

North American Economic Outlook: “Gradual Though Sustained Recovery”

Presentation to the Canadian Association of
Movers

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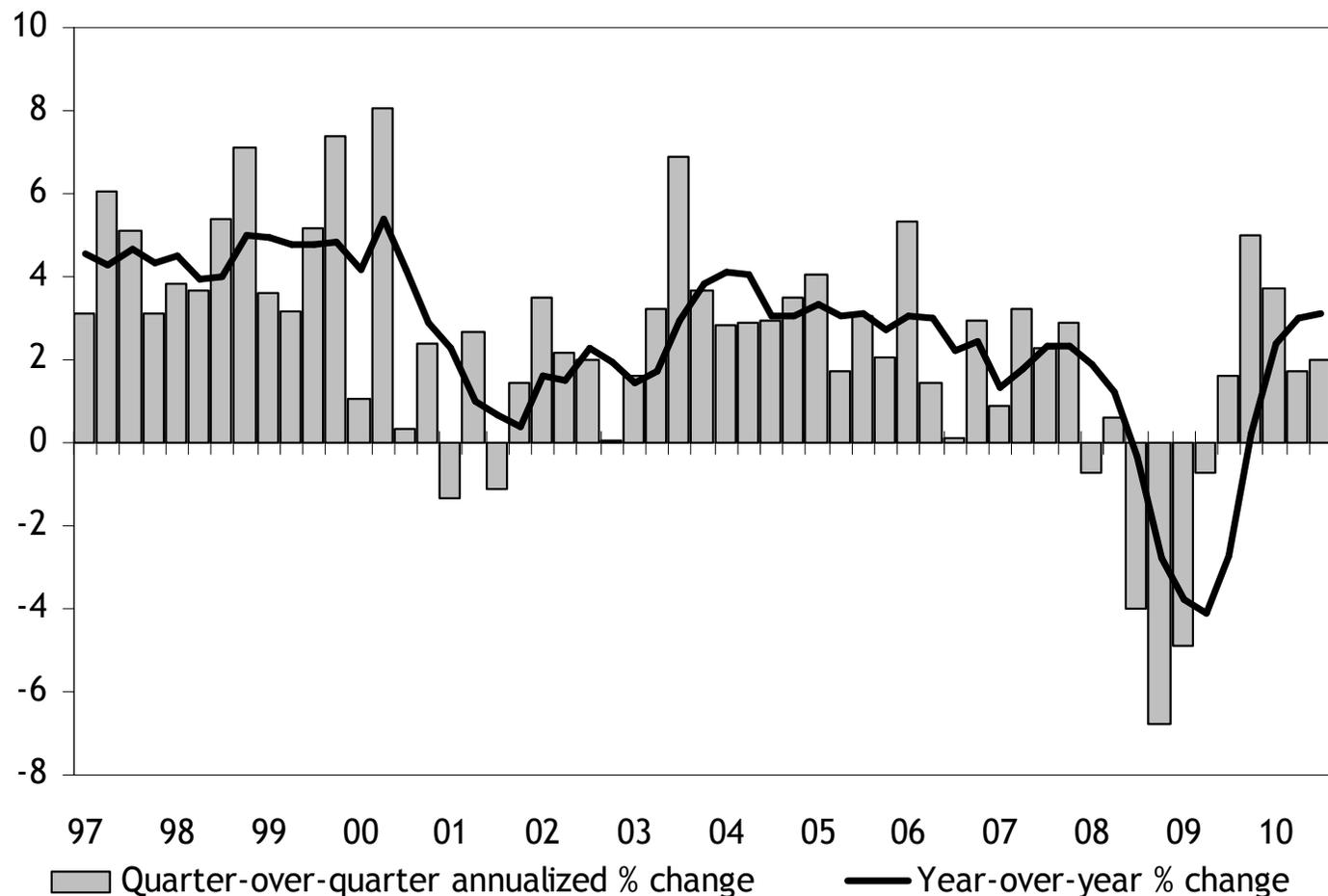
U.S. Economic Outlook:

**Strengthening Employment Growth
Key to Sustaining the U.S. Recovery**



The U.S. recovery has slowed after initially rebounding strongly from the severe financial market shock

U.S real GDP growth



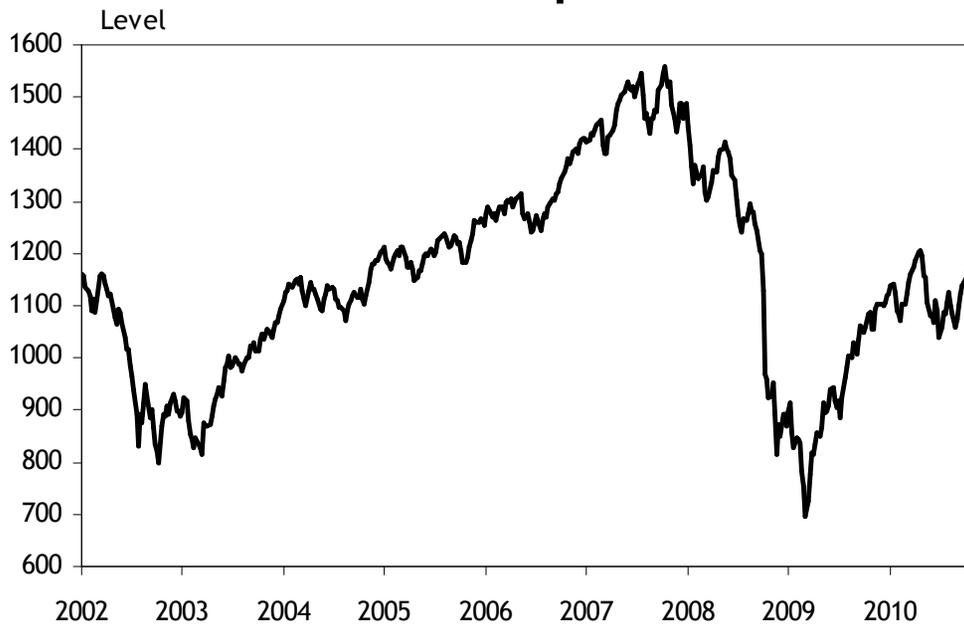
Source: Bureau of Economic Analysis, RBC Economics Research

What is needed to sustain the U.S. recovery?

The uncertainty as to who was holding U.S. subprime mortgages weighed on financial markets though these pressures have reversed

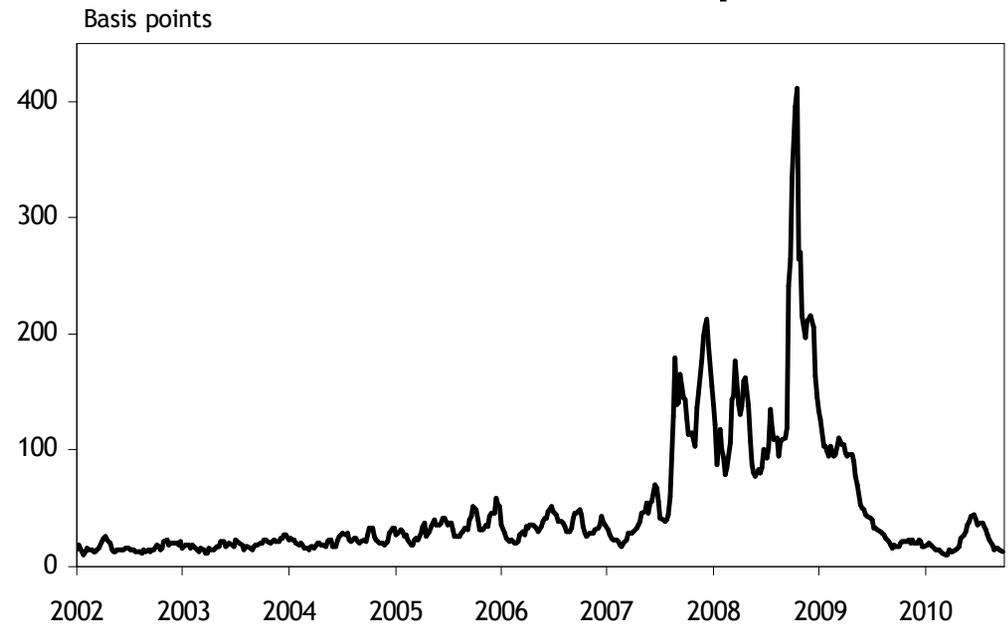
Weekly observation

S&P 500 composite index



Source: Bloomberg, RBC Economics Research

Three-month TED spread*

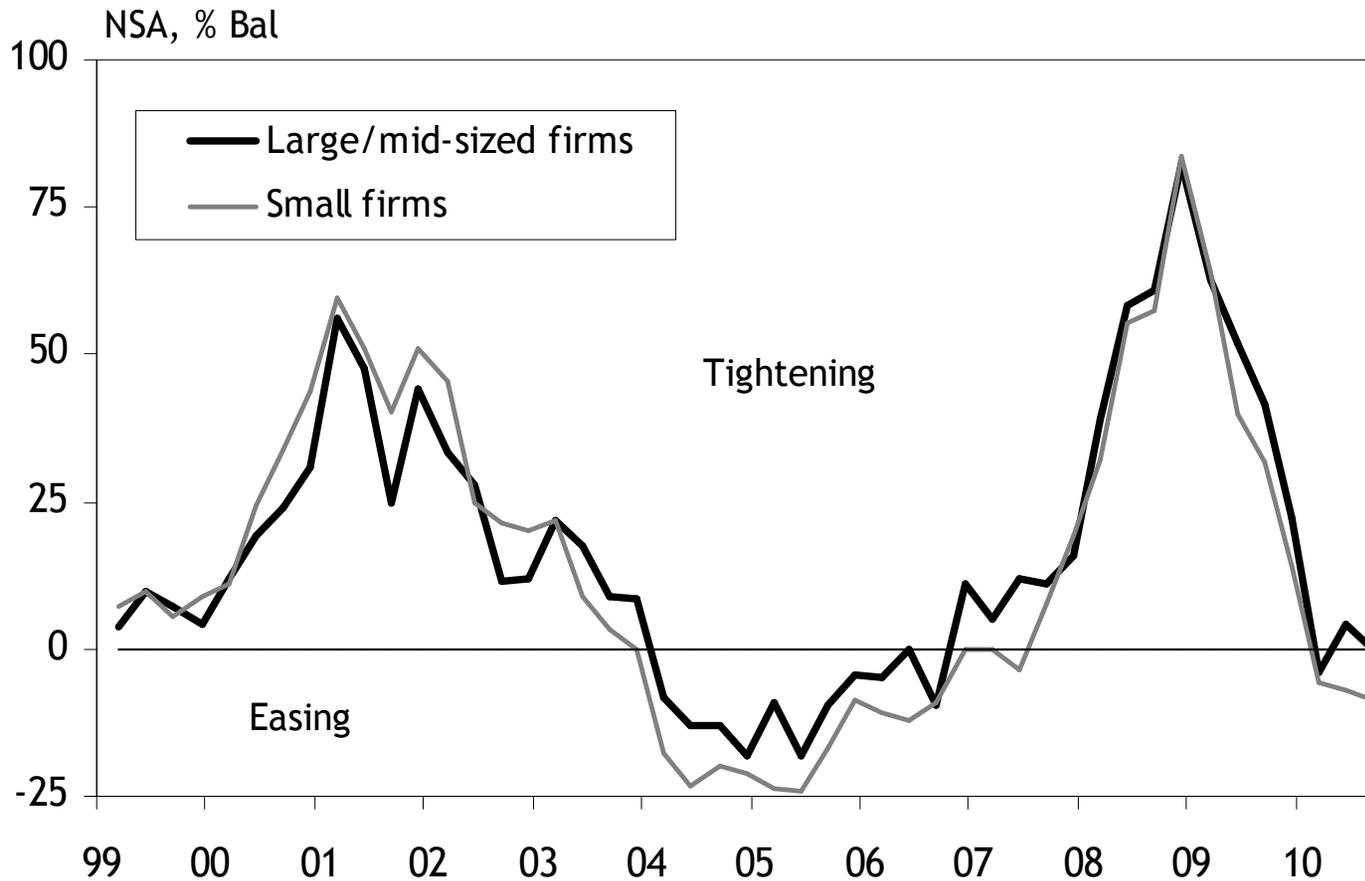


*Three-month LIBOR rate minus Three-month T-bill

Source: Federal Reserve Board, RBC Economics Research

U.S. commercial banks have ceased tightening lending standards...

