

Canada in the Throws of Global Headwinds:

How long can Canada remain an island of stability in a world of turbulence?

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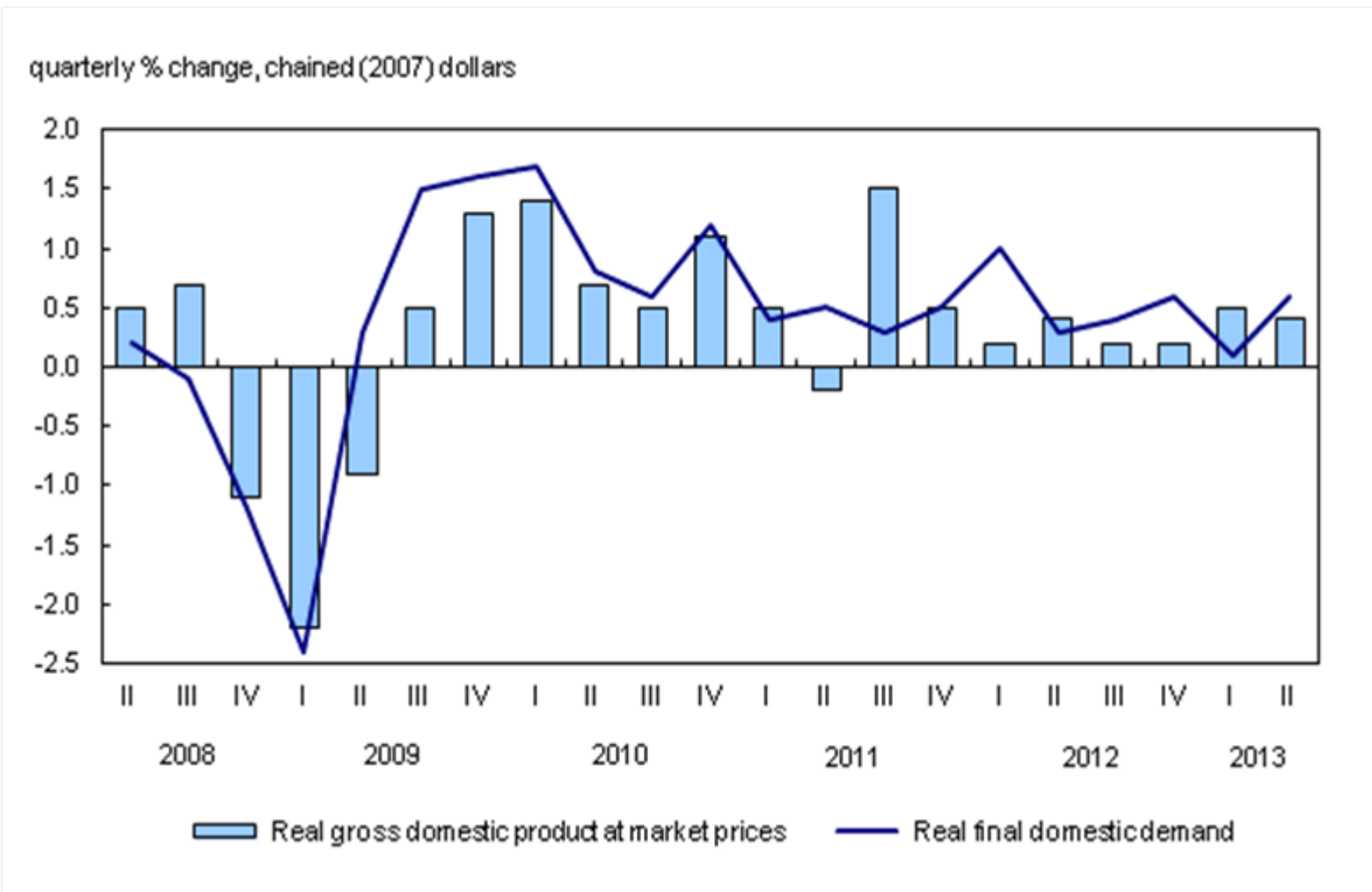
The Challenges Facing Canada

- Canada's economy has performed relatively better than its G7 peers during the global financial crisis and Great Recession
- Despite this, growth and job creation have slowed down due to a number of internal and external factors.
- What are the headwinds that are holding our economy back? What are our vulnerabilities? What threats are looming ahead and what are the opportunities as we move forward in the medium term horizon?
- Internal Threats:
 - Overvalued housing market
 - Excessive household debt
 - Overinvestment in housing and energy
 - Low productivity growth
 - Rising unit labour costs

What Should We Be Prepared For Ahead

- External Threats
 - Reversal in our exceedingly advantageous terms of trade and decline in high commodity prices
 - Slow growth in our key export markets: USA, EU, Japan and insufficient exposure to emerging markets
 - Slowdown in China and risk of negative surprises
 - Slowdown in emerging market economies
 - Resumption of sovereign debt and banking crisis in Europe, it is not over
 - Competitive devaluations and currency instability
- External Opportunities
 - The USA is on the verge of a major secular upswing

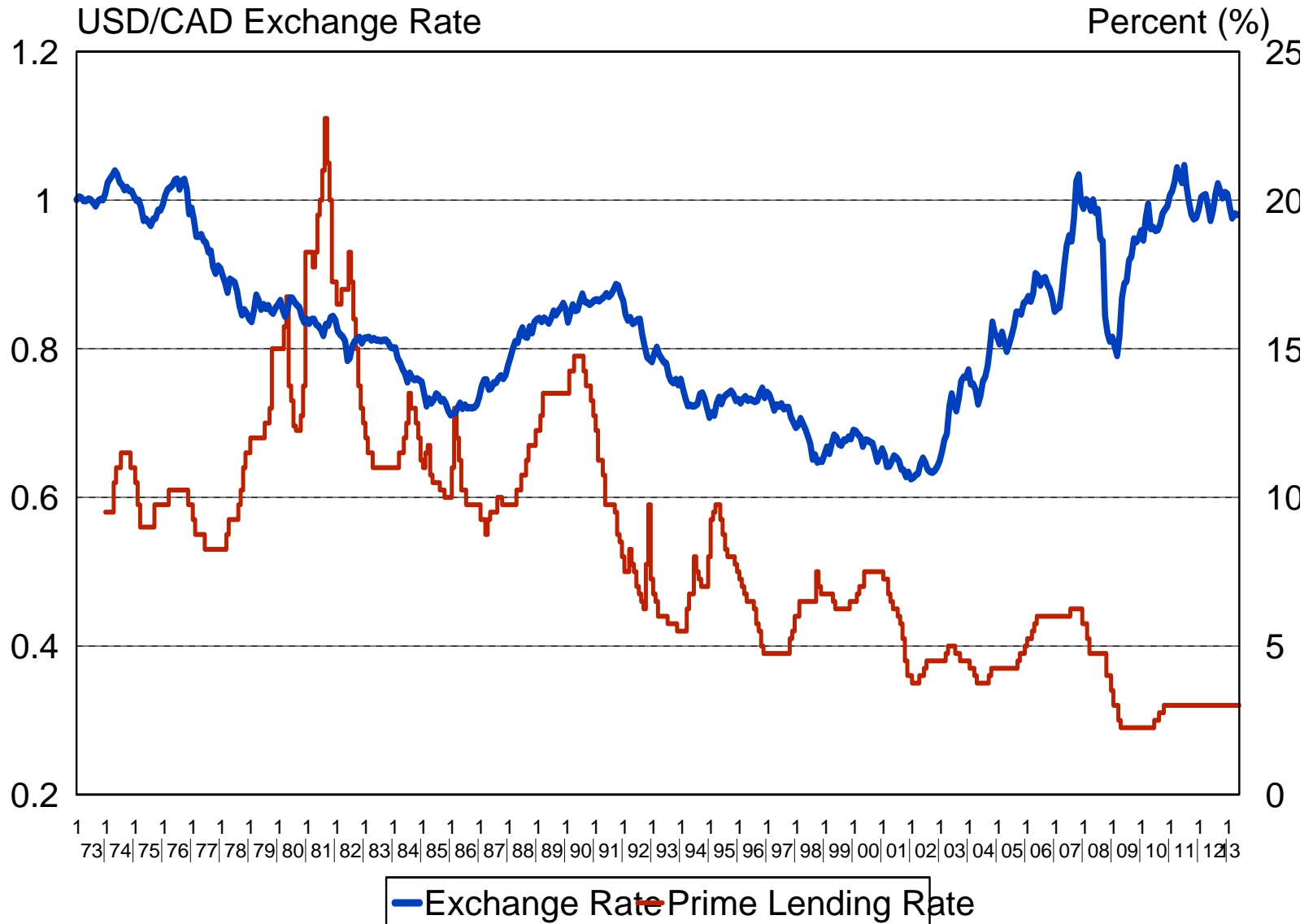
Quarterly Change in Real GDP, Canada: 2008-2013



Vital Indicators of Long-term Growth, 2012

	Canada	USA	EURO Area	Japan	China	World
Gross Saving Rate	20.8	13.1	20.2	21.6	49.5	23.9
Gross Investment Rate	24.5	16.2	18.3	20.6	46.9	23.6
External Balance	-3.7	-3.1	1.9	1	2.6	0.3
Productivity Growth Rate	0.5	1.3	0.6	1	6	2.8
Budget Deficit	-2.6	-6.4	-2	-9.3	-0.9	
Net Debt-to-GDP Ratio	63.3	87.9	71.9	134.3	?	

Caught Between a Rock and a Hard Place: If we raise interest rates our dollar will rise further



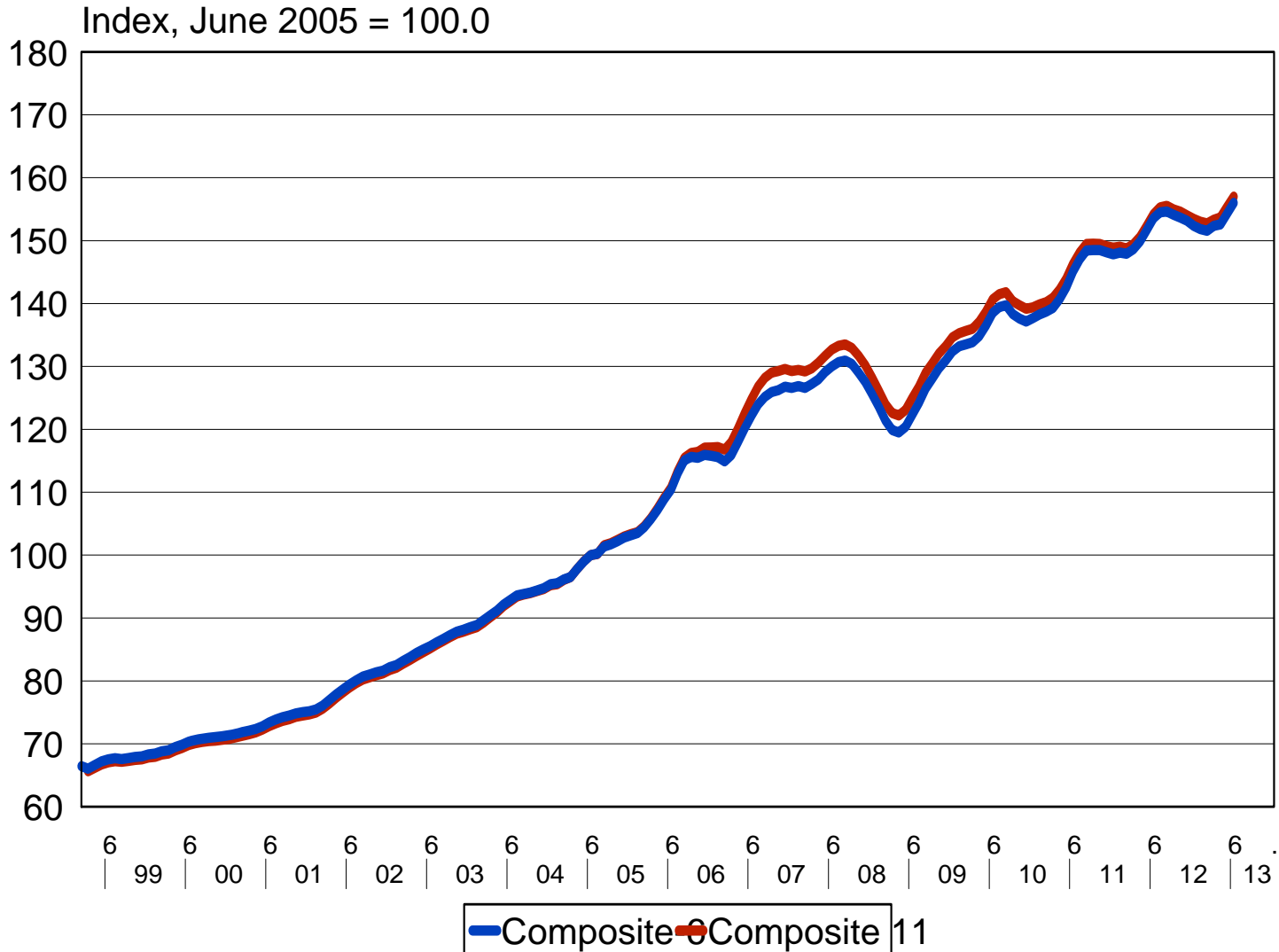
Private and Public Debt in Canada: 2012

Households owe more money than federal and provincial governments combined and more debt than the business sector

