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Economic & Financial Outlook 2010

Economic Dinner

**Toronto
November 24, 2009**

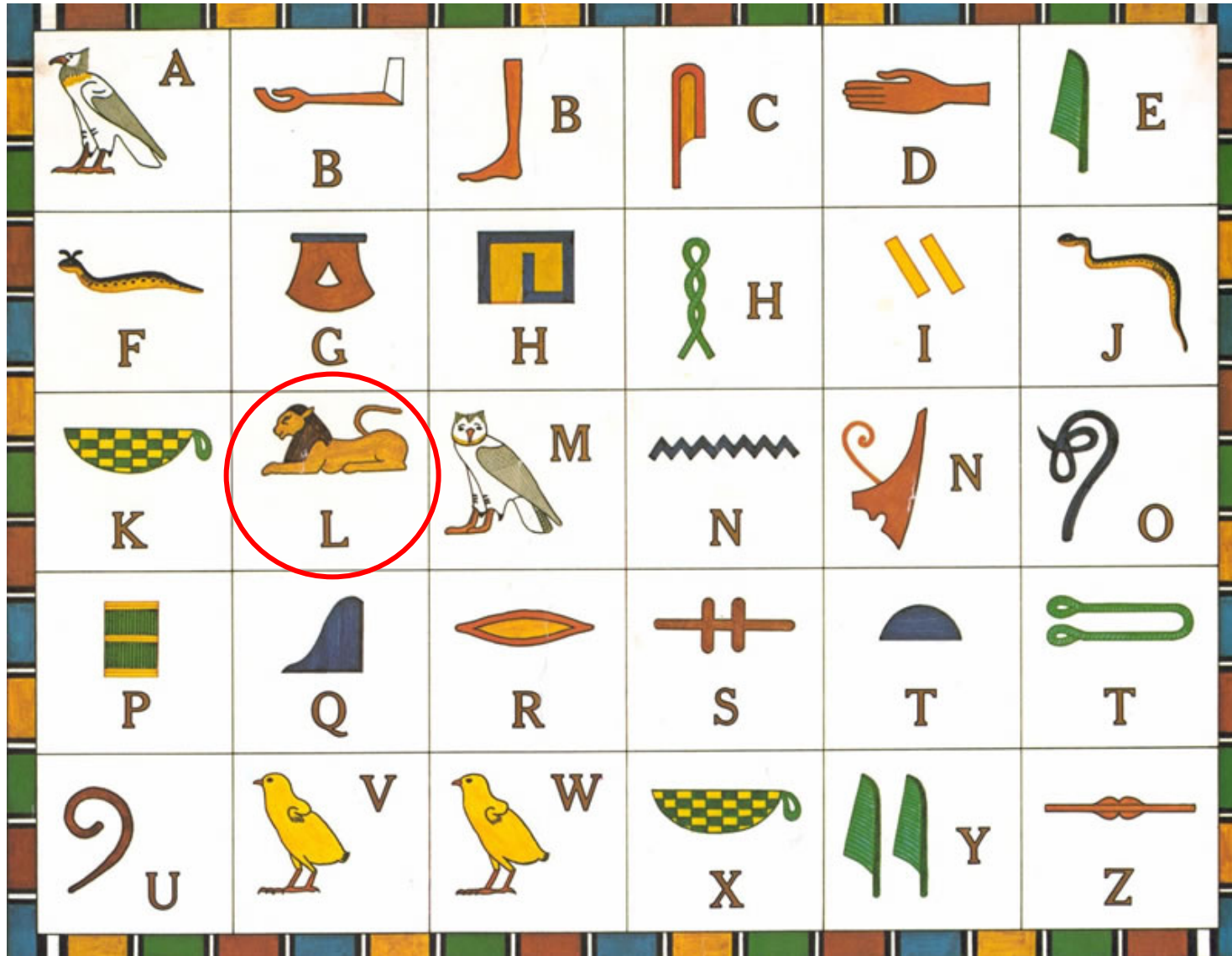
Stéfane Marion
Chief Economist and Strategist

Outlook 2010: Welcome to the year of the scribe !

“The letter I would choose to describe the course of the recovery doesn’t exist in our alphabet, but if I were to describe it, it would look something like an “L” with a gradual upward tilt of the base”

Janet Yellen
President of the San Francisco Federal Reserve
November 10, 2009

A lion shape recovery?



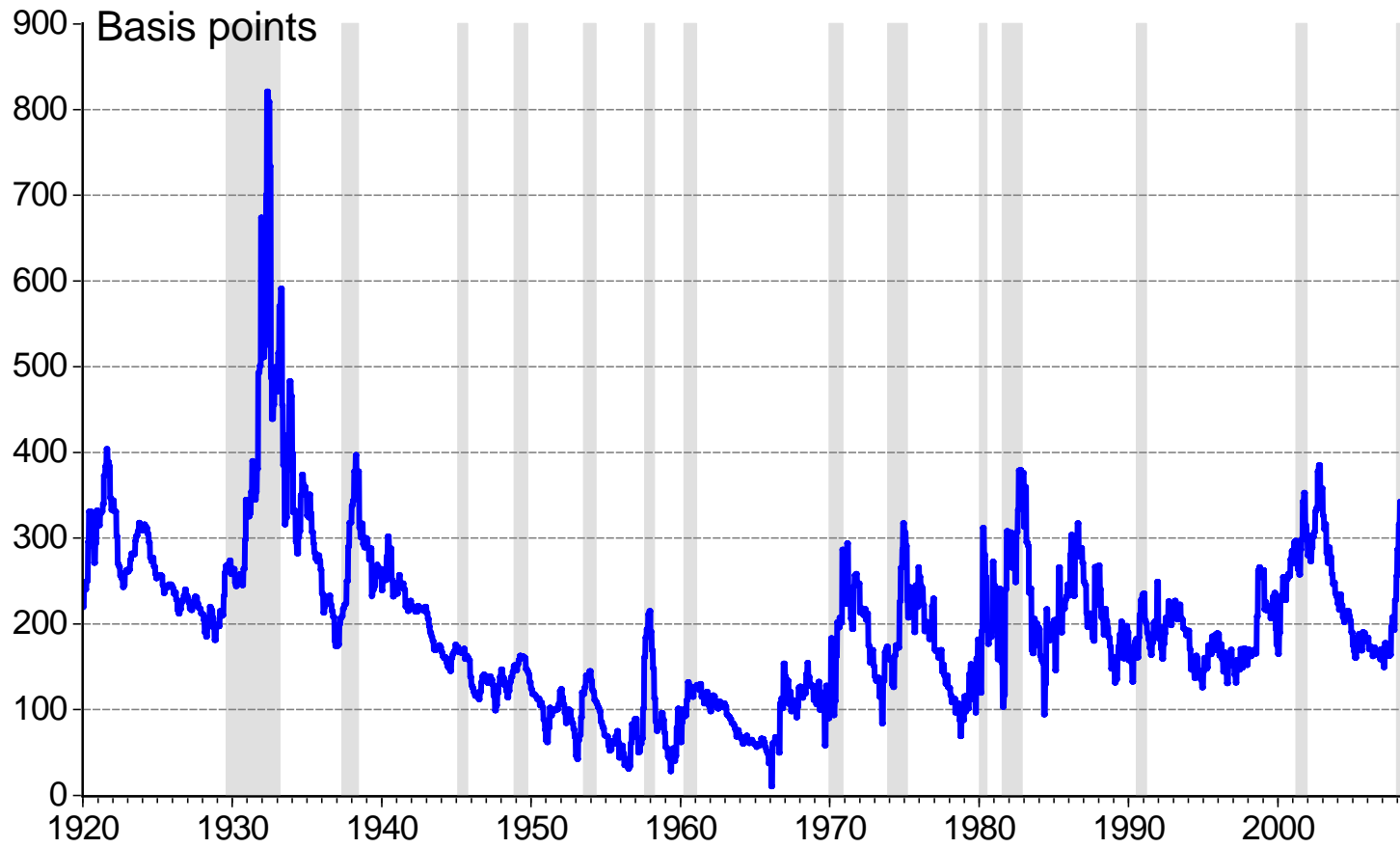
***Our view
(just the numbers, no letters):***

***Real GDP to « roar back »
3% to 4% in 2010
and grow 2 to 2.5% after that***

***And yet the year
began very badly***

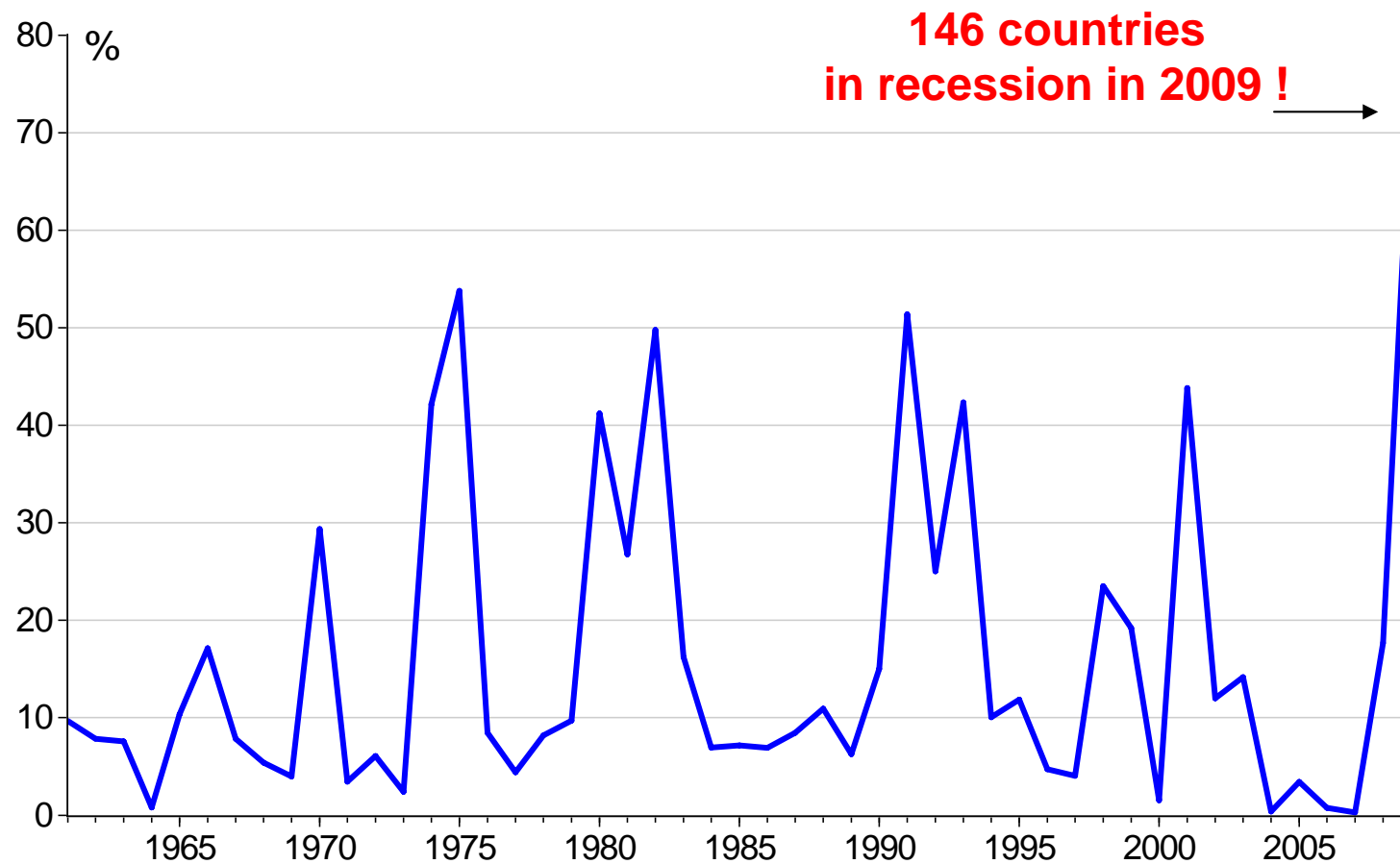
Credit was no longer available...

BAA less 10-year Treasury



NBF Economy & Strategy (data from NBER)

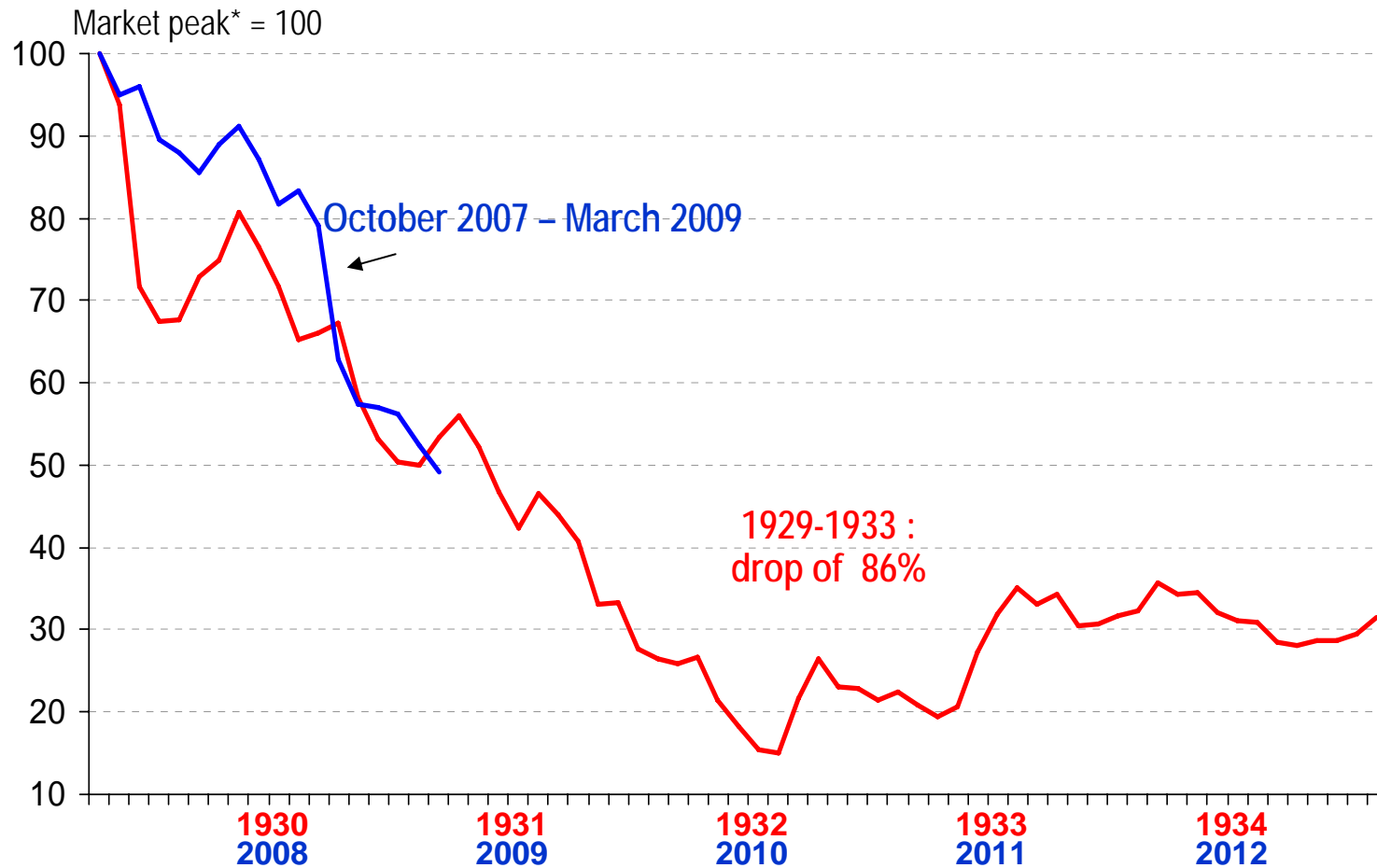
...75% of countries were in recession...



NBF Economy & Strategy(IMF, WEO April 2009. p.14)

...equities were down more than 50%

S&P 500: The 1930s vs. now



* septembre 1929, octobre 2007

Économie et stratégie FBN

*The media was
foreseeing a
repeat
performance...*



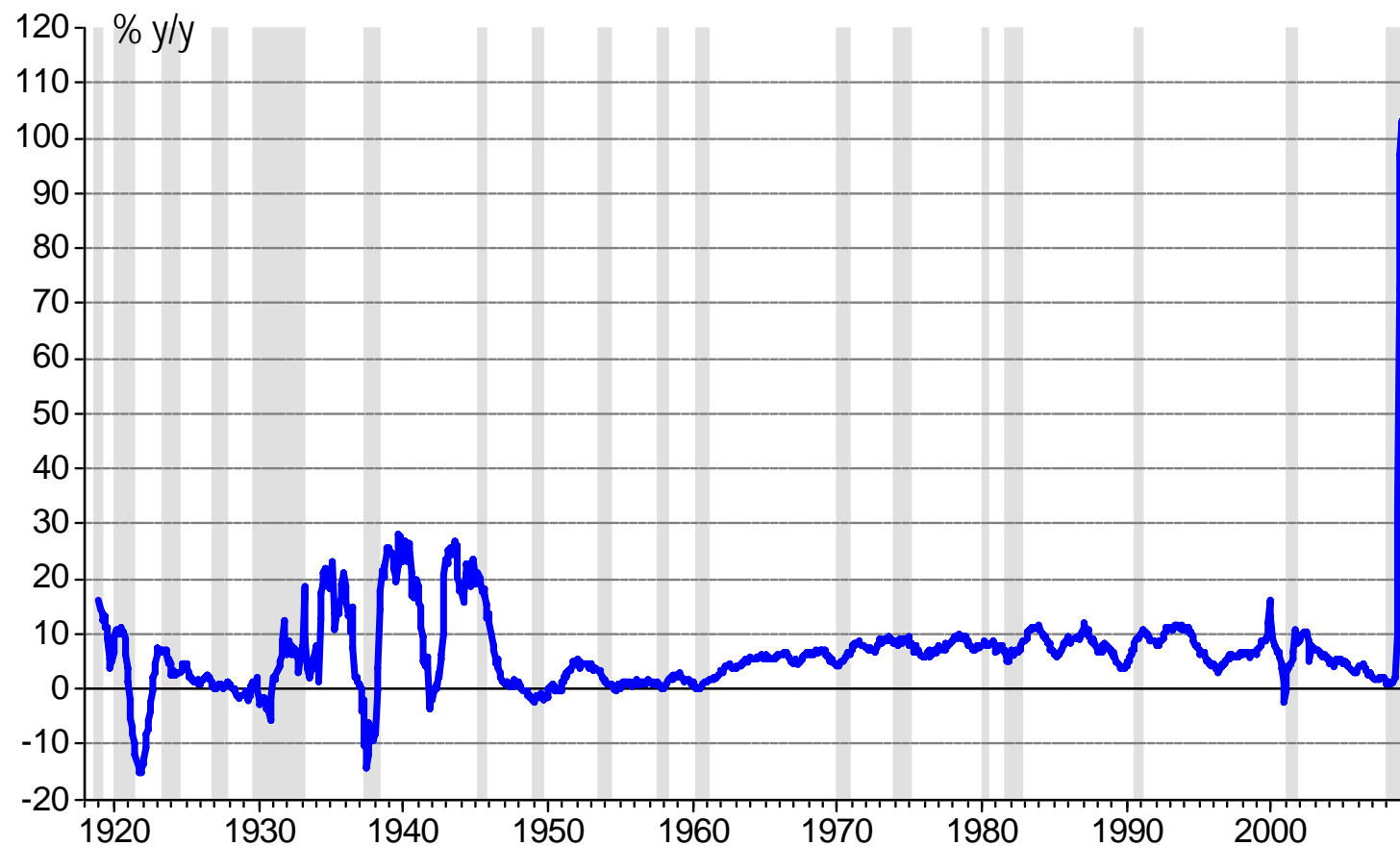
**«Those who cannot remember the
past are condemned to repeat it »**

Georges Santayana
(Writer-Philosopher 1863-1952)

***Luckily, central bankers have a
good long-term memory***

U.S.: A monetary easing for the record books ...

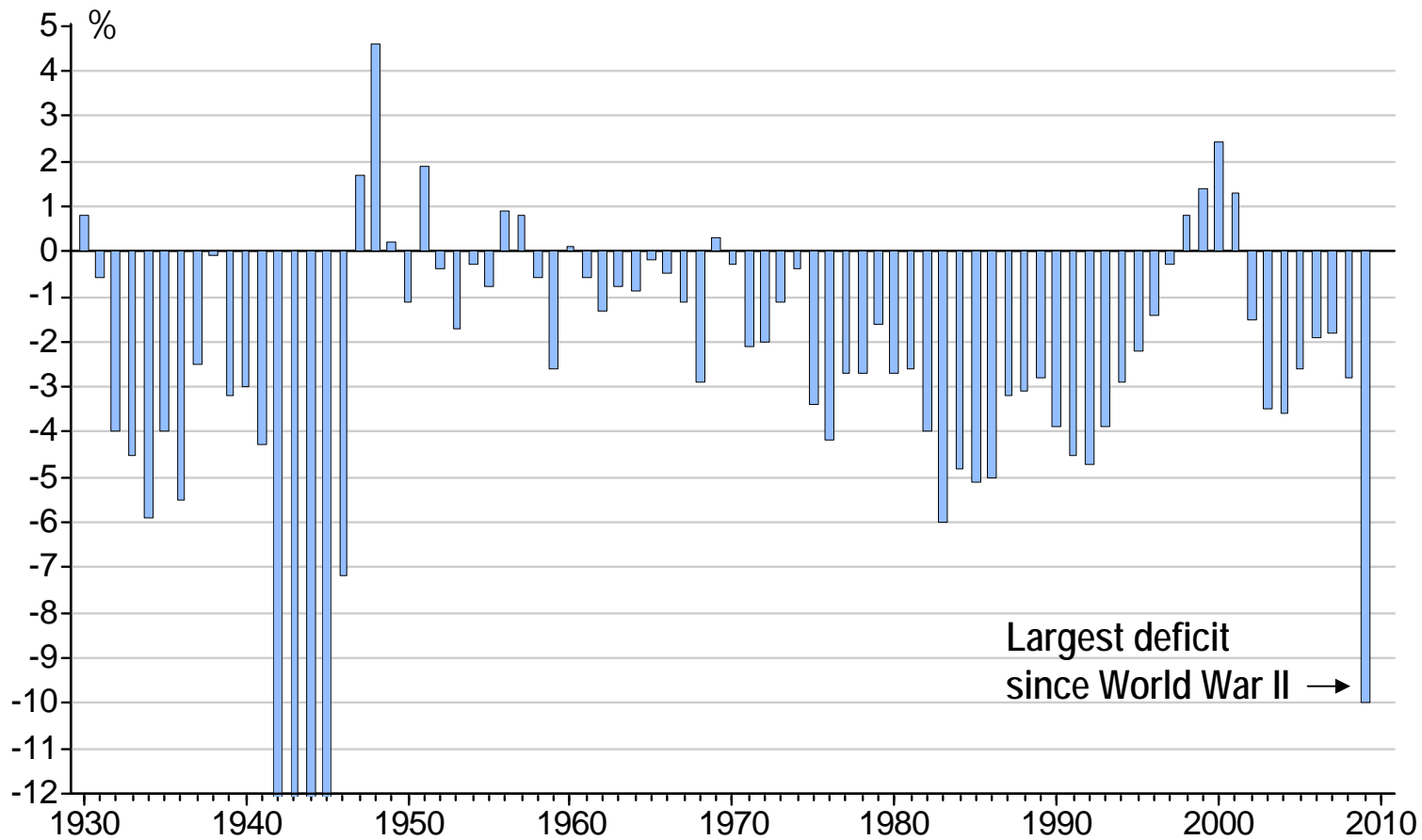
Monetary base



NBF Economy & Strategy (data from Federal Reserve Bank of St. Louis)

... combined with massive fiscal stimulus ...

