

North American Economic Outlook: “Gradual though Sustained Recovery”

Presentation to the Burlington Chamber of
Commerce

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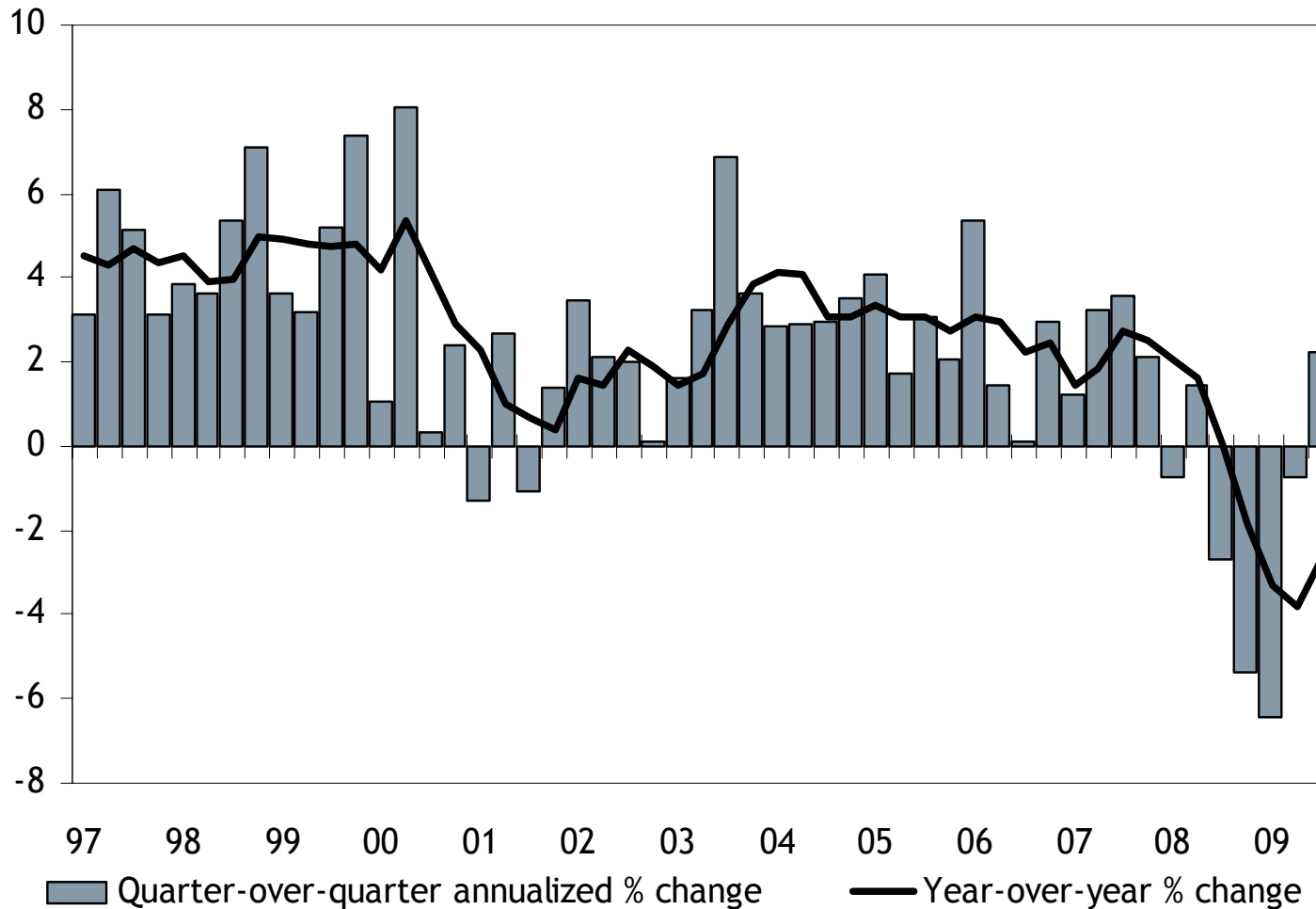
U.S. Economic Outlook:

**Policy Actions Prompted Recovery
-Though Private Sector Response
Needed to Sustain Growth**



The U.S. economy is starting to recover from a severe shock that boosted the cost-of-capital

U.S real GDP growth

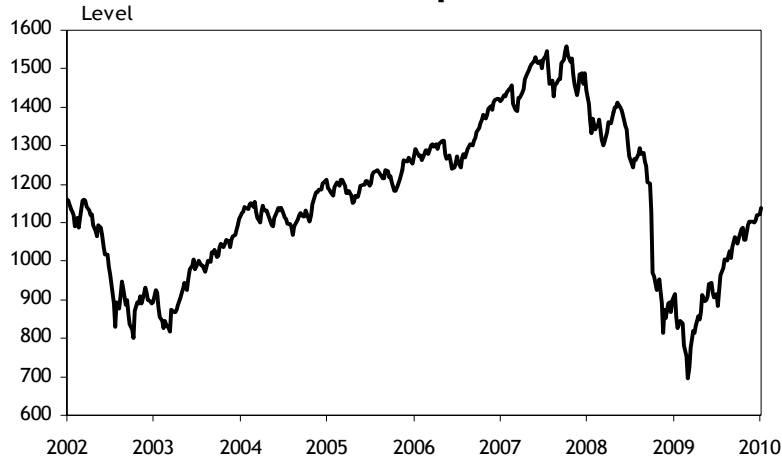


Source: Bureau of Economic Analysis, RBC Economics Research

The uncertainty as to who was holding U.S. subprime assets weighed on financial markets though these pressures are reversing

Weekly observation

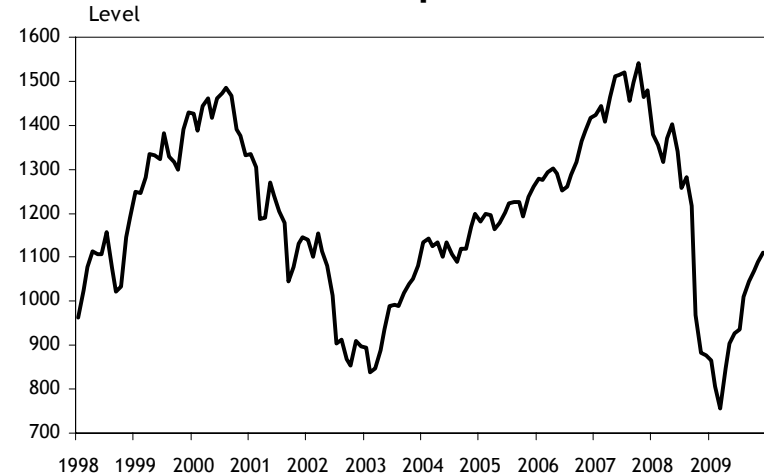
S&P 500 composite index



Source: Bloomberg, RBC Economics Research

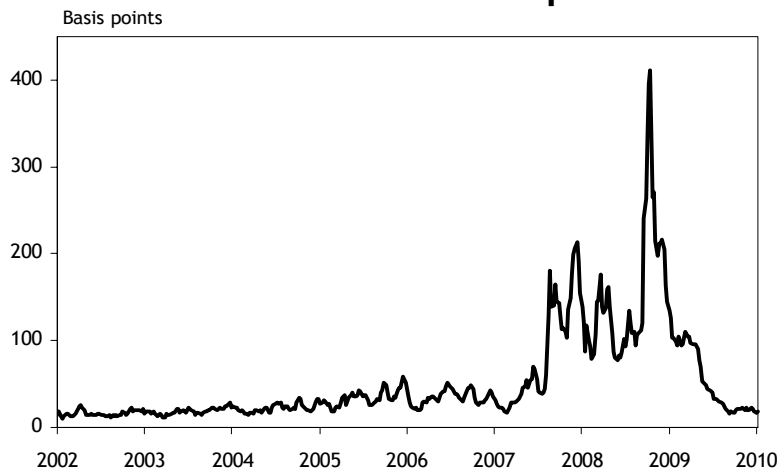
Monthly observation

S&P 500 composite index



Source: Bloomberg, RBC Economics Research

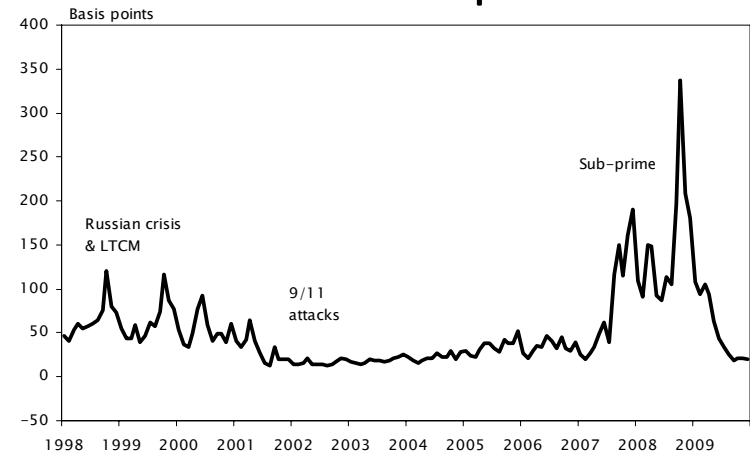
Three-month TED spread*



*Three-month LIBOR rate minus Three-month T-bill

Source: Federal Reserve Board, RBC Economics Research

3-month TED spread*

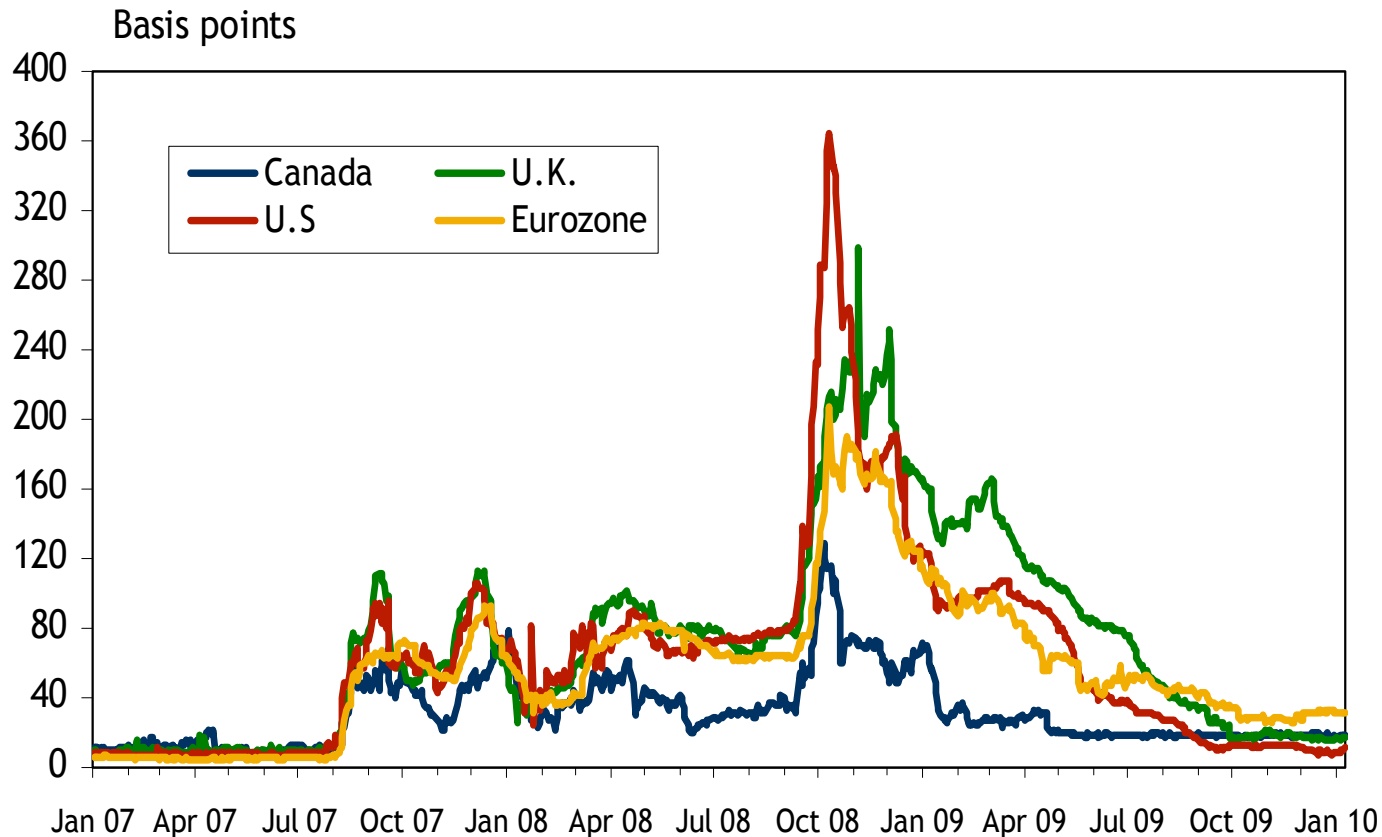


*3-month LIBOR rate - 3-month T-bill

Source: Federal Reserve Board, RBC Economics Research

The rise in lending cost was more muted in Canada

Short-term funding spreads 3 month LIBOR vs. OIS



Source: Bloomberg, RBC Economics Research

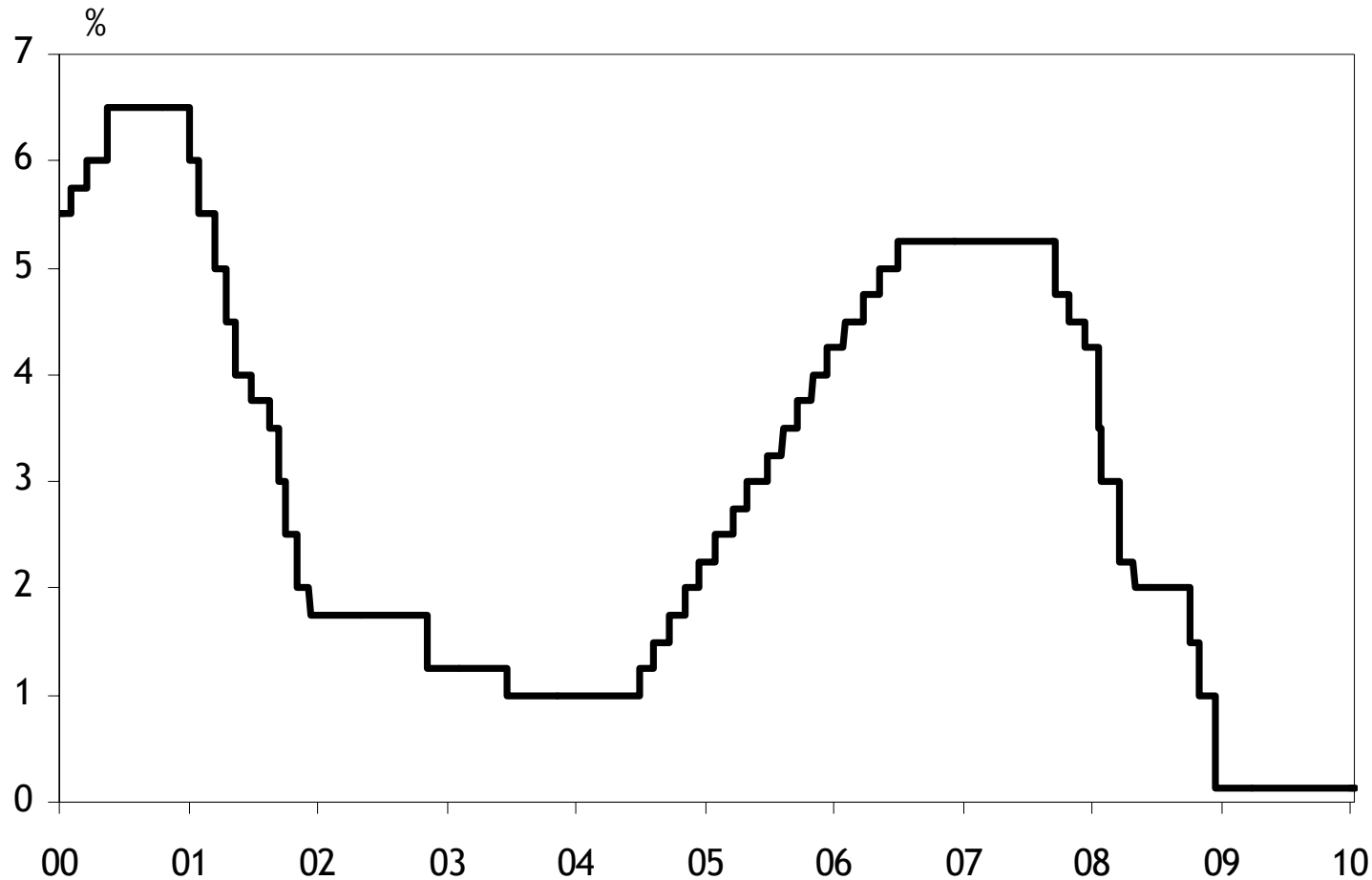
What prompted the improvement in financial markets?

