

# Canadian and Global Economic Outlook: 2015-2016

**Kenneth Matziorinis, Ph.D.**

Adjunct Professor of Economics, McGill School of Continuing Studies  
and  
Partner, Canbek Economic Consultants Inc.

Dominion Lending Centres & Ottawa AHEPA Chapter  
Hellenic Meeting & Reception Hall  
Ottawa, ON  
November 19, 2014

# Where do We Stand Today?

In comparison to the rest of the world we are doing well

- Canada's economy has outperformed all G-7 economies since pre-recession (2009) levels:
  - #1 in GDP and investment growth
  - #2 in Employment growth
- Median per capita disposable income has caught up with the USA
- The federal government's budget is on track to be balanced by the Spring of 2015
- Canada has by far the lowest net federal debt

## But all is Not as Well as it Seems and Outlook is Murky

- There are landmines on the ground we stand on that can potentially explode in our face
- We are surrounded by a highly uncertain and potentially explosive global economic and geopolitical environment
- The outlook is highly uncertain and not very positive.

# Domestic Threats to Financial Stability

- Over-indebted household sector
- Over-valued housing market
- Over-valued bond market
- Over-dependence on cheap money
- Over-dependence on commodity prices and energy exports
- Over-dependence on housing construction
- Poor productivity growth
- Rising unit labour costs and diminishing global competitiveness
- Deteriorating provincial fiscal environment

## External Threats to Financial Stability

- Stagnation and deflation in the Eurozone
- Economic slowdown and brewing financial crisis in China
- Weak and uncertain outlook in Japan
- Slowing growth in newly emerging economies
- Over-valued global equity markets
- Exchange rate instability and 'currency wars'
- Resumption of 'cold war' between the West and Russia
- Break-down and chaos in the Middle East
- Emergence of extreme Islamic movements from W. Africa to Far East
- Ebola outbreak and other epidemiological risks

# Private and Public Debt in Canada: 2014

---

<b><u>Public Sector</u></b>	<b><u>2014</u></b>	<b><u>Percent of GDP</u></b>
Federal government net debt	682.3	36.3%
Provincial government net debt	537.1	28.6%
Total public sector net debt	1,219.4	64.9%
<b><u>Private Sector</u></b>		
Household sector gross debt	1,774.7	94.5%
Business sector gross debt	1,572.5	83.7%
Total private sector (non-financial) debt	3,347.2	178.2%
<b><u>Total private and public sector debt</u></b>	<b><u>4,566.6</u></b>	<b><u>243.2%</u></b>
Of which, Net External debt (NIIP)	57.3	3.1%

---

Source: Department of Finance, Fiscal Reference Tables, October, 2014 and Bank of Canada, Banking and Financial Statistics, July, 2014. (Table E2)

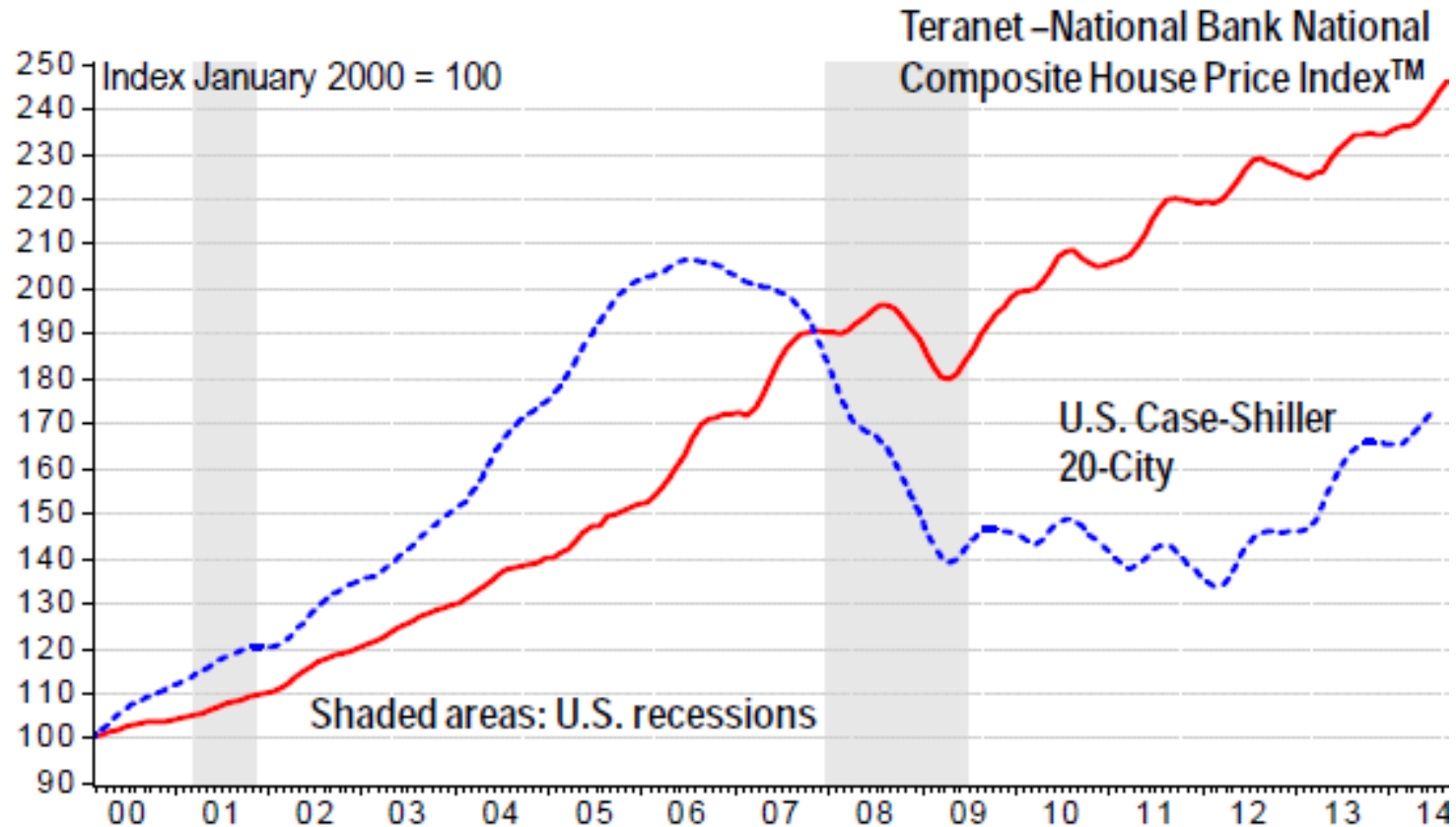
# Record Low Long-term Interest Rates

*The risk-free return has never been so low since Noah stepped out of his ark*



# Housing Prices in Canada and the USA: A Tale of Two Countries

*Canadian housing prices continue to defy gravity*



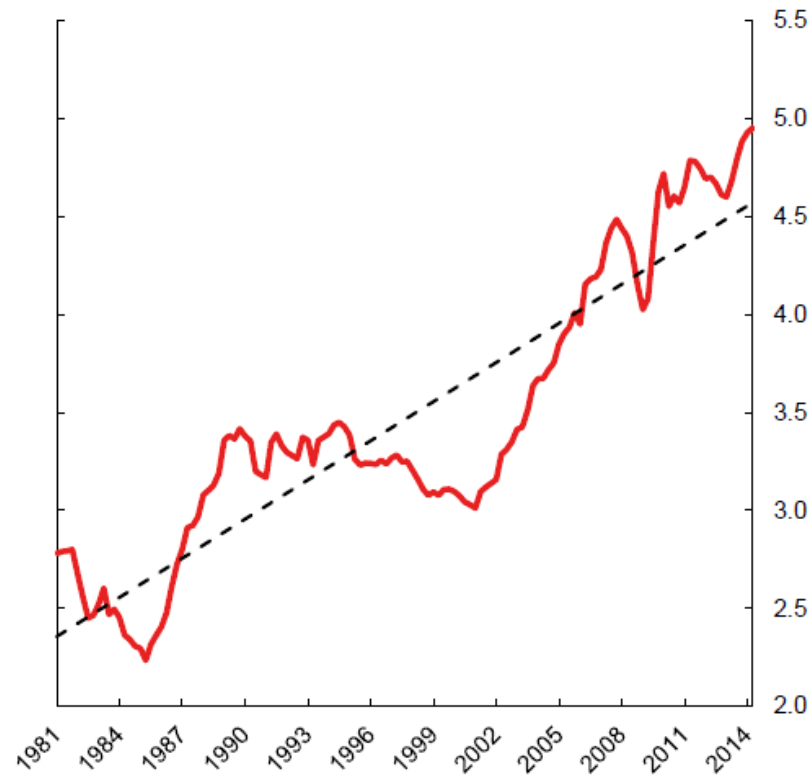
*NBF Economics and Strategy, Teranet-National Bank House Price Index and S&P*



