



Key News

- [Ruble Falls in Longest Slump Since February on Record Drop in Russian GDP](#) (Bloomberg)
- [China's Exports, Lending Fall, Adding Pressure to Maintain Stimulus Effort](#) (Bloomberg)
- [German Consumer Prices Post First Drop in 22 Years](#) (Bloomberg)
- [Troubled Assets May Still Pose Risk](#) (New York Times)

Quotable

"We noticed that some loans didn't go into the real economy."

Zhang Jianguo, President, China Construction Bank Corp, *in an interview on August 6 discussing the bank's decision to cut second half lending by 70%*

FX Trading – Credit Crunch to Linger ... Longer?

Let's reminisce on the credit crunch, shall we?

Liquidity dried up; demand went missing; the global economy's gears all but stopped turning; national and international regimes went into savior mode.

Now, where do we stand?

If you've been playing along at home then you know there have been a steady handful of positive economic measures popping up in the US and around the world. In just the last few weeks some numbers on industrial production, business confidence, home sales, etc. have prompted some serious bottom-calling – the worst of the recession is behind us.

So it's onwards and upwards from here, right?

Now is when I use the metaphor about counting chickens relative to when they hatch. Basically, there are still some things to keep a close eye on as players become more confident that recovery is really happening.

One market watcher recently noted a valid point about the stock market leading credit spreads. This was different from before, during the credit crunch, where concerns over credit led moves in share prices. Now it's become a self-fulfilling trend towards risk taking – as share prices are climbing, confidence (tightening credit spreads) is following close behind.

Another question: can rising stocks mean a healthy, stable market for credit ... in the current environment?

S&P 500 Futures vs. VIX Daily:



Again, I am skeptical.

US consumer credit is still in the tank. In June the number dropped by more than \$10 billion. Being the fifth month of declines in a row, it marks the longest drawdown period since 1991. Consumers are saving more of their incomes. What they're not saving they're putting toward paying down debt – a two-legged trend that's likely to last.

The point is, there's been a major attitude shift ... and consumers aren't the only one's watching out for themselves. Corporations are keeping their cash close to them. Capital

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expenditures just aren't an attractive move to make right now. What's happened over the last two years has caused many to rethink their approach to business and finance.

So, with credit markets starkly different from pre-crisis mode, is the financial crisis behind us? Depends who you consider when I say "us."

There remain some major risks to German banks. At the top of the "risk list" for these banks are corporate downgrades and lingering toxic assets. In other words, should their big-name corporate customers suffer downgrades the banks would need to have larger amounts of capital on hand to deal with those inevitable capital fluctuations plus whatever writedowns they themselves must make.

The status of the banks remains the biggest risk to all of Europe and its recovery potential. And being Europe's largest economy, Germany and its banks will certainly be under the microscope.

Like in the US, liquidity has been pumped through Europe by government and the European Central Bank. But it hasn't exactly resonated as had been hoped – bank lending is not where they want it to be.

Is it clear that Europe will considerably lag the US in recovery? Perhaps not yet, but it seems likely the case. In such an environment, even the smallest differences between the US and Europe could mean a lot in the performance of the US dollar.

John Ross Crooks III

www.blackswantrading.com

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