BDC
Entrepreneurs first

economic LETTER

DECEMBER 2015

Highlights of the month

- Thanks to the Trans-Pacific Partnership, Canadian businesses will have preferred access to some countries that have strong growth potential. The agreement has been signed but will probably not come into force before the end of 2017, giving businesses time to position themselves in these markets.
- After struggling at the beginning of the year due to the plunge in oil prices, the Canadian economy picked up in the third quarter, largely thanks to an increase in net exports. Economic growth will be modest this year, but should accelerate in 2016.
- The Bank of Canada has left the interest rate unchanged, and the majority of forecasters expect that it will stay at its current level of 0.5% until the fourth quarter of 2016. Business credit conditions should therefore remain favourable to investment.
- The job market is doing better and better in the United States, giving reason to believe that the U.S. economy is gaining strength, as expected. This bodes well for Canadian firms that export south of the border.

THE TRANS-PACIFIC PARTNERSHIP: WHICH SECTORS WILL BENEFIT?

The Trans-Pacific Partnership will expand Canada's presence in the Asia-Pacific region

The Trans-Pacific Partnership (TPP) is a free trade agreement between 12 countries: Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam. The agreement was finalized on October 5, 2015 but will probably not come into force before the end of 2017, due to a long process that includes a legal review, translation, drafting and checking of the text of the agreement by each member country. This gives Canadian businesses time to position themselves in these markets.

Like the Comprehensive Economic and Trade Agreement that Canada entered into with the European Union in 2014, the TPP is a very broad trade agreement. Besides promoting wider circulation of goods between the participating countries, the TPP also aims, among other things, to liberalize services and investment

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- Employment tumbles
- Housing starts lose ground, but the trend is still positive
- The trade deficit widens

United States
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Key indicators

BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to December 5. Reliance on and use of this information is the reader's responsibility.

and to allow access to procurement contracts.[1] Canada has already signed free-trade agreements with four of the TPP member countries: the North American Free Trade Agreement with the United States and Mexico, the Canada-Chile Free Trade Agreement and the Canada-Peru Free Trade Agreement, which came into force in 1994, 1997 and 2009, respectively. The TPP will give Canada greater access to the Asia-Pacific countries.[2]

Canada's current trade with the TPP countries

Compared with its trade with the United States, Japan and Mexico, which are already among its 10 largest trading partners, Canada's trade with the other TPP countries is far more limited. That said, Canadian exports to those countries represented $6.7 billion in 2014, and imports came to $13.2 billion, for total trade of nearly $20 billion, which is considerable.

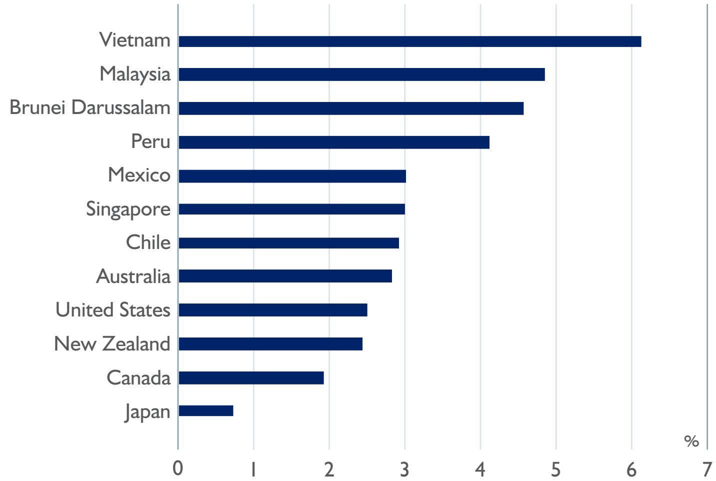
The TPP should promote trade with these countries, and therefore the value of Canadian exports to those destinations is likely to increase in the years to come. The TPP should also benefit the many Canadian companies that already export to Japan, a country that has many restrictions on imports.

Preferred access to some countries with strong growth potential

Among the TPP member countries, some, like Brunei Darussalam, Malaysia, Peru and Vietnam, have fast-developing economies. These are markets where the middle class is expanding and consuming more and more imported products. Between 2000 and 2014, Canada's exports to Peru and Vietnam increased respectively by 10% and 16% per year, on average. The International Monetary Fund predicts that real GDP will expand at average annual rates of 6% in Vietnam, 5% in Malaysia and 4% in Peru between now and 2020 (graph), which means that the pace of growth of Canadian exports to those countries should remain robust in the years to come, and could even accelerate thanks to the TPP.

