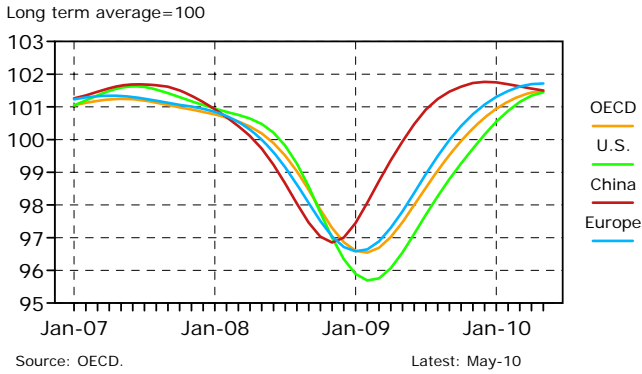


# Economic Update and Outlook

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Central 1 Credit Union

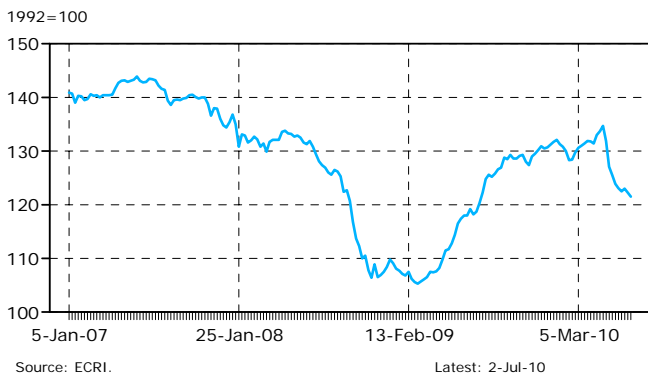


### Leading Economic Indicators, Selected Countries



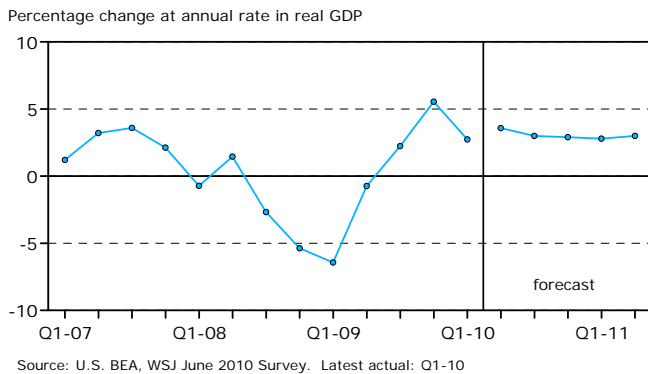
- ▶ The global recovery rebound is losing momentum according to the LEIs. The rate of growth is slowing, and in the case of China, is negative in the most recent months.
- ▶ Chinese authorities are tightening various policy settings to cool their luxury property markets. Policymakers applied a large amount of stimulus during the 2008 financial crisis and global recession.
- ▶ This is typical LEI behaviour during the recession/recovery transition phase of a business cycle.
- ▶ The LEIs are not pointing to a recession but rather to a growth slowdown. Growth rate slowdowns occur frequently for a variety of reasons and in this instance is likely due to the fading of pent-up demand, the inventory cycle, and policy stimulus.

### U.S. Leading Economic Indicator, Weekly



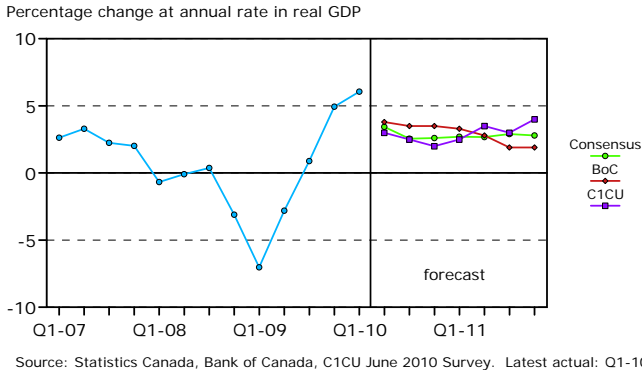
- ▶ A more current LEI is the weekly from the ECRI. Its U.S. indicator is negative on the short-term course of the U.S. economy.
- ▶ Its downturn in recent weeks is in its financial components - equity market, yield curve, credit spreads - largely due to the sovereign debt crisis in Europe. Its real economy components are in better shape.
- ▶ The U.S. LEI is pointing to a growth slowdown at a minimum, and if the LEI continues to decline, a possible recession.

### U.S. Economic Forecast



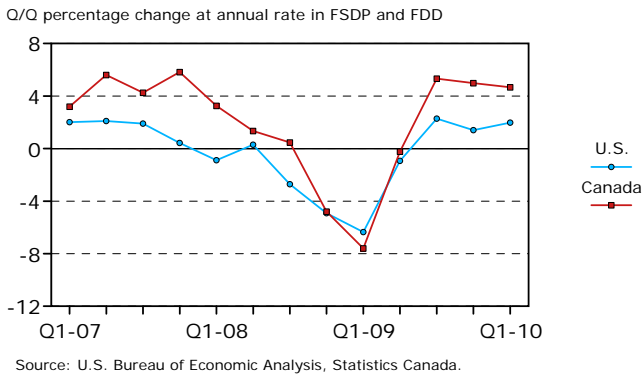
- ▶ After growing 5.1% annualized in Q4-09, the U.S. economy slowed to 2.7% a.r. in Q1-10. The main sources of growth during the recovery, which technically began in Q3-09, are the inventory cycle and policies to boost home and car sales, machinery and equipment investment or via income transfers or infrastructure spending.
- ▶ Q2-10 real GDP growth is seen at a slightly higher pace (3.6%) than in Q1-10 before slowing to 3.0% in the next four quarters.
- ▶ This forecast survey was taken in June and lower expectations will likely prevail in the July survey.
- ▶ At the end of 2010, the Bush tax cuts expire and unless renewed in some form will result in a tax hike for the economy, which would slow spending.
- ▶ The risk of recession contagion from Europe is small, but the risk of financial contagion from a banking crisis is larger.

