

BDC's MONTHLY ECONOMIC LETTER

May 2009



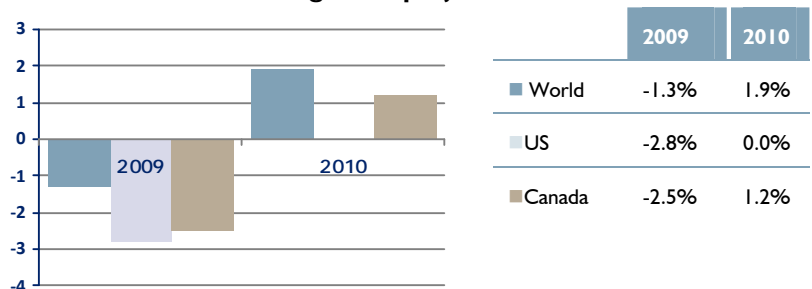
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IMF: Financial crisis means recovery will be longer than usual

- In its latest World Economic Outlook (WEO), the IMF now projects the global economy to shrink by 1.3% in 2009, with a slow recovery expected to take hold next year.
- Historical evidence presented in the WEO suggests recovery may be slower than in other recessions. The IMF notes that while there have been some encouraging signs of improving sentiment since the Group of 20 (G-20) meeting in early April, confidence in financial markets is still low, weighing against the prospects for an early economic recovery.
- According to the IMF, achieving the projected turnaround will depend on stepping up efforts to heal the financial sector, while continuing to support demand through monetary and fiscal easing.
- Overall, the advanced economies are forecast to contract by 3.8% in 2009, with the U.S. economy shrinking by 2.8%. Emerging and developing economies will see positive growth of 1.6%, bouncing back to 4.0% next year.
- The IMF now projects the Canadian economy to contract by 2.5% in 2009 before rebounding by 1.2% in 2010. The new projection for 2009 is significantly lower than the -1.3% projected growth rate projection in January, suggesting that Canada's recession will be longer than previously anticipated.

IMF growth projections



Source: IMF

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Highlights

Canada

- Bank of Canada cuts overnight target rate to 0.25%
- Real GDP contracts by 0.1% in February
- Canadian economy creates 35,900 jobs in April
- Retail sales edge up 0.2% in February
- Manufacturing shipments rose 2.2% in February
- Housing starts plunge 25% to 117,400 units in April

United States

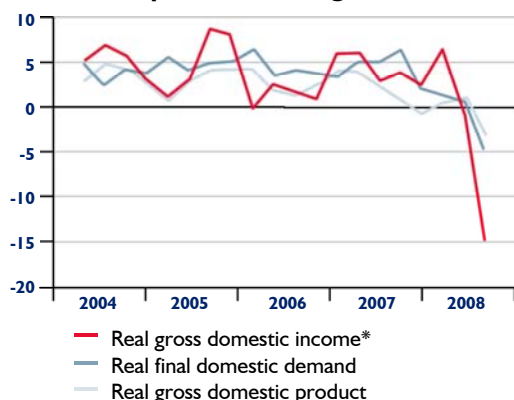
- FOMC keeps the fed funds rate steady
- U.S. economy sheds a further 539,000 jobs in April
- U.S. real GDP drops by 6.1% in Q1
- Manufacturing activity rises for a fourth straight month
- Housing starts drop 10.8% to 510,000 units in March
- Retail sales edge down by 0.1% in February

Bank of Canada Monetary Policy Report

The Bank of Canada released its April Monetary Policy Report Update. In an environment of continued high uncertainty, the Bank states that the global recession has intensified and become more synchronous since the January Monetary Policy Report Update, with weaker than expected activity in all major economies.

As a result of the sharper contraction in the global economy, economic growth in Canada has been much weaker than anticipated in the January Update. Export volumes fell sharply in the fourth quarter of 2008, led by dramatic declines in exports of motor vehicles and construction-related products to the United States. The terms of trade also plunged, causing real gross domestic income to register its largest quarterly decline on record.