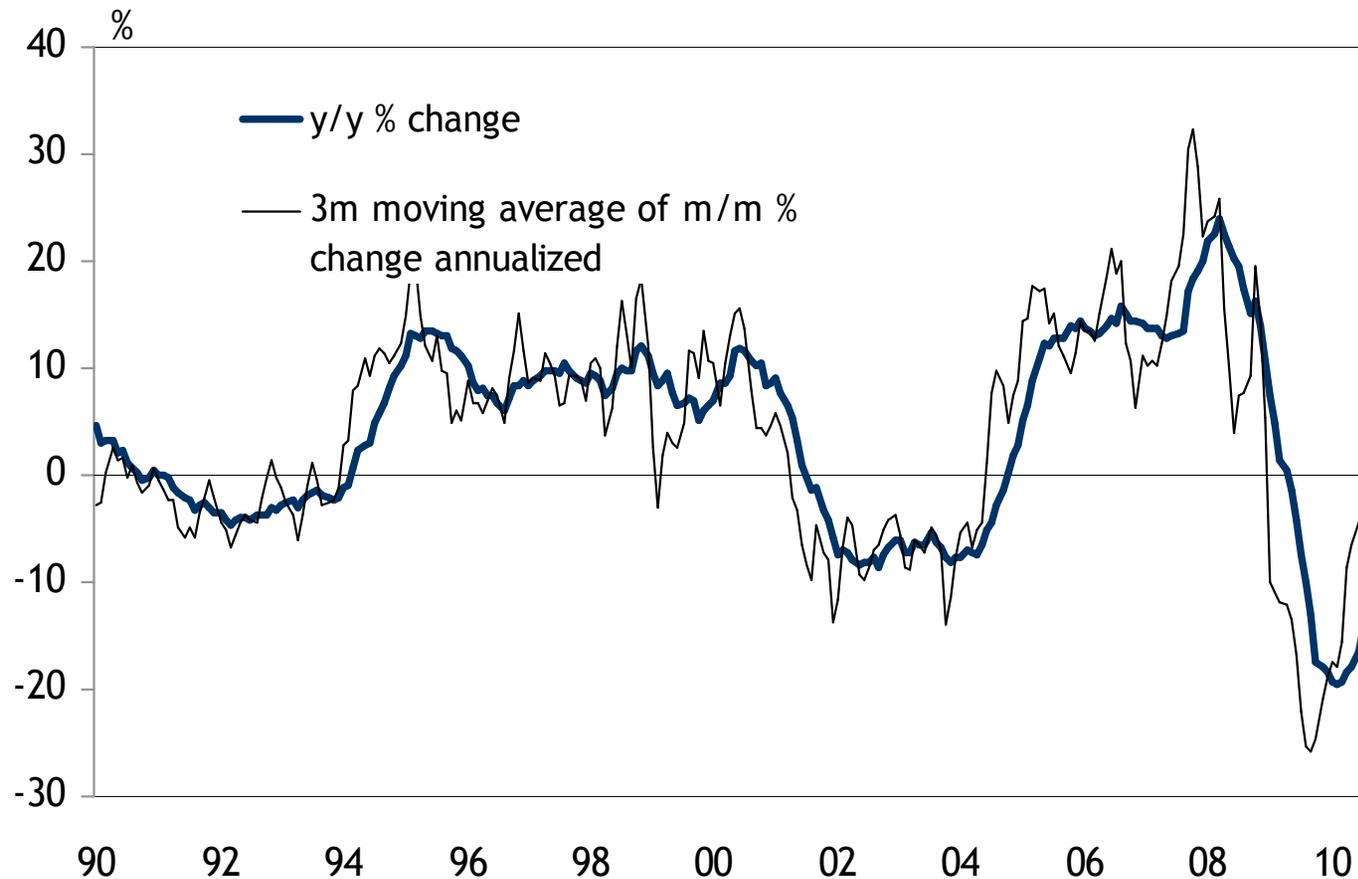
Federal reserves senior loans officer survey



Source: Federal Reserve Board, RBC Economics Research

...which augurs well for the improving trend in lending to continue

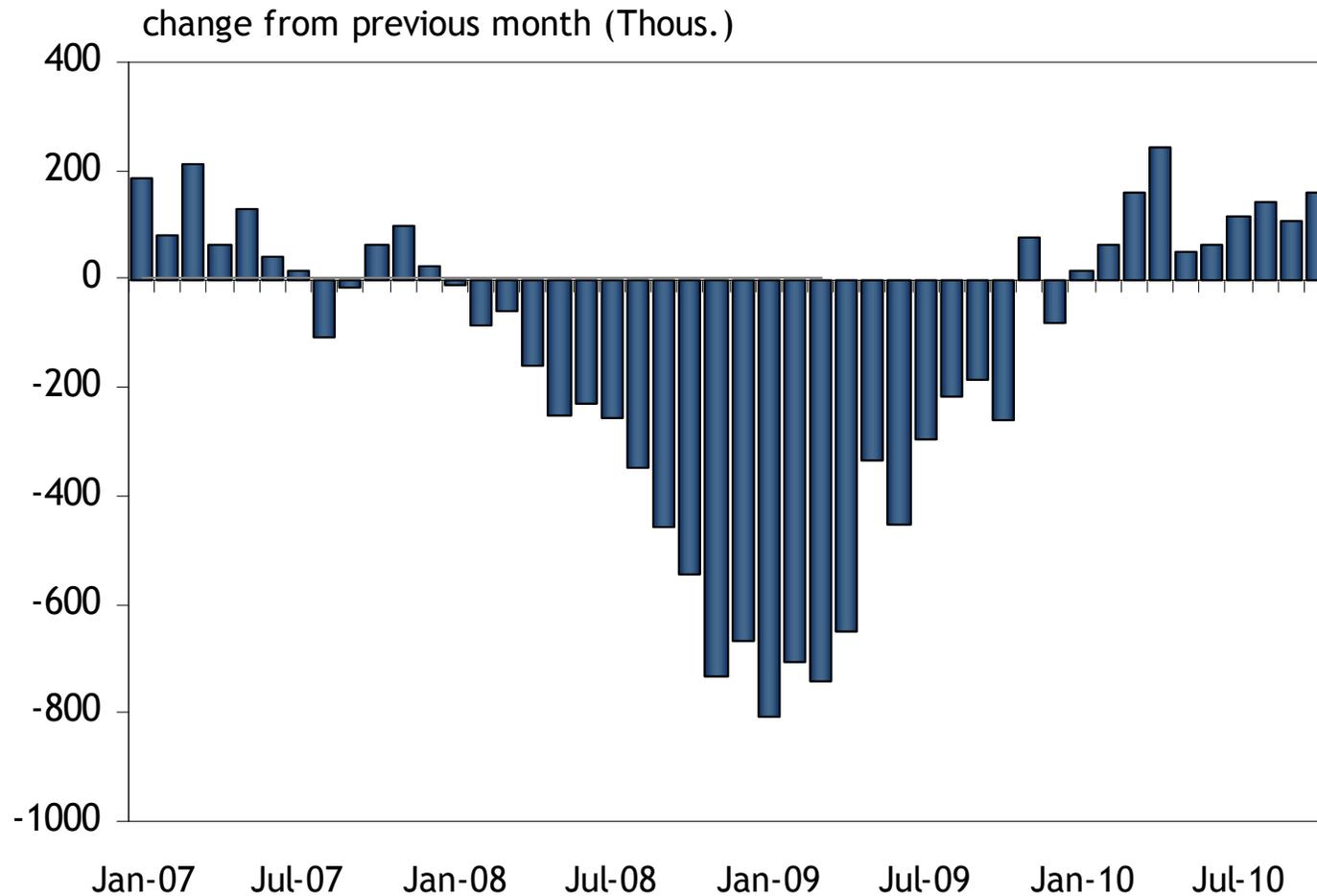
U.S. C&I loans at commercial banks



Source: Federal Reserve Board, RBC Economics Research

Private sector hiring needs to continue to improve

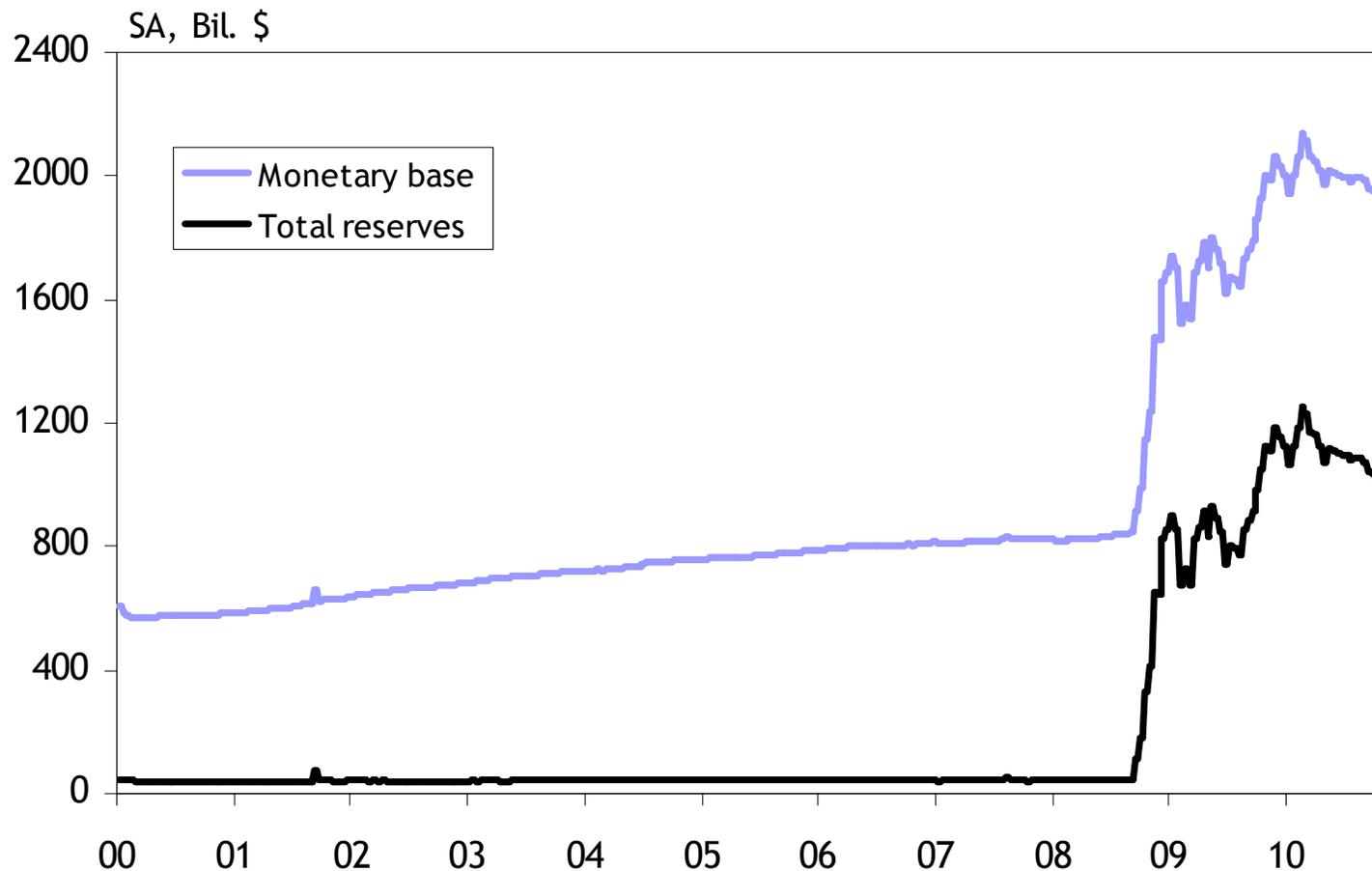
Private sector employment growth



Source: Bureau of Labor Statistics, RBC Economics Research

To help facilitate this, the Fed is poised to embark on another round of “Quantitative Easing”

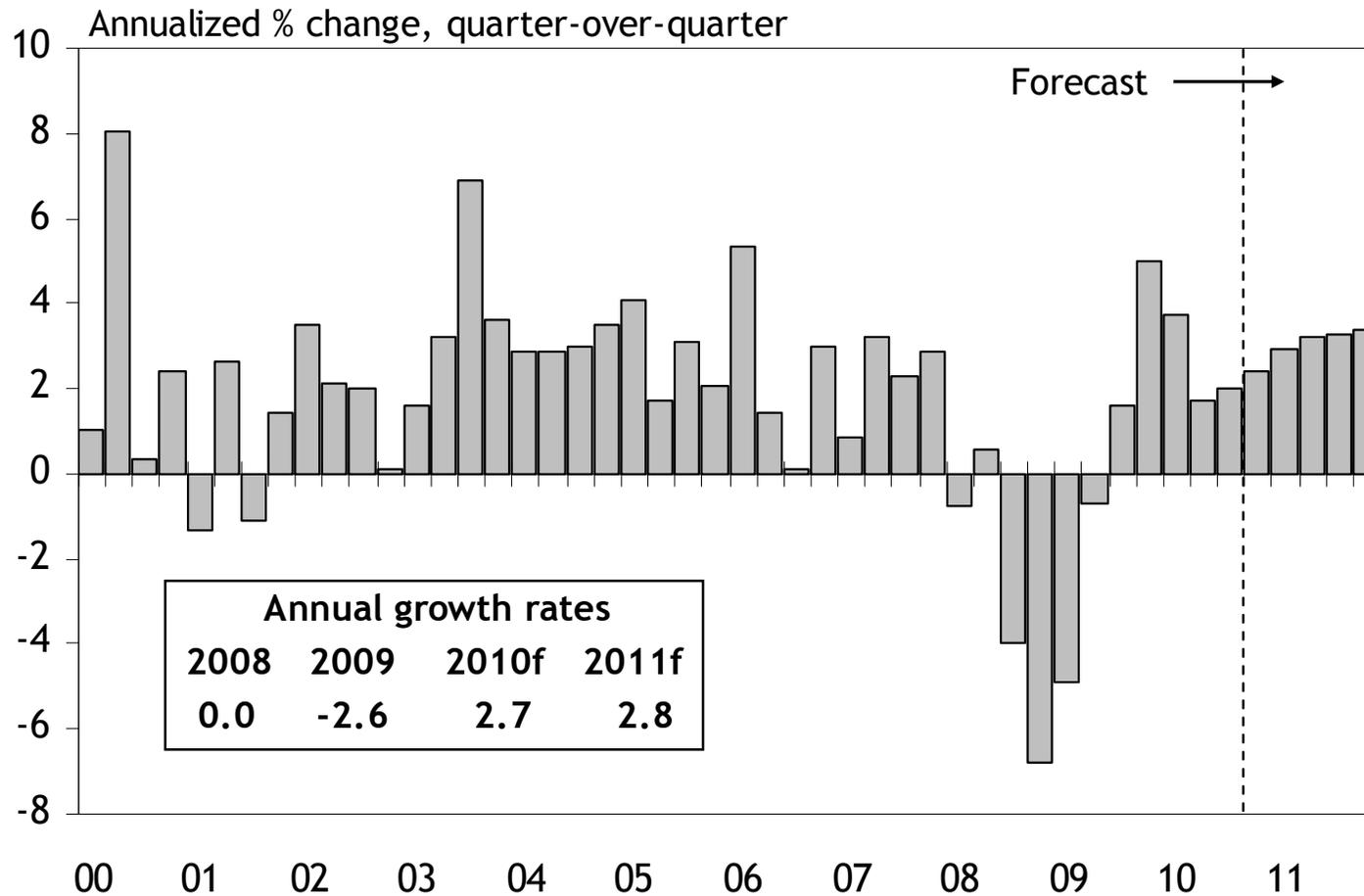
Reserves held by the Fed



Source: Federal Reserve Board, RBC Economics Research

Our forecast assumes that this private sector support along with policy actions will sustain the recovery