### Canada's Economic Forecasts



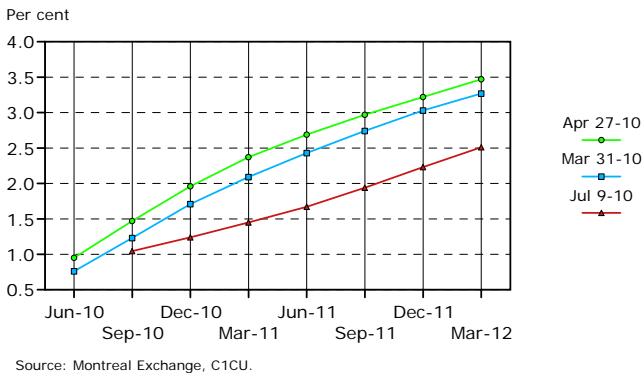
- ▶ Growth in Canada's economy is seen slowing to 3.4% a.r. in Q2-10 from 6.1% a.r. in the previous quarter. Growth during this recovery is largely domestically driven by personal consumption, residential investment, government spending and the inventory cycle. Exports grew but imports grew faster resulting in a net trade drag on growth.
- ▶ The Bank of Canada forecast is from last April and will no doubt be revised lower to incorporate recent developments in Europe and elsewhere.
- ▶ A growth slowdown emanating from external sources and normal recession/recovery dynamics in the domestic sector pulls the economy into a weaker growth path in the second half of 2010 and early 2011.
- ▶ A return to higher growth rates later in 2011 is expected when global and U.S. conditions improve.

### Domestic Demand Growth, U.S. and Canada



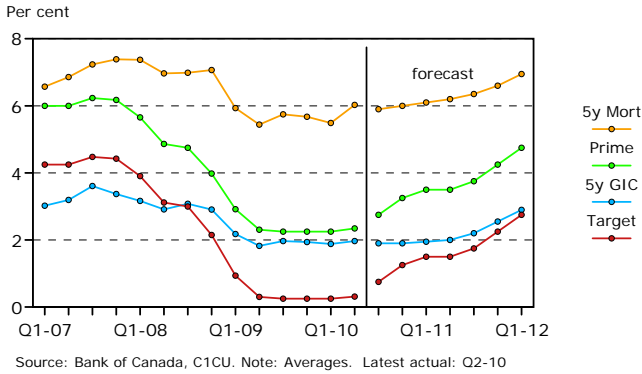
- ▶ Canada's domestic economy is growing at a much higher pace than the U.S. domestic economy.
- ▶ U.S. households are saddled with higher debt loads and weaker balance sheets than their Canadian counterparts. U.S. personal consumption spending growth is lacklustre due to their finances and also to high unemployment.
- ▶ The official unemployment rate in the U.S. is about 10% but when marginally attached workers are included it jumps to above 16%. At these high rates, wage and salary growth is minimal.
- ▶ Investment spending in Canada is more robust than in the U.S. as well. This is most evident in the residential sector.
- ▶ A stronger domestic economy is the main reason behind the Bank of Canada's decision to commence the rate normalization process.

### Three-Month Canadian Bankers' Acceptance Futures



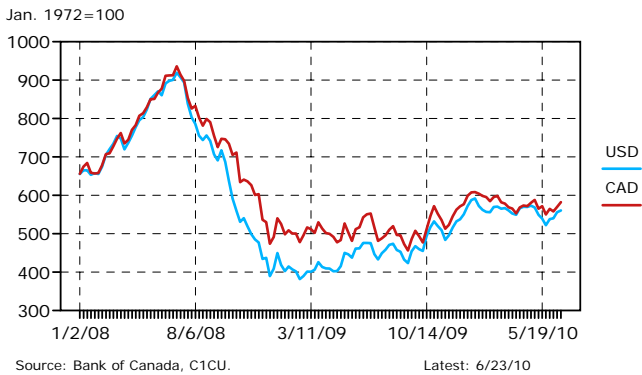
- ▶ Futures market rate expectations have downshifted markedly since the Euro debt crisis came to the fore in early May.
- ▶ The current three-month Canadian Bankers Acceptance futures rate in Mar-12 is down 100 basis points from the end of April.
- ▶ Nonetheless, the futures market is pricing in about a 150 bps increase in the 3m-BA rate by the end of 2011.

### Interest Rate Forecasts, Quarterly



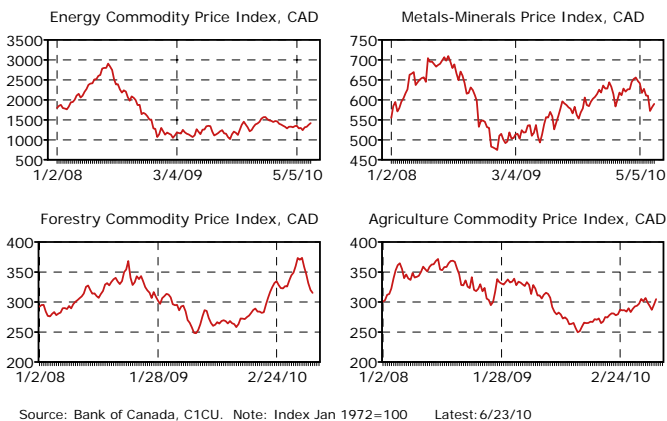
- ▶ The Bank of Canada is raising rates at their July, September and October meetings by 0.25% on each occasion. The case for higher rates is strong since the economy is well out of its recession and growing. The emergency conditions that brought a near-zero policy rate have past.
- ▶ The yield curve is steep but has narrowed during the Euro crisis induced flight-to-safer assets. When this motive diminishes, the yield curve will shift up and flatten during the central bank's rate normalization process.
- ▶ A pause in the Bank's initial rate moves is expected later in 2010 in response to the growth slowdown in the U.S. and elsewhere.

### Bank of Canada Commodity Price Index



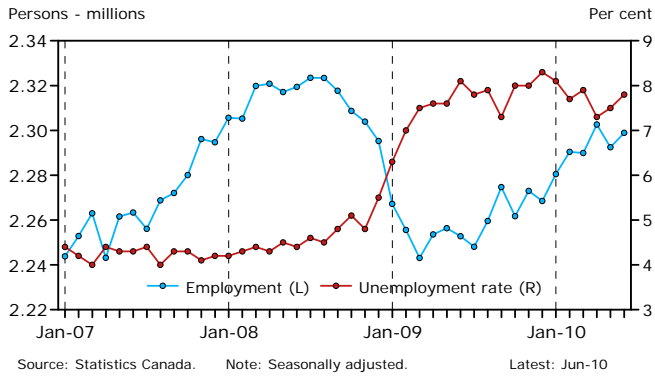
- ▶ Commodity prices took a huge hit during the Great Recession and have recovered only modestly thus far. The BoC index is a composite of Canadian commodities sold in world markets.
- ▶ Virtually all of these commodities are quoted in U.S. dollars and the U.S.-Canada exchange rate affects the return Canadian exporters receive.
- ▶ Since the recession ended, commodity prices in U.S. dollars are up about 35% but in CAD terms, prices are up only 15%.
- ▶ Some of the increase in USD prices is due to USD depreciation and not to commodity supply/demand conditions.