U.S. federal fiscal balance as % of GDP

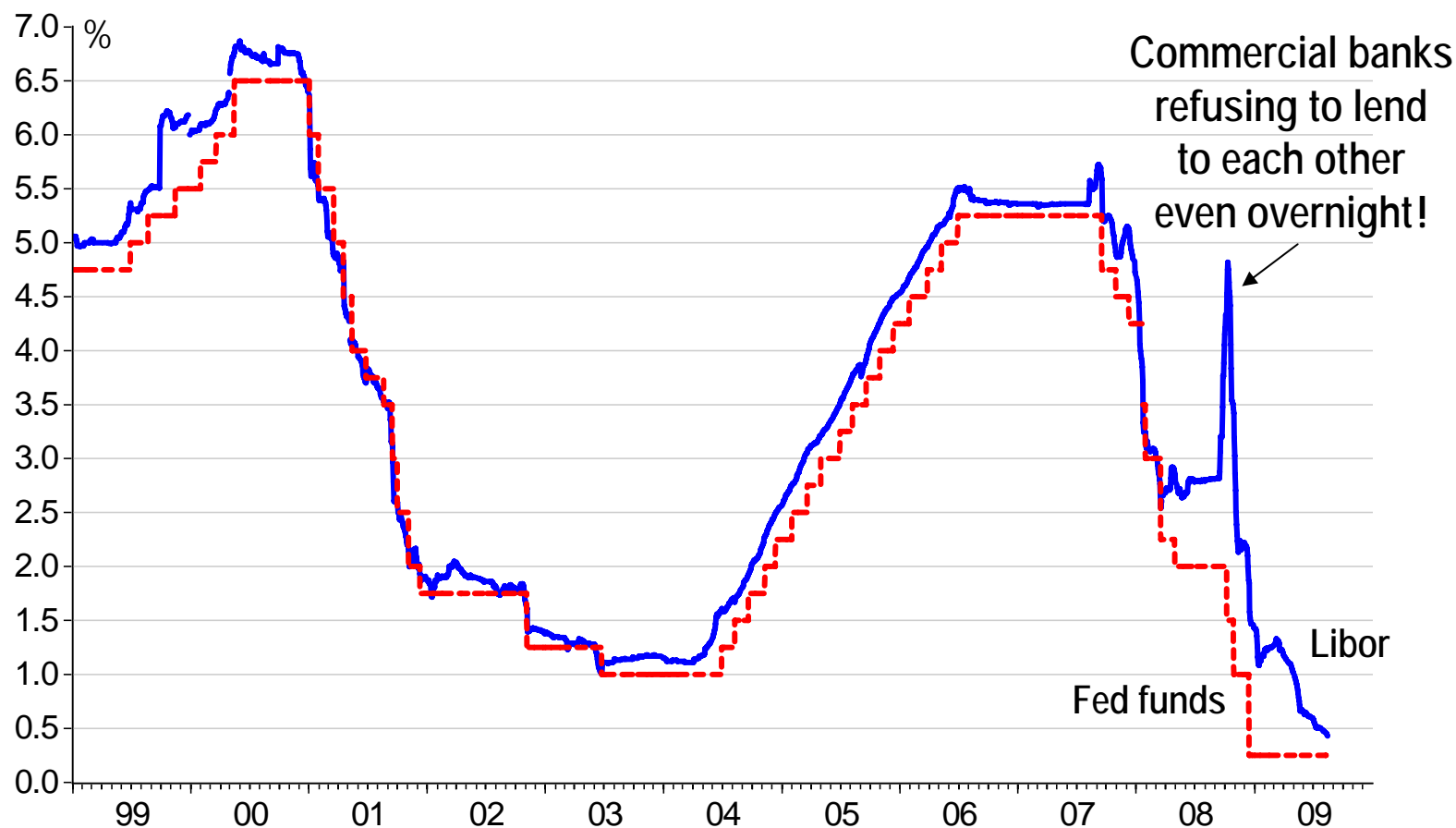


Largest deficit since World War II →

NBF Economy & Strategy (historical data from OMB)

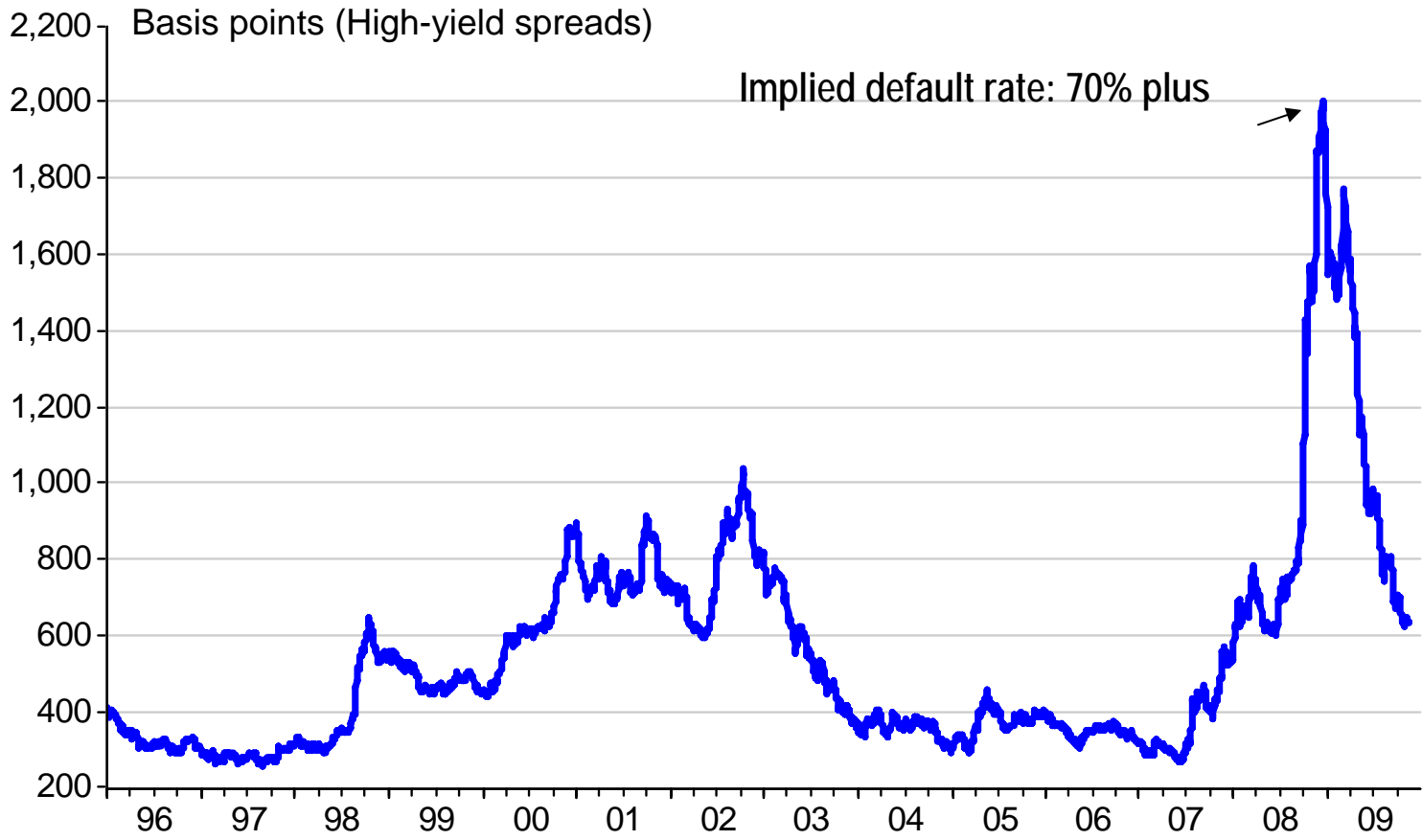
... a normalization of credit markets ...

Target fed funds rate vs. Libor



NBF Economy & Strategy (data from Federal Reserve Bank of St. Louis)

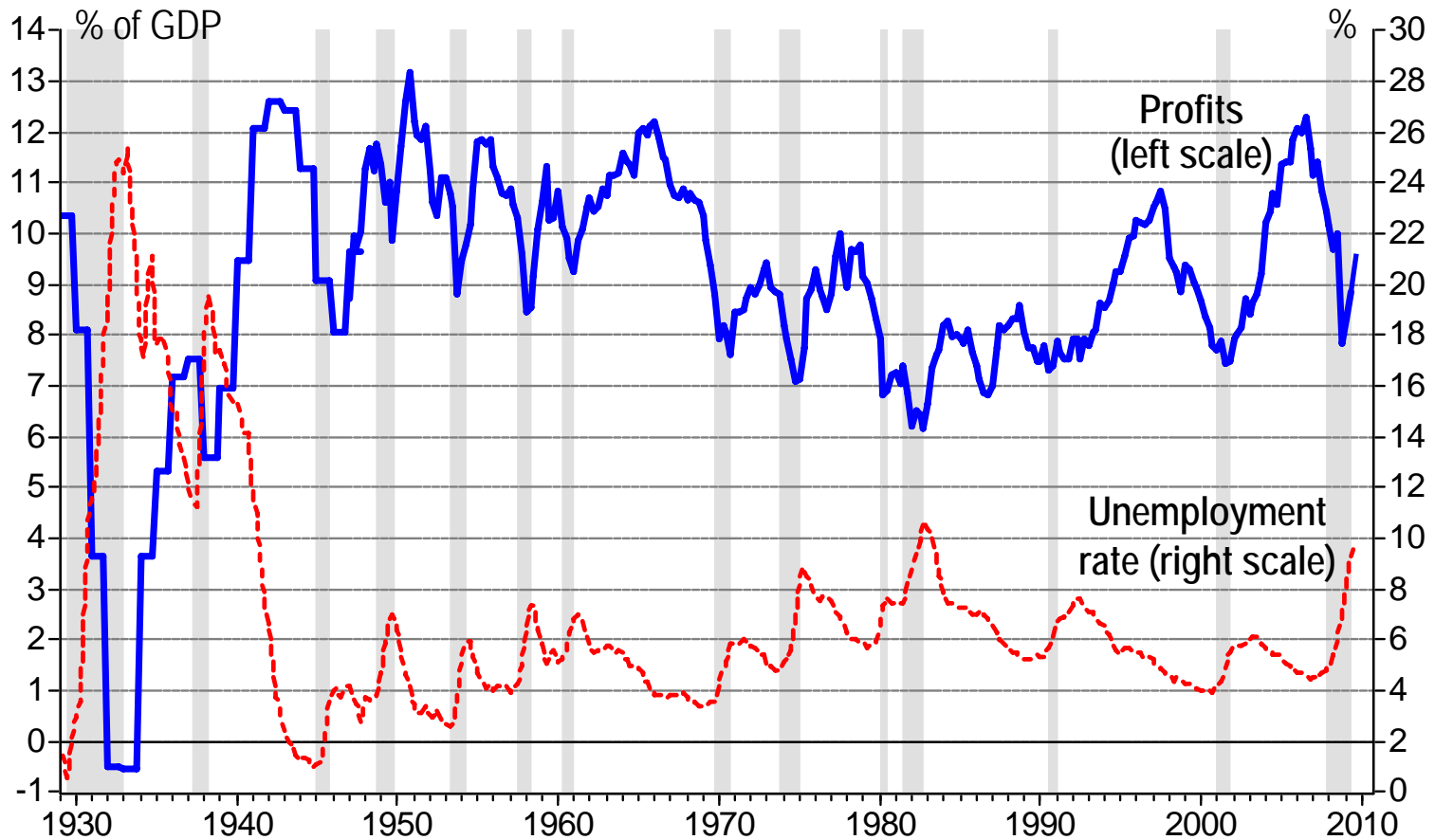
Disappearance of Armageddon premiums



NBF Economy & Strategy (data from Global Insight)

No depression for the economy

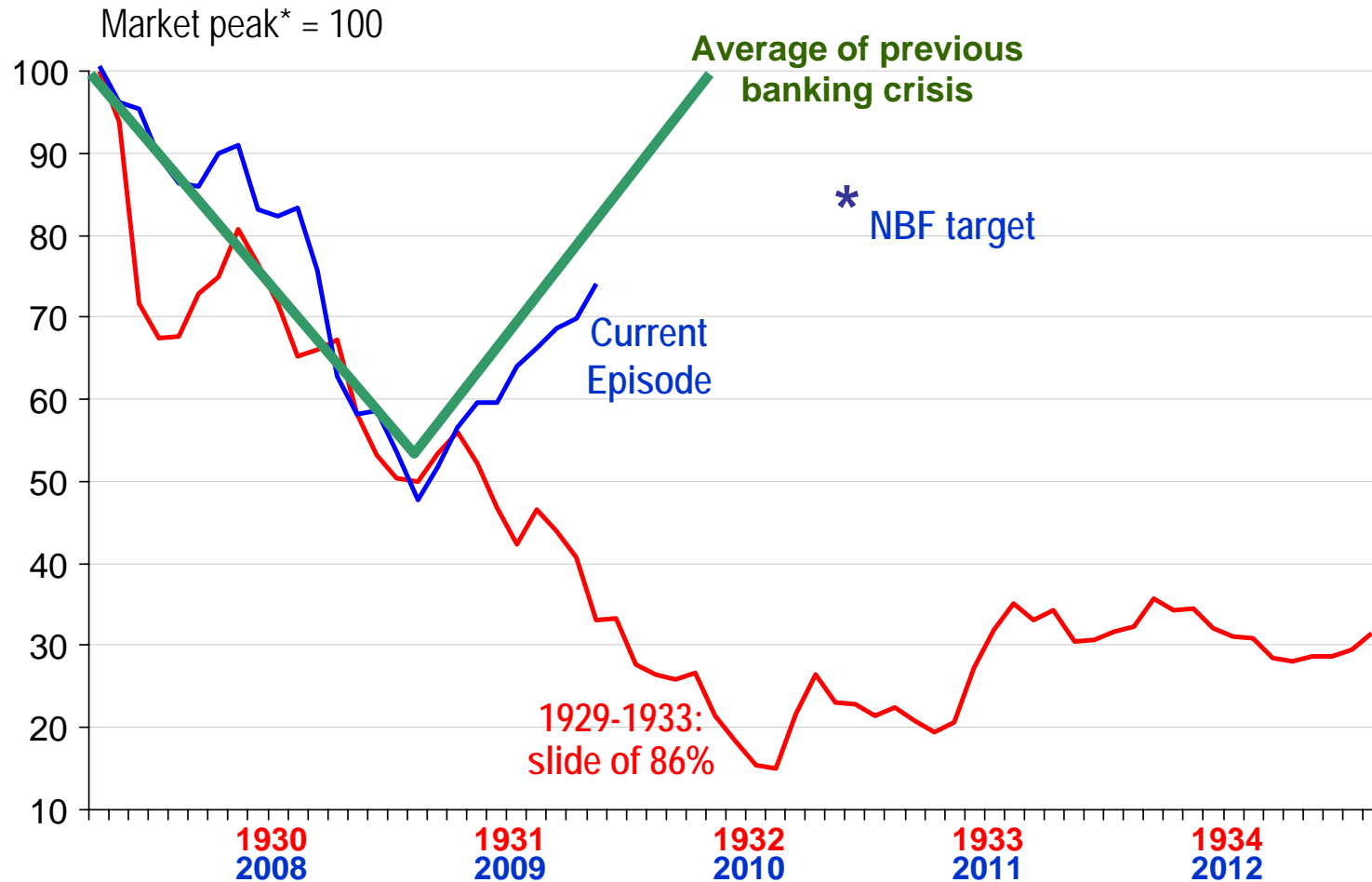
U.S. unemployment rate and corporate profits as % of GDP



NBF Economy & Strategy (data from NBER and Global Insight)

Equities no longer heading for Depression depths

S&P 500 index, 1930s and today

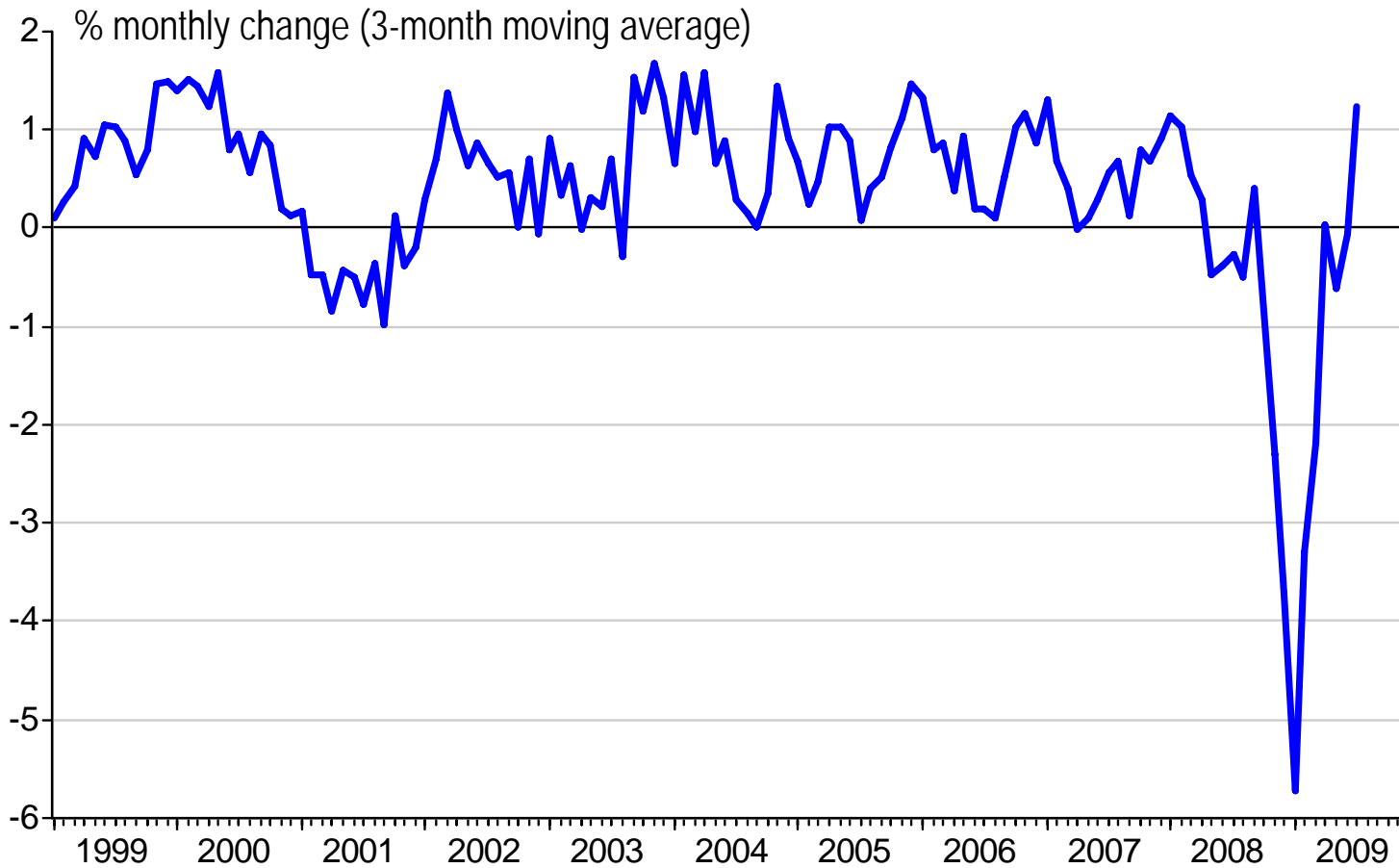


* September 1929, October 2007

NBF Economy & Strategy

Normalization of credit
=
Normalization of the economy

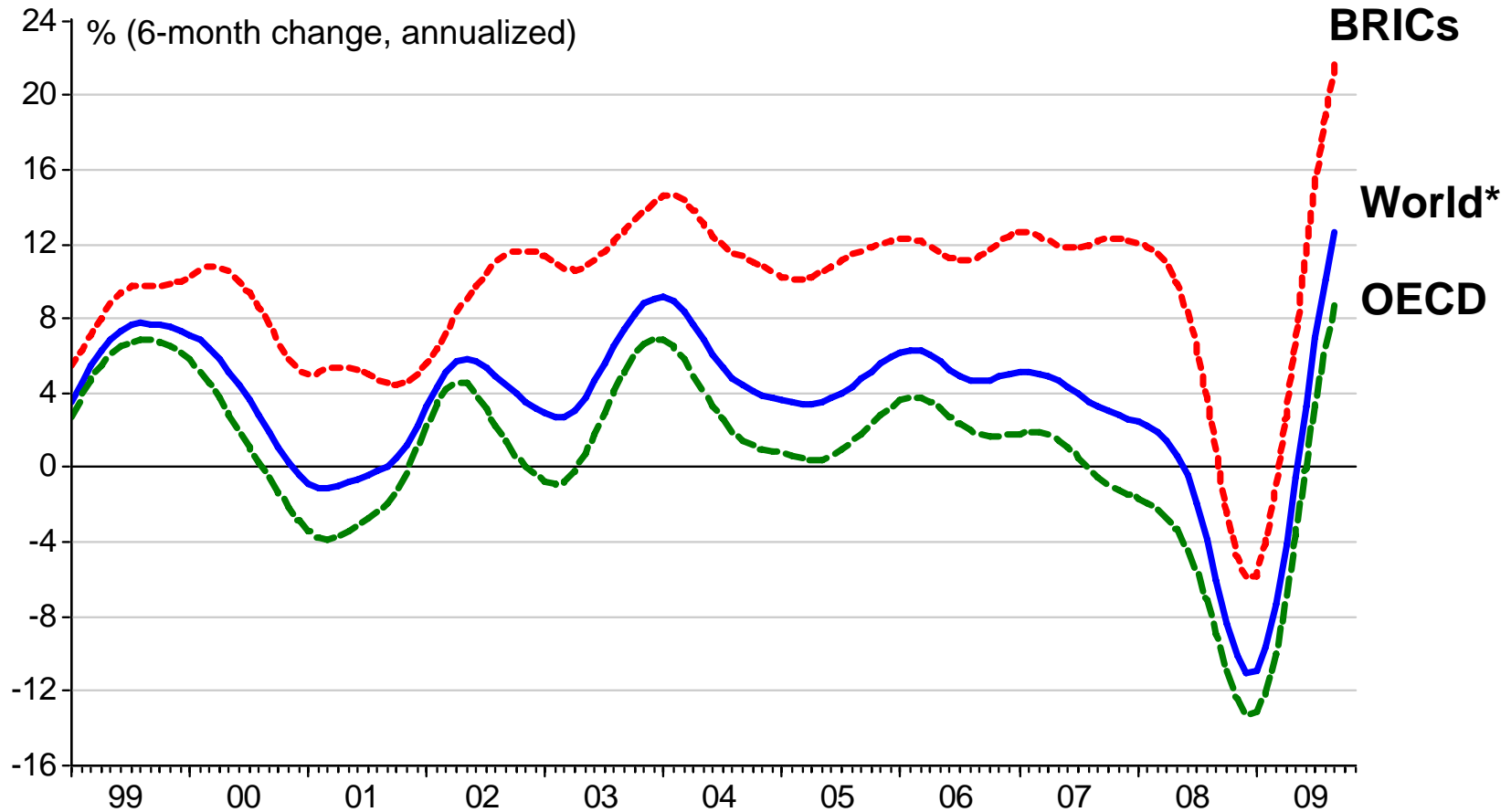
International trade volume growing again



NBF Economy & Strategy (data from Netherlands CBP bureau of economic analysis)

World: LEIs suggest above-trend growth

Leading economic indicators

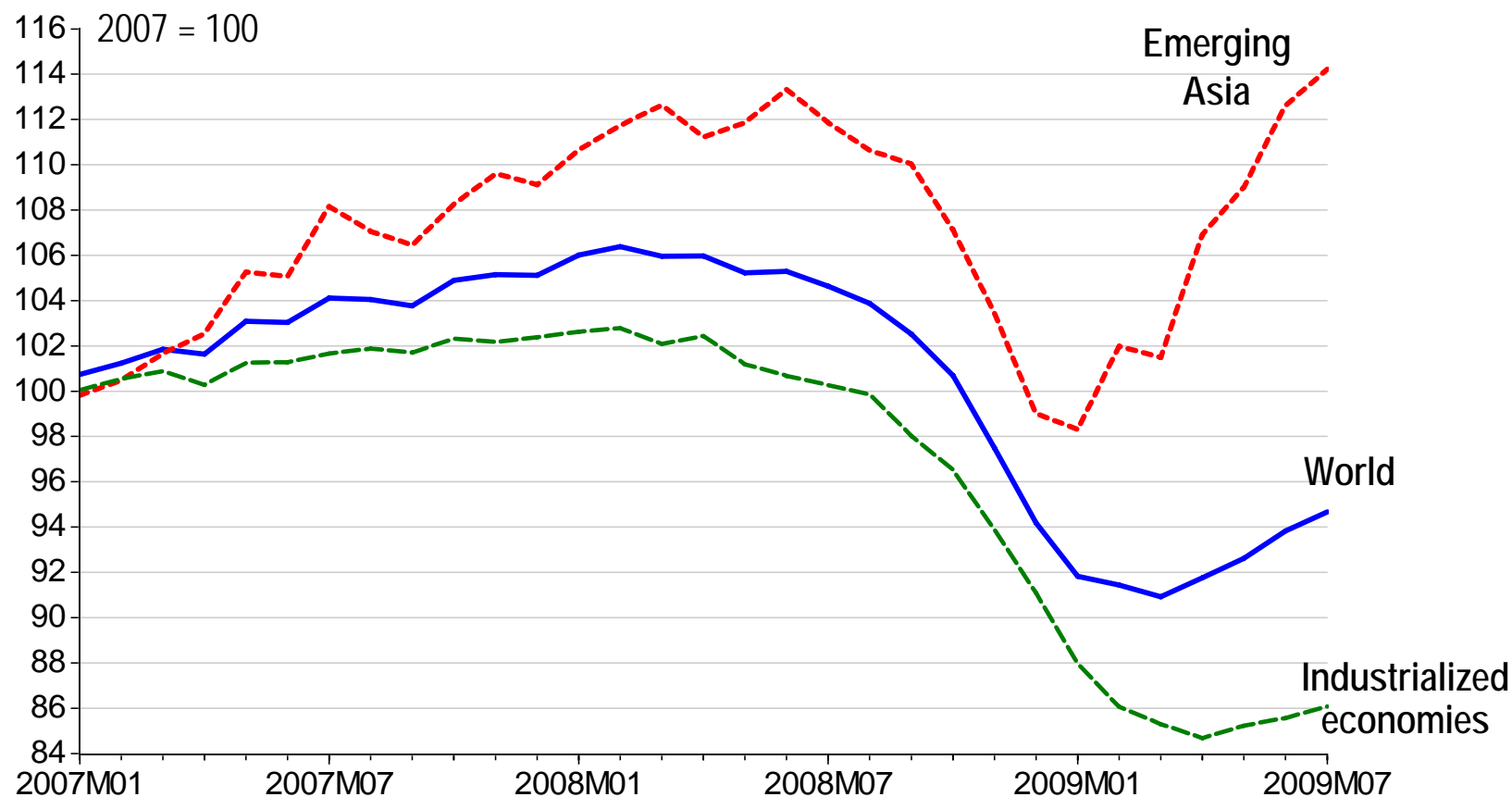


* Weighted 70% OECD, 30% BRIC

NBF Economy & Strategy (OECD data via Datastream)

