

USD-JPY \$99.0550 ▲ 0.83%

S&P TSX 9,596.21 ▲ 0.43%

S&P 500 930.99 ▲ 2.89%

OIL \$63.00 ▲ 3.21%

GOLD \$749.10 ▲ 2.03%

## Who Cares About the U.S. Presidency? You Do!

BY KYLE FRASER

The North American Free Trade Agreement (NAFTA), the war in Afghanistan, and the energy policy positions the Democrats are taking in the U.S. will be vastly different from the politics Canadians have become accustomed to. With the economy at the forefront of issues Americans are unhappy with, the new government will be looking at options to appease the citizens by reducing the deficit and spurring growth. How do they plan on doing this? With change, and not the kind we carry around in our pockets!

It's no secret that the U.S. is Canada's largest trading partner. Out of a total of over \$463 billion worth of goods that Canada exported in 2007, almost \$360 billion of those goods went to the United States. With NAFTA in place, much of the trade conducted was beneficial to both parties in that almost all tariffs had been eliminated on goods traded between Canada, U.S., and Mexico. For Canadian firms, this was particularly attractive as it opened the doors to a market ten times the size of their own. That's not to say trade wouldn't occur between the two nations if tariffs existed, but coupled with the traditionally low price of the Canadian dollar vs. the U.S. dollar, importing goods from Canada could be hugely economical for an American firm.

President (Elect) Obama is painted as a protectionist. This means he believes in protecting domestic businesses and workers from foreign competition. This protection could be enforced by renegotiating the terms of NAFTA, and implementing quotas and/or tariffs on certain items not produced in the United States, stimulating domestic production and reducing the benefit of importing goods. Obama has gone as far as describing NAFTA as "a big mistake." At a time when the American industry is on its knees, when their GDP growth has officially retracted for one full quarter,



when Wall Street has lost workers' pensions and can't raise capital for what investors recognized as the most secure investments, America will take great strides to make the changes they desperately need.

However, those strides apparently don't include withdrawing from Afghanistan. Although Obama has stated he will remove soldiers from Iraq within 16 months, Afghanistan is a different story. An aide to Obama has publicly stated that "there will be no free rides" and that "allies will be expected to pull their weight." British Prime Minister Gordon Brown is expecting a request of up to 3,000 more troops in Afghanistan, where they currently have approximately 8,000 committed. Recent estimates indicate that by the time Canadian soldiers are scheduled to leave Afghanistan, the total price could be as high as \$18 billion. Of course, if Canadians receive a similar request as that which Britain is poised to receive, the price could go much higher. But would the Canadian government agree to such a request? Most experts say Canada's military is already stretched very thin. The important question to ask would be whether Canada will be in the financial position to risk damaging relations when the Democrats are dangling free-trade policies on a thread thinner than our overstretched military? The probability of the U.S. making such a request is very good, and would be directly in-line with their goal of reducing their budget deficit.

The cherry on this light, sweet cake is Obama's crude plan to lay heavier taxes on the major oil companies (the

same ones that have been investing billions of dollars into Alberta's tar sands projects). Obama has suggested that taxes be levied on every barrel of oil sold at a price exceeding \$80. This has the potential to be catastrophic for Alberta as recent reports suggest oil must be trading at approximately \$85 per barrel in order for the tar sands to be economical. It begs the question: what will happen to home prices in Alberta if oil prices continue at today's levels? When their most profitable industry succumbs to the pressures of the current economic slowdown, will the province still be able to boast another \$4.6 billion surplus as they did for their 2007-2008 fiscal year? Regarding oil, however, our future does not lay in Obama's hands - it lies in those countries belonging to the Organization of Petroleum Exporting Countries (OPEC). When they decide how profitable they want to be, that will dictate how profitable, or destitute, Alberta will be.

The flipside of this equation is the added comfort such a tax would afford alternative energy companies, both domestically and internationally. This type of tax could cause relatively short term pain in Canada's booming oil industry but could be better for the country as a whole in the long run.

