Special to the Globe and Mail

Steadyhand

Loonie, Oil Decline All Part of the 'Great Rebalancing'

By Tom Bradley

The Canadian dollar and oil prices. We can't go a day without hearing about them, and for good reason. Both are having a big impact on Canadians and businesses. What many don't realize, however, is that what we're going through is a small part of a worldwide shift. I call it the Great Rebalancing.

The changes so far have been nothing short of remarkable, especially since they've come without a crisis to act as the catalyst. Significant moves in exchange rates and energy prices have recast the shape of trade and capital flows. Countries previously deemed uncompetitive are back in the game and swashbuckling oil countries are getting a severe dose of reality. To better understand the impact of this rebalancing, I want to start by defining it.

Out of whack

The word "rebalancing" implies that things were not where they should be. While economies are never in perfect balance, the world has strayed a long way from equilibrium. It got to the point where Asia made everything, the Western world bought almost everything (mostly on credit) and oil-producing countries coined it on the side. Western countries were left gasping as debt levels grew and businesses moved production to China and elsewhere.

So far

One of the most effective tools for rebalancing the world economy is exchange rates. In this regard, the U.S. dollar has been a powerhouse, reflecting the strength of the U.S. economy. It's up 20% in just more than a year versus its trading partners. Currencies closely linked to the greenback, such as the Chinese yuan, have also been strong. As a result, Japan, Europe and Canada are in a better position to compete for new business.

In addition, there's a new balance between oil-producing and oil-consuming regions. Five years of premium prices have triggered a strong wave of investment in fuel efficiency and alternative energy. The producers no longer have the hammer, while net importers of oil and gas, such as Japan and Europe, have been given a shot in the arm.

Oh Canada

Canada could be the poster child for this rebalancing. Our standard of living was out of line with our competitive position and productivity. We weren't a low-cost producer of anything, and were high cost at most things. And yet, on the strength of our oil revenues, we were able to go south of the border and buy food, booze and houses at a significant discount. Our dollar at par was not sustainable.

The currencies of Japan and Europe weren't reflective of their economic circumstance either. The strength of the yen after the 2008 crisis had priced Japan, one of the world's greatest exporters, out of the market. Today, both regions are back in the game.

Of course, there are many elements to this tectonic shift. Business decisions are also being influenced by the need for shorter delivery cycles, wage inflation in China and technological advances such as robotics and 3-D printing. Manufacturing a product in North America or Europe may again make sense for economic reasons, not just patriotic ones.

Portfolio impact

The Great Rebalancing has had a significant impact on investment returns. Oil-related stocks have taken a hit and U.S. stocks have been the stars, having benefited from expanding profits and (for Canadian investors) a stronger greenback.

The future is not so obvious, although I'm reasonably certain it will look different than the past two years. For instance, Canada has gone back on the world's buy list. For Americans in particular, our companies and properties are now a lot cheaper.

The odds have increased that Europe will emerge from the doldrums. In addition to weak currencies and low energy costs, the fiscal drag of the past five years is abating. We may be surprised by the pace and magnitude of Europe's rebound. And the United States? Well, for foreign investors, the bar has been set high and the ability of U.S. corporations to amaze may be diminishing. Profit margins are already at record levels and the impact of the super dollar is starting to limit earnings growth.

Equilibrium is rarely achieved, but it's like a magnet. Over time, currencies, commodities and securities are drawn back to what makes economic sense.

Tom Bradley is the President of Steadyhand. A version of this article was published on April 20, 2015, as a Special to the Globe and Mail.