Asia: From recovery to expansion

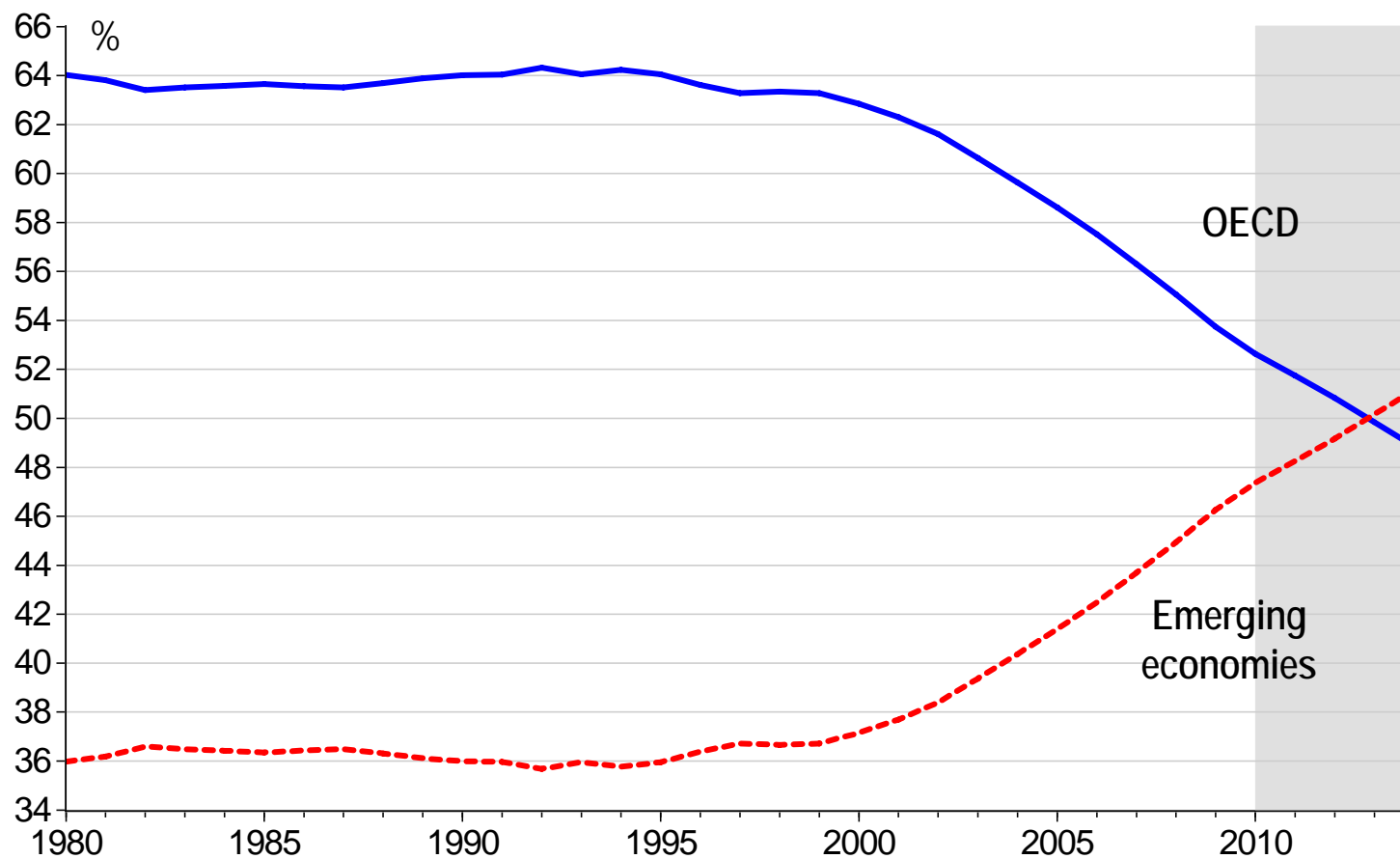
Manufacturing output: Emerging Asia vs. industrialized economies



NBF Economy & Strategy (CBP data)

World: Emerging economies are 50%

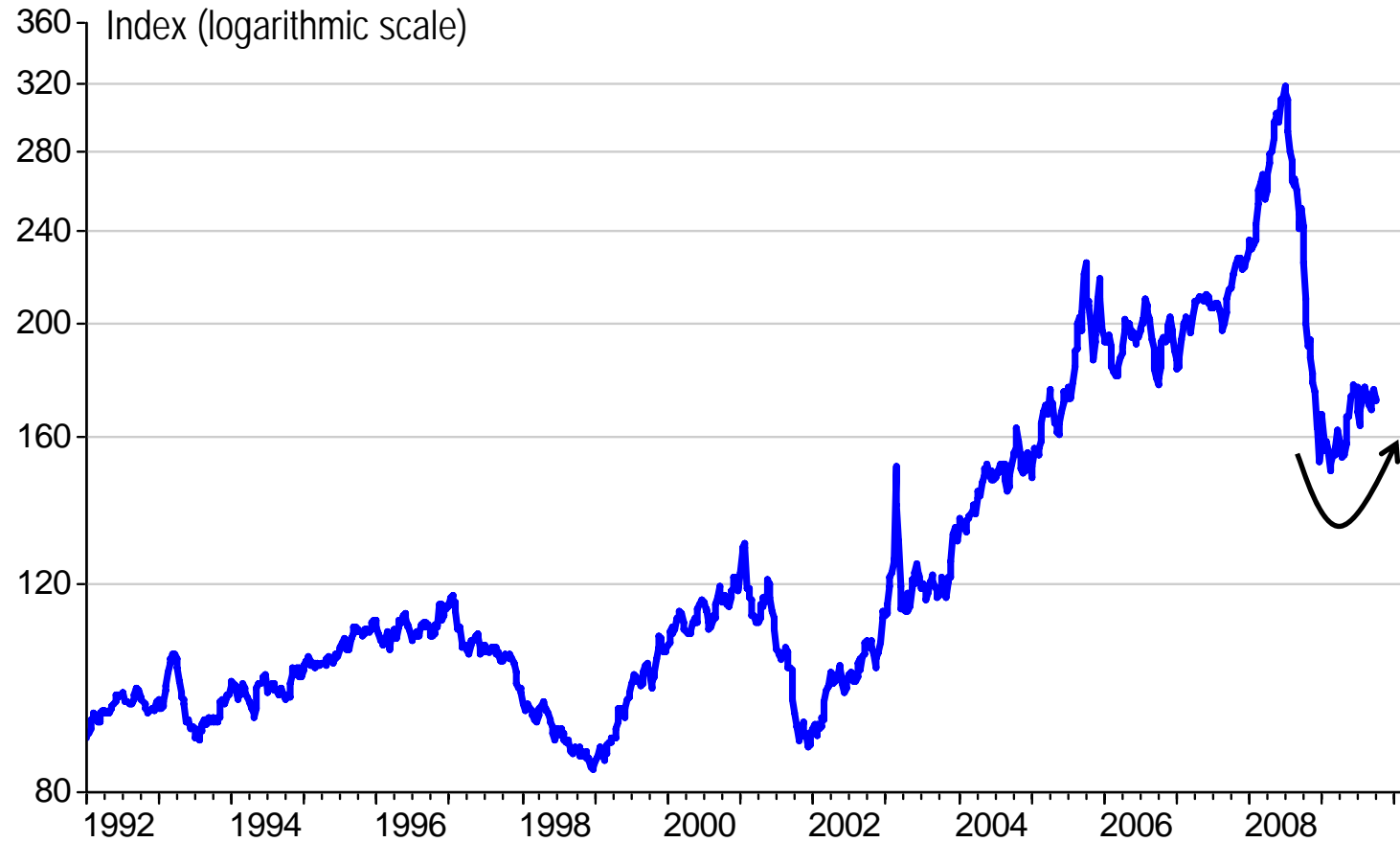
Share of global GDP



Économie et stratégie FBN (données du FMI)

Commodity prices

Commodities produced in Canada



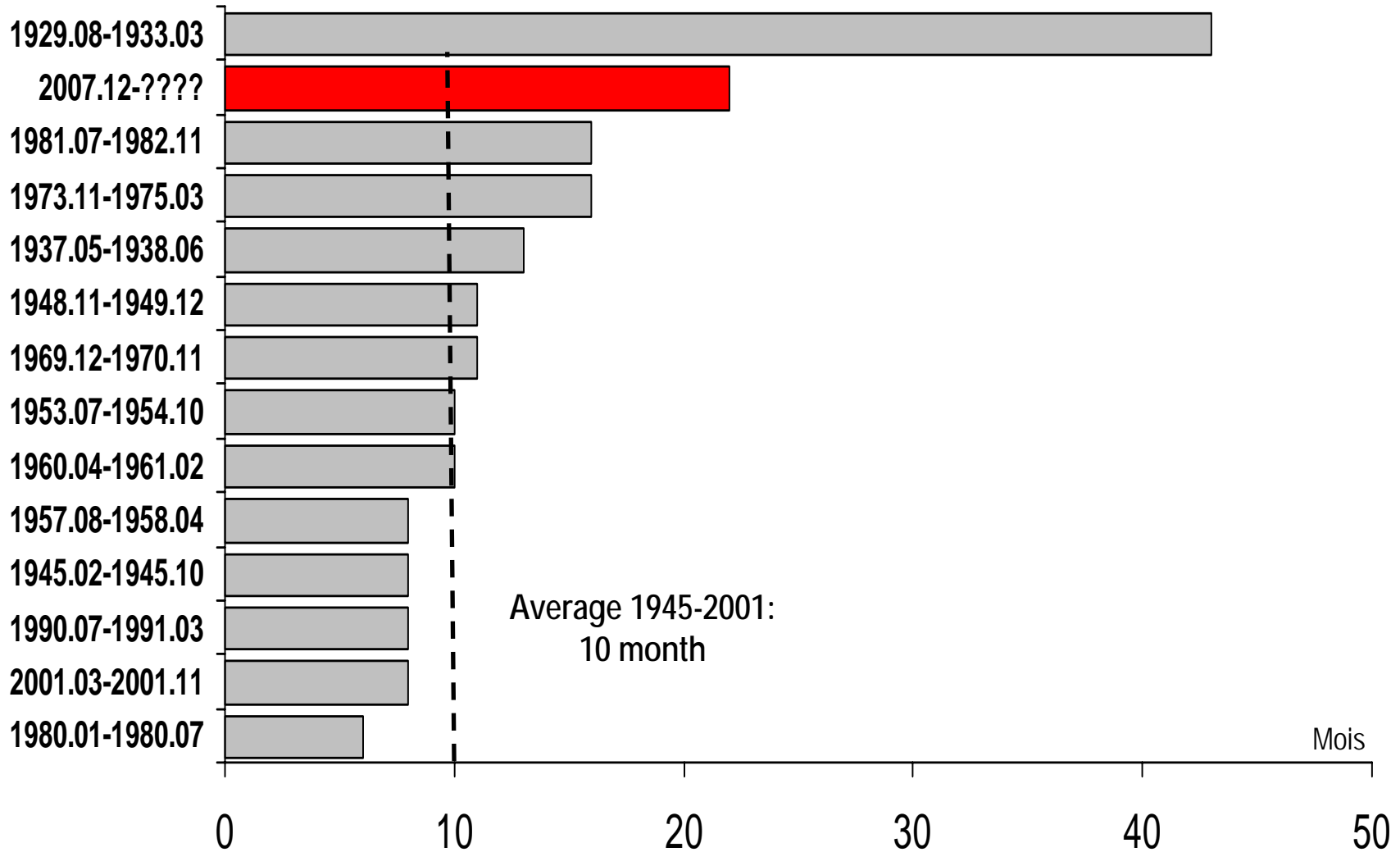
NBF Economy & Strategy (CBP data)

The U.S.:

What's the story?

The second longest recession in 80 years...

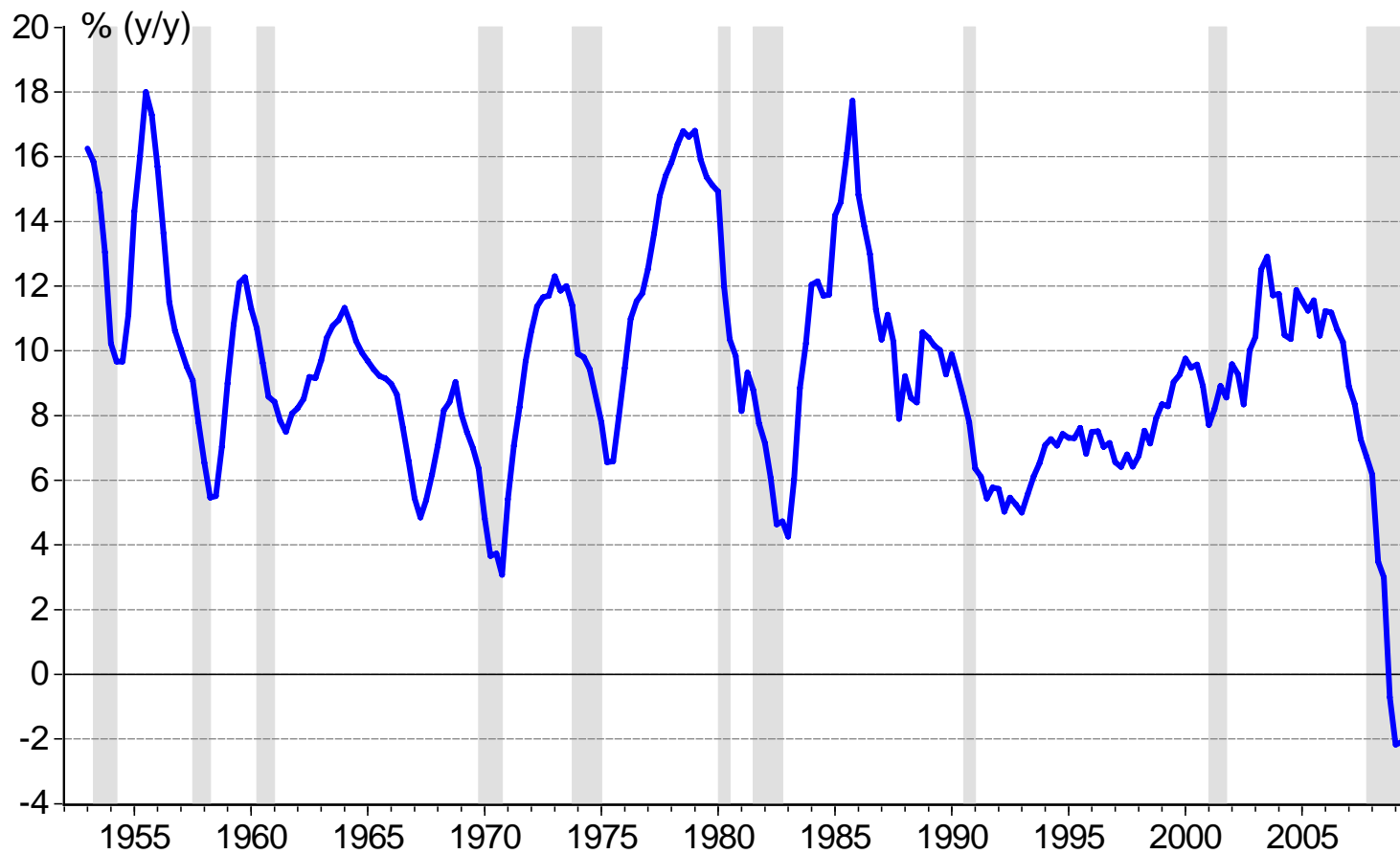
Longevity of U.S. recessions since 1929



NBF Economy & Strategy (data via NBER)

...made worse by deleveraging

Household debt



Économie et stratégie FBN (données Federal Reserve par Global insight)

U.S.: How high is the savings rate likely to go?

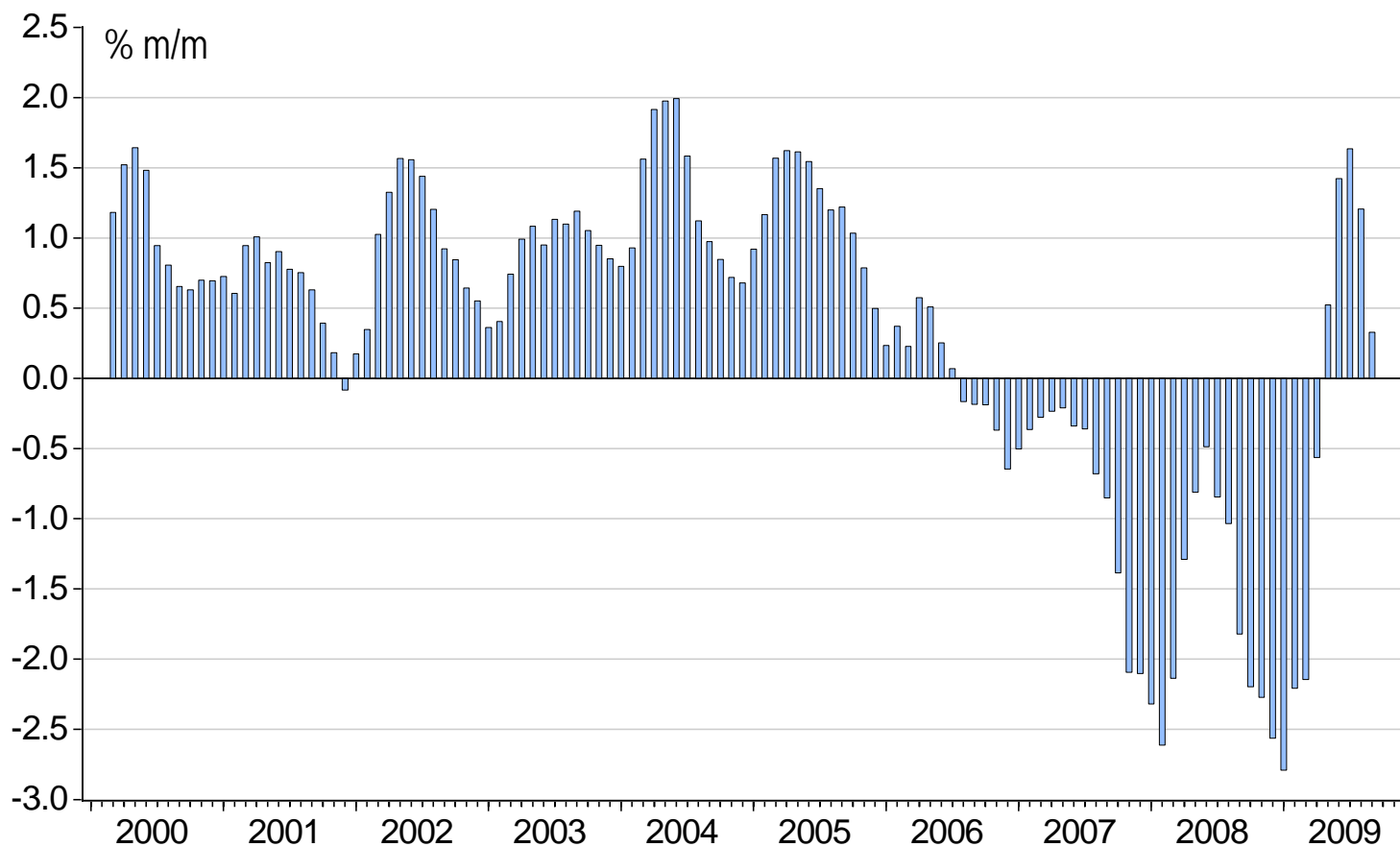
Personal savings rate



NBF Economy & Strategy (data from NBER and Global Insight)

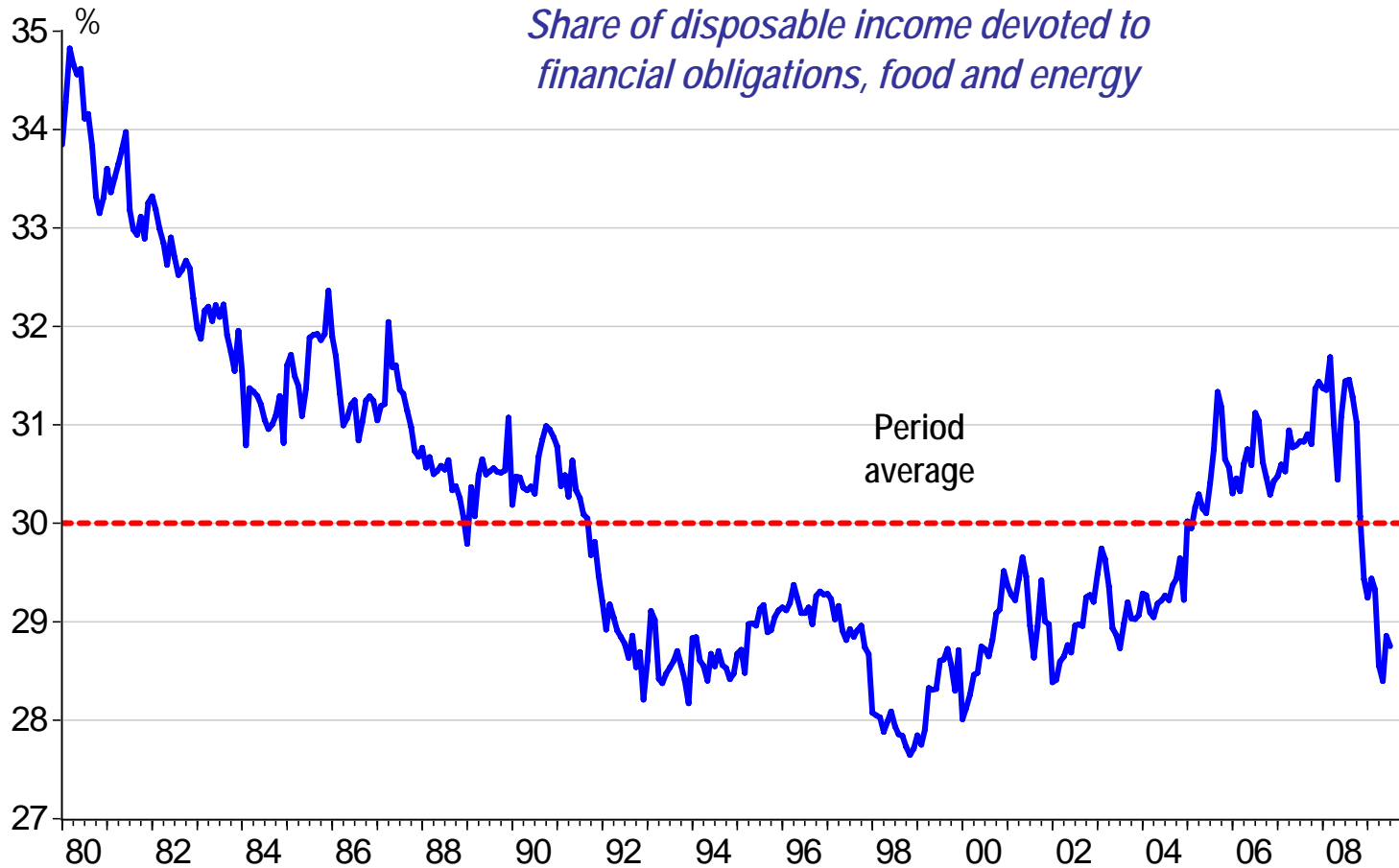
The end of U.S. home-price deflation

Case-Shiller 20-city index, monthly change



NBF Economy & Strategy (data via Standard & Poors)

U.S.: Consumers have room for discretionary spending

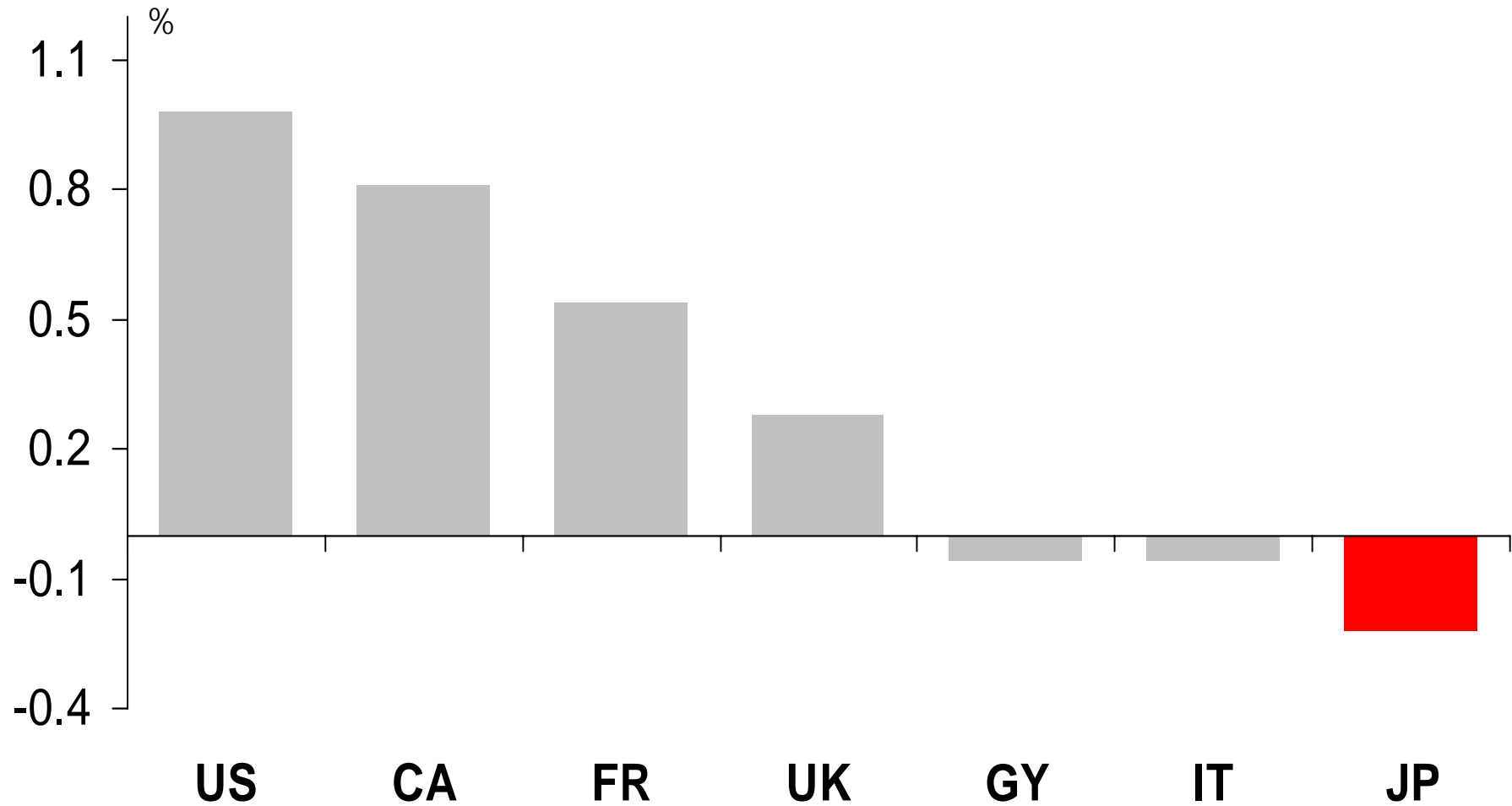


* Debt service plus auto lease payments, rents of tenant-occupied property, homeowner insurance premiums and property taxes

NBF Economy & Strategy (BLS and Federal Reserve data via Datastream)

The U.S. is not Japan !

