

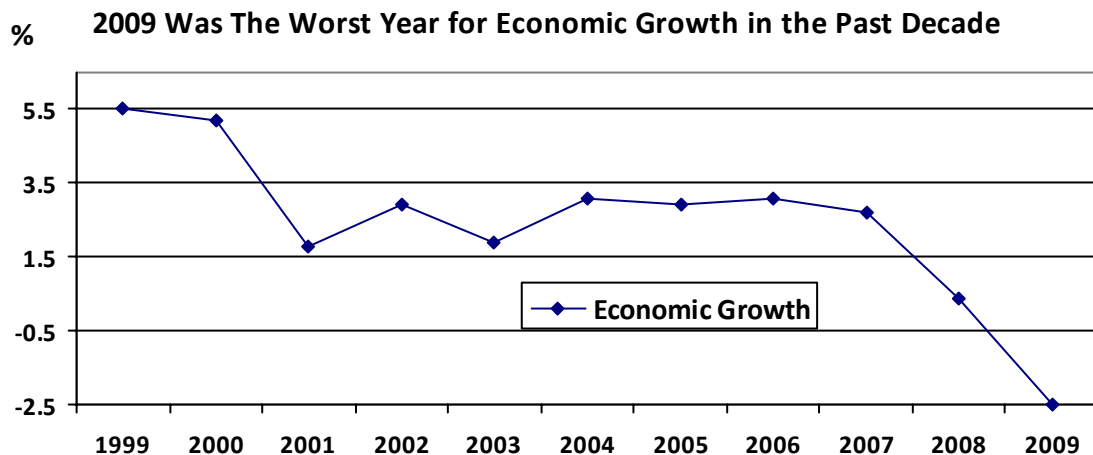
The Most Remarkable Economic Statistics of 2009

The past year has generated some of the most remarkable economic statistics in years – mainly miserable, recession related numbers. From the economic performance perspective, we will certainly be happy to see the end of 2009. In this note I put these remarkable economic statistics of 2009 into historical perspective – and promise to conclude on an optimistic note.

1. Weakest Year of Economic Growth Since 1982

It wasn't until November 2008 that most economists began forecasting recession for Canada for 2009. The forecasts of late 2008, for no growth for 2009, eroded sharply into forecasts of negative growth, not stabilizing to the current forecast of -2.5% growth until about mid year. The currently forecasted -2.5% growth in real GDP for 2009 would make 2009 the weakest year of economic growth for Canada since the -2.9% of 1982.

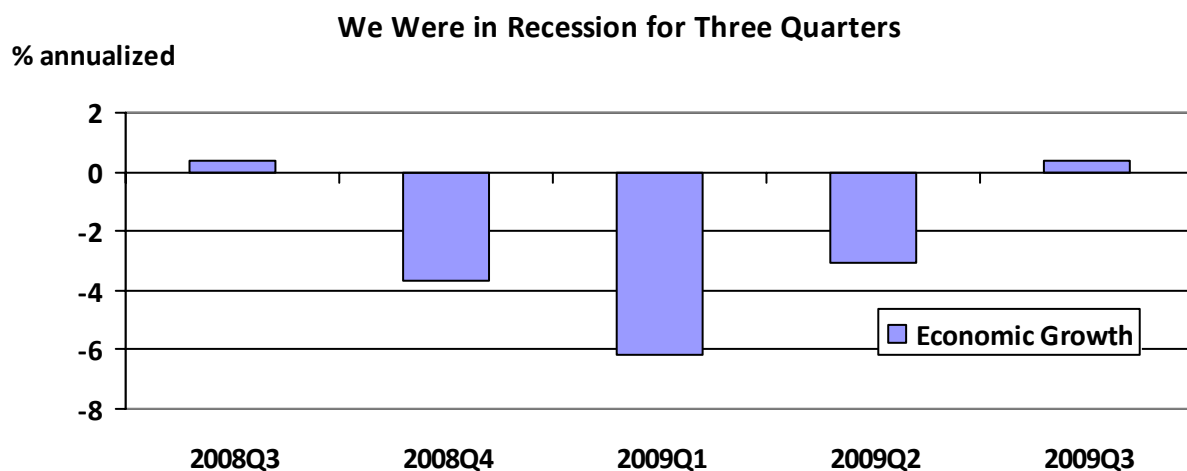
Chart 1.



