Ermes Monaco

From: Ermes Monaco <emonaco@dundeewealth.com>
Sent: March-08-13 12:43 PM
To: 'Ermes Monaco'
Subject: VALUED CLIENT MAIL LIST: Dundee Economic Monitor - February 2013

DUNDEEWEALTH

Currency Poker

A sound indication that the world is a global village is the flow of international trade in goods and services. Prior to some 40 years ago, countries were largely self-reliant and prospered or languished according the human and physical resources available within their borders.

With the advancement of travel and communication, goods and services are now able to conveniently move around the globe to meet demand. As domestic production supplies offshore markets, countries rely on exports rather than domestic consumption to foster growth. In a race to garner a bigger piece of the global pie, this has created a situation of excess industrial capacity supplying a finite global market with the same goods. As a result, it is primarily internal economic mechanisms such as wages and standards of living which distinguish competing product on the basis of price.

Another key mechanism to remain competitive on the basis of price is to ensure the currency of the exporting country remains weaker relative to the importing nation such that the imported goods will be more attractive. This has become a major tactic in an era of modest global growth where countries are "adjusting" their currencies to win more of a dwindling pie.

China remains accused by the U.S. of manipulating its Renminbi to undermine its value relative to its share of global trade and most recently Japan has undertaken similar measures to weaken the Yen. Of course, it can be said that the U.S. has been doing the same through its Federal Reserve QE policies although, in fairness, the U.S. is in a significant trade deficit position and is orchestrating a weak U.S. dollar to prevent recession rather than to maintain global market share.

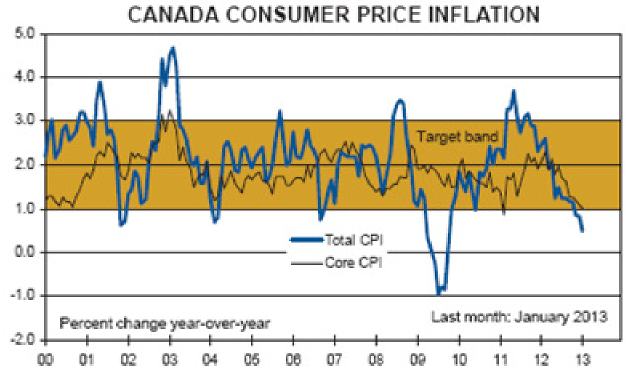
The result is a game of currency poker where players are seeing the bets and raising, er, lowering their currencies, in an attempt to have a better hand. But, from an economic perspective, unless a better balance of capital flows is created, markets on both sides of the supply/demand equation will deteriorate as the importing nations lose the ability to consume through increasing unemployment and loss of production capacity. This will weaken the ability of export markets to support growth in foreign markets as capital flows create idle surpluses and crippling deficits. This can be clearly seen in a chart below which illustrates the FX Reserves and Import ratio.

Two actions that would help a better balance of global capital flows are an increase in domestic consumption and setting of more equal two-way trade tariffs. This would reduce the temptation for countries to interfere with the natural currency markets. Water always finds its course and building dams will only create temporary effect. However, history has shown repeatedly that situations are only be addressed after the dam breaks.

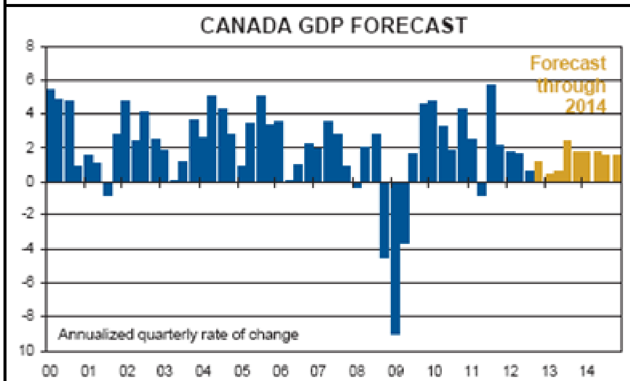
(Source for all charts and statistics: DundeeWealth Economic Monitor unless otherwise indicated)

KEY ECONOMIC INDICATORS	

The Canadian dollar continues to weaken in line with commodity prices and exports as well as a modest GDP and interest rate outlook.



Modest prospects for economic recovery continue to undermine consumer confidence and consumption which are driving CPI lower.



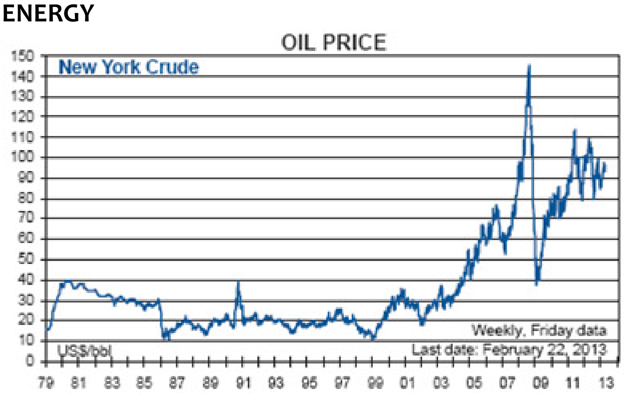
Given the current global trend and Canada's national economic strategy, GDP is likely to remain below 2%.

