

Jun 22, 2009

# Economic Update

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## Highlights

- The Bank of Canada cautions that a rapid ascent in the loonie could prolong an economic recovery.
- The loonie is currently trading at US\$.88, after being 'talked down' from US\$.91.
- Along with the loonie, commodity prices have appreciated over the past month. Oil is trading above \$70/barrel, compared to less than \$60/barrel a month ago.
- As aspects of the economy begin to turn around, there is speculation rates may increase in the U.S. With inflation in negative territory and the unemployment rate expected to reach 10% by year end, getting a hole in one may be more likely than a Fed rate hike over the near term.
- Prime Minister, Harper, will receive the support of Liberal leader, Ignatieff, for the spending bill on June 19, preventing a summer election. During the discussions, the leaders agreed to work on the EI program, with a panel of six people appointed to the review.

## Bank of Canada

- Overnight rate 0.25%
- Last: Jun 4, hold
- Next: Jul 21, hold *forecast*

## U.S. Federal Reserve

- Federal funds rate 0%-0.25%
- Last: Apr 29, hold
- Next: Jun 24, hold *forecast*

## A PERIOD OF IRRESPONSIBILITY IS REFORMED

The U.S. financial system will face tighter regulations, according to a new plan delivered by United States President, Obama. Obama stated that the plan will prevent excessive risk taking, which contributed to the current recession.

Once approved by Congress, an agency will be created to monitor consumer financial products; the Federal Reserve will be responsible for the largest financial companies; and hedge and private equity funds will be under the watchful eye of the Federal Reserve.

The Federal Reserve will oversee all risky financial firms, which should remove gaps that caused the biggest recession since the depression. Authority will blanket banks as well as other financial firms, including insurers and hedge funds.

The plan will create a council of regulators called the Financial Services Oversight Council to monitor risks across the financial system. A Consumer Financial Protection Agency will also

be created to review products ranging from credit cards to mortgages. The Agency would have the ability to fine and penalize companies that violate regulations, as well as attempt to terminate exotic mortgages, such as those with balloon payments or hidden fees.

Over-the-counter derivatives will also be regulated, which may have prevented the failure of insurance giant, AIG.

Lenders will be forced to maintain a 5% stake in all asset-backed security sales, in order to prevent shady lending practices where risks can be sold off to investors.

Higher capital requirements and greater scrutiny are also part of the plan, along with a detailed review of the Federal Reserve's structure. The review is intended to improve accountability and ensure the Fed is able to achieve their economic responsibilities.

Although Obama wants the legislation to be passed by the end of the year, he is under steep scrutiny from Republi-

cans. There is also criticism that the new regulations will be a burden on financial institutions that had nothing to do with the subprime market crash.

The large banks in the United States appear to be recovering, with many hurrying to repay TARP funds and attempting to generate capital on their own in the market.

However, Standard & Poor's recently downgraded eighteen banks, stating that the industry will not be as strong as it once was due to increased volatility and regulation. S&P analysts stated that as companies restructure and adjust their balance sheets, lower ratings are warranted. Those downgraded include Wells Fargo, Capital One Financial Corp, and U.S. Bancorp. Seven of the companies downgraded were evaluated in the U.S. government stress test performed earlier this spring.

## CANADIAN ECONOMIC RELEASES

### Trends

<i>Employment; Unemployment rate</i>	May -41.8k; 8.4%	Apr 35.9k; 8.0%	Mar -61.3k; 8.0%
<i>Headline; Core CPI (annualized)</i>	May 0.1%; 2.0%	Apr 0.4%; 1.8%	Mar 1.2%; 2.0%
<i>Housing starts (annual units; monthly change)</i>	May 128.4k; 9.2%	Apr 117.6k; -19.7%	Mar 146.5; 14.1%
<i>Real GDP (quarter to quarter change)</i>	Q1-2009 -5.4%	Q4-2008 -3.7%	Q3-2008 +0.4%

**Employment** shed 41,800 units in May, wiping out the gains from April. Although eight out of ten provinces increased, a 47,000 drop in the Ontario manufacturing sector helped boost the unemployment rate to 8.4%, the highest level in eleven years and an increase of 2.3% over the past year. Ontario's unemployment rate rose to 9.4%. Alberta also realized a 0.6% increase in the unemployment rate (6.6%), due to a rise in the labour force. The manufacturing sector was hit the hardest, falling by a total of 58,400 due to the Chrysler shut down, which also impacted transportation and warehousing (-15,700). Wage rates trended downward, falling to 3.4% year-over-year, compared to 4.3% in the prior month.