2. Three Quarters of Negative Growth Make a Recession

The most common definition of a recession is 2 consecutive quarters of negative growth. More thorough definitions also take account of the performance of labor markets, retail markets and industrial production. Canada had a recession in 2009 by most any definition of a recession. However, the recession was actually from, and including, the final quarter of 2008 and the first two quarters of 2009. While the third quarter of 2009 is currently measured as being slightly positive, note that even a small downward revision by Statistics Canada could tip this quarter into negative territory as well. The severity of the hole we fell into in the first quarter of 2009 must be put into perspective. First, it was the weakest quarter for economic growth since 1991. Second, note how miserable -6.2% at annualized rates is relative to every and any year's rate of growth over the past decade, as shown in chart 1 above.

Chart 2.

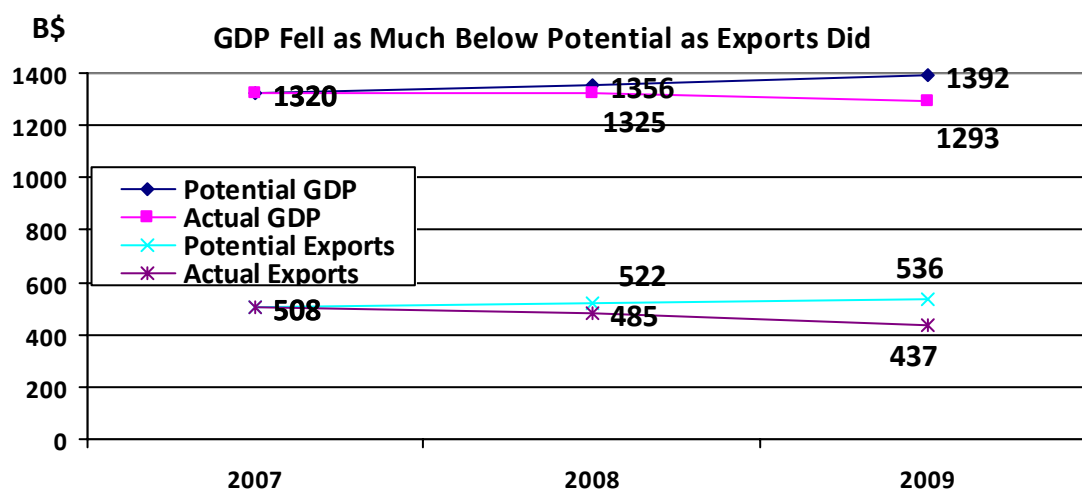


3. This Was An Export - Led Recession

A glance at the economic statistics of 2009 clearly shows this has been an export led recession, with “Made in the U.S.A.” written all over it. As shown in Chart 1, Canada experienced four years of solid growth over the 2004 through 2007 period, and in 2007 we were expecting and hoping that this trend would continue. One interesting illustration of the extent to which this has been an export - dominated recession is to note that, if the economy would have growth at a stable pace of 2.7% (“potential”) over the 2008 and

2009 period, real GDP would have been \$1,392 billion in 2009. It will be about \$100 billion short of that total for 2009. If exports would have maintained their share of the economy, they would have been \$536 billion in 2009. Instead, they will be very close to \$100 billion short of that. That is, on net, the shortfall in economic growth of \$100 billion we experienced in 2009 was entirely due to the weakness in exports of about \$100 billion. Consumption and investment ran slightly under potential, with government spending slightly above. Imports fell about as much below potential as exports.

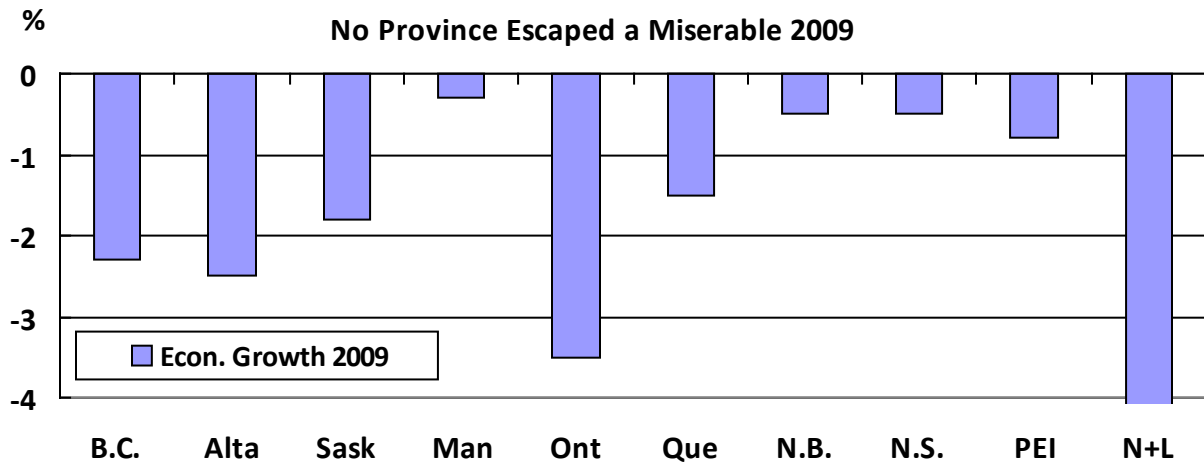
Chart 3.