Many TPP member countries will experience strong growth in the years to come

Forecast average annual real GDP growth from 2015 to 2020



Source: International Monetary Fund

Many industries should benefit from the TPP

The agriculture and agri-food industry

Canadian exports of agricultural and food products to the TPP countries amounted to $36 billion in 2014, including $4.1 billion to Japan.[3] Canadian agricultural products are subject to tariffs (imposed by Japan) averaging 17.5%, so this industry will greatly benefit from the abolition or reduction of these tariffs. The majority of tariffs that Malaysia and Vietnam apply to these products, amounting respectively to 17% and 11%, on average, will also be reduced or eliminated.[4] It is expected that the consumption of many food products, in particular meat and seafood, of which Canada is a major producer, will increase in these countries in the years to come as the standard of living of their populations rises.

Note that the Canadian government has announced that it would set up programs and initiatives to protect the revenues of producers and processors who are subject to supply management, such as producers of milk, poultry and eggs.

1 "Access to procurement contracts" refers to the possibility for a Canadian firm, for example, to supply goods or services to a government of another member country.
2 Australia, Japan, Malaysia, New Zealand, Singapore and Vietnam are located in the Asia-Pacific region.
3 This includes agricultural, livestock, hunting and fishing products as well as manufactured food products.
4 The tariffs reported in this letter are drawn from the Department of Foreign Affairs, Trade and Development: http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/index.aspx?lang=eng, site visited on November 30, 2015. In most cases, the tariffs will be reduced or eliminated gradually over a predetermined period.

The forest industry
In 2014, Canada exported nearly $11 billion worth of forest products to the TPP countries.[5] Significant tariffs are imposed on forest products in many of these markets, in particular tariffs of up to 10% in Japan, up to 31% in Vietnam, up to 40% in Malaysia, up to 5% in Australia and New Zealand and up to 20% in Brunei.

Services
The TPP will provide more transparent and predictable market access for the types of services where Canada excels, such as professional services (including architecture and engineering), research and development, the environment, construction and transportation, and mining and oil and gas extraction. The agreement will also foster greater participation by Canadian financial services firms in the TPP markets, ensuring that those markets remain open to Canadian suppliers and that the firms' investments are protected.

Industrial products and consumer goods
Canadian exports of industrial goods to the TPP countries reached over $337 billion in 2014. The tariffs on goods such as metals and minerals, chemical products and iron and steel products (which can be as much as 50% in some cases) will be abolished. The TPP also calls for changes to tariffs and other measures in the fields of aerospace, automobiles, industrial machines, farm equipment, construction equipment, information and communications technologies, life sciences (medical instruments and pharmaceutical products) and cosmetics. With respect to the automobile industry, the government has negotiated a number of measures designed to protect this country's industry, in particular rules governing the place of origin of exported vehicles and parts. ■

CANADA

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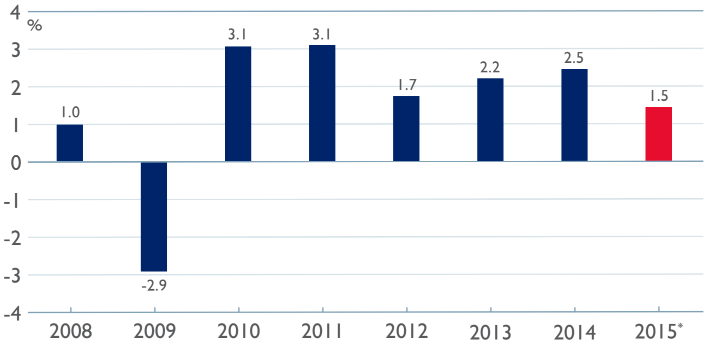
Real GDP growth rebounds

After contracting in the first half of the year, the real gross domestic product (GDP) expanded by 2.3% in the third quarter. It was mainly net exports that supported growth in that quarter. Exports recorded robust growth of 9.4%, while imports fell by 2.9% compared with the previous quarter. Growth in household consumption slowed compared with the second quarter, government expenditures and investments declined and residential investment accelerated. Non-residential investment by businesses lost ground for the third quarter in a row; this probably still reflects, in part, the negative impact of the plunge in crude oil prices on investments. The third quarter ended on a sour note, with real GDP contracting by 0.5% in September. This decline is mainly attributable to the oil and mining sector, whose output fell by 5.1% compared with the previous month. Thanks to its upturn in the third quarter, real GDP growth over the first three quarters of the year comes to 1.5% (graph). According to the Consensus, growth should come in at 1.1% this year, and reach 2.0% in 2016.