**Consumer prices** in May rose a greater than expected 0.7%, holding the annual inflation rate at a modest 0.1%, compared to 0.4% in April. Not surprisingly, gasoline prices were a big contributor to the report, rising 8.3%. Energy and alcohol & tobacco were also up in the month, rising 4.4% and 1.2%, respectively. Core inflation rose 0.4%, which increased the annual pace to 2.0% from 1.8%.

**Housing starts** rebounded in May, gaining 9.2% following a disappointing April. Annualized units are now at 128,400 as both single and multiple units rose in the month. The gain is being attributed to greater affordability and a rise in building permits over the past two months. Starts in Ontario were healthy, following the 1996 low experienced in April. B.C. continues to struggle, with starts at 11,200 annualized units; levels not seen since the early 80's and late 90's.

**Manufacturing shipments** dipped 0.1% in April, following the heftier than expected 2.7% drop in March. Manufacturing sales were flat between February and April, after decreasing 18.7% from October to January. Transportation equipment realized a large gain in April (16.4%), while other industries, such as petroleum & coal and primary metal manufacturers pulled the report down. Inventories continue to deplete, falling 0.9%, which lowered the inventory-to-shipments ratio slightly, to 1.58 from 1.59.

**Retail sales** dropped 0.8% in April, below expectations following a quarter of consecutive increases. Sales are down 6.2% year-over-year, compared to -10.0% in the U.S. Excluding autos, sales fell 0.5%. Furniture, clothing, drugs and food were all depressed in the month. Compared to a year earlier, furniture sales are down 9.0%, a reflection of the downturn in the housing market.

**Real GDP** fell 5.4% in quarter one, below expectations of a 6.5% decline, and just below the record low of -5.9% in Q1-1991. Growth was halted by a large inventory correction, which took 4.3% off of total GDP. Weakness does seem to be slowing, with March GDP down 0.3%, compared to 1.0% and 0.6% in December and January, respectively. (*April data release June 25.*)

## U.S. ECONOMIC RELEASES

### Trends

<i>Employment; Unemployment Rate</i>	May -345k; 9.4%	Apr -504k; 8.9%	Mar -652k; 8.5%
<i>Headline; Core CPI (annualized)</i>	May -1.3%; 1.8%	Apr -0.7%; 1.9%	Mar -0.4%; 1.8%
<i>Housing starts (annual units; monthly change)</i>	May 532k; 17.2%	Apr 454k; -12.9%	Mar 521k; -9.2%
<i>Real GDP (quarter to quarter change)</i>	Q1-2009 -5.7%	Q4-2008 -6.3%	Q3-2008 -0.5%

**Non-farm payrolls** decreased 345,000 positions in May, the smallest decrease in the past eight months and well below the average decline of 605,000 over the past seven months. The manufacturing sector was hit hard once again, while construction and retail trade were not as depressed compared to prior months, although they were still negative. The unemployment rate is at a new 26-year high, gaining 0.5% to 9.4%. Twelve months ago the unemployment rate was a mere 5.5%. Average hourly earnings are up 3.1% year-over-year, and the average hourly work week fell 0.7%, and is now down 6.7% compared to a year earlier.

**Consumer price inflation** increased a less than expected 0.1% in May, leaving the annual change at -1.3%, the lowest level since 1950. Most areas were flat or declined, aside from gasoline prices, which rose 3.0%. Food and clothing prices were both down, along with tobacco prices, which experienced a sharp rise over the past two months due to a federal tobacco tax increase. The core rate, which excludes food and energy, also increased 0.1%, with the annual pace slipping back to 1.8%.