### Commodity Price Index by Type



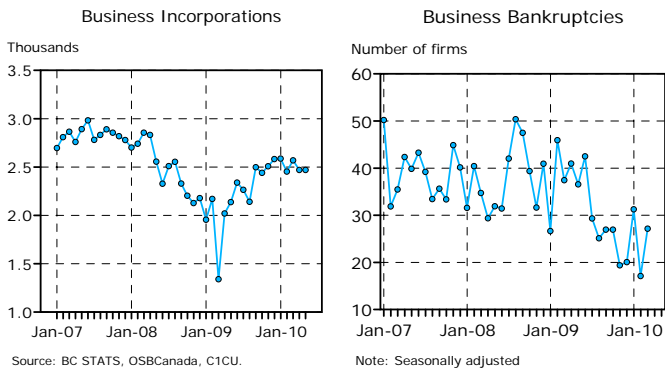
- ▶ In CAD terms, energy prices have lagged during the recovery with the main gains coming from the forestry and mining sectors.
- ▶ Forest product prices are well off their recession lows but remain historically low, especially for lumber prices. The lumber sector is emerging from a four-year recession that saw volume and prices drop to decade lows.
- ▶ Metals-minerals prices have rebounded from their lows, though showing some weakness in recent weeks due to negative global events.

### B.C. Labour Market



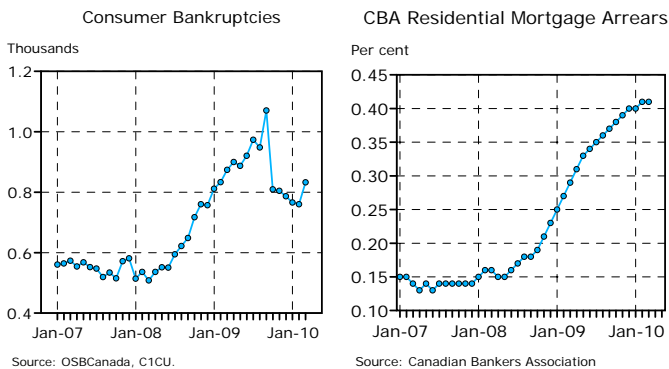
- ▶ B.C.'s labour market is steadily improving and employment is well above the recession lows.
- ▶ The unemployment rate is near 8% though below its peak.
- ▶ Job growth since the recession has been in both full-time and part-time jobs.
- ▶ Most of the job gains during the recovery have been outside of Metro Vancouver. The recession hit the regions outside Vancouver the hardest while the Vancouver market held up.
- ▶ At the same time, public sector job growth is outpacing the private sector. Gains in education, health, and government services overshadow most private sector industries with the exception of retail trade, finance/real estate, and other services.

### B.C. Business Indicators



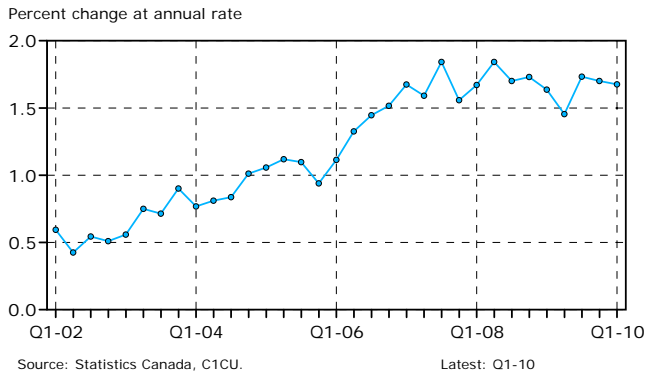
- ▶ Rising incorporations and declining bankruptcies are positive signs in the business sector.
- ▶ Normally, bankruptcies rise noticeably during recessions but not in this instance.

### B.C. Consumer Indicators



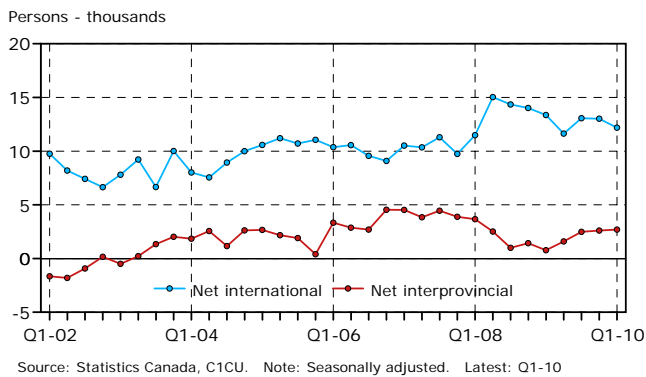
- ▶ The bankruptcy situation for consumers is as expected during a recession - a sharply rising trend.
- ▶ Residential mortgage arrears in chartered banks located in B.C. also rose sharply though from every low rates in 2007.
- ▶ The spike in bankruptcies in Sep-09 was due to changes in the Bankruptcy and Insolvency Act effective in Sep. 18-09.

### B.C. Population Growth Rate, Quarterly



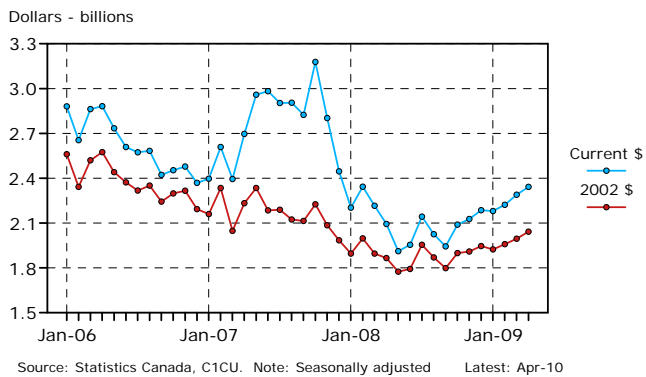
- ▶ Population growth held up well during the recession amidst concerns of larger net outflows of interprovincial migrants.
- ▶ The more severe recession in Alberta and Saskatchewan caused relative unemployment rates to shift in favour of B.C. Those provinces are seeing net outflows to B.C.
- ▶ This level of population growth supports the domestic economy.