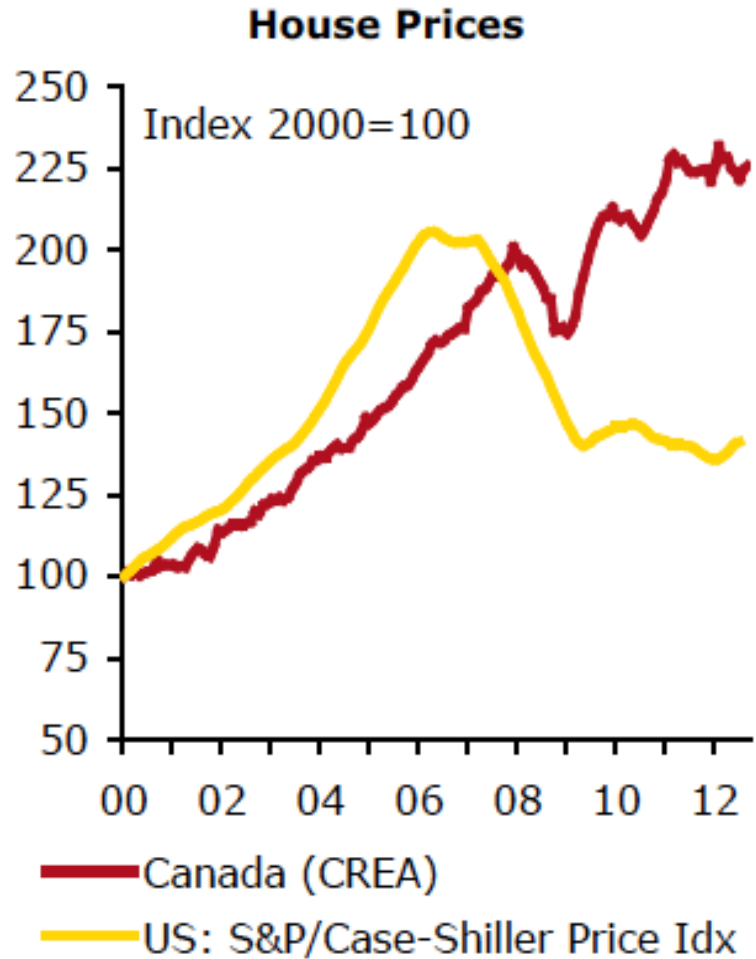
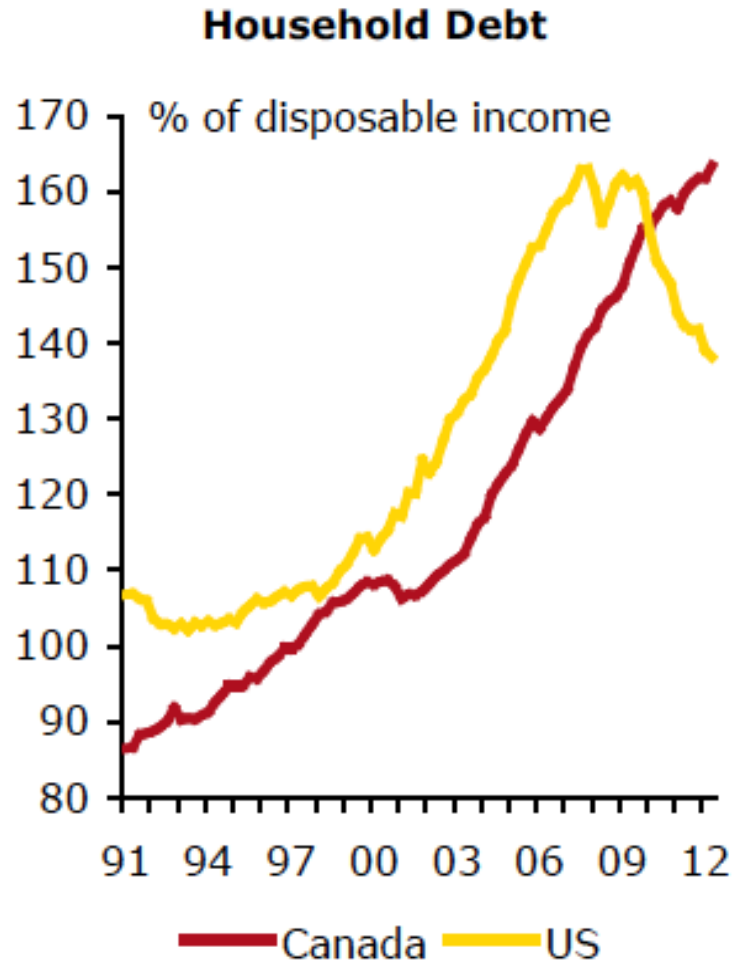
<u>Public Sector</u>	<u>2012</u>	<u>Percent of GDP</u>
Federal government net debt	650.1	36.5%
Provincial government net debt	477.5	26.8%
Total public sector net debt	1,127.6	63.3%
<u>Private Sector</u>		
Household sector gross debt	1,674.2	94.1%
Business sector gross debt	1,395.9	78.4%
Total private sector (non-financial) debt	3,070.1	172.5%
<u>Total private and public sector debt</u>	<u>4,197.7</u>	<u>235.8%</u>
Of which, Net External debt (NIIP)	252.2	14.2%

Teranet National Bank Composite-6 and 11 Market Housing Index, Canada, As at June, 2013

