

**NOVEMBER 29, 2017**

THE BEST OF TIMES?  
GETTING A FIX ON OUR ECONOMY

**PRESENTED TO**  
**ASSOCIATION OF WOMEN IN FINANCE**  
**VANCOUVER, BC**

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## A BRIGHTER INTERNATIONAL ECONOMIC BACKDROP

**“The global economic expansion continues to strengthen and broaden across countries”**

(Bank of Canada, Monetary Policy Report, October 2017)

**“Everything is awesome”**

(Wells Fargo Economics, U.S. Review, November 3, 2017)

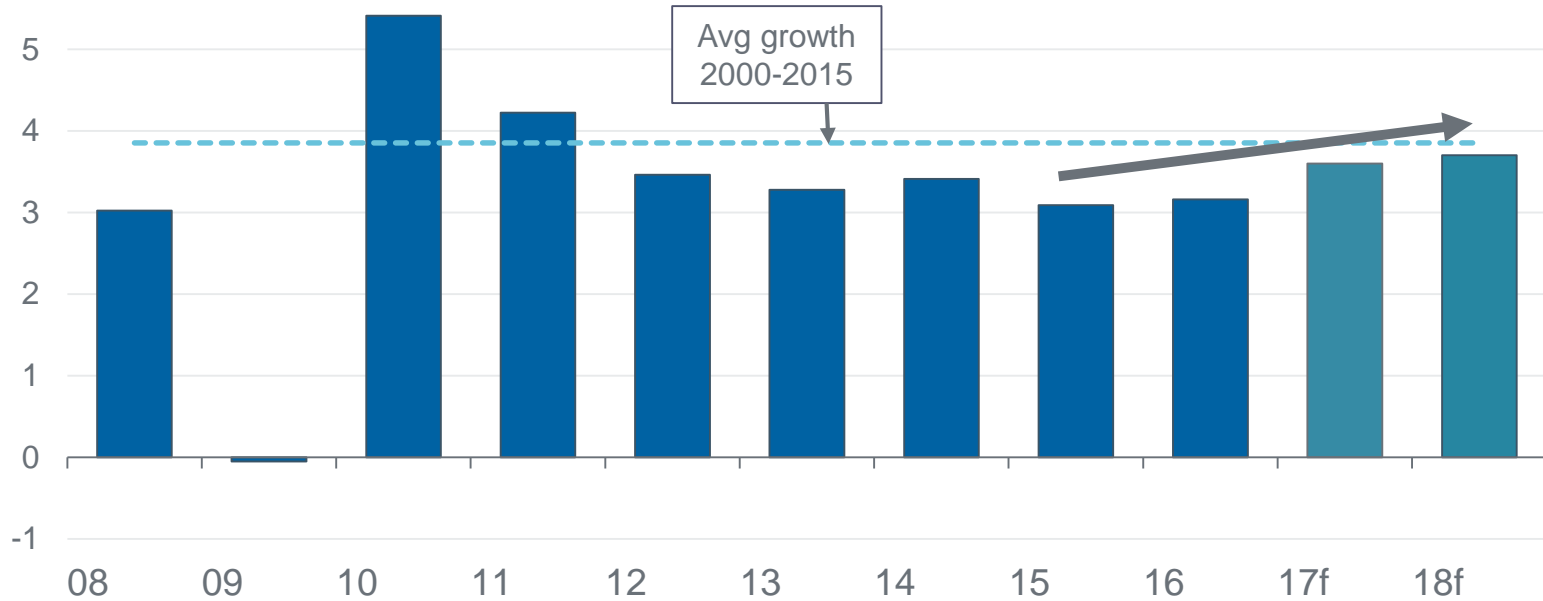
**“Euro-area economic boom spurs fastest job creation in a decade”**

(Bloomberg News, November 6, 2017)

**“China continues to enjoy strong growth – projected at 6.7% for 2017”**

(IMF, “China’s Economic Outlook in Six Charts,” September 2017)