Aggressive policy actions by the Administration and Congress:

- **undertook credible stress tests of the banking system**
- **committed over a trillion dollars to “rid the system of toxic assets”**
- **the Obama Administration introduced a \$787 billion fiscal stimulus package**
- **undertook initiatives to stem mortgage delinquencies**

The Fed also aggressively cut interest rates to essentially 0% . .

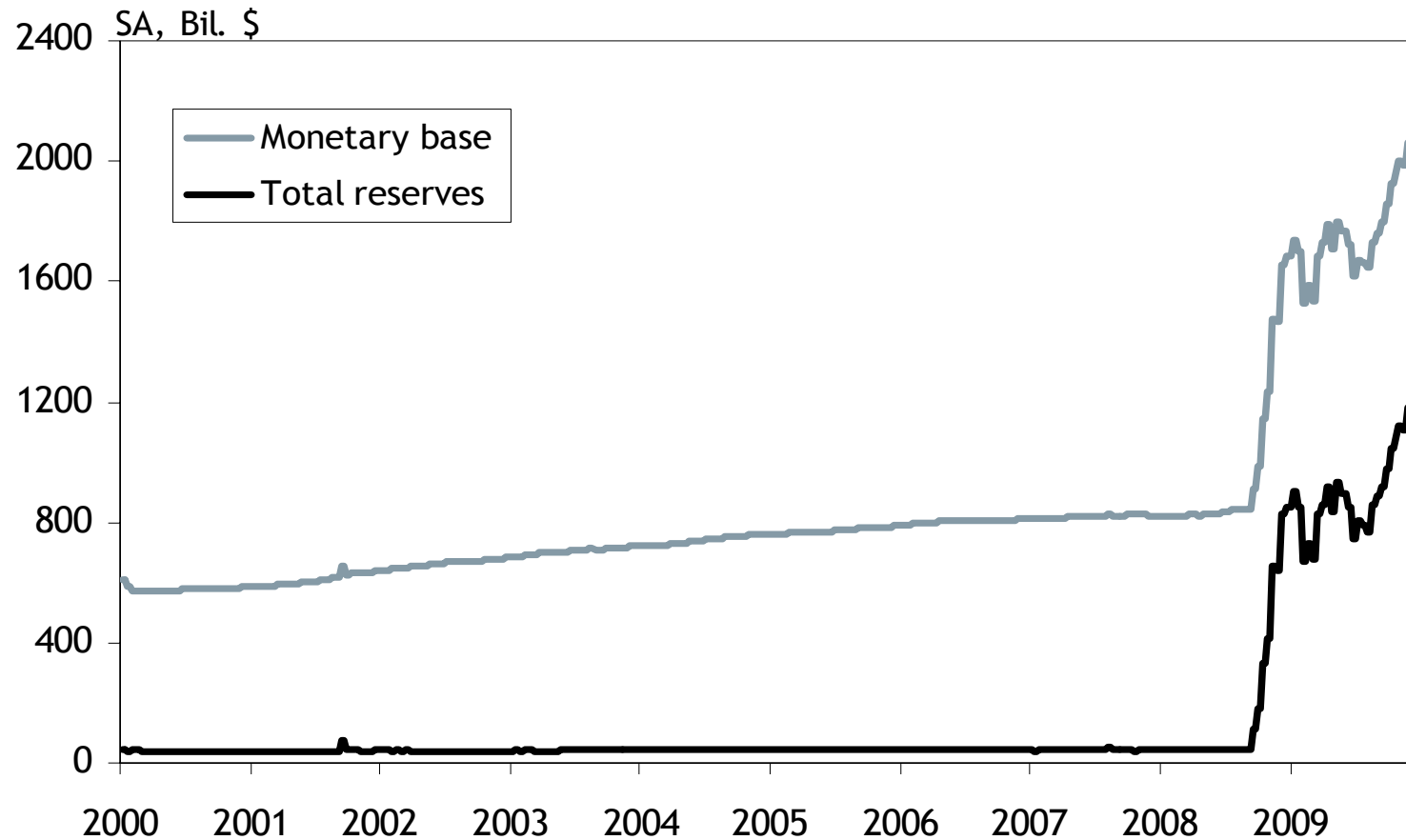
U.S. Fed funds rate



Source: Federal Reserve Board, RBC Economics Research

... and then turned to “using its balance sheet”

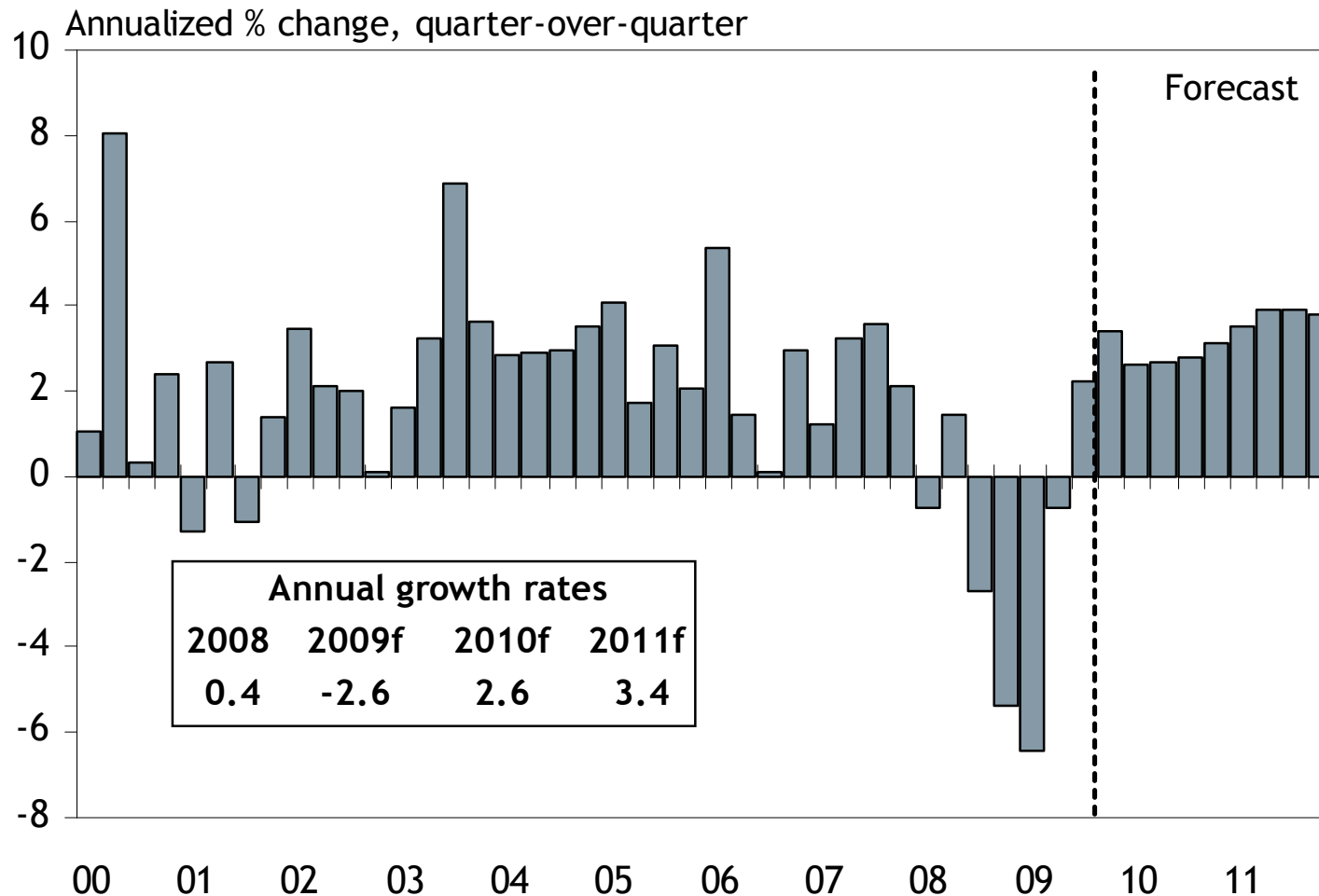
Reserves held by the Fed



Source: Federal Reserve Board, RBC

A steady easing in credit tightening and simulative policy are expected to allow positive growth to be sustained...

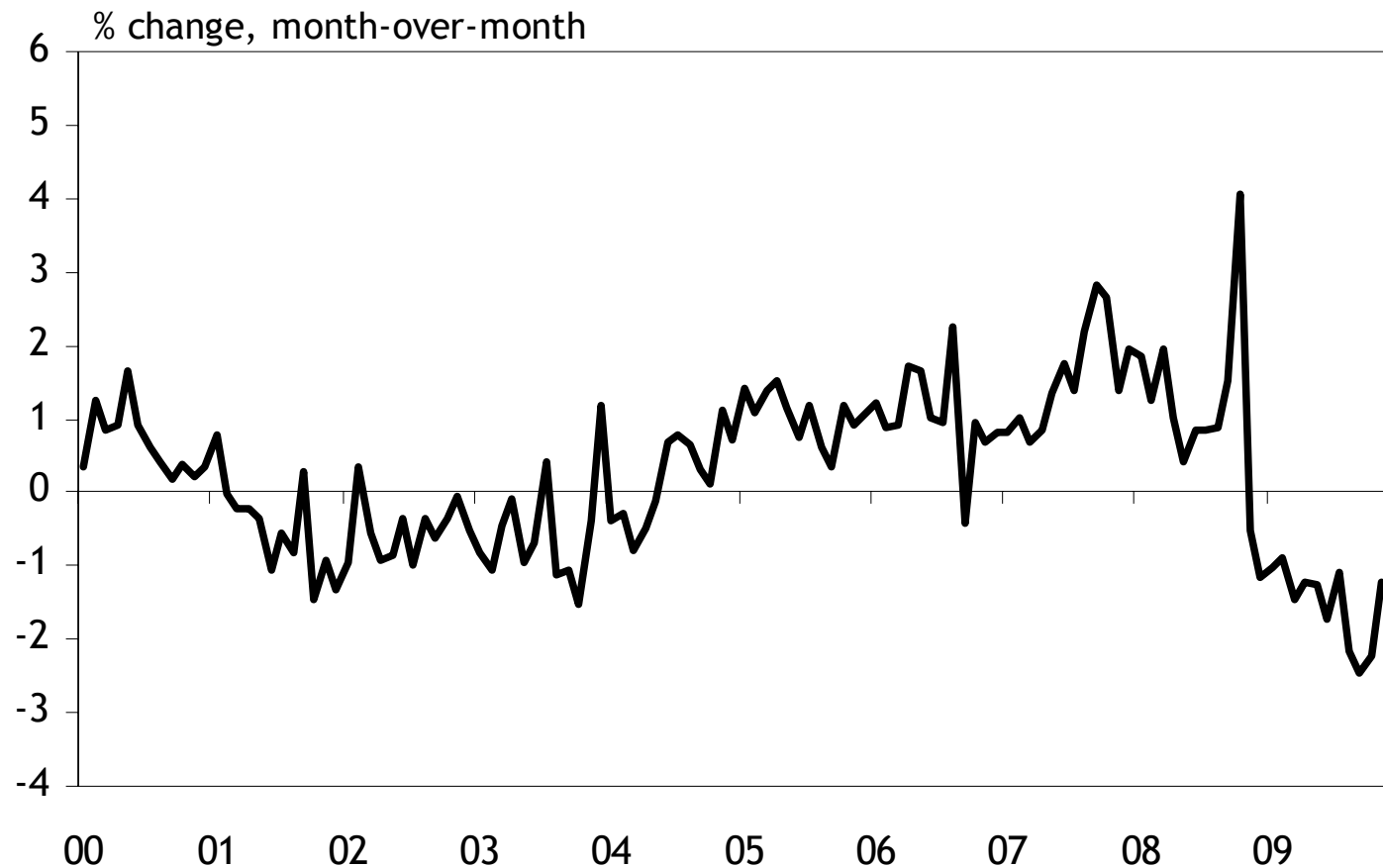
U.S. real GDP



Source: Bureau of Economic Analysis, RBC Economics Research

...though private-sector lending will need to resume

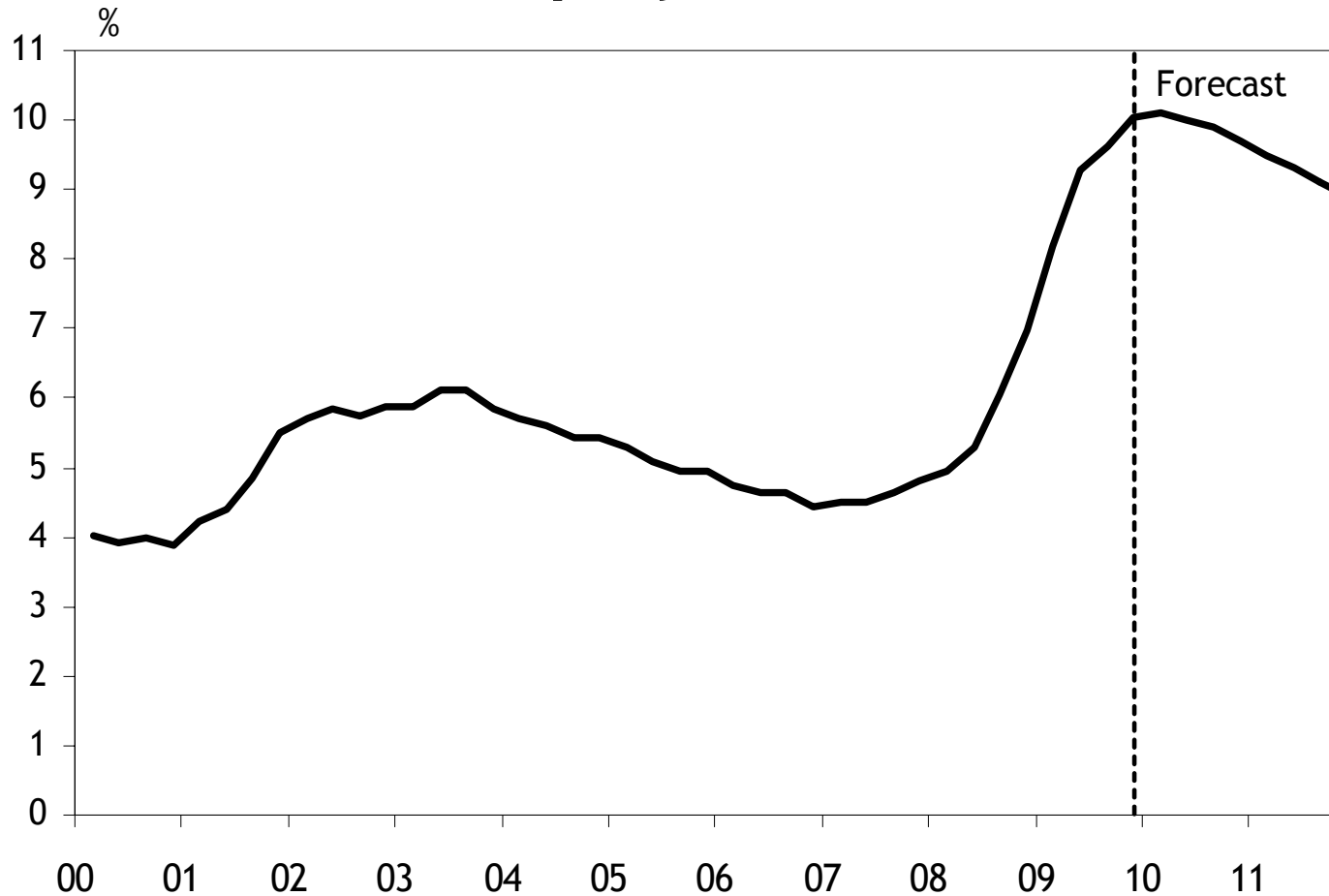
C&I loans in bank credit: All commercial banks



Source: Federal Reserve Board, RBC Economics Research

The modest recovery will keep unemployment historically high...