# Unsustainable Fundamentals in Housing Prices & Household Debt

## High house prices

House-price-to-income ratio and linear trend

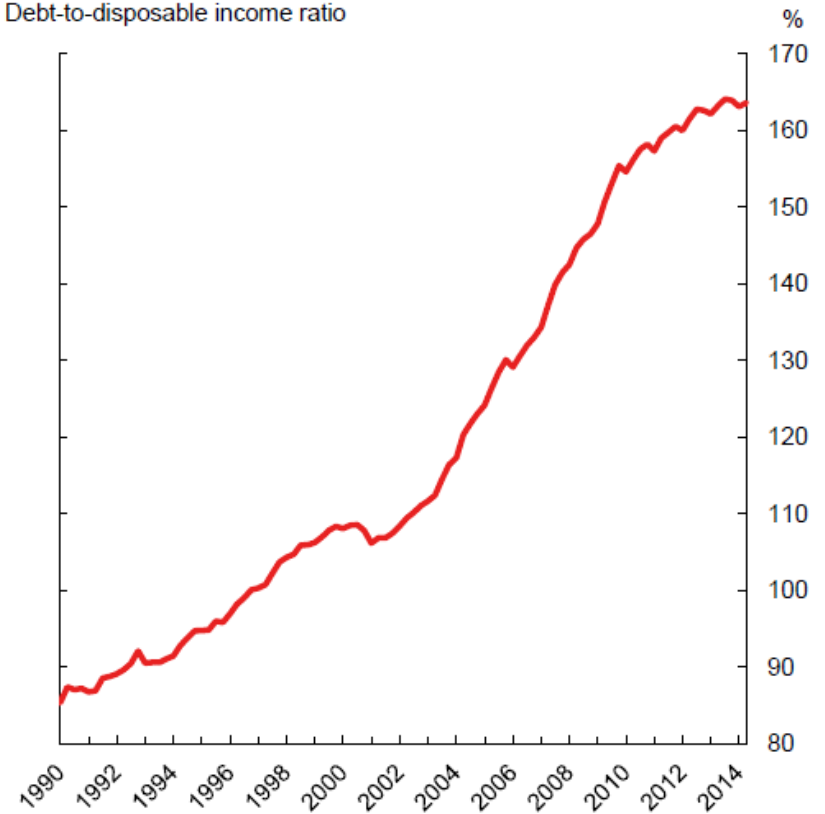


Sources: Statistics Canada, Canadian Real Estate Association and Bank of Canada calculations

Last observation: 2014Q2

## High rates of household debt

Debt-to-disposable income ratio

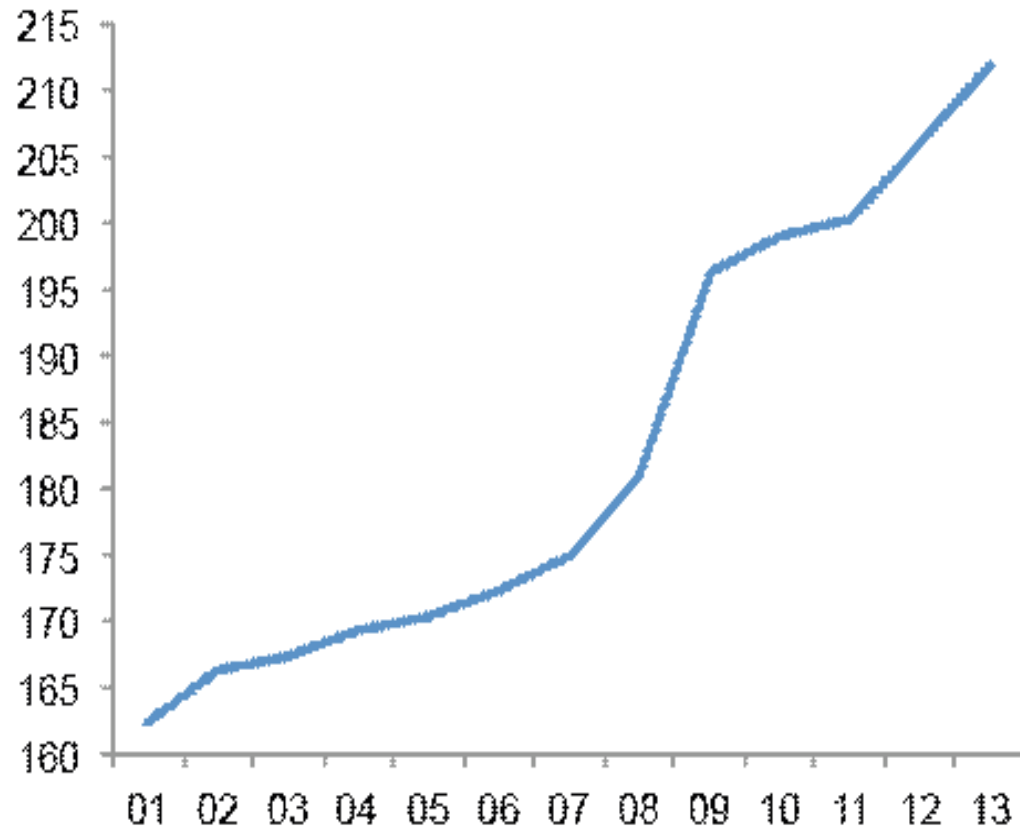


Source: Statistics Canada

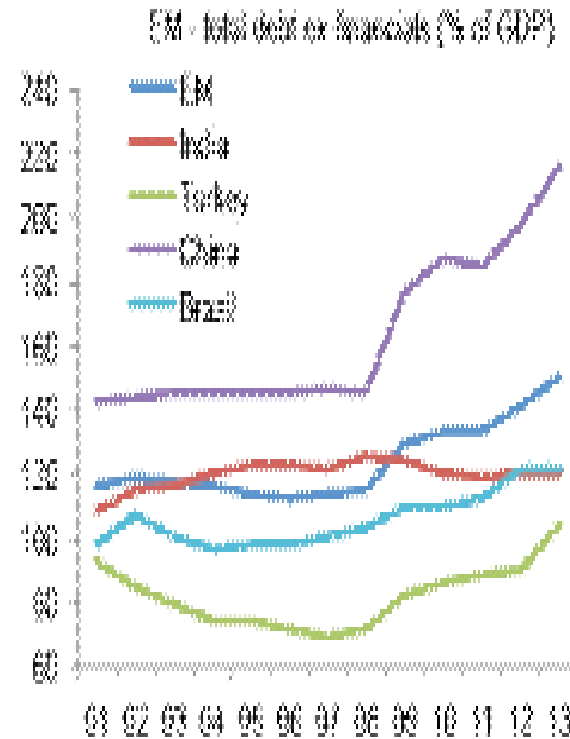
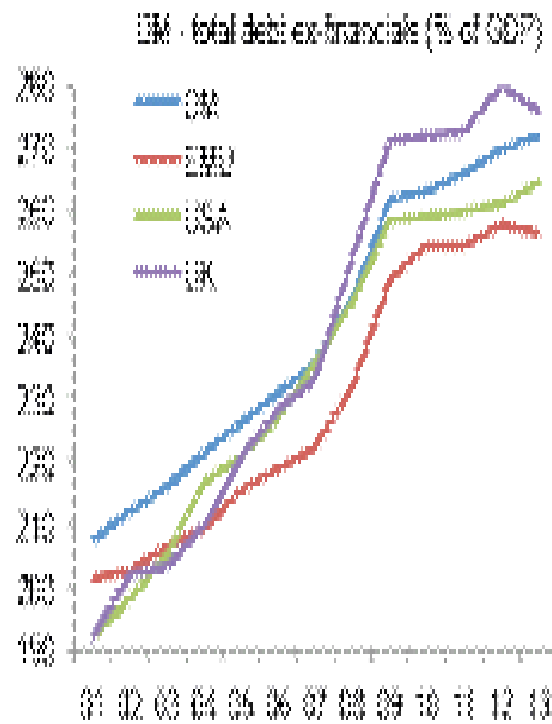
Last observation: 2014Q2

# Global Debt-to-GDP Ratio: 2001-2013

*Deleveraging? What deleveraging?*



# Debt Ratios Continue to Rise Especially in China



# World Stock Market Capitalization Has Reached New Records

*Global stock market capitalization has reached \$65 Trillion, surpassing previous record peak*