## GLOBAL ECONOMIC EXPANSION GAINS TRACTION

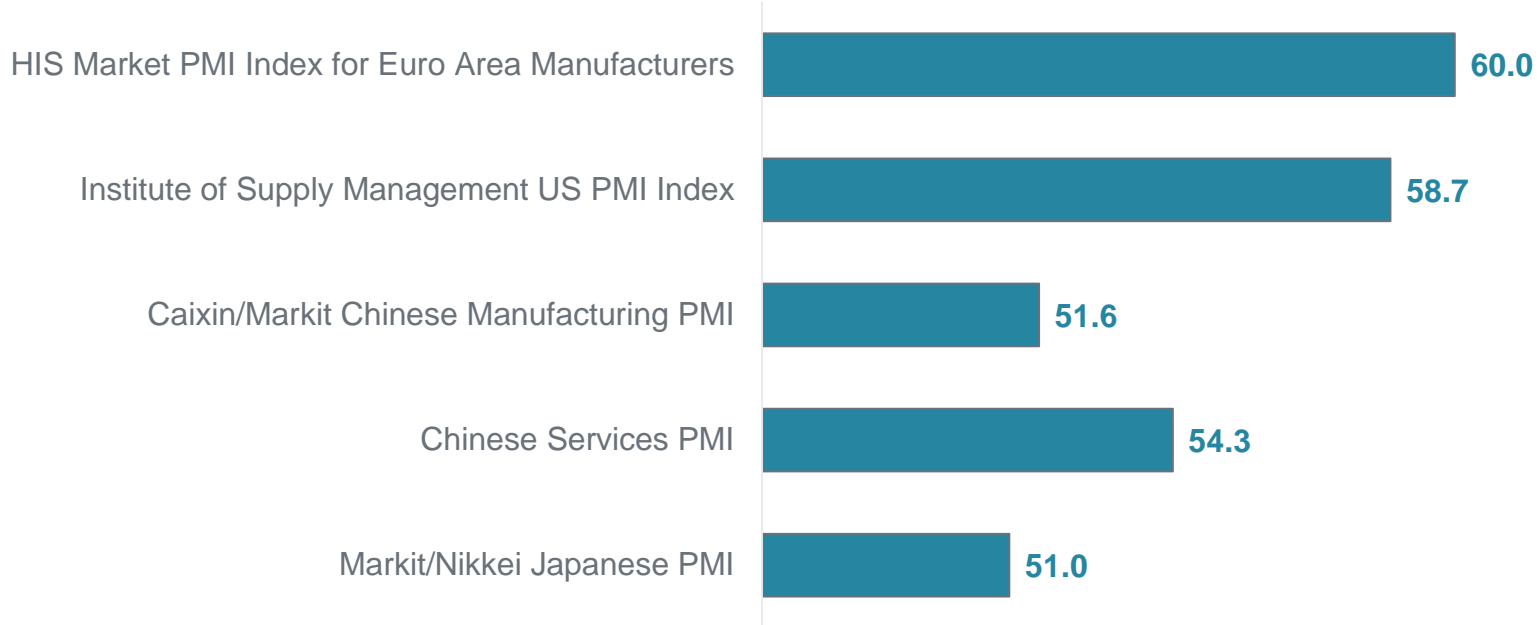


e=estimate f=Forecast.

Source: IMF World Economic Outlook, October 2017.

## PURCHASING MANAGER INDEXES – LATEST READINGS

(ANY READING ABOVE 50.0 SIGNALS ECONOMIC EXPANSION)



## US REMAINS ON A SOLID ECONOMIC FOOTING

- Growth has accelerated in 2017
- Employment still rising, but monthly increases slowing
  - 82 months of consecutive job gains; real wages picking up
  - consumer spending continues to climb -- confidence at the highest levels since 2000
  - real *median* household income increased appreciably in 2015-16 (+5%)
  - business capital spending has turned up
- Equity markets at record highs, substantial gains in wealth/net worth
- Economy is forecast to grow 2.2% this year and 2.3% in 2018
  - ignores the effects of possible tax cuts/reform
- Inflation remains subdued, despite the economy running near capacity
- Federal Reserve expected to hike its policy rate by 75-100 basis points by the end of 2018

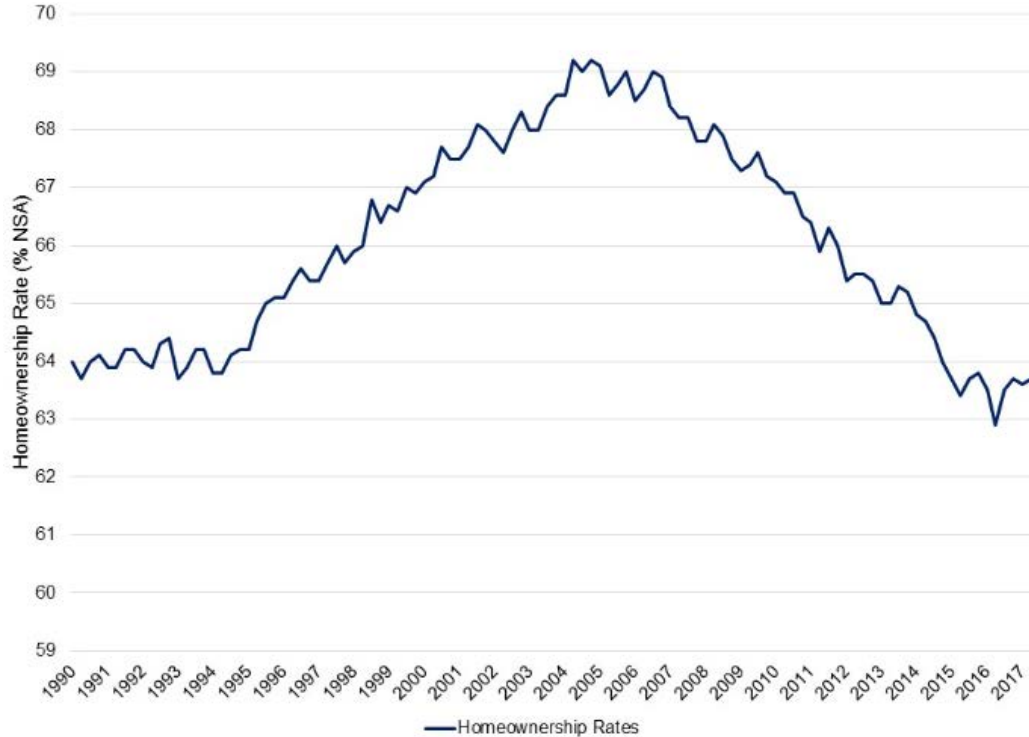
## US HOUSING STARTS – STILL ROOM TO GROW



Latest: September 2017

Source: US Census Bureau, seasonally adjusted data.

## US HOME OWNERSHIP RATE INCHES HIGHER



## NAFTA: INITIAL EXPECTATIONS

“We will modernize NAFTA so that it is a win-win for all our trading partners” (VP Mike Pence)

“More than our entire deficit (with Canada) comes from hydrocarbons and electric energy... I don't call that blameful exports” (Commerce Secretary Wilbur Ross)





BUT...

“We can’t let Canada... take advantage and do what they did to our workers and farmers... I want to just mention included in there is lumber, timber and energy”

“We lose with Canada – big-league. *Tremendous, tremendous trade deficits with Canada.*”



