



Why Canadians Should Listen to Donald Trump's Concerns About China

Description

Last week, Billionaire Donald Trump responded to news that China had devalued its currency by 4% against the U.S. dollar by stating the move would be “devastating” for U.S. businesses. The 4% drop represents the biggest drop since 1994, and Trump may not be wrong about the effect on American business—a cheaper yuan makes American exports more expensive and less competitive in the Chinese market, but also in other emerging markets.

Do Canadians need to worry as well? The unfortunate answer is yes, as the declining yuan affects commodity prices, the strength of the loonie (which not only affects companies that import lots, but also broader equity markets), and could contribute to deflation. Shareholders of **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK) and **Canadian Oil Sands Ltd.** (TSX:COS) need to pay special attention to this trend.

Here's why Canadians should also pay attention to Mr. Trump's warnings about the yuan, and what actions you can take.

Canada's commodity-based economy is ground zero

While Trump warned the weak yuan would affect American exporters, they will hit a specific kind of Canadian exporter especially hard—commodity companies. Canada's primary exports include oil and gas as well as other commodities such as copper, potash, and coal, and after the U.S., China is Canada's second-largest trading partner.

Since commodities are priced in U.S. dollars, a weaker yuan means that commodities will become more expensive for Chinese buyers. This in turn could weaken demand. This is certainly an issue, considering that China accounts for 50% of global consumption of copper, iron ore, and cement. China is also the world's largest importer of oil, and consumes more steel than the next nine largest importing countries combined.

A strong U.S. dollar could pressure China to resort to more domestic production, and could also keep Chinese producers afloat (since they would receive a boost to earnings from U.S. priced sales), which would add to supply.

Teck Resources is poised to be hit especially hard by this phenomenon (and already has been). China is a main buyer of Teck's coking coal (which is used to make steel) and copper. China's permanently lower growth (a cause of the yuan devaluation) has already hit demand for Teck's products hard, and the strong U.S. dollar combined with moves by China to reduce imports to protect its struggling coal industry means Teck's main customer is seeing a major reduction in demand.

Canadian Oil Sands Ltd. will not fare much better. As a 100% pure play on oil prices, the strong U.S. dollar and weak yuan will provide a constant headwind going forward.

The devalued yuan also hits the loonie and Canadian equities

As China's currency weakens (a decline that could very well continue, especially as China moves to have a more market-based currency), it could have a couple of effects. The first is it will lead to a stronger U.S. dollar as well as weaker commodity prices.

The end result is that the Canadian dollar weakens as well, since the Canadian dollar's strength is heavily affected by commodity prices. Since the Canadian dollar is linked to the performance of the TSX, a weak dollar could pressure Canadian stocks.

It is also bad news for Canadian imports, and since Canada imports 55% of goods, this could be a headwind. Canadian retailers who import a large portion of their products are poised to be particularly affected.

Can you protect yourself?

Fortunately, there is one company that is poised to take advantage of these factors, and that is **Fairfax Financial Holdings Ltd.** ([TSX:FFH](#)). Run by "Canada's Warren Buffett," Prem Watsa, Fairfax is protected from weakness caused by China's economy and a devalued yuan.

One big fear is that a weak yuan will lead to deflation (as commodities fall and exporters struggle to compete with China). Fairfax will profit from this thanks to \$112 billion in derivative contracts that will profit if deflation occurs. Watsa also has his equity portfolio hedged, which adds more protection.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TECK (Teck Resources Limited)
2. TSX:FFH (Fairfax Financial Holdings Limited)
3. TSX:TECK.B (Teck Resources Limited)

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Author

amancini

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