Housing prices have doubled since 2001

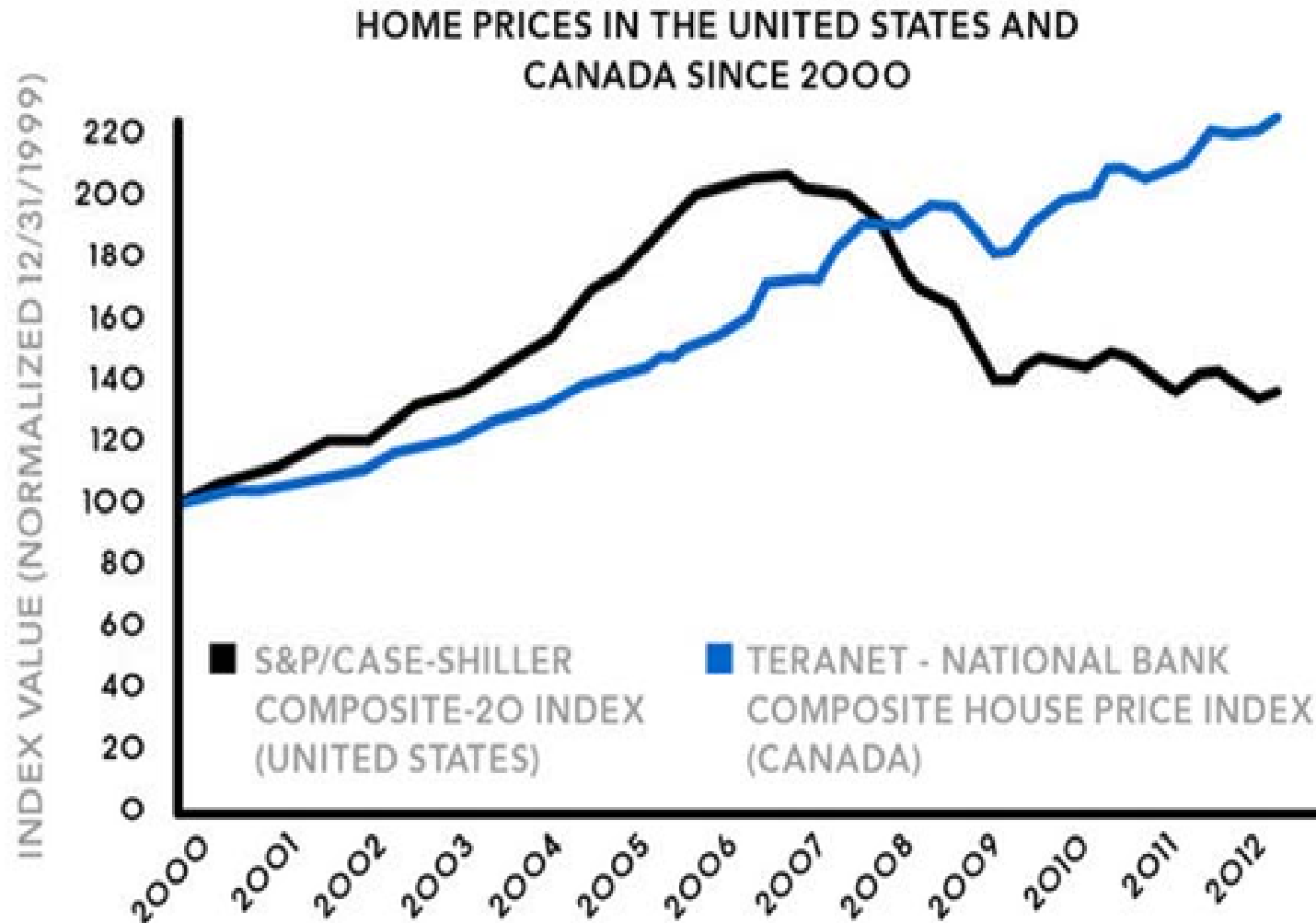


While US Households are Deleveraging Canadians are Leveraging



Growing Gap in House Prices Between Canada and the United States

How long can this be sustained? Economics 101 says it can't

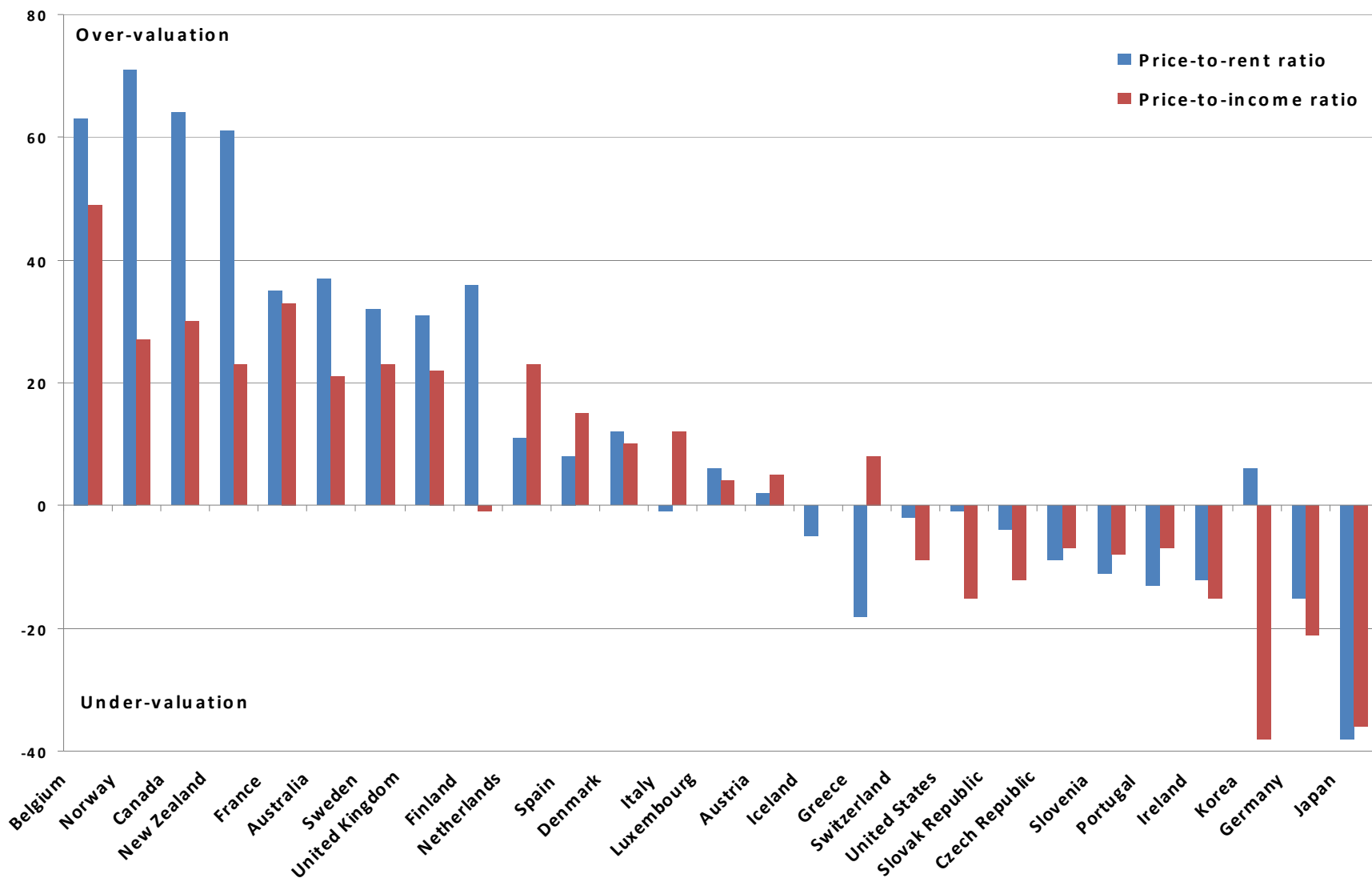


The Housing Market is Vulnerable to External Shocks and Economic Slowdown

Housing Price-to-Income Ratio

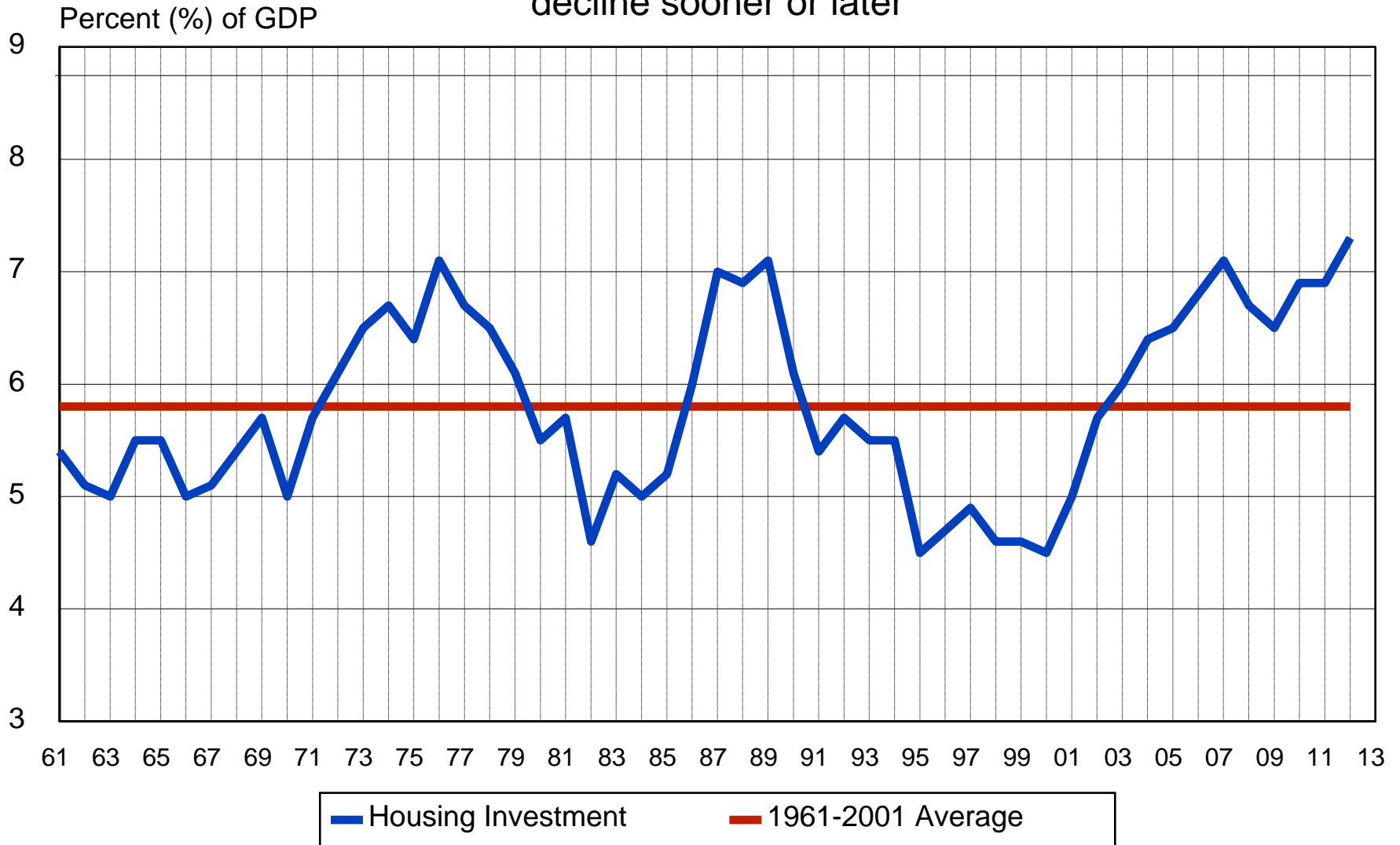


Housing Market Valuations Across OECD: Price to Rent & Price to Income Ratios, 2013



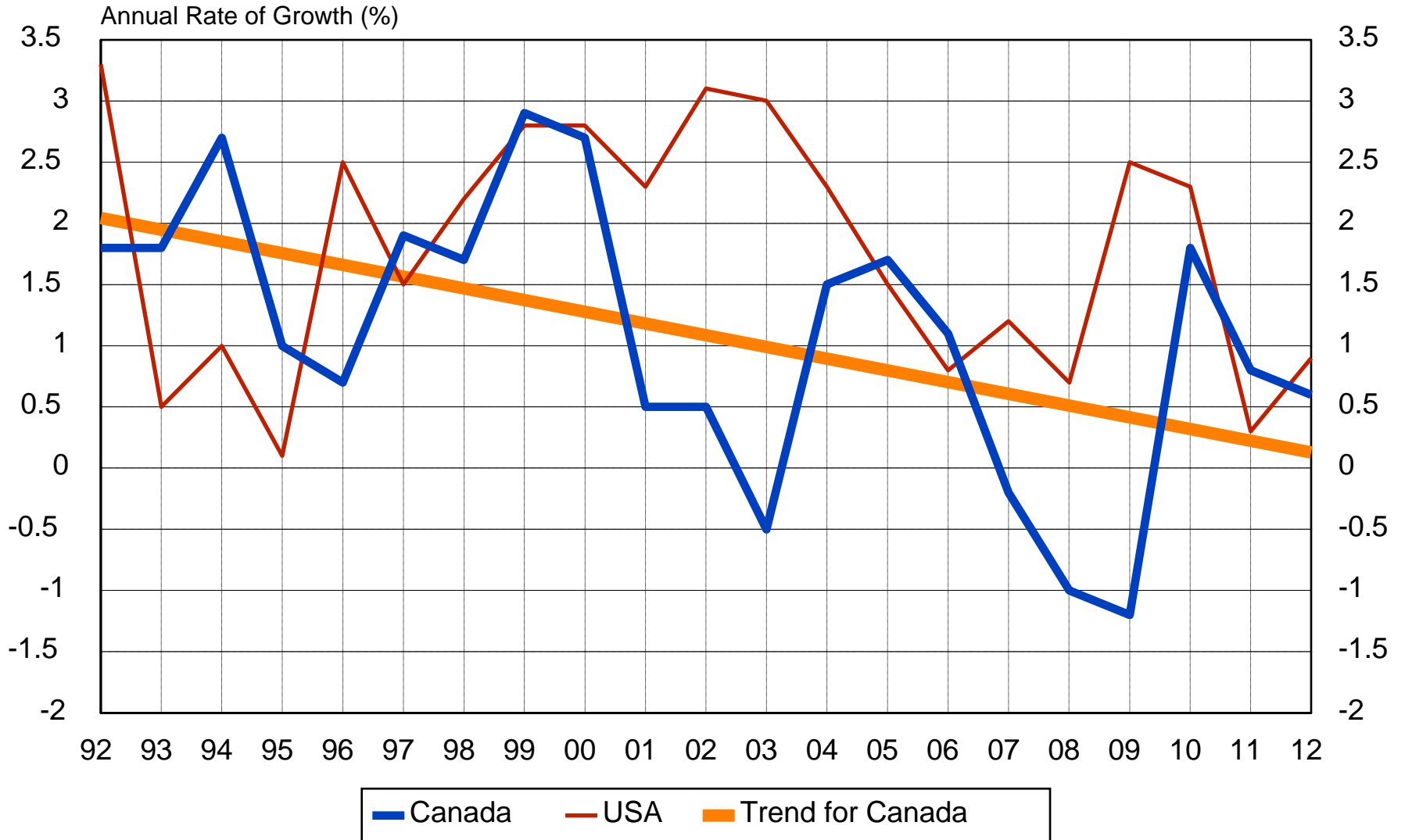
Residential Housing Investment as a Share of GDP: 1961-2012

Housing investment is well above the long-term average of 5.8% and is poised to decline sooner or later