4. The Recession Hit All Across Canada

Every province will have negative economic growth in 2009. This is highly unusual. Even as Canada's GDP fell by over 2% in 1991, Saskatchewan in particular experienced positive growth. This year, I expect every province to experience negative growth. Growth in Manitoba, Nova Scotia and New Brunswick will be just slightly negative. But certainly, it will be negative in per capita terms, which is most important from the individual family's standard of living perspective.

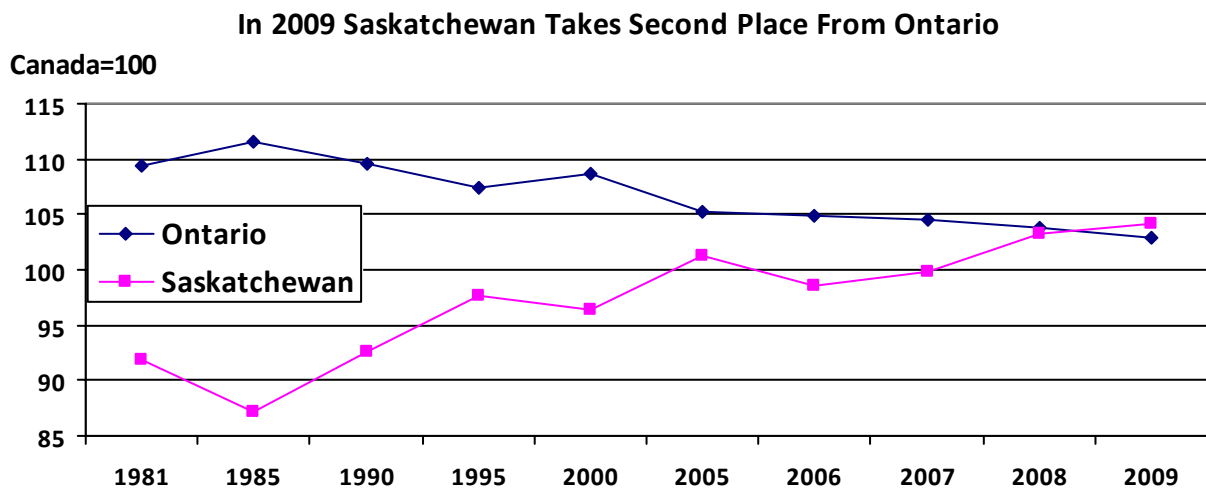
Chart 4



5. Ontario Loses Second Spot to Saskatchewan in the Provincial Standard of Living Rankings

From 1980 until 1990 Ontario's per capita real GDP (the most common measure of standard of living) was steadily about 110% relative to the Canadian average, putting it in second spot behind Alberta. Since then Ontario's real GDP per capita relative to the Canadian average has trended downward, reaching only about 104% relative the Canadian average in

Chart 5.



2008. However, Ontario still held on to second place in 2008. It was Ontario's exposure to the higher Canadian dollar, and particularly its reliance on auto exports, which lie behind this steady erosion. Saskatchewan has been moving up towards the Canadian average, rising from the 87% level relative to the Canadian average in 1985 to almost 98% in 1995 as its energy sector strengthened. By 2008, with further assistance from potash, Saskatchewan had reached just over 103% relative to the Canadian average, a whisker behind Ontario.

2009 was very unkind to Ontario, with very weak exports to the U.S.,- particularly in autos. Ontario's per capita GDP growth will be about - 4.5% for 2009. This will move Ontario down to only about 103% relative to the Canadian average. Saskatchewan will not have a good year in 2009 either, but at least it will be less weak than most other provinces, especially Ontario. As a result, for 2009, Saskatchewan will have finally crept past Ontario, moving to 104% relative to the Canadian average, while Ontario will fall into third spot for the first time, at 103% of the Canadian average.