**Housing starts** finally displayed some sign of life in May, rising 17.2% to 532,000 annualized units, as both single and multiple units were in the black. Single units are at the highest level since November 2008. Building permits rose 4.0%, offering future optimism. Although the housing market remains far off the one million annualized unit mark, a gradual turnaround is welcome.

The **ISM (Institute of Supply Management) Index** peaked at its highest level in eight months in May, rising to 42.8, although it remains well below the expansionary level of 50. Out of eighteen industries, five reported growth, while production and new orders also improved. New orders are up for the first time since November 2007. On a negative note, prices paid rose sharply and the employment index decreased, suggesting further job losses in the future.

**Retail sales** rose 0.5% in May, the first increase in a quarter. Most of the rise was related to gasoline prices, as well as auto sales, as dealers, such as Chrysler, attempt to clear out high inventories. Excluding autos and gas, sales were up a more modest 0.1%. Building materials, apparel and food sales were all up in the month.

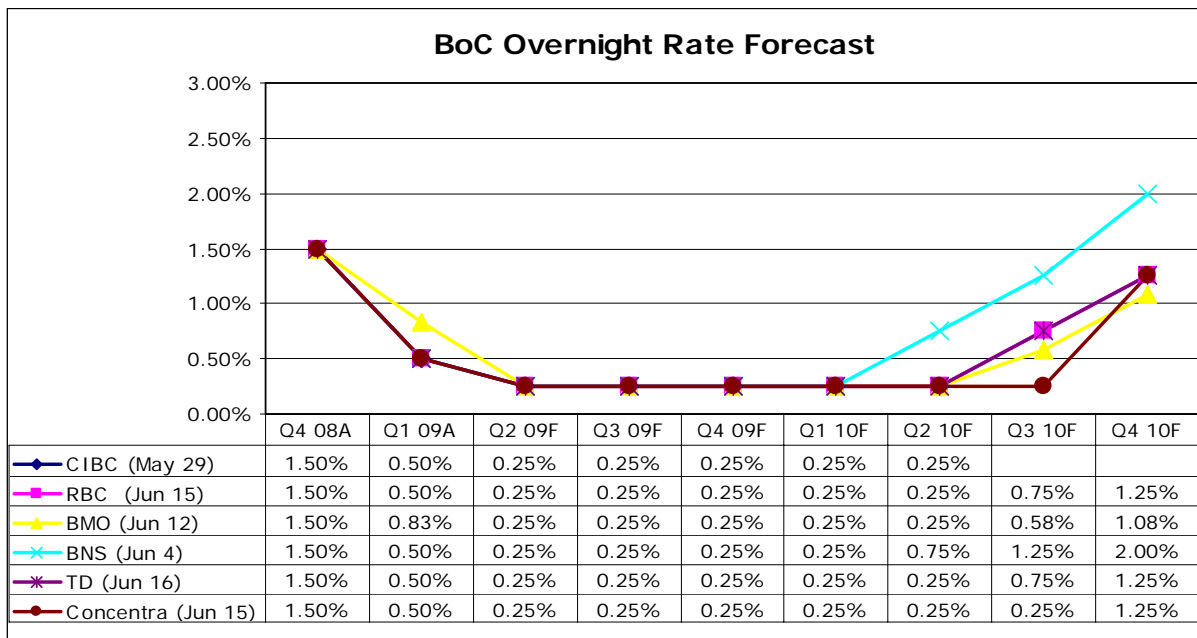
**Real GDP** in the preliminary estimates fell 5.7% in quarter one (down from -6.1% in the advanced estimates); an improvement from the -6.3% decline in quarter four, which was the worst report in 26 years. The smaller decrease in quarter one is a result of declining imports, which are subtracted from the results, along with negative contributions from exports, software and equipment, private investment, and non-residential construction. (*Quarter one final results released June 25.*)

## GLOBAL MARKET

**Eurozone** (16 nation) unemployment levels continue to soar, with 1.22 million jobs lost during the first quarter. Spain, Slovakia, and Greece were the countries hardest hit. Meanwhile, inflation increased a modest 0.1% in May, taking the annual pace to 2.2% from 2.3%, just above the 2.0% target. The core rate was flat in the month, leaving the annual pace at 1.5%, down from 1.7% in April. The European Central Bank cut the repo rate to a record low of 1.0% in order to help with the flow of credit and stimulate the economy. There is a possibility they may reduce rates further given the weak labour market and contained inflation. There was a bit of optimism, as the German ZEW index, a measure of investor confidence, increased for the eighth consecutive month.