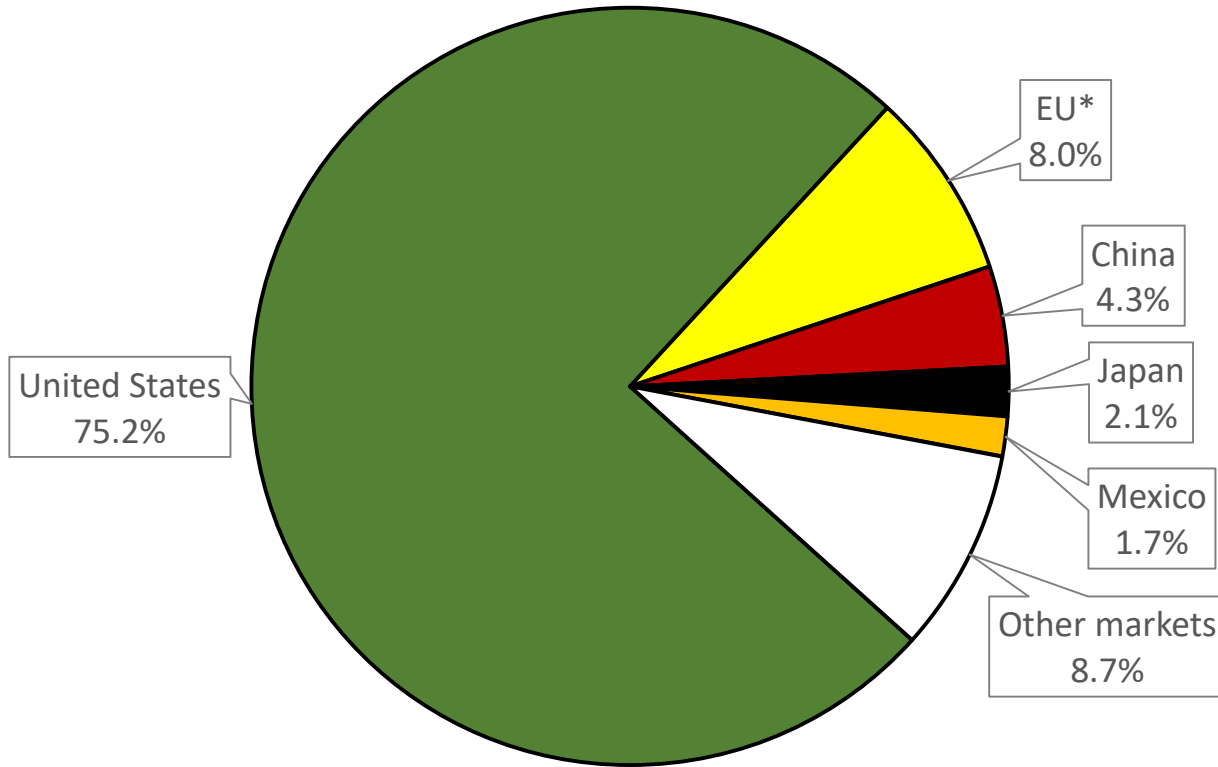
## US TRADE BALANCES: THE NON-FAKE NEWS (US\$ BILLIONS)

Goods Trade – 12 months to June 2017				
	Exports to	Imports from	Balance	Value of total trade
Canada	272	291	-19	563
Mexico	235	304	-69	539
China	124	480	-356	604

U.S. Services Trade Balance (4-quarter monthly series)	
With Canada	+23
With Mexico	+4

Total U.S. Goods/Services Balance	
With Canada	+4
With Mexico	-65

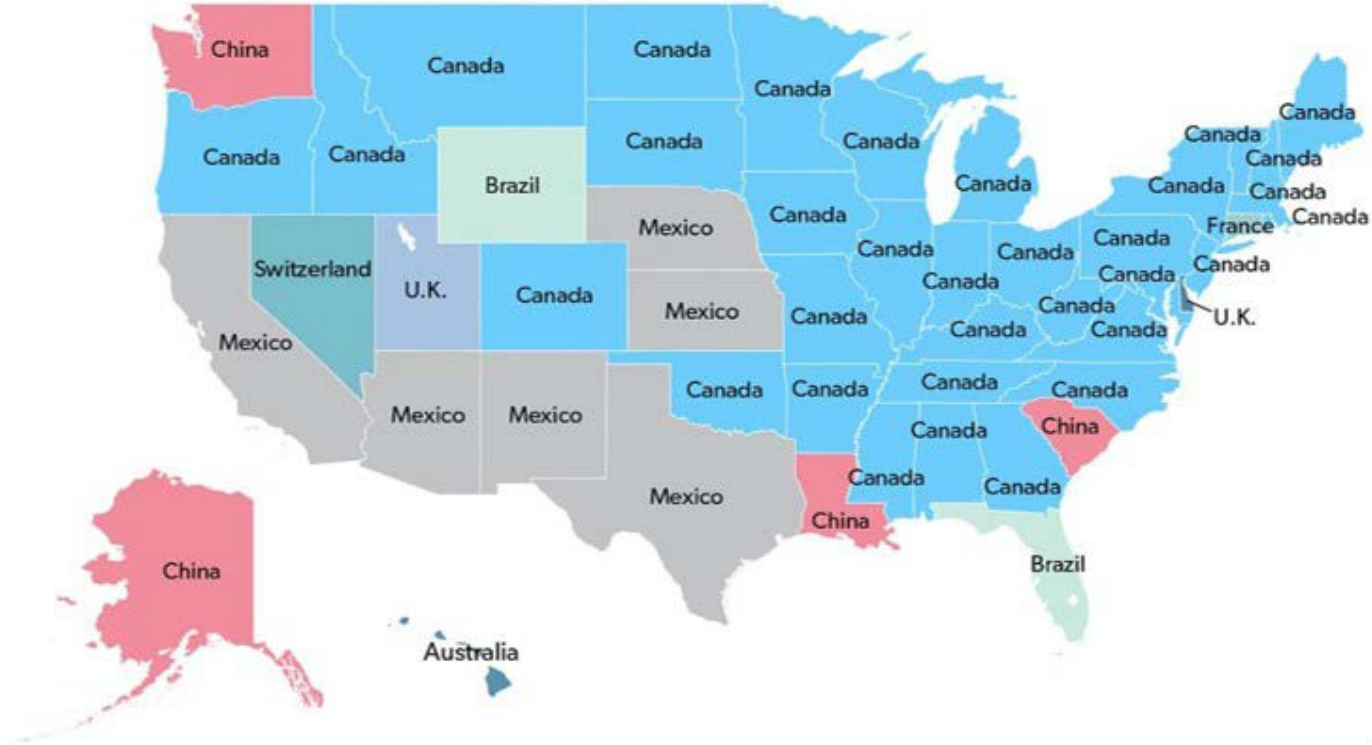
## CANADA'S MERCHANDISE EXPORTS, 2016 BY DESTINATION MARKET



\*EU 28, including the UK.

