

# BDC's MONTHLY ECONOMIC LETTER

December 2009



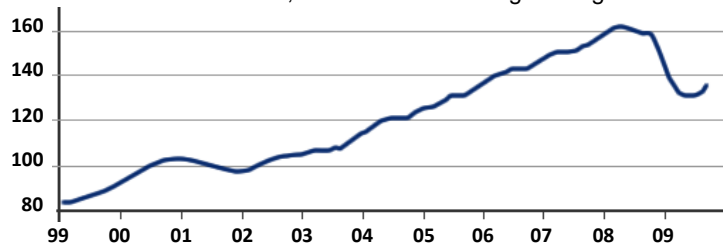
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## Resumption of Global Trade Bodes Well for Canada

- According to the CPB Netherlands Bureau for Economic Policy and Analysis, world trade volume expanded by 5.3% in September from the previous month, the largest increase recorded by the CPB series since its start back in 1991.
- On a quarterly basis, world trade is up by 4.3%, the first quarterly increase since the first quarter of 2008, and the second highest quarterly increase in the CPB series.
- Nonetheless, world trade is still 14% below its peak of April 2008, suggesting that the global recovery will be tepid. Over the preceding 12-month average (12-month momentum), trend growth was deeply negative in September: -14.4%, the lowest figure in the series so far.
- While it's still too early to call for a strong global recovery, the resumption of global trade bodes well for Canada. The OECD now expects a contraction of 2.7% in Canada's gross domestic product this year, with the economy expanding by 2% in 2010 and by 3% in 2011.

**World Merchandise Trade Volume (Seasonally Adjusted)**  
Level Index, Three-Month Moving Average



Source: CPB Netherlands Bureau for Economic Policy and Analysis

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## Canada

- Bank of Canada leaves overnight rate unchanged
- Canadian economy emerges from recession
- Jobs surge in November
- Housing starts edge up to 158,500 units in November

## United States

- U.S. unemployment rate declines to 10% in November
- Manufacturing index drops to 53.6 in November
- Housing starts decline to 529,00 units in October
- Retail sales rise 1.4% in October

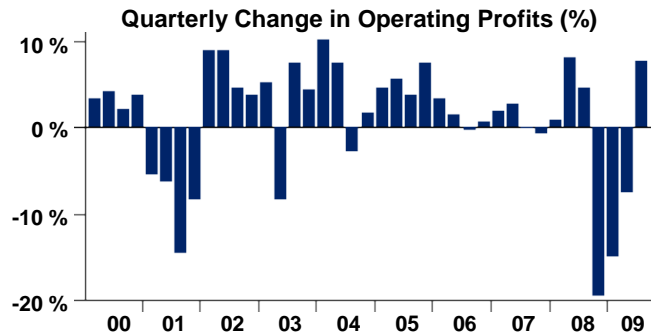
## Canadian Economy

### Bank of Canada leaves overnight rate unchanged

- As expected, the Bank of Canada held the target for the overnight rate at 0.25%, and reiterated its commitment to keep rates at their effective lower bound through the second quarter of 2010. The Bank's decision is consistent with a tepid Canadian recovery, as a 0.4% growth rate in the third quarter of 2009 fell short of the Bank's own projection. The Bank does recognize that developments on the global economic landscape have been slightly more positive than they had anticipated in October. However, these developments did not warrant any revisions to the Canadian economic outlook as "fragilities" remain and justify keeping rates at their lower effective bound in the near term. On the inflation front, while headline inflation has grown in-line with the Bank's projections, core inflation has been slightly stronger. However, they continue to believe that the inflation rate will remain below the 2% target until mid-2011. The Bank stated that risks to the inflation outlook remain balanced and have not changed since October's Monetary Policy Report.

### Canadian economy emerges from recession

- The Canadian economy grew 0.4% in the third quarter, marking the end of the 2008-2009 recession. Although the headline figure showed modest growth, the details of the report revealed bright prospects for the economy. Importantly, consumption was up a solid 3.1% with services gaining 2.8%. Moreover, investment in machinery and equipment shot up by more than 25% at an annualized rate, its biggest increase since 1997. In this environment, it is not surprising to see net exports shaving multiple percentage points off Canadian growth, as imports grew at their fastest pace since 1987. Domestic demand is doing much better in Canada than in the U.S., growing twice as fast. Momentum in domestic demand should continue in the coming quarters as wealth in equity and housing markets, in addition to improvements in the labour market, underpin consumer spending. Finally, corporations earned \$54.1 billion in operating profits in the third quarter, up 7.9% from the previous quarter. This will encourage businesses to increase their capital outlays, providing more support to the economy in the coming quarters.