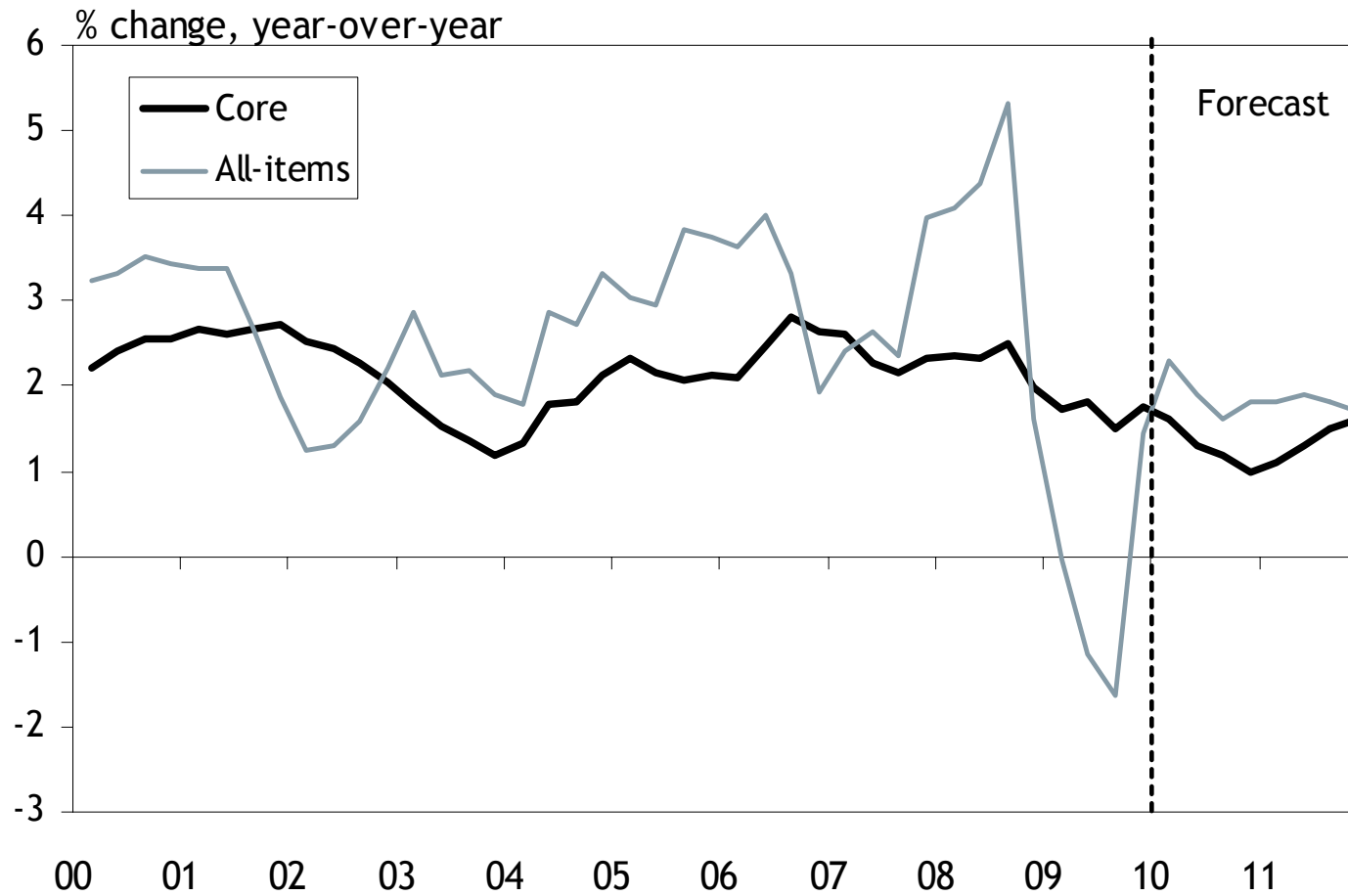
Unemployment rate



Source: Bureau of Labor Statistics, RBC Economics Research

...and inflation low...

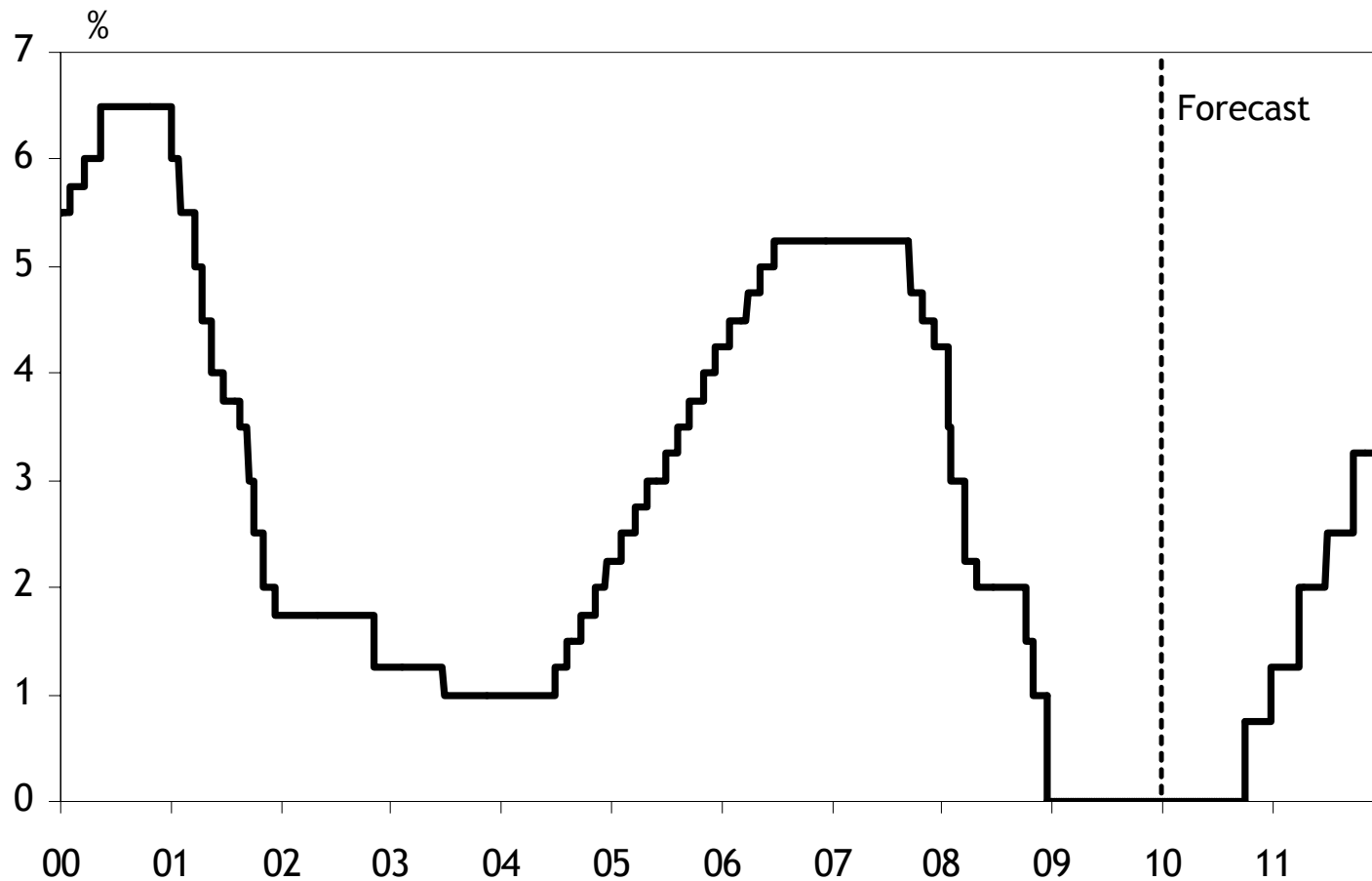
U.S. inflation



Source: Bureau of Labor Statistics, RBC Economics Research

...that will delay the tightening in monetary policy until late in 2010

U.S. Fed funds rate



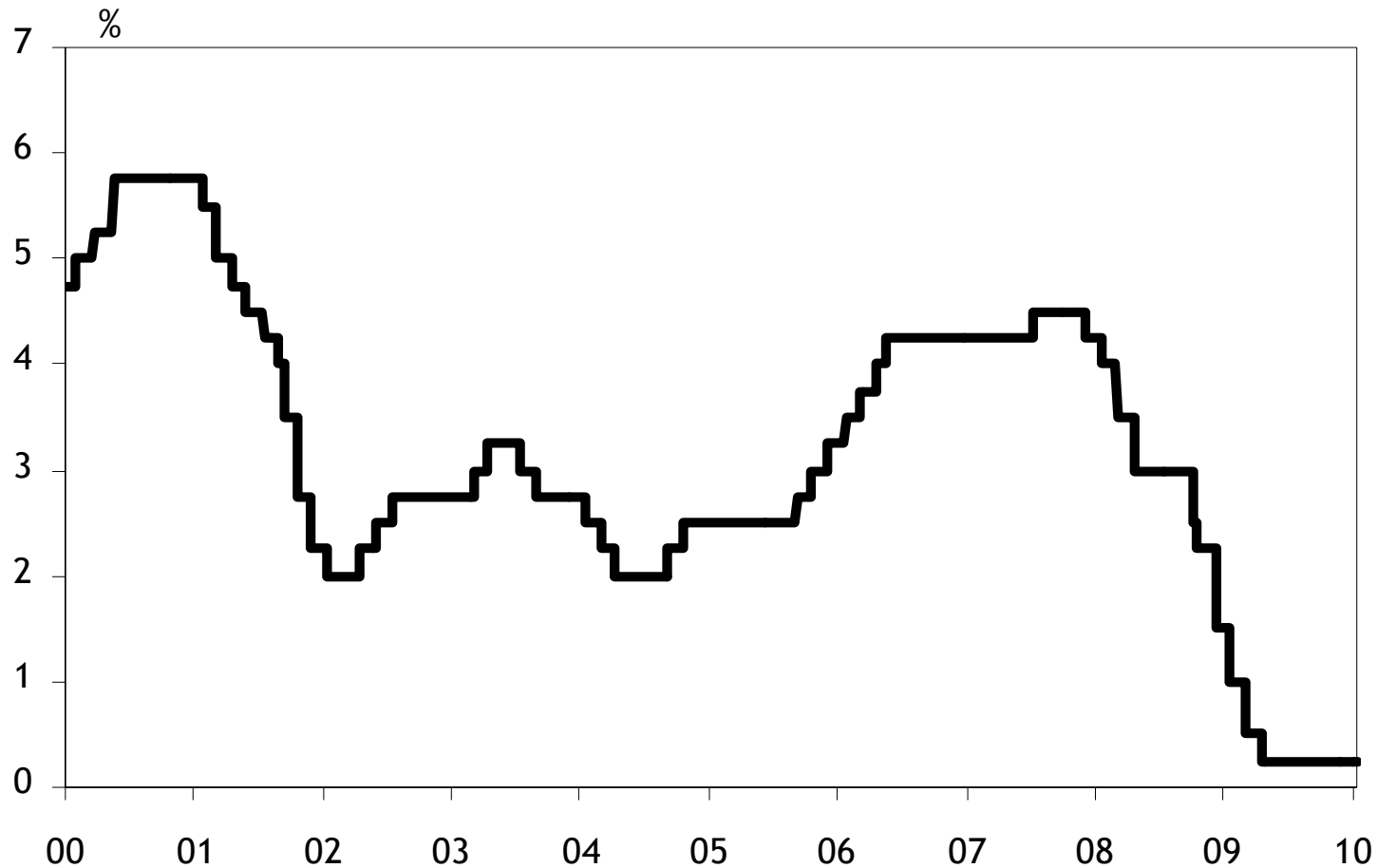
Source: Federal Reserve Board, RBC Economics Research

**Canadian Economic Outlook:
Less Damaged by Recession
-Though Still Dependant on
Sustained U.S. Recovery**



Canada has weathered the U.S. downturn helped by an aggressive easing in policy...