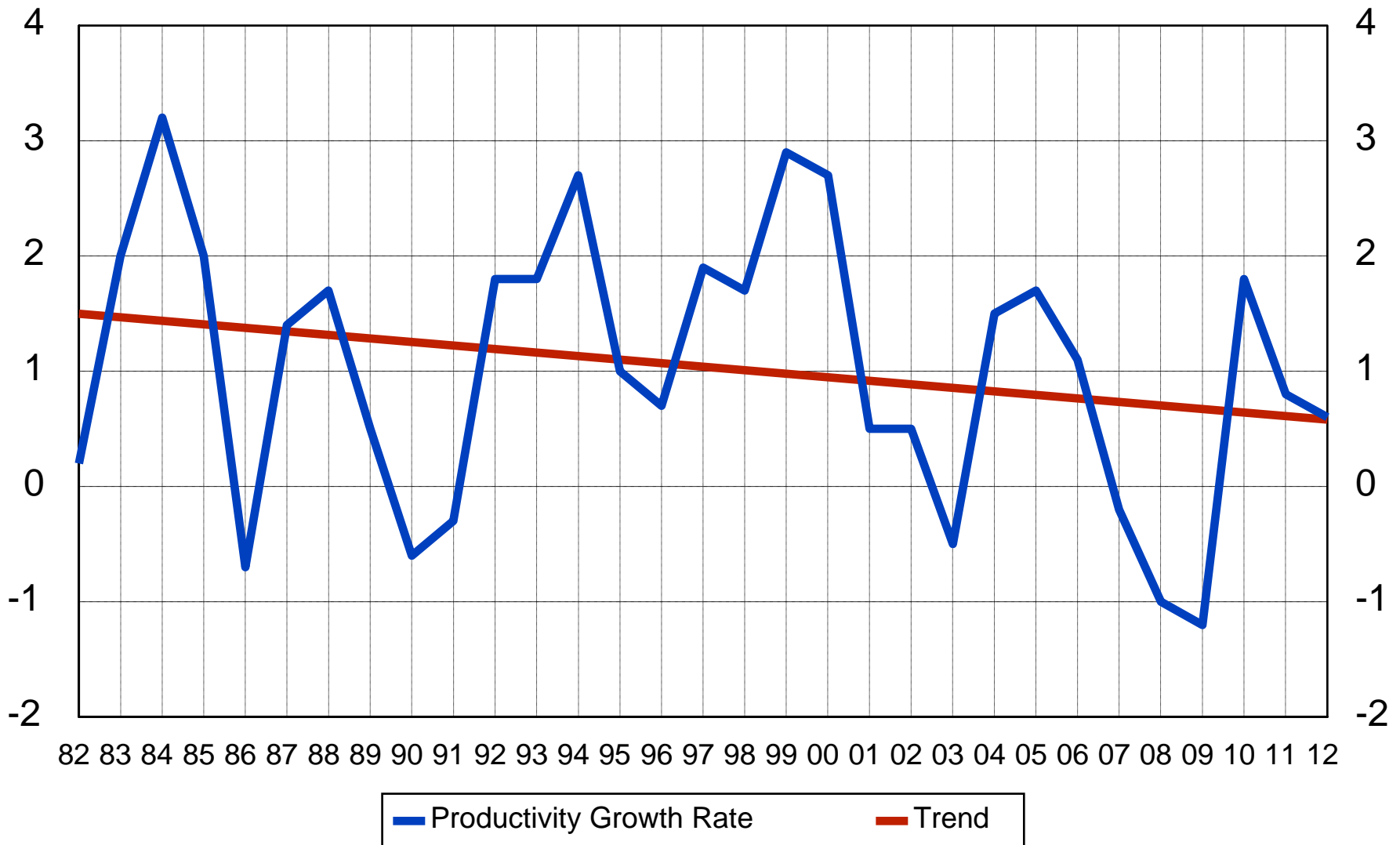
Productivity Growth: 1992-2012

Labour productivity growth for the total economy has been lower than the USA and exhibiting a downward trend



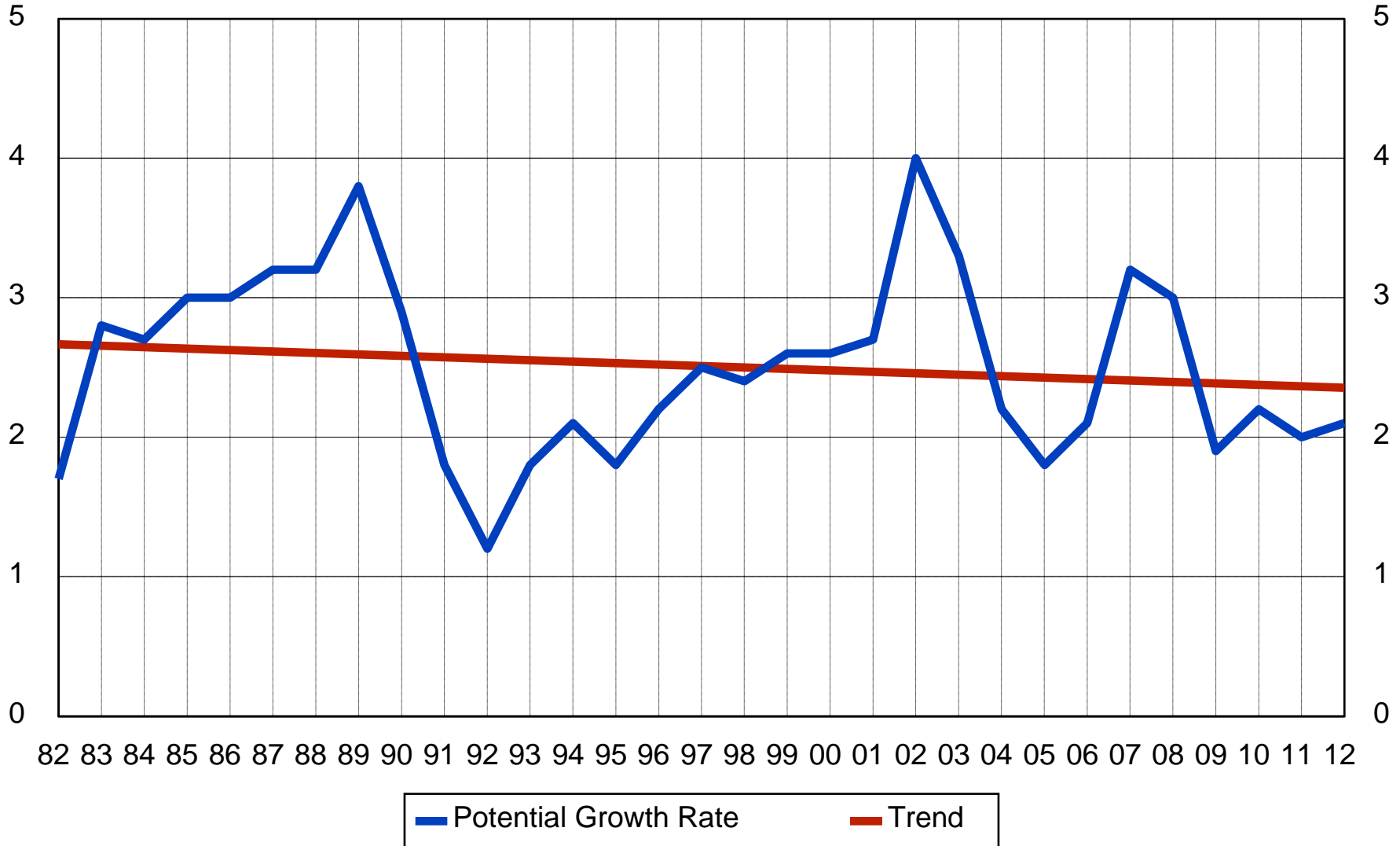
Productivity Growth: 1982-2012

Productivity growth has declined by roughly 1 percentage point since the late 1970s from 1.5% to 0.5%



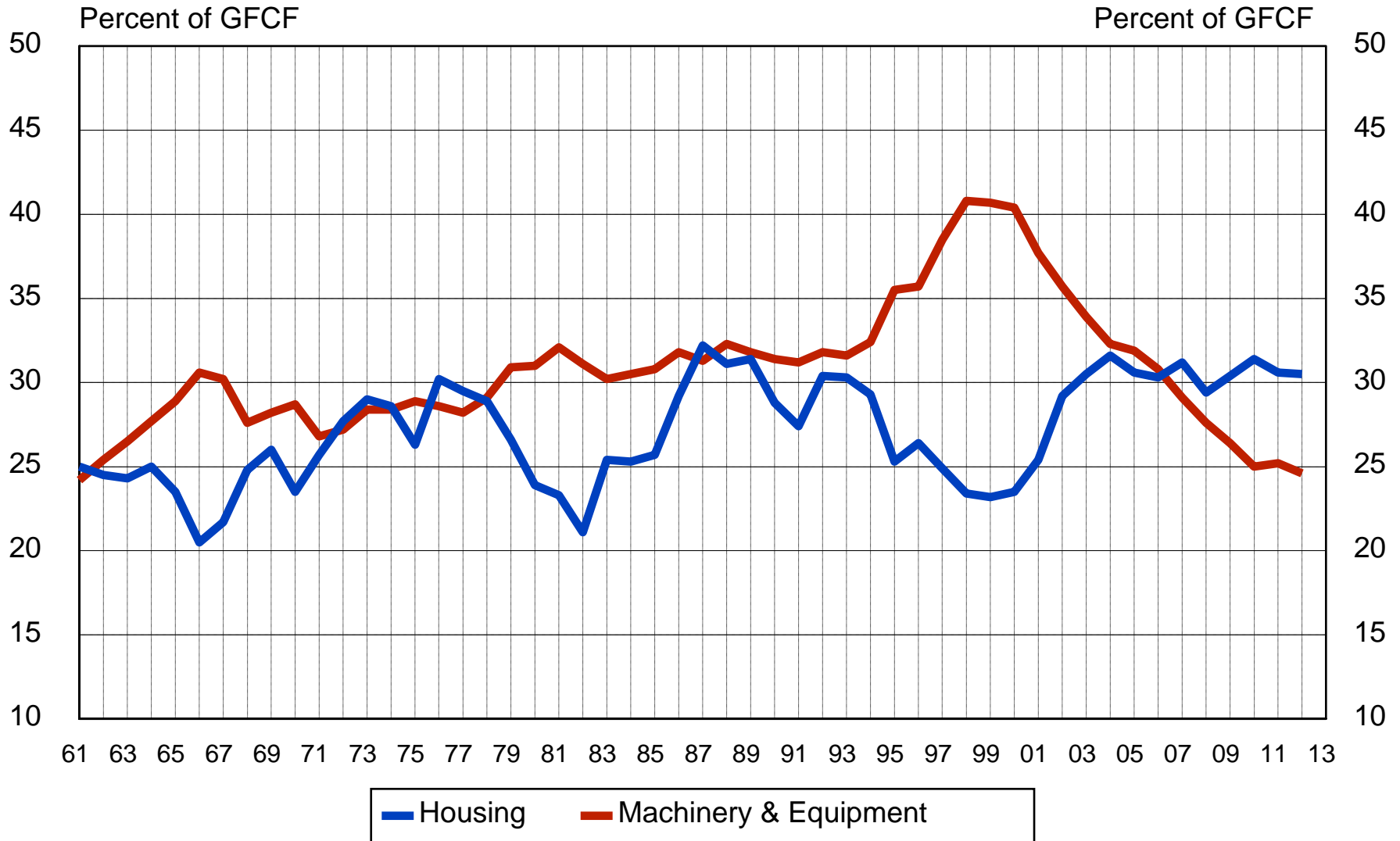
Potential Growth Rate: 1982-2012

With low productivity growth and slowing labour force growth due to aging of the population, the economy's potential growth rate is slowing from 3% to 2.5%