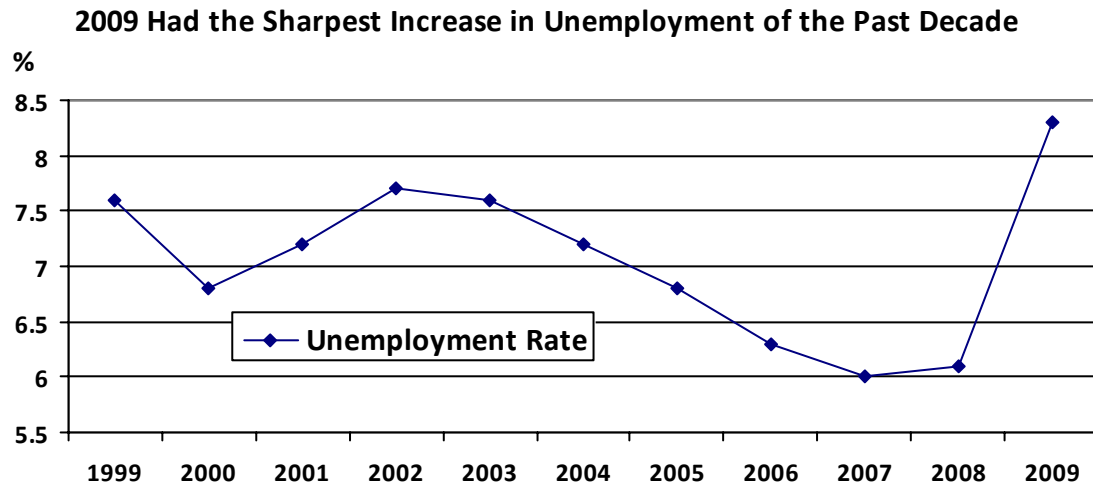
6. 2009 Was Also Unkind to Labor Markets

Labor markets usually follow behind economic growth in the turn down to recession as well as in the recovery phase, and 2009 was no exception. Employers are reluctant to lay people off, given the costs of replacing experienced workers and the costs of hiring. In the recovery, they want to be sure the recovery is very solid before committing to new hires. They make the initial adjustments to increased output by asking part time workers to work full time and others to work over-time. The unemployment rate will be about 8.3% in 2009, up sharply from the 6.1% of 2008. This increase in the unemployment rate of 2.2% is similar to the increase in 1991, so we have to go all the way back to 1982 to find a year when the unemployment rate increased more than it did in 2009. Until 2009, the largest increase in the year over year unemployment rate over the past decade was only 0.5%.

Another remarkable development in 2009 is that the "factoid" relating to the rigidity in the rankings of unemployment rates across provinces has finally been violated for the first time since we have been measuring unemployment as we do today. *Every year since 1974, every province Ontario and westward has had an unemployment rate lower than every province east of*

Ontario (i.e. the “factoid”). Finally, in 2009 the unemployment rate in Ontario (9.1%) will exceed that in Quebec (8.5%). This remarkable statistic is further testimony to how severely this recession is hitting Ontario.

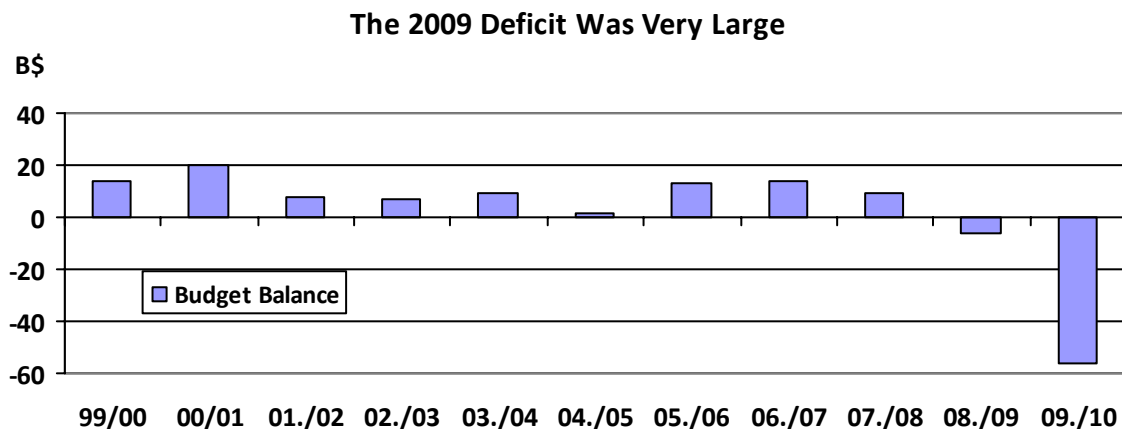
Chart 6.



