



BDC's MONTHLY ECONOMIC LETTER

October 2009



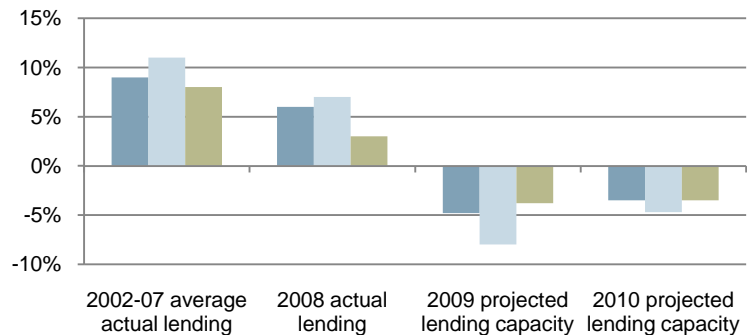
TABLE OF CONTENTS

Global Financial Risks Subsiding	1
Highlights	2
Canadian Economy	2
U.S. Economy	3
Jobs Data Send Oil Prices Near \$70	4
Canadian Dollar Little Changed	4
SME Optimism Rises in August	4
CFIB Business Barometer Index	4
Key Indicators — Canada	5

Global Financial Risks Subsiding

- According to the IMF's latest Global Financial Stability Report (GFSR), risks to the global financial system have subsided as a result of unprecedented policy actions and a nascent global economic recovery.
- Nevertheless, banks still face substantial challenges. The GFSR estimates that commercial banks have already recognized \$1.3 trillion through the first half of 2009, but face another \$1.5 trillion of potential asset writedowns ahead. Hence, overall, banks have recognized slightly less than half of their expected losses. U.S. banks have recognized slightly more than have those in the United Kingdom and euro area.
- The report points to the need to further repair bank balance sheets to enable the institutions to make the loans needed to support the economic recovery. Pressures on balance sheets have diminished the capacity to increase their lending, which could affect the economic recovery.
- The IMF revised its global growth forecast upwards to 3.1% in 2010, compared with a 2.5% estimate in July, and now projects the Canadian economy will grow to 2.1% in 2010 (up from 1.6% in July), the fastest pace among G7 economies.

Bank Lending Capacity – Growth



Source: IMF

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Business Development Bank of Canada

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Canada

- Bank of Canada holds overnight target rate at 0.25%
- Canadian real GDP unchanged in July
- Retail sales fall 0.6% in July
- Manufacturing shipments rise 5.5% in July

United States

- Federal Reserve sees brighter outlook for U.S. economy
- U.S. economy sheds 263,000 jobs in September
- Manufacturing activity expands further in September
- Housing starts rise to 598,000 in August

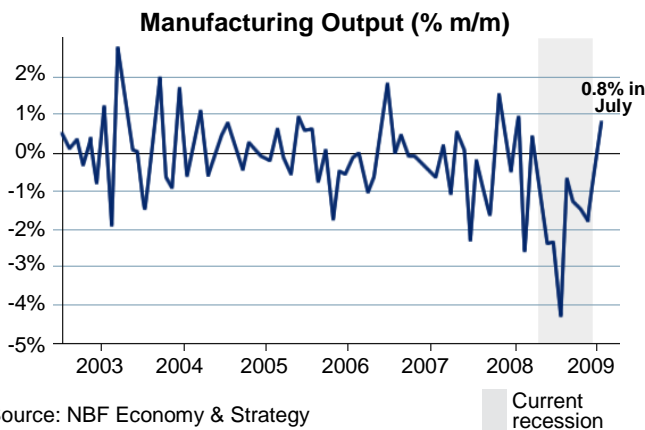
Canadian Economy

Bank of Canada holds overnight target rate at 0.25%

- The Bank of Canada maintained its overnight target rate at 0.25%, reiterating its commitment to holding the rate at its current effective lower bound until the second quarter of 2010. The Bank observed signs that the recovery has commenced, stating that Canada's growth in the second half of 2009 could be stronger than the Bank anticipated in its July Monetary Policy Report (MPR). The Bank noted that a rebound in confidence, firmer commodity prices, stimulative policy and improving financial conditions are all supporting domestic demand. In particular, the Bank pointed to inventory adjustments and automotive production as positive indicators. Nonetheless, the Bank remains concerned about the persistent strength of the Canadian dollar and has flagged it as a potential risk to growth.

Canadian real GDP unchanged in July

- Canadian monthly GDP remained unchanged in July. Manufacturing ended a 9-month string of declines in July, rising 0.8%, as motor vehicle production posted a 16.5% gain. Services such as wholesale trade, accommodation and food, and finance and real estate also advanced in the month. However, Statistics Canada noted that temporary plant closures in the mining industry led to a sharp drop in output that offset gains in these areas. The July GDP numbers suggest that Q3 will not be as strong as initially assumed but the strength in manufacturing, a pick-up in exports and an improving domestic economy will set the stage for a stronger recovery in Q4.