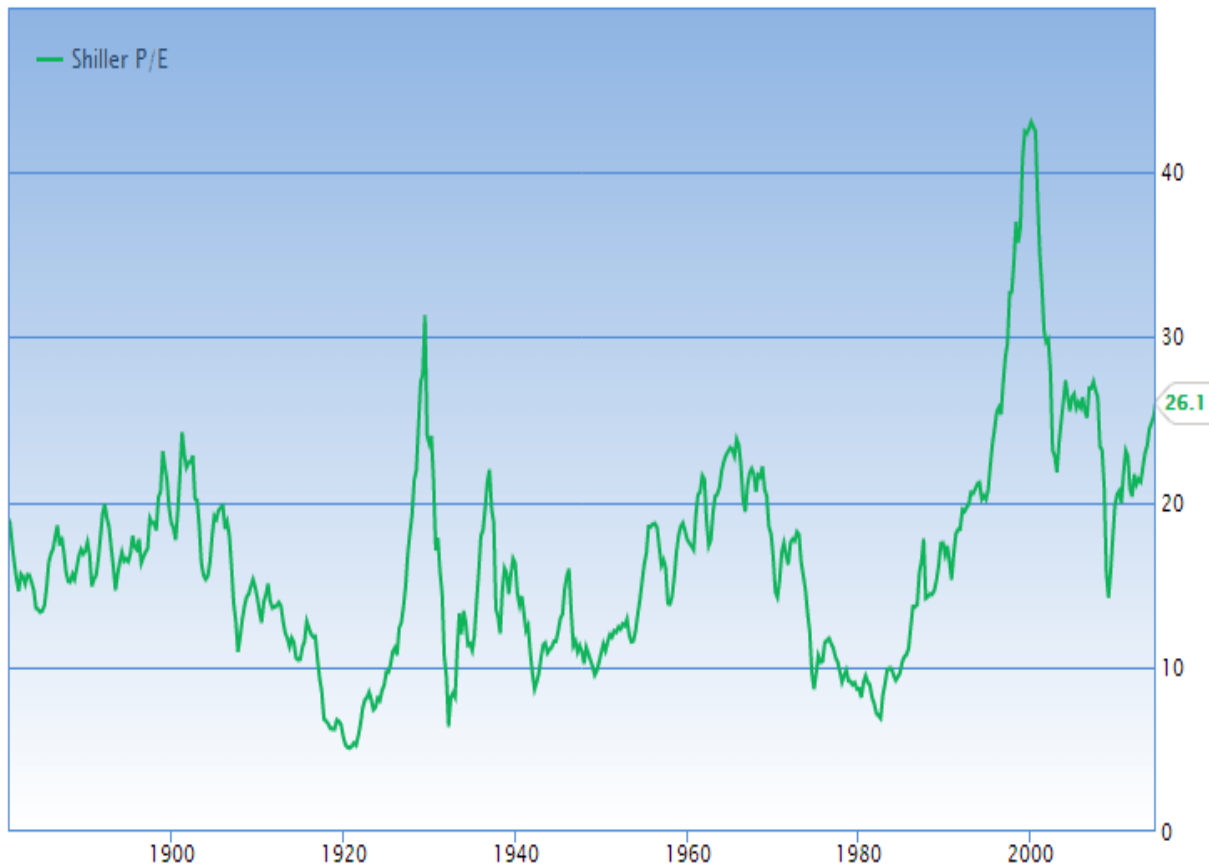
# S&P 500 Dividend Yield

*High prices low dividends*

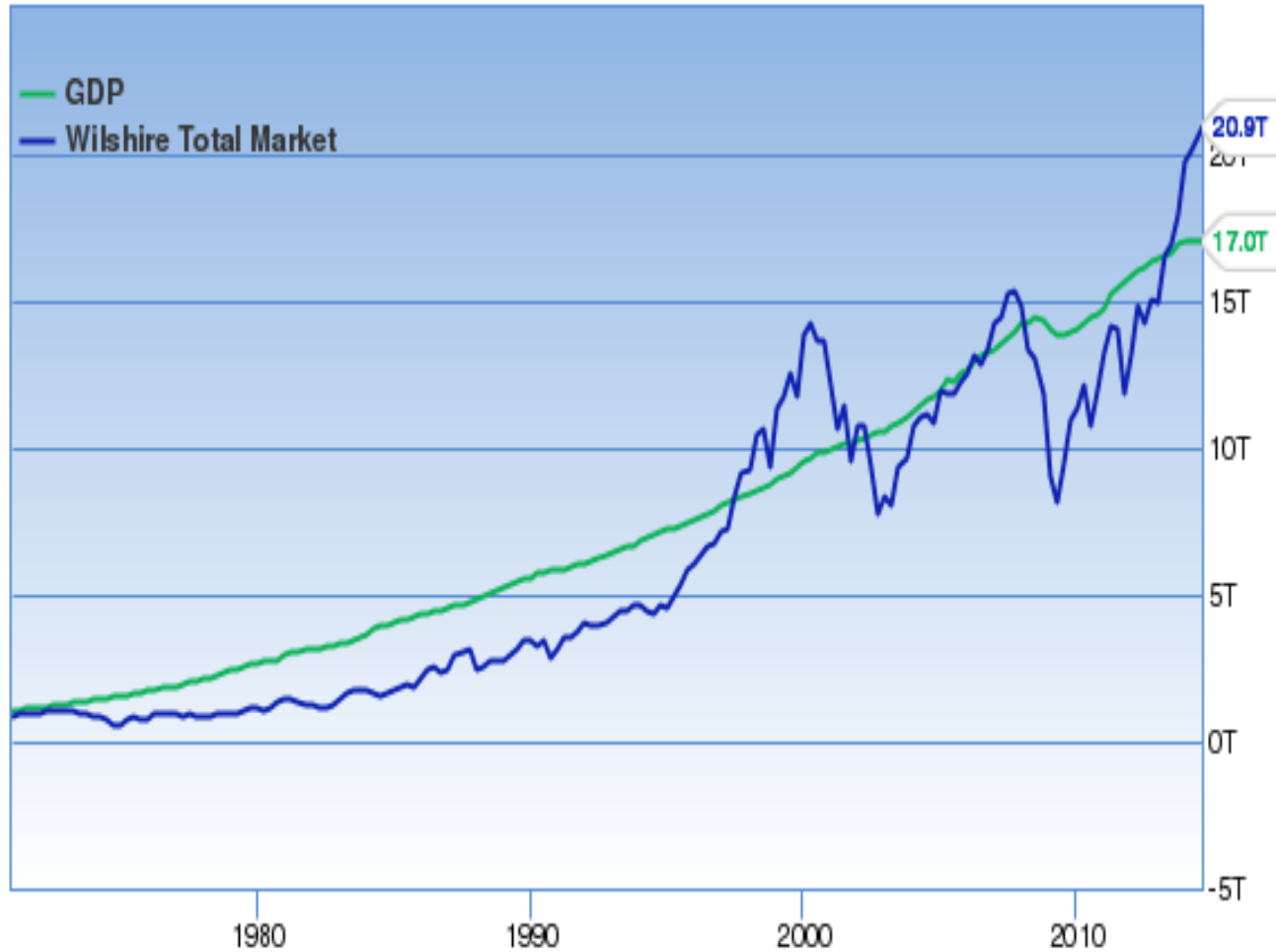


# Shiller Price/Earnings Ratio

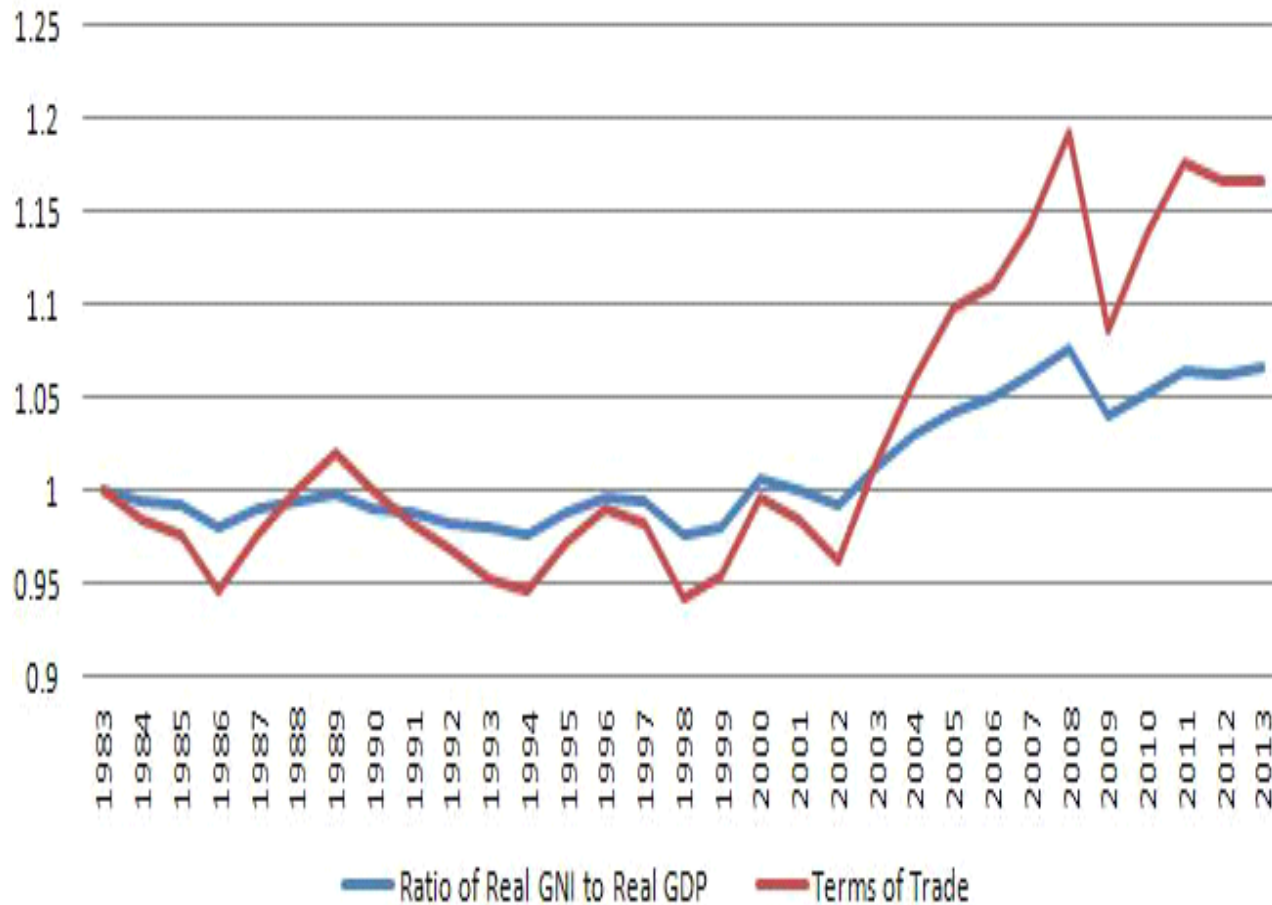
*Overvalued equity markets*



# US Market Capitalization Exceeds GDP

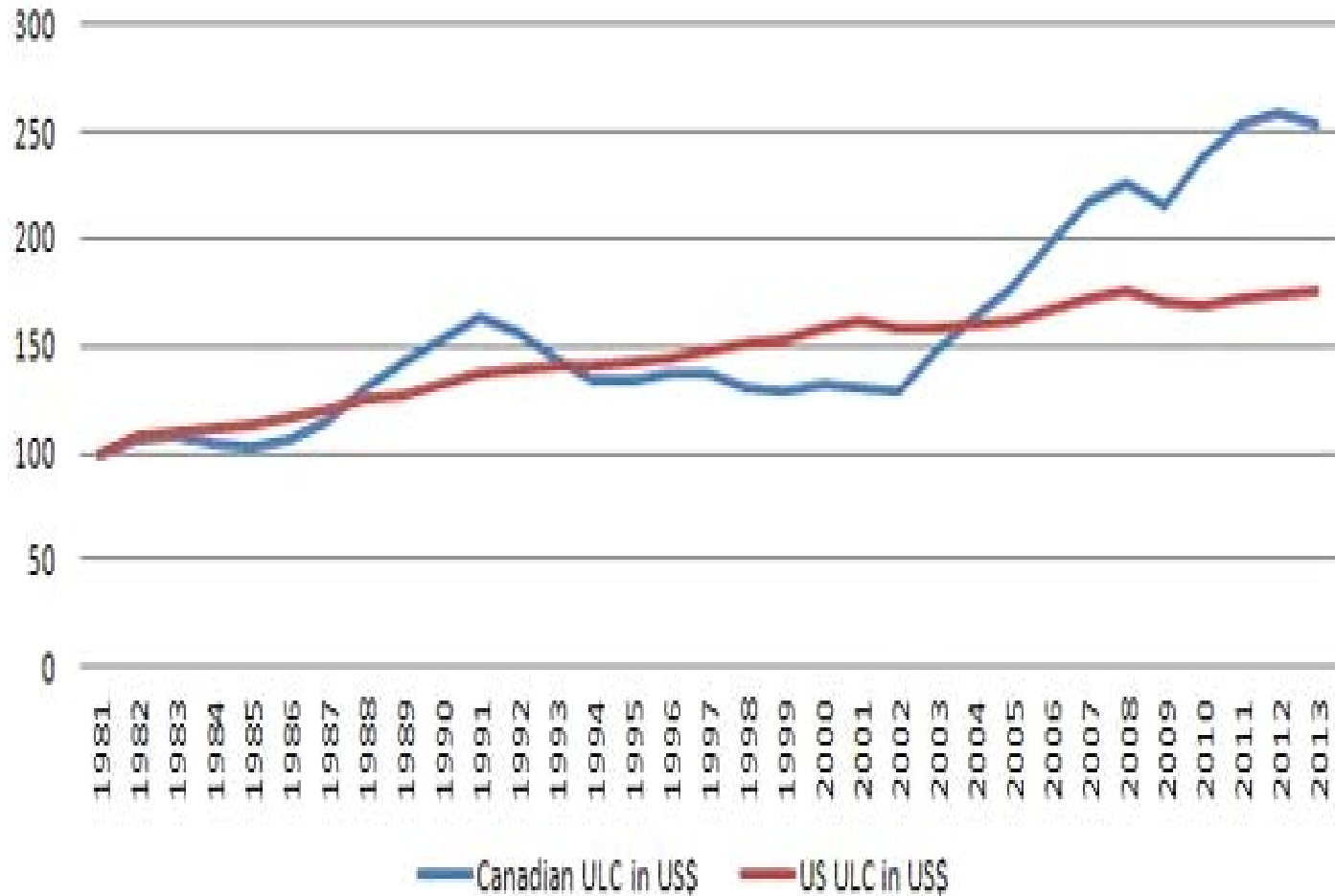