U.S. real GDP

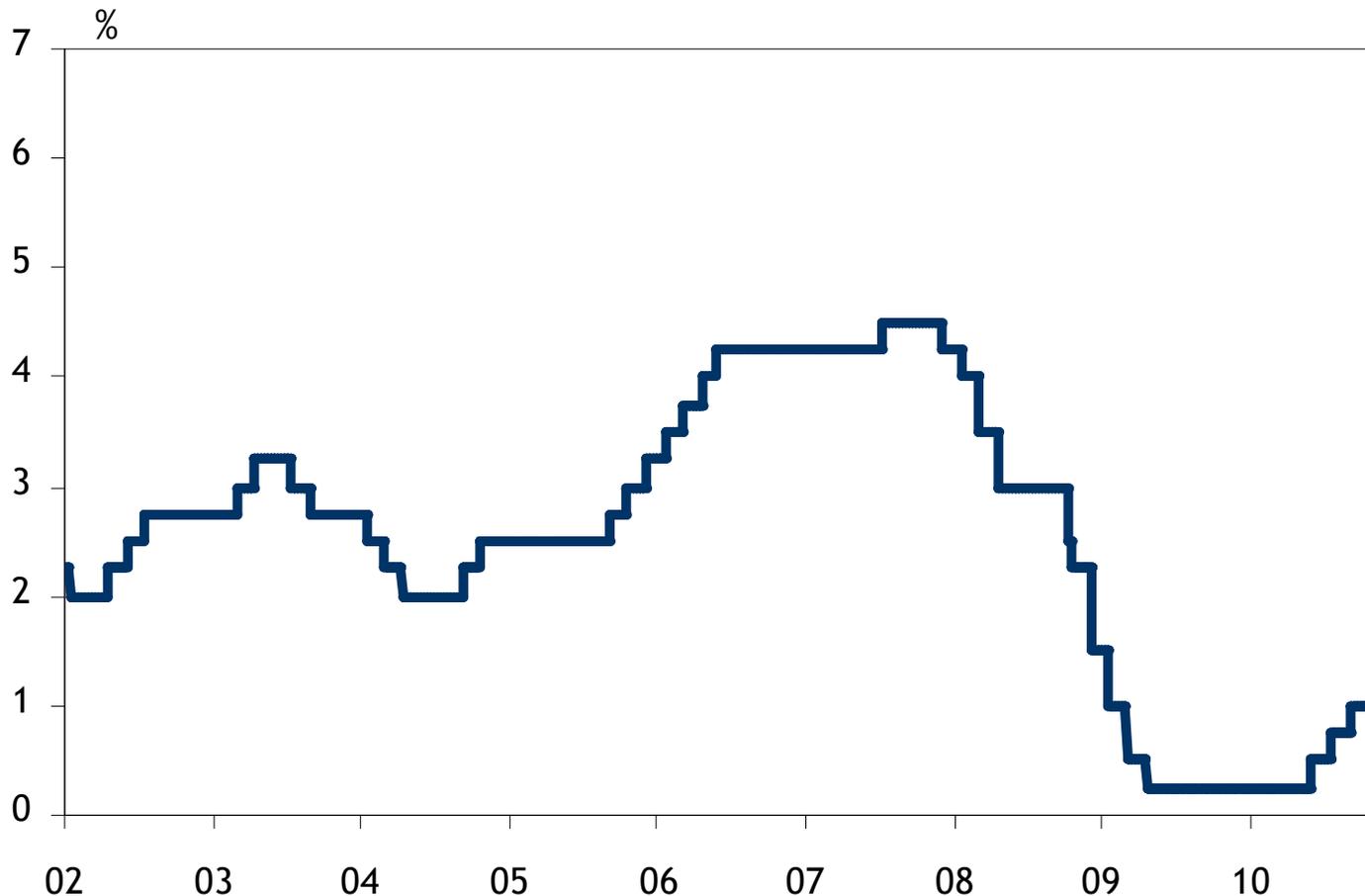


Source: Bureau of Economic Analysis, RBC Economics Research

**Canadian Economic Outlook:
Less Damaged by the U.S. Recession
-Though Still Dependant on Sustained
U.S. Recovery**

Canada has weathered the U.S. downturn helped by an aggressive easing in policy...

Bank of Canada overnight rate



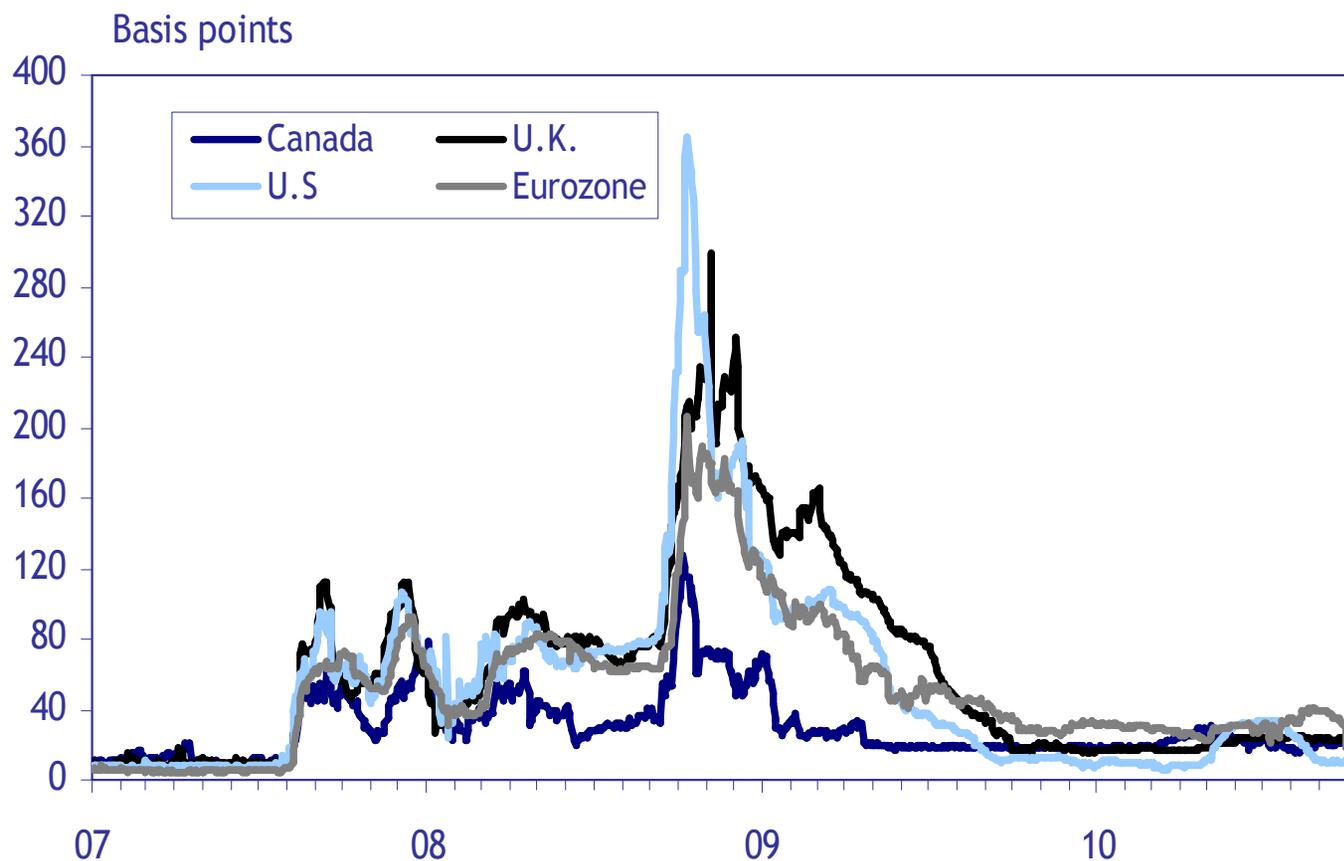
Source: Bank of Canada, RBC Economics Research

...with the impact of the U.S. recession also tempered by three additional factors:

- **less upward pressure on the cost of capital**
- **commodity prices, though trading lower, remained at historically high levels which helped boost export revenues**
- **the Canadian housing market avoided the free-fall in activity evident in the U.S.**

The rise in the cost-of-capital was more muted in Canada

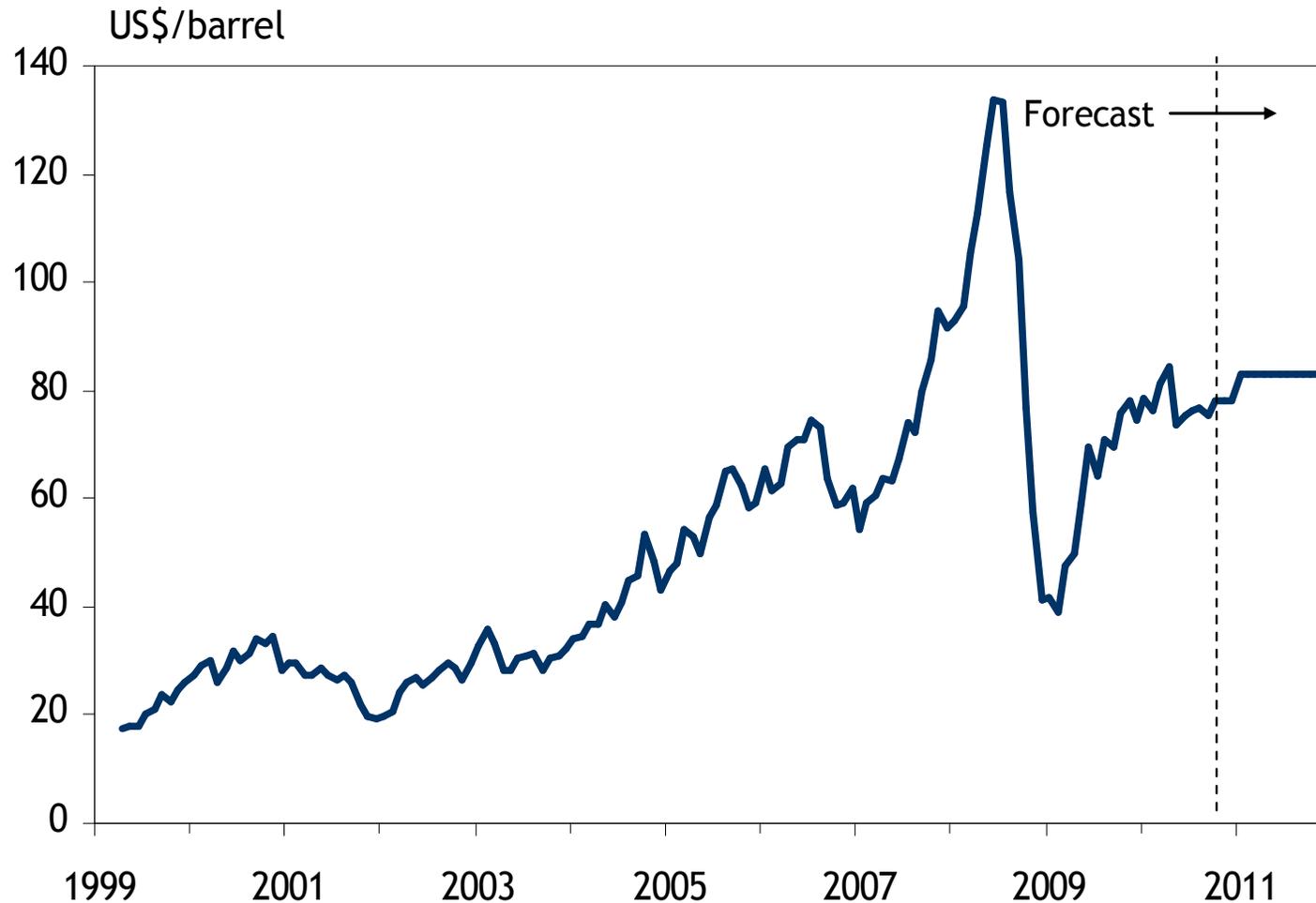
Short-term funding spreads 3 month LIBOR vs. OIS



Source: Bloomberg, RBC Economics Research

Oil prices have generally remained, and are expected to continue to remain, historically high ...

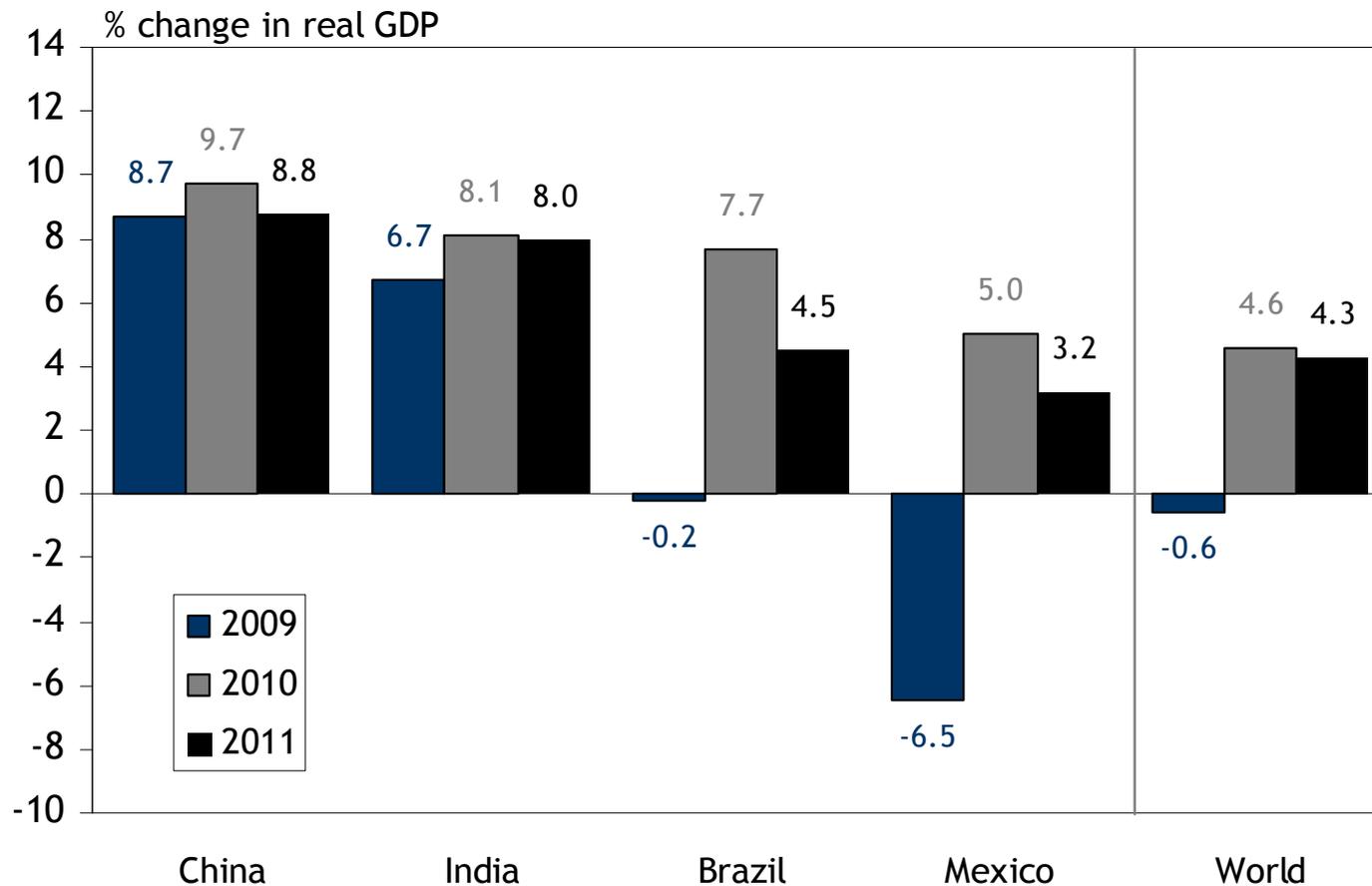
Oil price forecast



Source: Wall Street Journal, Bloomberg, RBC Economics

...as demand from emerging markets, though slowing, did not collapse and has started to rebound