Real GDP growth slowed in 2015 but is still positive

Annual change in real GDP, 2008 to 2015*



Source: Statistics Canada

*Average of the first three quarters of 2015 divided by the average of the first three quarters of 2014

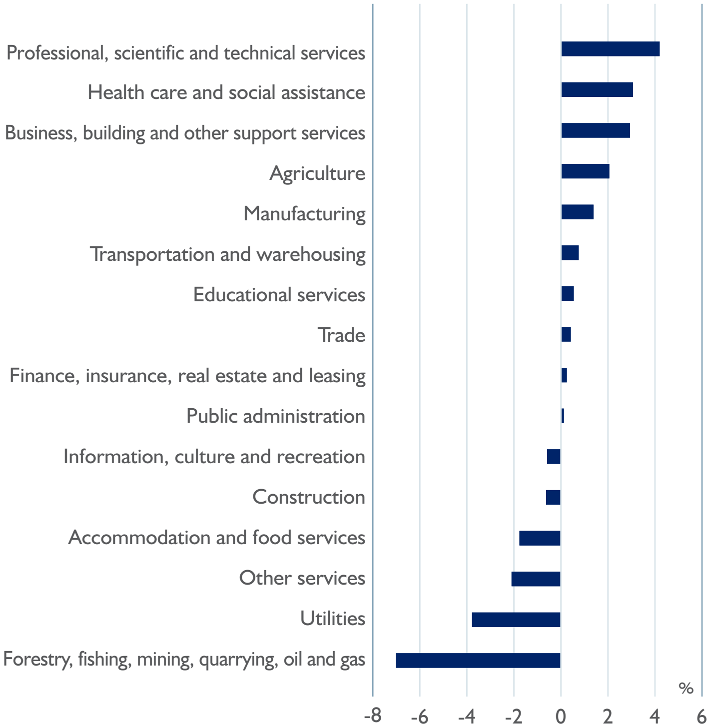
Employment tumbles

After expanding by 44,400 jobs in October, employment declined by 35,700 jobs in November. This is due to the disappearance of some 30,000 temporary jobs that were created in October in connection with the federal election. If we exclude public administration jobs, we see an increase of 12,400 jobs in October, followed by a loss of 3,200 jobs in November. Over a 12-month horizon, employment has risen by 0.7%, and this growth is entirely attributable to full-time jobs, which ticked up by 1.3%, while part-time jobs fell by 2.0%. Looking at the various sectors, we note a sharp downturn in employment in the mining and oil extraction sector, while the health care and social assistance sector shows the biggest gains (graph). ▼

5 Includes forestry and timber harvesting, as well as manufactured wood products.

Employment in the mining and oil sector has declined significantly in the past 12 months

Growth over 12 months in November 2015, by industry



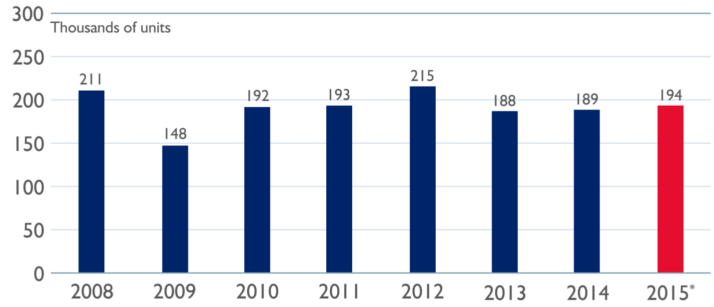
Source: Statistics Canada

Housing starts lose ground, but the trend is still positive

Housing starts were down by 14.4% in October compared with the previous month. In the urban centres, starts of multiple-unit projects plummeted by 22.4%, while those of single-family dwellings edged up by 1.3%. So far this year, housing starts are up compared with 2014 (graph). With an average of 194,000 units in the period from January to October, the number of starts is in the upper range of the forecasts prepared by the Canada Mortgage and Housing Corporation in the first quarter of the year, i.e. between 154,000 and 201,000 units.