### B.C. Net Migration by Type, Quarterly



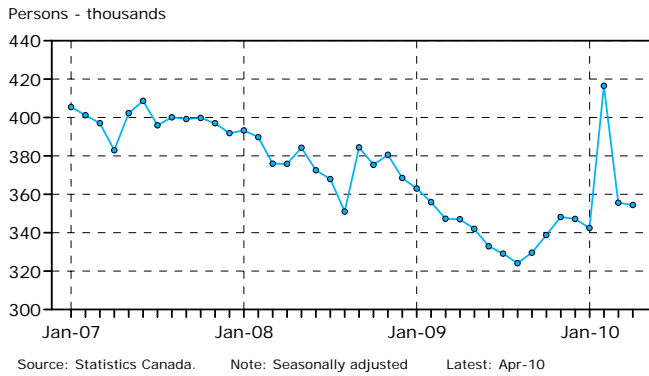
- ▶ Net interprovincial migration turned up in 2009 mainly to net inflows from Alberta, which previously were net outflows to Alberta.
- ▶ International migration levels are slightly higher than in prior years.
- ▶ The majority of B.C. population growth comes from migration to the province.

### B.C. International Merchandise Exports



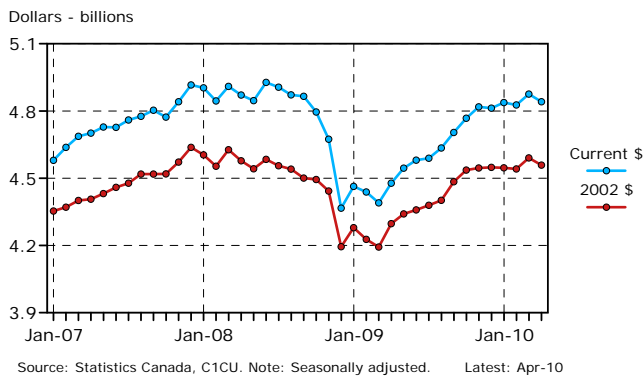
- ▶ B.C. goods exports are beginning to climb led by forestry and coal products. In both cases, exports plummeted during the recession and are recovering from decadal lows -- particularly for lumber exports.
- ▶ The elevated CAD restrains B.C.'s export growth as does its higher cost of production relative to globally competing supply sources.
- ▶ Nonetheless, global economic recovery increases demand and pricing for B.C. exports.

### B.C. International Tourist Entries



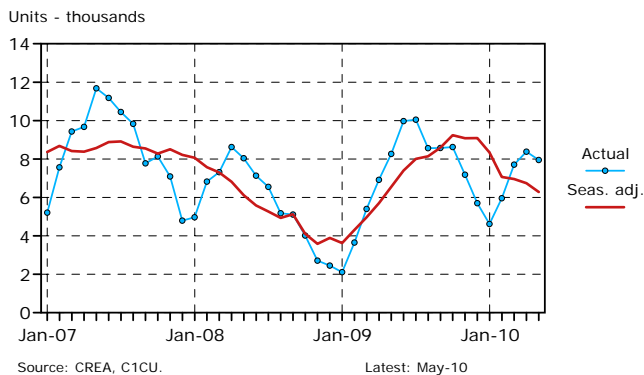
- ▶ The 2010 Winter Olympics caused a sharp spike in the number of international tourists coming to B.C. and provided a temporary economic boost.
- ▶ The short-term outlook for international tourism neutral and hinges on U.S. traffic. Increased visits from Asia are expected since Canada received Approved Destination status from China. The European outlook is dimmer following its sovereign debt crisis.

### B.C. Retail Sales



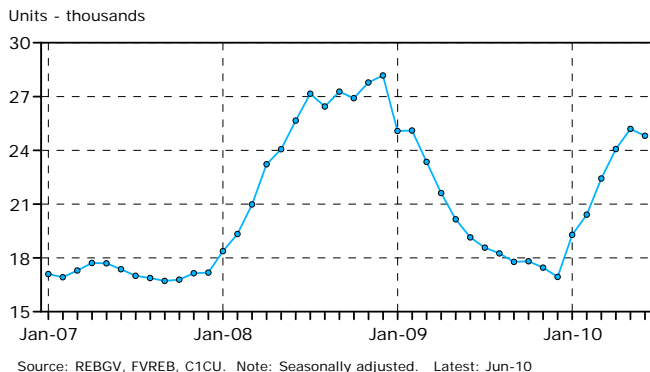
- ▶ B.C. consumer spending retrenched during the recession but recovered rather smartly until late 2009 when retail sales flat-lined thereafter.
- ▶ Spending is well up from year ago levels but the trend in the most recent months is much less positive.
- ▶ Possibly, May and June sales will spike in advance of the HST effective July 1.
- ▶ Consumer fundamentals are less than ideal but should be supportive of growth rather than stagnation. It is too early to reach the conclusion that the B.C. consumer is tapped out.

### B.C. MLS Residential Sales



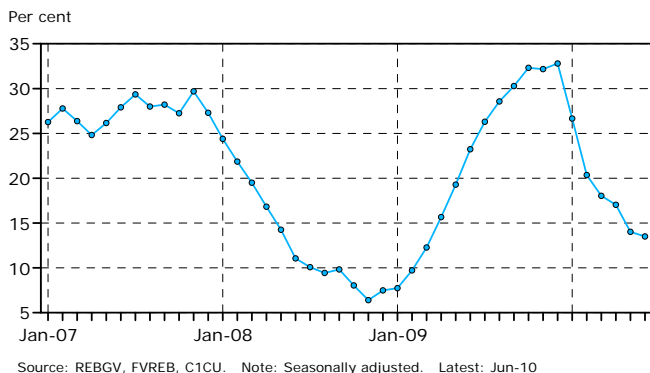
- ▶ Housing sales have turned lower since last October following a strong rebound from their recession low. Jun-10 sales, not shown in the graph, are about 8% lower than May seasonally adjusted unit sales.
- ▶ The short-term outlook is for further declines in the summer months before turning higher later this year or in early 2011.
- ▶ Fixed term mortgage rates are edging lower, though the variable rate mortgage will increase when the BoC raises its target rate.
- ▶ The weaker sales market leads to lower prices and improves affordability.
- ▶ The housing market is undergoing an adjustment phase but not likely fall back into recession.