From 1993-2001, the last time the Democrats were in the White House, Canada's employment growth rate averaged 2.1% per year. This may be attributed to the expansionary period following the recession of the early 1990's. But, when Obama has clearly been caught playing both sides of the border (literally and figuratively) re-

garding NAFTA, what are we left to believe? Will Obama be the saviour of the teetering American economy by continuing to pave the socialist super-highway the Bush administration started, or will he put on the brakes and reinvigorate the country by using the means that brought it to the top (namely, capitalism)? It certainly wasn't high taxes and strained international relationships that made the U.S. the one and only global superpower. A changing of the guard is taking place, a change that all of America needs and the right change according to Obama. The only problem is the country might need a bit of that pocket change.

### Asia-Pacific Region Experiences Lowest Growth in Years

BY DEREK LEONG

As the credit crisis continues to strain the global economy, the once thriving Asia-Pacific region is starting to feel the pain. Over the past two weeks, Asia-Pacific's largest central banks have all announced interest rate cuts as their governments attempt to stimulate growth. Further rate cuts and stimulus packages are also expected in the near future.

With fears the global economy is slipping into recession, countries like China, India, Vietnam, South Korea and Indonesia are finding themselves severely deprived of liquidity. Asia, once a magnet for foreign investment, is now experiencing the reverse as investors are pulling their funds out in a flight to safety. The short supply of external capital has left these nations unable to fuel their export-dependant economies and the financial consequences are starting to become apparent. Across the Asia-Pacific region, industry and exports have both seen slowdowns, and overall economic growth is sluggish.

The impact is most notable in China, the Asia-Pacific region's largest emerging economy. Accounting for one third of global GDP growth over the past year, there are now signs that China's economy is faltering. Chinese GDP growth in September fell to its lowest level in five years, dropping below double digits for the first time in several years. Furthermore, growth of industrial production has fallen to a

six year low and export volume has dropped more than 7%.

Prior to the crisis the more immediate threats of rising commodity prices and rapid inflation had distracted Asian policymakers from the possibility of a slowdown. However, given that inflationary pressures have subsided, governments can now focus on ramping up growth. In China, the central bank has cut its key interest rate three times in six weeks, reduced the bank reserve ratio and increased export tax rebates. Elsewhere in Asia governments are taking similar measures in order to stimulate their economies and increase export demand.

Despite the negative outlook, transitioning Asian economies are expected to continue growing. Compared to stagnant Western economies, Asia-Pacific's largest economies are still expected to grow at rates of between 5% and 9%. Recent high growth rates have allowed these countries to improve their economic stability and accumulate large foreign reserves and financial infrastructure. They will also benefit from strong domestic demand and increased inter-Asian trade. When compared to the developed world, all of these factors hint that Asia should be substantially better equipped to deal with the current crisis than many developed regions of the world.

There are still ramifications to the decreased growth. Manufacturing, which accounts for anywhere between 20% and 50% of GDP in these economies, is expected to see widespread defaults and employee lay-offs. If

growth decreases further, there are also concerns over the economies' ability to absorb new entrants to the work force (an inevitability given population growth), compounding existing unemployment problems.

With growth rates hitting new lows, Asian policy-makers will have a difficult time supporting stable economic conditions. Since developing economies are currently the drivers of the world economy, their slowdown will have negative effects on the harshly-hit developed economies and may cause uncomfortable consequences for North Americans.

### Treasury Secretary Candidates

BY ROBBIE HARES

With the U.S. election over, President-elect Barack Obama is now focusing on candidates for his key policy positions. In the current economic environment, most attention has been focused on the selection of the Secretary of the Treasury. *The Economic Outlook* takes a look at the shortlist below.

#### LAWRENCE "LARRY" SUMMERS

*Education:* S.B. from MIT, Ph.D. in Economics from Harvard.

*Career:* Former Harvard professor, former president of Harvard, former Chief Economist for the World Bank. Previously served as Secretary of the Treasury under President Clinton.

*Interesting Facts:* At 28 years old was the youngest tenured professor in the



Lawrence Summers

history of Harvard. Writes a column for the Financial Times. Has two Nobel prize-winning economists as uncles (Paul Samuelson and Kenneth Arrow).

*Problems:* Carries the stigma of being Clinton's Treasury Secretary and a former proponent of deregulation. Caused controversy when he was quoted as saying males' innate ability was the cause of gender disparities in the fields of science and applied science.