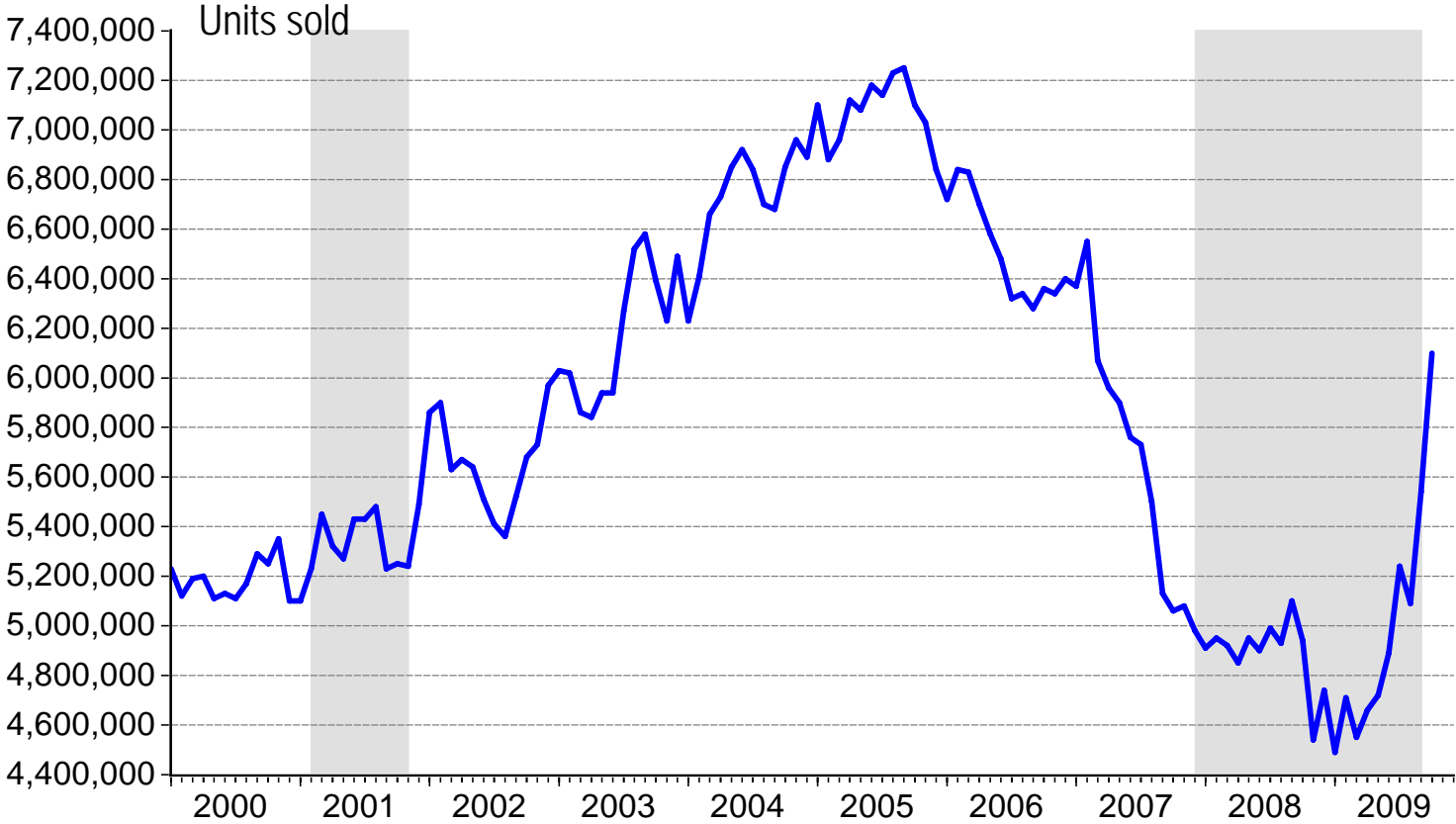
Population growth estimated for 2010



NBF Economy & Strategy (data via US Census)

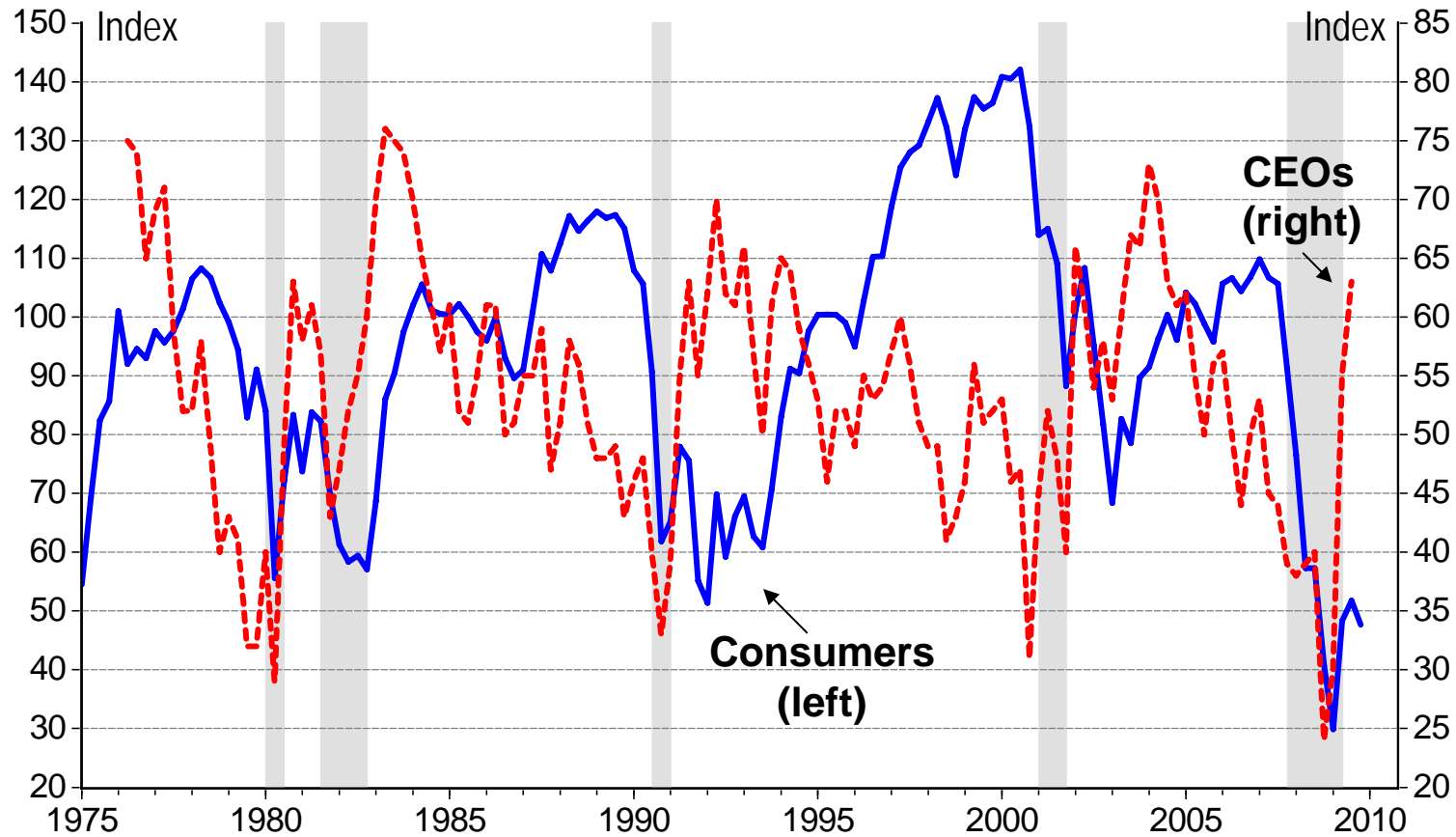
Home resale activity picks up

Home resales



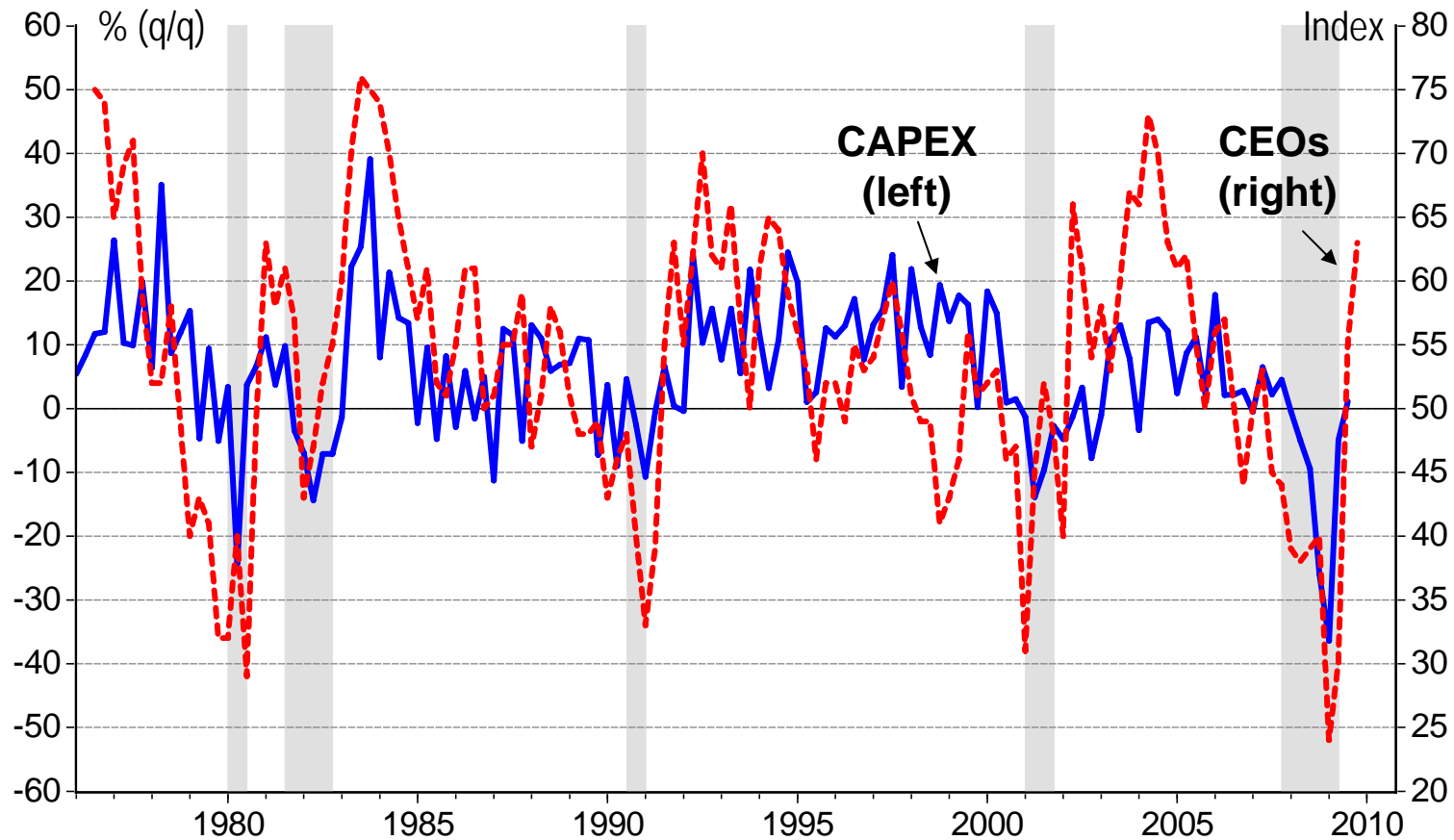
NBF Economy & Strategy (data from Global Insight)

Confidence: Business executives vs. households



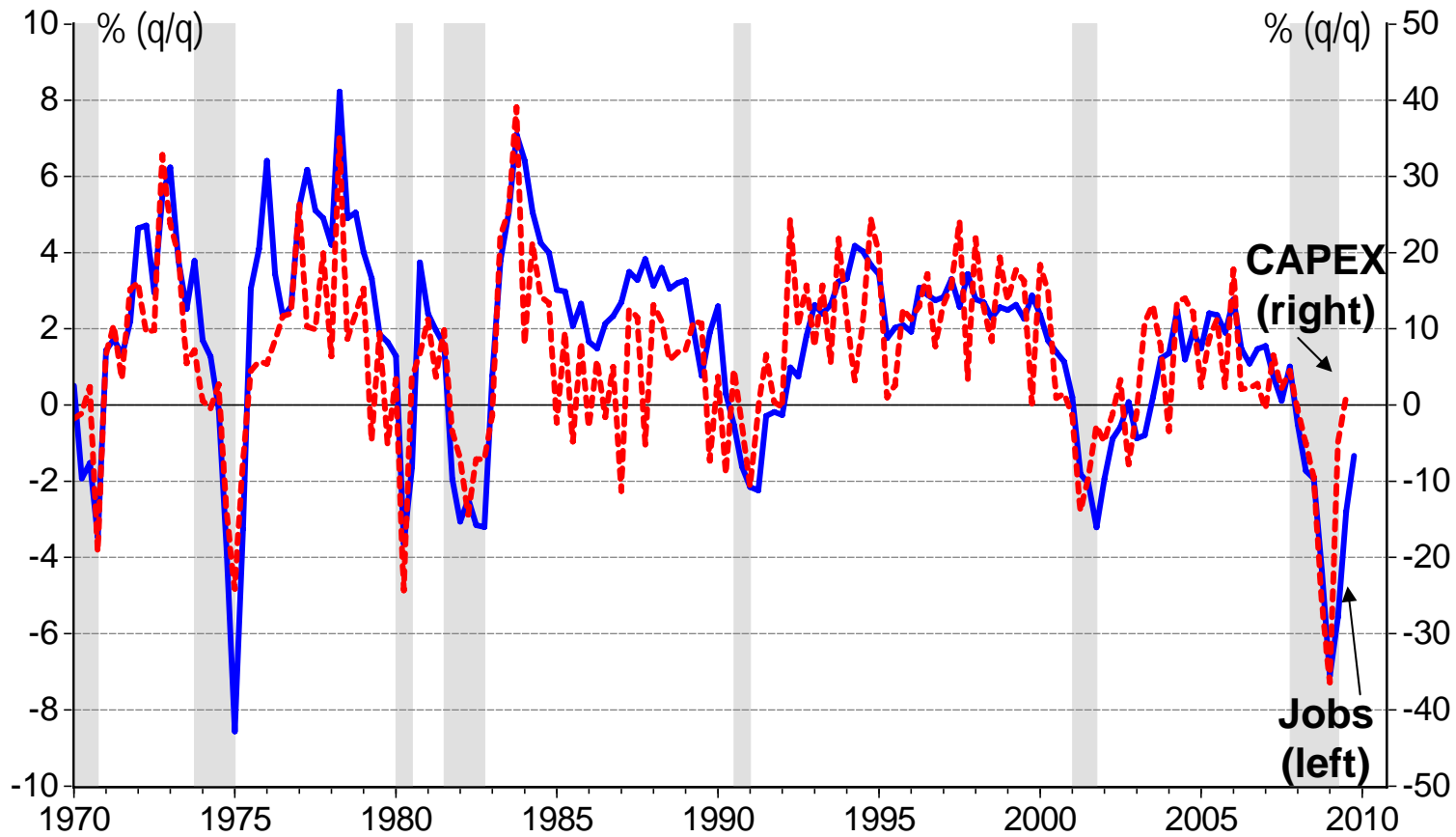
NBF Economy & Strategy (data from Global Insight)

Business executives confidence vs. CAPEX



NBF Economy & Strategy (data from Global Insight)

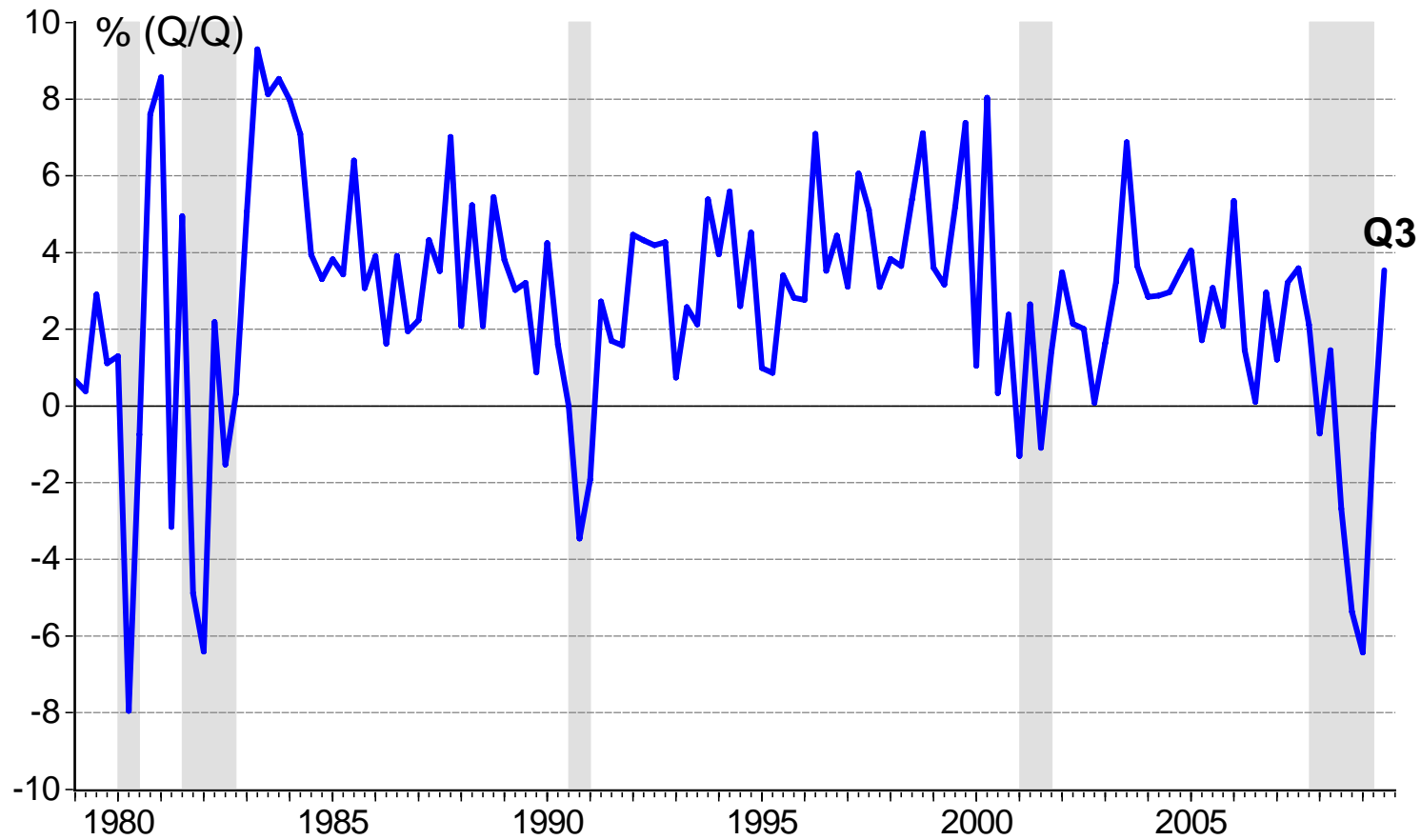
CAPEX vs. job creation



NBF Economy & Strategy (data from Global Insight)

GDP is back in positive territory

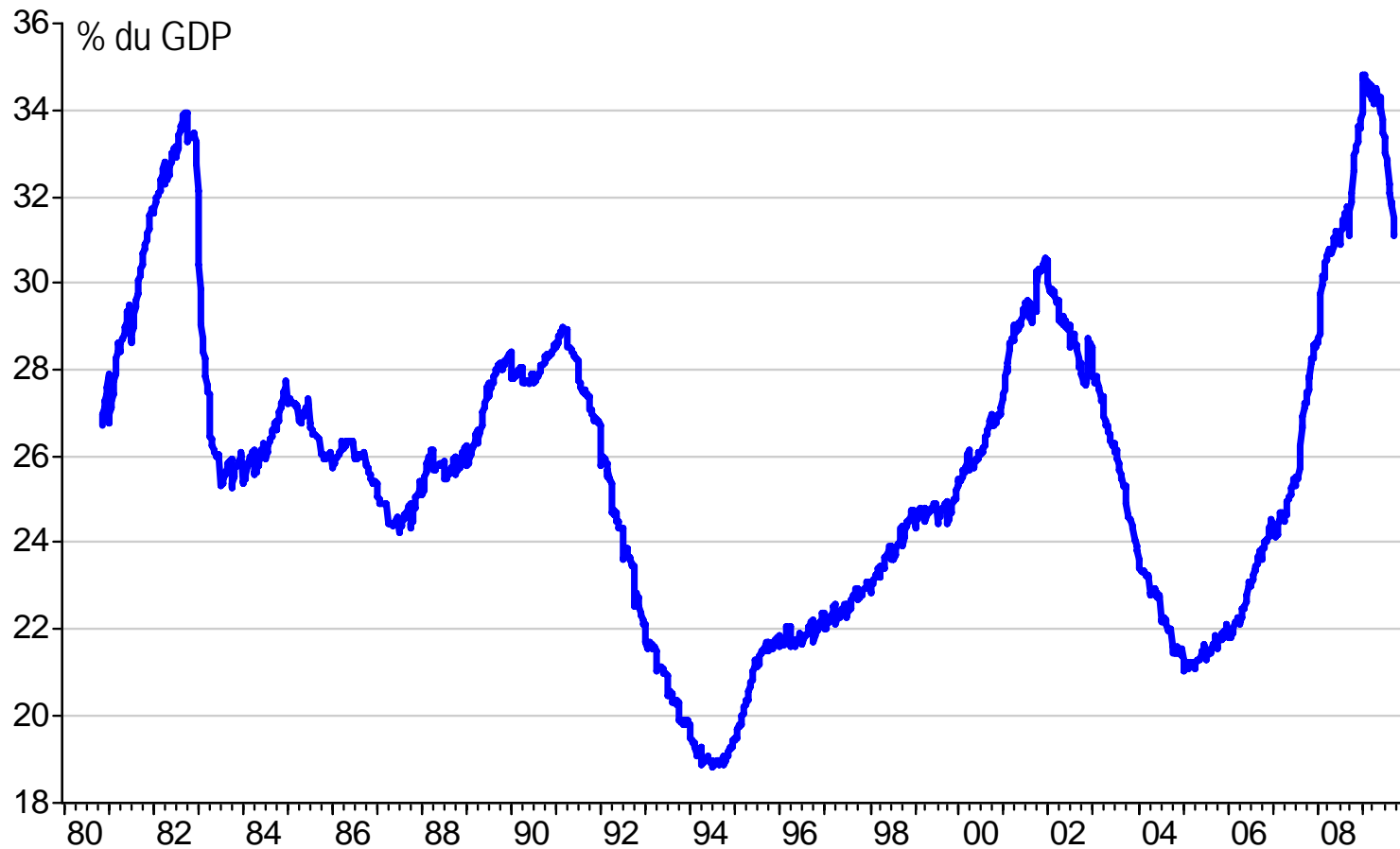
Real GDP



NBF Economy & Strategy (data from Global Insight)