### MLS Residential Active Listings, Lower Mainland



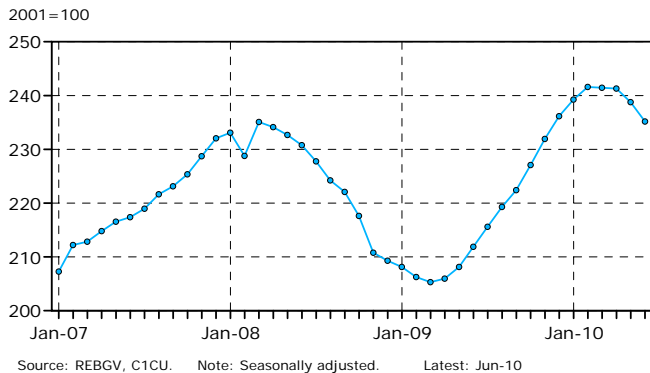
- ▶ A high number of units are for sale on the market. The data shown are for the lower mainland real estate boards only. However, a similar situation applies to other B.C. markets.
- ▶ At more than 24,000 units for sale, this is well in excess of demand and puts downward pressure on prices.
- ▶ New listings are beginning to decline which is part of the adjustment process and will lead to fewer active listings.
- ▶ The May-10 level is very likely a near term peak.

### MLS Residential Sales-to-Active Listings Ratio, Lower Mainland



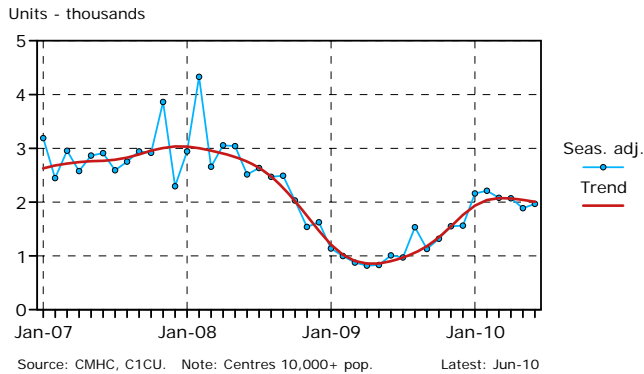
- ▶ The sales-to-active listings ratio is low less than 15% and indicates a substantial oversupply imbalance in the market. In a normal market, the ratio is about 20%.
- ▶ Downward pressure on housing prices continues for a few more months.

### MLS Housing Price Index, Lower Mainland



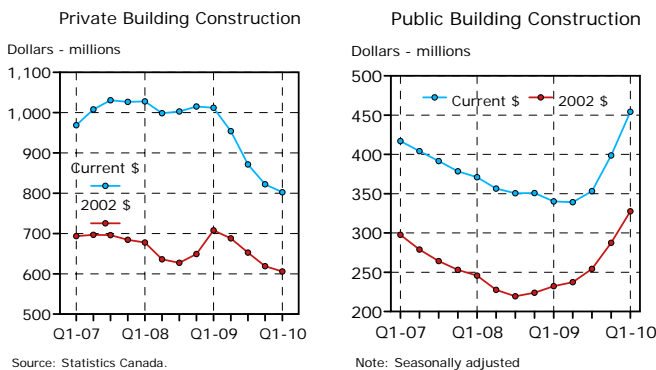
- ▶ The MLS Housing Price Index (HPI) is the best measure of housing price performance and it is available only for the lower mainland real estate boards.
- ▶ Prices are turning down and reached a near-term peak in Jan-10.
- ▶ The price decline will continue through the summer months and possibly beyond depending on how quickly supply contracts.
- ▶ A 5% price correction during a market adjustment phase is within normal bounds.
- ▶ This adjustment phase is not expected to morph into another recession since housing demand fundamentals are not hugely negative. Should the European crisis generate a banking/financial crisis, a more severe market correction occurs.

### Urban B.C. Housing Starts



- ▶ Housing starts fell to very low levels during the recession and have rebounded in response to higher sales and prices.
- ▶ The near-term trend is beginning to roll-over and will likely worsen since sales and prices are declining.

### B.C. Non-residential Building Construction Investment Spending



- ▶ Private investment spending on commercial and industrial buildings is down on weak market conditions for offices, hotels, retail space, and other income producing properties.
- ▶ No turnaround is expected in 2010 or likely in 2011.
- ▶ In the public sector, spending is rising sharply due to the fiscal stimulus measures of the federal and provincial governments. Education, health, and community facilities are being built and spending will be rising during 2010 and into 2011. A decline should be in the works around mid-2011.

### B.C. Economic Outlook

Indicator	2009	2010f	2011f
Real GDP, % change	-2.3	3.4	2.5
Nominal GDP, % change	-4.4	4.9	3.8
Personal income, % change	-1.8	2.1	2.9
Employment, % change	-2.4	1.9	2.2
Unemployment rate, %	7.6	7.5	7.2
Corporate profits, % change	-32.2	19.0	14.5

Source: Statistics Canada, C1CU estimate\* and forecast.

- ▶ The Olympics raised growth well above 3% in 2010 but the 2011 outlook is less robust due to the U.S./global economic slowdown ahead and the temporarily elevated 2010 activity.
- ▶ Domestic demand will grow at an average pace supported by population growth, favourable interest rates, and moderate job growth.
- ▶ Exports will increase after the slowdown but at a moderate pace since the CAD will remain elevated.
- ▶ Private investment in M&E and nonresidential projects will lag since their derived demand sectors are not robust.
- ▶ Government investment spending climbs in 2010 and into 2011 while spending on current goods and services slows.
- ▶ The case for robust growth in 2011 is weak as is the case for a recession, unless externals turn more negative than anticipated.