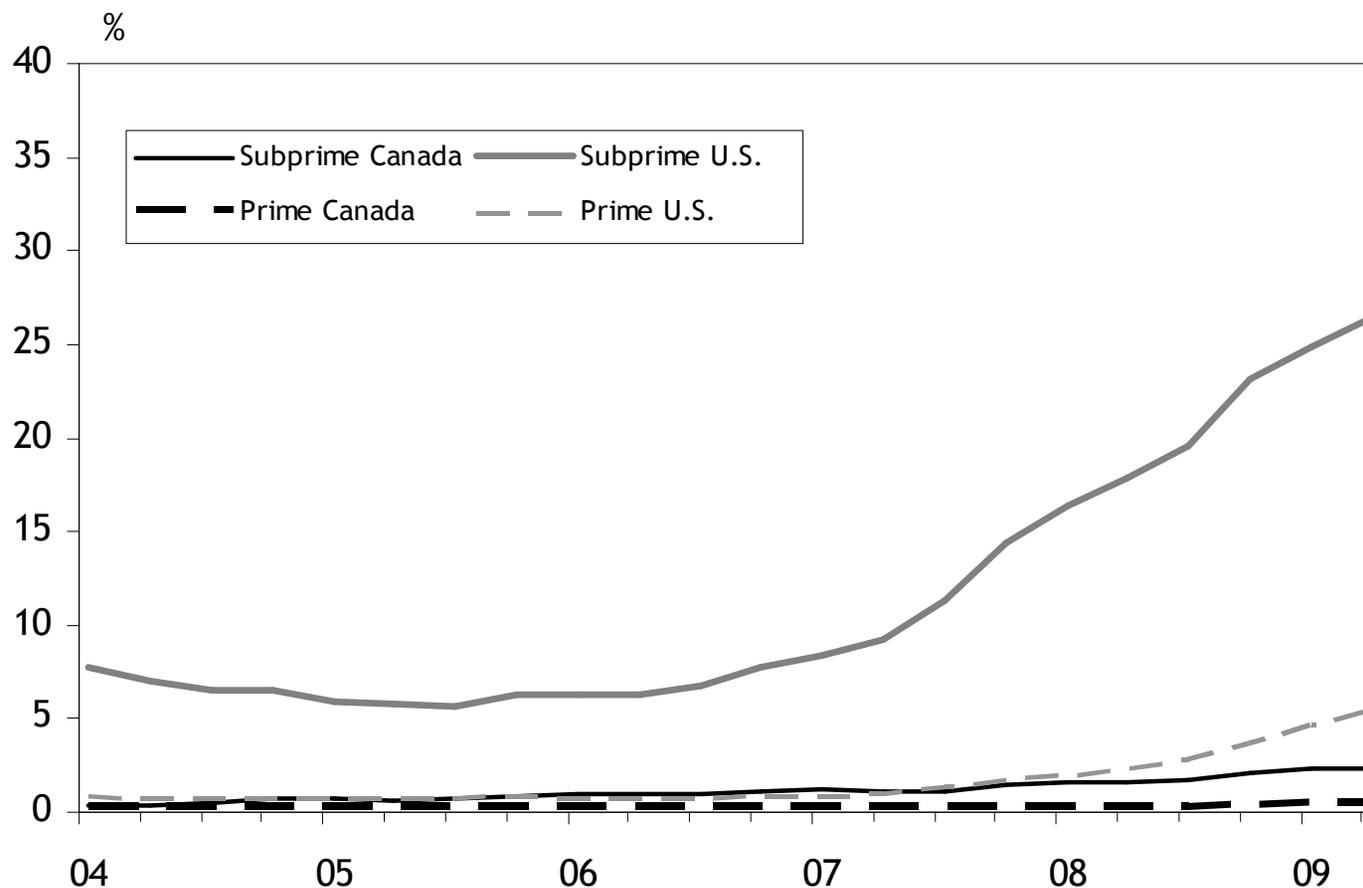
Major emerging economies



Source: IMF, RBC Emergin Markets Research, RBC Economics Research

More prudent mortgage lending in Canada with less involvement in subprime mortgages...

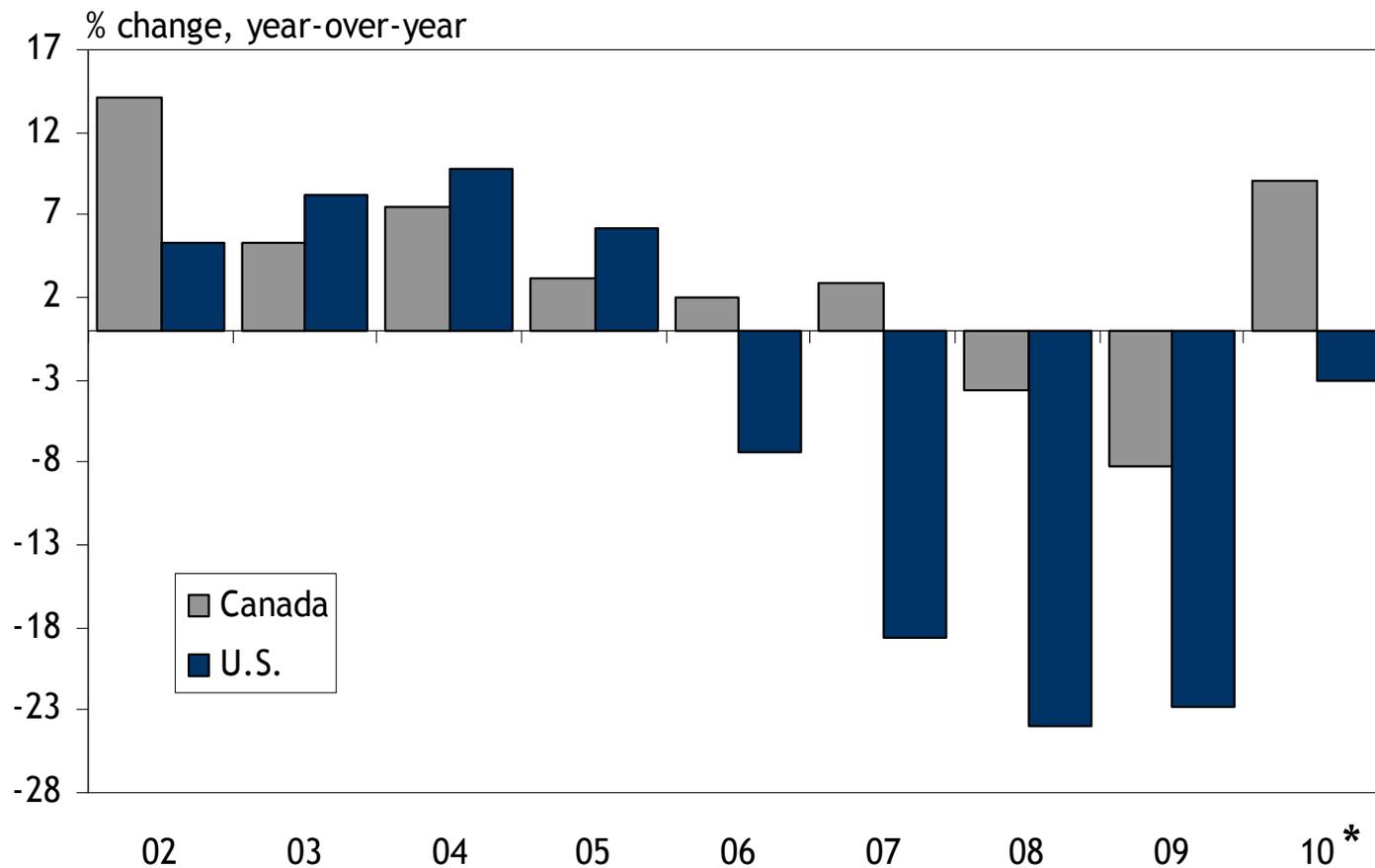
Percentage of mortgage in arrears



Source: Bank of Canada, Mortgage Bankers Association, RBC Economics Research

...limited the extent of declines in residential investment in Canada relative to the U.S.

Residential investments



* Forecast

Source: Statistics Canada, Bureau of Economic Analysis, Office for National Statistics, RBC Economics Research

There was concern that a housing market bubble might be emerging with an earlier sharp rise in house prices...

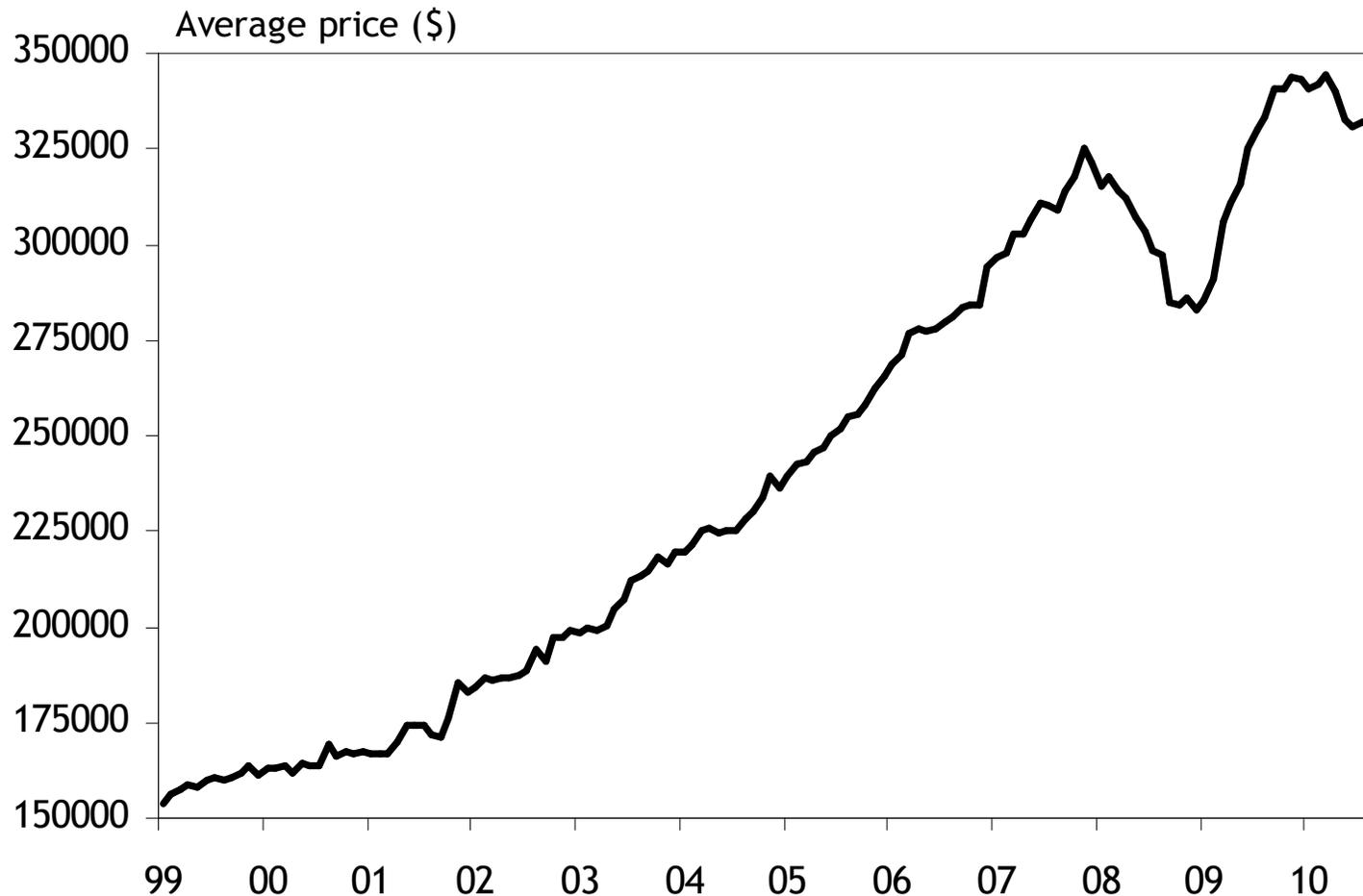
Canadian house prices



Source: CREA, RBC Economics Research

...however, those increases largely reversed earlier weakness with greater stability emerging