Productive vs Unproductive Investment: 1961-2012

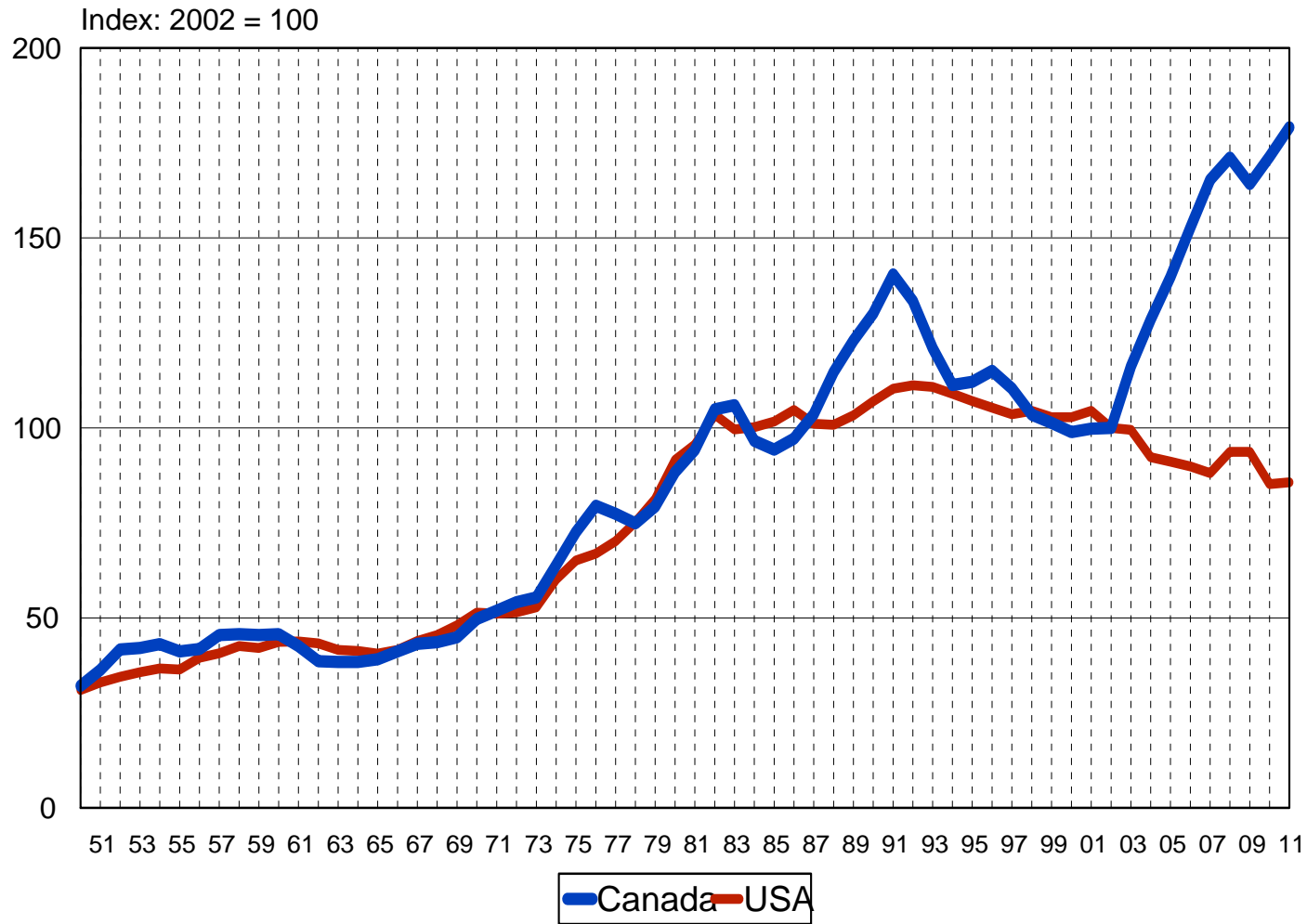
Too much investment in housing which is unproductive for the economy. With low interest rates and a strong dollar why isn't there more investment in machinery & equipment?



Increasing Reliance on Mining, Oil & Gas

2011	Manufacturing	Mining and oil and gas Extraction
Share of GDP	12.8	4.5
Share of Total Investment	4.8	21.4
Share of Employment	10.2	1.9

Unit Labour Costs in Canada in Record Territory Compared to the USA: 1950-2011 (US \$ Basis)

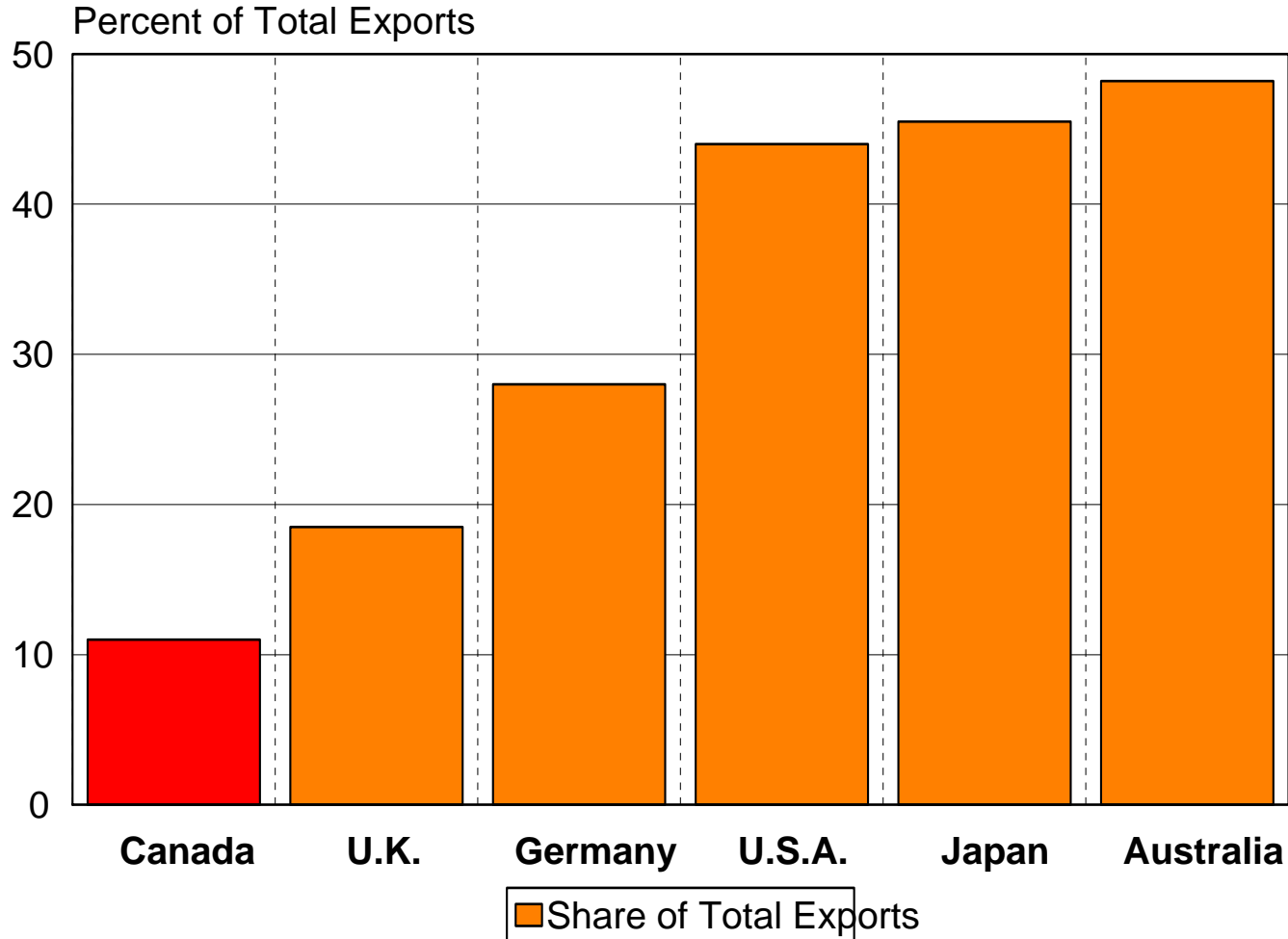


Source: St-Louis Federal Reserve Bank (FRED data base)

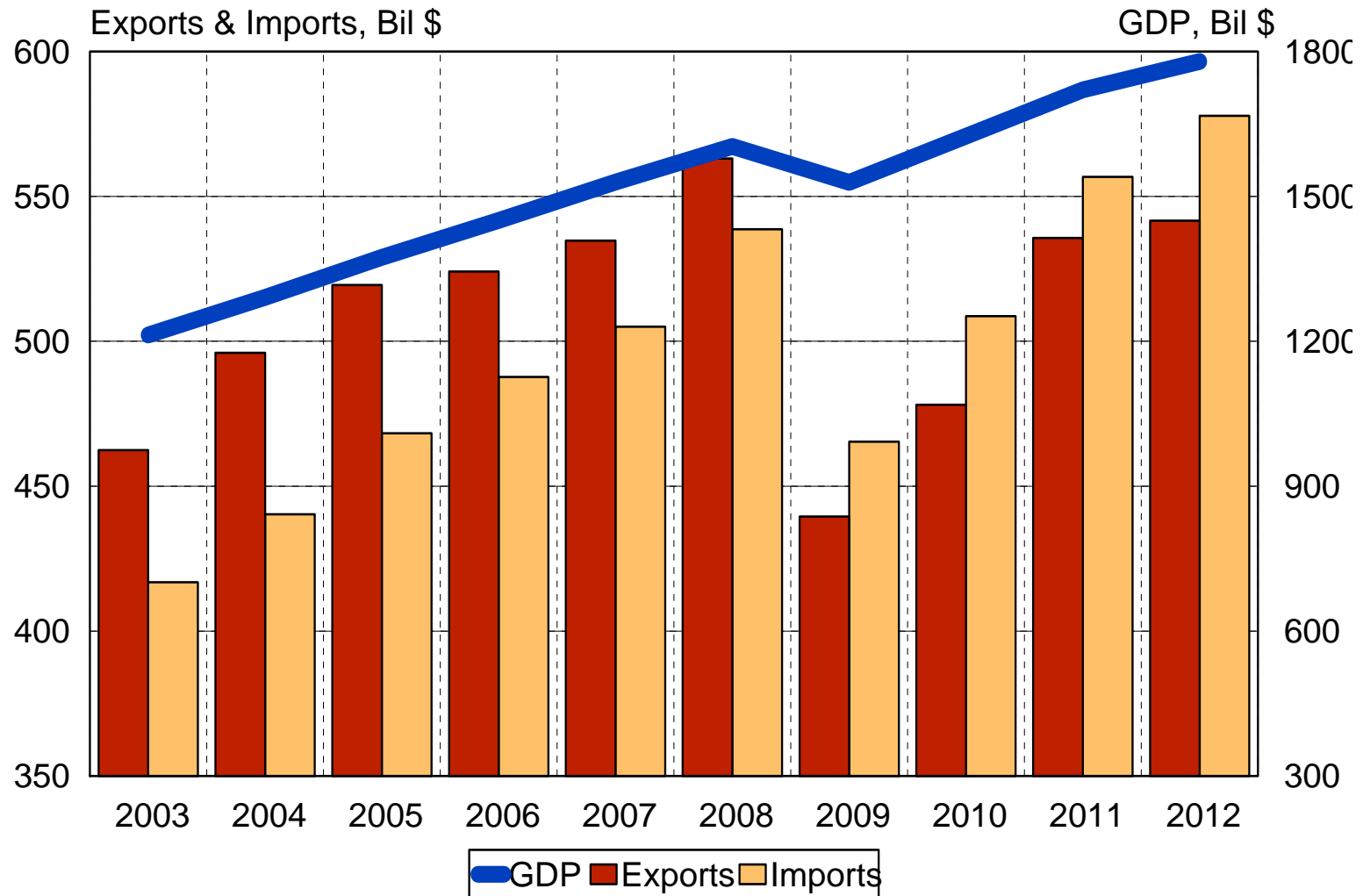
Our Main Trading Partners Are Growing Too Slowly, If At All

	Share of Canada's Exports 2008	2008	2009	2010	2011	2012	2013	2014
United States of America	75	-0.3	-3.1	2.4	1.8	2.2	1.7	2.7
Euro Area		0.4	-4.4	2	1.5	-0.6	-0.6	0.9
United Kingdom	15	-1	-4	1.8	1	0.3	0.9	1.5
Japan		-1	-5.5	4.7	-0.6	1.9	2	1.2
Other Countries, of which EM	10	6.1	2.7	7.6	6.2	4.9	5	5.4

