



**Aircraft Exports Help To Narrow Trade Gap**

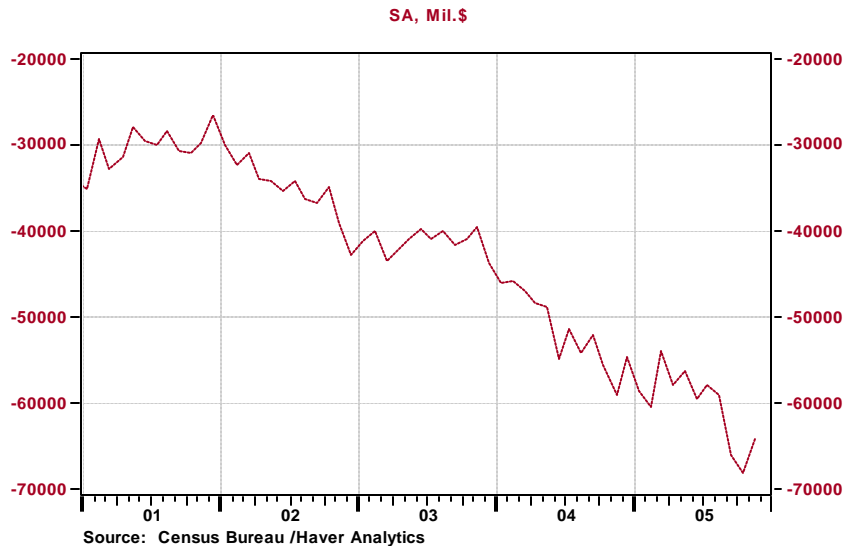
The trade gap narrowed to \$64.2 billion during November from \$68.1 billion in the previous month reflecting a 1.8% increase in exports of goods and services and a 1.1% drop in imports of goods and services.

**International Trade in Goods and Services – November 2005**

	<u>Trade Balance</u>		<u>Exports (% change)</u>		<u>Imports (% change)</u>	
	Goods & Services	Goods	Goods & Services	Goods - 2000\$	Goods & Services	Goods - 2000\$
<b>Jun-05</b>	-59.4	-63.8	0.1	0.1	2.0	2.1
<b>Jul-05</b>	-57.8	-62.5	0.8	0.1	-0.5	-1.6
<b>Aug-05</b>	-59.0	-64.1	1.6	2.6	1.7	0.9
<b>Sep-05</b>	-66.0	-71.3	-2.4	-4.9	2.7	0.4
<b>Oct-05</b>	-68.1	-73.2	1.5	1.7	2.2	1.9
<b>Nov-05</b>	-64.2	-68.9	1.8	3.8	-1.1	0.3

Inflation adjusted exports of goods and services advanced 3.8% in November, with capital goods, consumer goods, and industrial supplies and materials making positive contributions. Of these, aircraft exports posted noticeable growth in November after robust gains in October. Exports of services fell 0.7%, following a 0.4% drop in the previous month. Inflation adjusted imports edged up 0.3% during November, following a 1.9% increase in October. Although prices of imported petroleum fell in November, there was a 6.8% jump in imports of petroleum following a 6.5% increase in the previous month. The October-November trade gap in goods (\$59.3 billion) is larger than the third quarter average (\$56.4 billion), which suggests that the trade deficit will be a drag on real GDP growth in the fourth quarter.