Quarter-over-quarter % change at annual rates



*Current-dollar gross domestic product deflated by the price index for final domestic demand. Source: Bank of Canada calculations, based on Statistics Canada information

The Bank notes that the economic contraction in Canada intensified significantly in the first quarter of 2009. Exports of automotive products, forest products, and industrial materials posted further substantial declines.

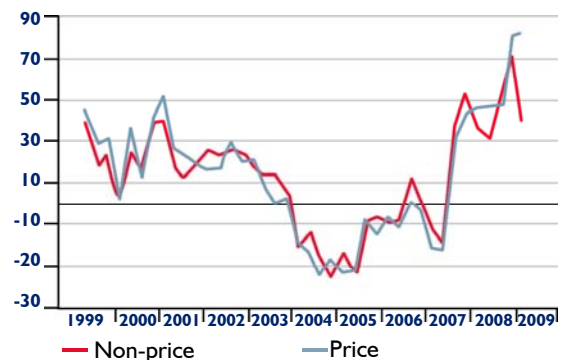
Firms have started to address their inventory problems, with widespread shutdowns in the automotive sector in particular. Business investment is expected to register another steep decline in response to rising unused capacity and weak terms of trade.

The Bank now projects the recession in Canada will be deeper than anticipated, with the economy projected to contract by 3.0% in 2009. The Bank also expects the recovery to be delayed until the fourth quarter and to be more gradual. The economy is projected to grow by 2.5% in 2010 and 4.7% in 2011. Given significant restructuring in a number of sectors, potential growth has been revised down.

Moreover, the deteriorating credit conditions have spread quickly through trade, financial, and while more aggressive monetary and fiscal policy actions are under way across the G-20, measures to stabilize the global financial system have taken longer than expected to enact.

The Bank notes that while financial conditions remain favourable in Canada and borrowing costs for banks have decreased, Canadian businesses are facing more difficult financing conditions. The pricing and availability of business credit, as reported in the Bank's latest Senior Loan Officer Survey and Business Outlook Survey, tightened further over the past three months. Nevertheless, the Bank notes that credit spreads for both financial and non-financial issuers remain near record levels but have begun to narrow recently.

Price and non-price lending conditions*



*Simple average of the balances of opinion for the small business, commercial, and corporate sectors. Balance of opinion is calculated as the weighted % of surveyed financial institutions reporting tightened credit conditions minus the weighted % reporting eased credit conditions. Source: Bank of Canada, Senior Loan Officer Survey



Canadian economy

Bank of Canada cuts overnight target rate to 0.25%

▪ The Bank of Canada cut 25 basis points, bringing the overnight target to 0.25%. Having cumulatively eased 425 basis points since December 2007, interest rate policy is at its effective lower bound (a 0% rate would create technical problems in money markets), and further monetary stimulus will require market interventions and direct injections. Given the deteriorating economic conditions and disinflationary pressures, the cut was widely expected. The Bank clarified its economic outlook, observing the intensifying and synchronized global headwinds and revising its forecast for rebound in 2010 downwards from 3.8% to 2.5%. The Bank also forecasts a deeper 3.0% contraction in 2009 – a revision from its January forecast for a 1.2% contraction – and anticipates that recovery won't take hold until the last quarter of 2009. With unprecedented transparency, the Bank committed to keeping rates low until the second half of 2010 in order to anchor longer-term interest rates. Going forward, the Bank has the option of Quantitative Easing, directly purchasing mortgage securities, corporate bonds and even long-term bonds if it needs to further stimulate the economy.