Source: Statistics Canada

### Jobs surge in November

- The Canadian economy created far more jobs than expected in November, 79,100 in total, the biggest gain since September 2008. This gain was large enough to repair eight months of damage (with employment now at its highest level since April of this year), bringing the unemployment rate down 0.1 percentage points to 8.5%. The increase was observed in both full-time (+38,600) and part-time employment (+40,400). Good news has been registered in the private sector with the addition of 57,000 jobs. Moreover, manufacturing showed a gain of 12,600 in November, a second rise over the last three months. Importantly, Ontario has added jobs to its manufacturing sector for three consecutive months now, a total of 17,500 new jobs, a clear sign that the economic recovery is underway. While overall employment remains 320,000 jobs below its peak in October of 2008, November's report was positive with employment gains broad-based among industries and provinces. The labour market is recovering quicker than most anticipated and the positive momentum should carry forward in the coming months.

### Housing starts edge up to 158,500 units in November

- Housing starts edged up 0.7% to 158,500 units in November. The composition of the increase in activity was favourable. It came from the single-detached home segment which tends to be more stable than multiple-unit starts. Urban multiple starts declined by 1,200 units (-1.7%), but were more than offset by an additional 2,300 (+3.4%) single-detached units. The regional composition saw increases in urban starts in B.C. (+6.2%), Quebec (+10.0%), and the Prairie region (+8.2%) while Ontario (-8.3%) and Atlantic region (-9.8%) experienced declines. While the rise in homebuilding activity recorded in November was modest, the sector should improve in the coming months. The resale housing market balance has been tight in recent months as a result of buoyant demand and a relative dearth of supply in many markets. As a result, existing home prices have been climbing. With a lag, this tends to elicit a positive supply response from homebuilding activity, which should sustain momentum in the housing sector in 2010.



## Retail sales rise 1% in September

- Retail sales rose 1% in September, the seventh monthly increase in the last nine months. The monthly advance in retail sales occurred mainly on the east coast, in Quebec and in B.C., with Ontario rising more modestly and the Prairies staying flat. Across sales categories, the gains were generally broad-based, with auto sales strong on the month. Auto sales are still down 10.8% since last September, but the market for auto sales is gradually improving. With sales of existing homes still blistering and renovation activity up, housing-related durables purchases were expected to rise. Home furnishing purchases advanced strongly after two months of decline. The September data show the robustness of Canadian consumers and the 1.2% real advance in sales highlight the strong contribution that consumption will make to September's GDP, pointing to a positive advance in Canadian output for the third quarter.

## Manufacturing shipments rise 1.4% in September

- Manufacturing shipments rose 1.4% in September. Improvements to manufacturing shipments were fairly broadly based, with 14 out of 21 industries gaining. The improvements were concentrated in durable goods industries, though certain non-durables industries also advanced. Motor vehicles were the big push to the monthly gains, with vehicle shipments rising 16.4% as U.S. auto retailers restocked depleted lots. As well, primary metals gained strongly, consistent with their strong September export tally. Across industries, the inventory correction continues, with 17 out of the 21 industries decreasing inventories in September. Looking ahead, new orders gained strongly in September, rising 8.3% on the month. This report highlights improvements in manufacturing and suggests that the outlook in the manufacturing sector will improve in the coming months. Nonetheless, for Canada's export-focused manufacturing sector, substantial challenges persist on the demand side, with gradual U.S. recovery, and, on the supply side, with an inventory correction to be completed before firms confidently ramp up production.

## Trade deficit narrows to \$927 million in September

- Canada's trade deficit with the world narrowed to \$927 million in September from \$2.0 billion in August. Exports increased by 3.5% in September due to rising volumes, while imports edged down 0.1%. After reaching a low point in May 2009, exports have increased in three of the four past months. Automotive products (+15.8%), industrial goods and materials (+6.3%), and machinery and equipment (+4.5%) were the main sources of the gains. Imports fell for the second consecutive month in September, as volumes edged down 0.8%. While the report is buoying Canada's struggling export sector, substantial impediments remain. In particular, the higher Canadian dollar and strong domestic demand means a faster recovery in imports versus exports, leading to a further deterioration in Canada's trade balance.