# Terms of Trade and Real National Income: Canada (Indexes 1983=1.0)

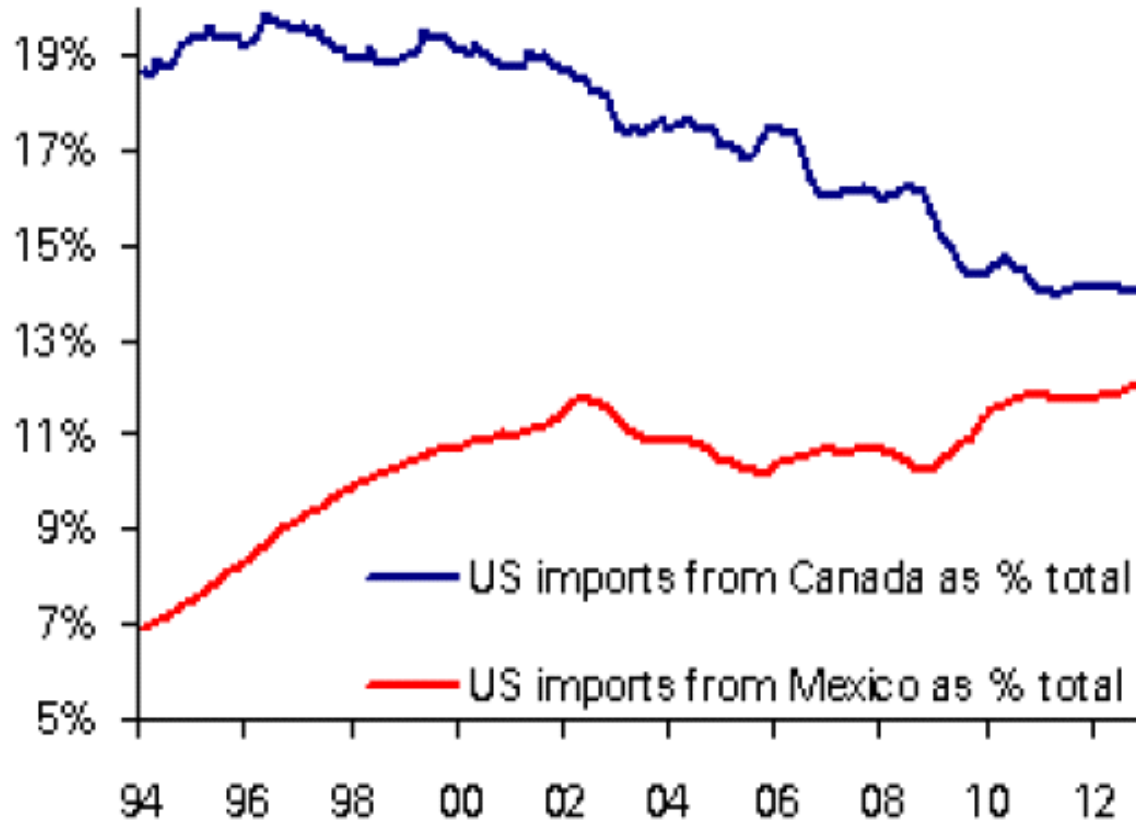




## Unit Labour Costs - Business Sector (Indexes 1981=100)



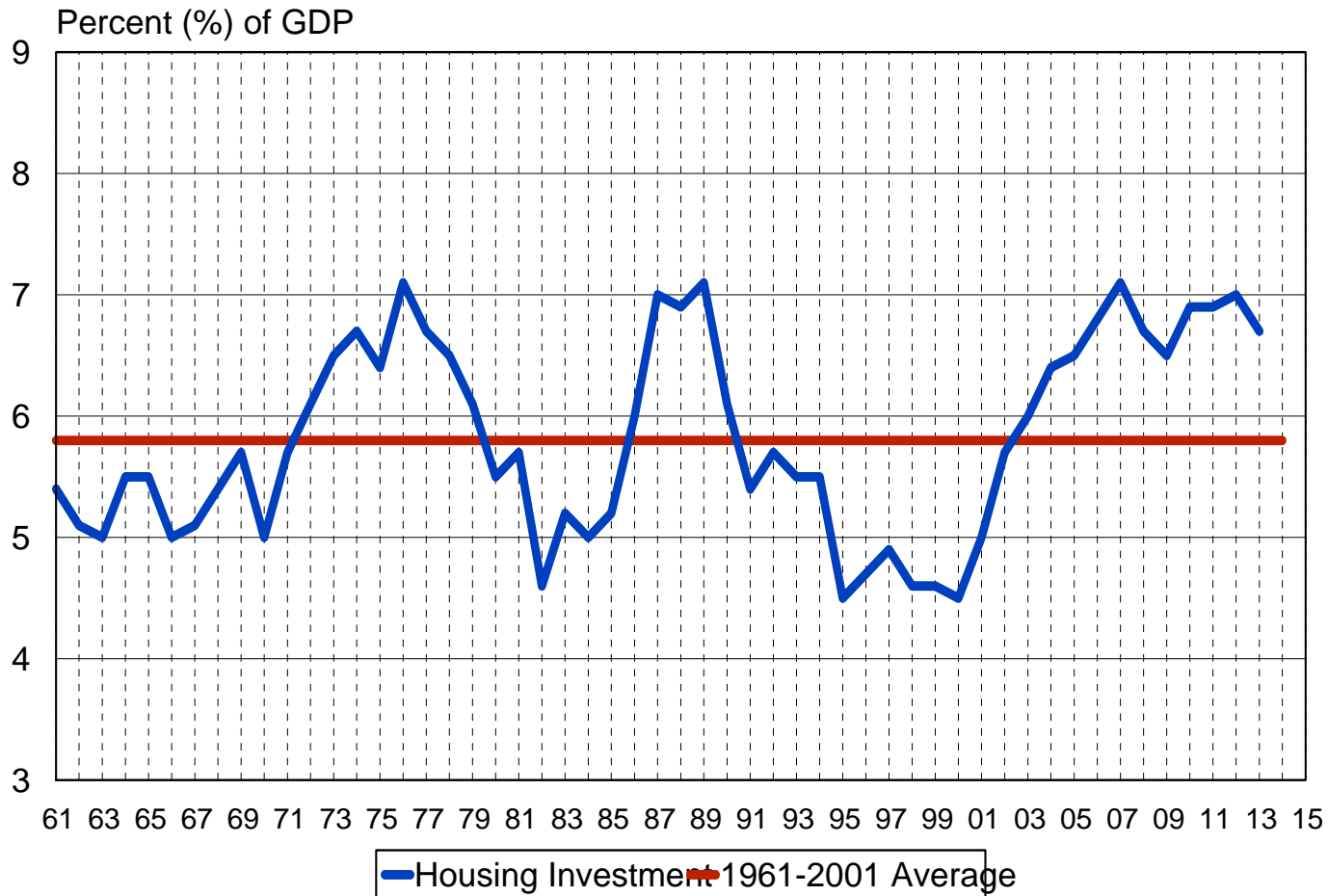
# Canada's Declining Market Share in US Market



Source: DB Global Markets Research, CEIC.