#### TIMOTHY "TIM" GEITHNER

*Education:* B.A. from Dartmouth, M.A. in International Economics and East Asian Studies from Johns Hopkins University

*Career:* Worked in the Department of the Treasury, was director of Policy Development for the International Monetary Fund, is the current President of the Federal Reserve Bank of New York.

*Interesting Facts:* Served as Under Secretary of the Treasury for International Affairs under Larry Summers.

*Problems:* As President of the NY Fed, was culpable in the Lehman collapse (could be taken as a positive, depending on your view of systemic risk and government intervention).

#### PAUL VOLCKER

*Education:* B.A. from Princeton, M.A. in Political Economy from Harvard

*Career:* Previously served as Chairman of the Fed under Nixon and Reagan. Previously worked with the NY Federal Reserve. Noted academic. Served as an economic advisor during Obama's presidential campaign.

*Interesting Facts:* Oversaw the collapse of the Bretton Woods system as a staffer in the Treasury during the Nixon administration. As Chairman of the Fed, he focused on a massive monetary contraction to combat stagflation. The now famous "Volcker Shock" was widely credited as stopping the overwhelming inflationary spiral experienced in the Carter years. It still didn't help Carter get re-elected.

*Problems:* At 81 years of age, many consider Mr. Volcker too old for the position.

#### WILDCARDS

*Jon Corzine*—A fellow Chicagoan and architect of the LTCM bailout as well

as the former CEO of Goldman Sachs and current Governor of New Jersey.

*Warren Buffett*—Both Obama and McCain referred to Buffett as a possible Secretary of the Treasury during the second Presidential debate. The probability of him accepting the position is quite low.

*Henry "Hank" Paulson*—Bush's current Treasury Secretary. Still carries the scarlet letter of financial deregulation. The jury is still out on his handling of the current crisis.

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## In Search of the Silver Lining

BY KENNY CUI

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If there is anything to take comfort from in today's turbulent times, it is that crises often cause positive change down the road. This may not be enough for those who have invested in anything outside of term deposits, but since financial markets are inherently forward looking, its participants should be too.

Although there is a financial and economic crisis now, the future will certainly be better because of it. Before totally embracing the good news, we must recognize the inevitable short-term pain: the recent housing bubble was the largest financial bubble in history, and those expecting only a moderate recession from the bust will be unpleasantly surprised. Today's problems are pervasive because past consumption habits were unsustainable, investment practices were unsound and government policy was insufficient. The silver lining here is the incentive to correct what has gone wrong. The crisis is good because it will halt the irresistible but destructive habits of good times and it will force stakeholders to address the fundamental issues that caused the problem in the first place.

The problems are numerous: frozen credit markets, rising unemployment, potential tax hikes for Joe the Plumber, insufficient healthcare and pension shortfalls for his elders. But these are symptoms rather than illnesses. Economist Nouriel Roubini, famed for the accuracy of his predictions on the current plight, suggests that the policy of increased homeownership has played a key role. Along with artificially lower interest rates,

these subsidies fuelled a massive boom in the consumption and speculation of housing. In turn, this propelled consumers to leverage their equity in order to spend beyond their means. This hyper-leveraging and overconsumption is at the root of today's financial crisis.

The other part, as Roubini indicated, is the result of America having substituted consumption for investment. Whereas yesterday's investment in productivity would have left benefits today, yesterday's consumption has left only bills. Consequently, all that remains is debt for which there is no production capacity to honour.

Thankfully, markets ultimately correct themselves. But politicians and regulators need to be proactive in refining flawed policies and allowing market mechanism to work. First, excessive housing subsidies need to be scaled back in order to avoid further distortions in the marketplace, like this consumption bubble. Second, and perhaps more urgently, we need a financial system that can channel savings into productive investments as opposed to merely securitizing our habitual consumption. This second requisite is a bit tricky: financial infrastructure needs to be made available for investment to work (perhaps decrease income tax and increased consumption tax is appropriate here?). Beyond that, future economic and financial reform must focus on proactive, principles-based governance to stop anything like this from ever happening again. It may seem far-fetched right now, but there's only one direction to go from here.

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