Source: Global Affairs Canada, [Canada's State of Trade](#), 2017.

# THE TOP EXPORT COUNTRY FOR EACH US STATE (2016)



Source: US Census Bureau

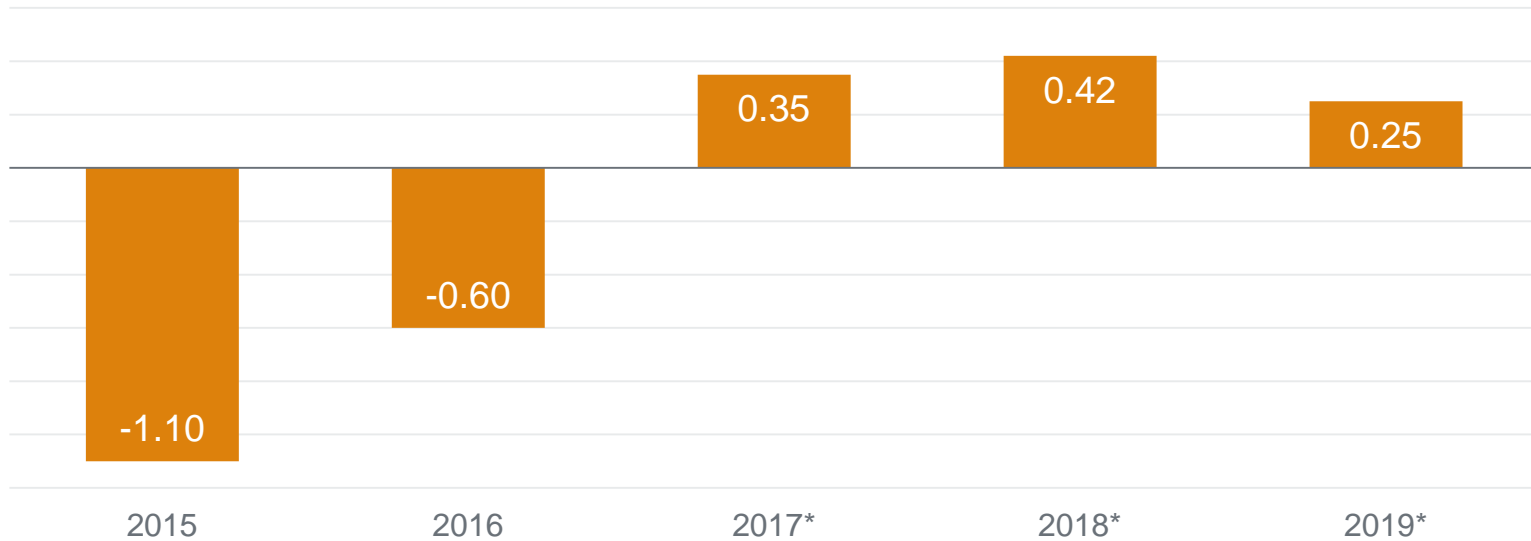
## NAFTA END GAME SCENARIOS...

- **Scenario 1:** A renewed agreement is stitched together in Q1 2018
  - this outcome looks increasingly unlikely
- **Scenario 2:** The US officially announces NAFTA withdrawal (with six months' notice)
  - negotiating tactic or a real choice?
  - reaction in Congress...can the legislative branch prevent termination?
  - legal action in the courts?
- Under Scenario 2, the 1988 Canada-US FTA may come back to life
  - FTA legislation remains 'on the books' in the US
  - would Trump support this...or try to kill the bilateral FTA as well?
- Implications for Canada if NAFTA unravels...
  - a small hit to GDP and employment (<1% of real GDP)
  - negative impact on the currency and business sentiment
  - the biggest risk: capital investment and management attention shift further toward the US, at Canada's expense, in many industry sectors

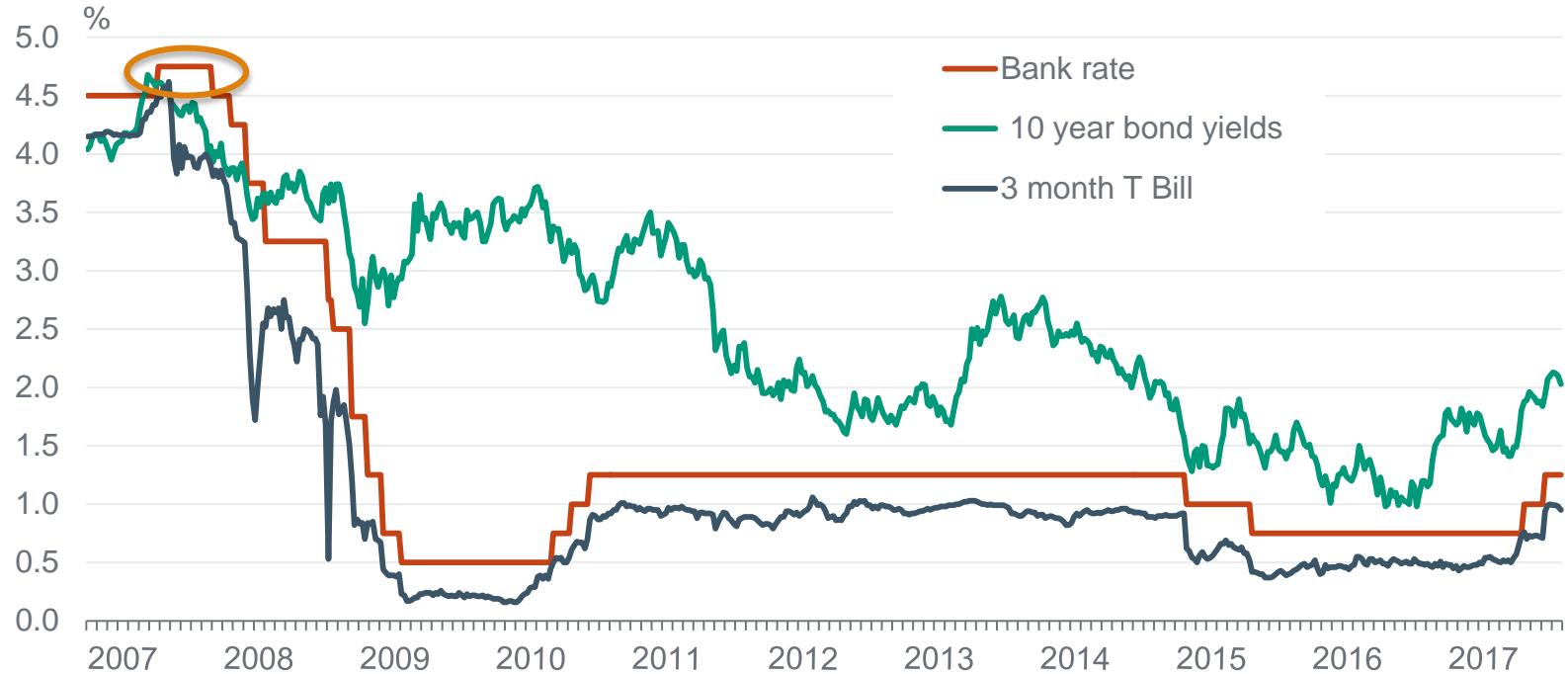
## CANADA'S ECONOMY HAS BEEN FLYING HIGH – BUT IS SET TO LOSE ALTITUDE IN 2018-19