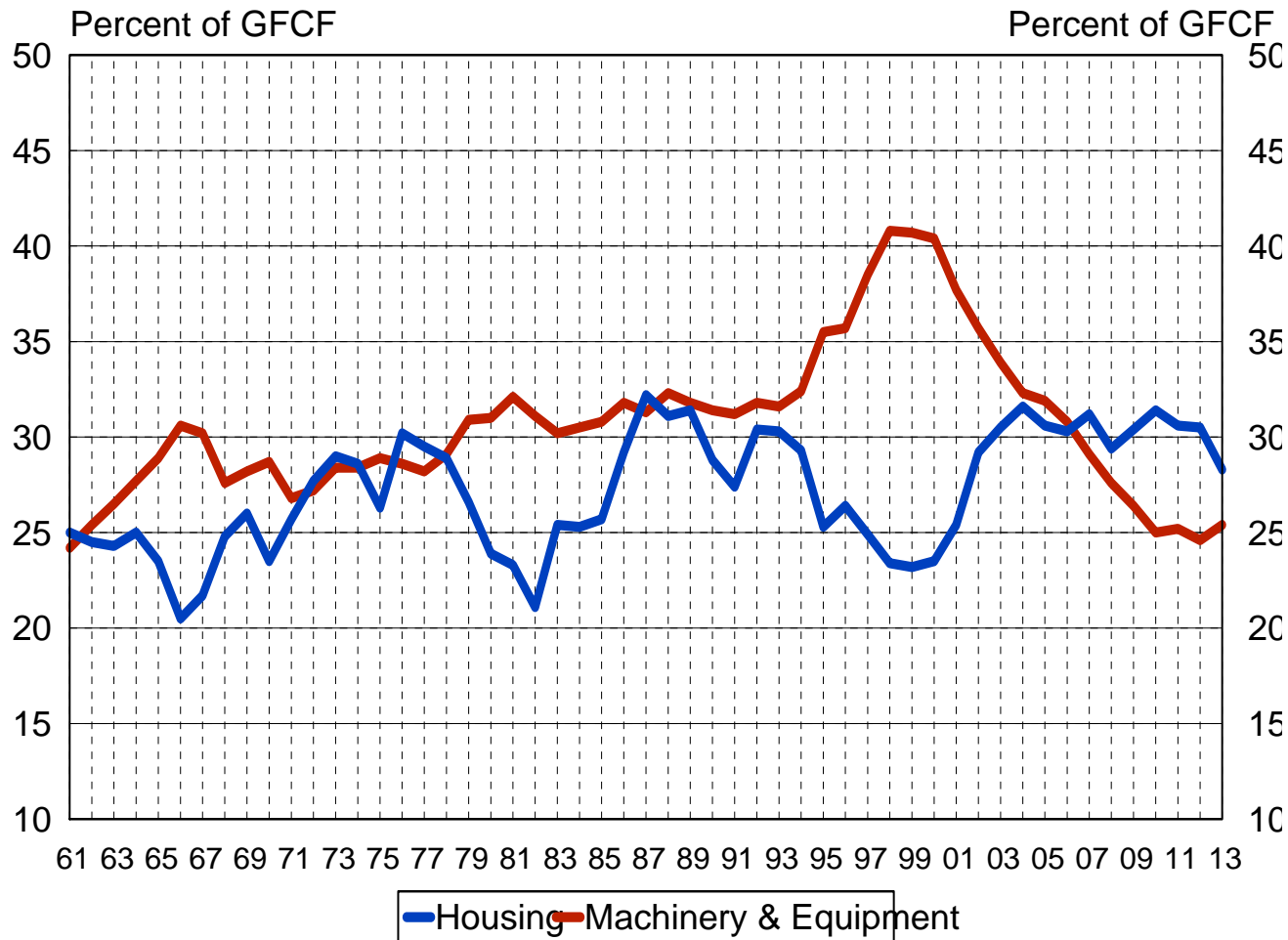
# Residential Housing Investment as a Share of GDP: 1961-2013

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



# Productive vs Unproductive Investment: 1961-2013

*Too much investment in housing which is unproductive not enough investment in machinery & equipment which creates wealth in the long-run*



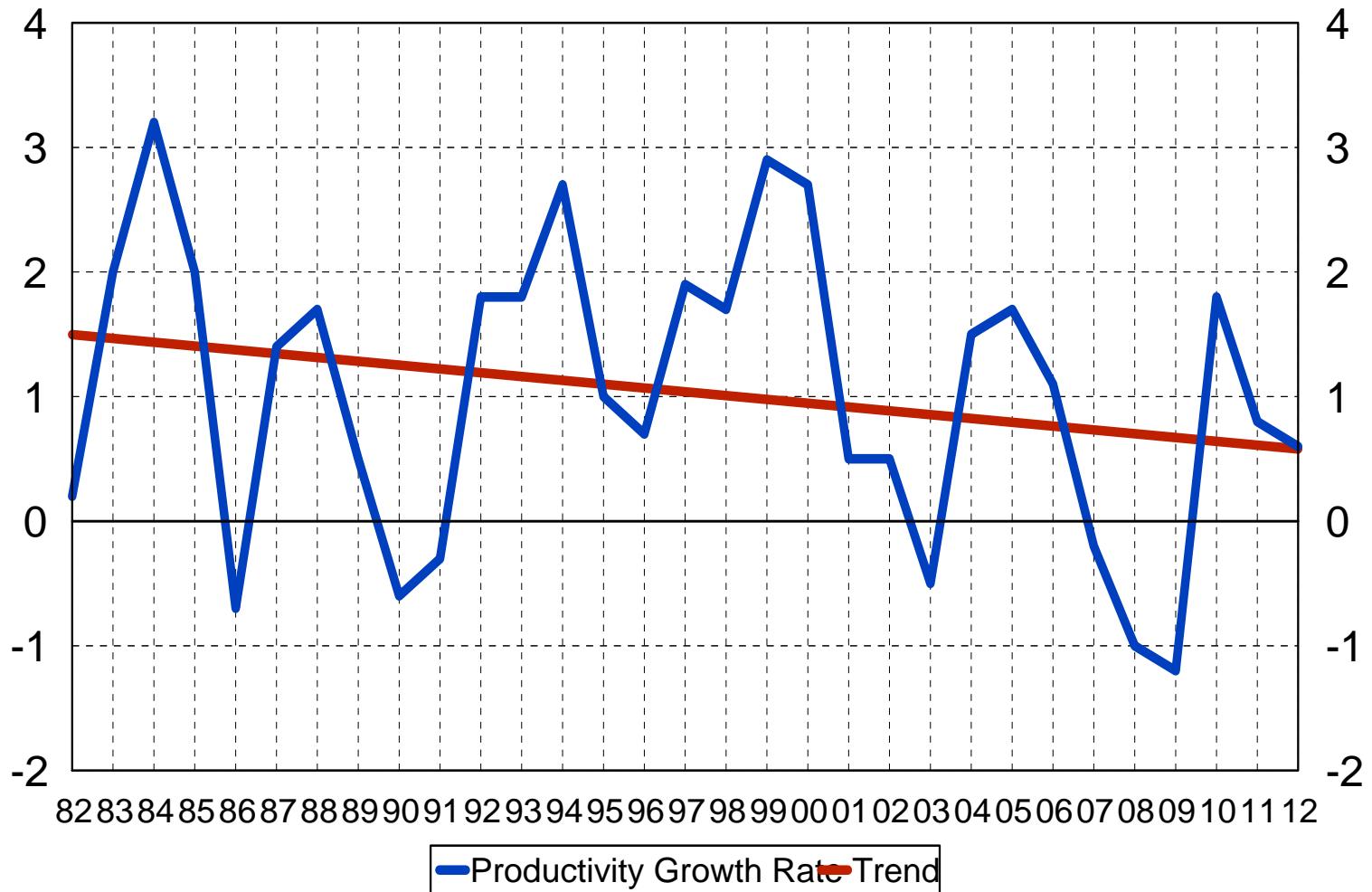
# Increasing Reliance on Mining, Oil & Gas

*Have we been overinvesting in energy extraction at the expense of other sectors of the economy?*