Bank of Canada overnight rate



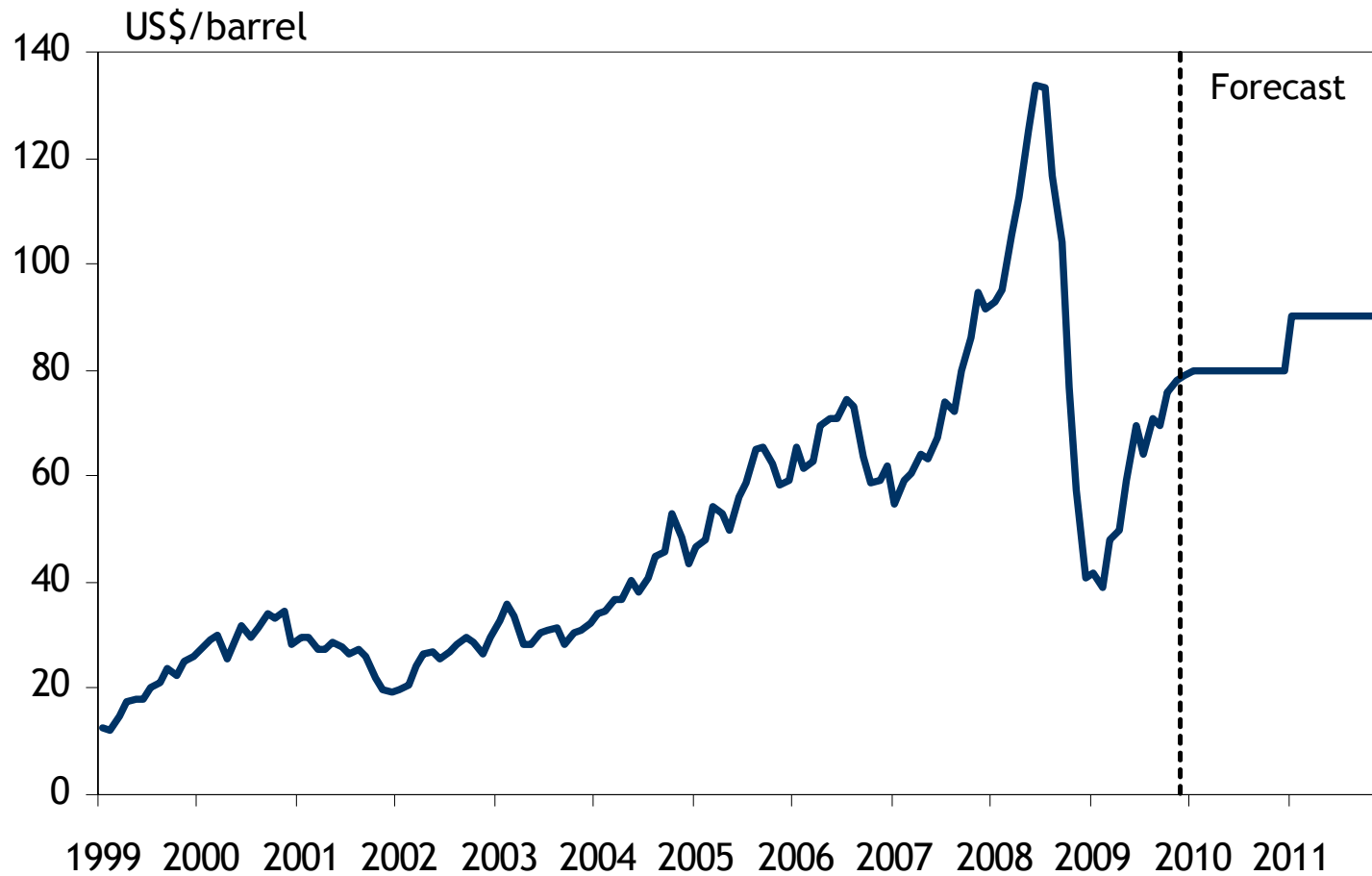
Source: Bank of Canada, RBC Economics Research

...though the impact of the U.S. recession has been tempered by three additional factors:

- **less upward pressure on the cost of capital**
- **commodity prices, though trading lower, remained at historically high levels which helped boost export revenues**
- **the Canadian housing market avoided the free-fall in activity evident in the U.S.**

Oil prices remained historically high ...

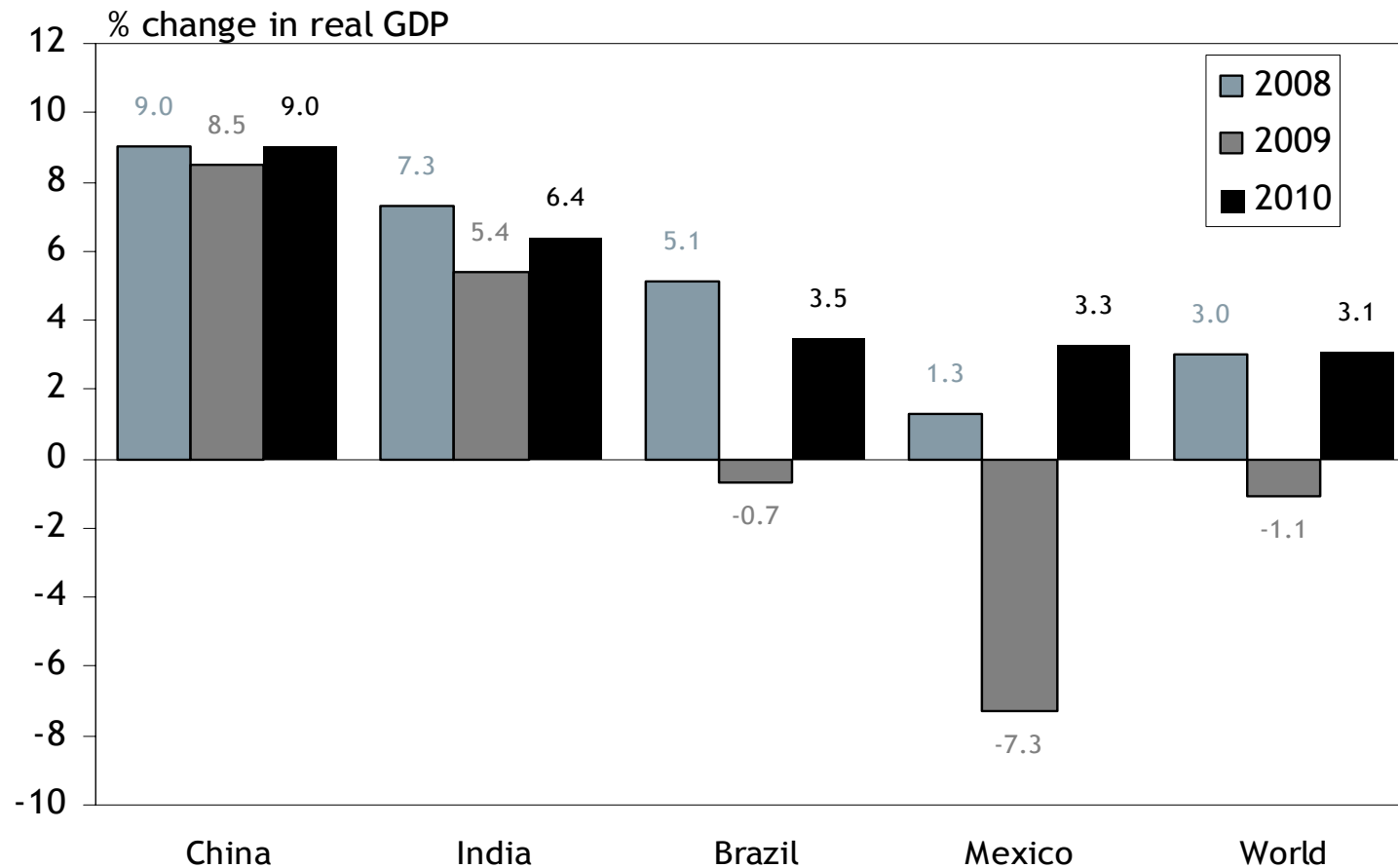
Crude oil price WTI



Source: Wall Street Journal, Bloomberg, RBC Economics Research

...as demand from emerging markets, though slowing, did not collapse

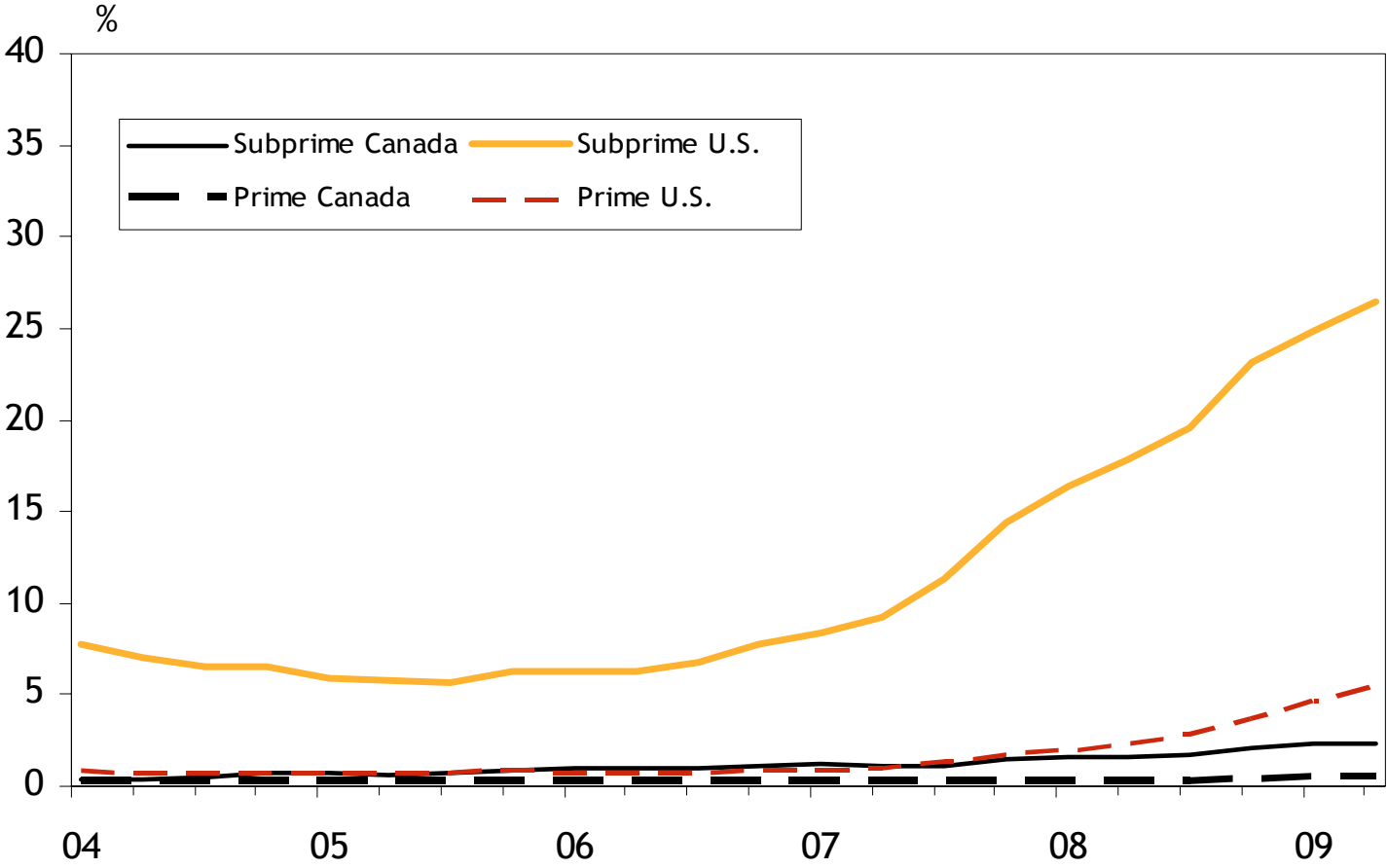
Major emerging economies



Source: IMF, RBC Economics Research

More prudent mortgage lending in Canada with less involvement in subprime mortgages...

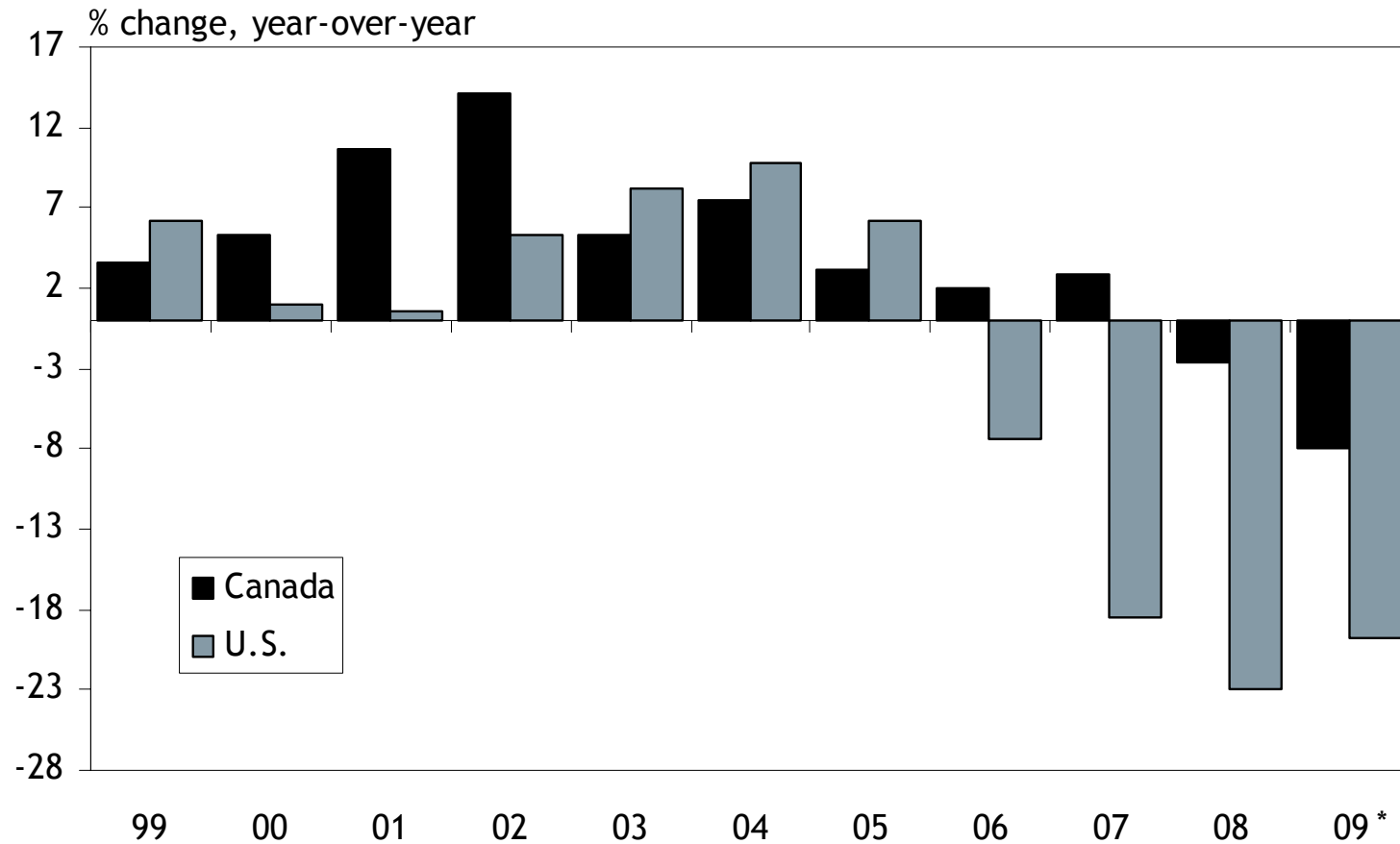
Percentage of mortgage in arrears



Source: Bank of Canada, Mortgage Bankers Association, RBC Economics Research

...has limited the extent of declines in residential investment in Canada relative to the U.S.