- Growth surged in H1 2017, with Canada leading the G7. Over Q1/Q2, real GDP was increasing at ~4% annualized
- Why?
  - 1) rebound in energy sector after slump in 2015-16
  - 2) benefits of a more competitive exchange rate
  - 3) some pick-up in exports, bolstered by higher commodity prices
  - 4) high levels of home-building/home renovation
  - 5) continued growth in consumer spending...supported by job gains (and debt)
- Most of these growth drivers are likely to **lose momentum in Q4 and through 2018**
- Financial conditions have tightened: Bank of Canada has nudged its policy rate higher, bond yields have increased, and the Loonie is up ~10% on a trade-weighted basis y/t/d

## CONTRIBUTION OF OIL AND GAS INDUSTRY TO CANADIAN ECONOMIC GROWTH (PERCENTAGE POINTS SUBTRACTED/ADDED TO REAL GDP)

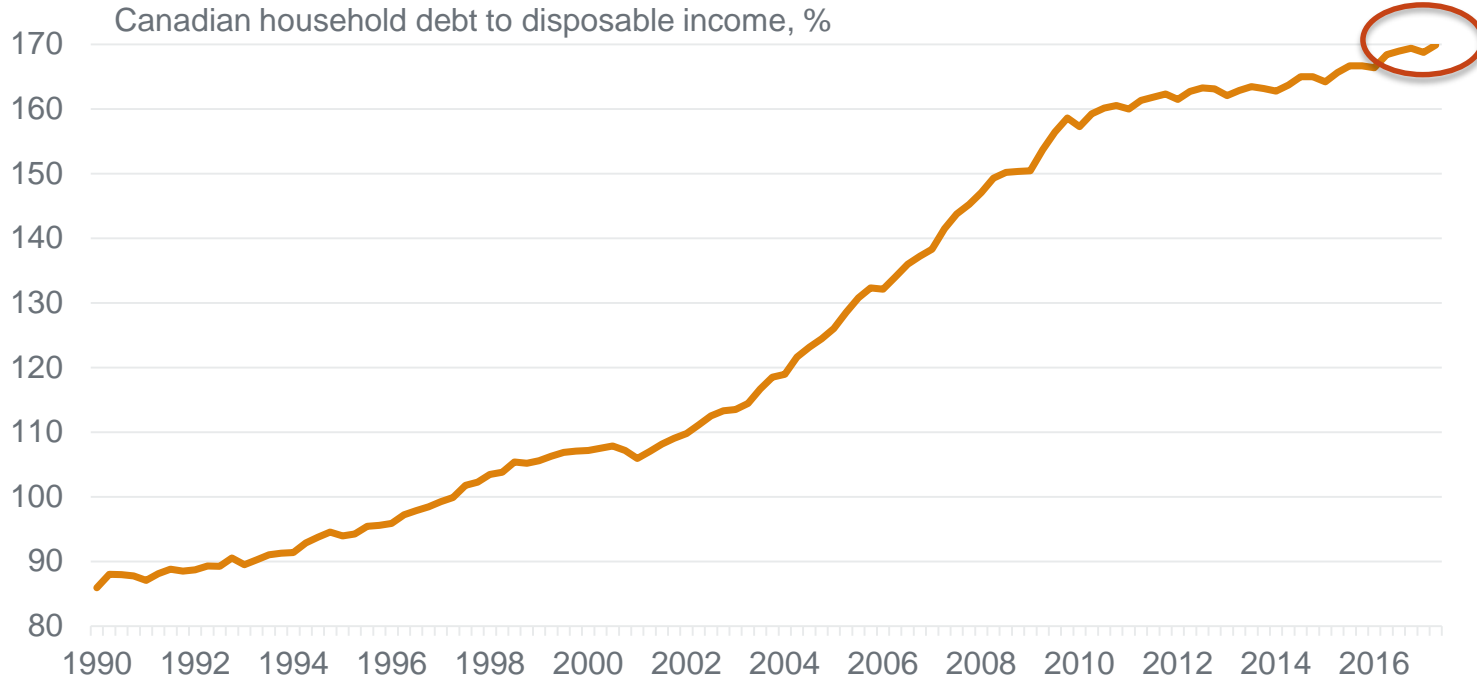


## CANADIAN INTEREST RATES EDGING HIGHER





## RECORD HOUSEHOLD DEBT BURDEN

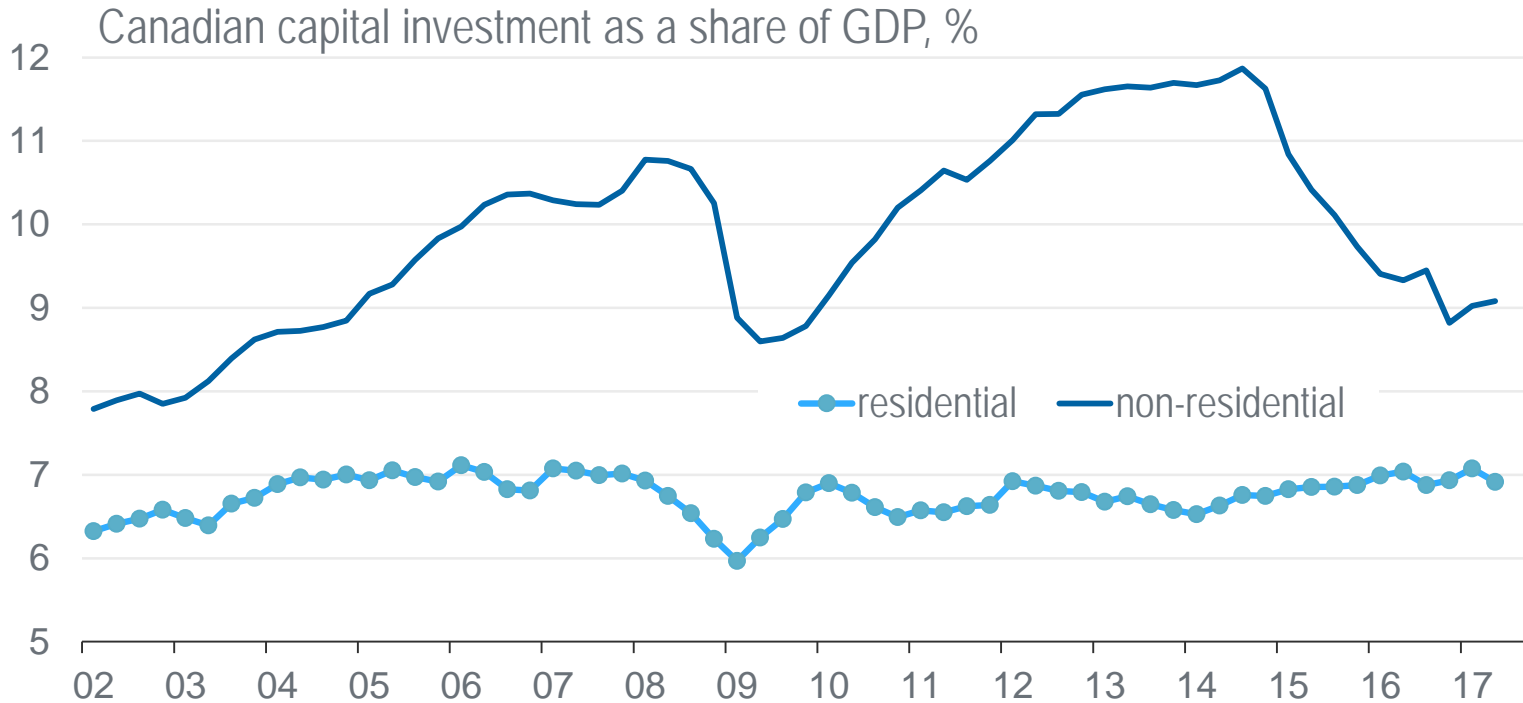


## HOUSING AFFORDABILITY IN CANADA

*Share of median pre-tax household income required to service a 25-year mortgage (5 year fixed rate), plus property taxes and utilities, based on average market prices and 25% down-payment*

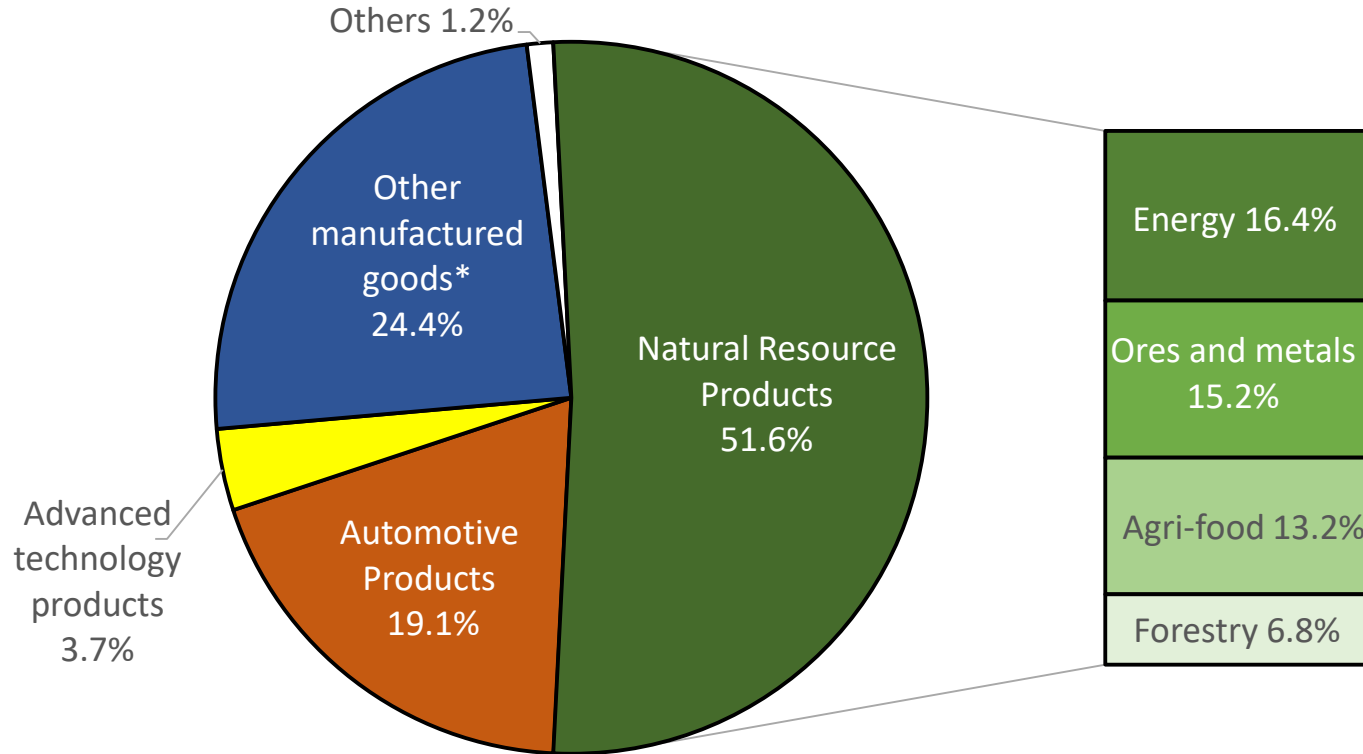
	Aggregate	Detached	Apartment
Metro Vancouver	81%	115%	46%
Greater Toronto	75%	92%	41%
Victoria	59%	63%	37%
Montreal	42%	43%	34%
Calgary	39%	43%	25%
Ottawa	37%	43%	28%
Halifax	32%	34%	30%
Winnipeg	31%	33%	25%
Edmonton	30%	33%	20%
<b>Canada</b>	<b>47%</b>	<b>52%</b>	<b>39%</b>