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

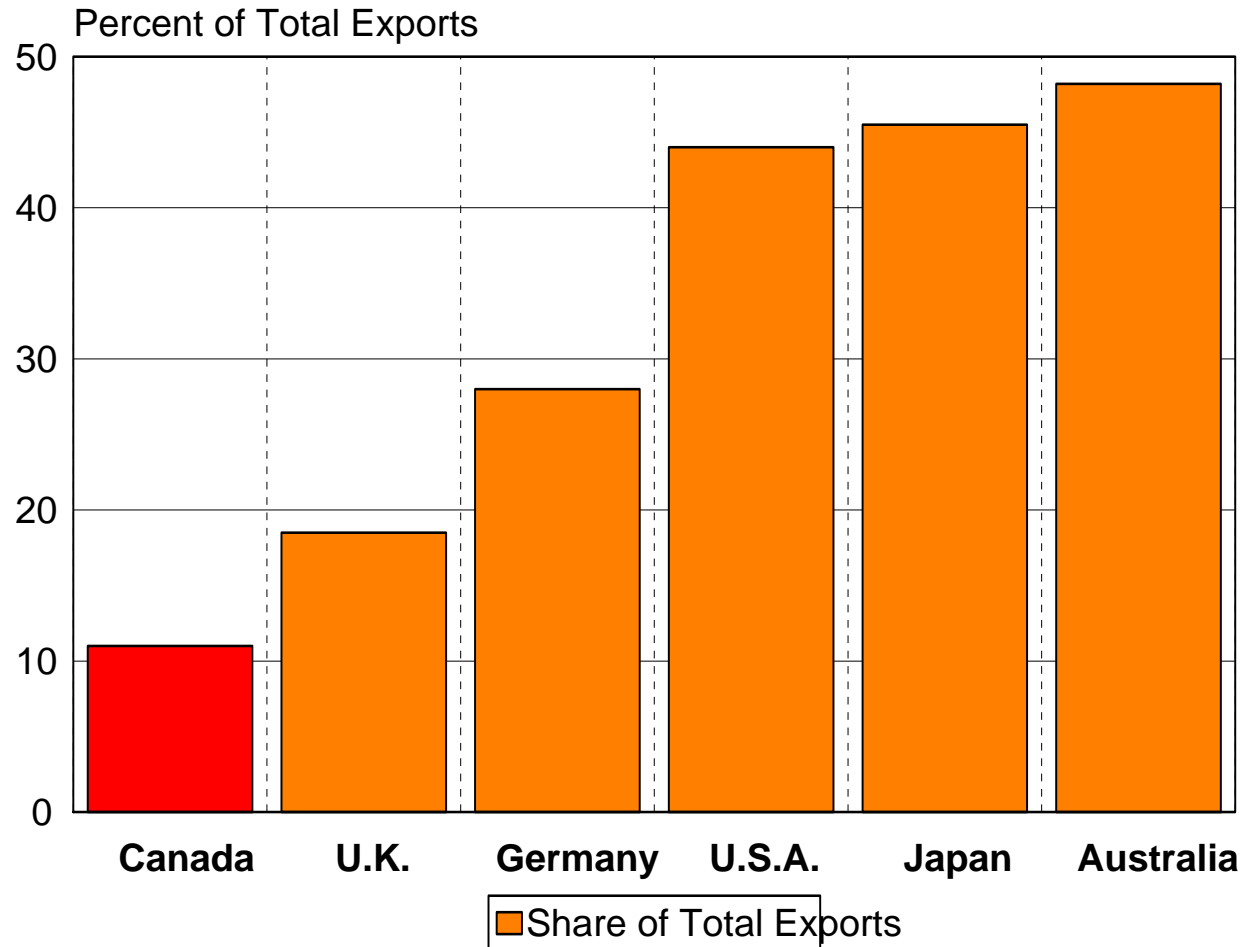
# Productivity Growth: 1982-2012

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



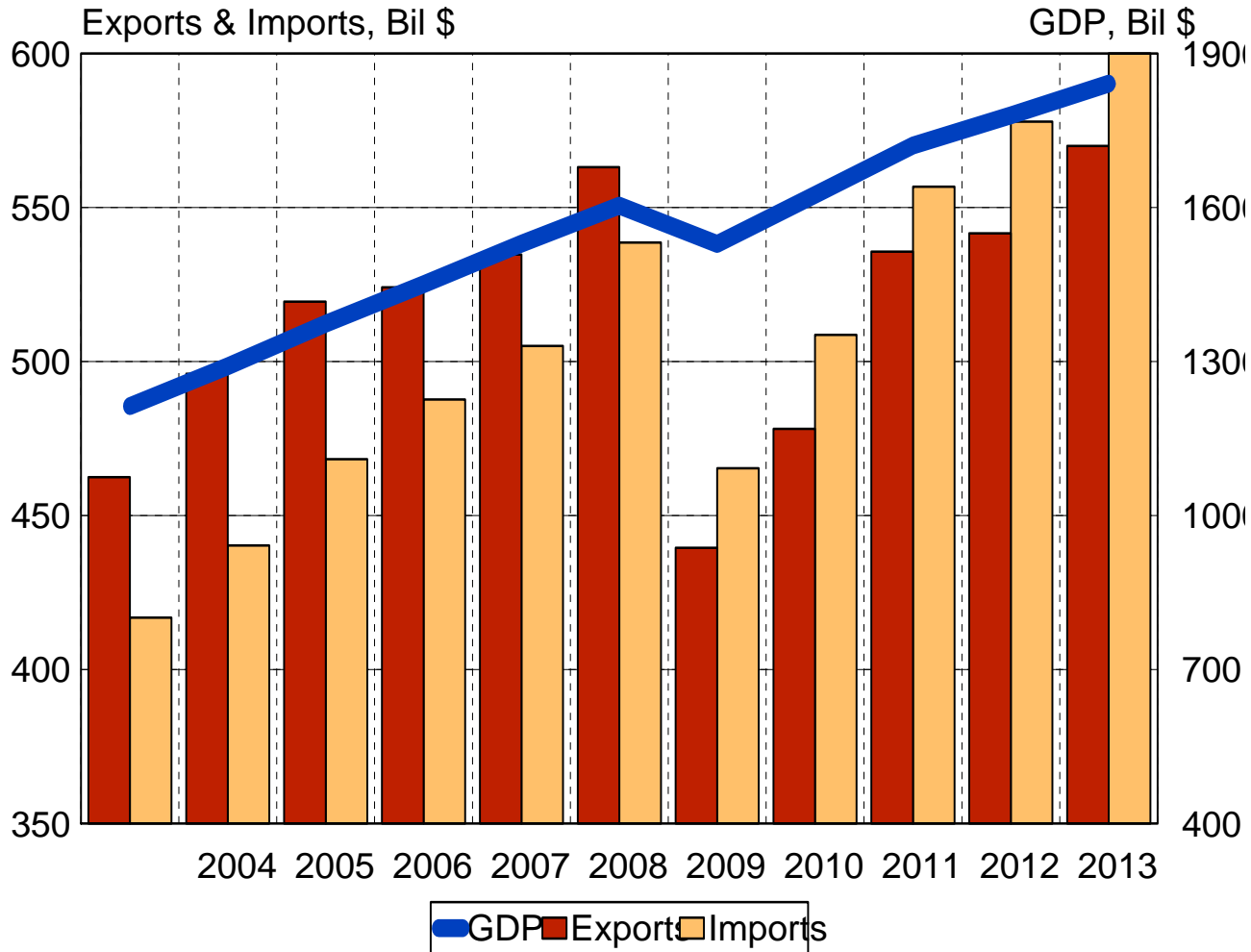
# Canada has a Small Exposure to Emerging Markets

*Canada has growth in Emerging benefited less from Economies*



# The Impact that the Global Recession of 2009 has had on our Exports and Imports

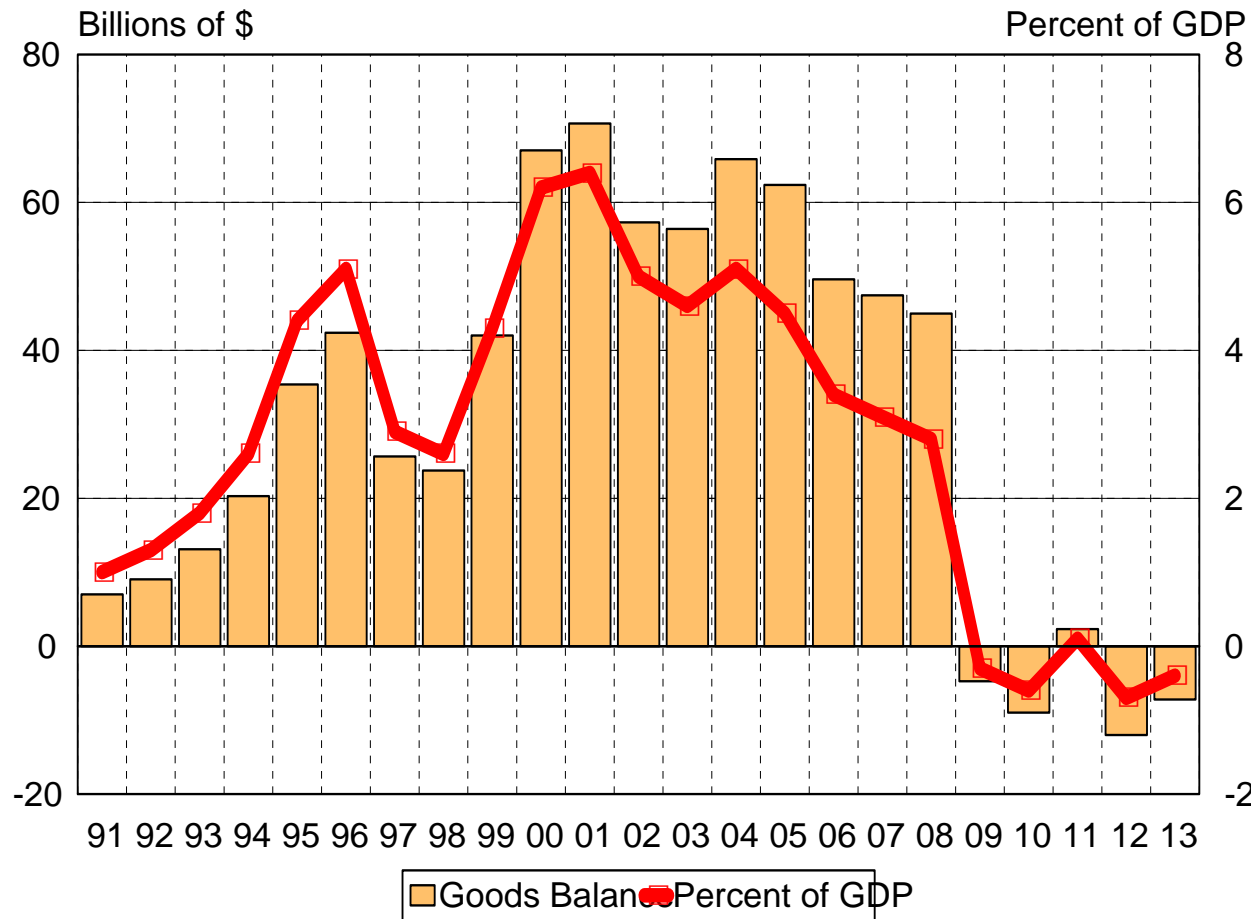
*Since the recovery, our imports have grown but our exports have recovered slowly*