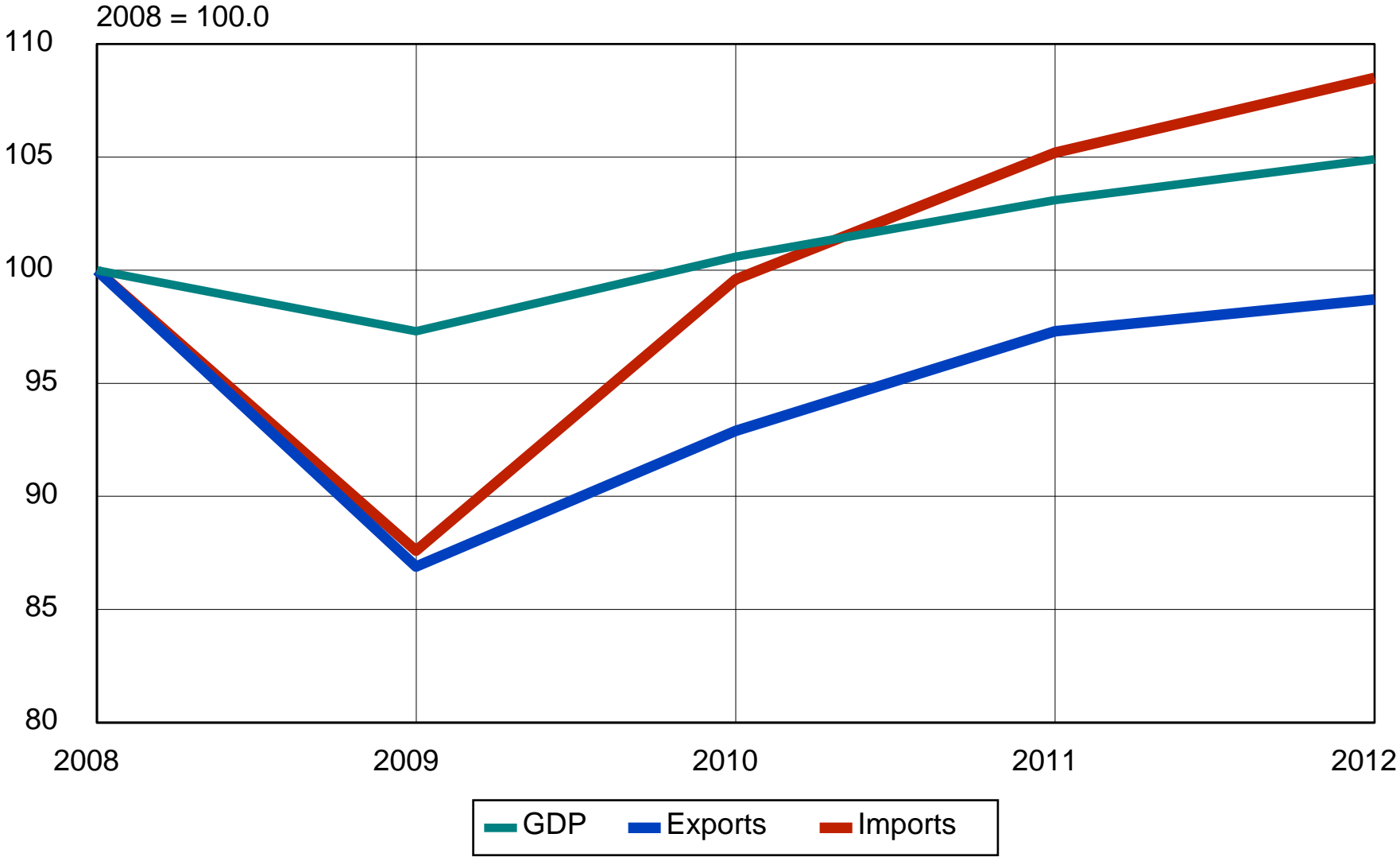
Canada has a Little Exposure to Emerging Markets



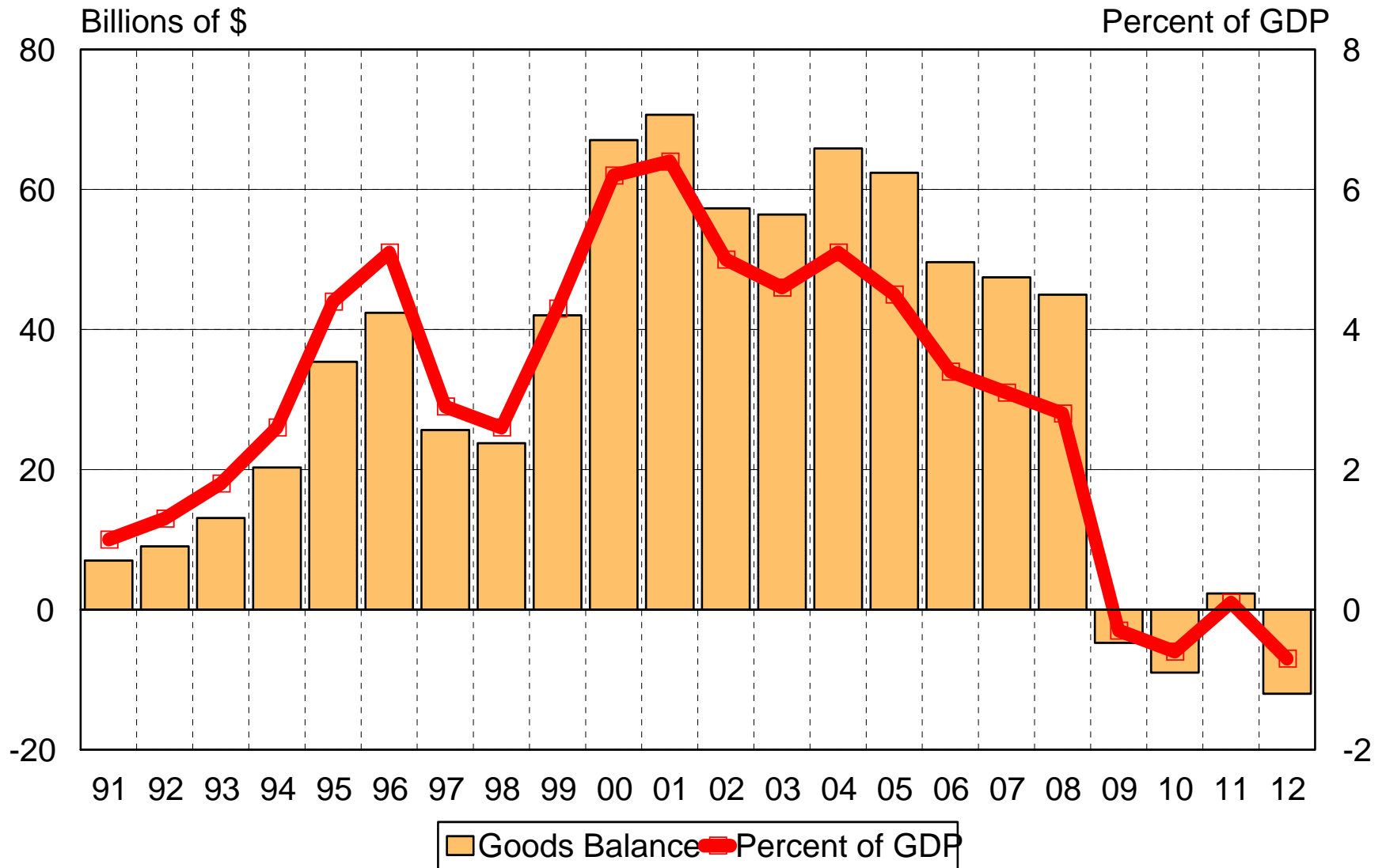
The Impact of the Great Recession and its Aftermath on Canada's Trade



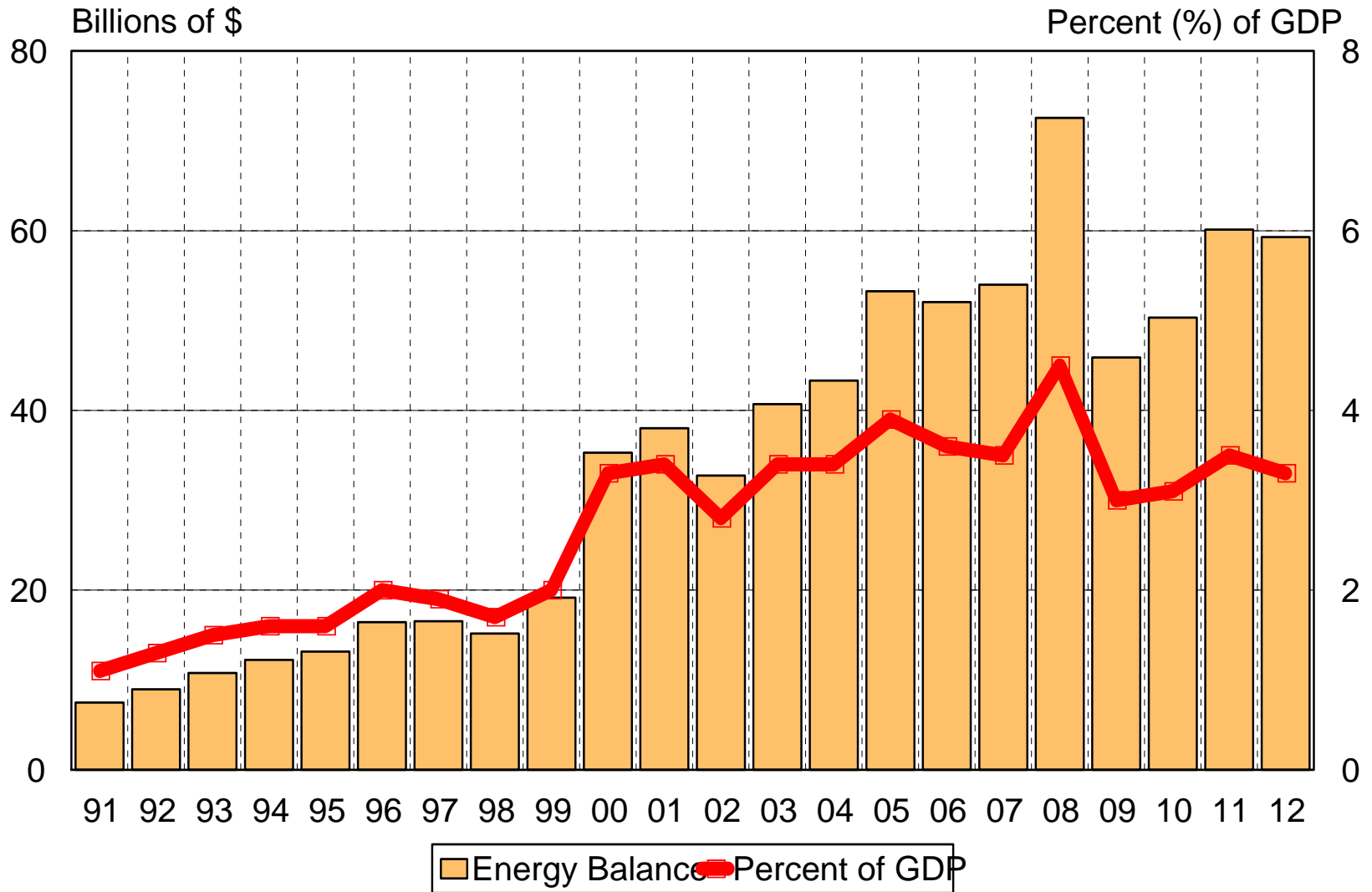
Exports Have Yet To Recover While Imports Have Outpaced Growth in Output