Housing starts are up slightly so far in 2015

Housing starts, 2008 to 2015*



Source: Statistics Canada

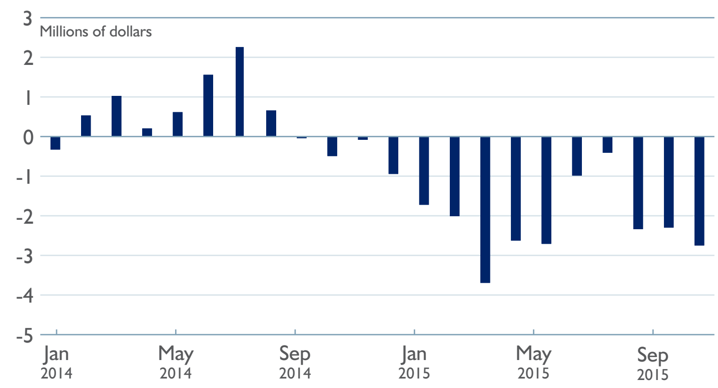
* January to October, at annual rate

The trade deficit widens

A 1.8% decline in exports and a 0.8% downturn in imports in October caused the trade deficit to widen, from $2.3 billion in September to $2.8 billion in October. Exports were down in all the main industry categories in October except for industrial machinery, equipment and parts, where they edged up by 1.1% compared with the previous month, and energy products, whose level remained unchanged. The balance of trade, which had improved in 2014, has been in a deficit position since the beginning of the year (graph). ■

The balance of trade has been in a deficit position throughout 2015

Balance of trade, January 2014 to October 2015



Source: Statistics Canada

UNITED STATES

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GDP growth is revised upwards

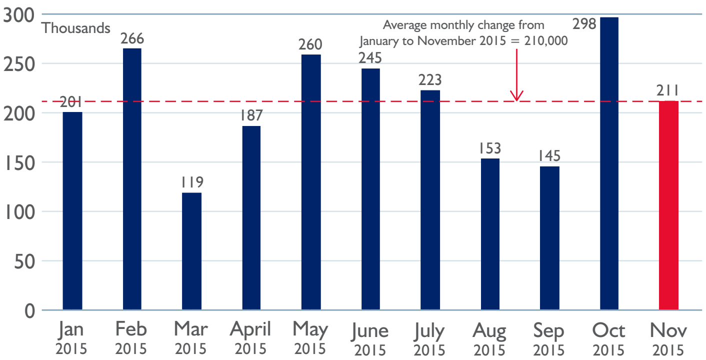
The Bureau of Economic Analysis in the United States has revised third-quarter real GDP growth upwards, from 1.5% to 2.1%. The revision is mainly attributable to a less-sharp-than-expected decline in the inventories of private companies.

Sound job growth

Non-farm payrolls were up by 211,000 in November, which is in line with the average monthly change recorded since the beginning of the year (graph). The unemployment rate is unchanged, at 5.0%. The construction sector gained 46,000 jobs in November, over half of which were in the residential sector. There were 30,770 new jobs in retail trade, bringing the gains won over the past 12 months in that sector to 284,200. On the other hand, job growth is weak in the manufacturing sector, where only 36,000 jobs have been created since November 2014.

November's job gains are in line with the average monthly change in 2015

Monthly change in employment, January 2015 to November 2015



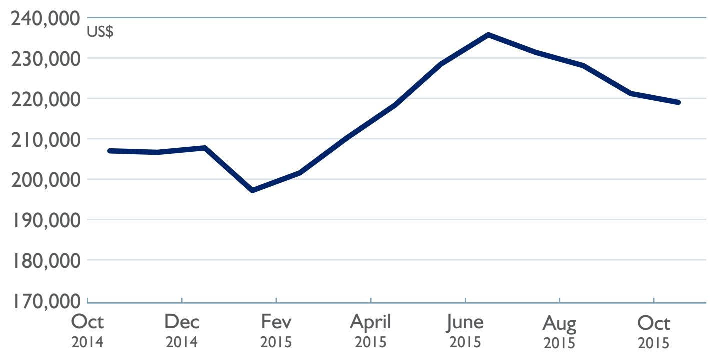
Source: U.S. Bureau of Labor Statistics

Housing starts and sales of existing homes pull back

The number of housing starts was down by 11.0% in October, compared with the previous month. Starts of single-family homes fell by 2.4%, and those of multiple-unit homes by 25.5%. The long-term trend, measured by the six-month moving average, recorded a slight downturn compared with September. Sales of existing homes also pulled back in October, from 5.55 million in September to 5.36 million in October—a decline of 3.4%. Despite this monthly contraction, home sales are 3.9% above where they stood in October 2014. The median price of homes, which stands at $219,600, has diminished in recent months but is still high compared with last year (graph). ■

The median price of homes has declined but is still high compared with a year ago