Canadian economy contracts by 0.1% in February

▪ Canadian real GDP contracted a further 0.1% in February, the seventh consecutive monthly decline. Economic activity has now fallen 3.0% from the peak in July of 2008, as production remains at the lowest levels in over 2 years. There were some bright spots in the report with only 13 of the 21 industries posting declines. While the Canadian economy is still struggling with a weakening export sector, there are some signs that external economic pressures are easing, as manufacturing edged up 0.1% in February. However, this was largely driven by an increase in demand for autos from the U.S., as motor vehicle production surged up 19%. While this is a sizeable increase, automotive production still remains 50% below last year's levels. Excluding autos, manufacturing fell 0.8%, largely reflecting continued weakness in global demand. On the domestic front, goods production remained under pressure. Construction was a major source of weakness for this sector, as building fell to a three-year low in February, led by a noticeable 5.7% decline in residential building. Non-residential building also slowed by 0.6%, as businesses scaled back on investment in the wake of depressed corporate profits. With mounting job losses and firms slow to adjust their inventories in the face of weakening demand, the Canadian economy will continue to contract in the first half of 2009.

Canadian economy creates 35,900 jobs in April

▪ The Canadian economy managed to add 35,900 jobs in April. This is quite remarkable (and highly unexpected) given the challenges the economy still faces. However, this jump follows five months of massive job losses, and in total the economy has lost 321,000 jobs since October. The unemployment rate remained at a seven year high of 8.0% in April, up 2.2% from its low in the beginning of 2008. While the headline number is encouraging, the details of the report point to further weakness. The rise in employment was fully owing to a 37,000 jump in self employed workers. The good news is that the massive job losses in the goods producing sector stopped in April, and manufacturing managed to add 6,700 jobs. However, this must be tempered by the fact that manufacturers have still cut employment by 13% since 2006. While it is encouraging that job destruction halted in April, this could be a one-month uptick. During the 90's recession it was not uncommon to have one or two months of large jumps in employment amidst several months of large scale job losses. Going forward, global economic weakness will continue to weigh heavily on Canada's labour market.

Retail sales edge up 0.2% in February

▪ Retail sales rose 0.2% in February, the second consecutive monthly increase. However, stripping away price effects, sales were down 0.3% and retail sales are still down 6.6% from their peak of September 2008. The headline number was largely driven by a 3% increase in building and outdoor supplies and a 0.7% increase in food and beverage stores. On a regional basis, the increases were largely skewed upwards by Central and Eastern Canada. Despite the rise in retail sales in the last two months, mounting job losses will continue to hamper consumer demand in the next few months.

Trade balance reverts back to surplus in February

▪ Canada's international trade balance reverted back to a surplus in February, rising from a deficit to a surplus of \$125 million. The change in the net trade position was driven by a 5.2% increase in exports, as imports grew by a more modest 1.1%. The rise in exports was driven by a surge in demand from around the globe, as Canada's trade balance improved with all trading partners. However, in spite of this positive development, the pop in overall export activity in February only partially offset the massive 10% decline in January, and the level of exports are still down 25% from the peak in July of 2008. Given such low levels, a small rise in the number of shipments can lead to a large percentage increase. Stripping out prices, the volume of exports was up



by an even heftier 6.7%. In contrast, the rise in imports was largely driven by higher prices, as the volume of imports remained flat in the month. Given the massive job losses in both the Canadian and U.S. economy, as well as continued international financial turmoil, it is unlikely that the pick up in demand for Canadian goods is sustainable moving forward.

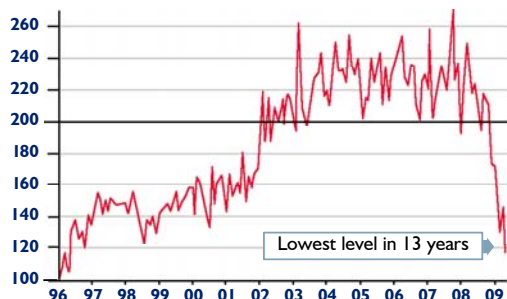
Manufacturing shipments rise 2.2% in February

- Manufacturing shipments rose 2.2% in February. The monthly gain was not broad-based and owed to a rebound in auto sales – with vehicles gaining 34.5% and parts up 38.5%. The rebound follows from the steep contraction during plant closures in January. Stripping out prices, volumes rose 2.6% - the first constant-dollar gain in six months. As well, unfilled orders climbed and inventories alleviated slightly. Moreover, the inventory to sales ratio declined in 15 of 21 industries, a positive development. Nevertheless, the monthly result highlights the ongoing weakness in manufacturing. Year-over-year, the decline in manufacturing shipments accelerated to an 18.7% loss. With the ongoing weakness in demand for Canada's exports, declines in manufacturing and weakness will continue until global demand regains traction.