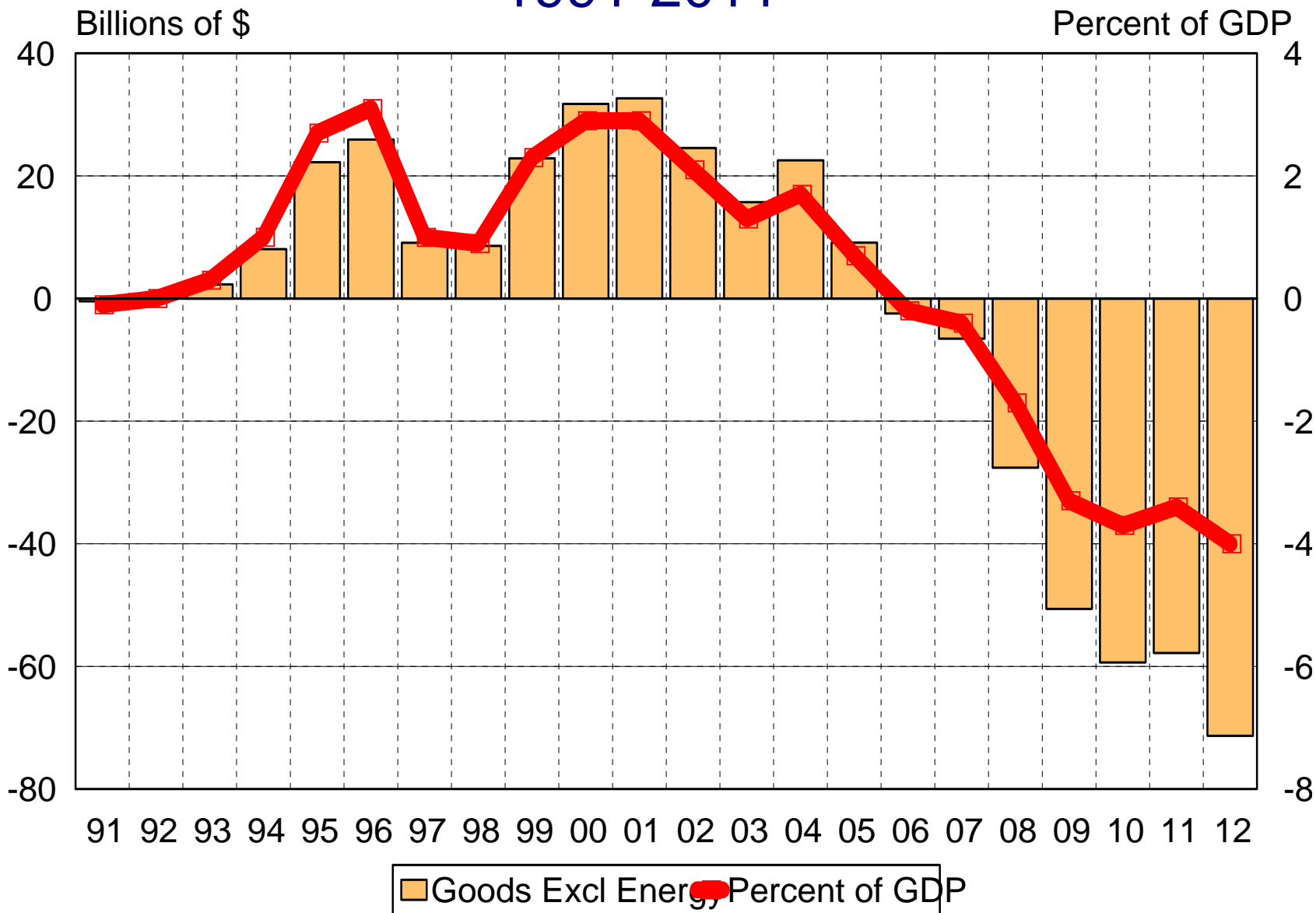
Merchandise Trade Balance: 1991-2012



Energy Trade Balance: 1991-2012

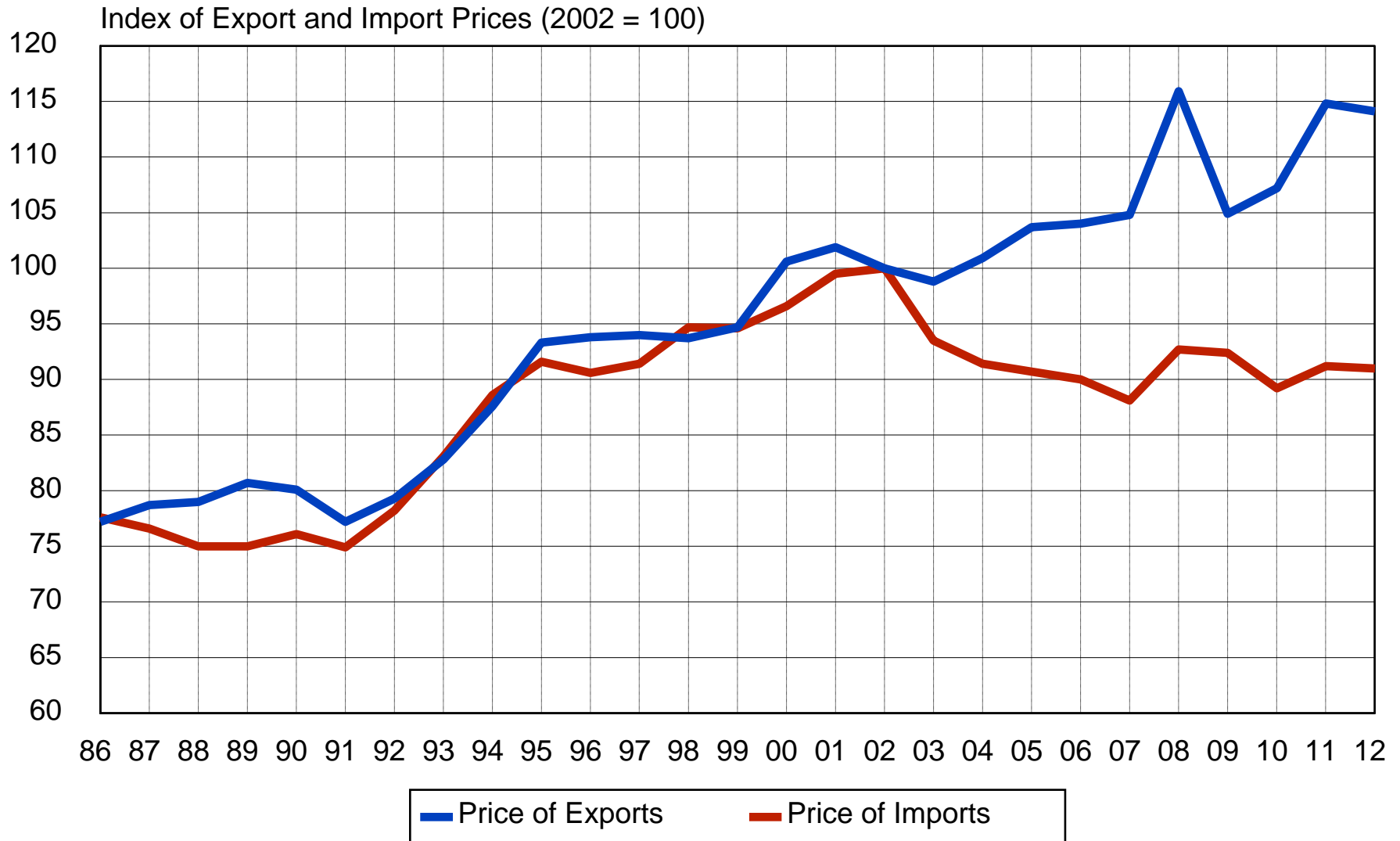


Merchandise Trade Balance Excluding Energy: 1991-2011



Canada's Terms of Trade: 1986-2012

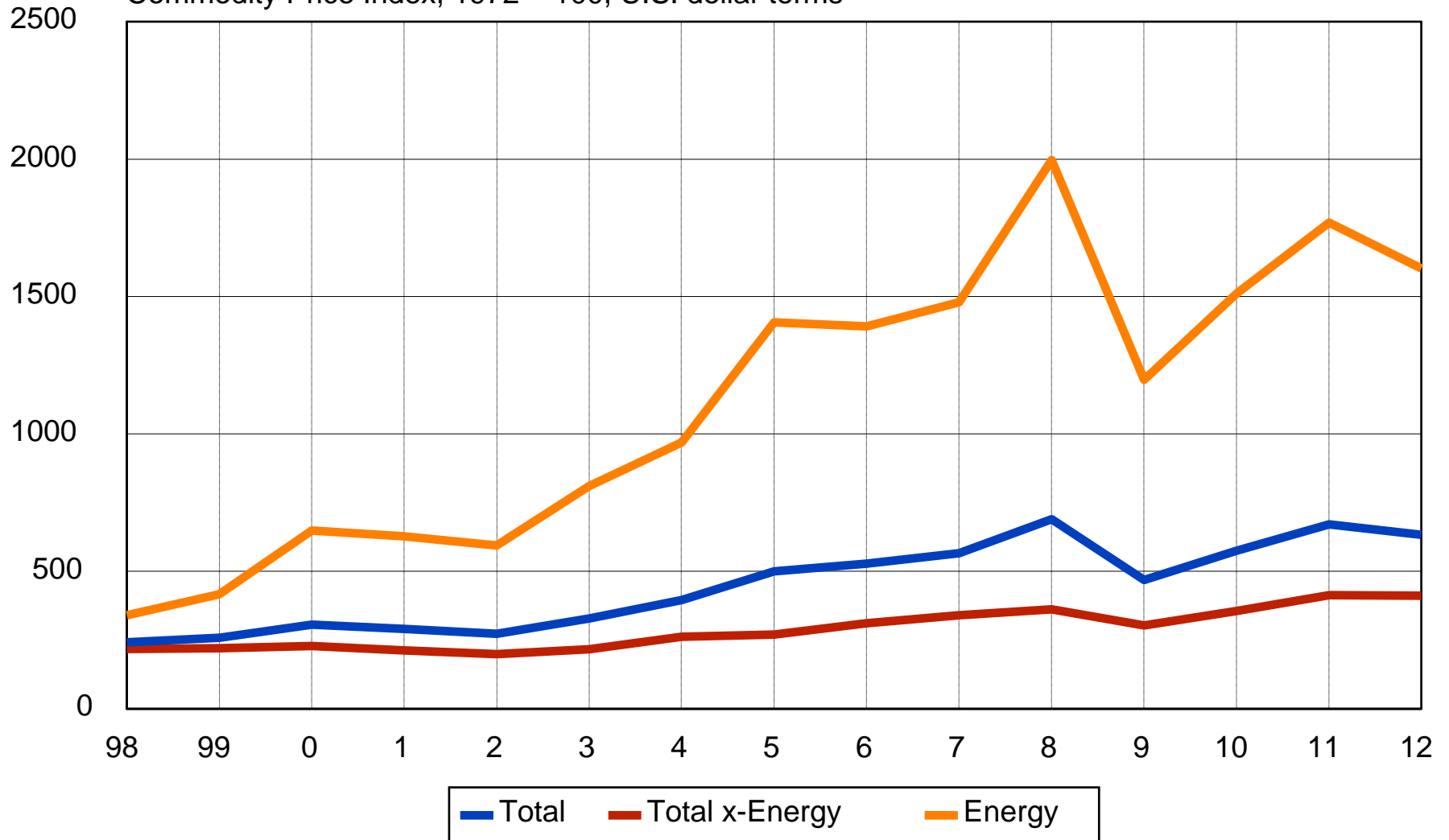
Over the past decade we experienced the best terms of trade in Canadian history.
Should we expect this to last forever?