Retail sales fall 0.6% in July

- Retail sales declined 0.6% in July. Most of the decline was due to lower gas sales, but sales also retreated in 5 of the 8 retail sectors. Food and beverage stores saw declines, with poor weather contributing to lower seasonally-adjusted sales of supermarket food and of alcoholic beverages. Despite the weakness in July's report, the trend in retail sales remains up and retail spending continues to contribute positively to GDP growth. The sales volume is up 1.5% so far in Q3 compared with the previous quarter while spending on discretionary items (which exclude gasoline, supermarket, and pharmacy and personal care store sales) is up a firm 2.6% in Q3, suggesting further strength in retail sales in the months ahead.

Manufacturing shipments rise 5.5% in July

Manufacturing shipments increased for a second month in a row, rising 5.5% in July. The monthly gain was due primarily to the surge in motor vehicle and parts shipments, up 48%. Sales were up in 15 of 21 industries which cumulatively account for 66% of all manufacturing. With indicators of future shipments easing—new orders fell 3.7% and unfilled orders fell 4.3%—it is unlikely that manufacturing will see strong gains in the months ahead. Unfilled orders declined most strongly in the aerospace industry, indicating that the current pace of aerospace shipments will ease, but unfilled orders in most other durable industries also declined. Nonetheless, inventory pressures are easing and new orders appear to be stabilizing. The gains in July provide additional evidence for renewed growth in the third quarter.

Trade deficit widens to \$1.43 billion in July

- Exports increased in July for a second consecutive month, but were outpaced by a strong expansion in imports, resulting in a trade deficit of \$1.43 billion, compared with a \$37-million surplus in June. Imports volumes were up by 8.7%, reflecting strength in the domestic economy, while exports volumes rose by 5.9%. Both exports and imports of automotive products and machinery and equipment registered large increases. Imports of energy products were also up significantly, while the value of energy exports fell. Canadian merchandise exports rose for a second consecutive month in July, by 3.3% to \$30.3 billion, the result of an increase in volumes (5.9%), as prices were down (2.4%). Machinery and equipment accounted for nearly three-quarters of the gains in exports, driven mainly by aircraft, motor vehicles and telecommunications equipment. Year-to-date, exports remain well below 2008 levels, down 25.5%. The trade deficit will likely widen in the third quarter as imports continue to outstrip exports with a 30-40% increase. The widening deficit is not a bad thing as the strength in imports signals a recuperating domestic economy. In particular, Canadian imports of machinery and equipment were up 10.6% in July, putting business investment on track for strong gains in the third quarter.

Headline inflation remains negative in August

- Headline inflation declined by 0.8% in August. This is the first time in 56 years that headline inflation has remained in negative territory for a full quarter. However, the decline in the headline figure is primarily due to the drop in energy prices. Excluding food and energy, prices were up 0.9% year-over-year, the slowest pace of price growth in over 10 years. Out-



side of energy, downward pressure on the CPI arose from outright contractions in the price for durable and semi-durable goods from year-ago levels as retailers aggressively offered incentives to attract buyers. The weakness was concentrated in motor vehicles and clothing and footwear. The strength of the Canadian dollar continued to weigh on the price of imported consumer-related goods. This trend is expected to intensify in the near term as higher commodity prices and the weak U.S. dollar continue to sustain the Canadian dollar.

Housing starts rise 12.1% to 150,400 units in August

- Housing starts bounced back in August to 150,400 units. This was the largest number of starts in 8 months and was broadly based as urban multiple unit starts (+23.8%) and single units starts (+2.5%) both rose from the previous month. Furthermore, each of the five regions of the country participated in the uptick in activity. Most notably, starts in urban B.C. surged by 6,000 units (+56%) and by 5,000 units (+14%) in Ontario. While overall national starts remained nearly a third below their year-ago levels, the August data confirmed the trough in housing activity and that homebuilding is slowly turning the corner.

U.S. Economy

FOMC sees brighter outlook for U.S. economy

- The Federal Reserve Open Market Committee (FOMC) kept the fed funds rate unchanged within a range of 0%-0.25%. The Committee noted that "economic activity has picked up following its severe downturn", in sharp contrast to the previous statement that simply stated that "economic activity is levelling out." In light of a more positive assessment of the economic outlook, the Fed did decide to slow the pace of purchases of the remaining \$1.45 trillion in mortgage-backed securities and agency debt, extending the program out by a full quarter to Q1 2010 instead of at the end of 2009. As far as the future is concerned, the Fed now sees the combination of improving market conditions and stimulative monetary and fiscal policies as setting the stage for a "strengthening of economic growth and higher levels of resource utilization". Despite the more upbeat outlook, the Fed still believes that the current environment of ongoing job losses and substantial resource slack still warrants keeping its target rate "exceptionally low for an extended period of time".

