

Gauging Economic Momentum

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Recent indicators point to a slow and erratic rebound, providing the Bank of Canada enough leeway to keep rates unchanged until June. But the severity of the slump and the unprecedented actions taken to correct it make the near-term outlook particularly difficult to forecast.

This week, we attempt to provide some perspective on the pace of the Canadian recovery. Our take: while all of the key segments of the economy are moving in the right direction, the rate of growth remains uneven, providing the Bank of Canada enough cover to delay a rate hike until the June meeting—even in the face of growing inflationary pressures—but not beyond.

In the early stages of the recovery, we commented on how much currency-sensitive sectors of the Canadian economy were dragging down economic growth.

While those concerns have faded, they have not disappeared. For perspective, we compiled the list of quarterly changes in some key indicators (**Display 1**). Perhaps the most important of these, jobs, shows the strongest upside momentum. Retail sales, manufacturing shipments and export growth are also clearly in recovery mode, although fourth-quarter gains are unlikely to match those of the prior quarter once December figures are incorporated.

If we were seeing this weakening in just one of these key indicators, it would not be worthy of focus. But the consistency of this pattern across so many indicators underscores the erratic nature of this recovery. Housing appears to be the biggest beneficiary of the rebound so far, especially in jobs. Home prices continue to rise, and we expect single-unit building permits to roughly match third-quarter increases.

The export story is of particular importance. The sharp climb in export growth over the course of 2009 demonstrates that the sector's fate is far more dependent upon global growth than it is on the general level of the Canadian dollar, even if one currently views the dollar as overvalued.

It appears that import growth stalled even more sharply in the fourth quarter than the other measures we examined, providing yet another cautionary signal for the economy (**Display 2, next page**).

But this also suggests that, in the fourth quarter, net exports—exports minus imports—were stronger and, thus, contributed to a stronger overall GDP number for that period.

Display 1
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2009 Key Indicators Quarterly Change					
	Jobs (CAD Mil.)	Retail Sales (CAD Mil.)	Single-Unit Building Permits (Thousands)	Manufacturing Shipments (QoQ CAD Mil.)	Exports (CAD Mil.)
1Q	(239.2)	(23.8)	(17.9)	(12,508)	(19,149)
2Q	(62.8)	(0.8)	2.9	(2,546)	(9,160)
3Q	(35.1)	18.5	21.3	4,467	2,596
4Q	38.1	0.2*	13.2*	204*	1,336*

*Through November 2009
 Source: Haver Analytics and Statistics Canada

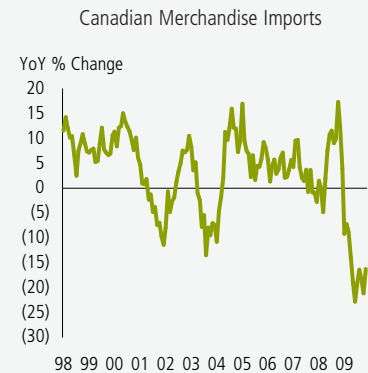
Another way to gauge the recovery's momentum would be to compare trends of these indicators today with those at similar stages of past rebounds. However, Canada has never experienced a downturn of this magnitude before, which is precisely what makes the current environment so tricky for central bankers. The loss of 239,000 jobs in the first quarter of 2009 was the first meaningful quarterly drop in jobs since the second quarter of 1995 (just 4,000 jobs were lost in the third quarter of 2008).

Comparisons are a bit more difficult for other indicators, because the composition of the economy as a whole has changed dramatically over the past few decades. The only real comparable period would be the 2001 slowdown, although even this period becomes less useful when comparing manufacturing trends. In 2001,

manufacturing shipments fell 4% versus the prior year, compared with a decline of roughly 20% in 2009. Until 2009, retail sales grew between 3.4% and 6.4% in every year that decade. In 2009, they likely fell around 4%. We found a similar story for virtually every data series.

This analysis convinces us that anyone making forecasts about this recovery needs to exercise some humility, no matter how skilled a prognosticator he or she may be. The uncharacteristic nature of the current cycle increases the odds of a policy mistake. Given the relative clarity of some of the key indicators, however, we think there is a good chance that the Bank of Canada will ultimately decide to stick to its plan to keep rates unchanged until June, start withdrawing some of the stimulus thereafter and then, like the rest of us, see what happens.

Display 2
Import Growth Is Real but Unsteady



Source: Haver Analytics and Statistics Canada

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