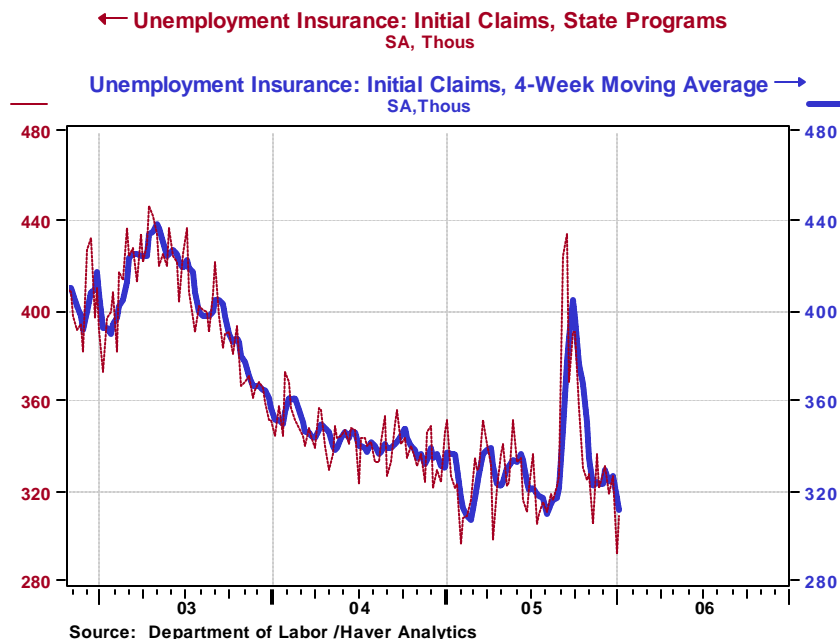
**Trade Balance: Goods and Services, BOP Basis**



The goods deficit with China decreased from \$20.5 billion in October to \$18.5 billion in November. The goods deficit with the European Union fell from \$12.1 billion in October to \$11.2 billion in November. The goods deficit with Canada narrowed to \$8.1 billion in October to \$7.5 billion in November, while the goods deficit with Mexico also declined from \$4.8 billion in October to \$4.5 billion during November.

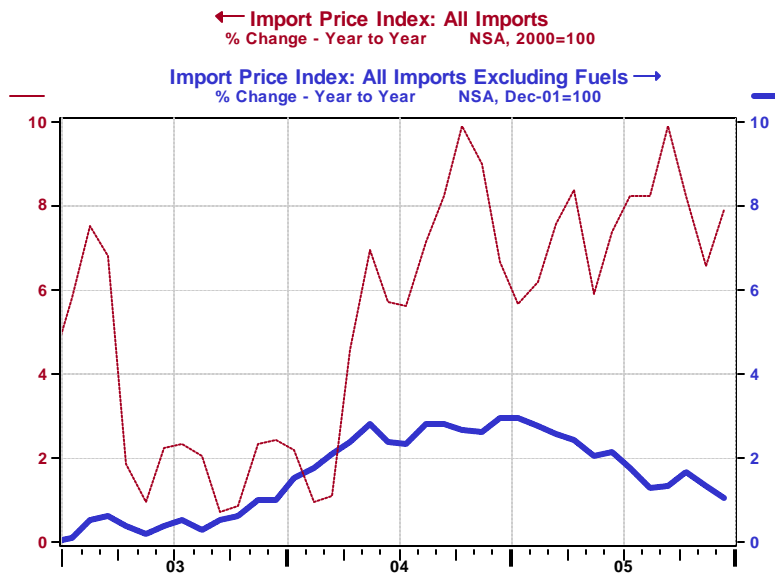
### Jobless Claims – Message distorted by holidays

Initial jobless claims increased 17,000 to 309,000 during the week ended January 7, after a decline of 34,000 during the previous week. Holidays in the past two weeks have introduced distortions which leads us to conclude that clean data going forward will give more a meaningful message. Continuing claims, which lag initial claims by one week, increased 12,000 to 2.702 million. The insured unemployment rate held steady at 2.1% for the fourth straight week.



### Deceleration In Prices of Imported Goods Is Noteworthy

Prices of imported goods fell 0.2% in December, after a 1.8% drop in November, due to lower oil prices. On a year-to-year basis, prices of imported goods rose 7.8% in 2005 vs. 6.7% increase in 2004. Excluding fuels, prices of imported goods increased 0.2% taking the year-to-year gain to 1.1% in 2005 vs. a 3.0% increase in 2004. The deceleration of prices of imported goods excluding fuel is favorable for overall inflation in the near term.