### B.C. Housing Market Outlook

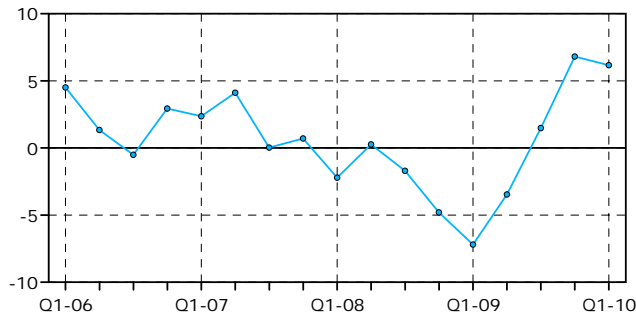
Indicator	2009	2010f	2011f
Population growth, % change	1.7	1.8	1.8
CPI, % change	0.0	1.9	1.7
Retail sales, % change	-4.4	5.2	5.5
Housing sales, % change	23.4	-9.0	10.0
Housing prices, % change	2.4	3.0	2.0
Housing starts, % change	-53.1	55.0	-5.0

Source: Statistics Canada, CREA, CMHC, C1CU forecast.

- ▶ Population growth holds with some upside potential if Alberta's unemployment rate remains near 7%.
- ▶ Housing sales decline this year but recover in 2011 when affordability conditions and investment opportunities are more attractive.
- ▶ The current price decline continues to the end of 2010 and possibly into 2011 but prices turn when 2011 sales have been rising for a few months.
- ▶ Housing starts undergo a substantial rebound off the 2009 low but look to come off in 2011. It is a close call for 2011 and a level of higher starts is conceivable.

### Ontario Economic Performance

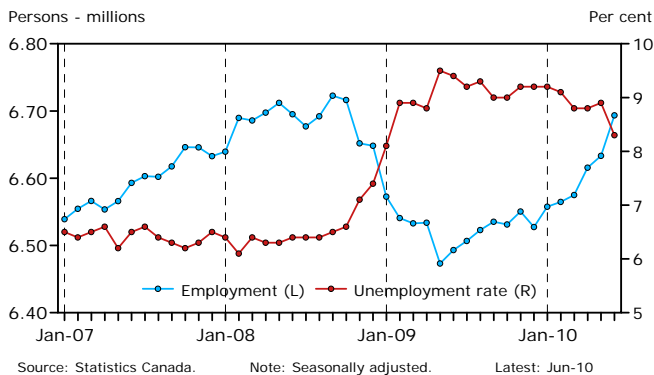
Percentage change at annual rate in real GDP



Source: Ontario Ministry of Finance.

- ▶ Economic growth in the last two quarters has been somewhat impressive though technically recovery growth rates are higher when the recession is deeper. The 2008/09 recession was the third worst since 1981.
- ▶ Since the recession originated externally, exports were particularly hard hit. The GM and Chrysler bankruptcy shutdowns exacerbated the drop in exports.
- ▶ Exports have rebounded and policy stimulus has lifted personal consumption spending and residential investment. Government capital spending is also a notable growth contributor.

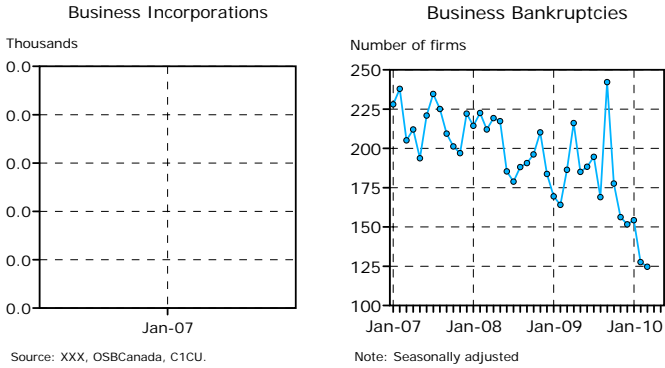
### Ontario Labour Market



Source: Statistics Canada. Note: Seasonally adjusted. Latest: Jun-10

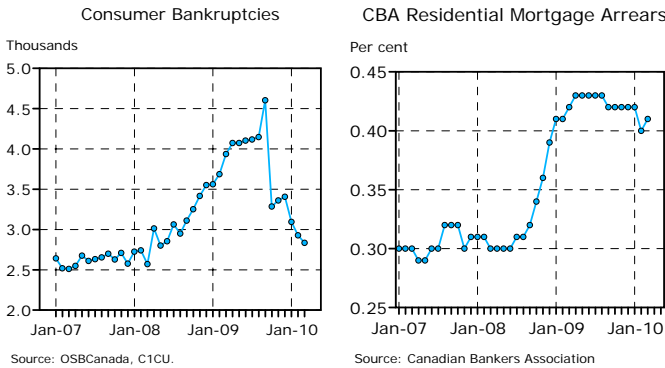
- ▶ Ontario's job growth has soared in the past three months and the unemployment rate is at its lowest point since the recovery began around mid-2009.
- ▶ During this recovery, job gains are mainly in the GTA, though since the beginning of 2010, employment in the rest of Ontario is up sharply.
- ▶ Job gains are evident in most industries with the notable exceptions of manufacturing, transportation-warehousing, and accommodation-food services.
- ▶ Some fallback from the large monthly gains in April and June is expected and the looming U.S. economic slowdown is another concern that those impressive gains will not be maintained.

### Ontario Business Indicators



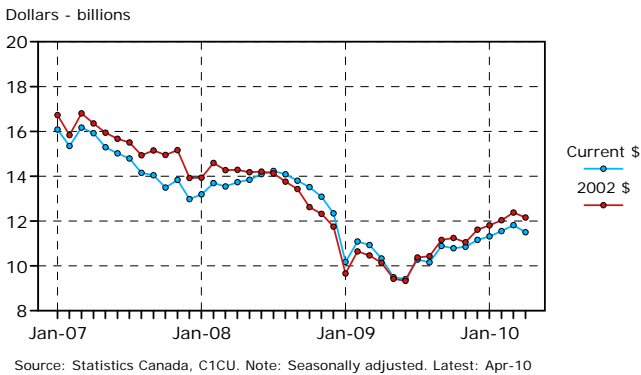
- ▶ Business incorporations data are not readily available.
- ▶ Business bankruptcies did not increase during the recession and continue to trend lower.
- ▶ The behaviour of bankruptcies during this recession is surprising and curious.

### Ontario Consumer Indicators



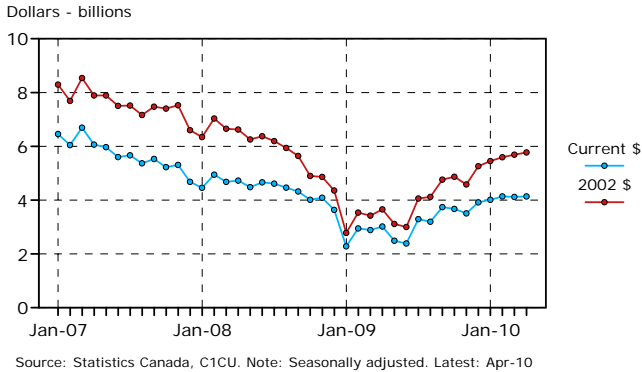
- ▶ Consumer bankruptcies and residential mortgage arrears behaved as expected during the recession.
- ▶ Both appear to be past their cycle peaks.