U.S. economy sheds 263,000 jobs in September

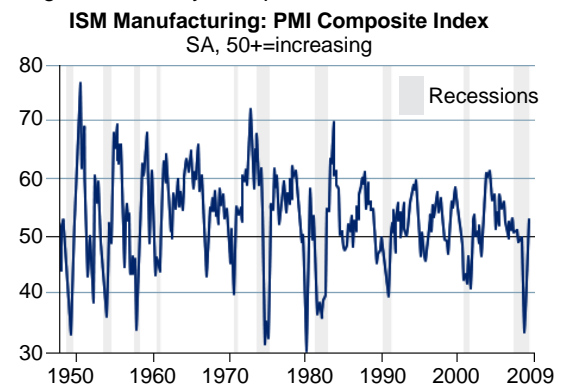
- The U.S. economy lost a further 263,000 jobs in September and the unemployment rate edged up to 9.8%. The figures came in well below expectations and the report was weak. The sharp benchmark revision of -824,000 to the previously-reported numbers suggests that the U.S. labour market is much weaker than previously thought. There were declines in employment in the goods-producing sector (-116,000) and the services-producing sector (-147,000). Total private sector employment was down by 210,000, while the public sector lost a further 53,000 jobs. At the industrial level, there were job losses across the board, with only the acyclical health and education industries posting modest gains in September. And the work week fell back to a record low of 33 hours, which is inauspicious for future hiring. The latest figures suggest that the U.S. labour market remains weak and that the effects of the recession are continuing to be felt. The report will dampen expectations for the near-term recovery, and will likely spur the Fed to keep rates low for an extended period.

Durable goods orders drop 2.4% in August

- U.S. durable goods orders declined 2.4% in August. The key driver for the sharp drop in total durable goods orders was the 9.3% drop in transportation orders, caused by the 42.2% plunge in the volatile non-defense aircraft component, while orders for computers (-0.7%) and electrical equipment (-0.5%) were modestly lower. More encouragingly, there was some meaningful growth in orders for primary metals (+1.9%), machinery (+0.7%) and fabricated metals (+0.8%) which are the basic building blocks for an eventual economic recovery. Moreover, the inventory-to-shipment ratio remained flat at 1.8. Excluding transportation, a volatile component, new orders increased 16% in the last three months, signalling that U.S. capital expenditures are recovering and that investment will pick up in Q3 2009.

Manufacturing activity expands further in September

- The U.S. ISM manufacturing index unexpectedly fell to 52.6 in September from 52.9 the month before. Even though the drop puts an end to 8 consecutive months of gains, the index remains above the 50-threshold indicating expansion. In the sub-indices, there were significant drops in the production (down from 61.9 to 55.7) and new orders (down from 64.9 to 60.8) sub-indices, but they remain well above the 50-threshold. The employment sub-index also declined, falling from 46.4 to 46.2, while new export orders eased from 55.5 to 55.0. On the other hand, there was some growth in the supplier deliveries index (up from 57.1 to 58.0), while the inventories index rose from 34.4 to 42.5. Despite the unexpected drop, the ISM manufacturing index continues to point to further growth in U.S. manufacturing sector activity in September.



Source: Institute for Supply Management

Housing starts rise to 598,000 units in August

- U.S. housing starts rose to their highest level since November last year, with a 1.5% gain in August to 598,000 units. The increase in construction, however, was all in the volatile multi-family unit component, which rose a dramatic 25.3% to 119,000 from 95,000 in July. The more stable single-family unit component declined a modest 3.0% to 479,000. The trend in new residential construction was also encouraging, rising to 592,000 units from 577,000 units. On the whole, the report underscores the growing optimism about the U.S. housing market, and suggests that home-building activity is continuing to rise beyond the cyclical low formed only a few months ago. Any pick-up in residential construction will add favourably to U.S. economic activity in Q3.

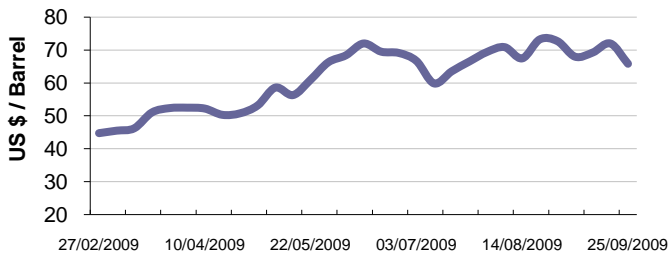


Retail sales rise 2.7% in August

- U.S. retail sales rose 2.7% in August. The Cash for Clunkers government program was expected to lead to a spike in the figures for August, and the expectations were met. The 10.6% jump in automobile sales is the strongest increase since 0% financing rates were introduced in October 2001. The surge in sales is not exclusive to the automobile sector. Other types of retailers also had good showings. For example, gas sales made a noteworthy positive contribution. Excluding automobiles and gas, retail sales still rose by 0.6%, the strongest increase since February. Gains made in clothing and electronics stores and stores that sell recreational items seem to indicate that sales related to the back-to-school period were particularly good this year, despite the difficulties in the job market and personal finances. Besides automobiles, which were expected to rise, retail sales did much better than expected. Household consumption has therefore ushered in the third quarter up strongly, another sign that the recession is probably over.