**Japan's** finance minister, Yosano, stated that the economy reached the bottom during the first quarter. Both the Central Bank and Government increased the economic assessment for the second straight month as industrial production and exports begin to improve. However, weak employment, housing starts and capital expenditures weigh on a recovery. The unemployment rate rose to a five year high of 5.0% in April, as two people compete for every available job. Prime Minister, Aso, continues to offer incentives for purchasing fuel efficient cars, energy friendly fridges, air conditioners, and televisions, which is spurring some spending. The total stimulus committed by the Government of Japan is US\$260 billion (or 25 trillion yen).

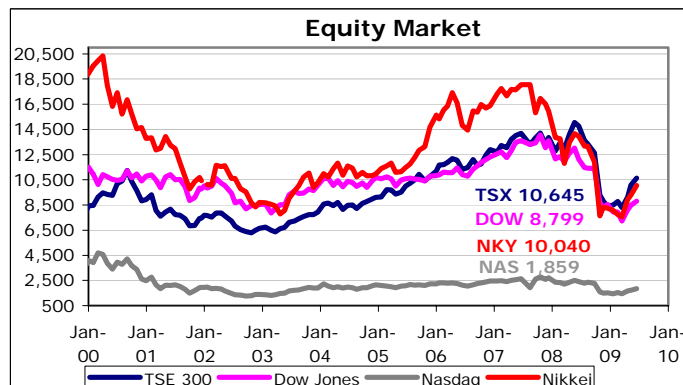
