The cost of a strong dollar and weak demand

By Barrie McKenna
October 8, 2012 – *The Globe and Mail*

Few people had ever heard of the Baltic Dry Index before the 2008 financial crisis, when it became a scary barometer of a global economy hitting the skids.

The index tracks changes in the cost of shipping bulk commodities such as metals, grains and crude oil by sea. The index falls when shippers aren't shipping, and between May and December of 2008, the BDI crashed 94 per cent.

So how is it doing this year amid renewed fears about the global economy? Not good. The index is down more than 55 per cent so far this year as too much capacity chases too little traffic.

This week investors will get a snapshot of how Canada is fairing in global trade, with Thursday's release of merchandise trade figures for August.

Also on tap this week are trade figures for several of the world's other major trading countries – Germany (today), Japan (Tuesday) and the United States (Thursday). All four countries are suffering the consequences of the weakness that's evident in the Baltic Dry Index. Activity is sluggish.

Canada is facing a double whammy of slowing global demand and a strong currency, which makes its exports more expensive. The dollar remains above par versus the U.S. dollar.

The merchandise trade deficit swelled in July to $2.3-billion – the largest since Statistics Canada began tracking the data in 1971 – driven wider by sharp declines in virtually all of the country's major exports. Exports are down 11 per cent since the end of last year.

Economists expect Canada to continue running a trade deficit through most of next year. Japan is facing similar pressures, including the high yen.

The United States doesn't have a currency problem. But it is feeling the effects of the global slowdown and a weak recovery at home. Germany, meanwhile, is starting to be hurt by the deepening recession in most of southern Europe, exacerbated by austerity measures.

The bottom line is that global demand is weak, according economists as JP Morgan Chase & Co. "The degree of pickup in global industry will be determined by the strength of final demand," JP Morgan pointed out in a research note. "Our biggest concern is a shift to business caution that has led to very weak capital expenditures."

Bank of Canada Governor Mark Carney has expresses similar concerns about cautious executives hoarding cash, warning recently that Canadian companies are sitting on "dead money." And that doesn't bode well for trade