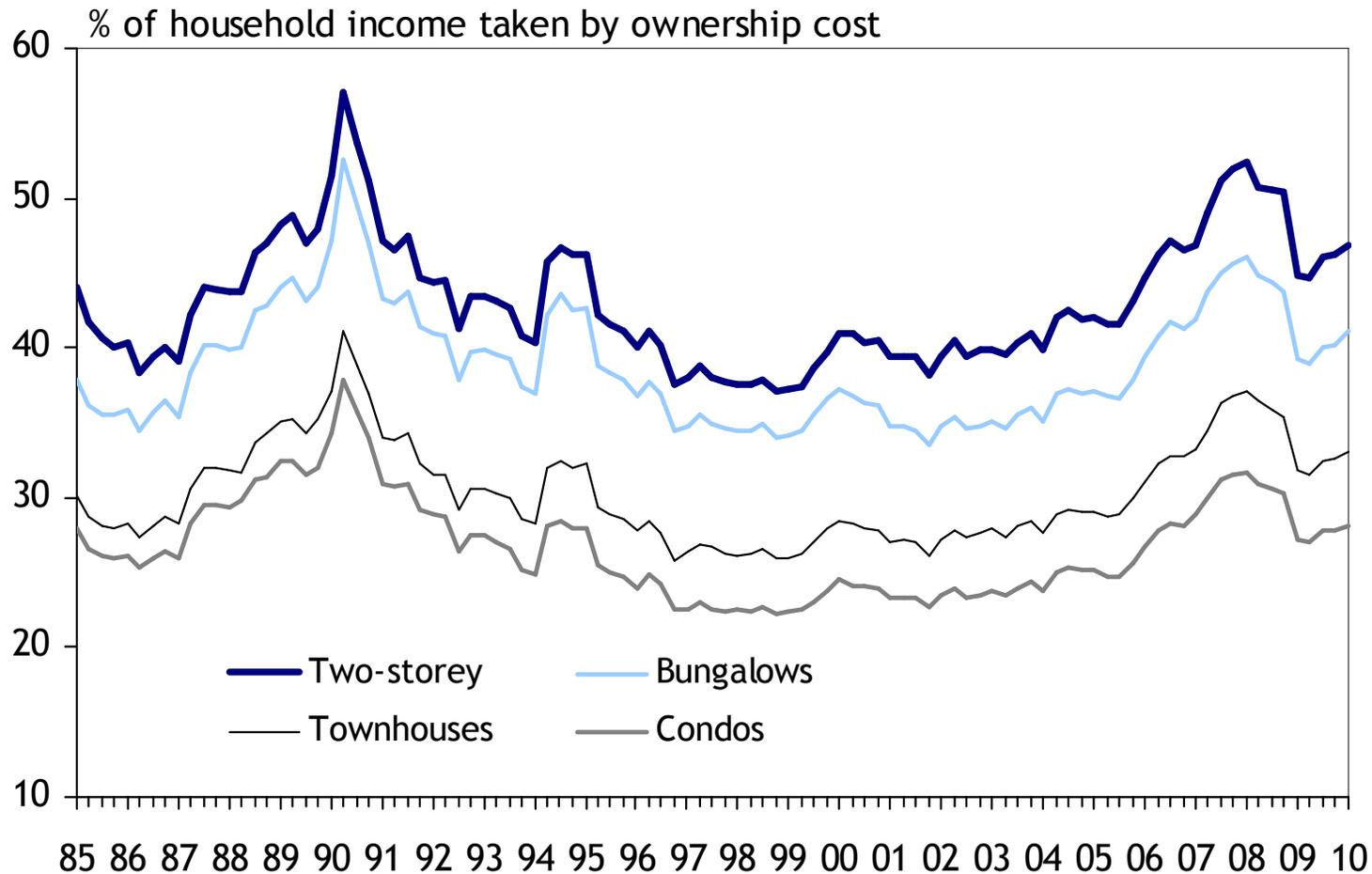
Canadian house prices



Source: CREA, RBC Economics Research

RBC's Housing Affordability measure is not flagging any major imbalances similar to the early 1990s

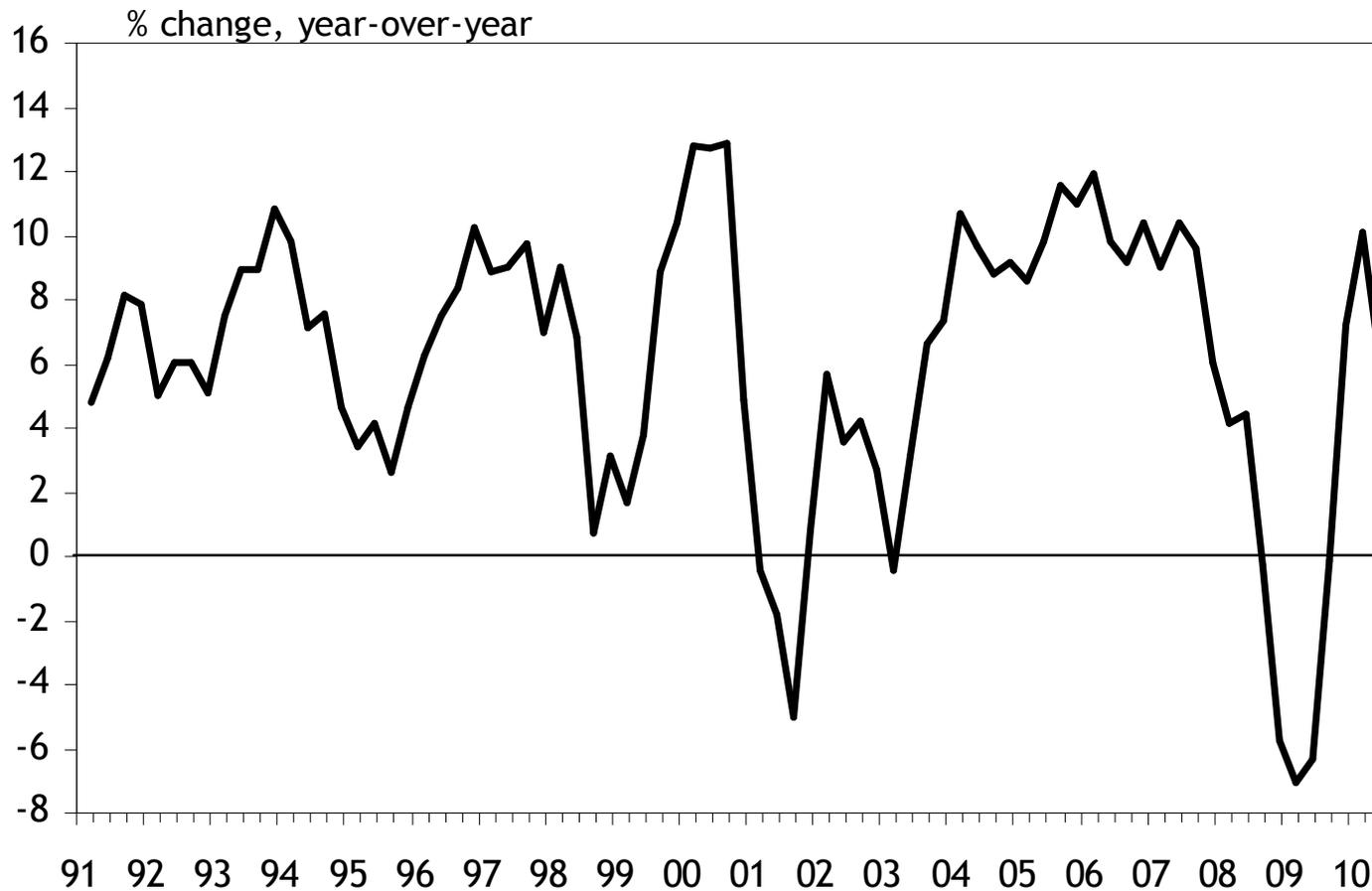
Housing affordability



Source: Statistics Canada, Royal LePage, RBC Economics Research

The financial market turmoil has hit household net worth though conditions are improving

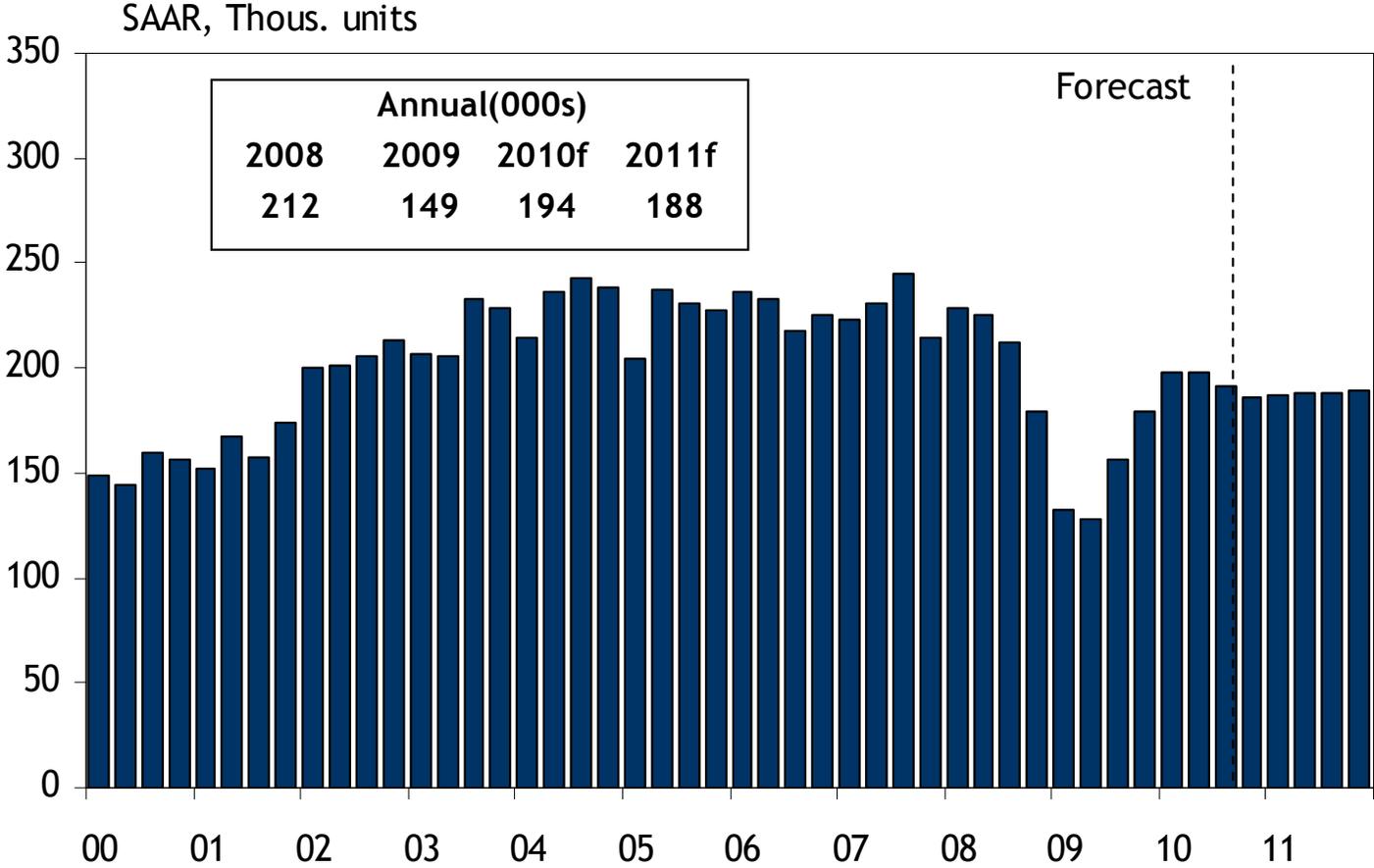
Household net worth



Source: Statistics Canada, RBC Economics Research

However, the hit to balance sheets will keep the recovery in housing subdued going forward

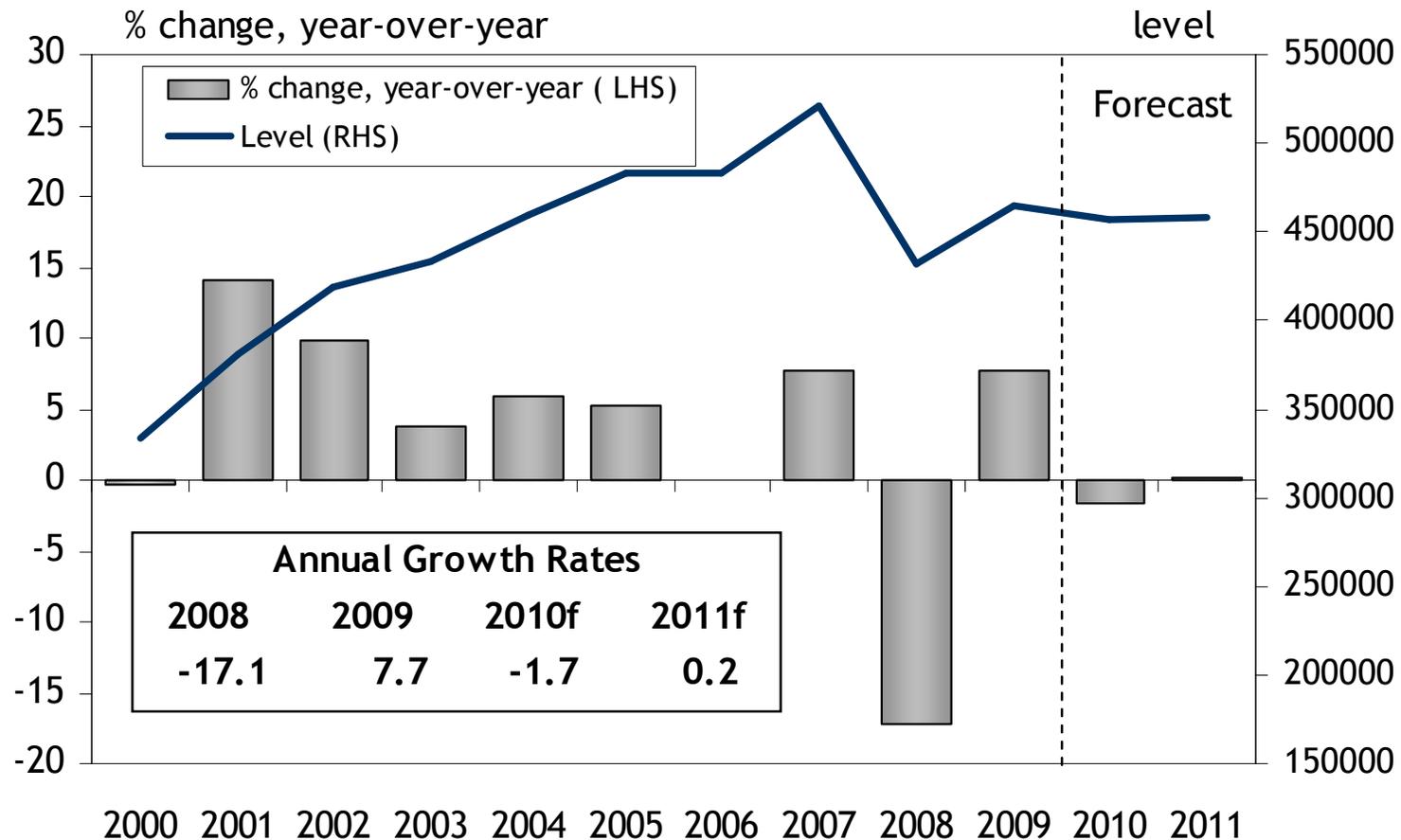
Housing starts



Source: CMHC, RBC Economics Research

Similarly following an initial bounce from recession lows, growth will slow for both housing sales...