Residential investments

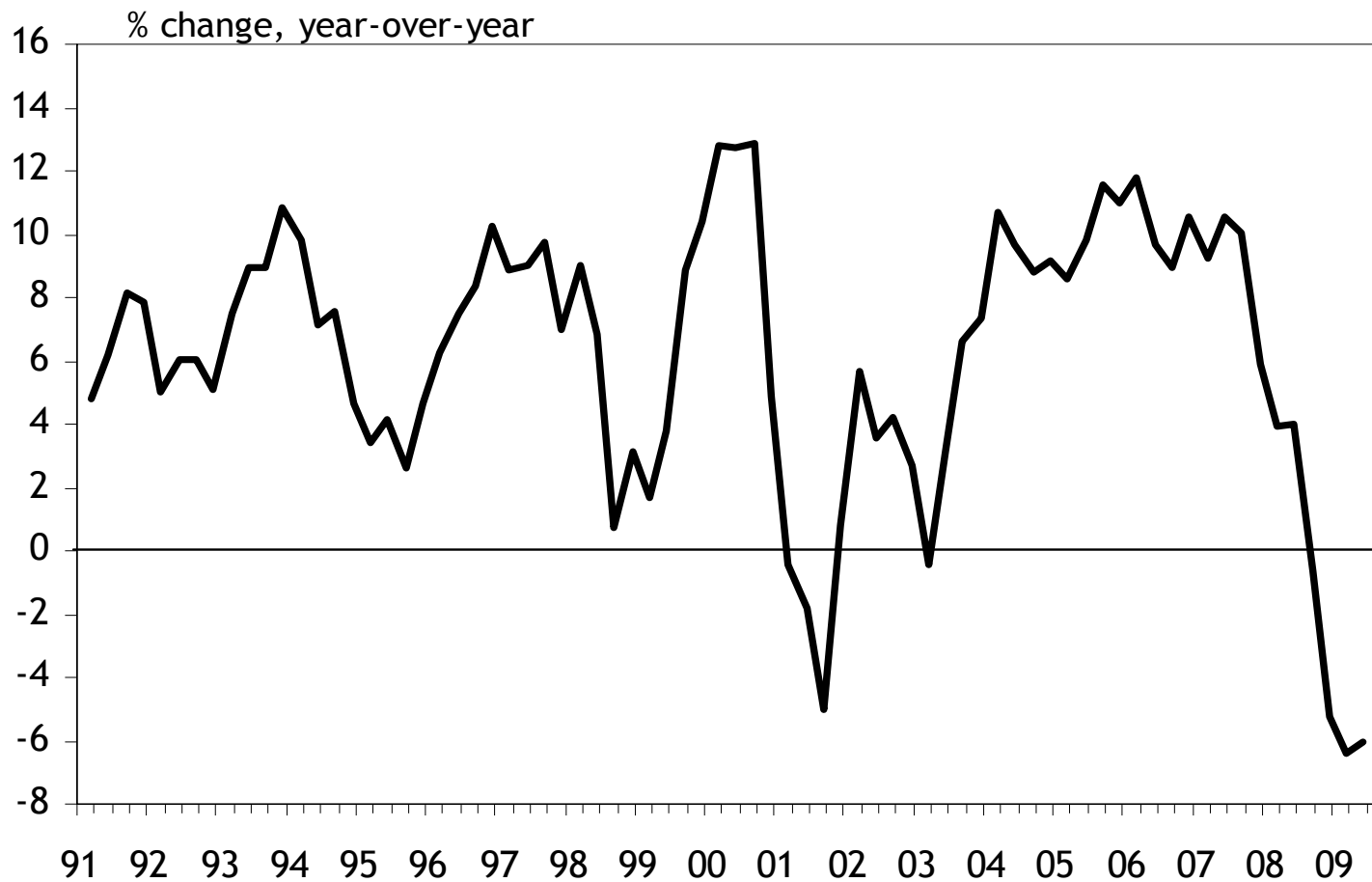


*Projected values for 2009 Q4

Source: Statistics Canada, Bureau of Economic Analysis, RBC Economics Research

However, financial market turmoil has hit household net worth...

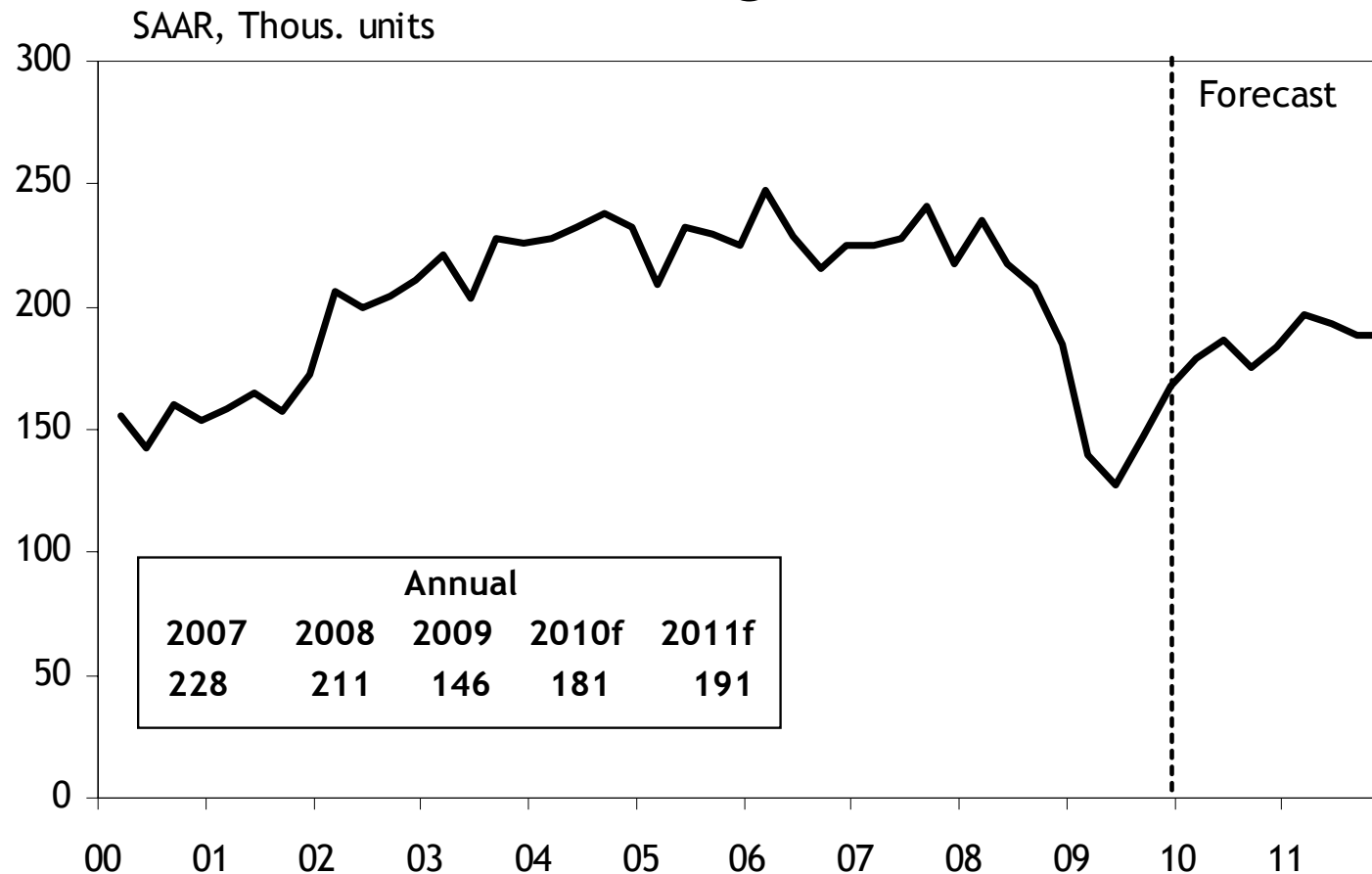
Household net worth



Source: Statistics Canada, RBC Economics Research

...which will keep the recovery in housing subdued despite low interest rates

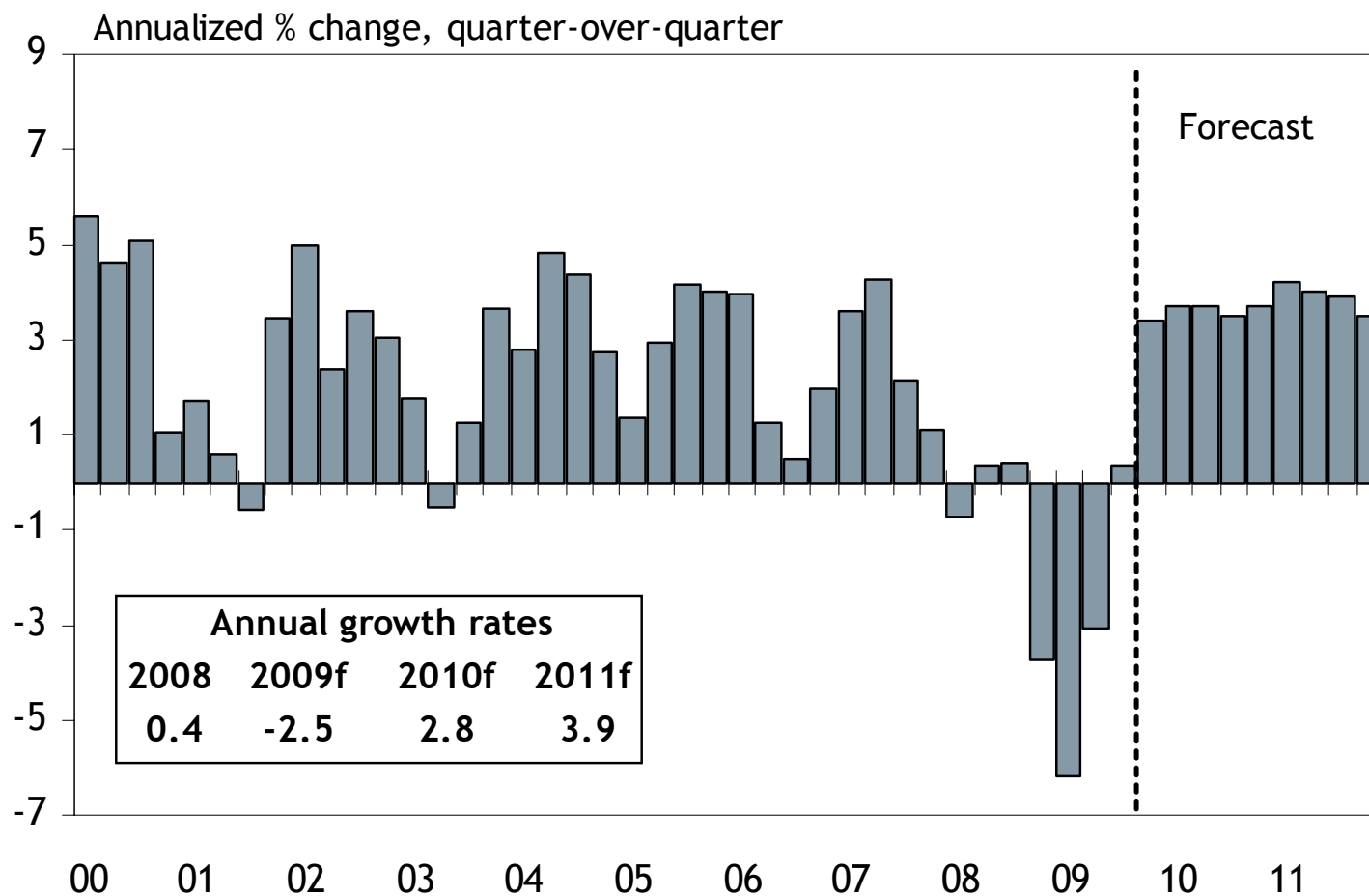
Housing starts



Source: CMHC, RBC Economics Research

Stimulative policy and U.S. recovery should allow Canada to sustain positive growth