Housing starts plunge 25% to 117,400 units in April

- Canadian housing starts fell 25% from March to 117,400 units in April. A 32.7% pullback in national multiple-unit starts led the way, in turn led by Ontario's condo segment. Starts increased by 5.1% in the Prairies but were lower in every other region of the country, led by Ontario's 42% pullback. The weakness in housing starts points back to an even sharper and entrenched downtrend that could hit bottom sooner rather than later. Nonetheless, we expect continued weakness in the coming quarters, and will be looking for signs of stabilization in homebuilding activity towards the middle of the year.

Housing starts, annual rate (000s)



Source: NBF Economy & Strategy

Inflation slows to 1.2% in March

- Canadian consumer prices declined 0.3% in March, as mounting excess capacity in the Canadian economy continues to put downward pressure on prices. On a year-over-year basis, the rate of inflation has slowed to 1.2%, down from 1.4% in February. The Bank of Canada's core measure of inflation was flat in the month. On a year-over-year basis, this measure is right on the Bank's target of 2.0%. As the domestic economy continues to slow in the coming quarters, inflation pressures will subside further in the coming months.

U.S. economy

FOMC keeps fed funds rate steady

- The Federal Open Market Committee (FOMC) kept the fed funds rate steady, and reaffirmed its commitment to keeping rates at exceptionally low levels for an "extended period." In terms of its monetary policy stance, the Fed noted that it expects the policy actions taken to stabilize the U.S. economy so far will contribute to a "resumption of sustainable economic growth." The Fed made no change to its current quantitative easing framework, changing neither the size nor composition of its balance sheet, noting that it "will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook". There was a slightly improved tone in the economic assessment, as the Fed stated that the economic outlook has improved modestly since the past meeting, though they indicated that economic activity is "likely to remain weak for a time".

U.S. economy sheds a further 539,000 jobs in April

- The U.S. economy shed a further 539,000 jobs in April, bringing the number of jobs lost since the turn in labour market conditions in January last year to 5.6 million. On the positive side, this was the slowest pace of monthly job losses since October last year. The unemployment rate climbed to 8.9%, the highest since late 1983, as many businesses remain wary of hiring given all the economic uncertainties. The details of the report were somewhat less encouraging than the headline number would suggest. The losses were equally split between the services producing (-269,000) and goods-producing (-270,000) sectors. The key catalyst for the improvement during the month was public sector hiring, as government payrolls added 72,000 jobs due to 2010 Census hiring. At the industry level, the manufacturing services (-122,000) and retail trade (-38,000) remain brisk. Despite some signs that the pace of

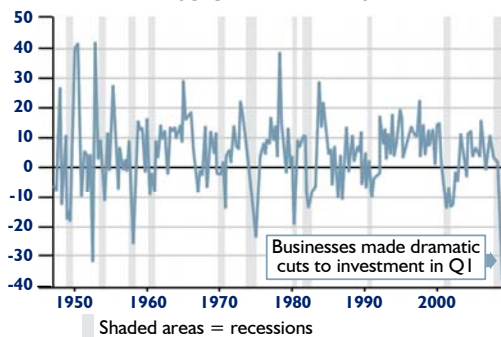


deterioration in the U.S. labour market may be easing, it is clearly evident that labour market conditions remain very dismal. The growing difficulty of displaced workers in finding new jobs will continue to place further upward pressure on the unemployment rate.