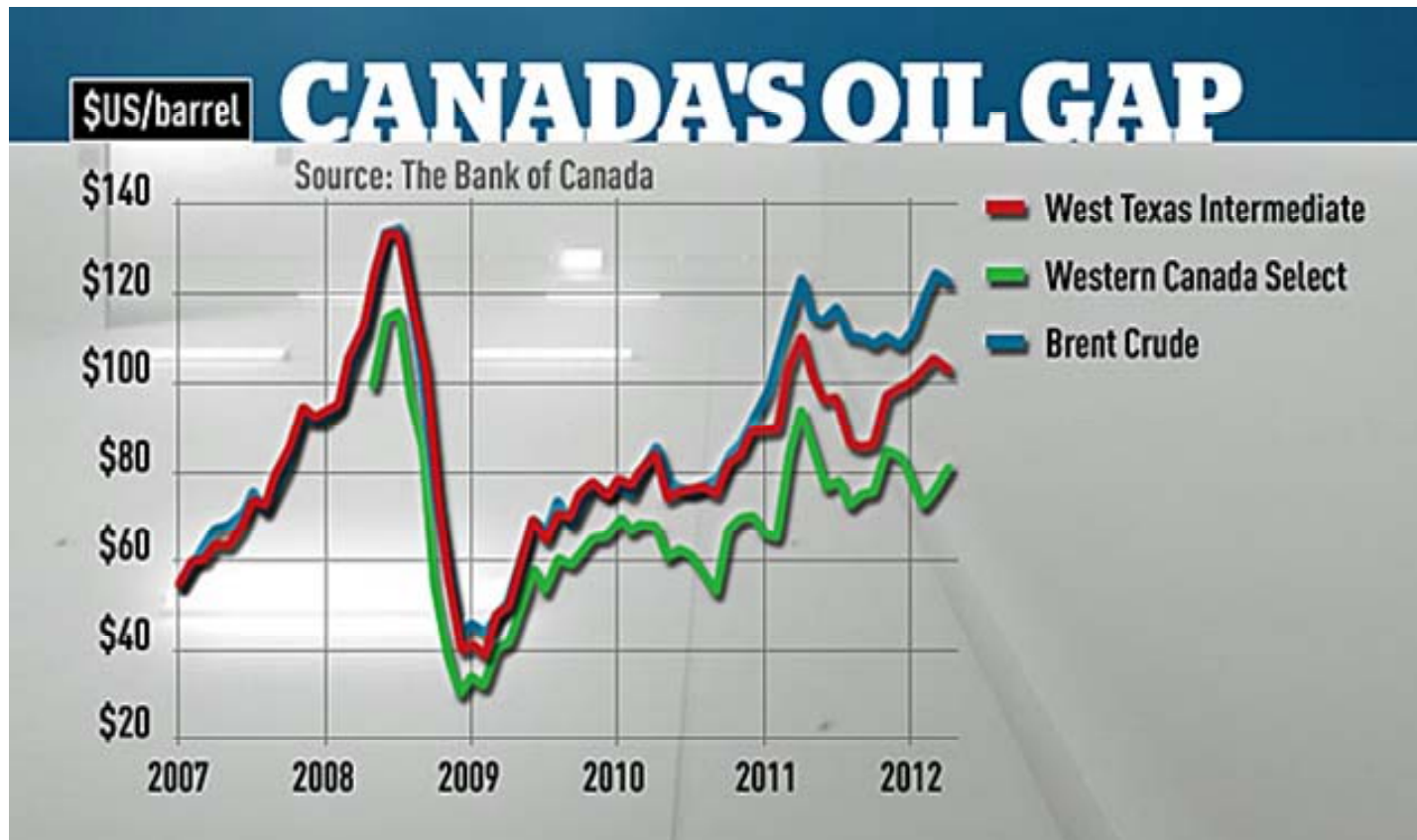
Commodity Price Index: 1998-2012

Since 1998, commodity prices have gone up 2.6x, non-energy prices have gone up 1.9x and oil prices have gone up 4.7x

Commodity Price Index, 1972 = 100, U.S. dollar terms

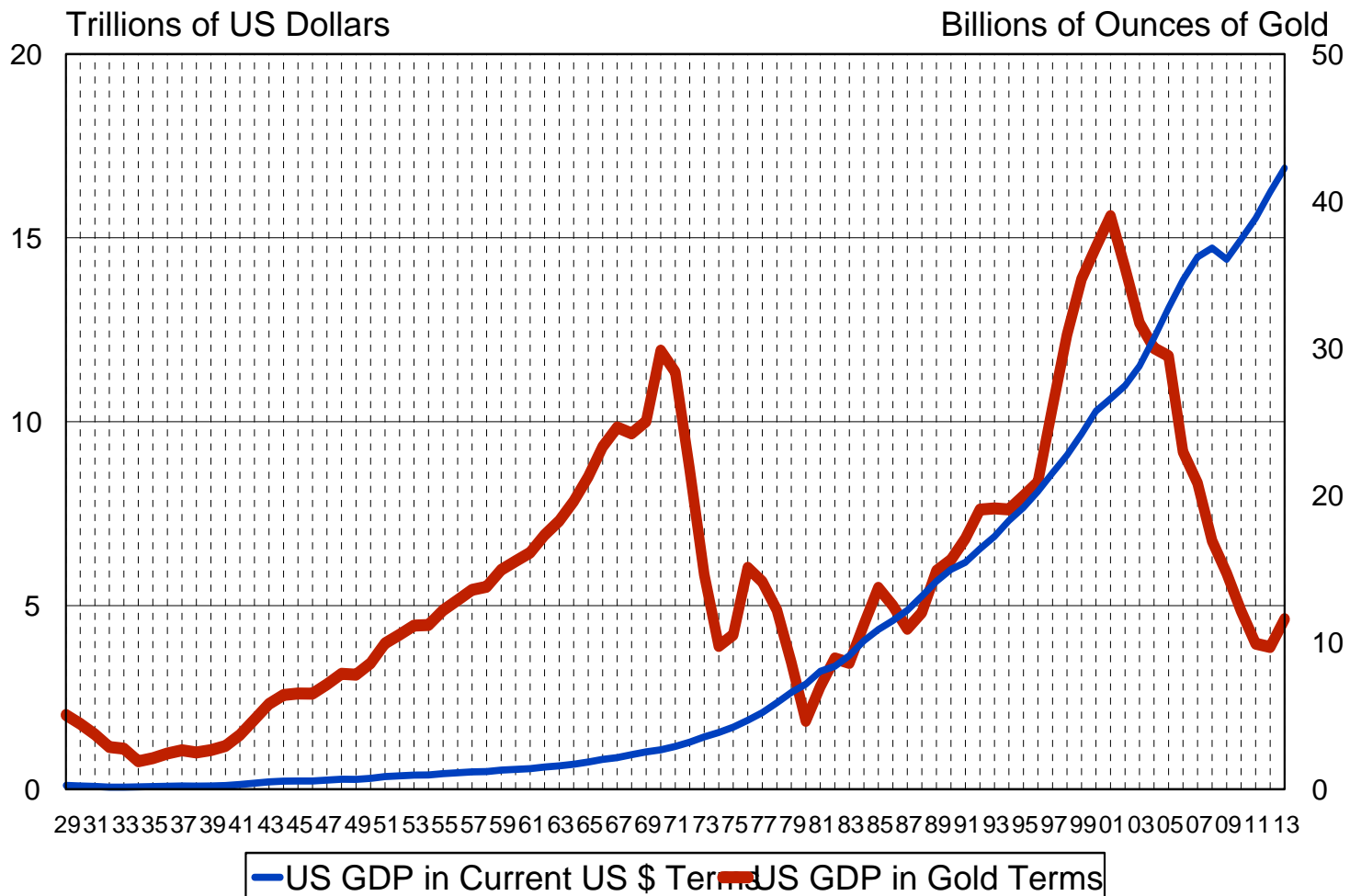


We Are Not Benefiting Enough From High Oil Prices and Paying More for the Oil we Import than the one we Export While US Oil Production is Booming Thanks to Fracking



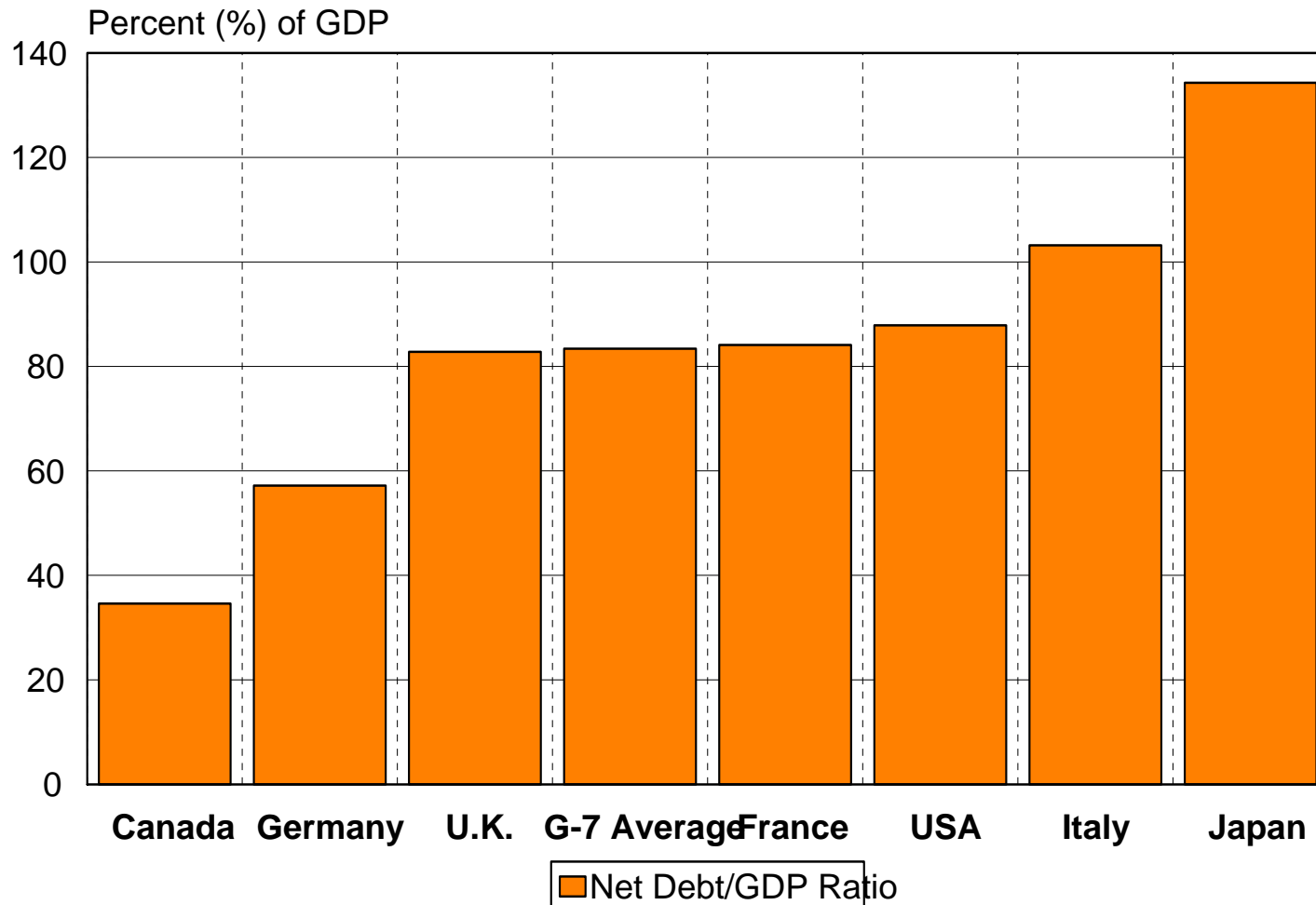
US GDP in Nominal Dollars vs. US GDP in Gold Terms: 1929 - 2013

The US has turned the corner and is embarking on a secular expansion that is going to drive global growth and benefit Canada



Net Public Debt to GDP Ratio, 2012

The Federal government has put in place a large fiscal capacity to deal with any negative shocks, should they arise



Conclusion

- High commodity and energy prices, a strong dollar, low interest rates and housing boom, that have been advantages for Canada in the 2009-2011 period have turned to drawbacks for the period ahead.
- Canada's vulnerabilities suggest slow and bumpy growth ahead
- But US has turned the corner and is on the verge of a major multi-year secular expansion
- Eventually headwinds will turn to tailwinds as the US pulls Canada and the global economy out of a period of slow growth
- In the meantime, a lower currency and larger budget deficits will serve as shock absorbers and buffers