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# CANADA FACING A SOFT PATCH

A number of indicators point to slower economic growth for Canada while the United States remains on the road to recovery. In Europe, the recession is proving to be deeper and longer lasting than expected.

The intensity of the global financial crisis has now eased and there is an increased tolerance for taking on business and investment risk. However, in contrast to the United States, the economic outlook for Canada is less than rosy. With annualized GDP growth now below 1.0% and likely to remain there throughout 2013, Canada is in the midst of an economic slowdown. Under this scenario, the recent employment gains appear unsustainable and this was confirmed in March when the Canadian economy shed 55,000 jobs. A recent survey of capital spending intentions showed the weakest increase in business capital spending since 2009, another indication of continued low GDP growth. As a result, unemployment could drift higher in the summer months. In addition, Canada's soft economy will increase both business and investor risk.

## BUSINESSES ARE CHALLENGED

Amid slow growth, businesses will see liquidity, cash flow and cost control as increasingly important. Canadian companies face lower business volumes as well as upward cost pressures coming from industrial supplies that are imported from the U.S. For example, the housing rebound in the U.S. is stronger than expected and the supply chain for lumber and building materials is being challenged. During the housing downturn, suppliers downsized inventories and production capacity is not easily restored.

## CONSUMERS ARE CONSTRAINED

Canadian consumers are becoming more cautious. In price-adjusted terms, retail sales in January 2013 were considerably lower than in November 2012 and 1% lower than in January 2012. Motor vehicle sales, a proxy for consumer confidence as they represent a big-ticket purchase, have experienced a significant decline on a seasonally-adjusted basis. Furthermore, the market for existing homes is weaker than expected and sales expectations are being revised downwards. Although the number of sales has not continued to decline after the downturn last summer, they do not seem to be re-accelerating either. Weakness in new housing is in the high-rise sector, which appears to be over-supplied despite relatively low vacancy rates for rental condominiums. The first-time buyer market is expected to be the hardest hit by economic uncertainty and tighter lending standards.

## CREDIT IS TIGHTENING

Canadian banks have become increasingly concerned about household debt and are tightening underwriting standards for all borrowers. For the construction industry, pre-sale requirements and loan covenants have become more conservative. Although mortgage rates remain low, it has become more difficult to obtain a mortgage. Interest rates are likely to remain low for an extended period of time. The continuation of a strong Canadian dollar, slow economic growth and a low rate of inflation would seem to rule out an increase in rates from the Bank of Canada. The U.S. Federal Reserve Board is unlikely to increase interest rates until unemployment in the U.S. has declined to 6.5% and this is not expected until 2015.

## EXPORT RECOVERY IS ON HOLD

Although the U.S. economy has grown over the past 12 months, Canadian exports to the U.S. have declined, both in value as well as volume terms. Exports of natural gas have dropped by 70% from 2008, reflecting the surge in natural gas production coming from shale gas deposits in the U.S. and the same trend is now evident in shale oil. As a result, the U.S. has sharply reduced its need for imports from Canada in terms of gas and oil. Increased uncertainty over oil prices, export demand and pipeline capacity is starting to slow Energy sector development. New pipeline construction uncertainty is also a concern. Some oil companies have announced reduced capital budgets but there is still a large number of oil sands projects that are either proposed, under construction or seeking regulatory approval.