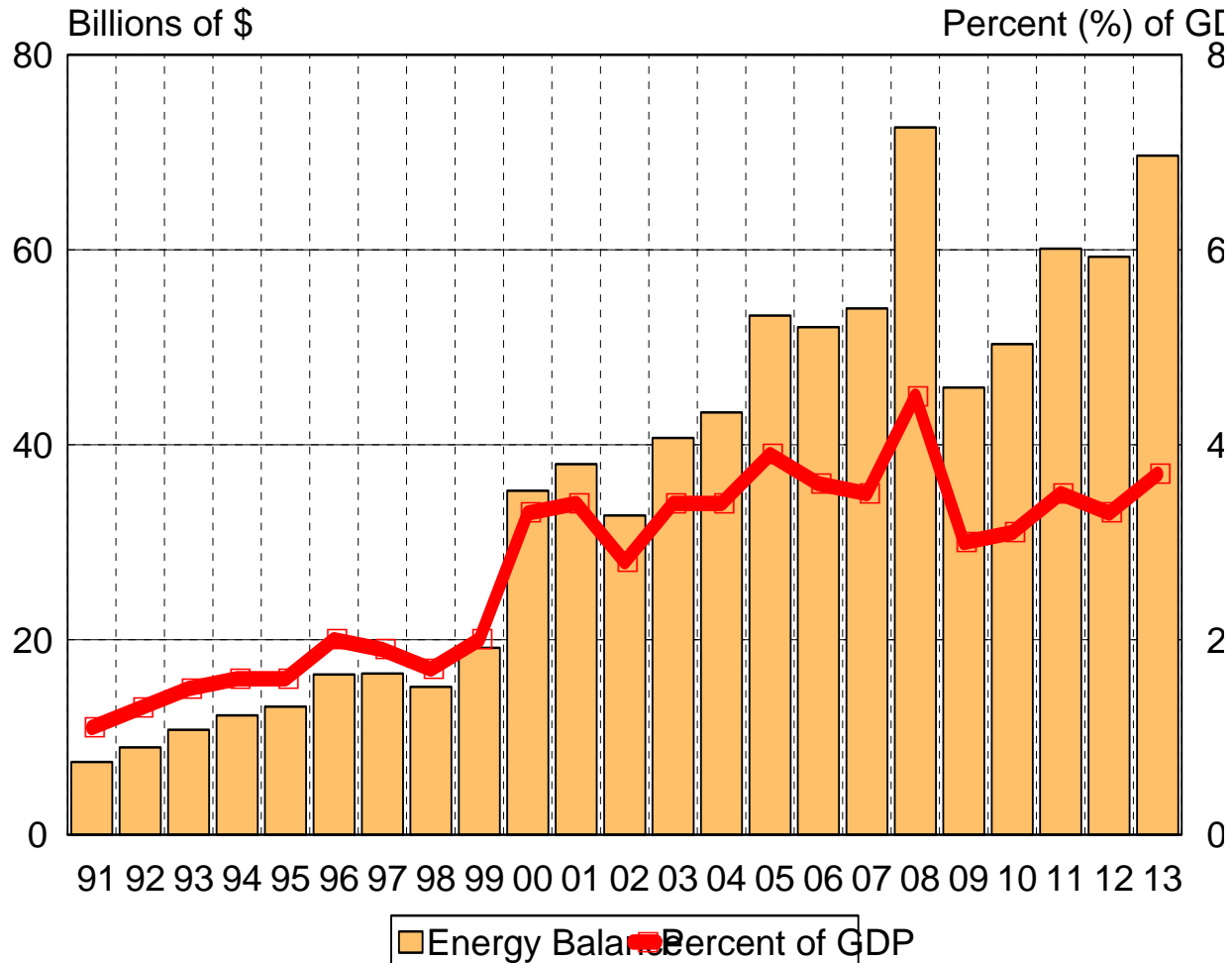
# The Effect of the Global Recession on Canada's Merchandise Trade Balance

*The Great Recession has injured Canada's merchandise trade balance severely*



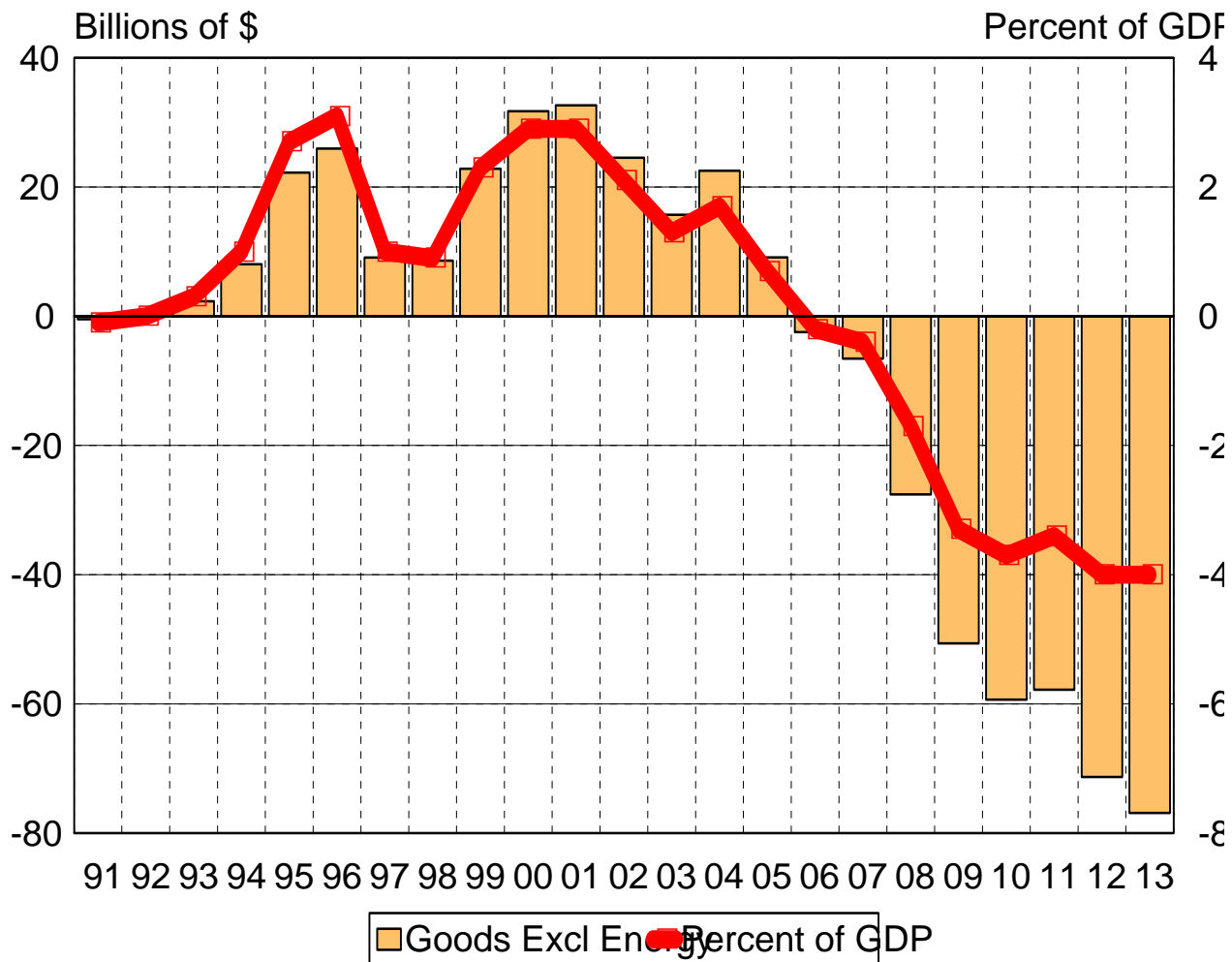
# Canada's Growing Dependence on Energy Exports