U.S. real GDP drops by 6.1% in Q1

The U.S. economy posted a worst-than-expected contraction of 6.1% in Q1. Much of the weakness was concentrated in business investment as firms tried to protect their bottom-line through aggressive cost-cutting measures – a move that was most certainly exacerbated by dysfunctional credit markets. Non-residential investment shrank by a record 38% during the quarter. The bottom line of this report is simply that the U.S. economy remains rather weak as the ongoing housing correction and financial sector crisis continue to weigh heavily on the domestic economy. However, there were some obvious glimmers of hope in the report as the improvement in consumer spending (which remains the lynch-pin of U.S. economic activity) during the quarter suggests that U.S. household spending may be on the rebound. Consumer spending rebounded 2.2% in Q1, the best showing since the start of the recession. This is good news as it shows that consumers took advantage from the combination of tax relief, the recent drop in import prices, and falling interest rates. At this juncture, however, it is premature to call for more sustained spending as this will need to be accompanied by a tangible improvement in labour markets.

Real business investment – structures and equipment % (q/q, annualized)



Source: NBF Economy & Strategy (BEA data via Global Insight)

Manufacturing activity rises for a fourth straight month

The U.S. ISM manufacturing index rose for the fourth straight month in April, climbing to 40.1, led by a massive gain in new orders, which surged to 47.2 from 41.2 in March. There were also strong gains in the production sub-index, which rose to 40.4 from 36.4. Another useful metric, the difference between new orders and inventories (a proxy for the future direction of production) also rose sharply, surging to 13.6, from 9.0 the month before. Despite the steady gain, the headline number continues to languish below the all-important 50-threshold, suggesting that U.S. manufacturing activity continues to decline at a dramatic pace, though the pace of deterioration is undoubtedly falling. Even so, the steady rise is encouraging and any further gains would suggest the U.S. economic recession is coming to an end.

Housing starts drop 10.8% to 510,000 in March

U.S. housing starts dropped 10.8% in March to 510,000 units. All of the declines were in the volatile multi-unit components, which declined a big 29.0% to 152,000, unwinding some of the staggering 62.1% gain the month before. The more stable single-family units were flat on the month at 358,000. Housing starts are now 77.6% lower than their January 2006 historical peak, when the U.S. housing market was in high gear. With the backdrop for U.S. homebuyers remaining weak (despite favourable mortgage rates and home prices), residential construction will likely remain weak for some time.

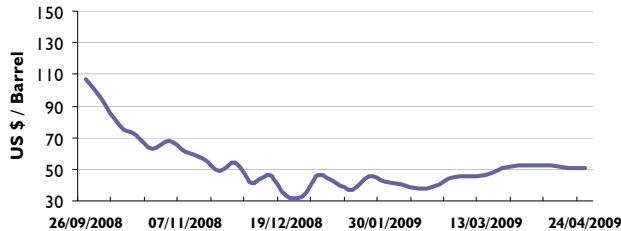
Retail sales plunge 1.1% in March

U.S. retail sales posted a dramatic 1.1% drop in March, ending two consecutive months of gains. Sales excluding autos were also quite weak, falling by 0.9%. Core retail sales, which strip out sale of autos and gasoline were also soft, declining by 0.8%. On a year-ago basis, all three measure are down significantly. The details of the report were weak all around. Spending in almost every category declined, with the exception of spending on food (which rose 0.5%) and health and personal care (rising 0.4%). On the other hand, there were big declines in spending on motor vehicles (down 2.3%) and furniture and home furnishing (down 1.7%). Given the weakness in the U.S. labour market, consumer spending will remain tepid in the coming months.



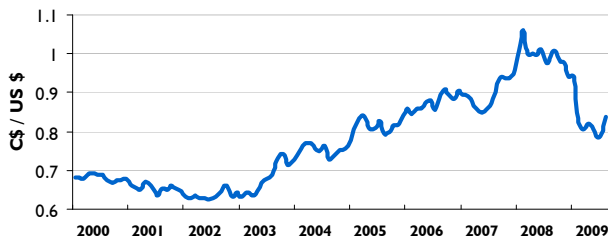
Crude oil rises above \$50 on signs of a recovery

- Oil prices ended above \$53 a barrel for the first time in a month as new economic reports showed that the recession may be easing.