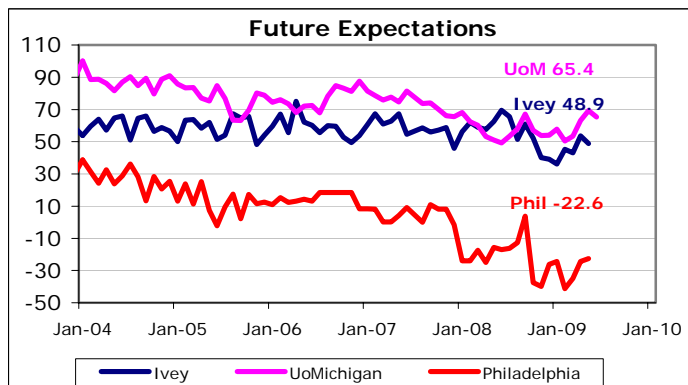
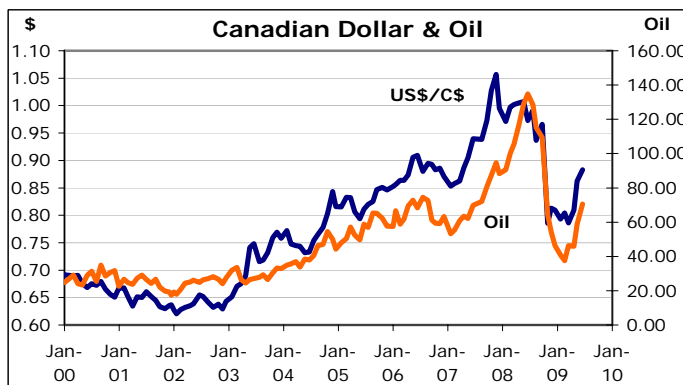
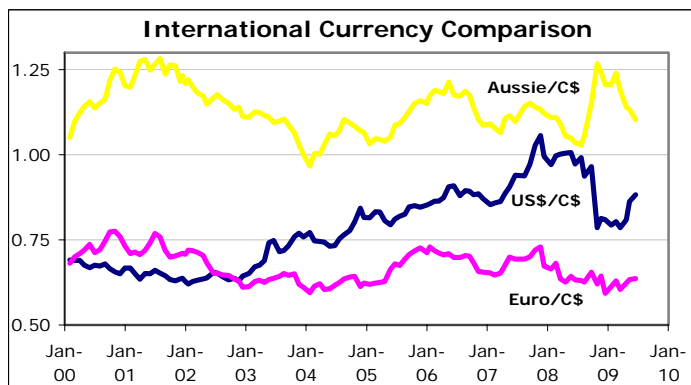
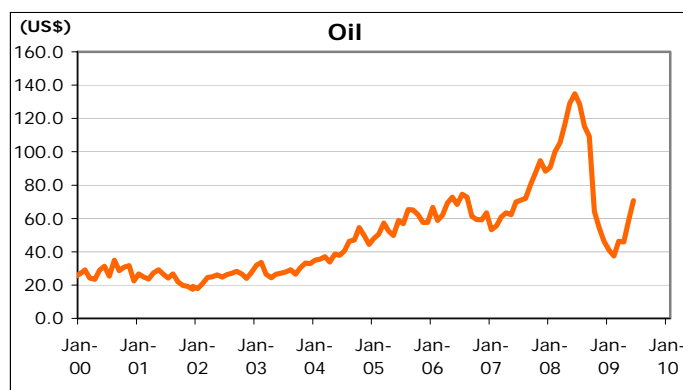
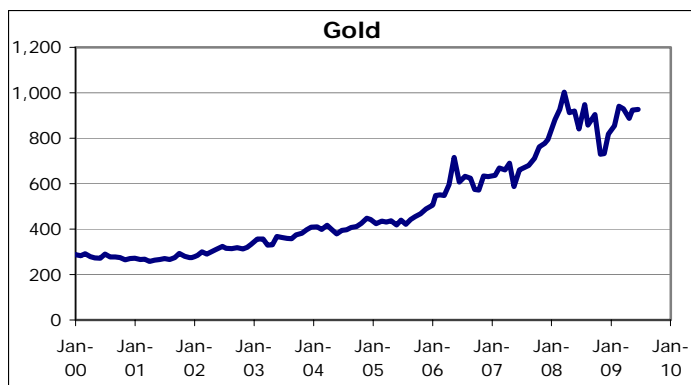
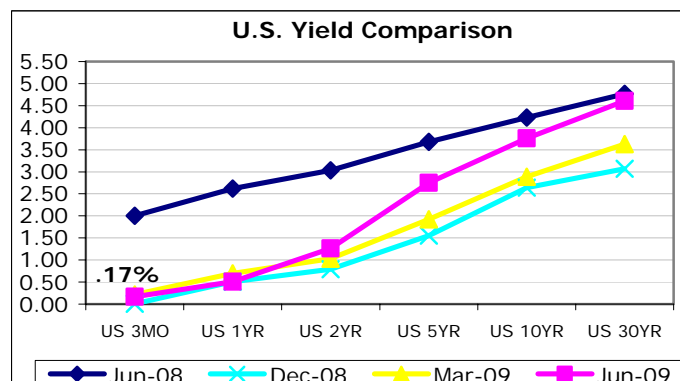
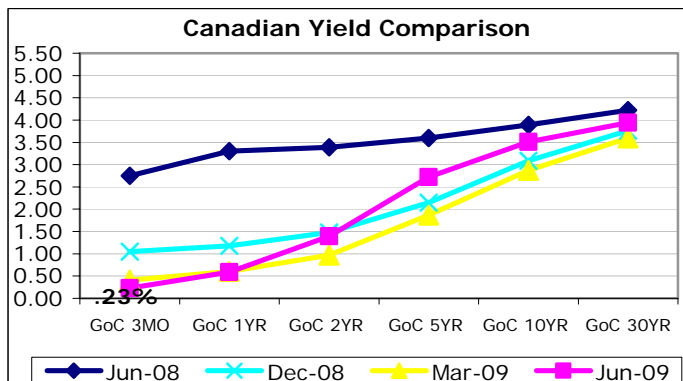
## BANK OF CANADA EXPECTATIONS



The risks of an economic recovery remain on the downside, as the Bank of Canada warns that a strengthening loonie could hinder a turnaround. Interest rates are expected to remain depressed, with the Central Bank offering no hint of an increase. BNS seems to be the most optimistic, calling for rates to begin to increase in Q2-2010, compared to the other consensus of Q3-2010.