## BUSINESS INVESTMENT HAS PLUNGED



Source: Statistics Canada, CANSIM 380-0064. Seasonally adjusted annual rates.

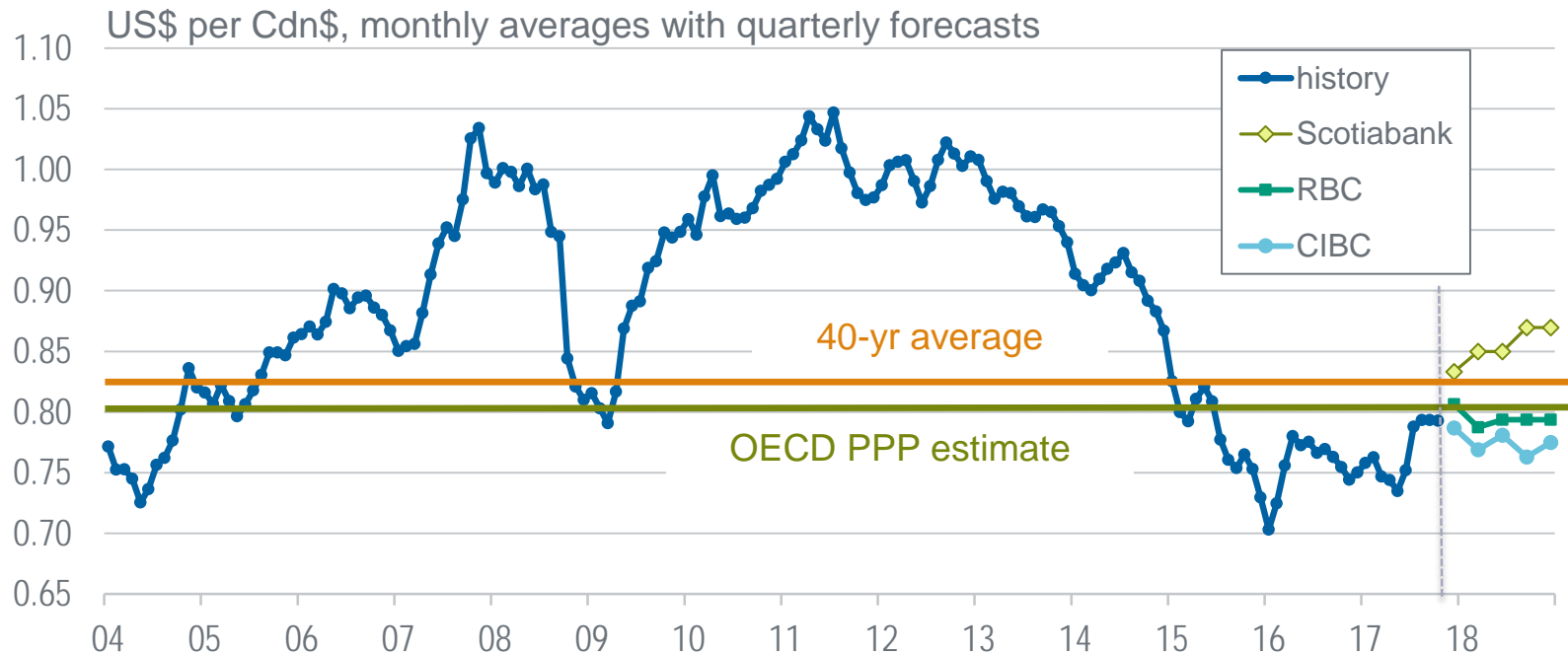
## CANADA'S MERCHANDISE EXPORTS, 2016 BY BROAD PRODUCT CATEGORY



\*Includes industrial machinery and equipment, aerospace, chemicals, plastics, fertilizers, and consumer goods.

Source: Export Development Canada, [Global Export Forecast](#), Spring 2017.

## A FLEXIBLE LOONIE



Latest: October 2017

Source: Bank of Canada, noon rate.