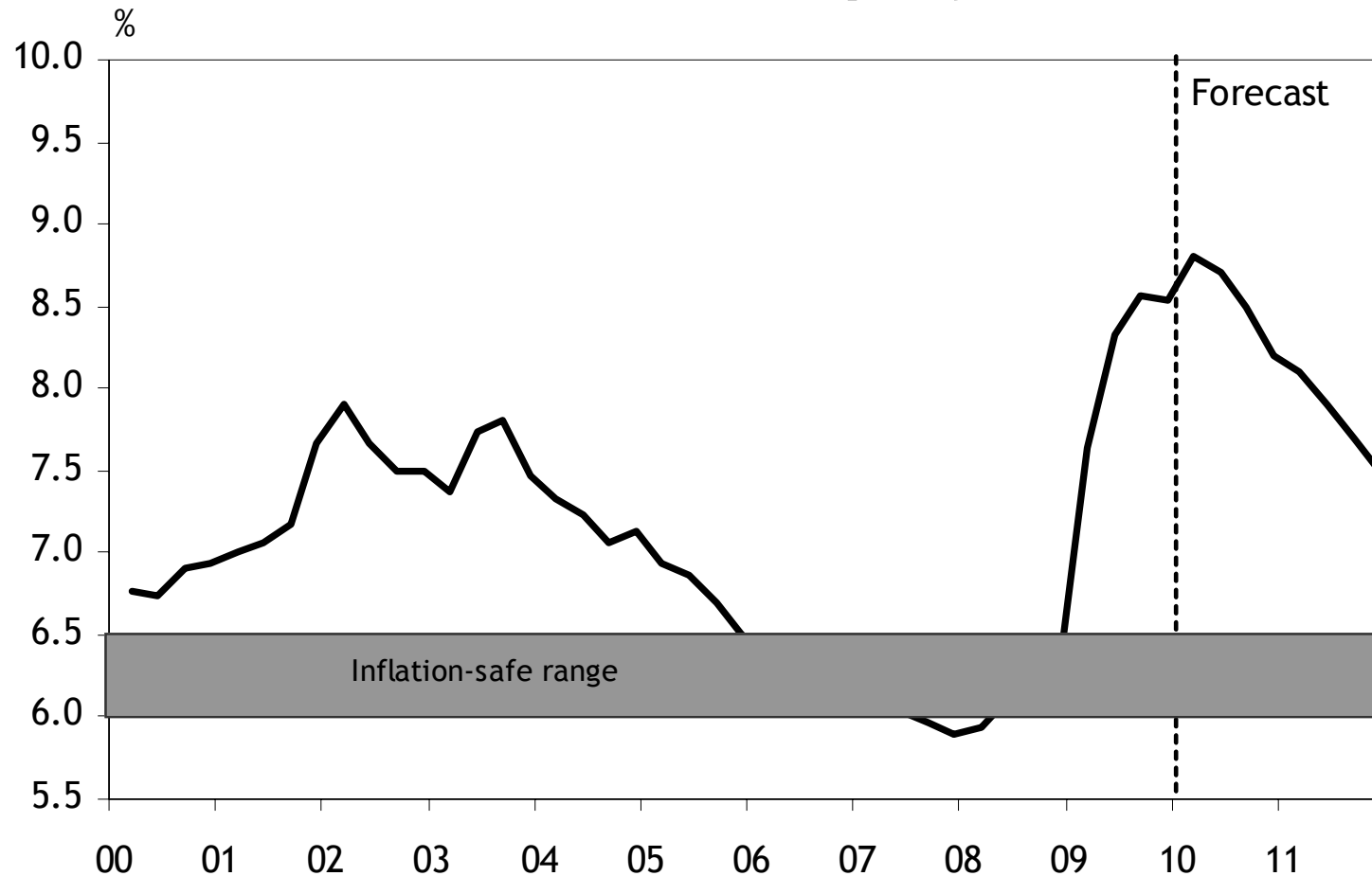
Canada's real GDP



Source: Statistics Canada, RBC Economics Research

The modest rebound will keep the unemployment rate high

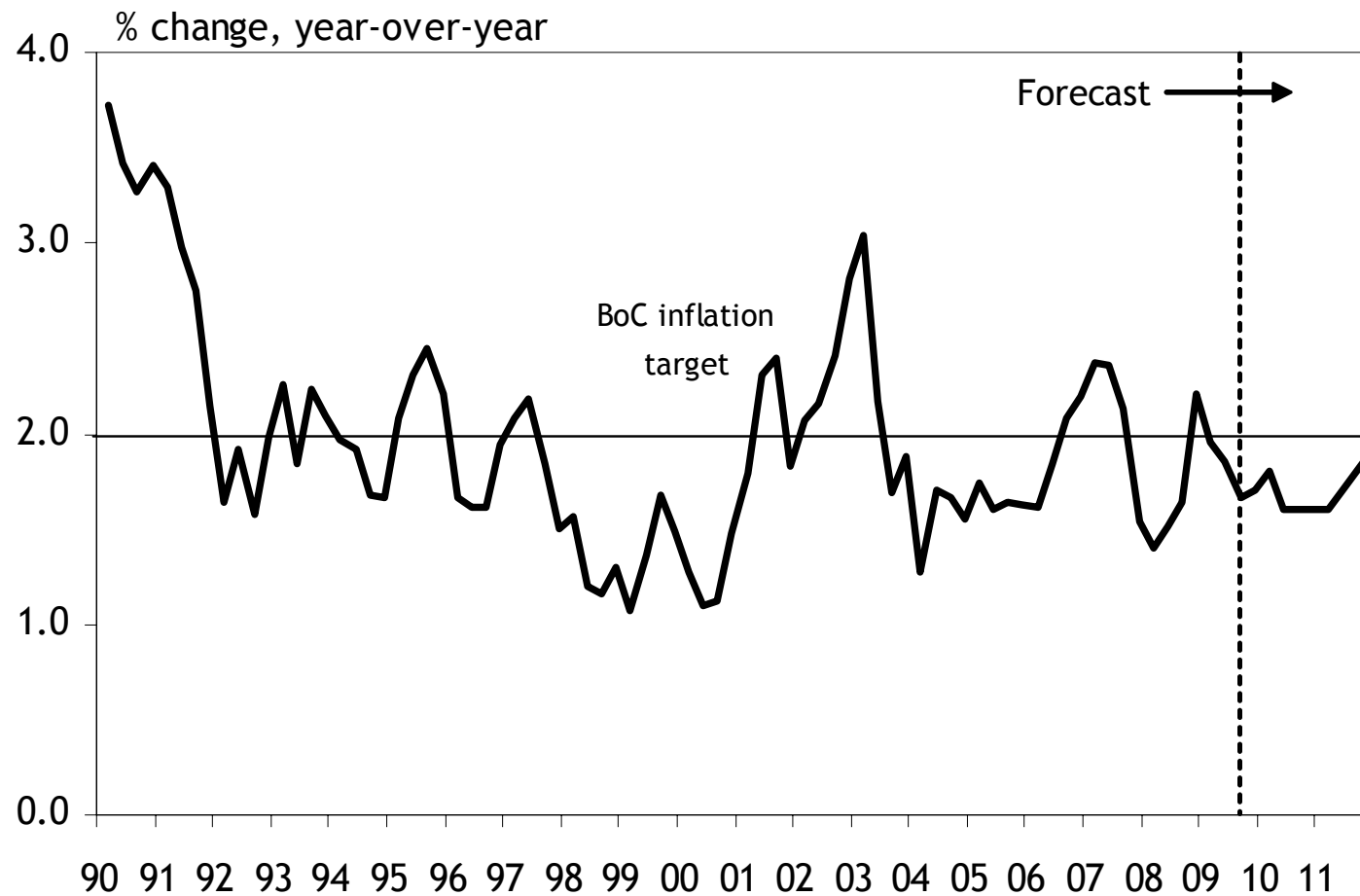
Canadian unemployment



Source: Statistics Canada, RBC Economics Research

This slack in the economy will also keep inflation below target near term

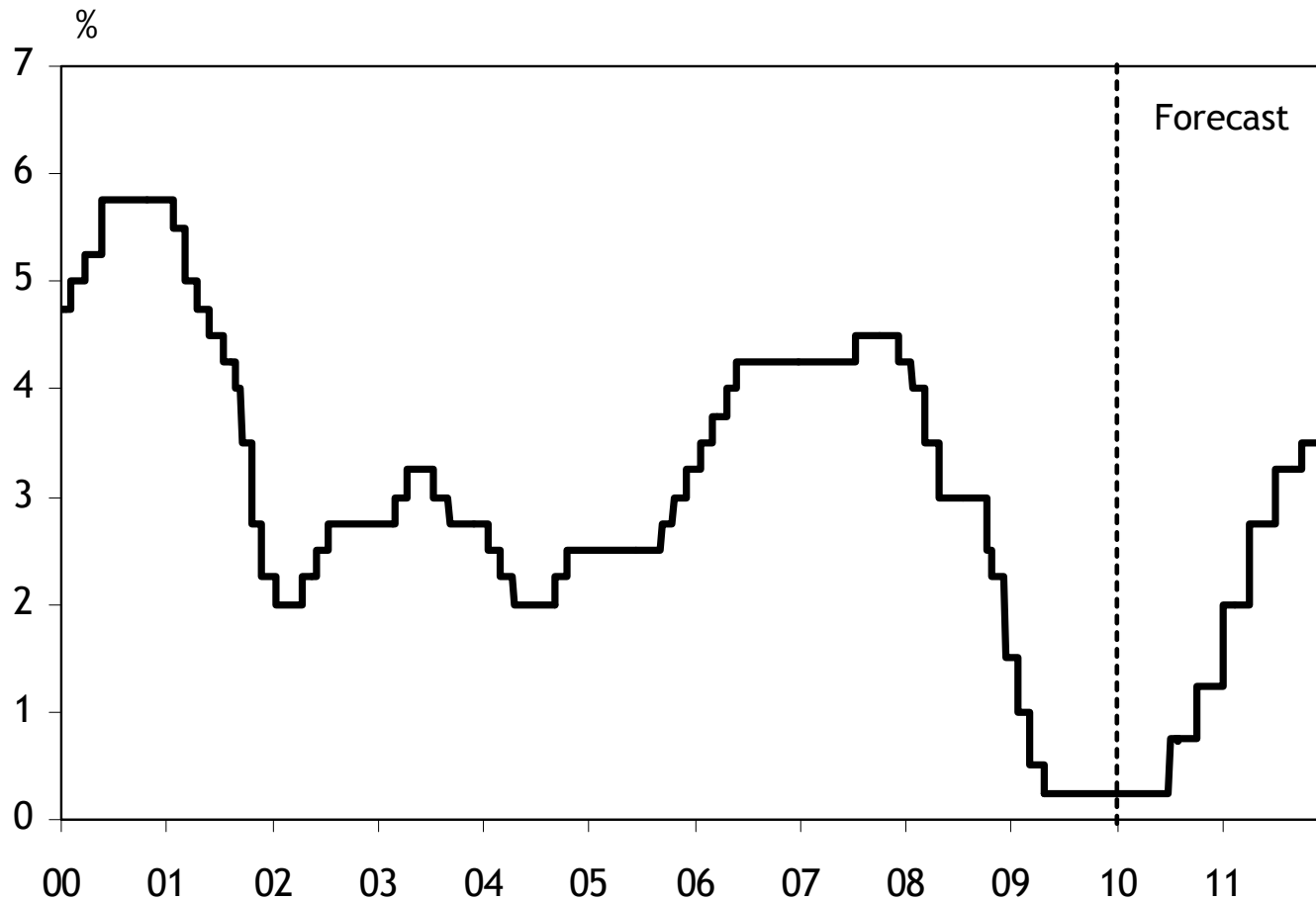
Canadian core inflation



Source: Statistics Canada, RBC Economics Research

Low inflation and high unemployment rate will delay Bank of Canada tightening until second half of 2010

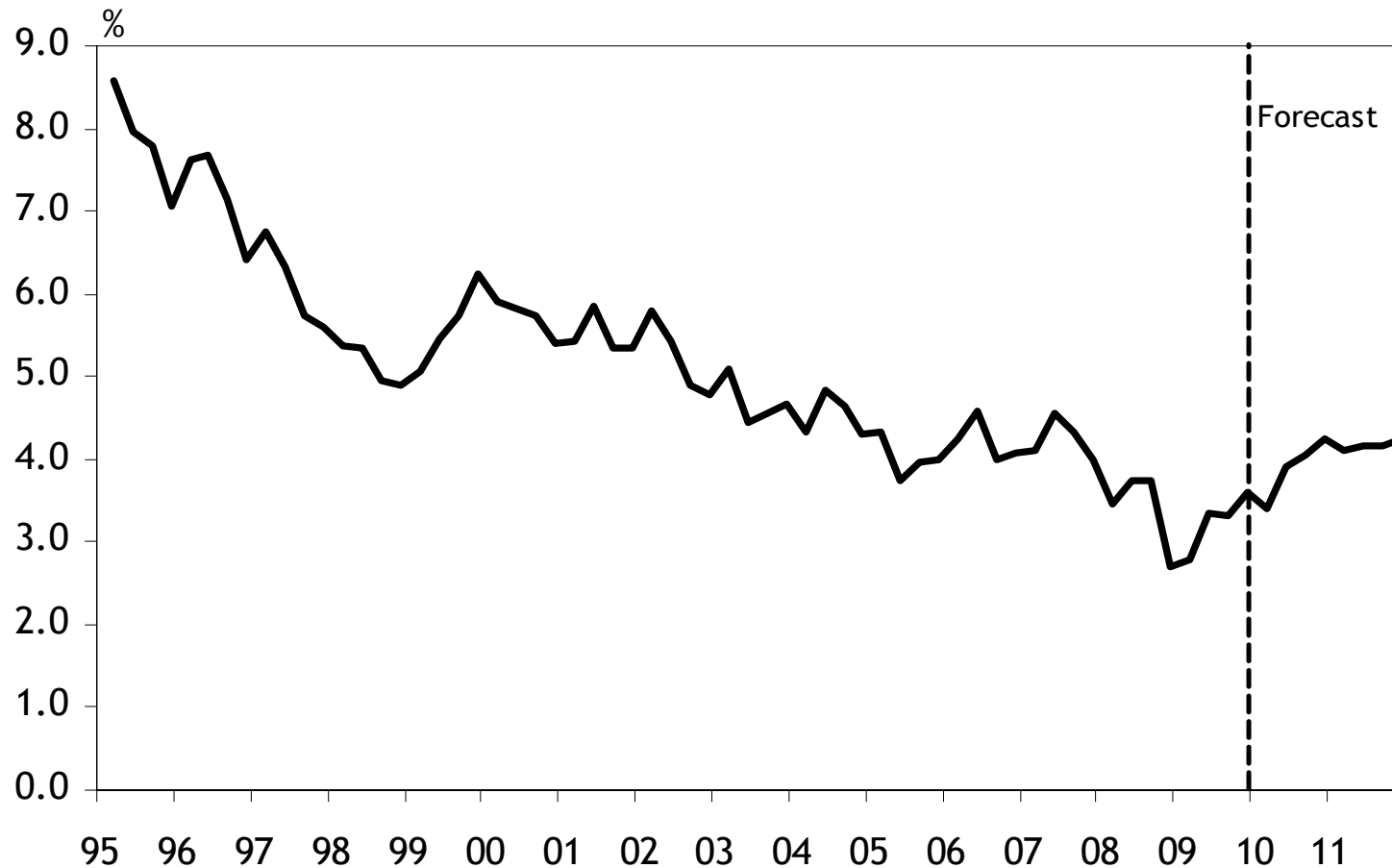
BoC overnight rate



Source: Statistics Canada, RBC Economics Research

Bond yields eventually rise as markets anticipate that the central bank easing will start to be reversed

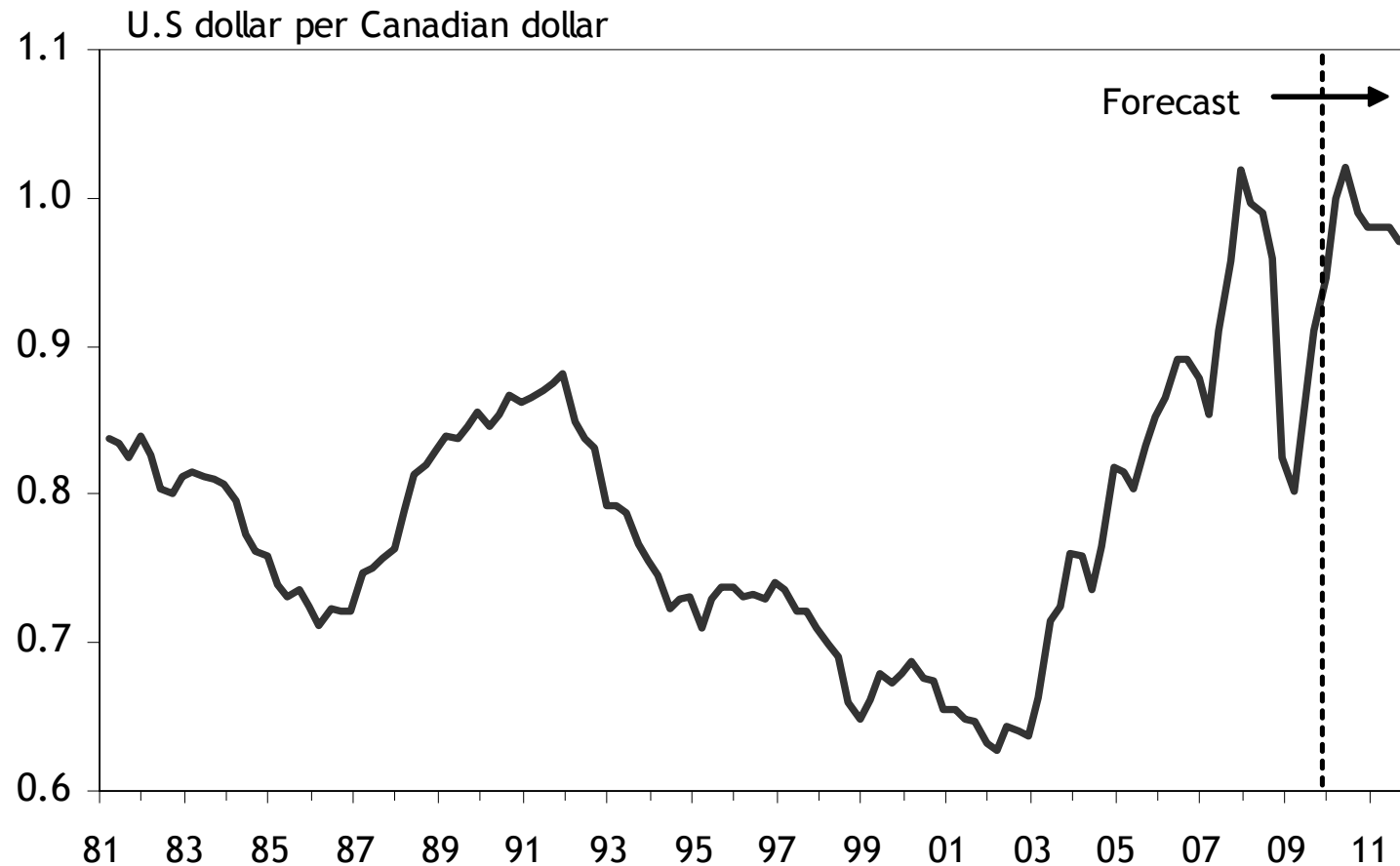
Canadian 10-year bond yield



Source: Bank of Canada, RBC Economics Research

The Canadian dollar to mirror growing optimism about the global recovery and attendant rise in commodity prices