*We are increasing our reliance on the export of energy products*



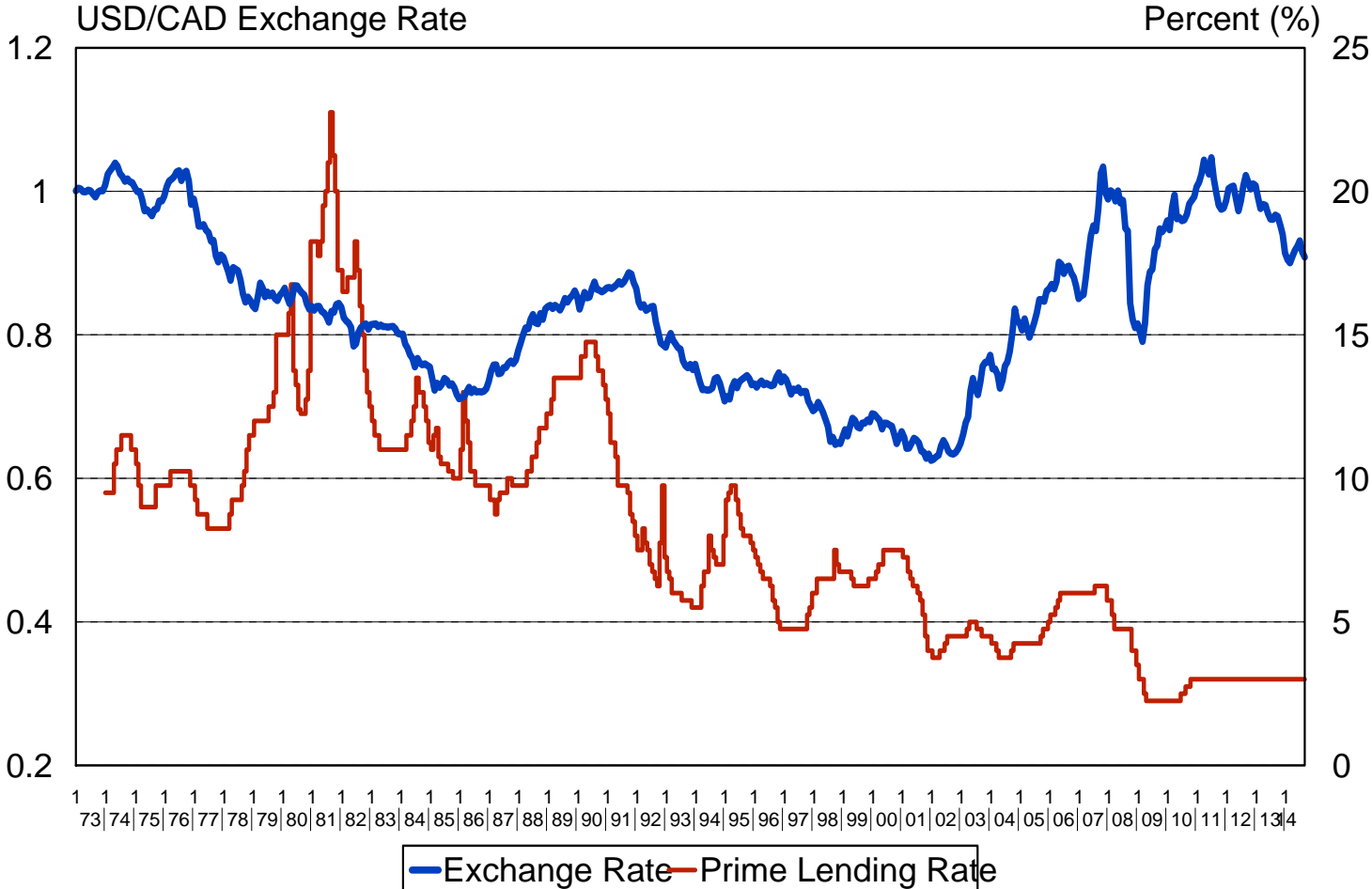
# Canada's Decreasing International Competitiveness

*When we exclude energy exports, we are running a growing deficit in our goods trade with the rest of the world*



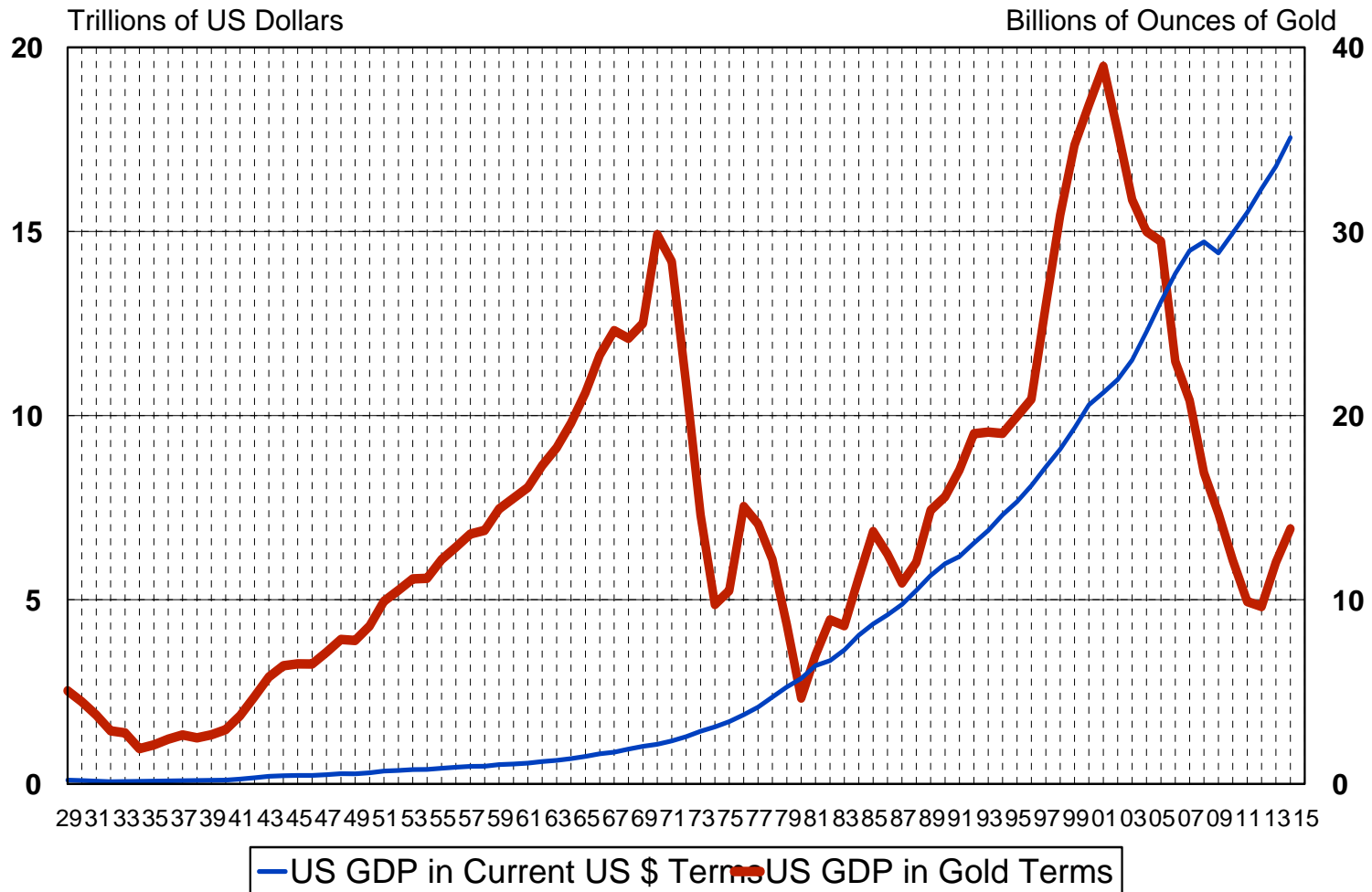
# Historically Low Interest Rates and a Strong Dollar Are Undermining Our Economy

*The combination of low interest rates and strong dollar have been a mixed blessing for Canada*



# US GDP IN NOMINAL DOLLARS vs. US GDP IN GOLD TERMS: 1929 – 2014

*A Resurging US economy will surprise the sceptics*



# Global Economic Environment

*Global economic growth is slowing with adverse implications for exports and debt dynamics of highly indebted nations*

- Europe is barely growing and flirting with deflation
- Growth in China is slowing, debt levels are rising too fast
- Japan continues to be mired in stagnation
- With the exception of India and Mexico, growth in Emerging Economies is slowing while debt levels are rising
- The supply/demand balance in the world oil market is shifting towards over supply
- Commodity prices are under downward pressure
- The only bright spot is the resurging US economy

# Implications for Canada

## *Mixed, Bumpy and Slow*

- Export growth to Europe and Japan will remain very weak
- Export growth to China will slow as China is shifting gears from an investment model to a consumer model and as growth in services will outpace growth in goods production
- Canada's terms of trade will deteriorate as commodity prices soften; GNI to GDP ratio will narrow
- Canadian growth will underperform US growth
- Exports to the USA will rise, while imports from the USA will slow
- Canadian dollar will continue to fall relative to the USD moving towards \$0.82 by the end of 2015
- Oil prices will remain soft and trend downwards towards \$65 USD a barrel
- Short-term interest rates to remain low and lag those in the USA
- Central Canada will outperform the Prairies, Ontario will outperform Quebec but the impact of the drop in oil prices will be net negative for Canada

# Risks to Canada's Economic Outlook

*Downside risks outweigh upside risks by considerable margin*

- Sudden correction to Canada's housing market
- Sudden rise in long-term interest rates
- Renewed crisis in the Eurozone
- Financial crisis in China and other Emerging Economies
- Geopolitical instability in the Middle East
  
- **WARNING:** These risks are inter-correlated, when combined they can create a highly explosive brew that result in another round of global financial instability
  
- **MITIGATING FACTORS:** A flexible exchange rate and fiscal automatic stabilizers will partly cushion the impact of adverse moves on Canadians



# Thank You.

[www.canbekeconomics.com](http://www.canbekeconomics.com)

E-mail: [canbekeconomics@videotron.ca](mailto:canbekeconomics@videotron.ca)

514-884-6962