### Ontario International Merchandise Exports



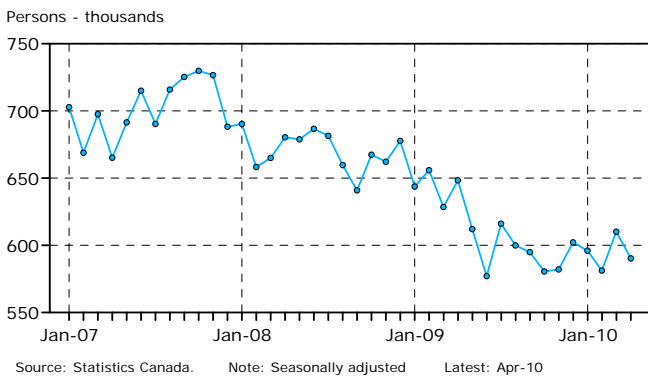
- ▶ Goods exports are rising from their lows adding a much-needed growth driver to the provincial economy.
- ▶ Performance of the U.S. economy is the main consideration for the future of exports. A U.S. slowdown would have the predictable impact of the province's exports.
- ▶ The high CAD is another factor and restrains export growth.

### Ontario Automotive International Exports



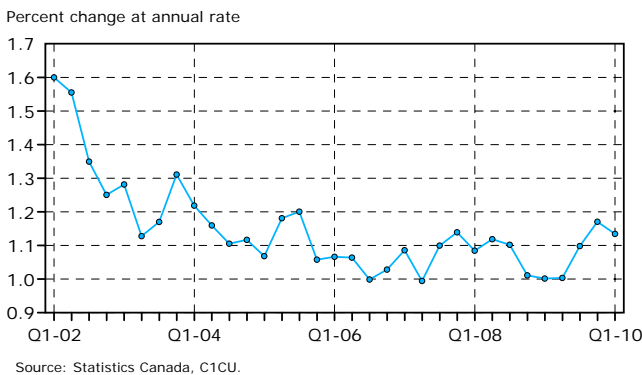
- ▶ The rebound following the GM and Chrysler restructuring and reopening gained momentum until the end of 2009. Restocking of inventories and meeting sales demand boosted by the cash-for-clunkers program was a primary impetus behind stepped up production.
- ▶ In recent months, production and exports are growing more modestly. U.S. vehicle sales are in the 11 million s.a.a.r. unit range and look to be waiting for demand improvements.
- ▶ Another sales stimulus package is unlikely leaving fundamentals such as job and income growth to drive sales.

### Ontario International Tourist Entries



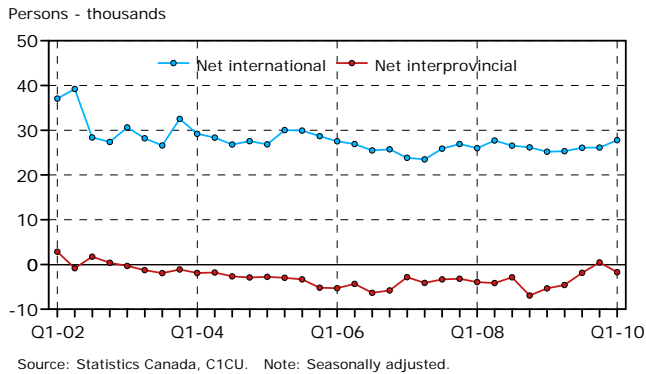
- ▶ External tourism traffic remains low though possibly stabilizing in recent months.
- ▶ Employment in the accommodation-food industry generally reflects this performance.
- ▶ The short-term outlook is muted since the CAD is high and the U.S. domestic economy is growing modestly. U.S. household finances are in poor shape and income growth prospects weak.

### Ontario Population Growth Rate, Quarterly



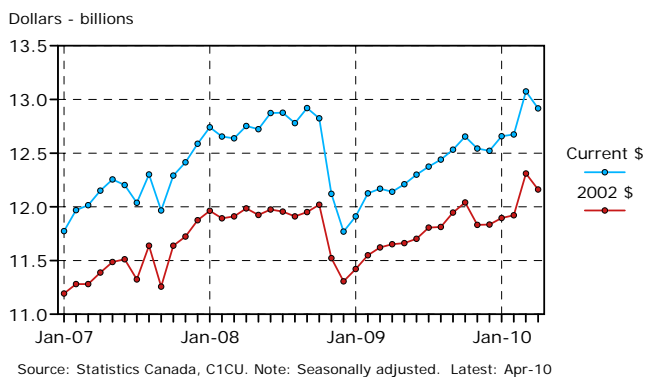
- ▶ Ontario's population growth hovers around 1.0%, well down from nearly 2% earlier this decade.
- ▶ The recent uptick to nearly 1.2% comes from slightly higher migration levels.

### Ontario Net Migration by Type, Quarterly



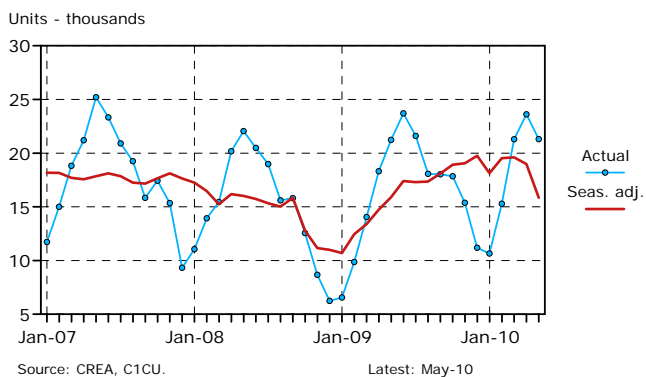
- ▶ Net migration to the province is edging up on gains from immigration and a lessening in the outflow of interprovincial migrants.
- ▶ International immigration in Q1-10 was at its highest level in a few years.
- ▶ The outflow to other provinces is down from its peak in late 2008 and early 2009. For example, Alberta's weaker labour market is no longer attracting as many workers.