## U.S. Economy

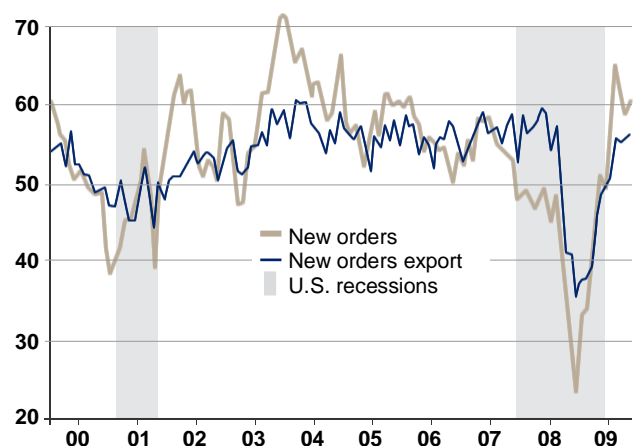
### U.S. unemployment rate declines to 10% in November

- U.S. non-farm payrolls declined 11,000 in November, surprising market participants that were forecasting losses of 125,000 jobs for the month. The decline represents the smallest monthly job loss since the beginning of the recession and the unemployment rate declined to 10.0% from 10.2% the previous month. The details of the report were strong, with total net revisions of 159,000 jobs being added over the last two months. Encouragingly, the service-producing sector added 58,000 jobs, representing the second consecutive month of positive job creation. The largest gainer on the month was business services (+86,000 jobs), with temporary employment adding 52,000 positions to that sub-category, the largest monthly advance since 2004. The surprisingly strong employment report clearly shows that the pace of job destruction is softening and that job creation is right around the corner. This will help bolster the otherwise weak U.S. labour market.

### Manufacturing index drops to 53.6 in November

- The U.S. ISM manufacturing index dipped slightly to 53.6 in November from 55.7 in October. Despite the drop, the manufacturing index remains above the 50-threshold signalling an expansion in manufacturing activity. The details of the report were somewhat mixed, with 6 out of 10 sub-components declining during the month. In particular, inventories (41.3 from 46.9 in October) and employment (50.8 from 53.1 in October) fell the most during the month, though this is likely a function of a temporary pullback after last month's run-up in both indicators. On the flip side, new orders (60.3 from 58.5 in October), new export orders (56.0 from 55.5 in October) and imports (51.5 from 51.0 in October) were the sub-components that saw monthly growth. The surge in the new orders components suggests that investment should continue to grow in the next quarter. Going forward, the overall level of the ISM manufacturing index continues to suggest growth in the manufacturing sector and confirms that a broader economic recovery is underway.

## New Orders Components of the ISM Manufacturing Survey



Source: NBF Economy & Strategy



### Housing starts decline to 529,000 units in October

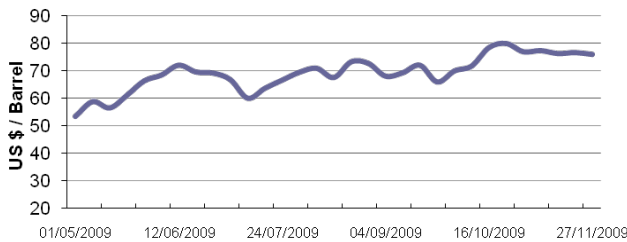
- U.S. housing starts unexpectedly declined to 529,000 units in October. This was only the second monthly decline in this indicator in six months, bringing the level of homebuilding activity to its lowest level since April. Construction of single-family units (down 6.8% to 476,000 units) and multi-family units (down 15.2% to 89,000 units) were lower on the month. Despite the drop, housing activity should pick up in the coming months. Pending home sales rose 3.7% in October, a ninth consecutive monthly increase, largely owing to the extension of the homebuyers' tax credit program and the favourable buying conditions (low mortgage rate and prices). Given these favourable conditions, the housing market will regain its footing as the economic recovery unfolds.

### Retail sales rise 1.4% in October

- U.S. retail sales rose by 1.4% in October. Excluding autos, sales were up for the third straight month, rising by 0.2%, while core retail sales, which exclude sales of autos and gas, advanced by 0.3%, representing a third consecutive monthly gain as well for this indicator. On a year ago basis, total retail sales are down by only 1.7%. The details of the report were mixed. Motor vehicle sales surged 7.4%, following the 14.3% drop the month before. Sales of general merchandise rose by 0.8%, while consumer spending on health and personal care (+0.5%) and clothing (+0.4%) were also higher. On the other hand, sales of building materials (-2.4%), sporting goods (-1.2%), furniture (-0.8%) and electronics (-0.6%) were a drag on the headline number. Overall, the report provided further evidence to show that U.S. consumer spending is slowly getting back on track, adding further momentum to the recovery that is now underway.