Note: BMO averages the quarterly rate reductions, versus stating it at a particular point in time.

# MARKET TRENDS



## PROVINCIAL HIGHLIGHTS

	Employment <i>May</i>			Unemployment <i>May</i>			CPI (2002=100) <i>May</i>		
	Value (Thousands)	% Change (Period)	% Change (Year)	Value	% Change (Period)	% Change (Year)	Value	% Change (Period)	% Change (Year)
<b>Canada</b>	16,800.0	-0.2	-1.7	8.4	0.4	2.3	114.7	0.7	0.1
<b>British Columbia</b>	2,258.8	0.1	-2.6	7.6	0.2	3.1	112.9	0.7	0.1
<b>Alberta</b>	1,993.5	0.0	-0.7	6.6	0.6	3.0	121.4	0.8	-0.7
<b>Saskatchewan</b>	523.2	0.6	2.6	4.9	-0.1	0.8	117.0	0.8	0.7
<b>Manitoba</b>	608.1	0.6	0.6	4.9	0.3	0.7	114.4	0.6	0.8
<b>Ontario</b>	6,485.4	-0.9	-3.3	9.4	0.7	3.0	114.0	0.7	0.4
<b>Quebec</b>	3,863.6	0.1	-0.4	8.7	0.3	1.2	113.7	0.9	0.1
<b>New Brunswick</b>	365.5	0.3	0.6	8.8	-0.1	0.1	113.7	1.1	0.2
<b>Nova Scotia</b>	452.9	0.8	0.8	8.9	-0.3	0.6	115.8	0.7	-1.1
<b>Newfoundland</b>	212.5	-0.8	-5.3	15.1	0.4	2.4	115.2	1.0	0.6
<b>P.E.I.</b>	68.7	0.1	-3.0	13.1	0.7	3.5	117.6	1.0	-1.1
	Retail Trade <i>April</i>			Manufacturing Shipments <i>April</i>			Housing Starts <i>May</i>		
	(SA, \$ millions)			(SA, \$ millions)			(SAAR, thousands of units)		
	Value	% Change (Period)	% Change (Year)	Value	% Change (Period)	% Change (Year)	Value	% Change (Period)	% Change (Year)
<b>Canada</b>	33,529.0	-0.8	-6.2	41,000.0	-0.1	-18.1	128.4	9.2	-42.4
<b>British Columbia</b>	4,350.1	1.3	-9.2	2,681.3	-2.1	-20.5	11.2	-4.3	-70.9
<b>Alberta</b>	4,597.3	0.6	-10.5	4,539.4	-2.6	21.6	12.4	0.0	-61.3
<b>Saskatchewan</b>	1,143.2	-1.4	-4.6	896.2	0.2	-6.5	4.9	69.0	32.9
<b>Manitoba</b>	1,195.4	-0.4	-4.0	1,235.0	-4.5	-4.7	3.3	6.5	-49.2
<b>Ontario</b>	12,034.7	-1.1	-5.8	18,632.4	-0.6	-18.6	43.8	20.7	-41.0
<b>Quebec</b>	7,578.8	-2.5	-4.1	10,843.9	4.7	-12.5	42.2	2.7	-17.7
<b>New Brunswick</b>	789.1	-1.0	-3.6	1,123.5	1.4	-36.3	4.0	-4.8	-24.5
<b>Nova Scotia</b>	986.1	-0.2	-2.4	702.9	-2.4	-22.5	3.0	20.0	-6.3
<b>Newfoundland</b>	588.8	0.1	1.1	224.8	-44.8	-63.5	2.7	-3.6	-27.0
<b>P.E.I.</b>	143.4	1.7	0.6	123.8	-1.6	5.2	0.8	60.0	14.3