THE CONTINENTAL ECONOMICS CURRENCY REVIEW
Economic Outlook October 2012

Summary

As indicated in the previous analyses at this place, the Great Recession continues and affects more and more parts of the world. Despite the massive fiscal and monetary stimulus, the U.S. economy remains weak and finds itself in a state that is not much different than that of Europe and Japan. While the economies of the industrialized countries continue its stagnation, the major other economies also suffer weak economic growth with a marked slowdown of economic growth in China and Brazil.
While there are signs of economic upturns in place, this should not provide reasons for complacency. If the world economy should pick up anytime soon, the overhang of liquidity could rapidly fire massive inflation.

Economic growth

After meager rates in 2011, U.S. economic growth accelerated slightly to 2.4% and 2.3% in the first and second quarter of 2012. In the meantime, the rate of economic growth in the Euro Area worsened in each quarter since the beginning of 2011, reached a rate of zero in the first quarter in 2012 and became negative in the second half of 2012 with a rate of -0.4%. Germany, which still had robust growth rates in 2011, also recorded weaker rates of 1.2% in the first and 1.0% in the second quarter of 2012, while the UK slumped with growth rates of -0.2% in the first and 0.5% in the second quarter of 2012. The Japanese economy could get out of negative territory that it was in in the past year and surprised with strong economic growth of 3.1% in the first and 3.6% in the second quarter of 2012.
The economic growth data are in tune with the data of industrial production where the United States could register a jump in the second quarter of 2012 to 4.6% while in the Euro area industrial production registered a negative rate equal to that of the United Kingdom which suffered from negative rates of -2.4% and -2.5% in this period.
After a sharp fall in industrial production in Japan in the second quarter of 2011, this country could register an increase in industrial production in the second half of 2012 by 4.8%.

International trade

The U.S. current account continues to be in deficit in 2012 more or less at the same rates as in 2011. After a current account deficit of 3.4% of GDP in the third quarter of 2011 and of 3.1% in the fourth quarter, the US current account deficit was 2.9% in the first quarter of 2012.

The Euro Area recorded a surplus in its overall current account of 1.5% in the last quarter of 201, while Germany continues with strong surpluses in the range of 7.3% in the fourth quarter of 2011 and of 6.3% in the first quarter of 2012.
Like the United States, the United Kingdom keeps on with current account deficits and suffered a deficit of -3.2% in the first quarter of 2012.
The current account surpluses of Japan and China were moderate due to weak economies in Europe and the United States. While China had a surplus in its current account of 3.5% and 3.0% in the second and third quarter of 2011, this figure fell to 2.5% in the last half of 2011 while Japan recorded a surplus of 0.8 % in the last half of 2011 and 1.7% in the first half of 2012.

Interest rates and currencies

The central bank of the United States continues to practice a policy of minimum interest rates as well as do the central banks of the Euro Area, the UK and Japan. The U.S. central bank has not changed its federal funds rate of 0.25% per year and Japan has maintained its rate of 0.10%. In Europe, the European Central Bank has kept its policy interest rate at 1.00% since April 2011 and the Bank of England continues to charge a rate of 0.50%. China has not changed its interest rate that remains at the level of 6.31%.

The euro weakened slightly against the U.S. dollar from 1.32 in April to 1.23 in July 2012 together with the pound sterling that fell from 1.60 in April to 1.56 in July 2012. Looking at the past 12 months one can note that the turbulences in international markets such as the sovereign debt crisis in Europe and the fiscal problems in the U.S. have not affected very much the exchange rates among industrialized countries. Even the rate of the yen against the dollar hand hardly changed over the past 12 months with 79.40 yen per dollar in July 2011 and 78.98 yen per dollar in July 2012. China revalued its exchange rate only marginally from 6.46 yuan per dollar in July 2011 to 6.32 yuan per dollar in July 2012.
While not much has changed with the exchange rates of the countries, Brazil has managed to devalue its currency from 1.56 real to the dollar in July 2011 to 2.03 real per dollar in July 2012.

Commodities

The gold price was relatively stable with US$$ 1,685.3 per ounce in August 2012. The price of oil in August 2012 had the same price as in August 2011 at a little more than US$114 per barrel. Over the past 12 months the price of oil recorded a maximum variation between US$ 122.7 in February 2012 and US$101.9 in May of the same year. More accentuated movements occurred with the prices of other commodities, with coffee down from 289.1 in August 2011 to 164.6 cents per pound in August 2012 same as sugar that dropped from 29.7 in August 2011 to 19.8 cents per pound in August 2012 while other commodities such as corn, soybean price slightly rose.

Outlook

The world economy is in a phase of treacherous tranquility with cracks and tensions all over the place. No clear investment preference is available and all runs down to the choice between bad and worse. Over the past couple of years there has been such a build-up of global liquidity that markets simply cannot recede even if they are clearly overprized. Stocks, bonds, commodities, for each and every investment item prices are high and given the avalanche of liquidity that has inundated the markets these prices can even go still higher. The link to sober valuations has been lost. The investment world is waiting for the final blow-off.

Watch out for the economies to show more signs of economic growth. Instead of being cause for jubilation, investors should be aware that more economic growth can easily ignite the megatons of liquidity which central bankers have planted around the world over the past couple of years.

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