Canadian dollar gains as commodities firm up

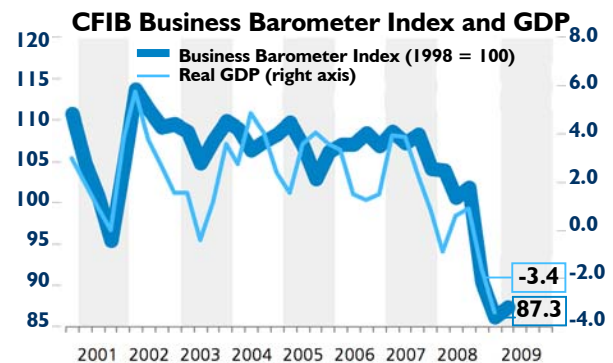
- Canada's currency gained as much as 1.7% to close at 84 cents, its strongest level since mid-April. The Canadian dollar lost a record 18% versus the U.S. dollar last year on slumping demand for commodities as the global economy contracted. Canada relies on raw materials such as crude oil, natural gas, copper and lumber for more than half its export revenue.



Source: Bloomberg

SME sentiment rises marginally in March

- After having to deal with significant levels of economic uncertainty through the early months of 2009, Canadian small and mid-sized enterprises' (SMEs) confidence levels have held firm.
- CFIB's Business Barometer Index rose marginally to 87.3 in March, about one point from the 86.1 level measured in December.
- Only 20% of businesses are performing 'much better' or 'somewhat better' than a year ago, less than half of what is needed during expansionary phases of the business cycle.
- Looking a year ahead, the balance of business owner expectations remains on the negative side as 26% expect business performance improvements 12 months out, while 43% expect further deterioration.



Source: Canadian Federation of Independent Business, March 2009.

KEY INDICATORS - CANADA	Historical					2008				Latest		Forecast	
	2003	2004	2005	2006	2007	Q1	Q2	Q3	Q4			2009	2010
Real GDP (% growth)	1.9	3.1	2.9	3.1	2.7	-0.6	0.6	0.9	-3.4			-2.3	2.1
Machinery & Equipment Expenditures (% growth)	7.7	9.3	10.8	7.4	5.1	2.1	-0.3	-2.4	-26.8			-13.0	-0.4
Pre-Tax Corporate Profits (% growth)	6.9	17.1	11.9	5.0	5.8	4.5	12.5	16.1	-7.3			-27.0	8.7
Industrial Production (% growth)	0.3	1.9	1.6	-0.2	0.3	-6.9	-3.0	0.4	-10.9			-8.7	1.6
Industrial Products Prices (% growth)	-1.4	3.2	1.5	2.3	2.1							-3.7	1.7
Capacity Utilization (%)	83.8	85.4	84.1	82.4	83.3	79.6	78.9						
Non-Residential Construction (% growth)	5.7	0.8	6.8	7.5	6.9	4.9	3.8	7.9	-0.1				
Housing Starts ('000 units)	218	233	225	227	228	234	218	208	185	Apr.	117	144	155
Personal Expenditures (% growth)	3.0	3.4	3.8	4.2	4.7							-0.9	1.7
Consumer Price (% growth)	2.8	1.8	2.2	2.0	2.2	1.8	2.3	3.4	1.9	Mar.	1.2	0.2	1.7
Employment (% growth)	2.4	1.8	1.4	1.9	1.9	2.0	0.8	-0.1	0.5				
Unemployment Rate (%)	7.6	7.2	6.8	6.3	6.0	5.9	6.1	6.1	6.4	Apr.	8.0	8.6	9.1
SMEs Confidence Index (CFIB)	107.8	107.8	106.6	107.5	108.2	104.0	100.7	101.8	86.1	Mar.	87.3		
Manufacturers Confidence Index (CFIB)	109.8	109.0	107.4	107.5	105.7	100.0	99.9	98.0	79.3	Mar.	85.0		

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