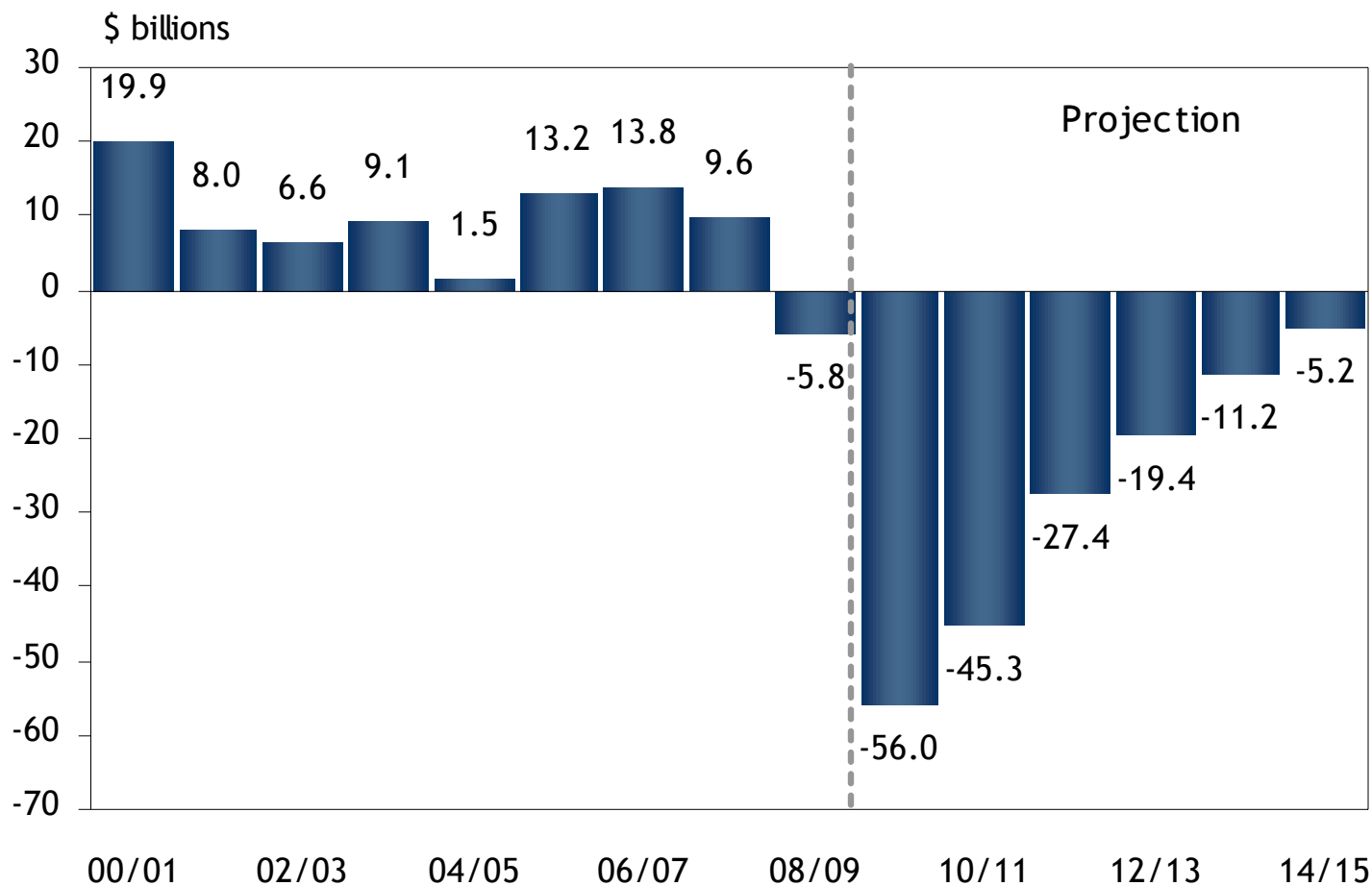
Canadian dollar forecast



Source: Bank of Canada, RBC Economics Research

Fiscal policy will need to tighten though over the medium not near term

Canadian federal government fiscal balance

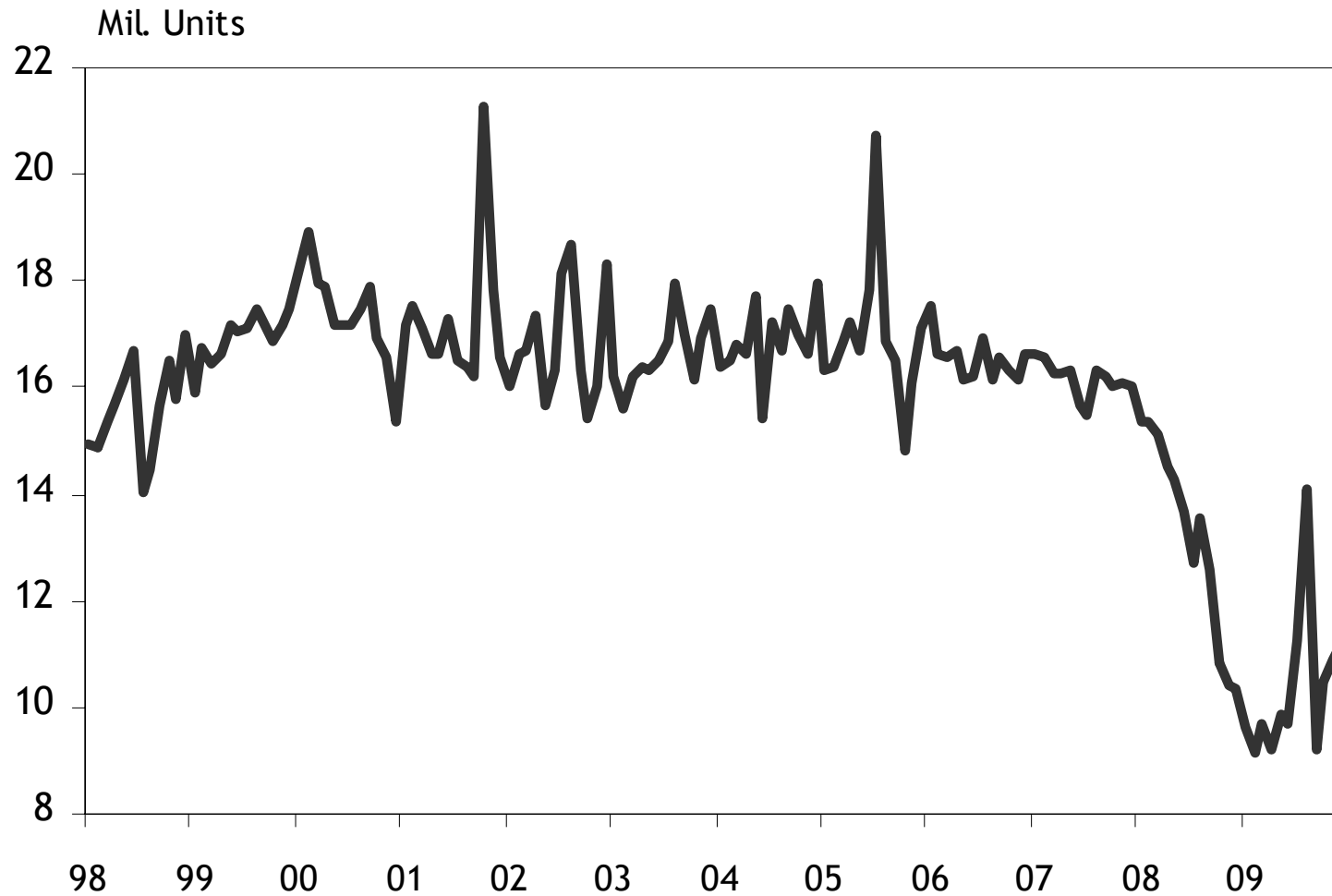


Source: Ministry of Finance, RBC Economics Research

Regional Outlook: Ontario is Particularly Dependant on the U.S. Recovery

The Ontario economy felt the full brunt of weak U.S. demand, particularly for autos...

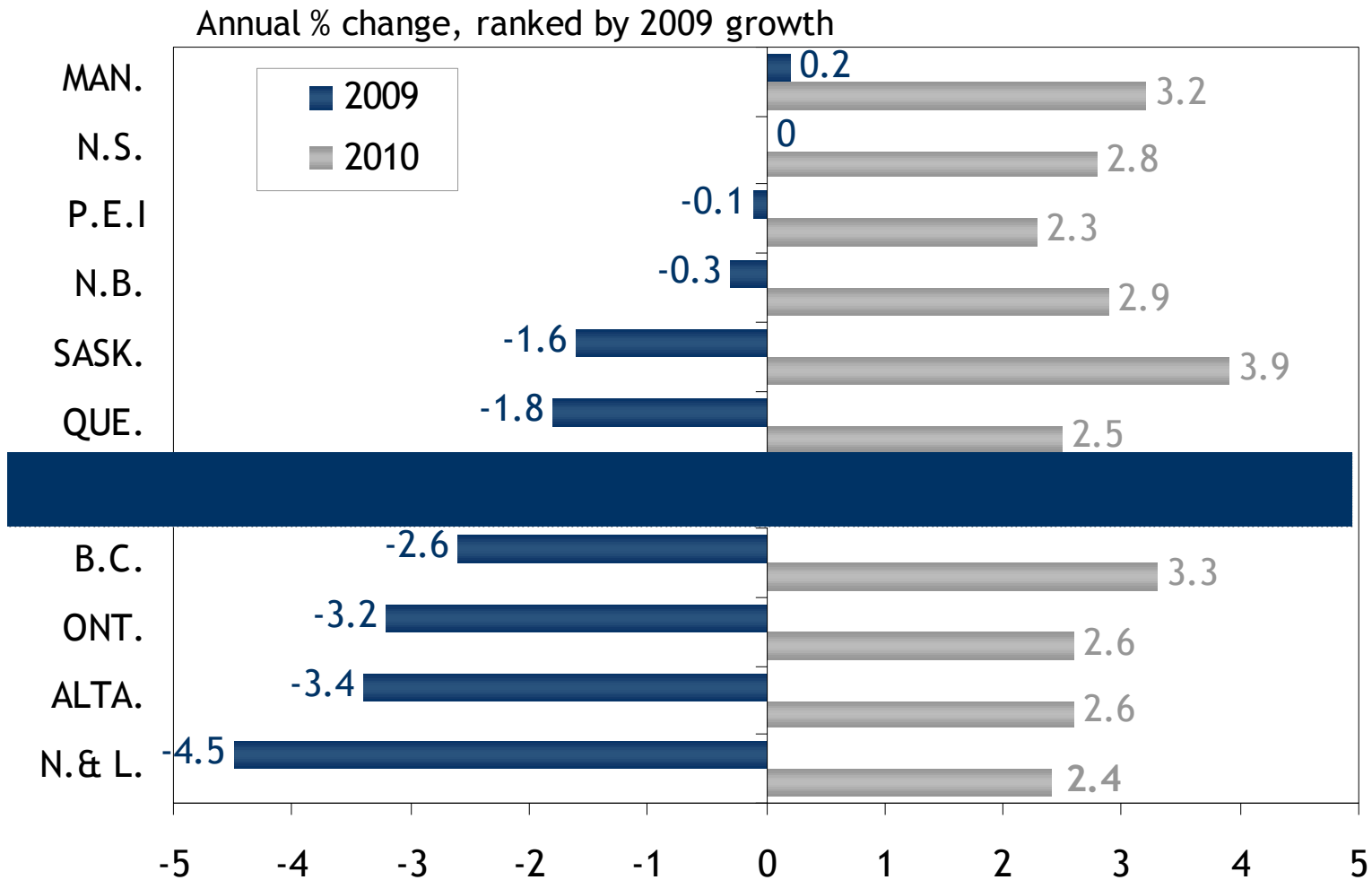
U.S. auto sales



Source: BEA, RBC Economics Research

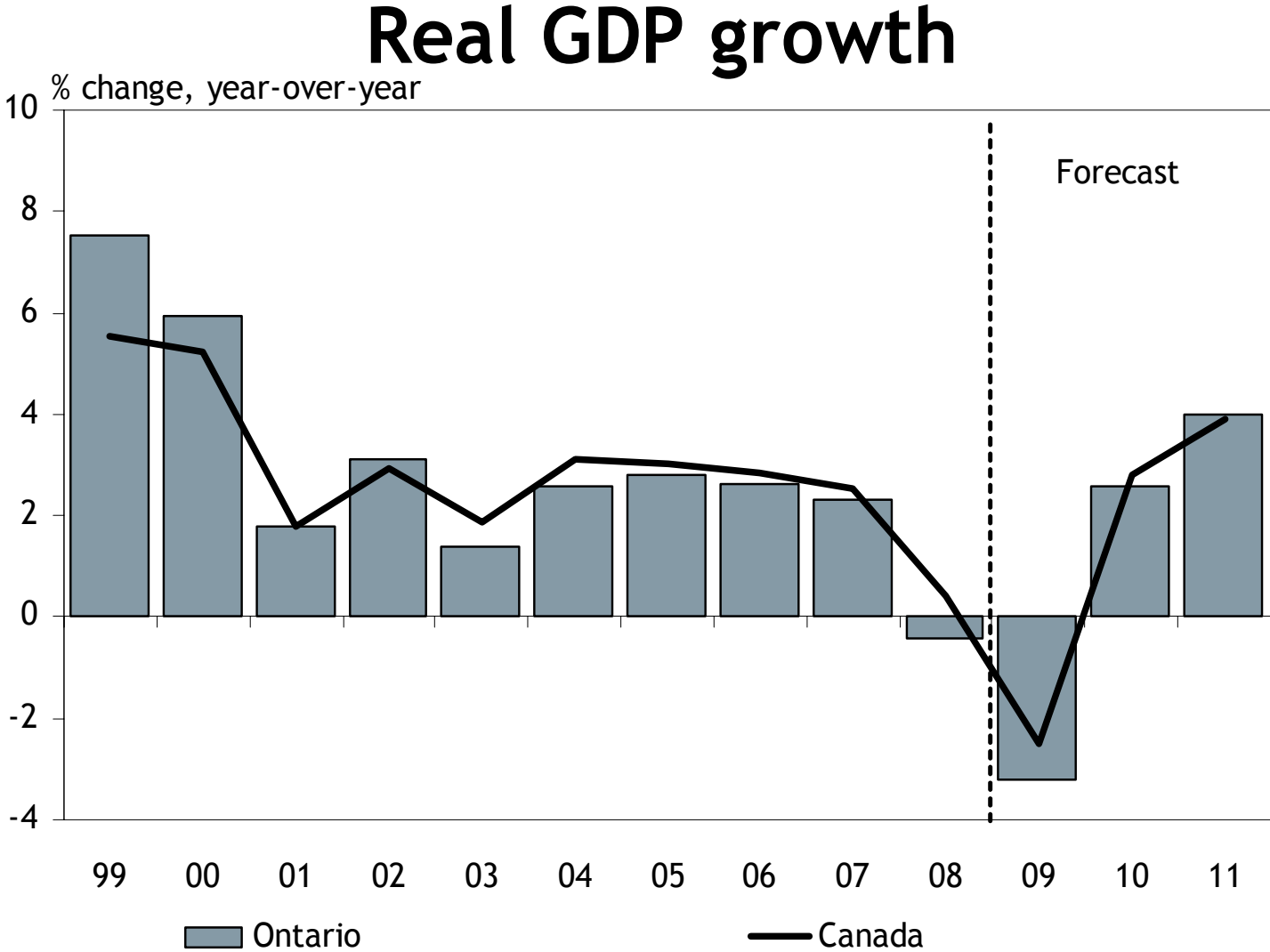
...with high commodity prices representing high input costs hammering growth in 2009