A large amount of sidelined cash

Money market mutual funds and small-time deposits



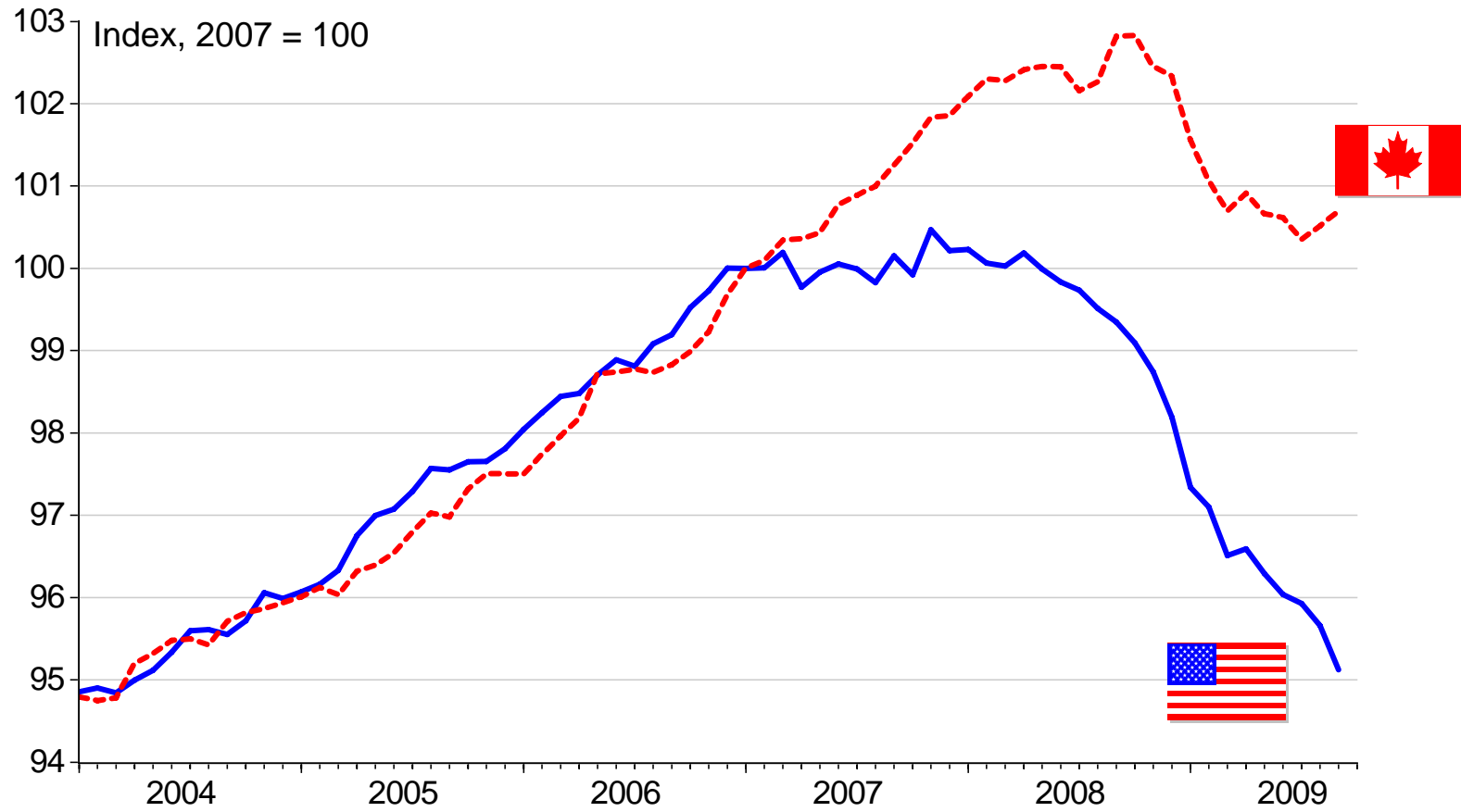
NBF Economy & Strategy (data from Global Insight)

The Canadian economy:

***A regional and sector-specific
recession***

Canada: Job loss was less severe

Household employment

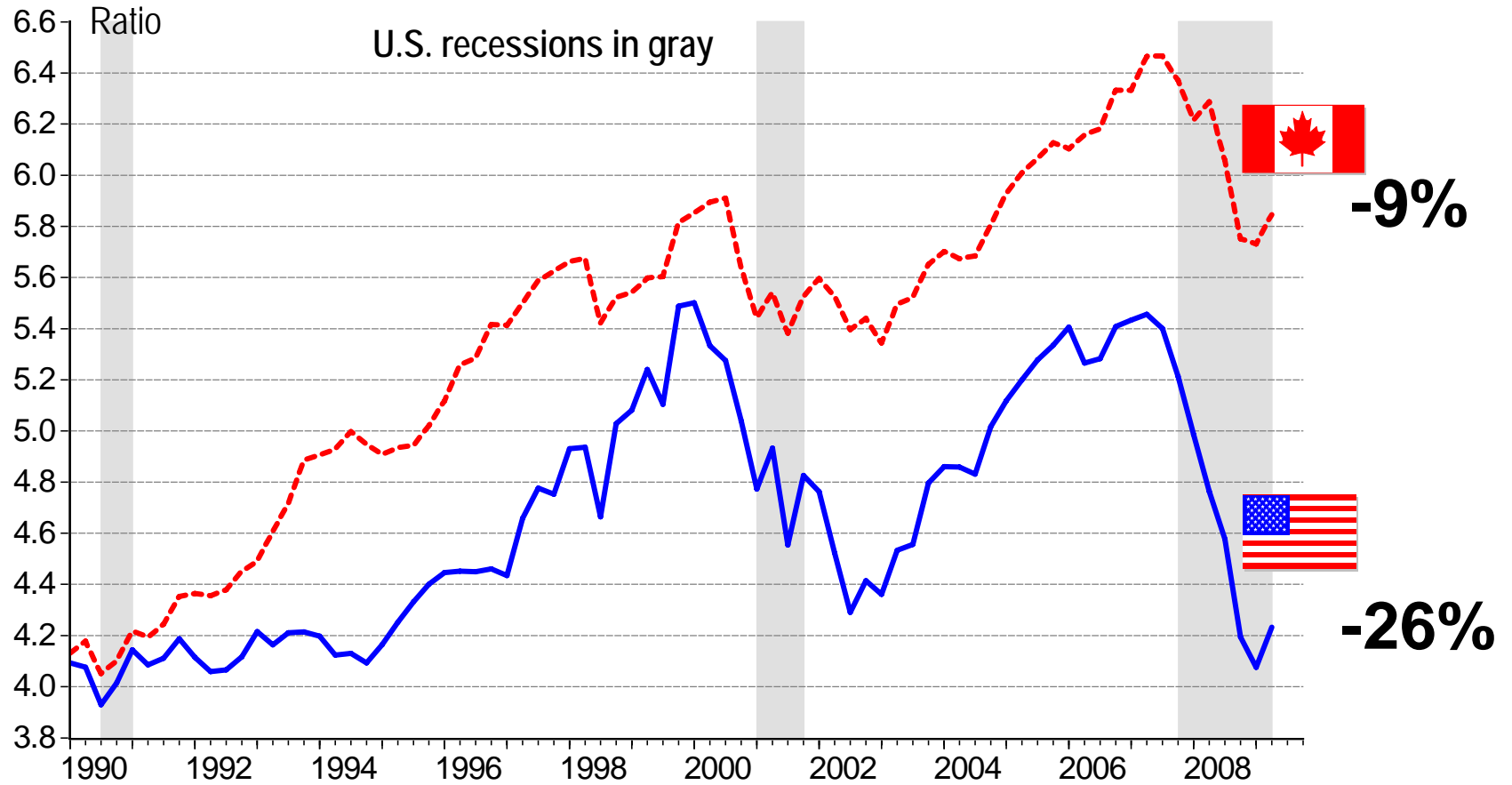


NBF Economy & Strategy (data from NBER and Global Insight)

***The financial crisis did much less
damage on this side of the border***

Negative wealth effect for household

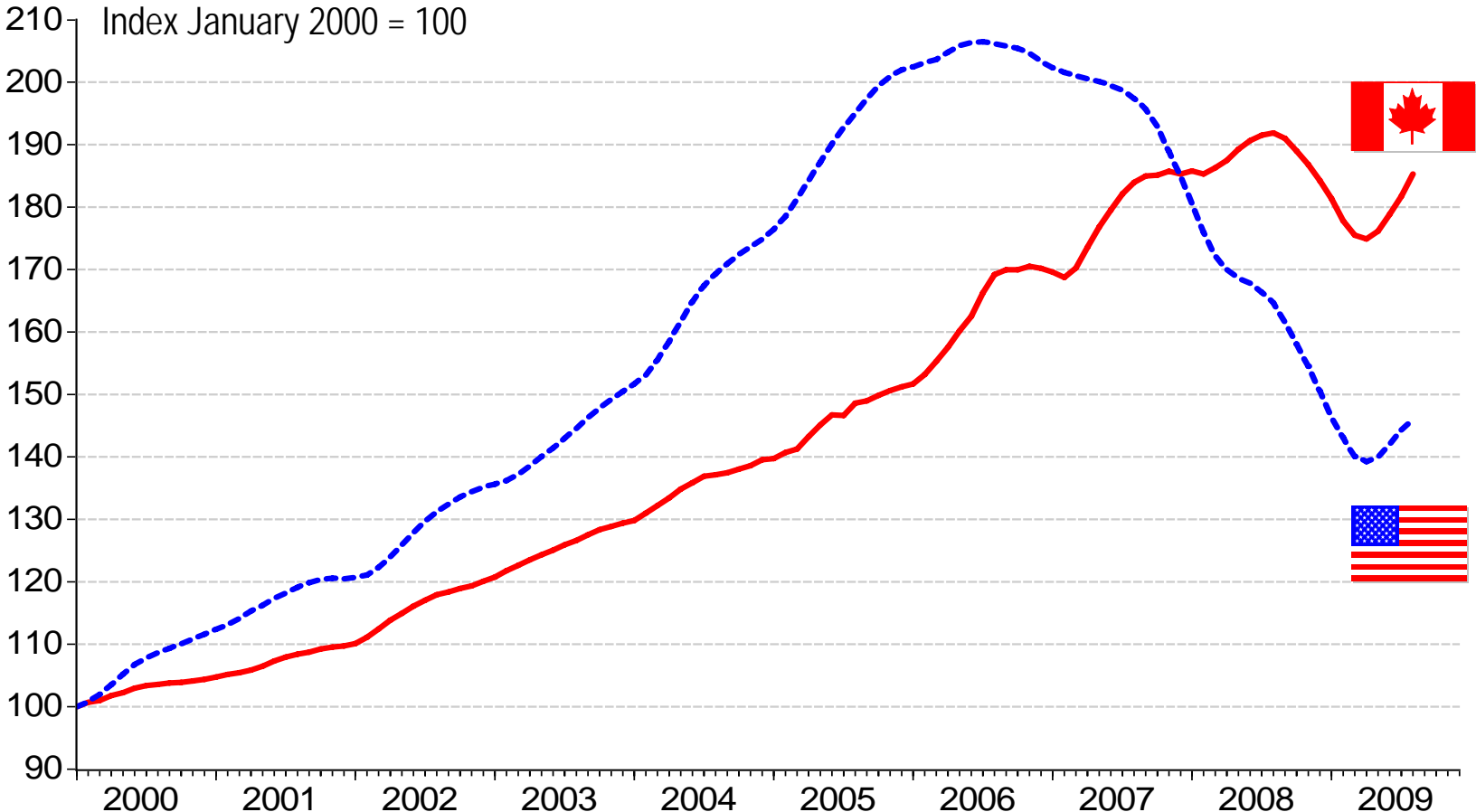
Net worth as multiple of annual disposable income, Canada and U.S.



NBF Economy & Strategy (Statcan and Federal Reserve data via Global Insight)

Canadian home prices much more resilient

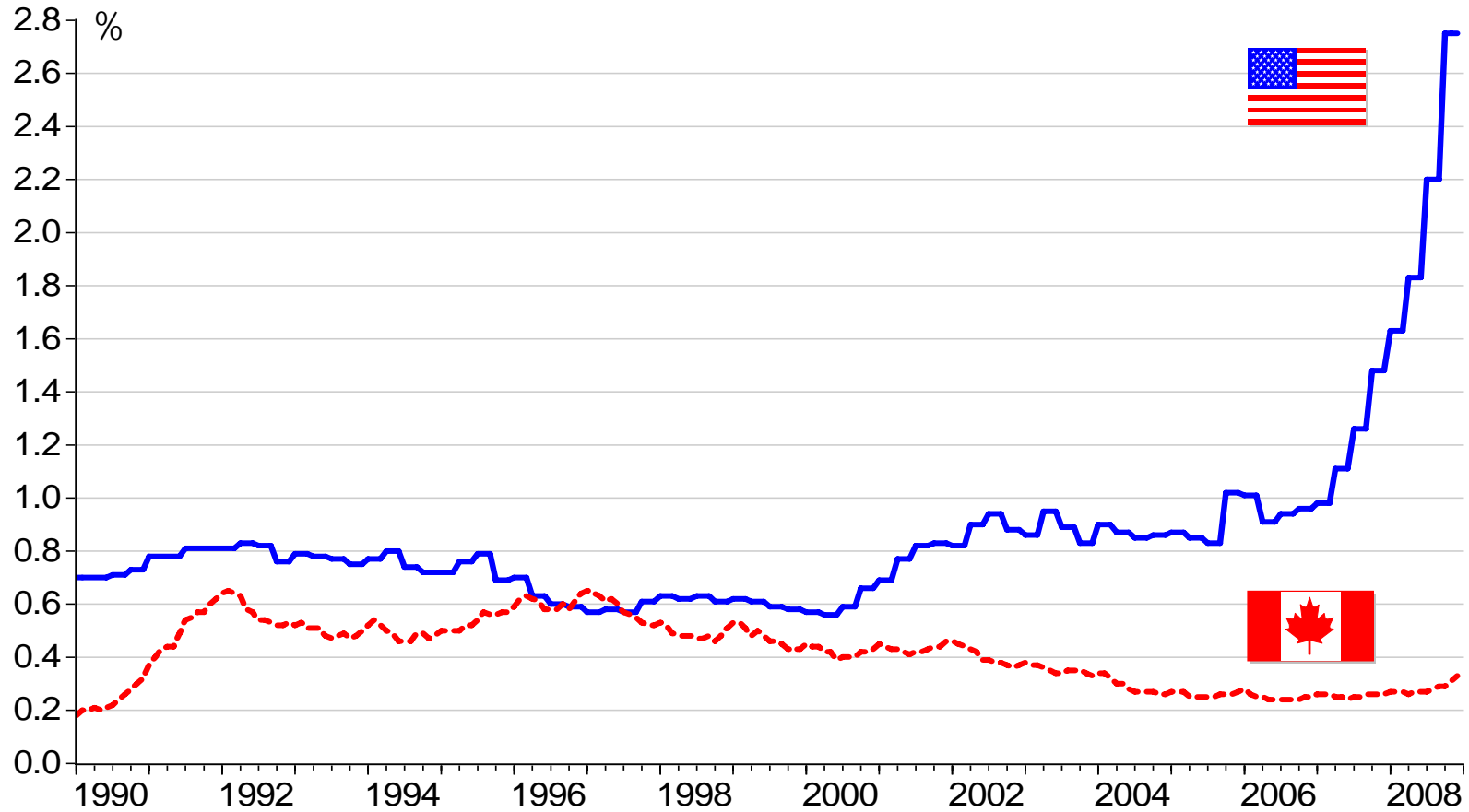
Home prices (repeat-sales method) in Canada (6 cities) and U.S. (10 cities)



Teranet–National Bank National Composite House Price Index™, Standard & Poors

Home mortgage default rates, Canada vs. U.S.

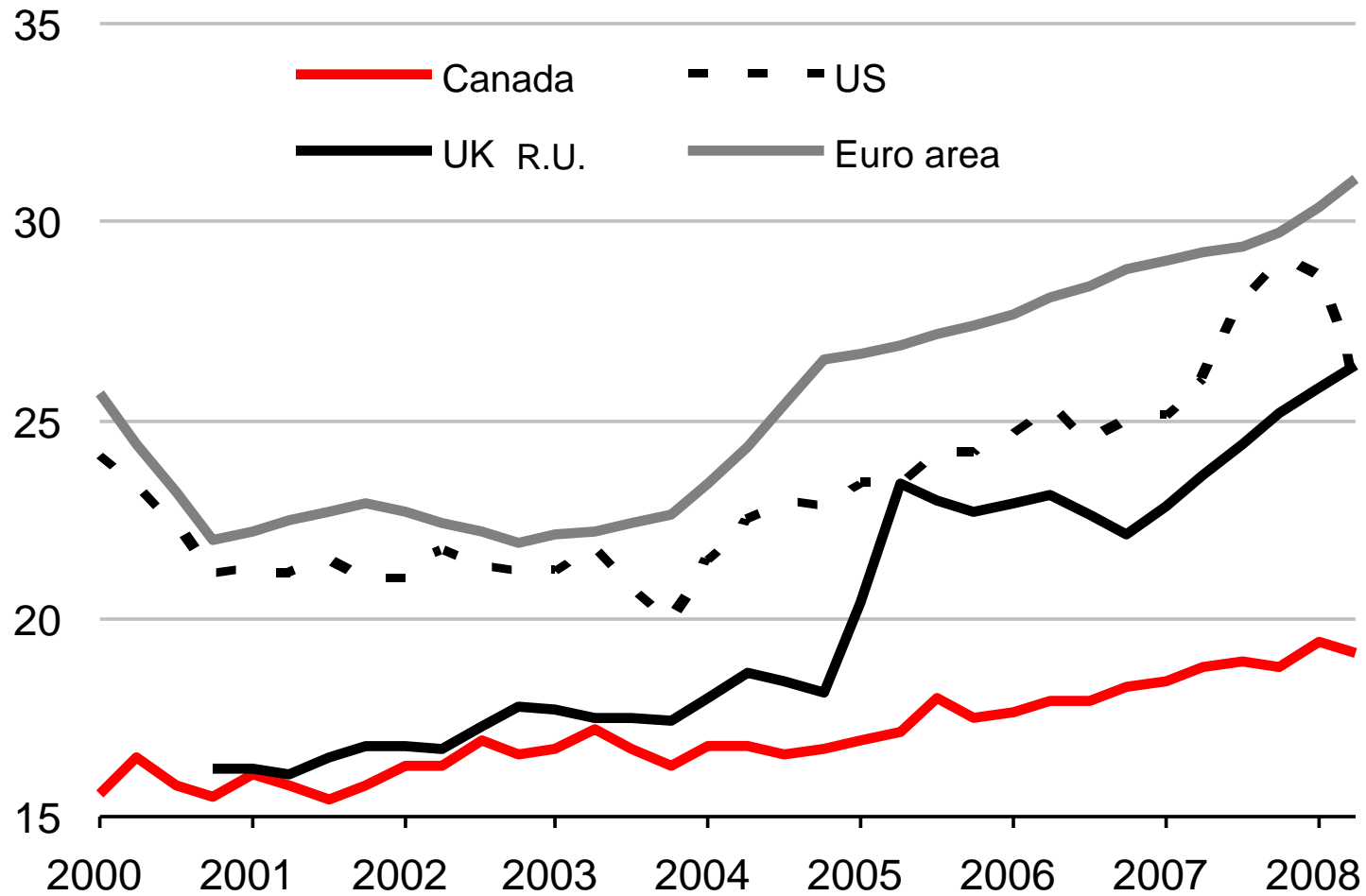
Payments in arrears more than 90 days



NBF Economy & Strategy

Leverage of the banking sector

Assets as a multiple of capital

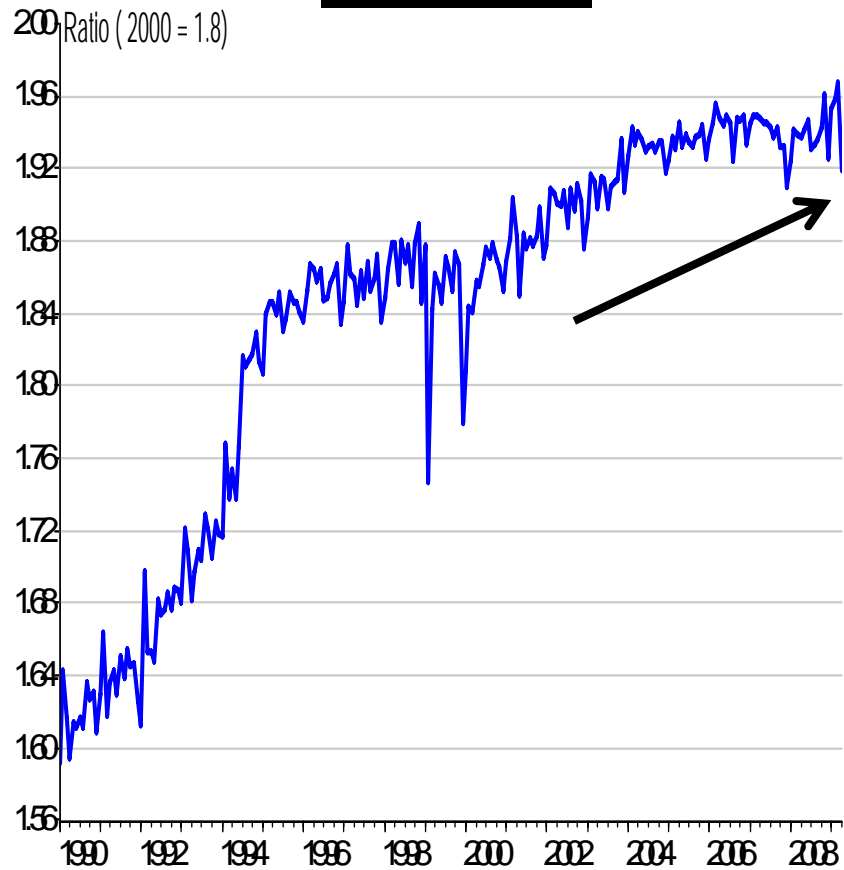


Finance Canada

Money Multipliers

Money multiplier (M1 as a ratio of monetary base)

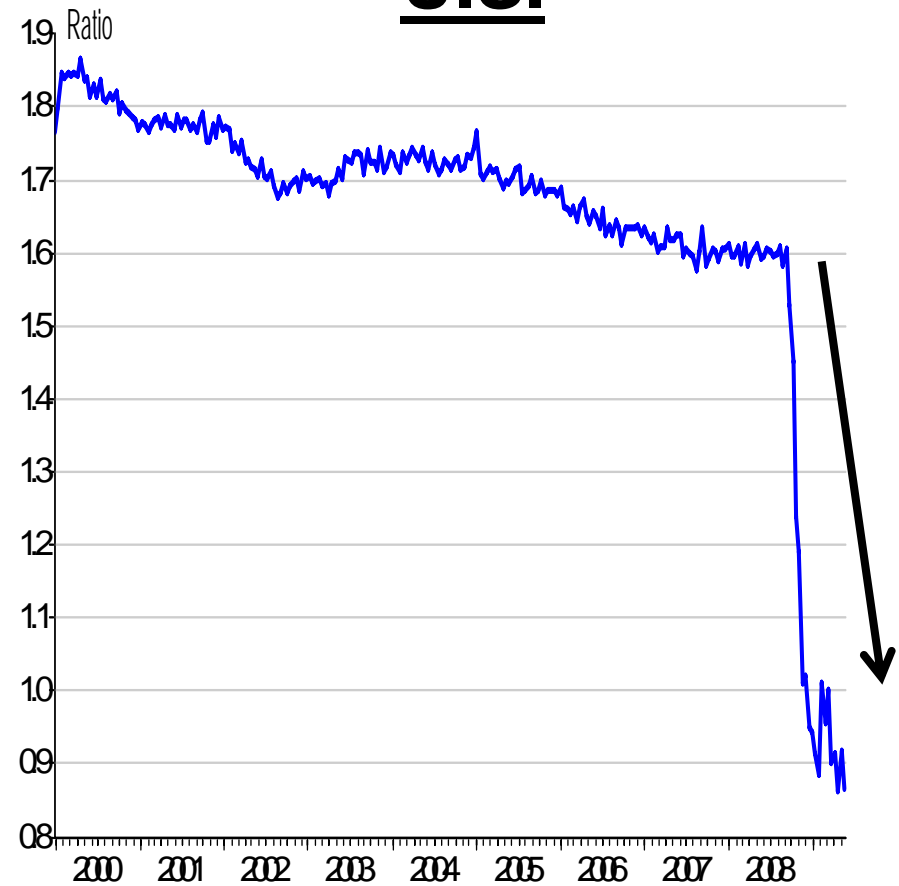
Canada



NBF Economy & Strategy (Statscan data via Global Insight)

