

# Recovery: Canada Will Be Stronger than U.S.

Dr. Sherry Cooper, Chief Economist

Fiscal and monetary stimulus in North America and abroad are kicking in, signalling an economic recovery has begun (*Chart 1*). The 45% rise in stock markets since early March reflects this improving outlook. Even the perma-bears are having trouble denying the positive signs. The Canadian economy is bouncing back faster than the States. American consumer confidence declined for the second month in a row in July. Confidence, which had rebounded strongly in late spring, has faded as worries about jobs offset any enthusiasm about the resumed stock market rally.

Certainly, the souring consumer outlook in our neighbour to the south presents an obstacle for retailers' critical back-to-school season. An improving job picture is vital in boosting consumer confidence and spending. Job security is a key factor in shoppers' willingness and ability to buy, so confidence is likely to improve only gradually and is not likely to return fully to healthy levels until 2011.

Nevertheless, the first glimmer of hope is there: the number of Americans drawing unemployment insurance benefits fell back to April levels, receding for the third consecutive week. According to the latest Fed Beige Book, the pace of the recession has slowed or stabilized in most areas. Be that as it may, regional respondents report protracted weakness in the job market even as the economy transitions to recovery. Meantime, other economic indicators have been more upbeat. The leading indicators index rose last month for a third consecutive month, reinforcing signs the economy may be emerging from the worst recession in 50 years.

Corporate earnings have improved somewhat and companies that a few months ago were too fearful to project their future earnings are now seeing evidence of an upturn in the year ahead. According to data compiled by Bloomberg, about three out of every four S&P 500 companies that released results since June 17 have exceeded analyst Q2 profit estimates. The data show they've beaten forecasts by an average 9%, even as overall earnings tumbled 31%.

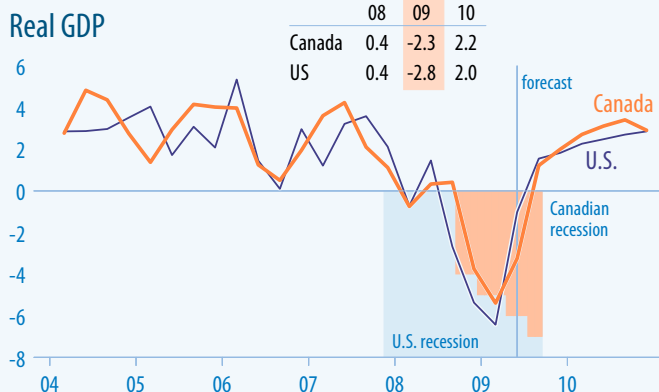
U.S. manufacturing orders are showing some signs of stability after months of declines that came as

factories shut down, cut their inventories and scaled back production as they confronted the worst recession in decades. Excluding volatile orders for transportation equipment, manufacturers' orders rose 1.1% in June.

The pummelled housing sector in the U.S. is showing signs of healing and the Canadian housing market has revived sharply from a relatively short period of shock-induced suspended activity. The closely watched Case-Shiller U.S. home price index for May posted its first monthly rise since the summer of 2006, suggesting that house prices might finally be stabilizing. U.S. existing home sales registered their third monthly rise in June and new home sales increased at the fastest pace in more than eight years. The inventory of unsold homes is at last edging downward as buyers take advantage of bargain prices.

**CHART 1**  
**RECESSION TO END IN 2009 H2**

(q/q % chng : a.r.)



New home construction, while still weak, picked up in June after strong gains in May. Housing starts and construction permits are surging after hitting all-time lows in April. According to the Commerce Department, building permits, a sign of future construction, rose 8.7% last month, the biggest gain in a year. Any resumption in building bodes well for the much-depressed Canadian forest products industry.

The global housing slump, now in its fourth year, may be stabilizing. Smaller job losses, rising stock prices and an improved manufacturing outlook provide more evidence that efforts to stem the financial crisis and lower borrowing costs may be paying off. The auto companies, now all out of bankruptcy, are poised to step up production and the 'cash-for-clunkers' programs in the U.S. and Germany have spurred sales. Retailers are beginning to restock their shelves after spending the past several months depleting a backlog of inventory. China and other emerging economies are showing even more pronounced improvement, which would spur U.S. exports and thereby Canadian exports as well. The resulting rise in commodity prices augurs well for the materials sectors of our economy, offset only in part by the surge in the Canadian dollar. Finally, forecasters are revising up, not down, their global economic forecasts.

Despite the incoming good news, however, forget a V-shaped recovery. The U.S. upturn will not be rapid. Even as companies begin cranking up production to replace depleted inventories, Americans who are out of work—or are fearful they may become so—will likely be disinclined to spend money.

**In contrast, the outlook is more positive for Canada's economy.** Canadians are willing to open their wallets owing to the relative strength of personal income growth and the more moderate loss of jobs. Furthermore, they are not nearly as debt burdened as Americans. Canadians have boasted high housing equity relative to mortgage balances. Enjoying improved affordability, realtors report increasing activity across all provinces. Housing construction is strengthening. Canadian housing starts in June were up to 140,700, having risen since early spring. This construction activity is broadly based, encompassing both the singles and multiples segments and the outlook is bright. CMHC is expecting housing starts to improve throughout 2009 and over the next several years to gradually become more closely aligned to demographic demand, which is currently estimated at about 175,000 units per year.

As well, Canada is not hampered by the overwhelming deficit and debt loads of the U.S. federal government. We have the lowest government-debt-to-GDP ratio in the G7 thanks to the deep restraint of the early-to-mid 1990s. Even with the recent return to deficit spending, our government bond yields are below those in the U.S. and the gap is likely to widen in our favour in coming years. Recent mammoth U.S. Treasury auctions have not been going well, a portent of what is to come.

We are expecting a 1.2% rise in Canadian GDP in Q3, and have revised up our 2010 forecast to 2.2%, with upside risk. The U.S. will emerge from a deeper recession with growth likely in Q3. The one relative advantage for the U.S. is the improvement in net exports owing to the decline in the U.S. dollar. The converse is true for Canada but this effect is mitigated by the improvement in our terms of trade (the price of our exports relative to the price of our imports). It is essential for Canada's continued future prosperity that we trade relatively more with countries outside the U.S., especially with the rapidly growing emerging economies of China, India and (to a lesser degree) Brazil and Russia.

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