Provincial real GDP growth



Sources: Statistics Canada, RBC Economics Research

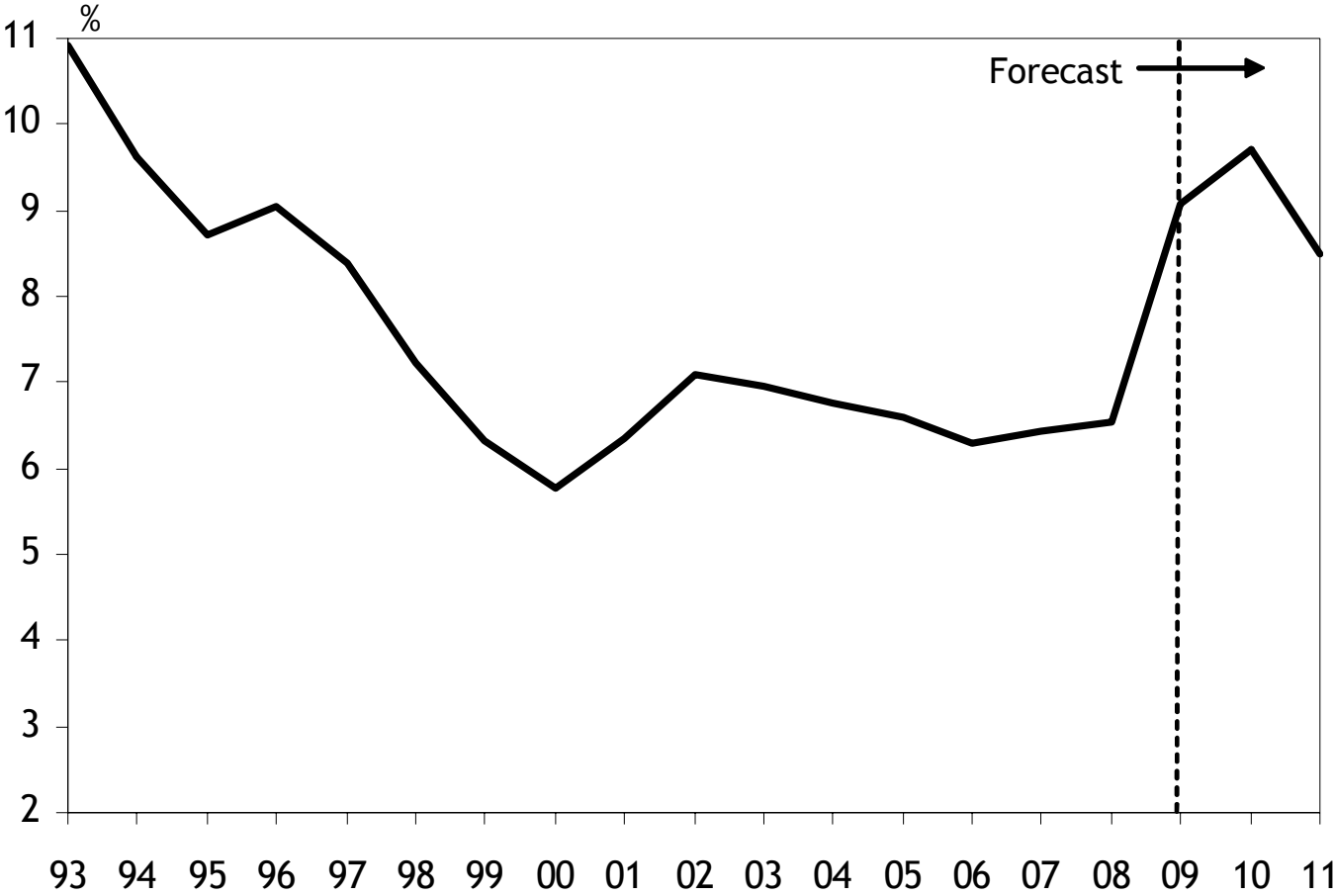
As U.S. demand recovers, the Ontario economy should return to positive growth



Source: Statistics Canada, RBC Economics Research

However, the modest pace of growth will still leave Ontario's unemployment rate high

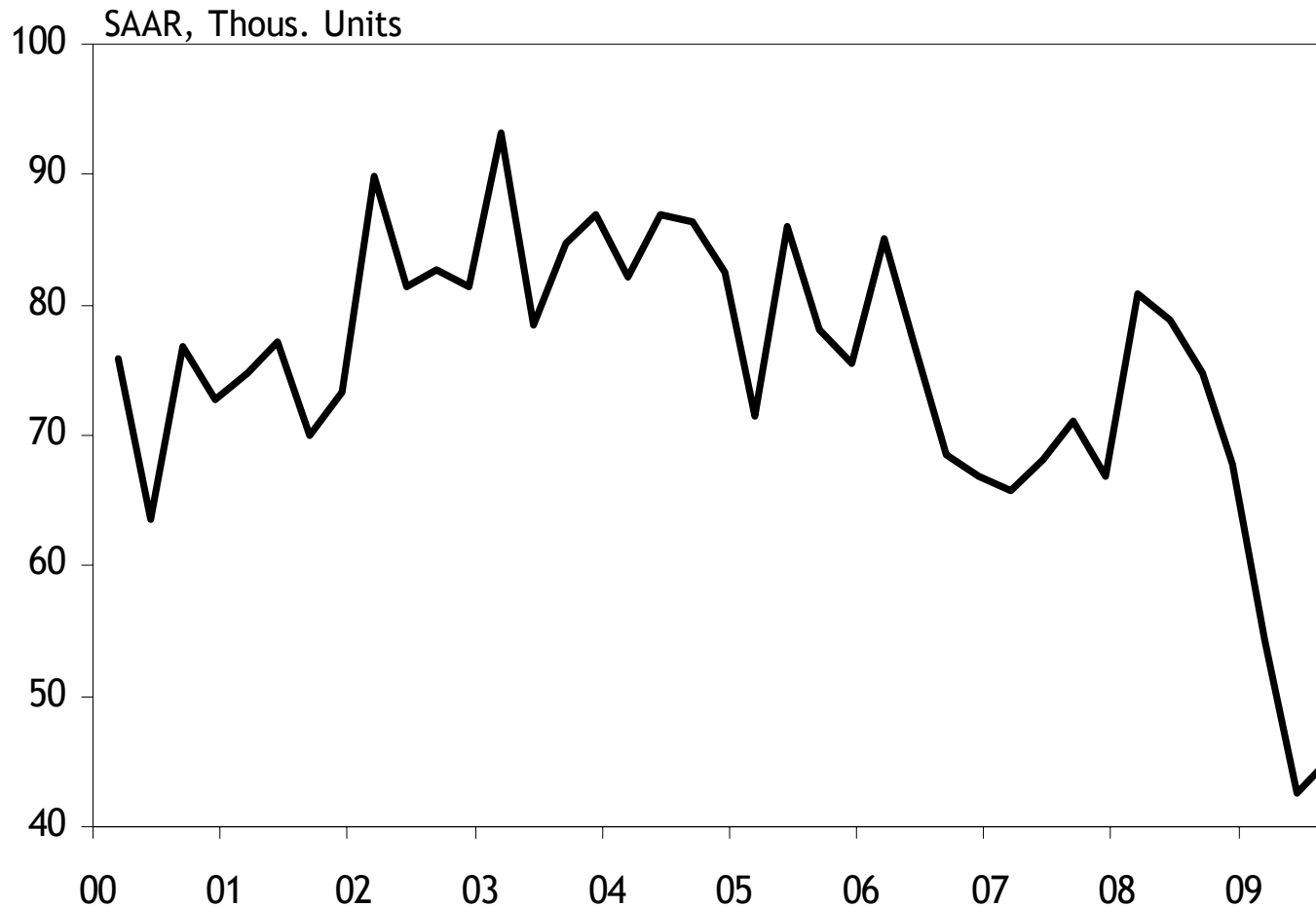
Ontario unemployment rate



Source: Statistics Canada, RBC Economics Research

The recession has contributed to a sharp weakening in housing activity...

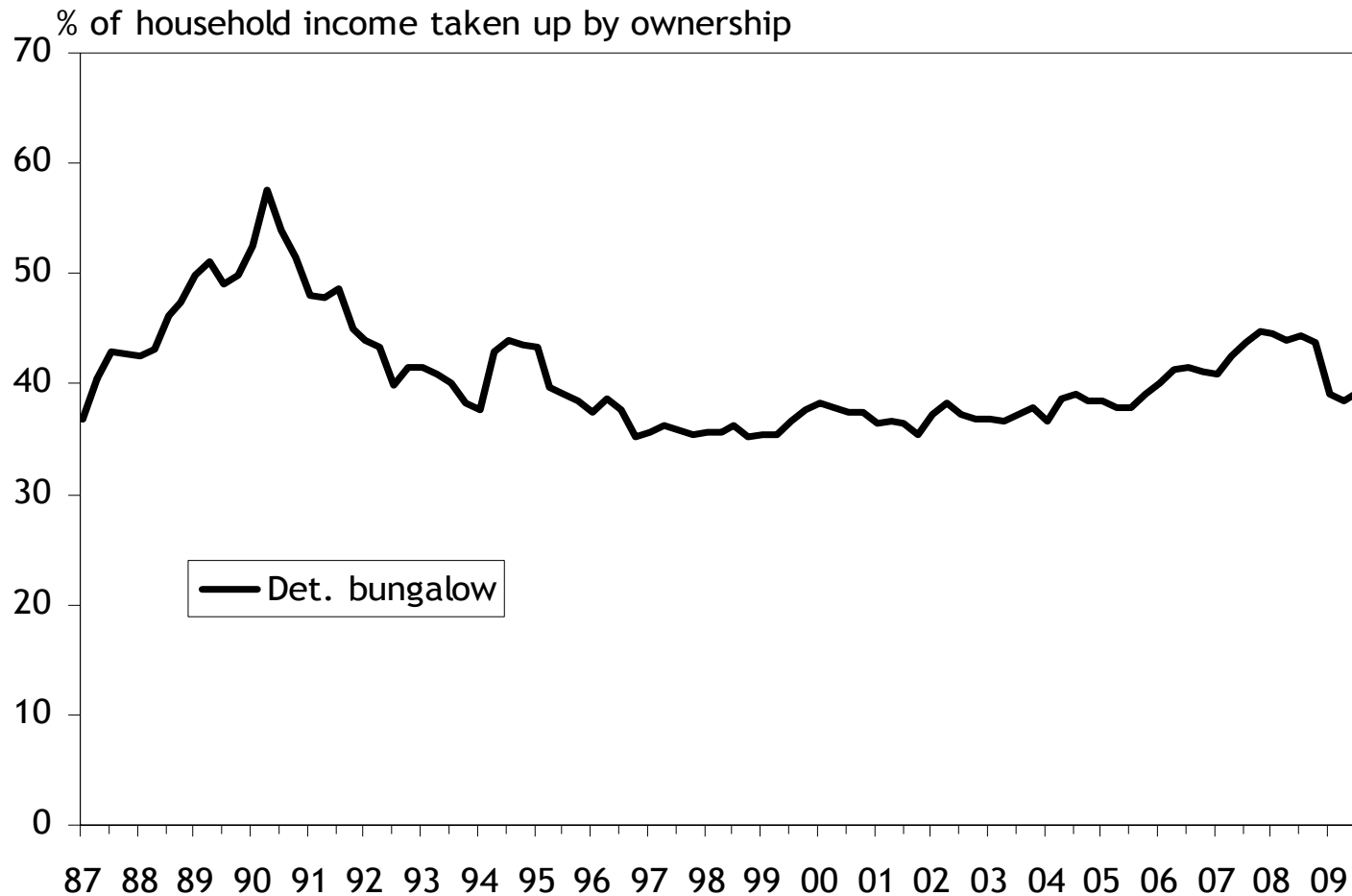
Ontario housing starts



Source: Canada Mortgage and Housing Corporation, RBC Economics Research

...though the lack of imbalances going into the downturn...

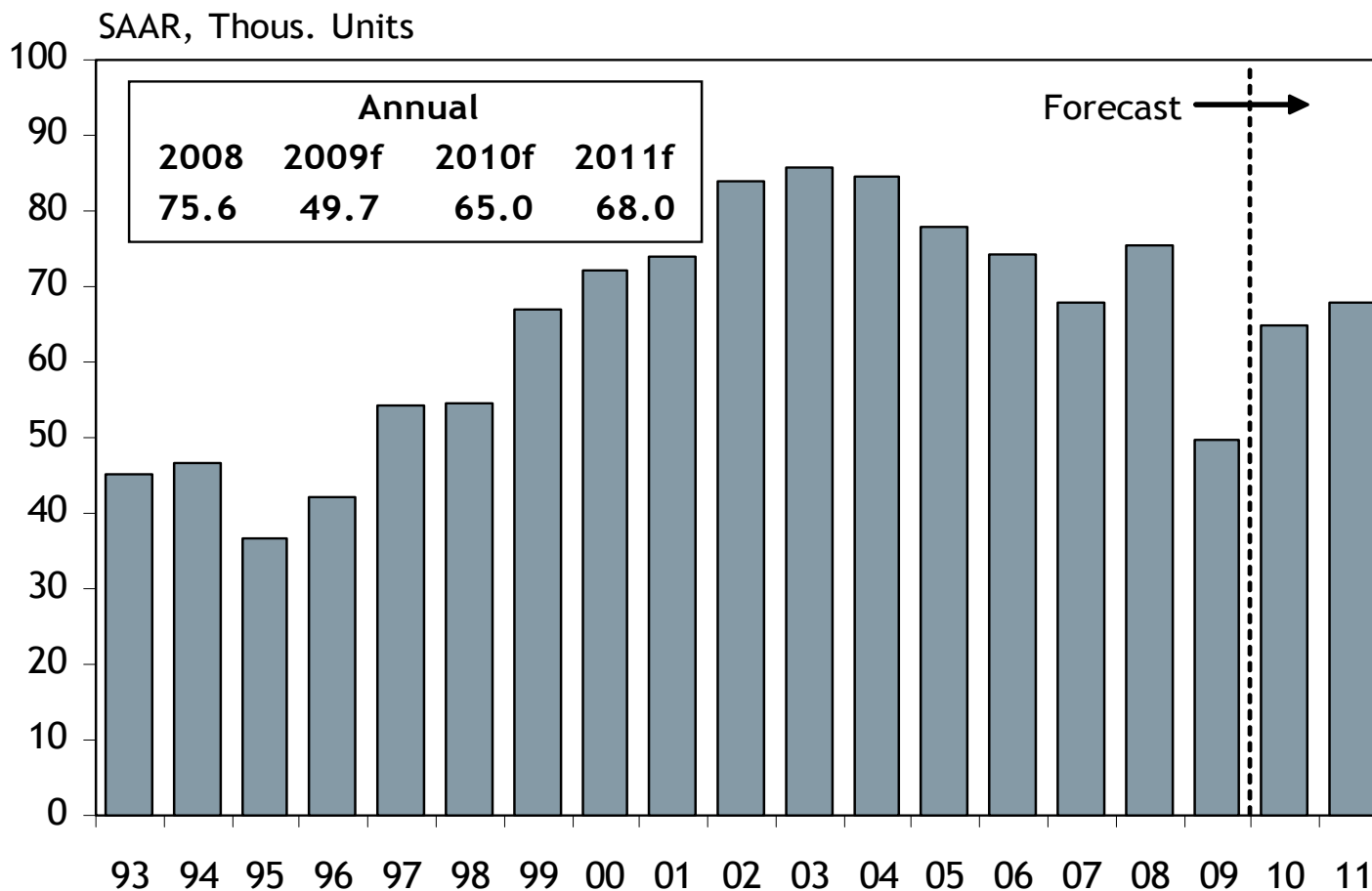
Housing affordability in Ontario



Source: Statistics Canada, RBC Economics Research

...should allow housing to rebound relatively quickly next year albeit to moderate levels

Ontario housing starts



Source: Canada Mortgage and Housing Corporation, RBC Economics Research

Impact of HST on the Ontario economy

Con

- **The price of new homes and services will rise as previously they were exempt from the PST.**
- **The impact on new homes will largely be on those priced over \$400,000. Rebates will be provided on the price of homes below this threshold.**

Pro

- **The HST lessens the administrative burden by eliminating one level of taxation. The attendant efficiency gains should contribute to a stronger provincial economy.**
- **Businesses will receive input tax credits for all sales tax paid on inputs used in the production of goods and services sold.**

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