Money multiplier (M1 as a ratio of monetary base)

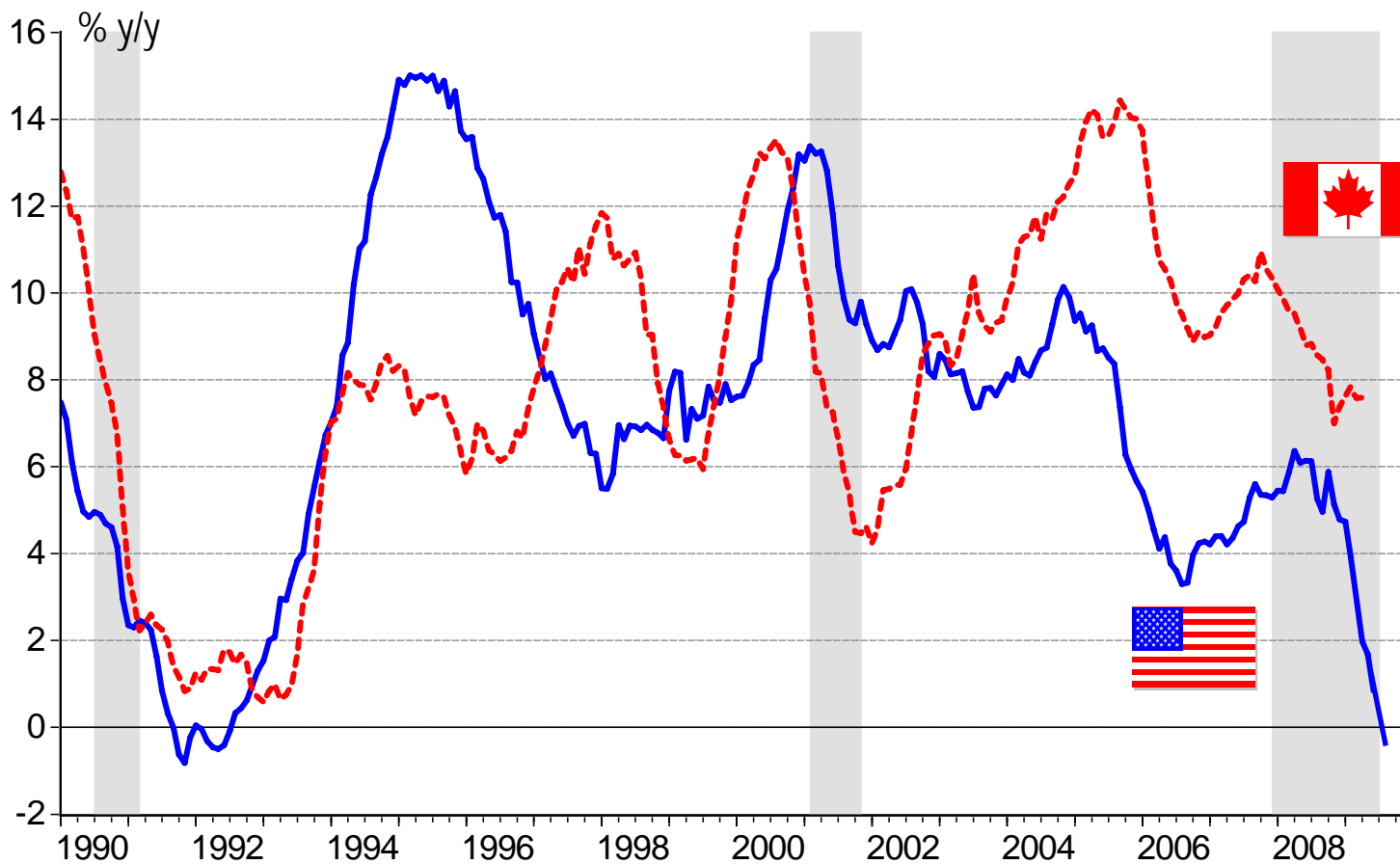
U.S.



NBF Economy & Strategy (Federal Reserve data via Global Insight)

Credit not a problem for Canadian consumers

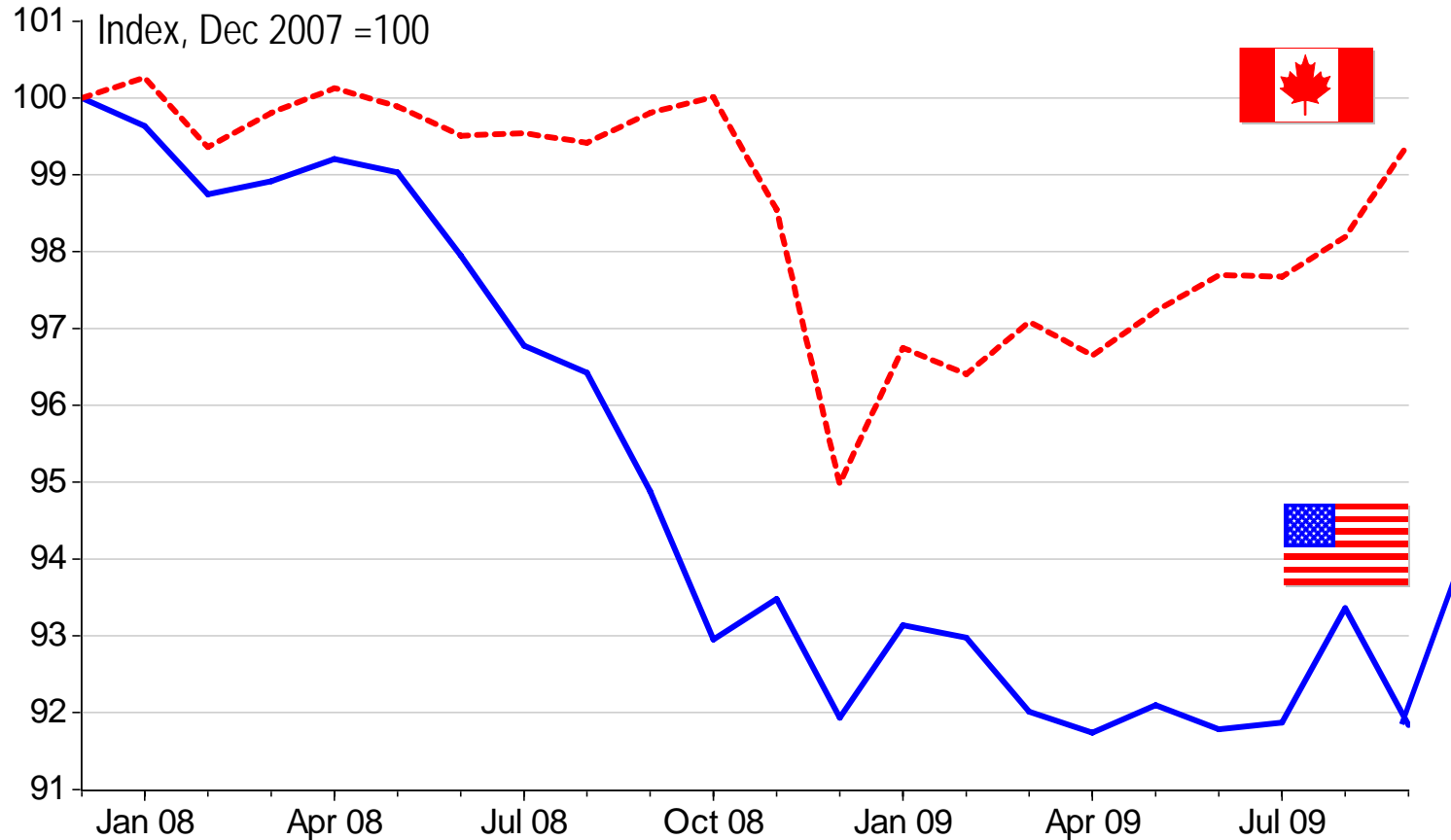
Consumer credit (including home equity lines of credit but not mortgages)



NBF Economy & Strategy (BoC and Federal Reserve data via Global Insight)

Canada: Retail sales back to pre-recession peak

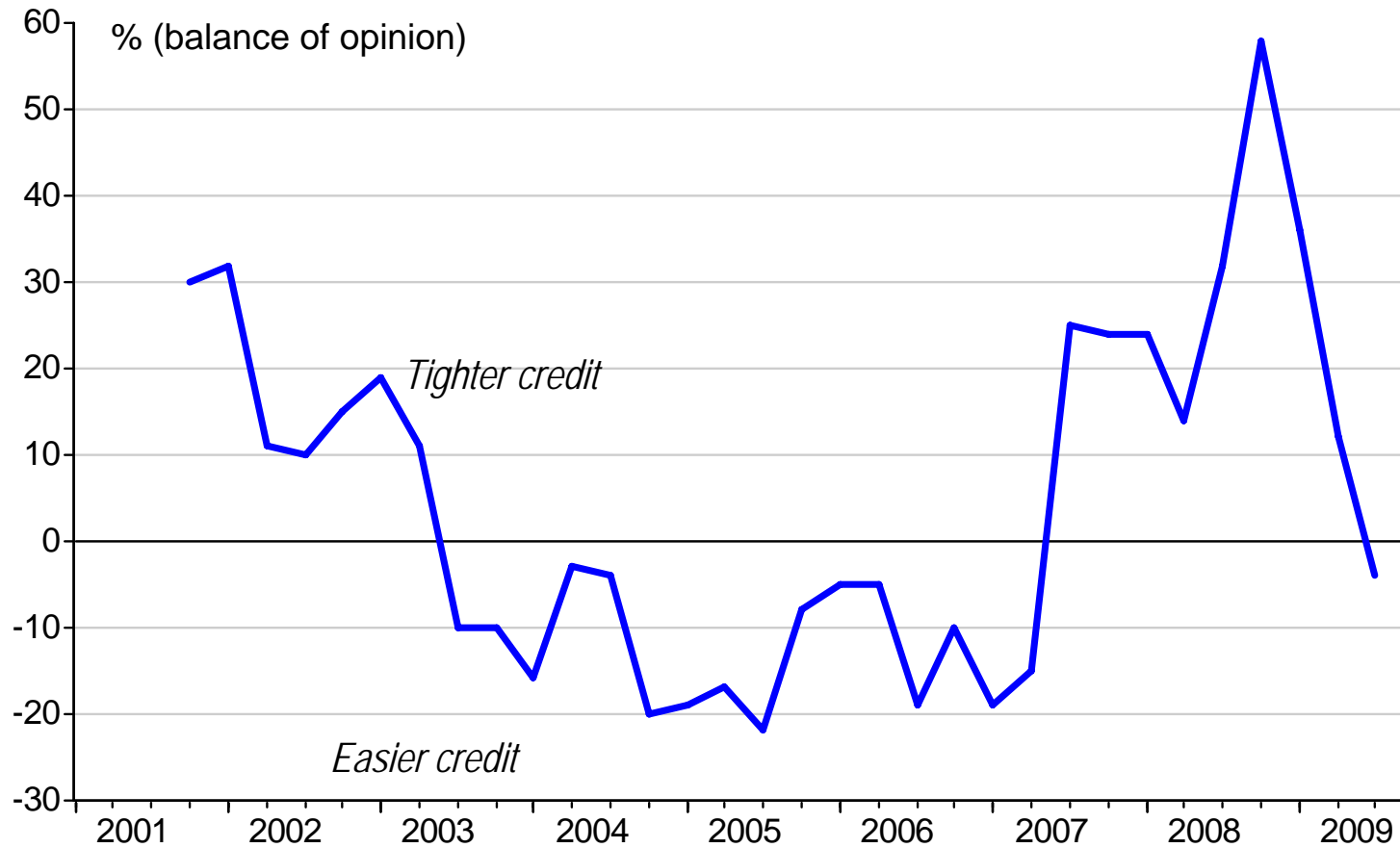
Volume retail sales



NBF Economy & Strategy (data via Global Insight)

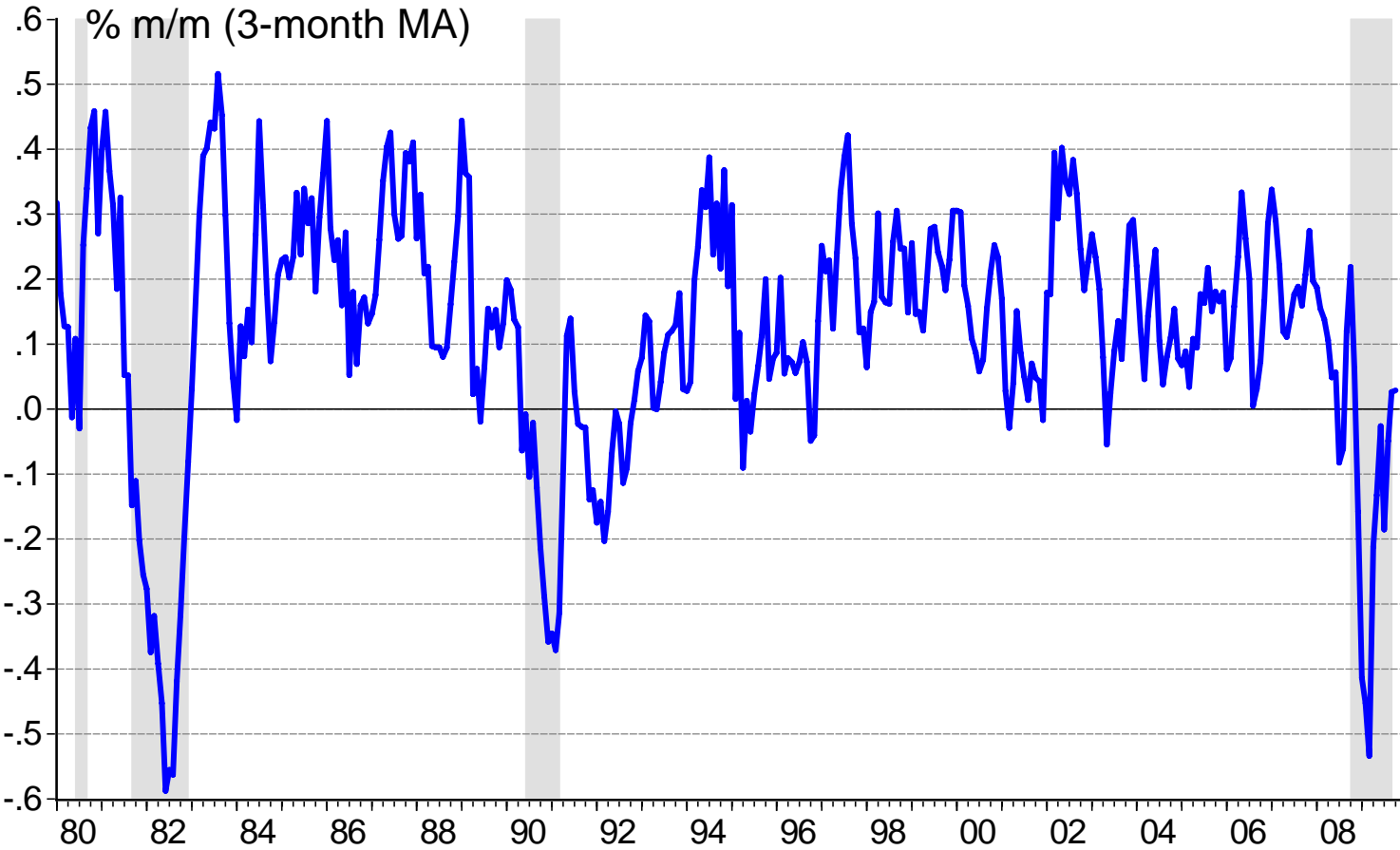
Credit conditions have stabilized

Business balance of opinion about credit



NBF Economy and Strategy (data Bank of Canada)

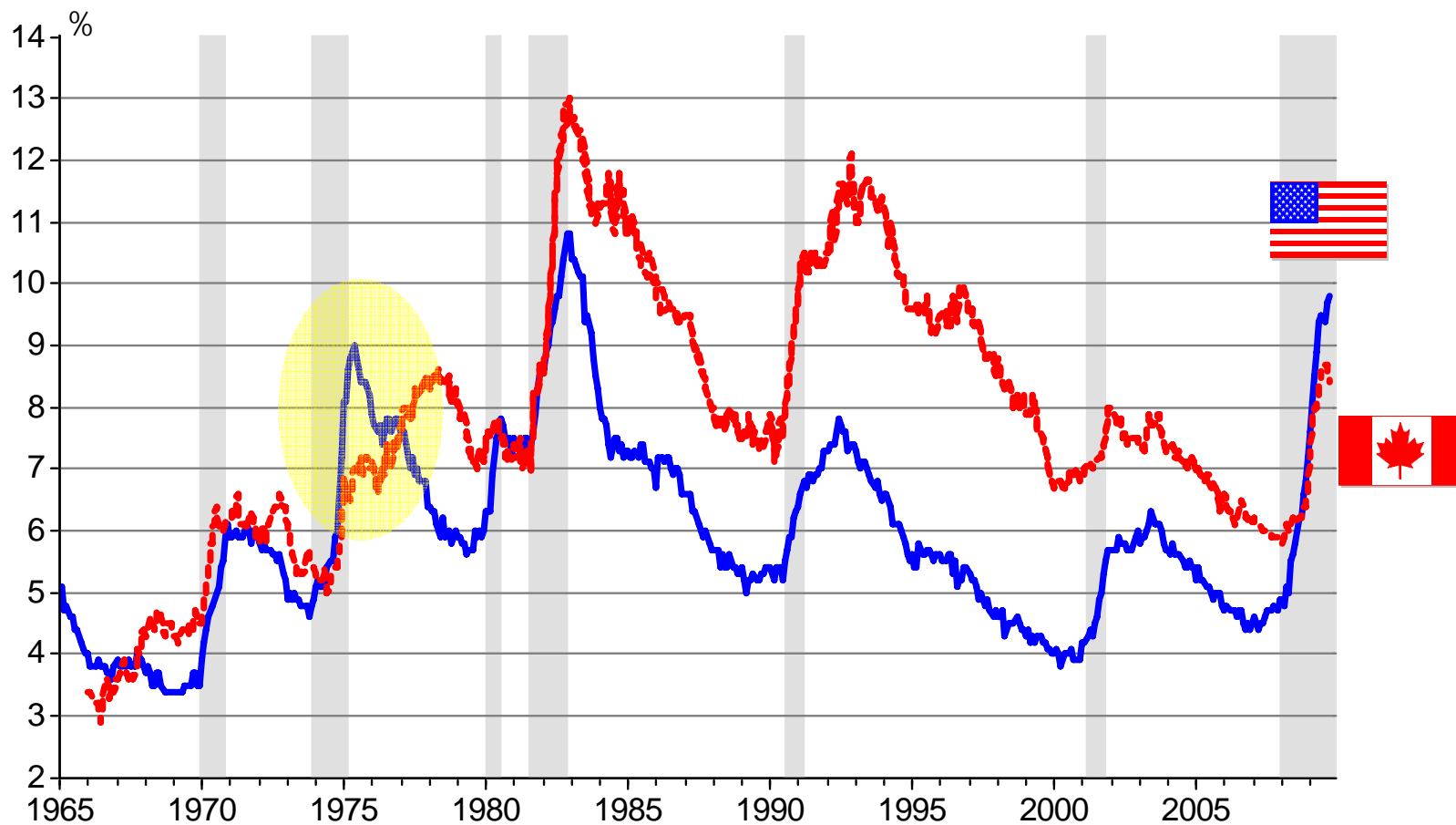
Canadian labour markets have stabilized



NBF Economy & Strategy (data via Global Insight)

A first in 35 years!

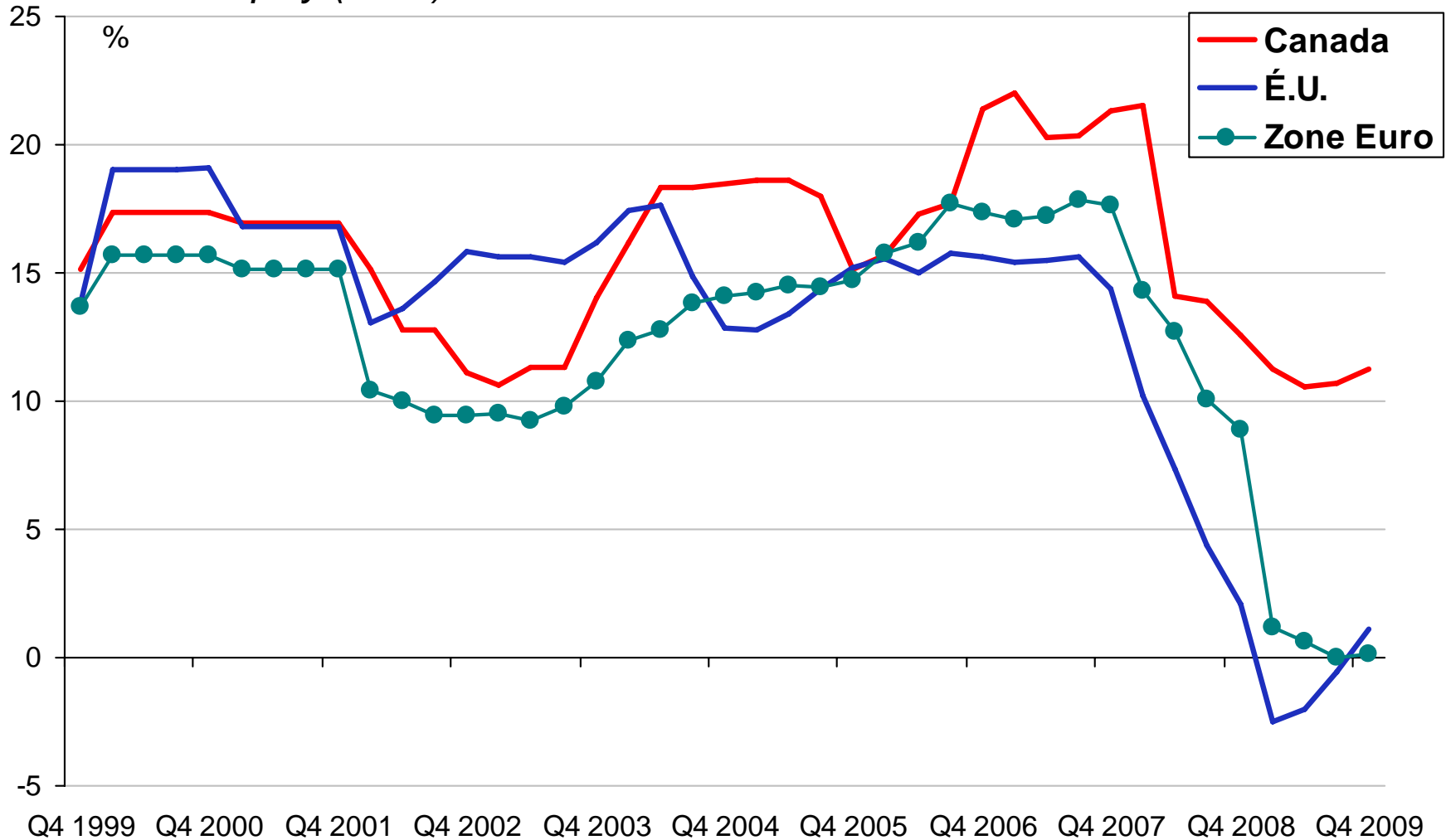
Unemployment rates, Canada and U.S.