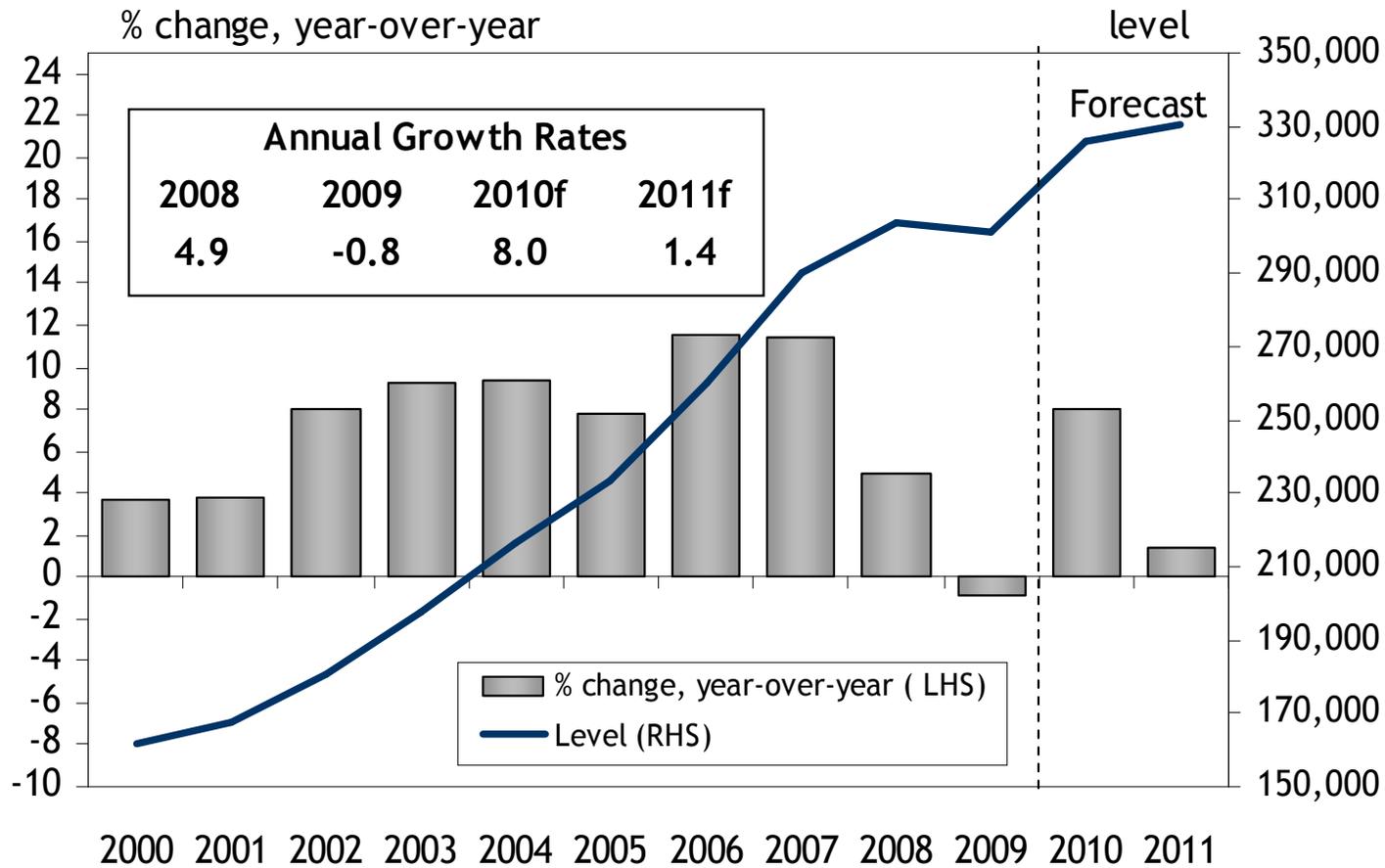
Housing resales



Source: CREA, RBC Economics Research

...and housing prices

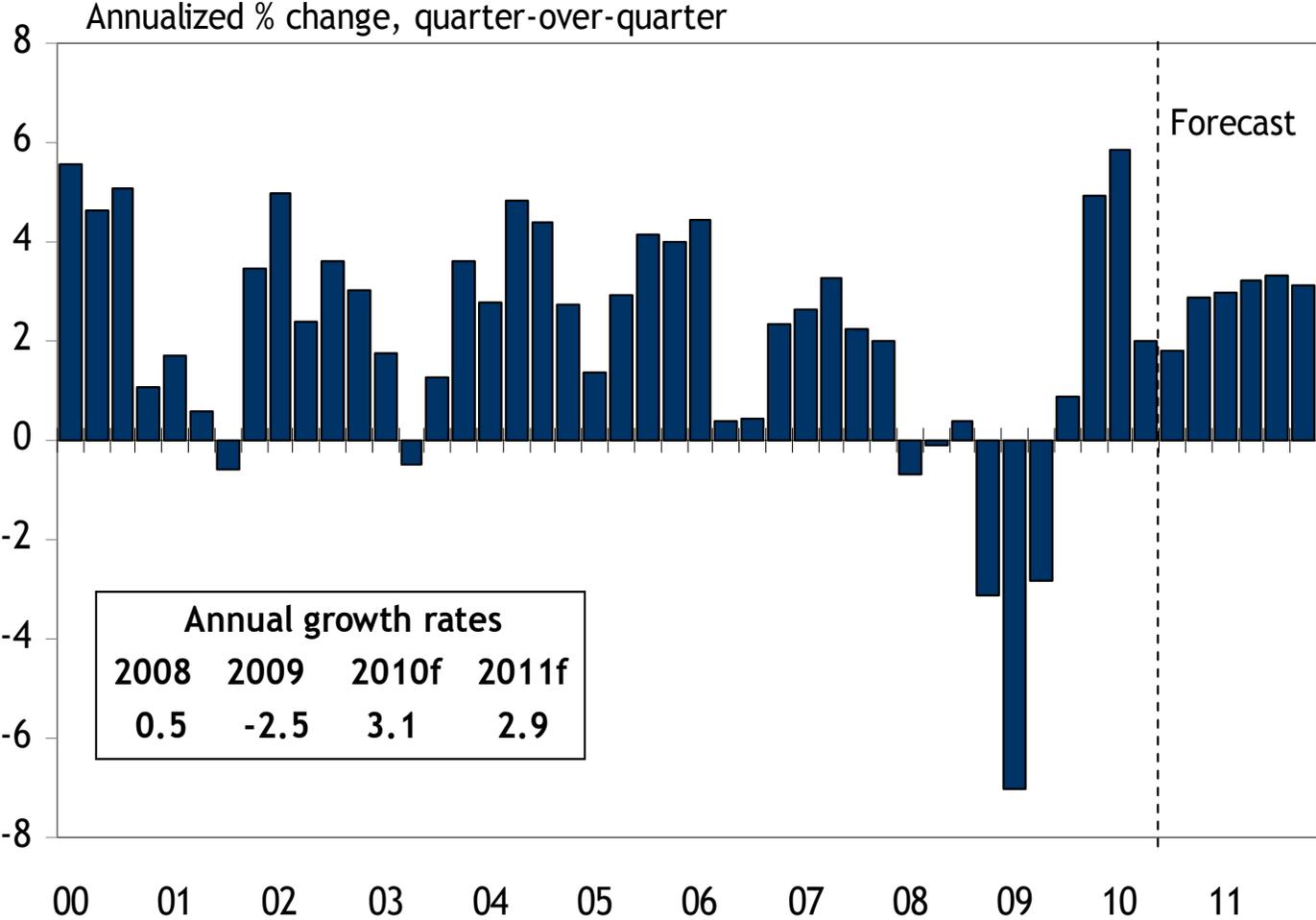
Housing prices



Source: Royal LePage, RBC Economics Research

Easing credit conditions, stimulative policy, and U.S. recovery should allow Canada to sustain positive growth

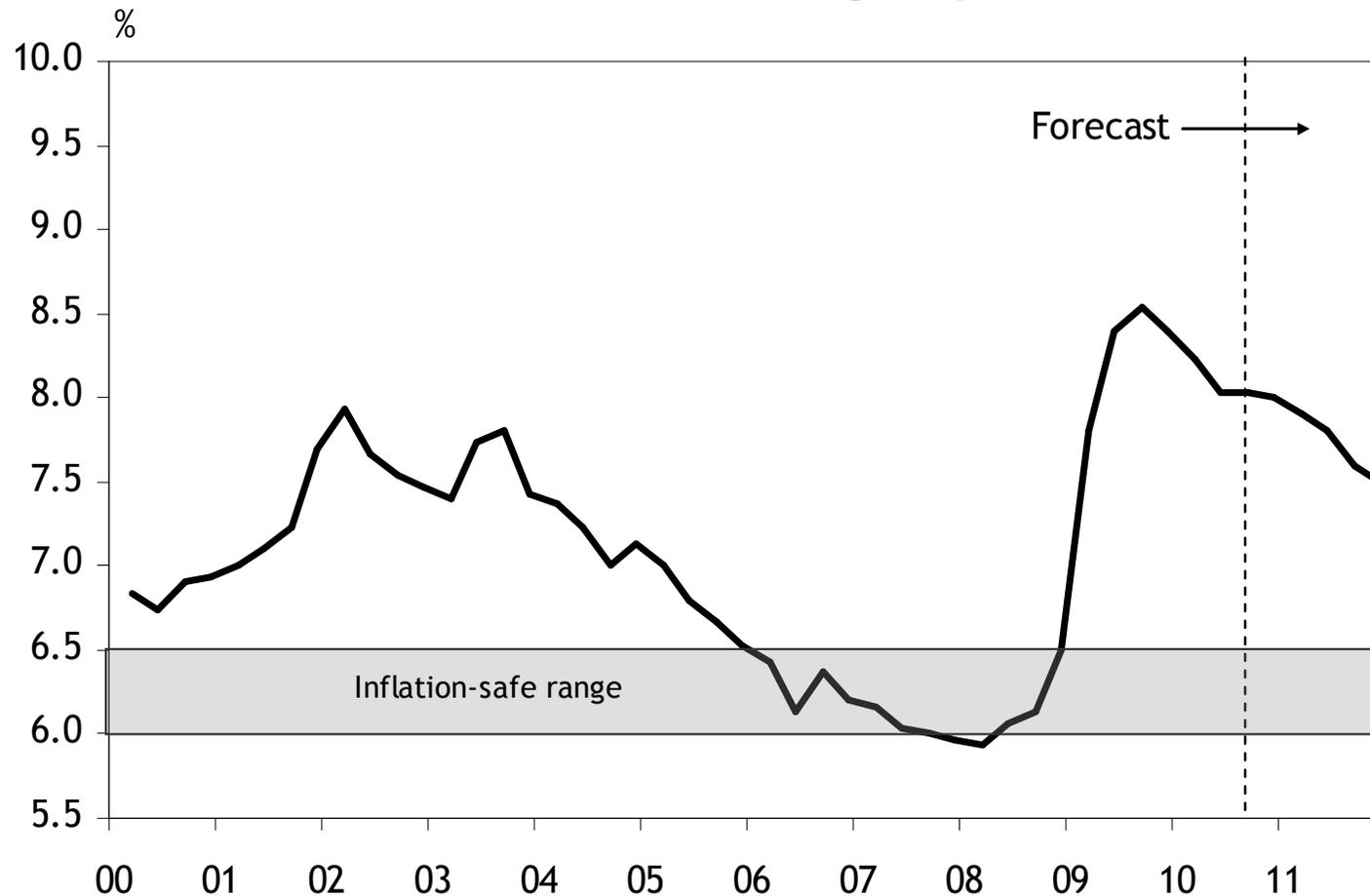
Canada's real GDP



Source: Statistics Canada, RBC Economics Research

The modest rebound will keep the pace of improvement in the unemployment rate gradual