### Ontario Retail Sales



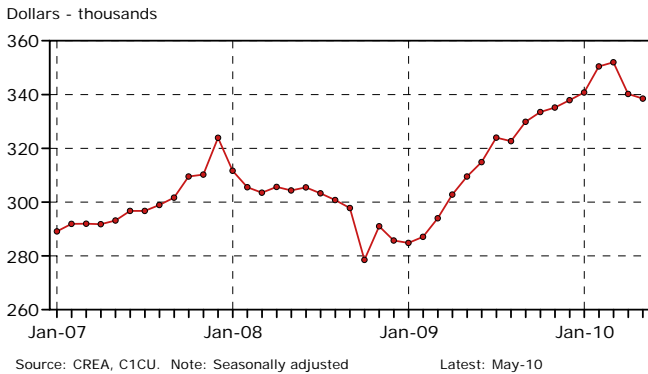
- ▶ Retail sales in Ontario have fully recovered to pre-recession levels.
- ▶ The pending HST on July 1, 2010 may advance sales activity at the expense of third quarter sales.
- ▶ With an improving labour market and slightly higher population growth, these consumer fundamentals point to further spending growth. In addition, consumer financing rates remain favourable.

### Ontario MLS Residential Sales



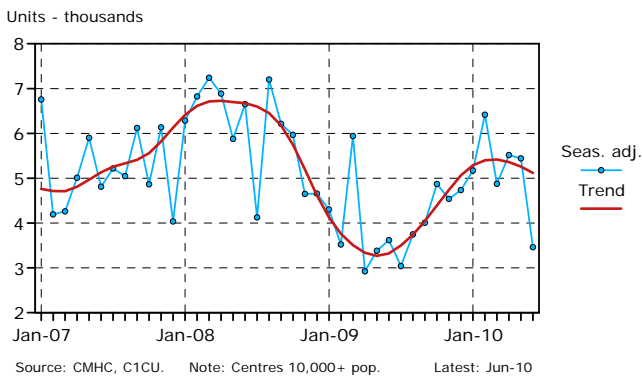
- ▶ Housing sales fell sharply in May and June prospects do appear brighter; a modest bounce back in June is possible but that would not alter the change in the sales trend during the past three to six months.
- ▶ Sales peaked in Dec-09 following a strong upturn from Jan-09's recession low. Purchasing conditions have worsened for low-equity buyers and CMHC's tighter mortgage insurance criteria (effective April 19, 2010) contributed to May's decline.
- ▶ The outlook is for the trend decline to continue for another three to six months. One positive is the recent decline in fixed term mortgage rates though variable rate mortgages are moving up.
- ▶ In the medium term, sales will revive to higher levels underpinned by improved employment and income conditions.

### Ontario MLS Residential Average Sales Price



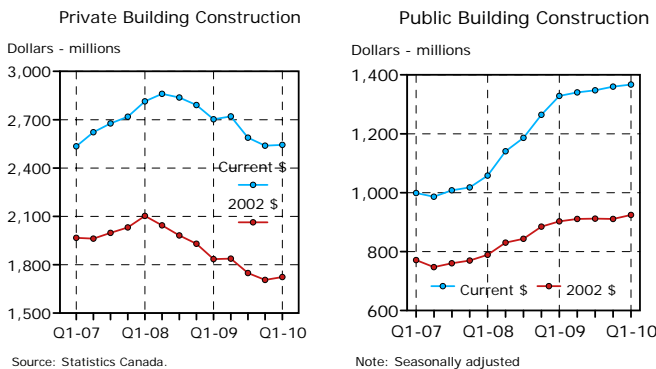
- ▶ Ontario housing prices are turning down with the sales decline and the higher level of listings on the market.
- ▶ The run-up in 2009 was impressive and while the average sales price is not the most accurate measure of prices, it is generally indicative of the change in market conditions.
- ▶ A modest price decline of about 5% from the peak is expected during this market adjustment period. An outright housing recession is not the working scenario and would only occur if external developments turned much more negative.

### Urban Ontario Housing Starts



- ▶ Housing starts are past their near-term high and trending lower.
- ▶ A reliable leading indicator for housing starts is housing sales and the recent sales decline does not bode well for near-term starts activity holding up.
- ▶ Some starts activity may have been advanced by the pending HST effective July 1. Nonetheless, lower sales levels and a weaker market will play the dominant role.

### Ontario Non-residential Building Construction Investment Spending



- ▶ The main source of construction growth is the public sector. Private sector spending on new commercial and industrial buildings is declining and awaits an improvement in vacancy rates and rents before the trend is reversed.
- ▶ Fiscal stimulus projects will keep the public sector trend rising for the rest of this year and into 2011. However, this initiative ends in 2011 and spending will decline later in 2011 and into 2012.

## Ontario Economic Outlook

Indicator	2009	2010f	2011f
Real GDP, % chg.	-3.0	3.2	2.6
Nominal GDP, % chg.	-3.3	4.5	4.1
Personal income, % chg.	-0.5	2.4	3.1
Employment, % change	-2.4	1.7	1.9
Unemployment rate, %	9.0	8.7	8.4
Corporate profits, % chg.	-33.8	25.0	15.0

Source: Statistics Canada, Ontario Ministry of Finance, C1CU forecast.

- ▶ The economic recovery will generate growth above 3% in 2010 but fallback in 2011 to the 2 - 3% range. Weak U.S. demand for Ontario exports is a restraining factor.
- ▶ The manufacturing sector's inventory restocking phase provides less impetus to economic growth in 2011.
- ▶ Domestic demand is lifted by government investment spending and moderate personal consumption growth.
- ▶ Business investment in M&E will contribute to growth since the higher CAD makes this investment more viable.
- ▶ Non-residential building investment looks to remain weak.

## Ontario Housing Market Outlook

Indicator	2009	2010f	2011f
Population growth, % change	1.1	1.2	1.2
CPI, % change	0.4	1.8	1.7
Retail sales, % change	-2.5	4.8	5.3
Housing sales, % change	8.2	5.0	9.0
Housing prices, % change	5.3	5.0	3.0
Housing starts, % change	-32.9	15.0	7.0

Source: Statistics Canada, CREA, CMHC, C1CU forecast.

- ▶ Consumer demand growth will remain moderate under relatively high unemployment but there is some growth impetus from pent-up demand and still attractive financing rates.
- ▶ Housing activity will expand at a modest pace in 2011 once the market adjustment period ends.