NBF Economy & Strategy (data via Statcan and BLS)

Canadian banks better resisted

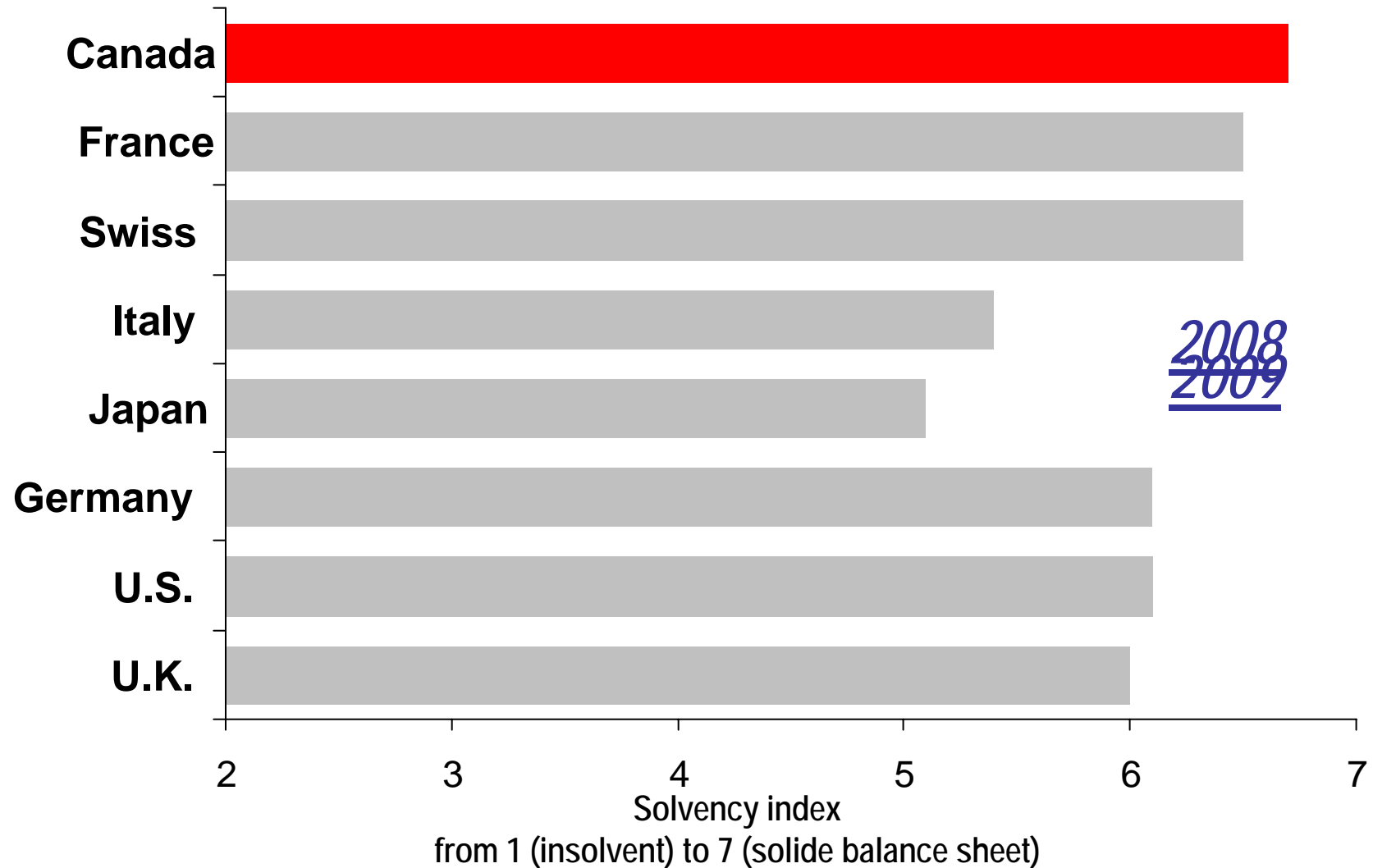
Return on equity (ROE)



NBF Economy & Strategy (data via Datastream)

Perception about Canadian Banks

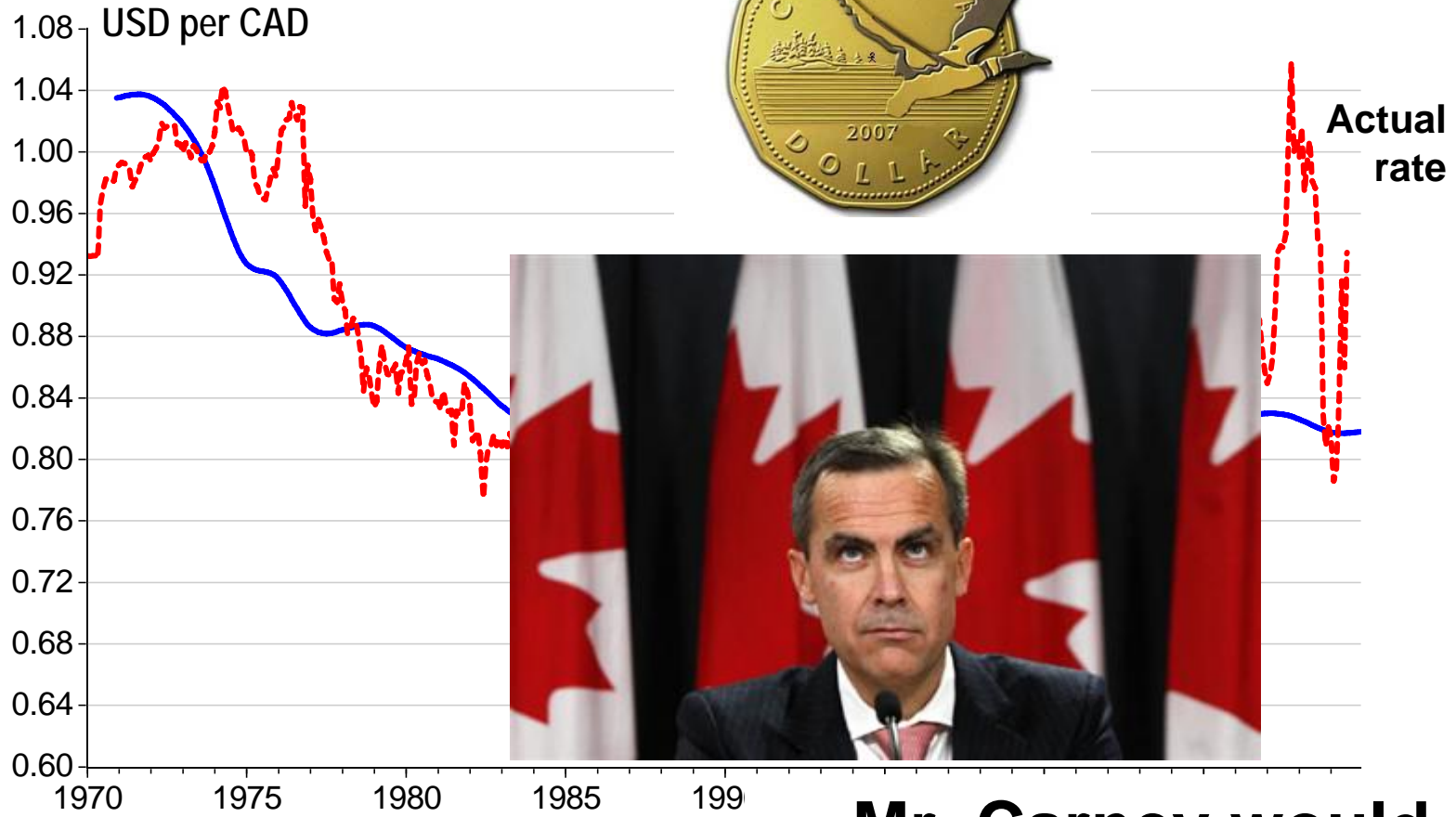
Solvency index – G7 plus Switzerland



Outlook for interest rates

Canadian dollar

The loonie takes off

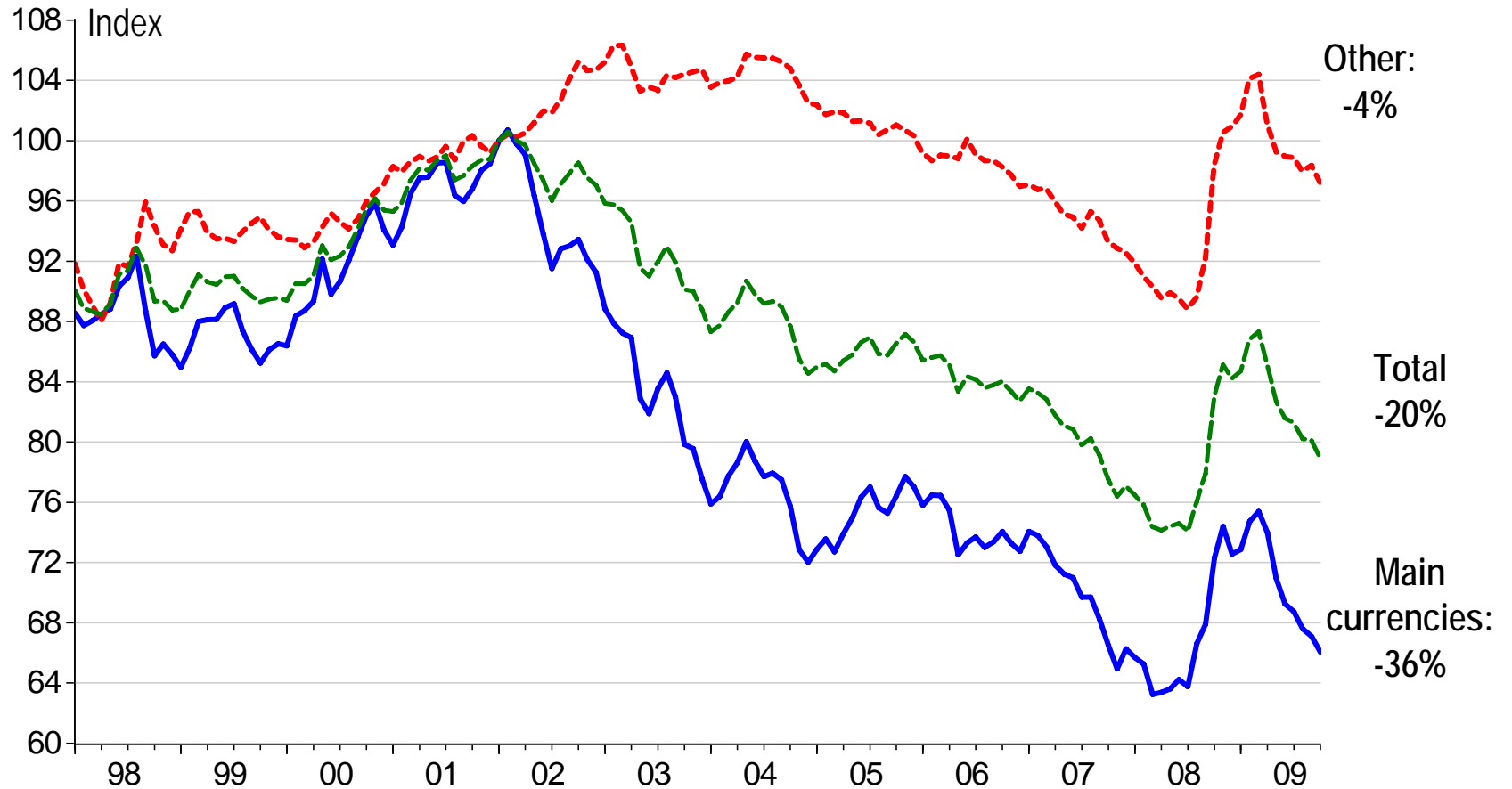


... Mr. Carney would like to clip its wings

NBF Economy & Strategy (OECD from D)

Who bears the brunt of USD depreciation?

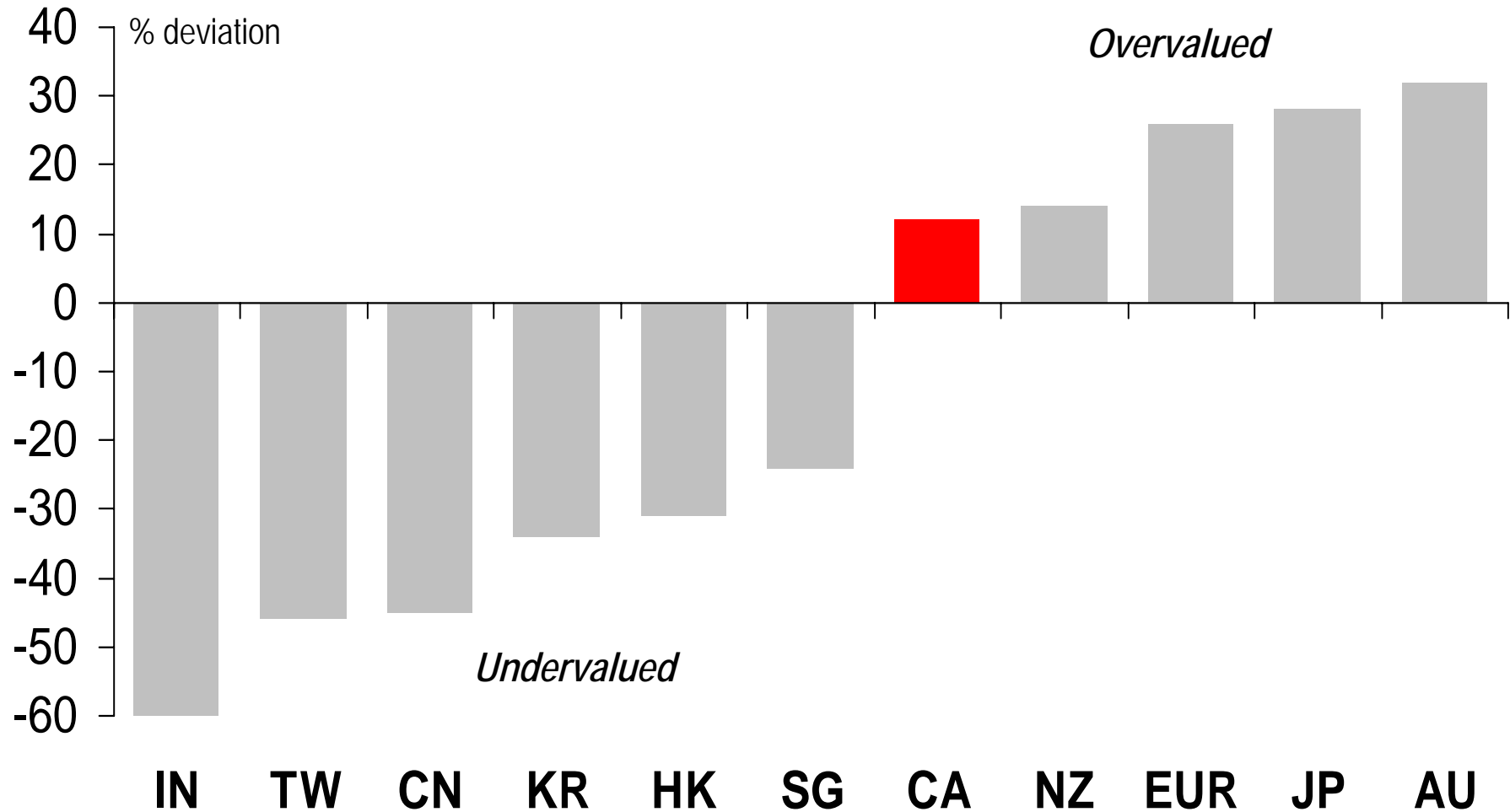
Trade-weighted exchange rate



NBF Economy & Strategy (data via Federal Reserve)

Time for currency realignment

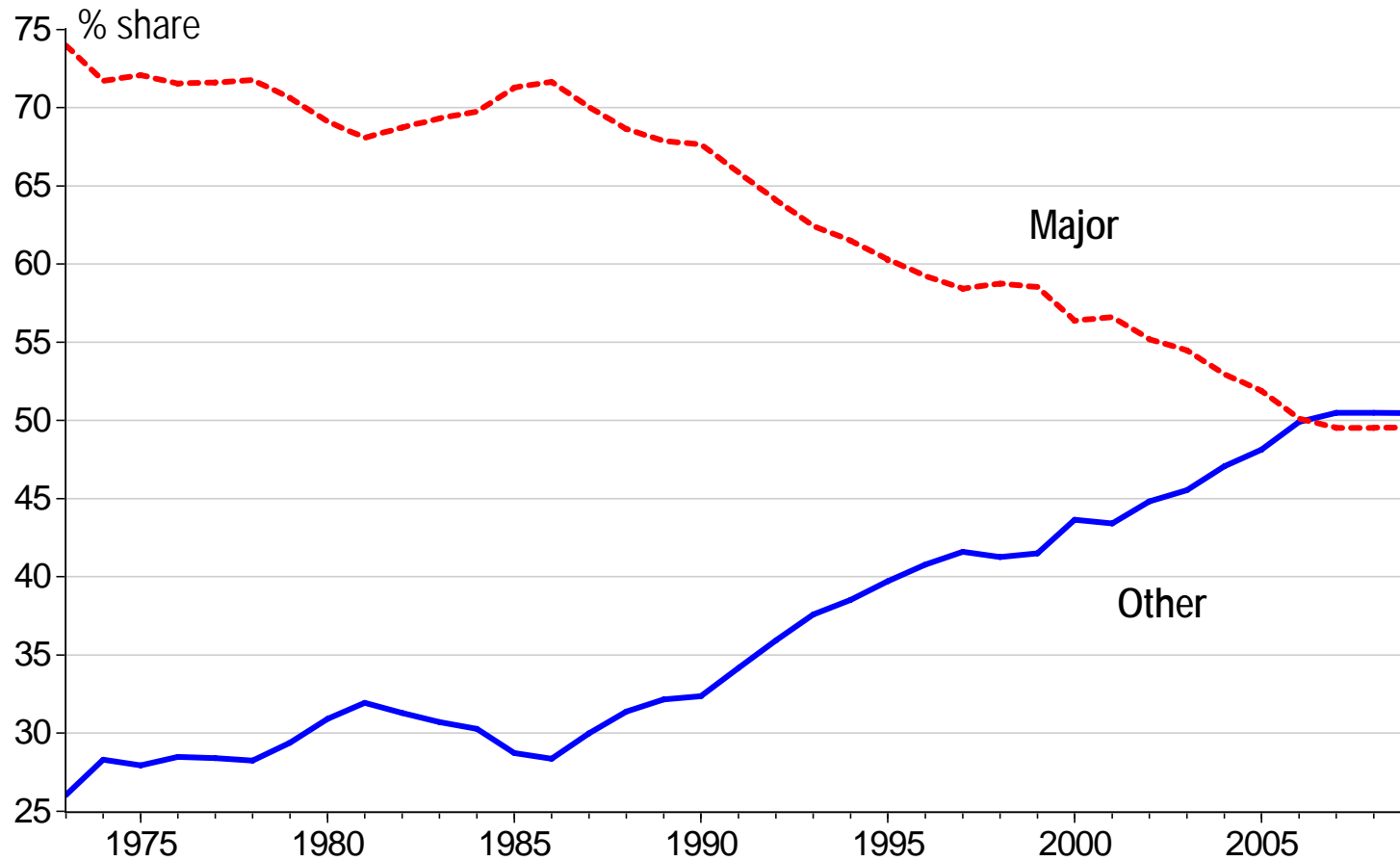
Deviation from purchasing power parity as estimated by the IMF



NBF Economy & Strategy (data via IMF)

Major currency bloc: Less than 50% of trade flows

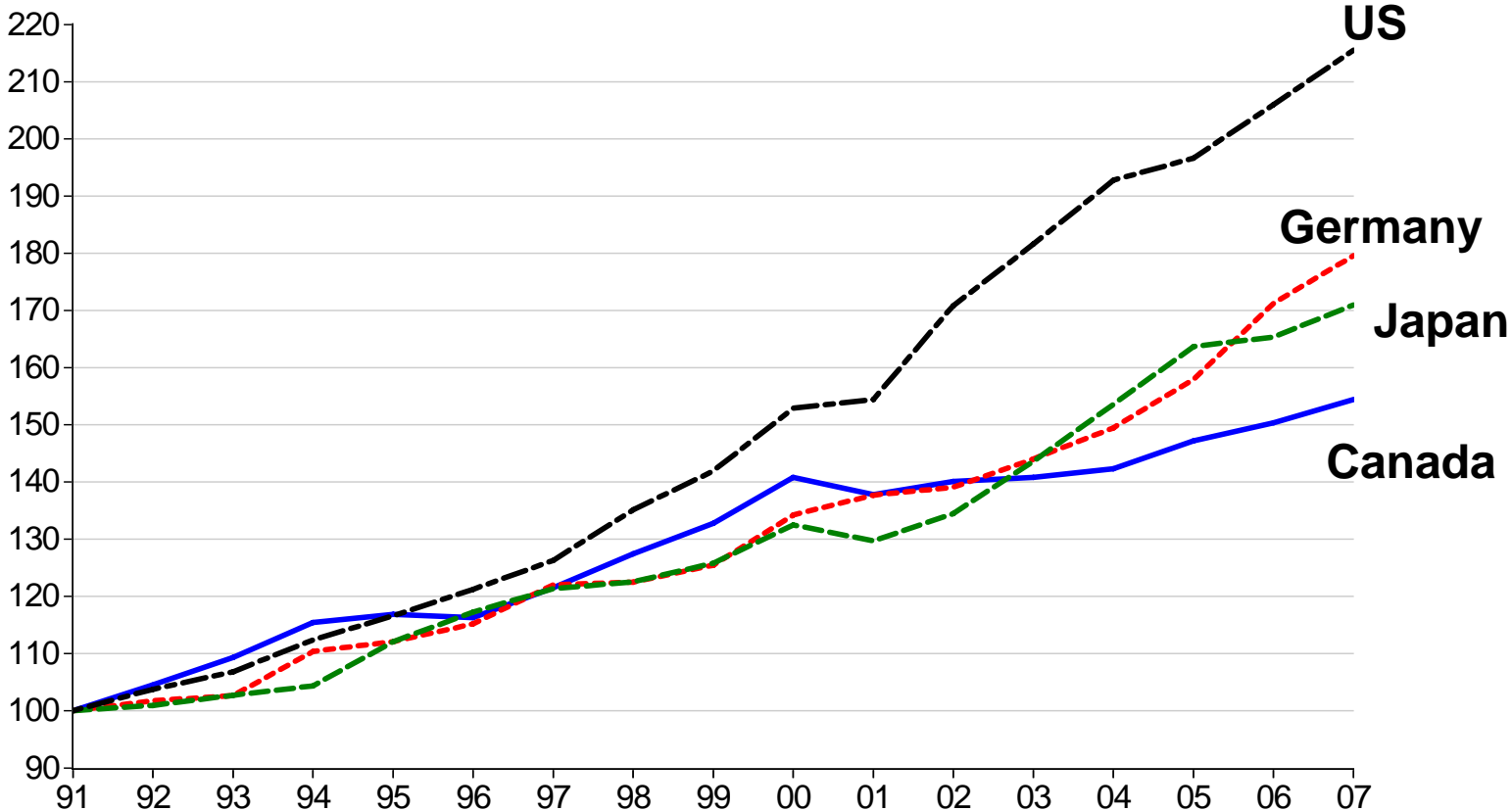
Share of trade with the United States



NBF Economy & Strategy (data via Federal Reserve)

The productivity challenge

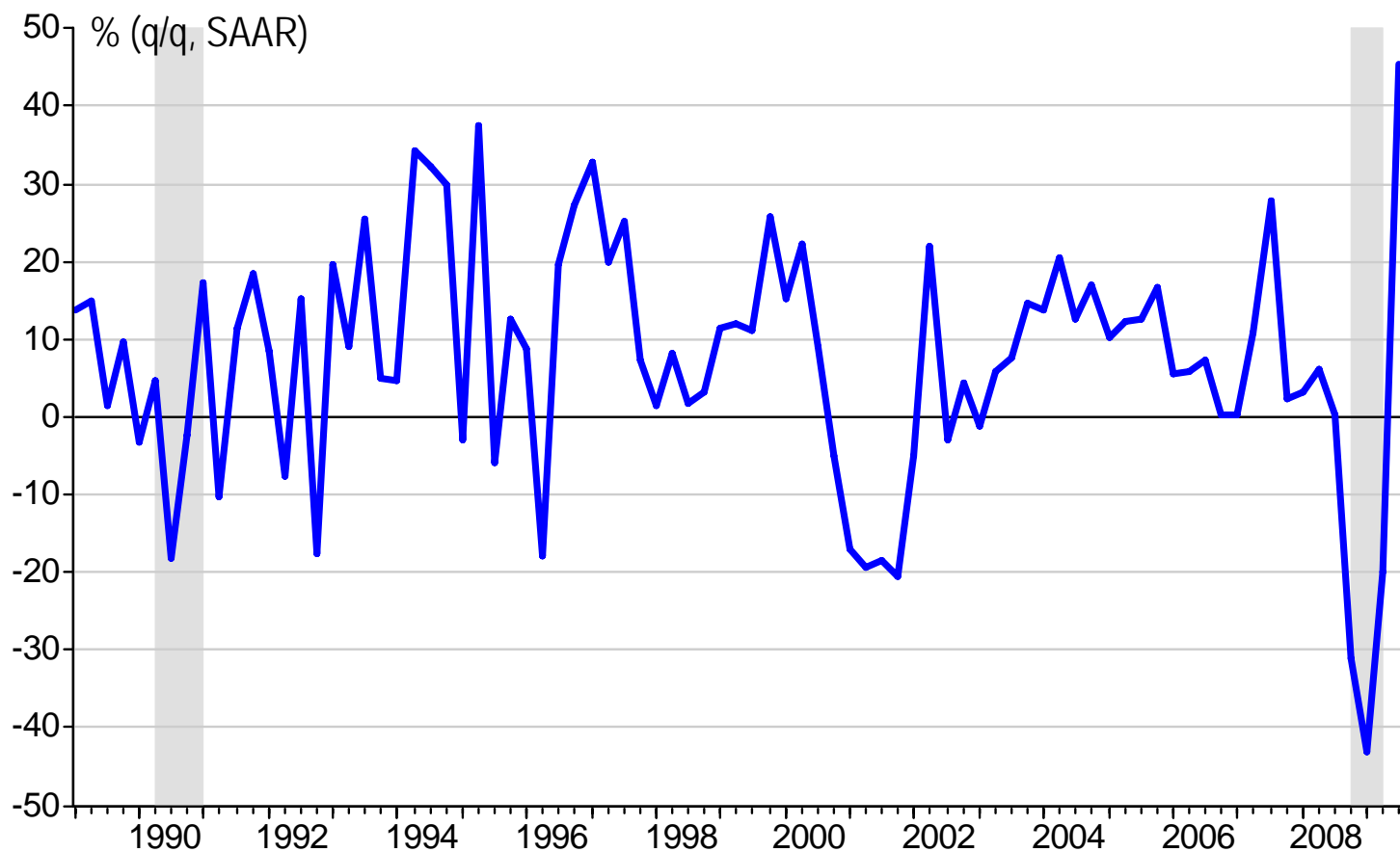
Output per hour in manufacturing (1991=100)



NBF Economy & Strategy (data via BLS)

Canada: Businesses are reacting!