## UPDATED CANADIAN FORECAST (ANNUAL % CHANGE UNLESS NOTED)

	2016	2017	2018	2019
Real GDP	1.5	3.1	2.2	1.8
Real consumer outlays	2.4	3.6	2.2	1.7
Real business fixed investment	-8.6	1.5	3.7	2.2
Employment growth	0.7	1.7	1.2	1.0
Unemployment rate (%)	7.0	6.4	6.0	5.7
3 month T-bill rate (%), Q4	0.45	0.9	1.50	2.30
10 yr bond yield (%), Q4	1.7	2.0	2.40	3.00

## CANADIAN ECONOMY – RISKS/CHALLENGES

- Second highest household debt/GDP ratio in the OECD
- Legacy of years of “over-investment” in housing- & real estate-related activity
- A deteriorating performance on key competitiveness indicators...
  - 14th in the World Economic Forum’s latest competitiveness assessment
  - Canada scores particularly poorly on business innovation, business sophistication, the effectiveness of public sector spending, and the complexity of the regulatory environment
  - Our share of total US goods imports has fallen from 20% to 13% since 1998
  - Non-energy Canadian export volumes are 10% lower than ten years ago!
  - Canada is receiving a dwindling portion of inward FDI in North America
  - Exodus of global energy companies from Canada
  - Plus...now we face Trump, rising American protectionism, skyrocketing US energy production, and the prospect of sweeping US tax cuts

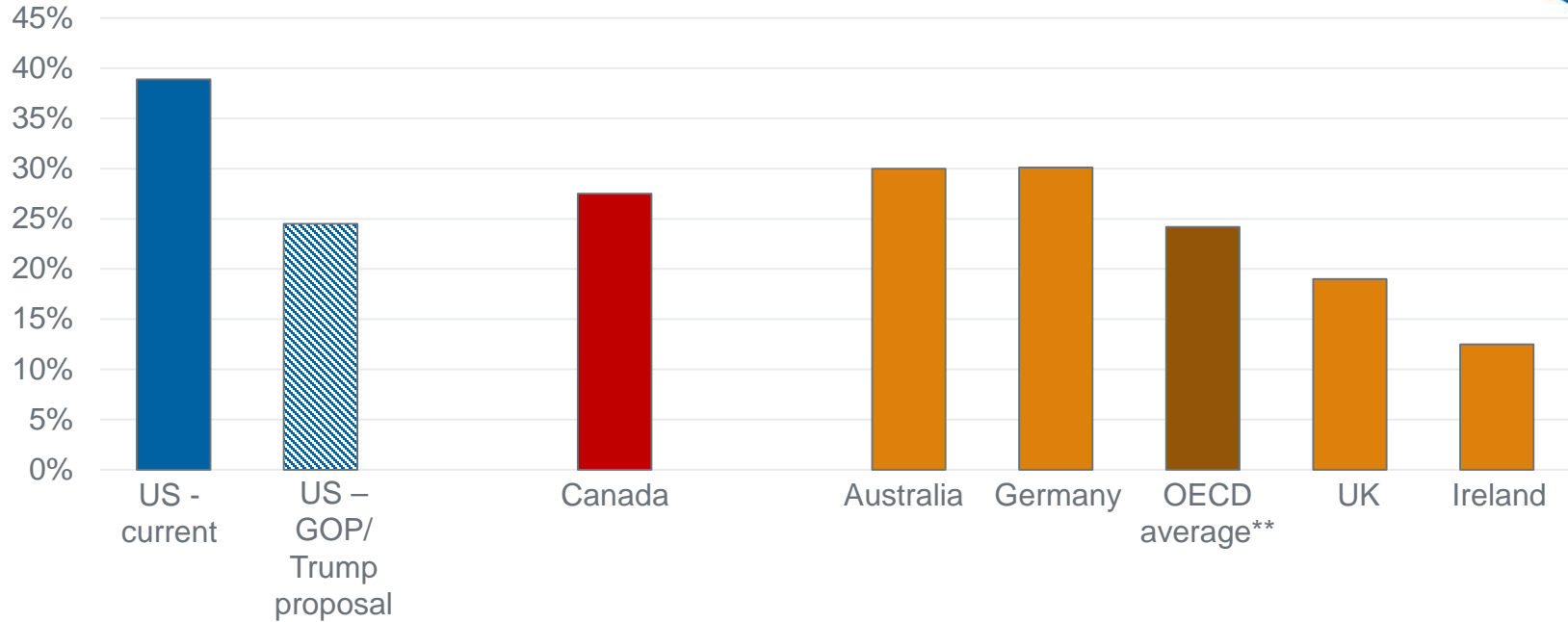
## CANADA'S INCREASINGLY COMPLEX AND COSTLY BUSINESS CLIMATE

- Political commitment to aggressive carbon pricing, coupled with a growing regulatory burden linked to policy action on climate change = rising energy and production costs for Canada's main export industries, in contrast to the picture in the US
- Complex and cumbersome regulatory regimes affecting new investment in the natural resource and infrastructure sectors
- Huge difficulty of building linear infrastructure of any kind
- Significant increases in minimum wages across the country
- Rising personal income tax burden on highly skilled employees, entrepreneurs and professionals
  - top marginal rates now >50% everywhere except Alberta and Saskatchewan (BC will hit 50% in 2018)
  - policy-makers overlook the top 1% already pay 21% of all income tax (the top 10% pay half)
- The Trudeau government has bungled proposed reforms to the tax rules applying to CCPCs, delivering a blow to its economic credibility and to business confidence
- On the business tax side, Canada is about to lose any tax advantages we may have enjoyed vis-à-vis the United States as the Trump administration moves ahead with overhauling the tax code



## STATUTORY CORPORATE INCOME TAX RATES\*

(AVERAGED ACROSS ALL INDUSTRY SECTORS; NATIONAL PLUS SUB-NATIONAL COMBINED)



\* National and sub-national government combined; averaged across all industry sectors; does not include the effects of tax incentives, differing statutory rates by industry, capital cost allowances, or other factors that may reduce the effective tax rate.

\*\* Unweighted.

## RECAP

- Global economic momentum has strengthened, even with ongoing political/policy risks
- US economy is on a solid growth footing
- But...we are late in the cycle, with the risk of recession rising post-2018
- Canada's economy has rebounded this year, with firmer energy prices helping
- But Canadian growth is poised to downshift in 2018-19. And over time, growth will be limited by Canada's reduced long-term potential (1.6% p.a.)
- Key near-term risks for Canada are around: NAFTA, high household debt, potential US tax cuts, and oil prices
- Concern over Canada's eroding competitiveness across a wide range of traded-industry sectors