Median price of existing homes, October 2014 to October 2015



Source: U.S. National Association of Realtors

INTEREST RATES

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The key interest rate holds steady

On December 2, the Bank of Canada announced that it was leaving the target for the overnight rate unchanged, at 0.50%. The Canadian economy is slowly adjusting to the lower commodity prices. The vitality of the U.S. economy, the weaker value of the Canadian dollar and the low interest rates are making that adjustment easier. The central bank expects that real GDP growth will slow in the fourth quarter, and then gradually accelerate in 2016. The Bank's decision came as no surprise to forecasters, who expect the key interest rate to remain stable until the fourth quarter of 2016. ■

OIL PRICE

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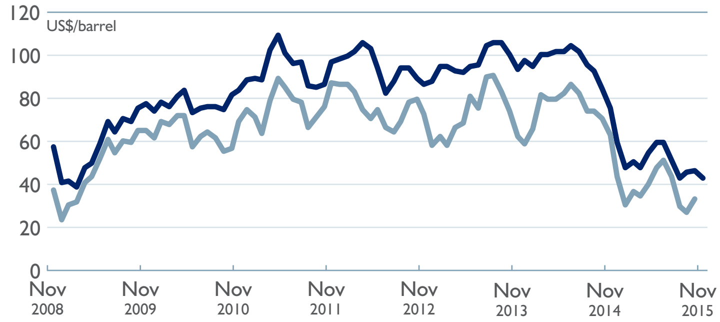
The price of crude oil has stabilized

The price of crude oil, as measured by that of West Texas Intermediate, remained relatively stable in November compared with the previous month, slipping from an average of US$46.34 per barrel in October to an average of US$43.01 per barrel (graph). The price of crude temporarily spiked during the month when a Russian plane was shot down in Turkey, which heightened the tension between those two countries. But concerns about the excess supply quickly gained the upper hand and pushed prices down. At month end, the price of crude was around US$42 per barrel. ■

The price of crude oil has stabilized in recent months

Prices of West Texas Intermediate and of Western Canada Select, November 2008 to November 2015



Source: Global Insight et Alberta Treasury Board and Finance

CANADIAN DOLLAR

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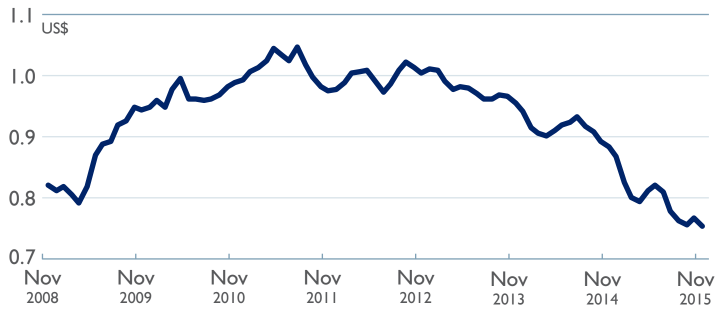
The Canadian dollar depreciates again, but very slightly

The Canadian dollar depreciated by 1.5% in November after appreciating at the same rate in the previous month (graph). Thus the value of the loonie against the U.S. dollar appears to be stabilizing, after several months of depreciation. This is largely due to the fact that the price of crude oil has also stabilized in recent months. Expectations of a change in the differential between Canadian and American interest rates (which, along with crude oil prices, are among the factors wielding the most influence on the CAD/USD exchange rate) have not changed during the month. ■