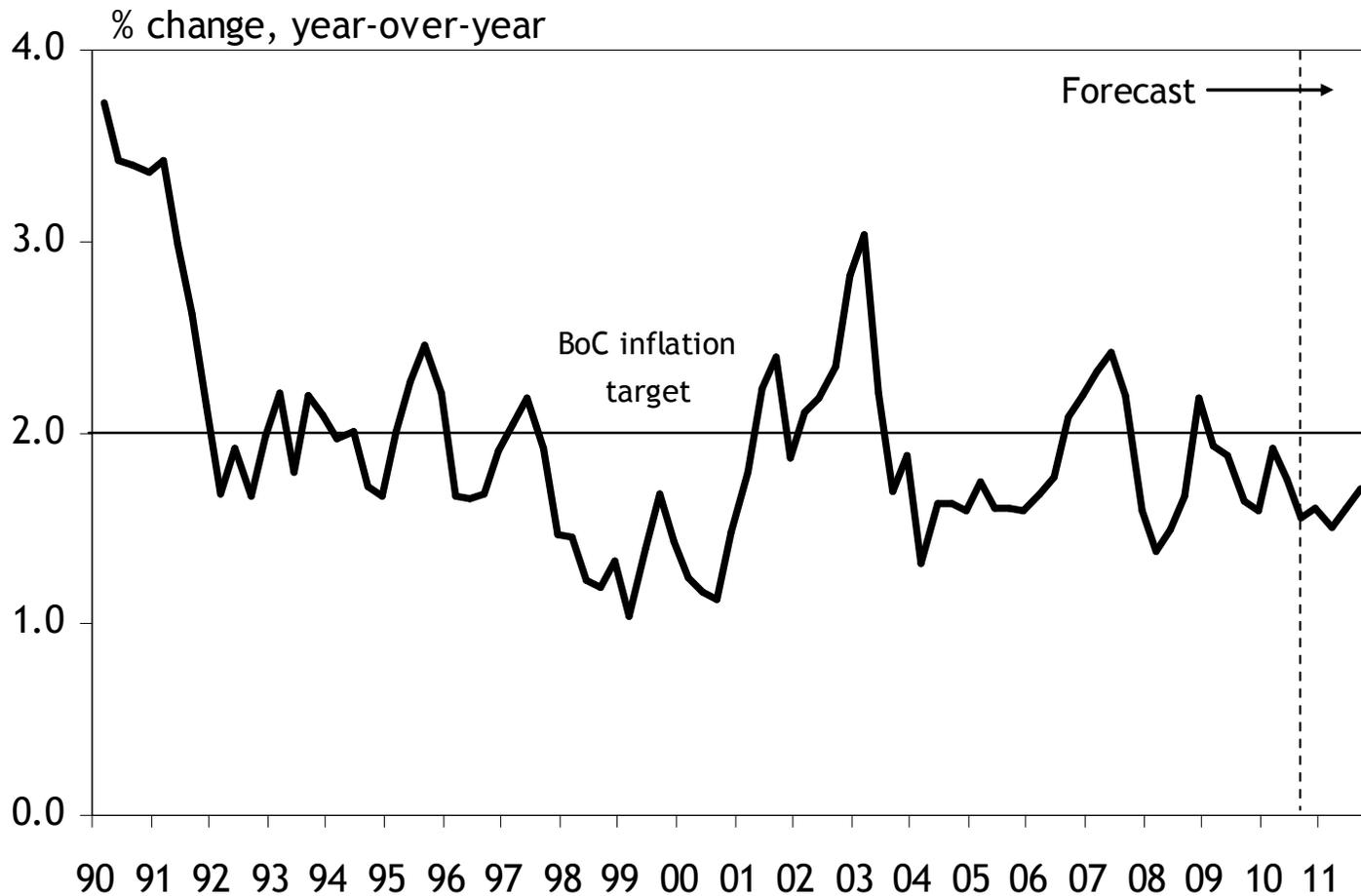
Canadian unemployment



Source: Statistics Canada, RBC Economics Research

This slack in the economy will also keep inflation below target near term

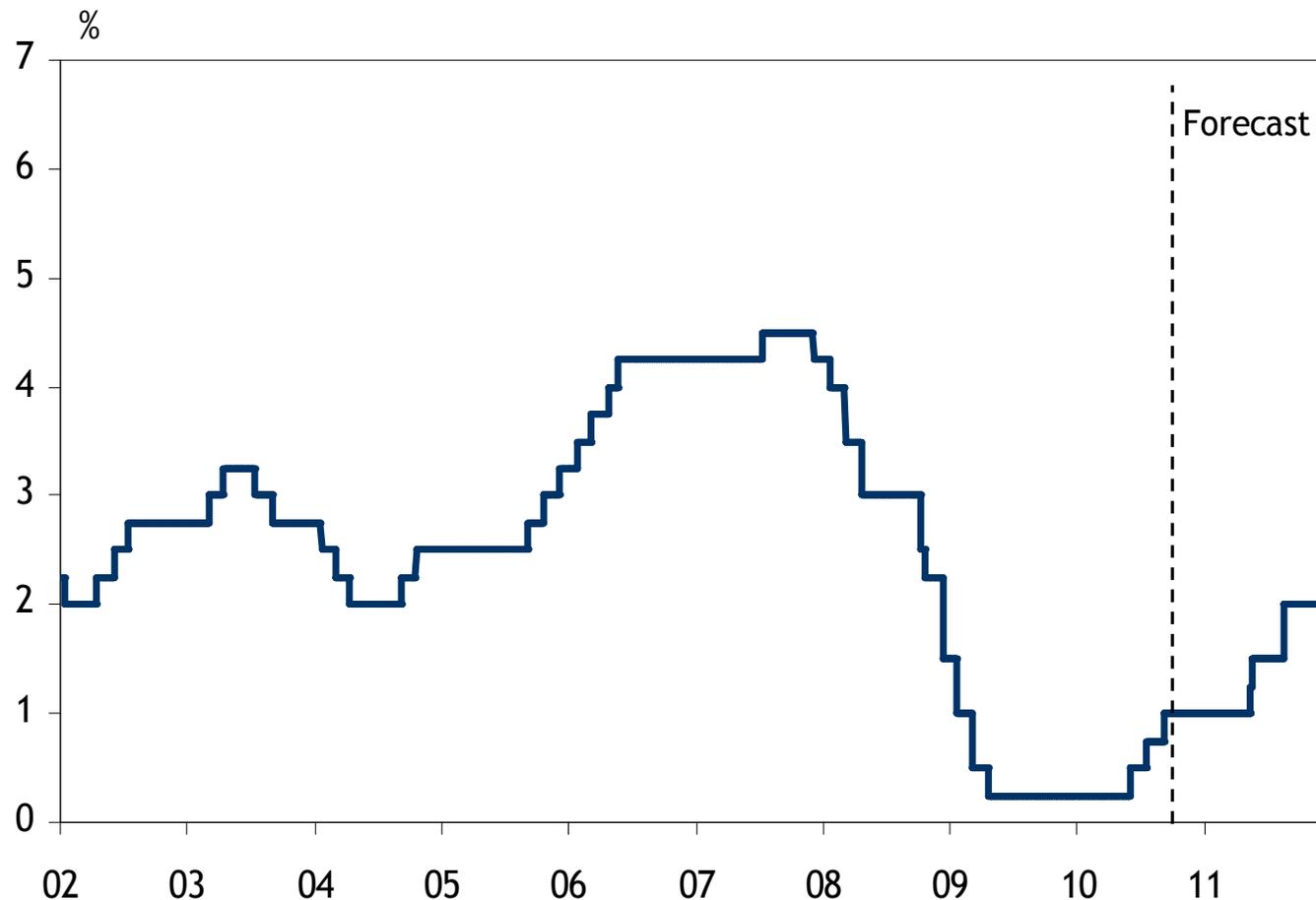
Canadian core inflation



Source: Statistics Canada, RBC Economics Research

Low inflation and high unemployment rate will keep the pace of Bank of Canada tightening gradual

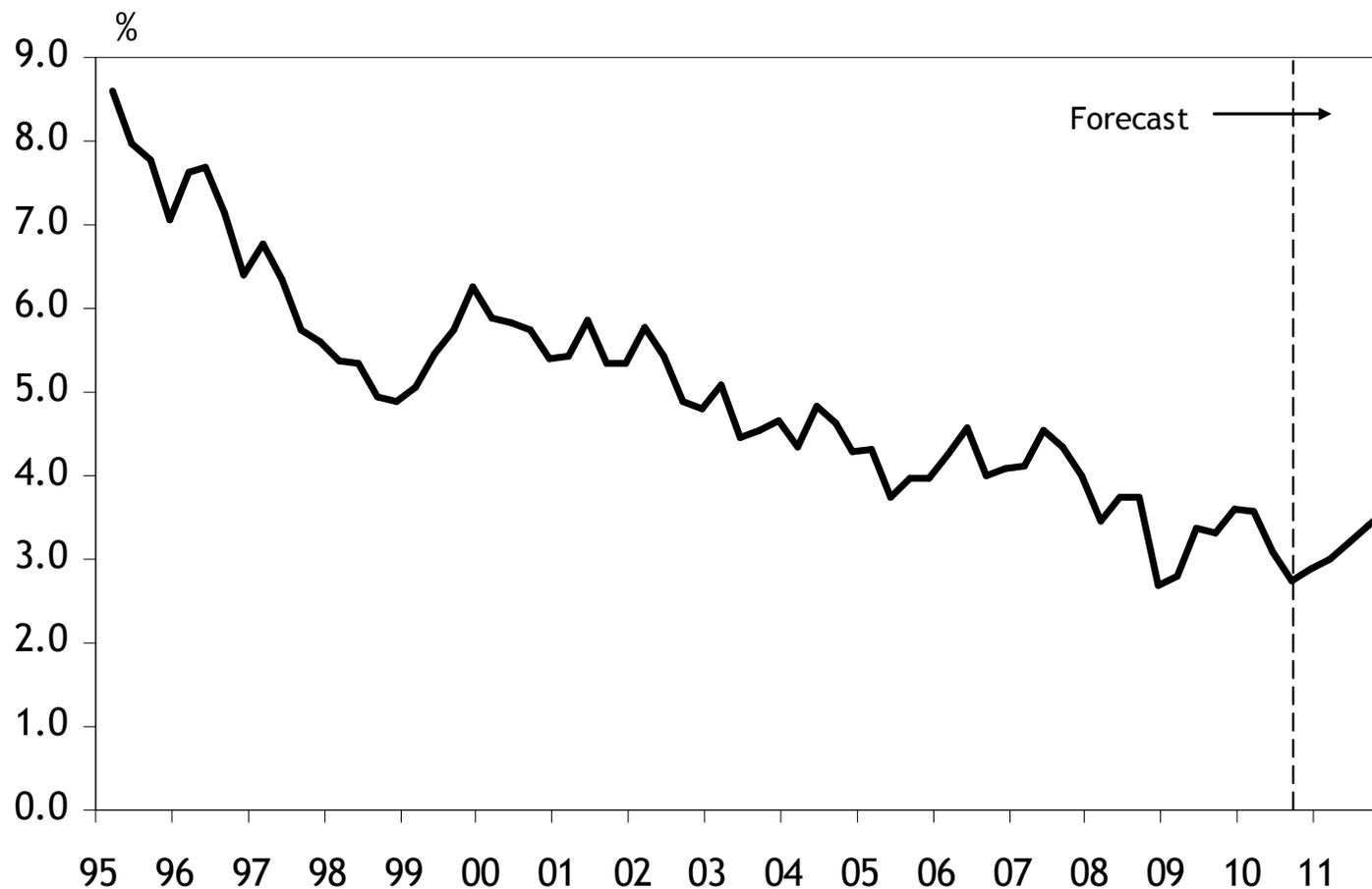
Bank of Canada overnight rate



Source: Bank of Canada, RBC Economics Research

Bond yields will rise modestly as the central bank tightens

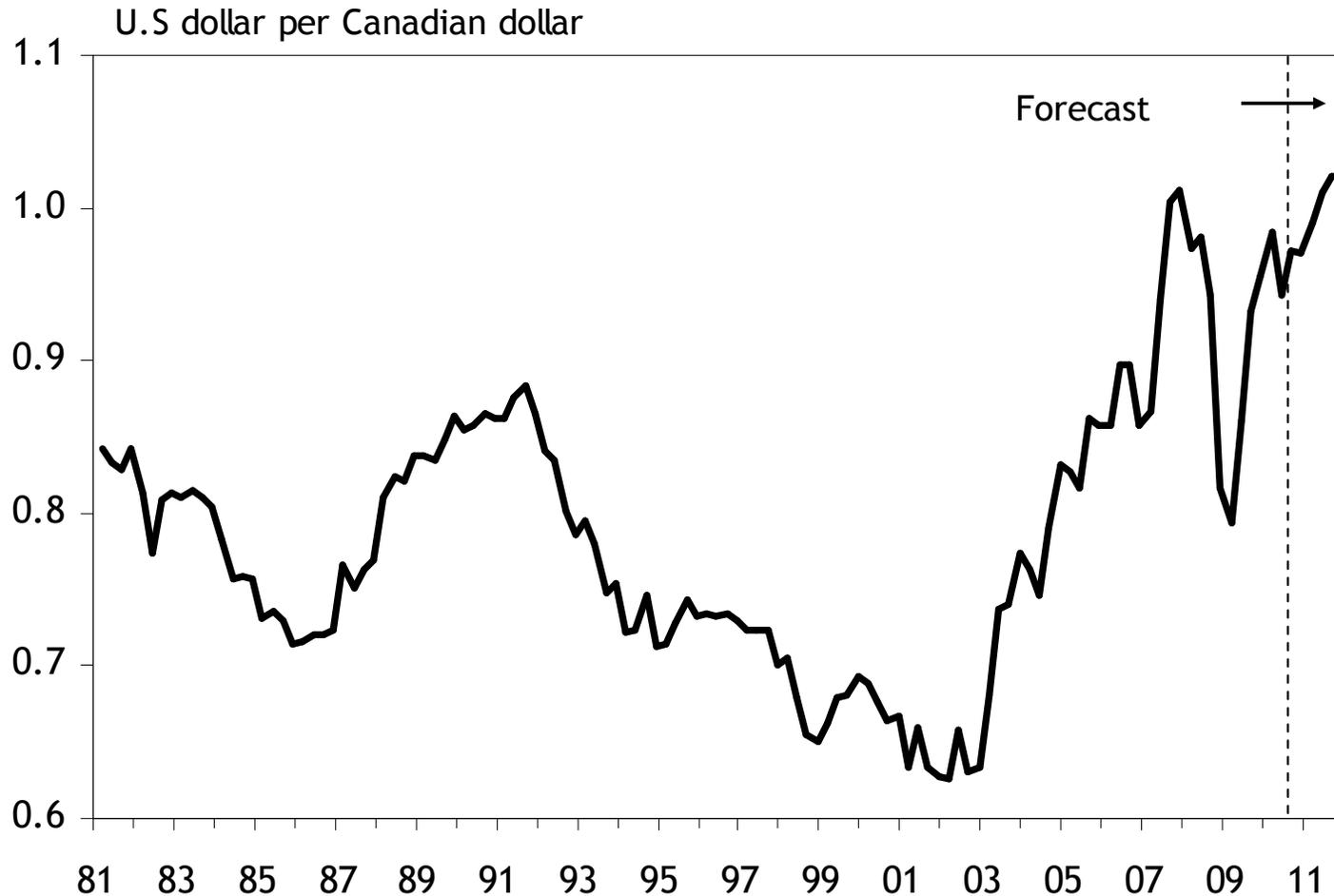
Canadian 10-year bond yield



Source: Bank of Canada, RBC Economics Research

The Canadian dollar to mirror growing optimism about the global recovery and attendant rise in commodity prices

