeed, US payrolls dropped by an unexpected 85,000 jobs in December. Hopes for a turnaround in the labor market were raised briefly in November, when 4,000 jobs were added – a drop in the bucket by US standards, but a move in the right direction nevertheless. Still, the econo-sphere had expected something closer to a no-growth scenario for December rather than a return to significant out-and-out job losses. The overall US unemployment rate held steady at 10%.

In Europe, the unemployment rate rose to 10% in November as well, its highest level in more than 11 years, and up from 9.9% in October. Germany, the largest economy in the region, was an exception, however, as unemployment declined and the unemployment rate steadied at 8.1%. The jobless numbers are reflected directly in consumer spending figures, which showed a 1.2% slump in month-over-month retail sales for November in the eurozone as a whole and a 1.1% drop in Germany.

Canadian employment fell slightly in December, with a loss of 3,000 jobs. The unemployment rate remained at 8.5%. However, the marginal loss of jobs has to be put in the context of an overall job-gain trend, with an average increase of 20,000 net new jobs per month over the previous five months, and a one-month gain of nearly 80,000 in November.

Against this backdrop of a very slow return to growth and persistently high unemployment, both of which are characteristic of recovery from deep recessions, are some more ominous developments in the esoteric world of government finances and monetary policy. These, along with currency imbalances, are likely to become issues dominating market action through 2010.

Growing fiscal deficits and ballooning debt are raising concerns of more pain ahead for shell-shocked consumers, as governments everywhere face the imperatives of imposing fiscal restraint through spending cuts, tax increases, and rising interest rates. That, of course, raises the risk of choking off economic recovery, a hard fact of economic reality that we've pointed out regularly in these comments over the past couple of years. One way or another, however, the piper must be paid. The first instalment is coming due this year. China has taken the first steps on this road by raising the yield on its three-month bills last week for the first time since August. Australia's central bank has already raised its key rate three times in the past quarter. Japan and France are agitating for international

talks on sorting out currency and trade imbalances between the US dollar, the Chinese yuan, and the euro. (Good luck with that!)

Stock markets mostly shrugged off these concerns and focused on the steady trickle of good news. Commodity prices trekked upward last week, and the resource-heavy S&P/TSX Composite Index followed suit, posting 1.8% week-over-week advance. The Dow Jones Industrial Average also gained 1.8% on the week, while the S&P 500 Composite ended the week up 2.7%.

It's an auspicious start to the year for equity markets, despite the problems looming on the horizon. But the old market saw that "as goes January, so goes the year" still has three weeks to play out. And much can happen in three weeks. ■

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