7. Whopping Fiscal Deficit in 2009/10

One of the most unfortunate results of the recession is the enormous fiscal deficit. As the economy turns down, personal income tax collections and EI premiums turn down more than nominal economic growth (the general tax base), corporate profits tax collections often do as well. GST revenues fall almost as much. On the spending side, EI benefits increase sharply in a

Chart 7



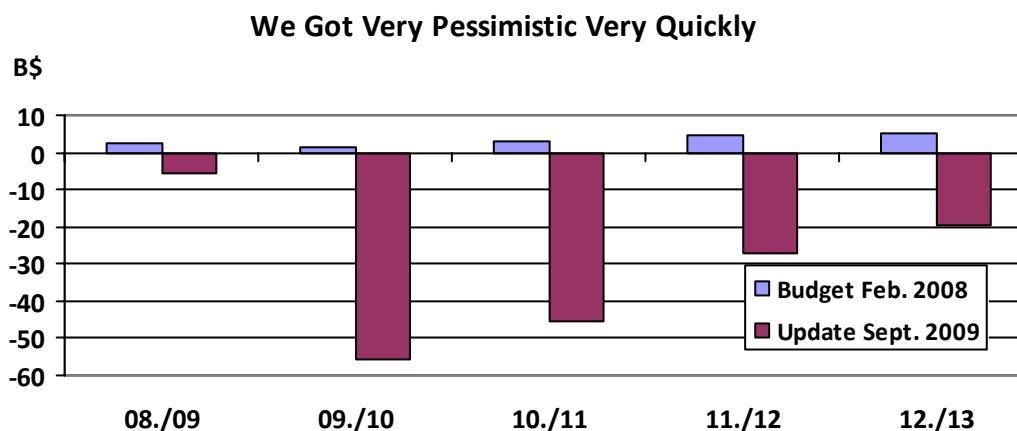
recession. In addition to the increase in the deficit resulting purely from the economic downturn, Budget 2009 provided a fiscal stimulus package of \$28 billion in federal spending. Further, the federal spending leveraged some provincial spending, all which made Canada's economic growth in 2009 slightly stronger than it otherwise would have been. Therefore, a precise partitioning

of the contributions to the deficit of the economic cycle, relative the policy actions, is a complex calculation. While we did have a small federal deficit in 2008/09, the \$56 billion in deficit of 2009/10 wipes out all the surpluses right back to 2001. In addition to the \$56 billion federal deficit this year, provincial deficits will total another almost \$40 billion.

8. We Never Expected to See Deficits Again

In the February Budget 2008, the government forecast small fiscal surpluses each and every year through 2012/13. Right through the October 2008 election all federal political parties supported balanced budgets. How disappointing to think that, in February 2008, we forecast a surplus of \$1.3 billion for 2009/10, which had shrunk to a \$56 billion deficit by the Economic and Fiscal Update of September 2009. Revenues were down by \$35 billion (some due to tax reductions) and spending was up by \$23 billion, much of it due to higher EI payouts.

Chart 8.