### Oil Prices Remain Range-Bound

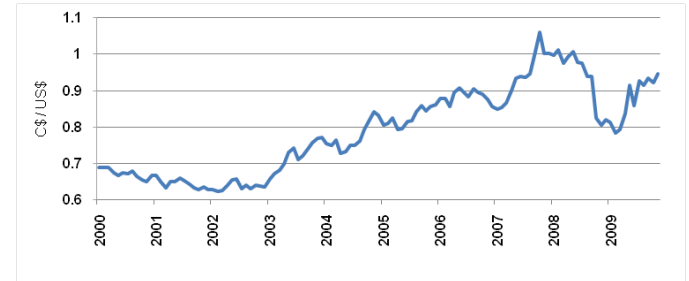
- Oil has rallied from below \$33 last December, but has held in a narrow band of \$70 to \$82 over the past two months. U.S. crude futures settled near \$77 a barrel in early December.



Source: Bloomberg

### Canadian Dollar Rises on Strong Fundamentals

- Strong domestic demand and rising commodity prices lent support to the Canadian dollar, which traded at 95.22 cents U.S. at the beginning of December.

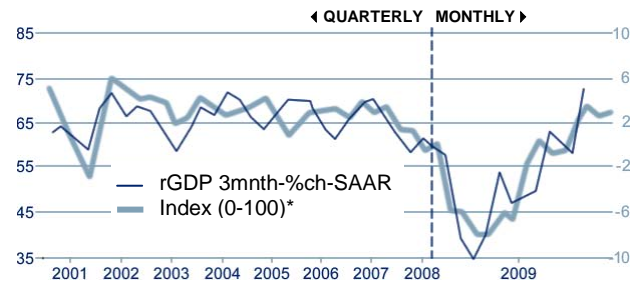


Source: Bloomberg

### SME Business Confidence Steady in November

- Business confidence among Canada's small and mid-sized business owners has held steady in November, according to CFIB's latest Business Barometer findings.
- The November index stands at 68.0—within a point of September and October results. These findings suggest that although the recovery is proceeding, its pace is gradual.

#### CFIB Business Barometer Index and GDP



Source: Canadian Federation of Independent Business

\* Index of 50 = equal balance of stronger and weaker business expectations. Note that CFIB's Business Barometer index has been revised as of May 2009. The index is based on the same survey, but is now a weighted average of response scores: 100 for stronger performance, 50 for same performance and 0 for weaker performance.



# BDC's MONTHLY ECONOMIC LETTER



KEY INDICATORS — CANADA	<i>Historical</i>					<i>2009</i>				<i>Forecast</i>	
	2004	2005	2006	2007	2008	Q1	Q2	Q3	Latest	2009	2010
Real GDP (% growth)	3.1	3	2.9	2.5	0.4	-6.1	-3.4	0.4		-2.4	2.5
Machinery and Equipment Expenditures (% growth)	9.3	14.1	10.5	4.4	0.5	-37.6	-16.1	25.6		-19.2	1.8
Pre-Tax Corporate Profits (% growth)	17.1	10.9	5.1	4.1	5.7	-30.8	-42.9	-42.0		-34.0	13.1
Industrial Production (% growth)	1.9	1.6	0.2	0.2	-4.2	-19.3	-17.3	-5.5		-10.4	2.3
Industrial Product Prices (% growth)	3.2	1.5	2.3	1.6	4.3					-3.3	1.4
Non-Residential Construction (% growth)	0.8	6.8	7.5	6.9	-2.7	-24.9	-17.8	-13.8			
Housing Starts (' 000 units)	233	225	227	228	211	140	128	148	Nov. 158	141	159
Personal Expenditures (% growth)	3.4	3.7	4.1	4.6	3.0	-0.7	-0.5	-0.5		-0.1	2.1
Consumer Price (% growth)	1.8	2.2	2	2.1	2.4	1.2	0.1	0.4	Oct. 0.1	0.3	1.7
Employment (% growth)	1.8	1.4	1.9	1.9	1.5	-5.5	-1.5	-0.8			
Unemployment Rate (%)	7.2	6.8	6.3	6	6.2	7.6	8.4	8.6	Oct. 8.6	8.3	8.6
SMEs Confidence Index (CFIB)	68.4	66.4	67.3	67.2	56.1	42.3	64.2	64.2	Nov. 68.0		
Manufacturers Confidence Index (CFIB)	70.4	68.3	66.4	64.5	52.7	38.8	64.4	64.4	Nov. 68.5		
Credit Conditions*	-10.8	-16.5	-9.8	15.0	32.0	35.0	34.5	25.5	Oct. -4.0		

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business, Bank of Canada

\*Bank of Canada's *Business Outlook Survey*, balance of opinion on tightened terms and conditions for obtaining financing compared with previous three months. Figures reflect annual averages.