The Canadian dollar has depreciated slightly once again

Canada/United States exchange rate, November 2008 to November 2015



Source: Bank of Canada

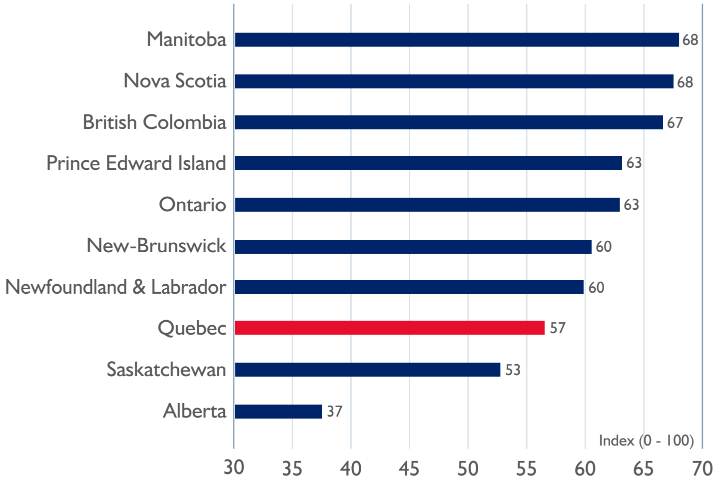
SME CONFIDENCE

Business confidence remains stable

After gaining ground in October, the Business Barometer Index compiled by the Canadian Federation of Independent Business was stable in November, recording a dip of 0.2% to reach 58.7. Business confidence is higher in the service sector than in the goods sector. Given the collapse in oil prices, it is not surprising that confidence is weak in the natural resources sector. What is more puzzling is why it is not stronger in the manufacturing sector, which is benefiting from the strength of the U.S. economy and from the low value of the Canadian dollar. The fact is that entrepreneurs in Quebec, where manufacturing is an important sector of the economy, are no more optimistic than those in the oil-producing provinces (graph).

Quebec entrepreneurs are as lacking in confidence as those in the oil-producing provinces

Business Barometer by province, November 2015



Source: Canadian Federation of Independant Busines

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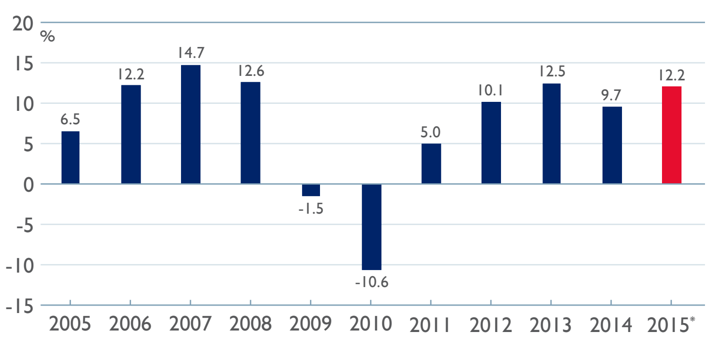
BUSINESS CREDIT CONDITIONS

Bank credit growth is still solid

Bank credit growth rose by 0.8% in October compared with the previous month, and by 13.4% compared with a year ago. Short-term credit climbed by 13.9% from October 2014 to October 2015, and long-term credit by 9.5%. Bank credit growth, which had slowed in 2014, has been picking up steam since the beginning of 2015 (graph).

Bank credit growth has been vigorous since the beginning of the year

Annual change in bank credit, 2005 to 2015*



Source: Statistics Canada

* Average from January to October 2015 divided by the average from January to October 2014

KEY INDICATORS—CANADA

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Key indicators—Canada

	Historical[1]				2015[2]				2015		Forecast	
	2011	2012	2013	2014	Q1	Q2	Q3	Q4	Latest[3]		2015	2016
Real GDP (% growth)	3.1	1.7	2.2	2.5	-0.7	-0.3	2.3		Sep	-0.5	1.1	2.0
Machinery and Equipment Expenditures (% growth)	8.5	2.7	1.0	1.0	-5.9	-14.5	-4.5				-5.3	-0.9
Pre-Tax Corporate Profits (% growth)	23.1	-9.5	6.5	4.8	-61.7	-20.8	-6.5				-10.8	5.2
Industrial Production (% growth)	4.8	0.0	2.2	4.0	-5.1	-9.7	5.8		Sep	-2.1	-1.2	1.6
Industrial Product Prices (% growth)	6.9	1.1	0.4	2.5	-0.4	1.8	3.7		Oct	-0.5	-0.6	2.6
Non-Residential Construction (% growth)	15.9	12.4	7.8	-0.4	-24.7	-9.3						
Housing Starts (' 000 units)	193	215	188	189	175	193	213		Oct	198	189	181
Personal Expenditures (% growth)	2.2	1.9	2.4	2.6	0.4	2.3					1.9	2.0
Consumer Price (% growth)	2.9	1.5	1.0	1.9	-0.2	2.5	2.3		Oct	0.2	1.1	1.9
Employment (% growth)	1.5	1.3	1.4	0.6	0.7	0.8	0.8		Nov	-0.2		
Unemployment Rate (%)	7.5	7.3	7.1	6.9	6.7	6.8	7.0		Nov	7.1	6.9	6.9
SMEs Confidence Index (CFIB)	66.3	63.9	63.9	64.9	61.4	60.2	57.0		Nov	58.7		
Manufacturers Confidence Index (CFIB)	67.3	66.5	63.8	65.8	61.9	57.8	58.2		Nov	57.8		

1. Annual growth rate
2. Quarterly growth, at annual rate
3. Month-over-month growth

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business.