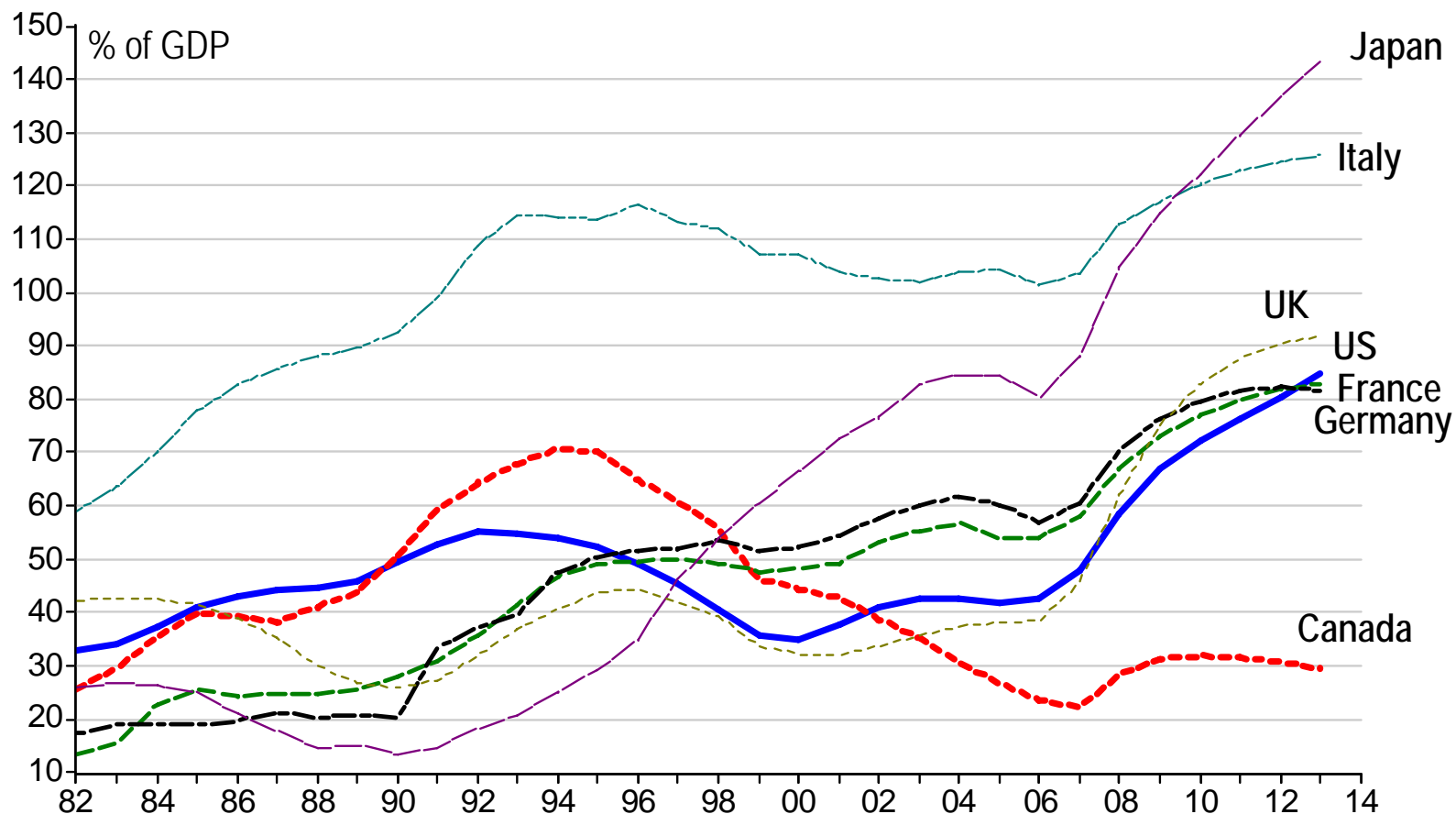
Volume imports of machinery & equipment



NBF Economy & Strategy (data via Global Insight)

Are USD depreciation fears overdone?

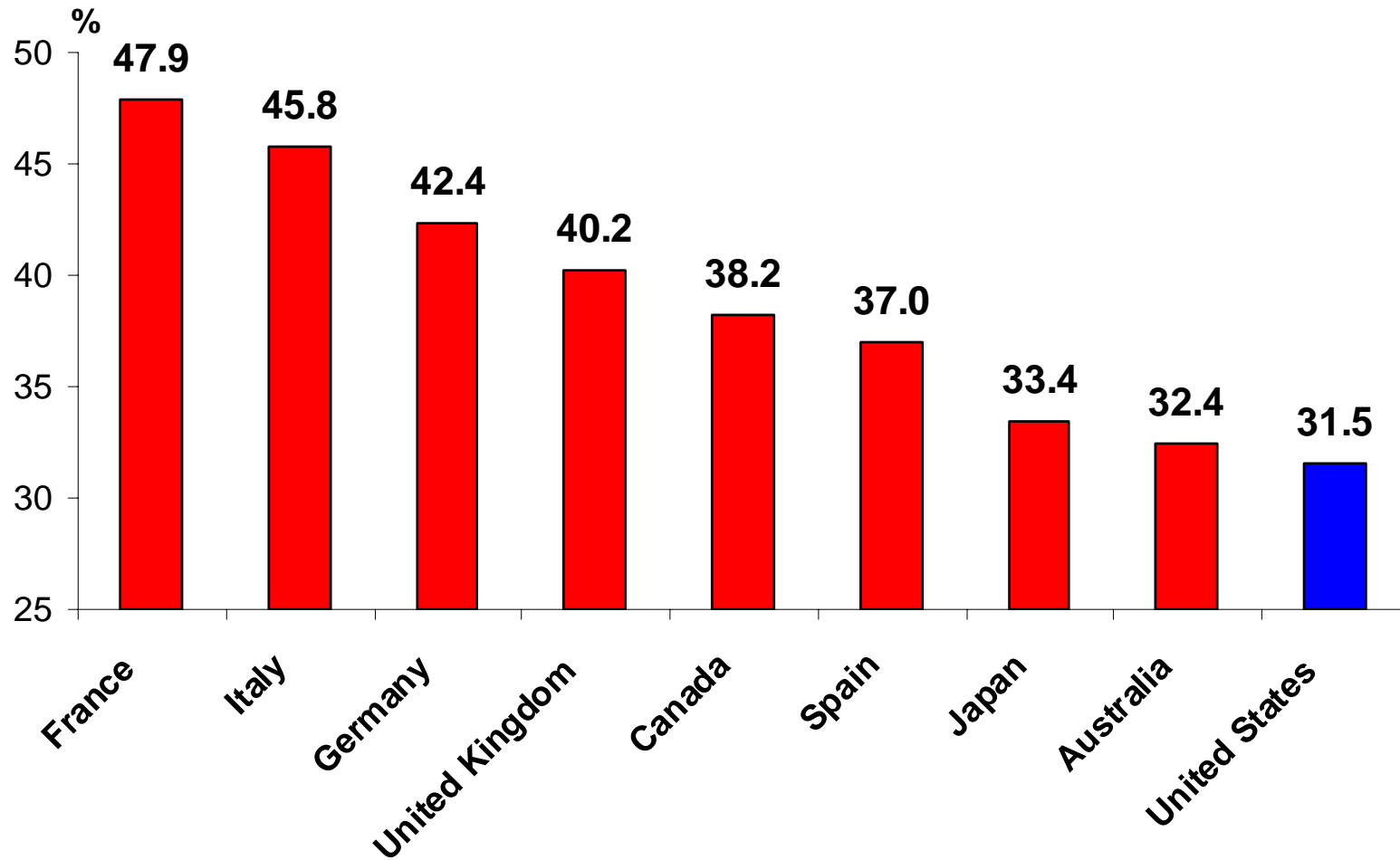
Net debt, general government



NBF Economy and Strategy (data via OECD)

Some room to maneuver on the tax front

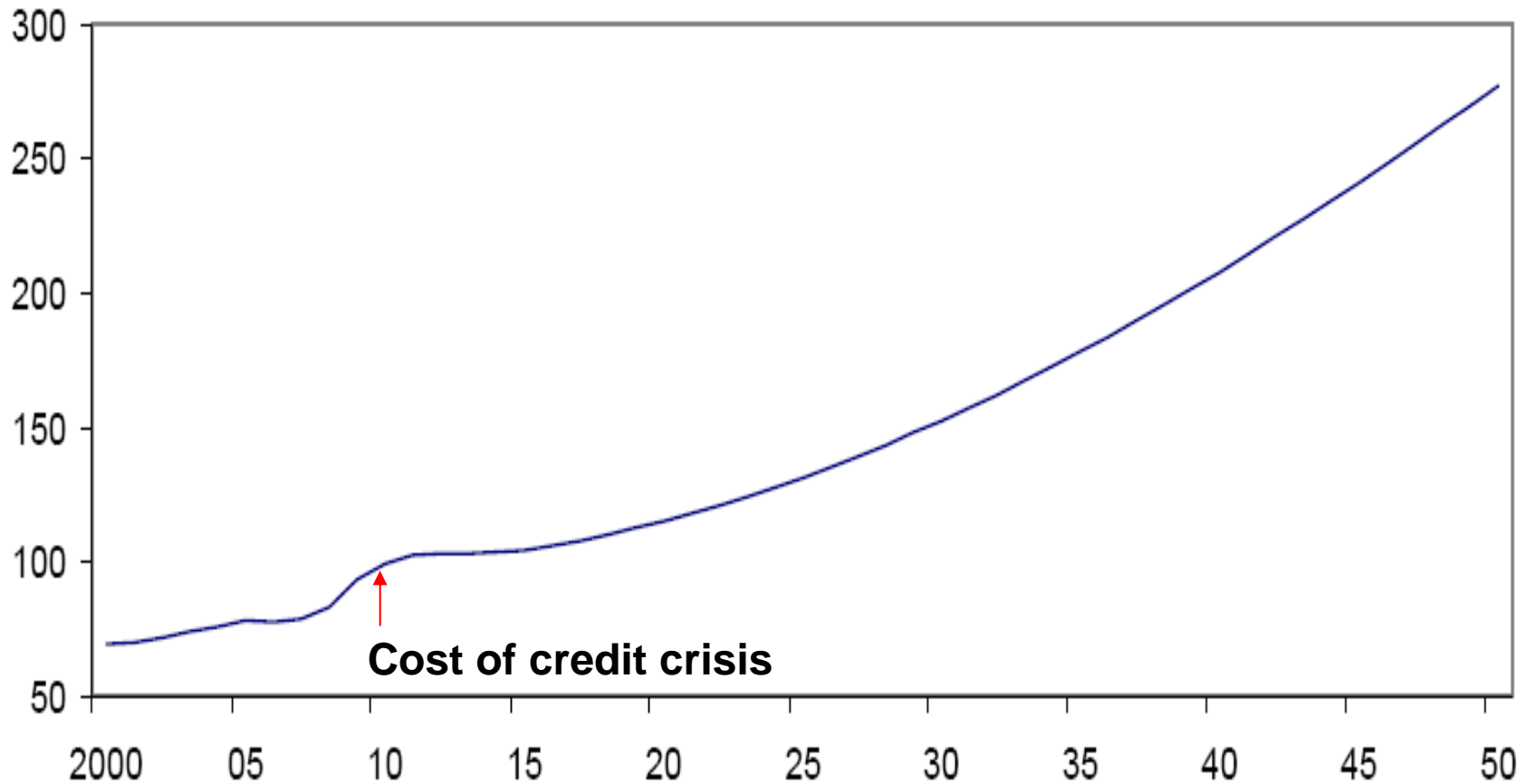
Total government receipts as a percentage of GDP



NBF Economy and Strategy (data via OECD)

Cost of aging dwarfs that of credit crisis

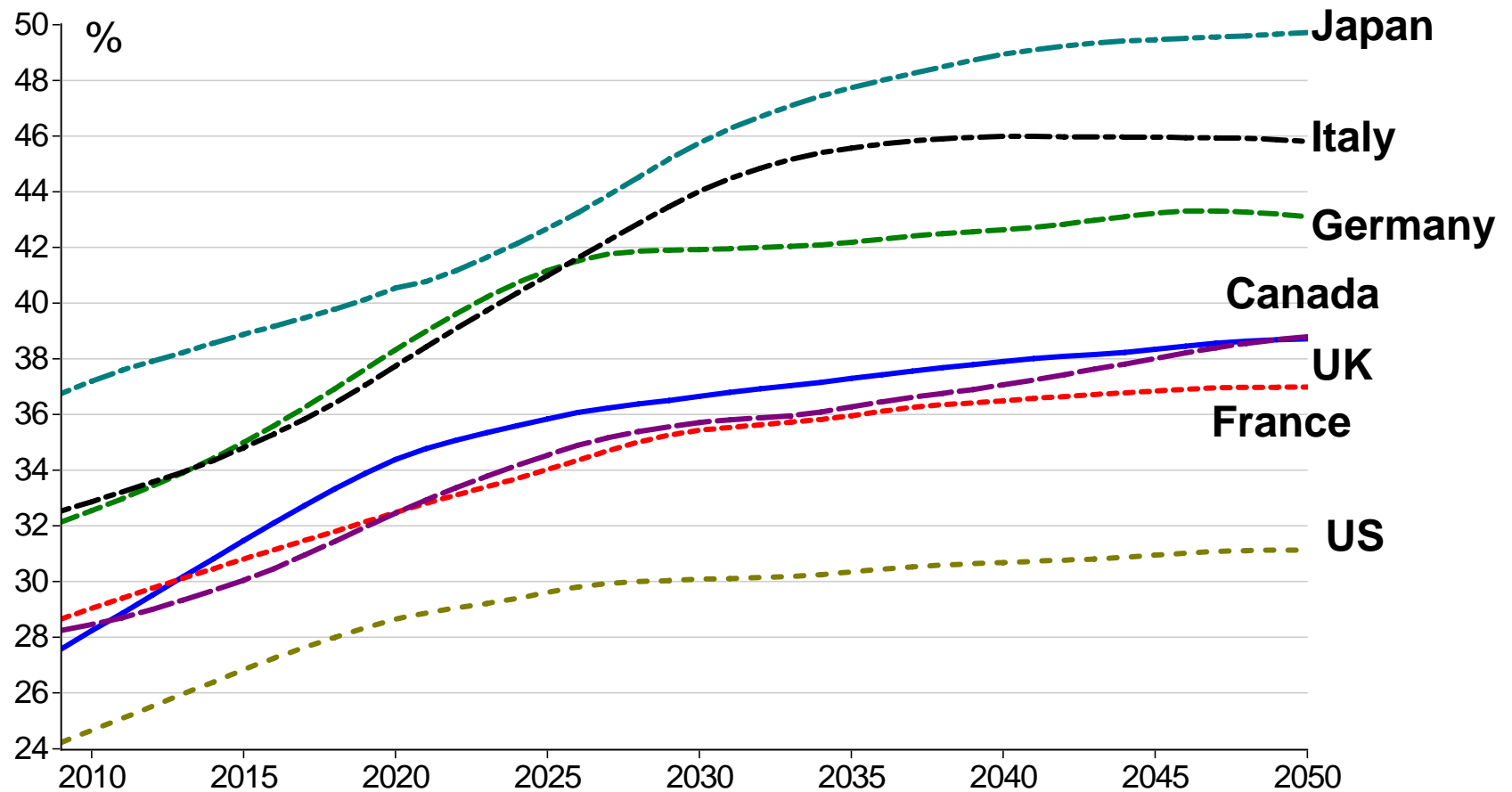
G-20 debt as a share of GDP



IMF (The State of Public Finances: Outlook and medium-term policies after the 2008 crisis)

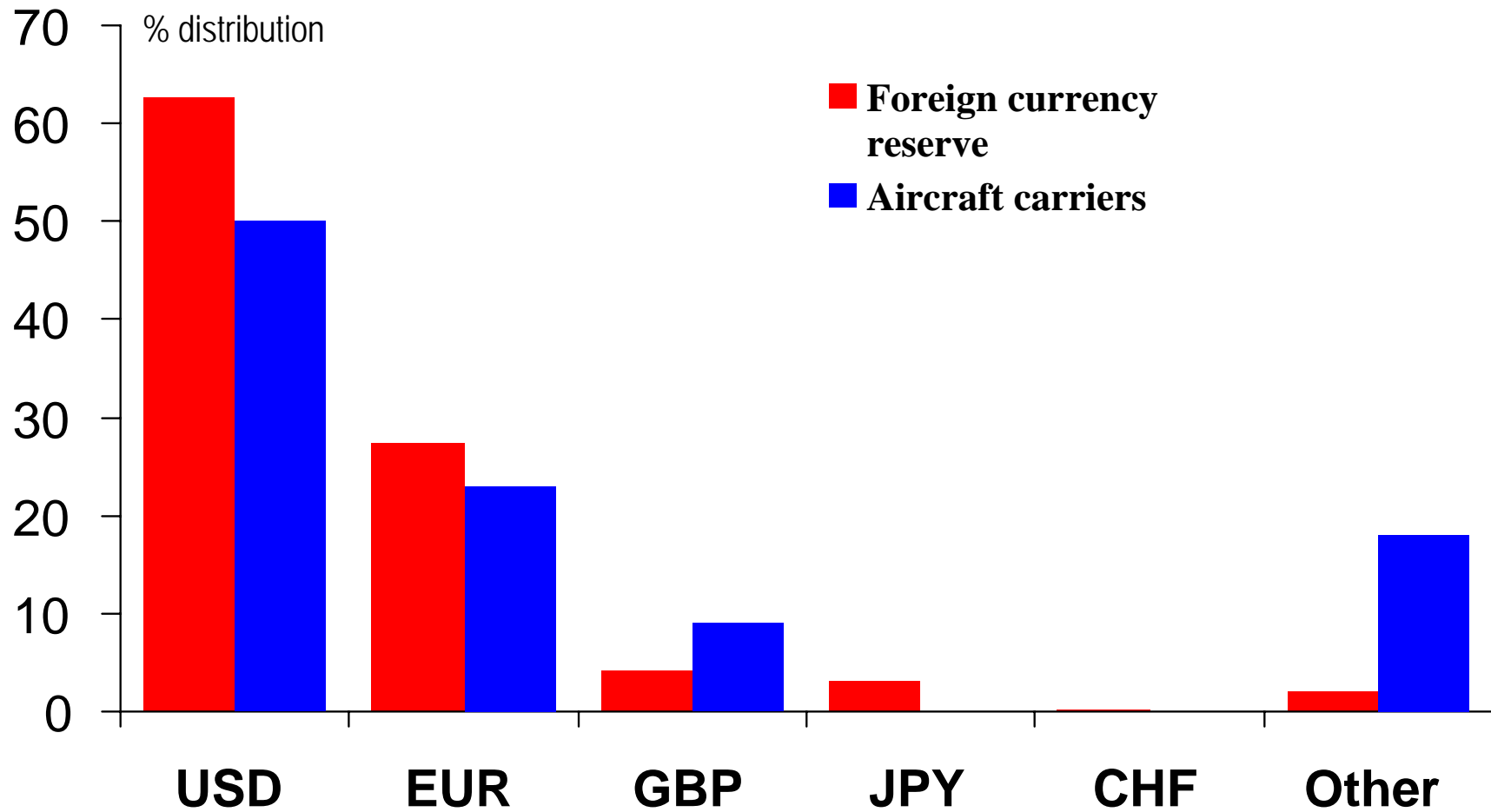
The U.S. is not aging as fast as others

55 and over as a percentage of total population



Economy and Strategy NBF (data via US Census)

Something else makes the USD the reserve currency



NBF Economy & Strategy (data via IMF and Wikipedia)

Summary: Outlook 2010

- **U.S.**
 - *Respectable growth through 2010*
 - *A double dip is unlikely*
 - *Rate rises are on the radar screen*
- **Canada**
 - *Cyclical recovery is now under way*
 - *Canada is well-positioned to ride the global recovery but we need to take up the productivity challenge*

Risk Factors

- A jobloss recovery
- Geopolitics (including protectionism)
- Commercial real estate
- Monetary policy falling behind (velocity of money)
- Exchange rate policies
- H1N1 (a pandemic)

Thank you for your attention!

The perils of linear projections



The great scare of 1898

Horse population of NY: 160,000

By-products:

Manure deposits: 3.5 million pounds daily

Urine deposits: 40,000 gallons daily

Projection made at the time:

“By 1930, horse droppings will rise to Manhattan’s third-story windows”

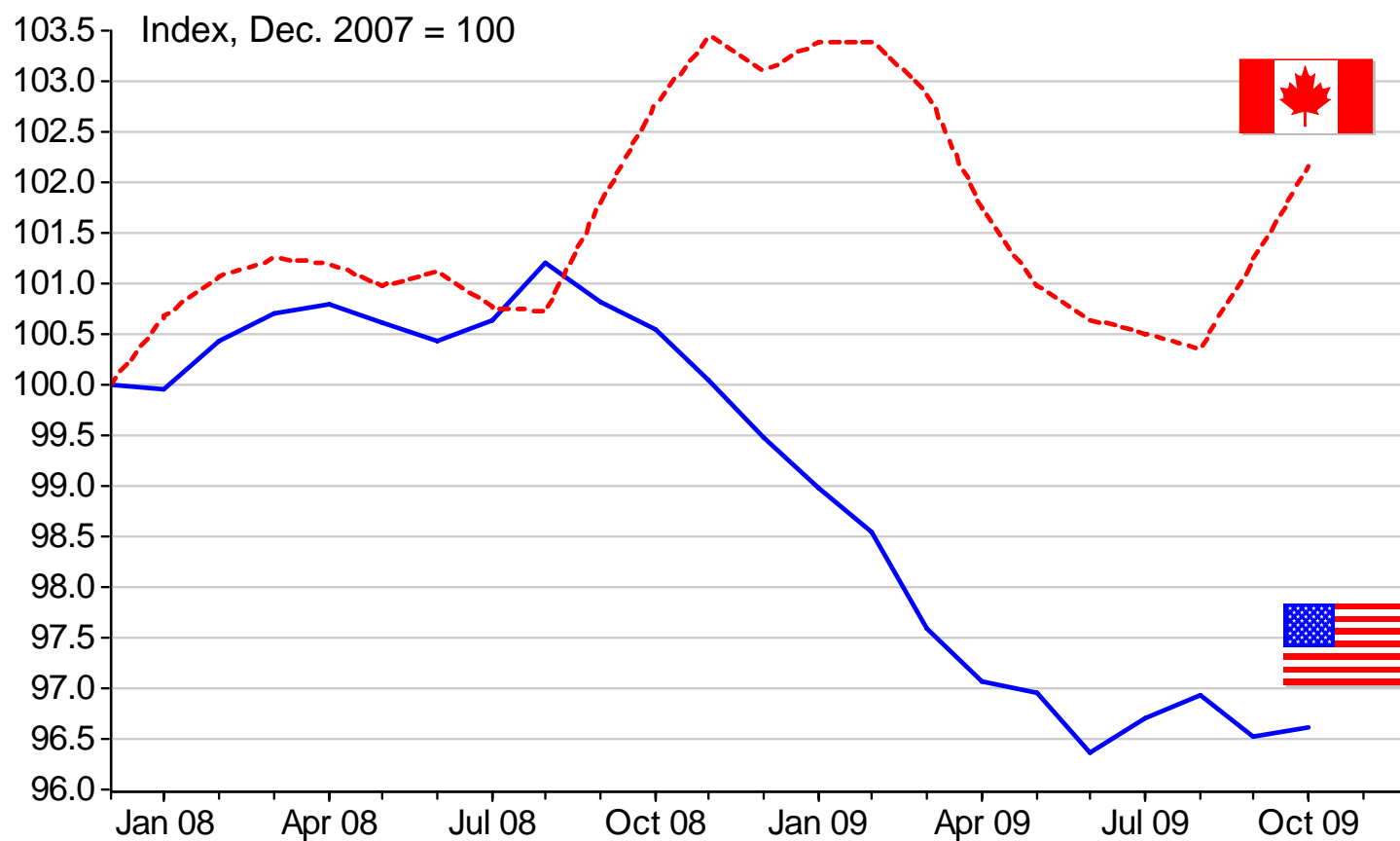
First international urban planning conference, NY, 1898

The reality:

By 1912, there were more automobiles than horses in NY

The wage bill did not deteriorate !

Economy-wide wage bill



NBF Economy & Strategy (data via Global Insight)