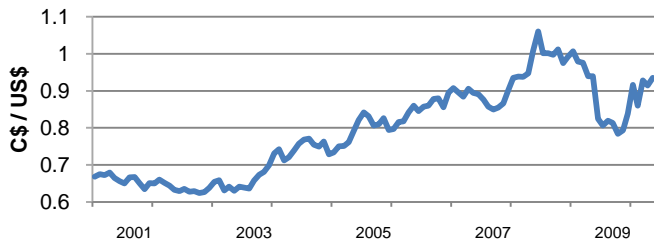
Jobs Data Send Oil Prices Near \$70

- Oil fell to near \$70 a barrel after the employment report raised doubts about the strength of the U.S. economic recovery, but a slump in the U.S. dollar helped drag crude prices off their lows.



Canadian Dollar Little Changed

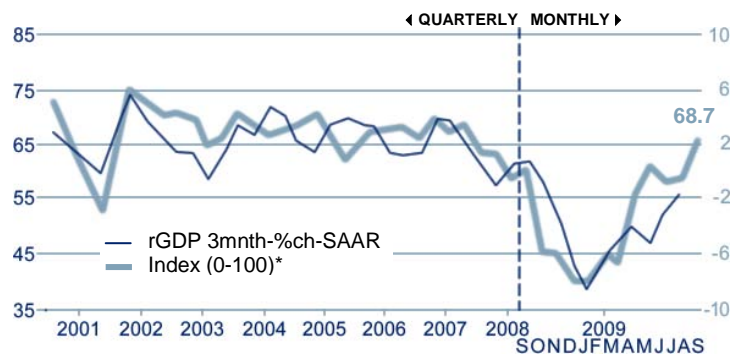
- Canada's dollar was little changed as crude oil and equities pared losses, improving the climate for commodity-linked currencies. The Canadian dollar is trading near 92 cents U.S.



SME Optimism Rises in September

- Small business confidence has taken another step upward, as signs of Canada's economic recovery become clearer.
- CFIB's Business Barometer Index rose to 68.7 in September, a 3.3-point rise over its August level. Confidence is now at its highest level since the first quarter of 2007.
- For the first time since the recession began a year ago, improving business sentiment has been supported by stronger capital investment.

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.



KEY INDICATORS - CANADA	Historical					2009			Forecast	
	2004	2005	2006	2007	2008	Q1	Q2	Latest	2009	2010
Real GDP (% growth)	3.1	3	2.9	2.5	0.4	-6.1	-3.4		-2.3	2.4
Machinery & Equipment Expenditures (% growth)	9.3	14.1	10.5	4.4	0.5	-37.6	-16.1		-20.1	0.3
Pre-Tax Corporate Profits (% growth)	17.1	10.9	5.1	4.1	5.7	-30.8	-42.9		-33.8	12.9
Industrial Production (% growth)	1.9	1.6	0.2	0.2	-4.1	-18.6	-15.5		-10.4	2.5
Industrial Products Prices (% growth)	3.2	1.5	2.3	1.6	4.3				-3.5	1.9
Non-Residential Construction (% growth)	0.8	6.8	7.5	6.9		-24.1	-17.8			
Housing Starts ('000 units)	233	225	227	228	211	140	128	Aug. 150	139	159
Personal Expenditures (% growth)	3.4	3.7	4.1	4.6	3	-0.7	-0.5		-0.3	1.9
Consumer Price (% growth)	1.8	2.2	2	2.1	2.4	1.2	0.1	Aug. -0.9	0.4	1.8
Employment (% growth)	1.8	1.4	1.9	1.9		-5.5	-1.5			
Unemployment Rate (%)	7.2	6.8	6.3	6	6.2	7.6	8.4	Aug. 8.7	8.5	8.9
SMEs Confidence Index (CFIB)	68.4	66.4	67.3	67.2	56.1	42.3	64.2	Sept. 68.7		
Manufacturers Confidence Index (CFIB)	70.4	68.3	66.4	64.5	52.7	38.8	64.4	Sept. 71.2		
Credit Conditions (Bank of Canada)*	-10.8	-16.5	-9.8	15.0	32.0	36.0	12.0			

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

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