	Actual				Projected						
	12-II	12-III	12-IV	26-Feb	Mar	Apr	May	13-II	13-III	13-IV	14-I
Treasury Bill (91-day)	0.98	1.00	0.99	0.96	0.95	0.90	0.70	0.77	0.50	0.50	0.55
Government Bond (10-yr)	1.87	1.72	1.77	1.86	1.80	1.80	1.75	1.80	1.90	1.95	1.95
Prime	3.00	3.00	3.00	3.00	3.00	3.00	2.75	2.75	2.50	2.50	2.50
Target Overnight Rate	***1.00***	***1.00***	***1.00***	***1.00***	***1.00***	***1.00***	***0.75***	***0.83***	***0.50***	***0.50***	***0.50***
Spread: 10-yr - T Bills	0.89	0.72	0.78	0.90	0.85	0.90	1.05	1.03	1.40	1.45	1.40

DundeeWealth's Economic Department continues to forecast interest rates moving range bound at current levels.

KEY SECTORS

ENERGY



Oil prices are dependent on global recovery although Canada will continue to sell its oil at roughly $20-$30 less a barrel until such time that it can build pipelines to reach markets outside of the U.S.

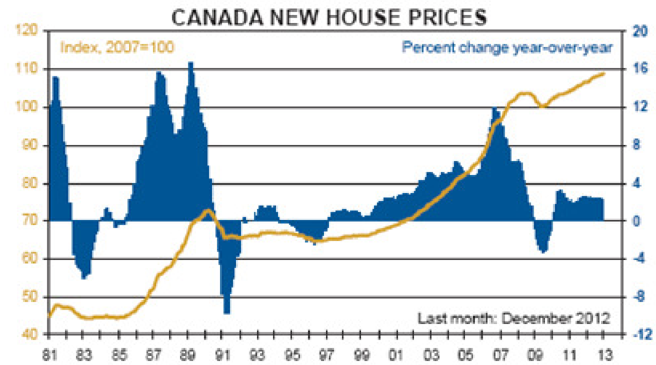
FINANCIAL MARKETS
(Last 3 years)

Source GlobeInvestorgold

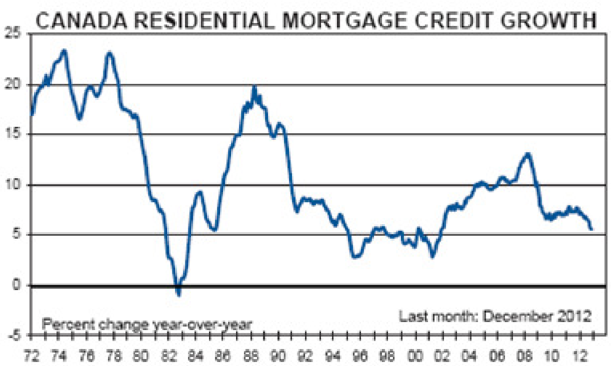
While the U.S. markets continue to reflect optimism, the value of investments in $US for Canadians remains exposed to currency risk so long as the Canadian dollar trades at par or above to the $US.

However, the possibility of a weaker loonie later in the year could provide an entry point.

REAL ESTATE



Source: Statistics Canada New House Price Index

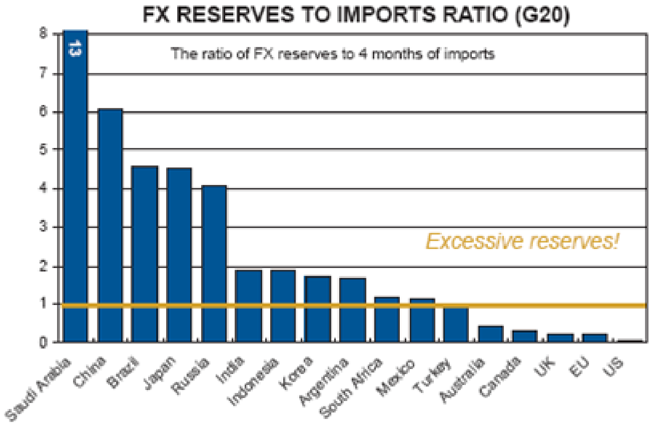


A slowing supply of new housing coming on line is moderating a decline in prices despite lower activity being caused in part by tighter lending conditions.

This is being seen in the re-sale sector as well although the experience varies dramatically by region with B.C. seeing steeper declines while prices in the west are firmer or increasing as in Winnipeg at this time.

TIMELY ITEMS

The latest entrant in the currency war is the Japanese Yen which has taken measures to weaken the currency in an attempt to ensure domestic goods are attractive to exporting markets.



A consistent trend in the west since the 1970's of import consumption has led to a significant transfer of wealth to the exporting nations. Substantial foreign currency reserves have been built up due to their orientation towards exports without achieving an import-export balance with their trading partners.

The Western trend toward outsourcing manufacturing to lower cost offshore centers has added to this trade imbalance, undermining employment and GDP growth.

Given increasing global supply capacity and declining Western consumption, this is not likely to be sustained over the longer term even with increased domestic consumption by the exporting nations.

Canadian manufacturing reflects this trend which is highly dependent on the U.S. as an export market and also subject to trade deficit imbalance.

QUOTES FROM THIS MONTH'S MONITOR

On Global currency volatility

So what exactly is a "currency war"? It is countries manipulating their currencies lower, below where the "market" would set the cross-rates, in order to gain advantage for its domestic producers – so that they (1) will export more, (2) experience less competitive pressure from imports, and (3) be in a better position to hire more workers. Indeed, when employment

On the Canadian currency perspective

The Canadian dollar has fallen back below parity thanks to weak economic data and weaker commodity prices.

Regards
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The Economic Monitor is available through the DundeeWealth website.