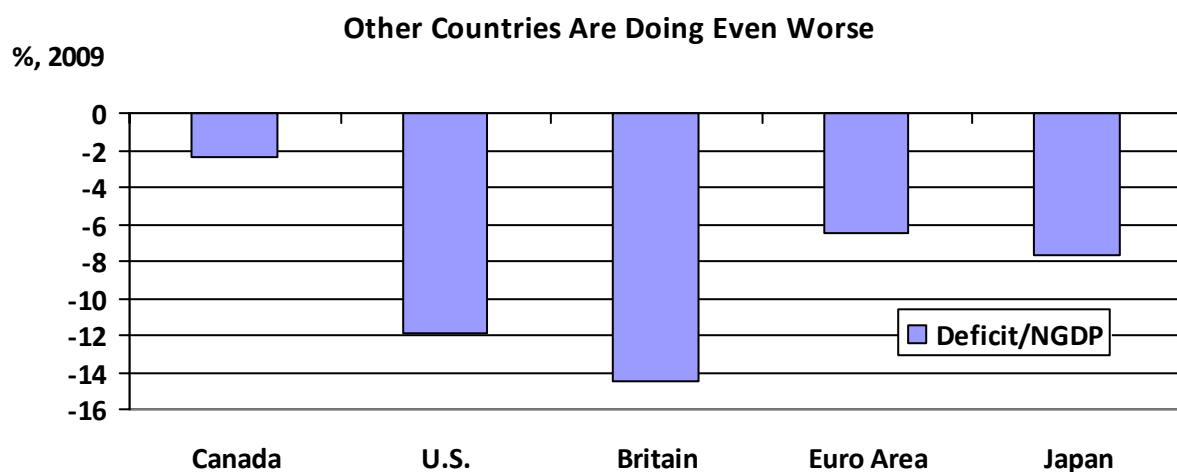


And Now to Close With Some Good News –

9. We're the Least Bad of a Sorry Lot

The fiscal deficit built up by the federal and provincial governments this year were very large relative to previous years and a bitter disappointment relative to forecasts of less than two years ago. However, Canada's deficit build - up is not nearly as severe as that of most other developed countries. For international comparisons we measure debts and deficits on a total government National Accounts basis. Canada's deficits this year will be - 2.4% of our GDP. This compares very favorably to the -12% of the U.S., Britain's almost -15% and the euro area's -6.5%.

Chart 9.



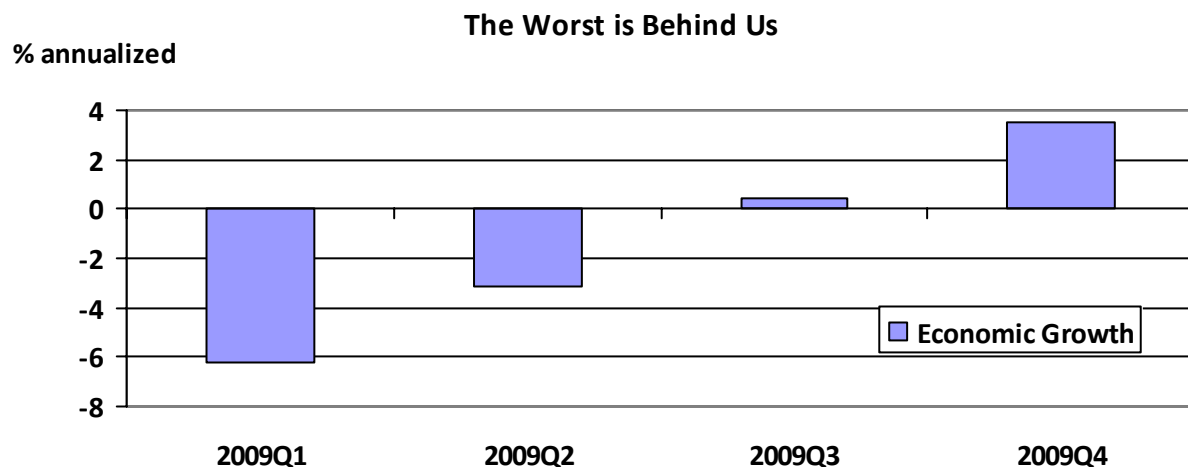
Source: Economist: Dec. 19, 2009 – Jan. 1, 2010

10. The Worst is Behind Us

Recall the miserable -6.2% (annualized) pace of economic growth in the first quarter of 2009. Things weren't quite as bad in the second quarter, but still, economic growth was negative. The economy did grow slightly in the third quarter, and now economists are expecting growth in the 3.5% range for the fourth quarter. Business investment in machinery and equipment was very strong in the third quarter and exports grew for the first time in a year.

Financial markets and credit conditions have come back nicely. It appears the stock market will be up almost 30% over 2009. The housing market is strong in most cities. Many of the tax reduction components of the federal stimulus program are already at work in the economy. Most of the impact of the infrastructure spending component of the stimulus program on job creation and economic growth lies ahead of us.

Chart 10.



The most important drivers of the rising pace of economic growth over the course of 2009 are the increase in the pace of growth in the U.S. and the low rates of interest instituted by the Bank of Canada. Note especially that economic growth in the U.S. was 2.2% in the third quarter. Much of the pickup in the Canadian economy to date can be traced to strengthened machinery and equipment investment, the stronger housing starts and the pickup in exports. While the federal stimulus program has been helpful, it is probably a distant third driver of the recovery in economic growth to this point.

Economic growth has been positive for 4 of the past 5 months. Employment levels are no longer trending down and the unemployment rate is expected to start improving very soon. The pace of economic growth is expected to improve from this year's -2.5% to a positive 2.5% for 2010.