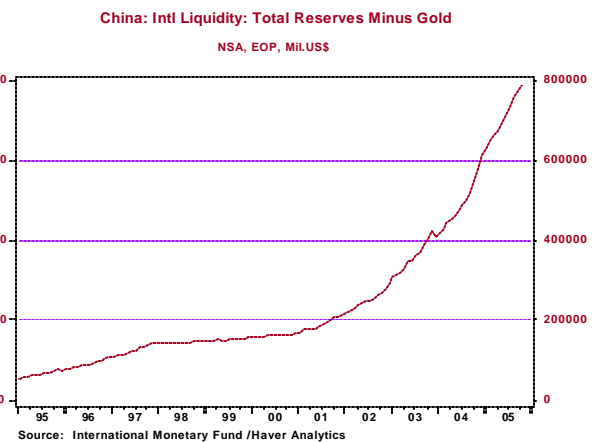
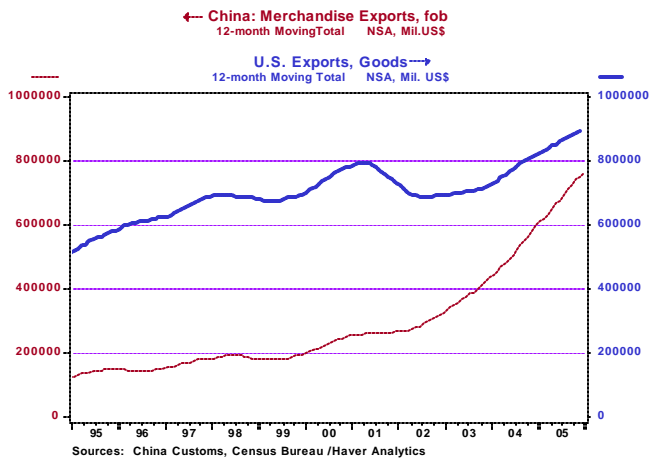


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### China: Some Thoughts About the Yuan

New Year has come and gone for the Western world without any major policy changes from Beijing, but with the approaching Chinese New Year there are lurking suspicions that the People's Bank of China (PBoC) might change its reserves policy just before Asian markets go on holiday on January 29<sup>th</sup>. Rumors abound about what exactly would occur, but the base case has the PBoC lightening its proportion of dollar-backed holdings. This may sound familiar, since the idea came up shortly after the yuan was revalued in July 2005, and we still feel that such a move is not yet practical.

China reported yesterday that the trade surplus touched \$102 billion for last year – a trebling of the \$32 billion surplus posted in 2004. The Chinese export market now equals 83% of US global exports and is growing at about 20% a year while US sales overseas remain static. The total trade surplus, combined with huge amounts of investment pouring into China, has boosted total international reserves to almost \$800 billion – most of which is held in US treasuries. Given such pronounced financial positions, it's easy to see why there would be concerns about a repositioning of reserves.



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When word came out of the PBoC early this week that policymakers were pondering the possibility of adjusting holdings to optimize value, the snap reaction of international traders was to sell off US treasuries before China dropped all kinds of notes and bills onto the market. The yuan strengthened marginally (the currency is still held in a tight range by the PBoC) and the dollar was battered. This reaction is precisely why the central bank may refrain from any significant adjustments to its treasury holdings, at least for the near-term. Any noteworthy sales would exert upward pressure on the yuan as the dollar fell, and reignite economic and diplomatic pressures to revalue the yuan to a stronger value. Not exactly a good scenario from China's side.

There is some rationale for the PBoC to reduce its US treasury holdings at some point. As the yuan strengthens, those dollar-backed t-bills kept as reserves holdings will be worth less and less in local currency terms. The central bank would like to retain the value of its international reserves if possible, so a shift to yen- or euro-denominated issues would be a better option if not for the market disruption. We see the occasional public "pondering" or "consideration" by the PBoC as a way of testing the waters before making a decision. If at a later point the market is receptive, then a little portfolio rebalancing may be initiated.

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