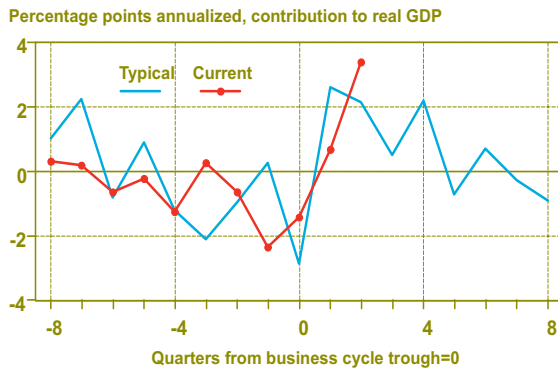
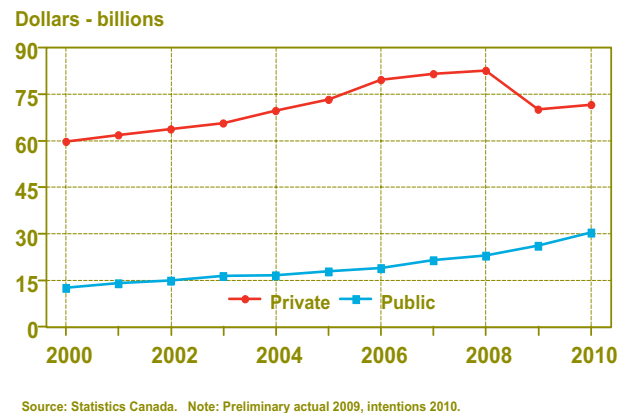


Inventory Cycle during Current and Typical U.S. Economic Recovery



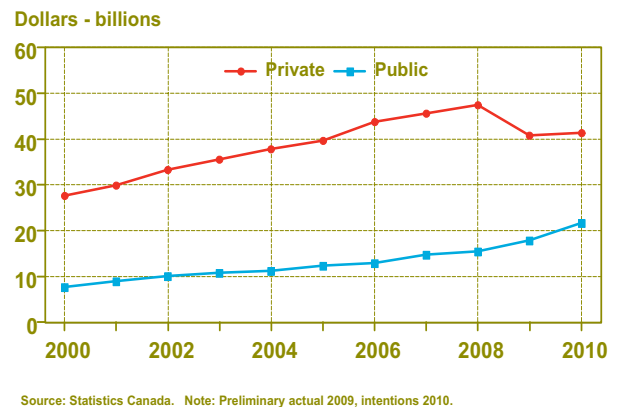
Total Capital Expenditures by Private and Public Organizations, Ontario



Through its impact on productivity, investment in physical capital is a critical factor in shaping an economy's growth performance. The annual survey of *Private and Public Investment in Canada, Intentions* by Statistics Canada is the main focus in this week's economic briefing. For Ontario, the survey found that a modest spending increase is planned this year, led by the public sector. Investment intentions are just that – intentions --and the actual results will differ, but they still provide a good deal of information about the state of Ontario's economy and possible activity in 2010.

Statistics Canada conducts this detailed survey between October and January of each year and, on this occasion, the economy was in the early stages of a technical economic recovery but operating with excess production capacity. Corporate profits turned up in the second half of last year, following steep plunges in late 2008 to mid-2009 when the financial crisis and recession were hitting hard, suggesting that rebuilding balance sheets is a greater priority than expanding investment. The cost of corporate financing, which soared during the crisis, was coming down during the

Capital Construction Expenditures, Ontario

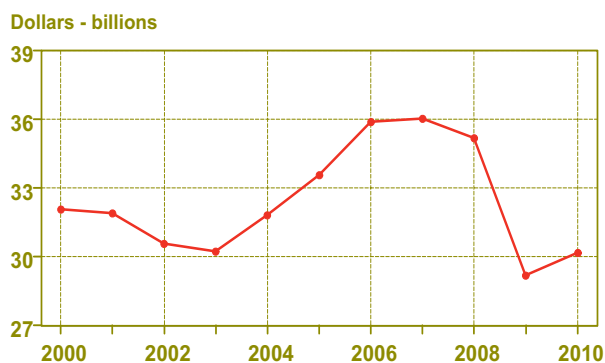


survey period to around 'normal' rates. Investment spending is ultimately dependent on its potential profitability and the market conditions faced by the firm.

Some of the numbers reveal that a modest 4.8% is planned this year by all organizations in Ontario,

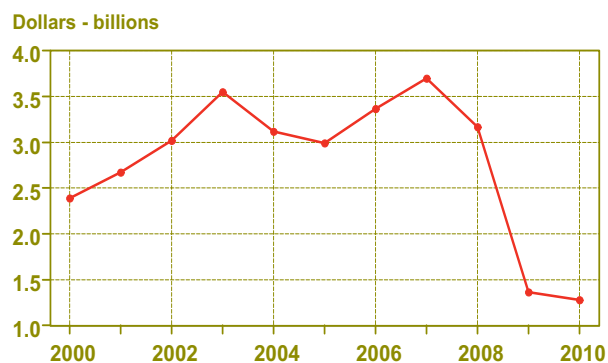


Private Capital Machinery and Equipment Expenditures, Ontario



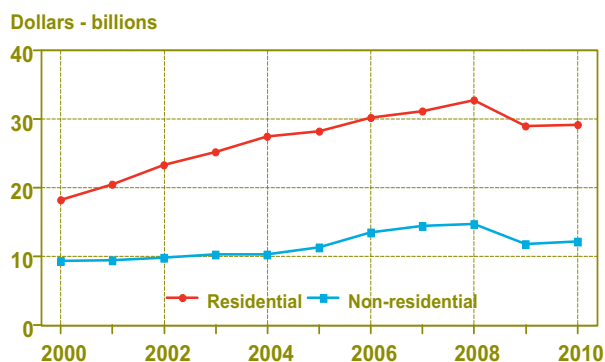
Source: Statistics Canada. Note: Preliminary actual 2009, intentions 2010.

Transportation Equipment Manufacturing Machinery and Equipment Expenditures, Ontario



Source: Statistics Canada. Note: Preliminary actual 2009, intentions 2010.

Private Capital Construction Expenditures by Type, Ontario



Source: Statistics Canada. Note: Preliminary actual 2009, intentions 2010.

which would still leave spending below the actual levels of 2007 and 2008. Last year's 9.5% overall decline to \$125.3 billion was the largest drop on record (which dates back to 1991); in the private sector, however, the decline was steeper, at 15.2%. This year's private sector intentions point to a small 2.1% increase. Public sector spending is set to rise 16.4% following a 14.0% increase in 2009, putting this spending at its highest level ever, at least in current dollars.

These data are not adjusted for price changes to estimate 'real' spending. Prices for non-residential construction will be generally lower in 2010 than in 2009, as will machinery and equipment prices. Counter to this trend are residential construction costs, which are expected to rise by about 4% this

year. Should this price forecast play out, residential construction spending intentions in 2010 will be lower in real terms than in 2009, instead of the small gain in current dollars.

Residential investment intentions are restrained and will very likely be exceeded by actual results when 2010 is closed. Housing market conditions are conducive for investment in new housing and this year's 0.8% planned increase (a shrinkage after construction inflation) will likely turn into a 20% to 25% gain. Housing starts are forecast to exceed 60,000 units this year from just over 50,000 in 2009.

One market that is not conducive to investment is the transportation equipment manufacturing sector. Here, manufacturers intend spending 6.2% less on machinery and equipment in 2010 than in 2009 on a current dollar basis. The \$1.28 billion in M&E spending is the lowest level since 1992, though higher after adjusting for inflation. The high Canadian dollar is advantageous to importing machinery and equipment and the private sector's total spending on M&E is slated for a 3.3% rise in 2010, and probably closer to 6% in real terms.

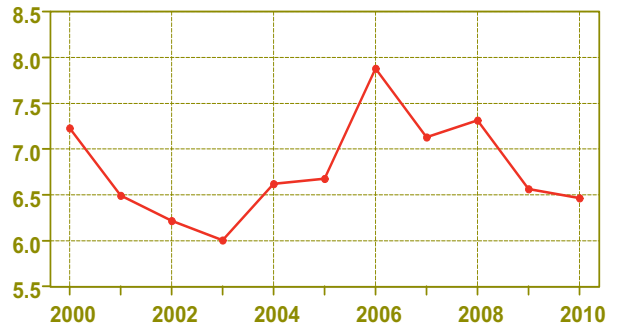
Another sector facing challenging market conditions is private non-residential building construction. Office vacancy rates are high; the tourism and hospitality sector is under-utilized, as is the retail trade sector. This sector's intended 2.4% spending increase in 2010 will likely not materialize.

One last sector to mention is finance and insurance. Here, spending intentions for machinery and equipment are down slightly by 1.4% to \$6.47 billion in 2010, compared to the recent high of \$7.88 billion set in 2006. Plans for building construction in 2010 are down 25.4% from last year to \$464 million.

Helmut Pastrick, Chief Economist
hpastrick@central1.com
604 737 5026

Finance and Insurance Sector Machinery and Equipment Expenditures, Ontario

Dollars - billions



Source: Statistics Canada. Note: Preliminary actual 2009, intentions 2010.