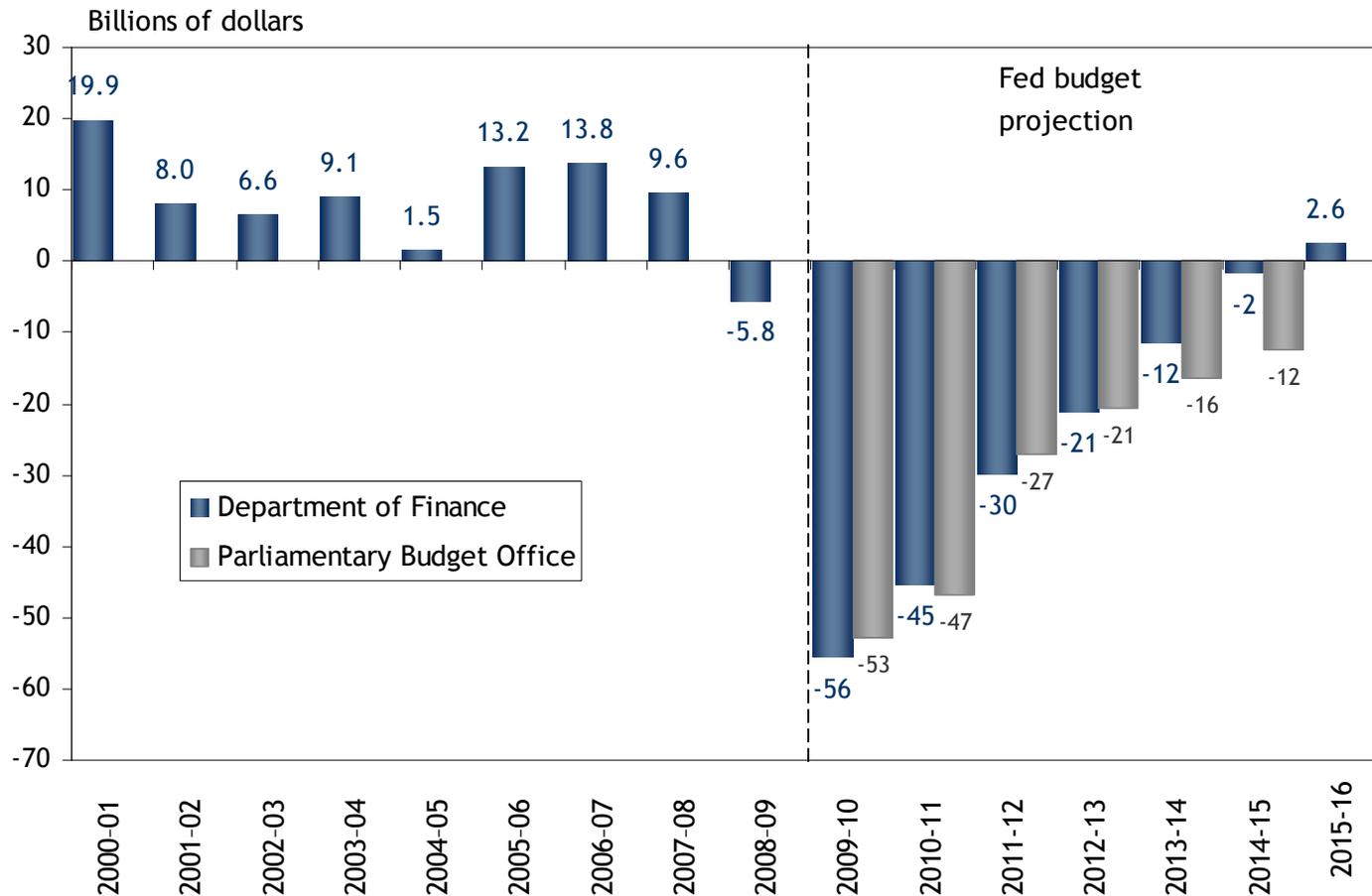
Canadian dollar forecast



Source: Bank of Canada, RBC Economics Research

Fiscal policy will need to tighten though more over the medium rather than near term

Federal government budgetary balance



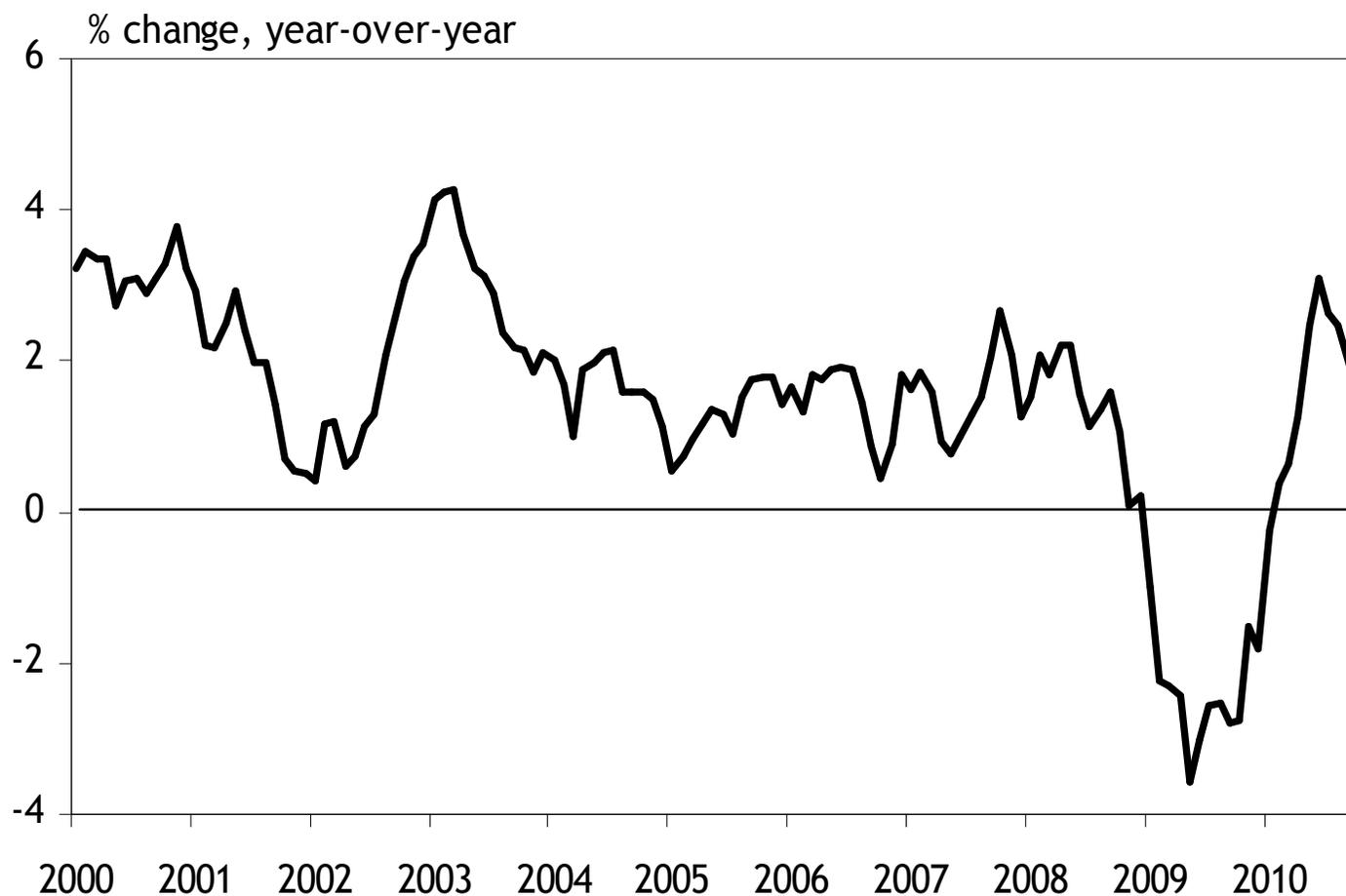
Source: Department of Finance, Parliamentary Budget Office, RBC Economics Research

Regional Outlook:

**The Recovery in Ontario is Very
Much Dependant on Sustained U.S.
Growth**

Employment growth in Ontario is bouncing back after sizeable declines through the recession

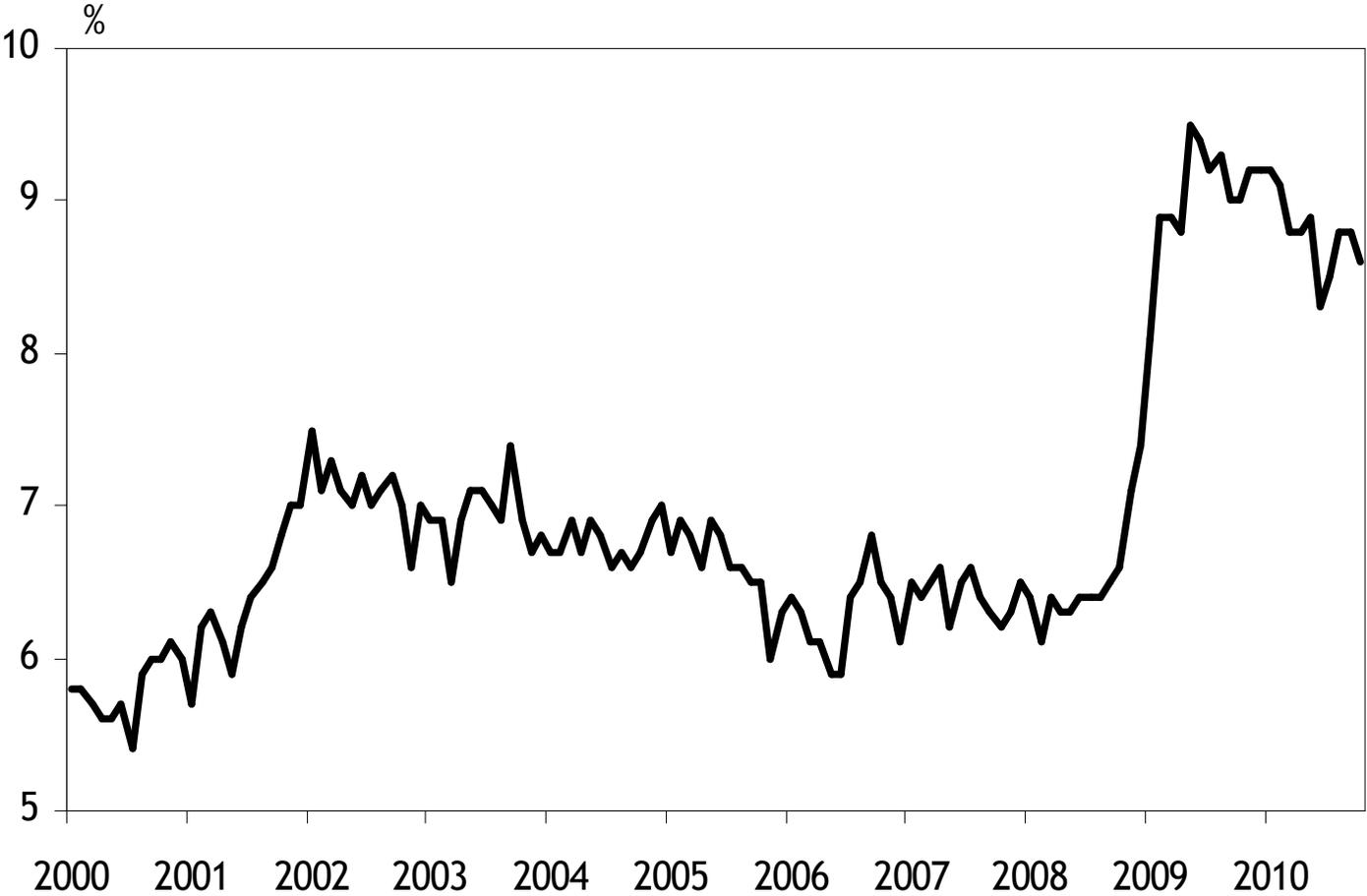
Ontario employment



Source: Statistics Canada, RBC Economics Research

However, the recent job gains have only resulted in a modest retracement of the earlier deterioration in the unemployment rate

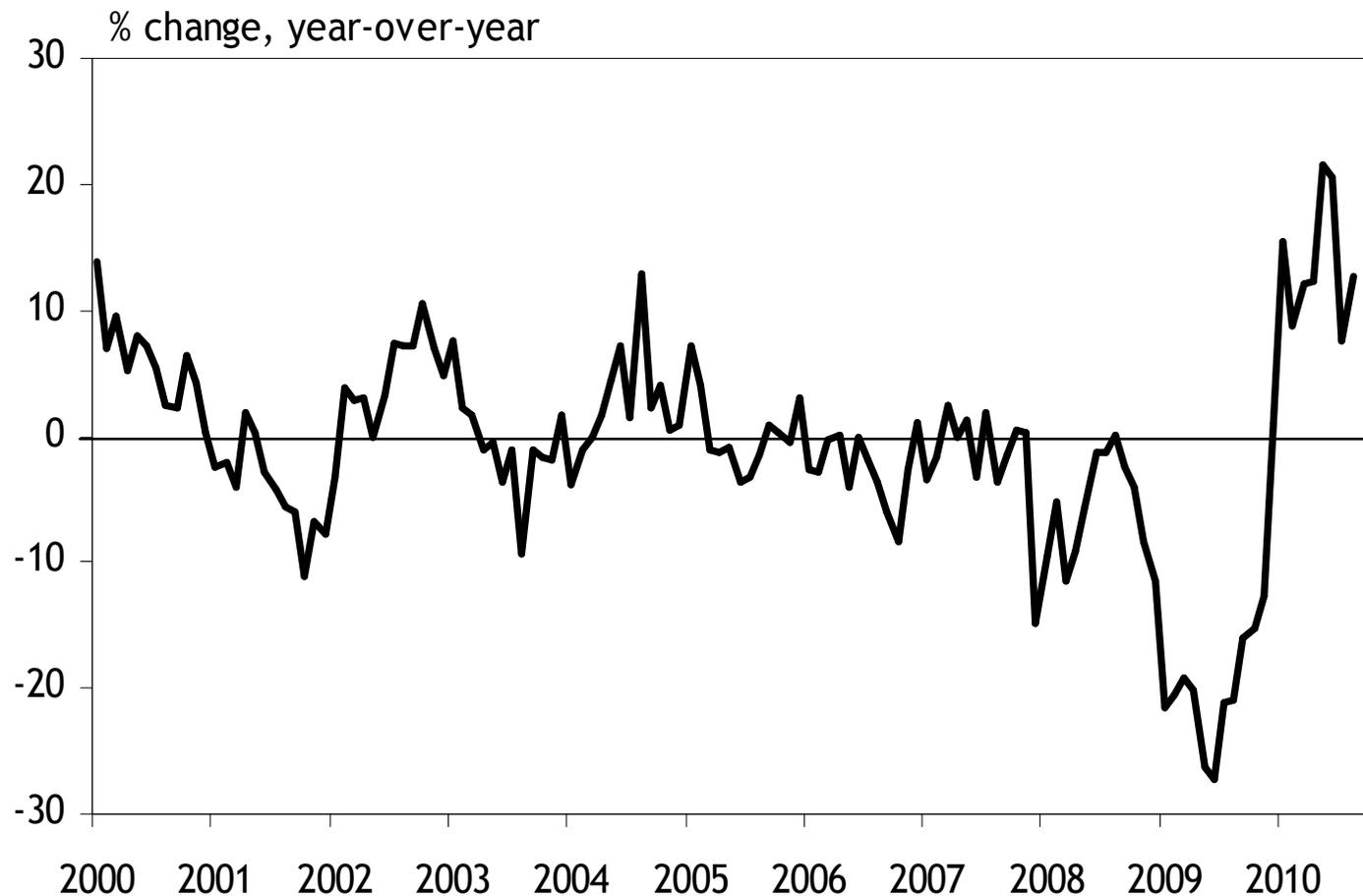
Ontario unemployment rate



Source: Statistics Canada, RBC Economics Research

The recovery in jobs has been helped by a return to growth in manufacturing

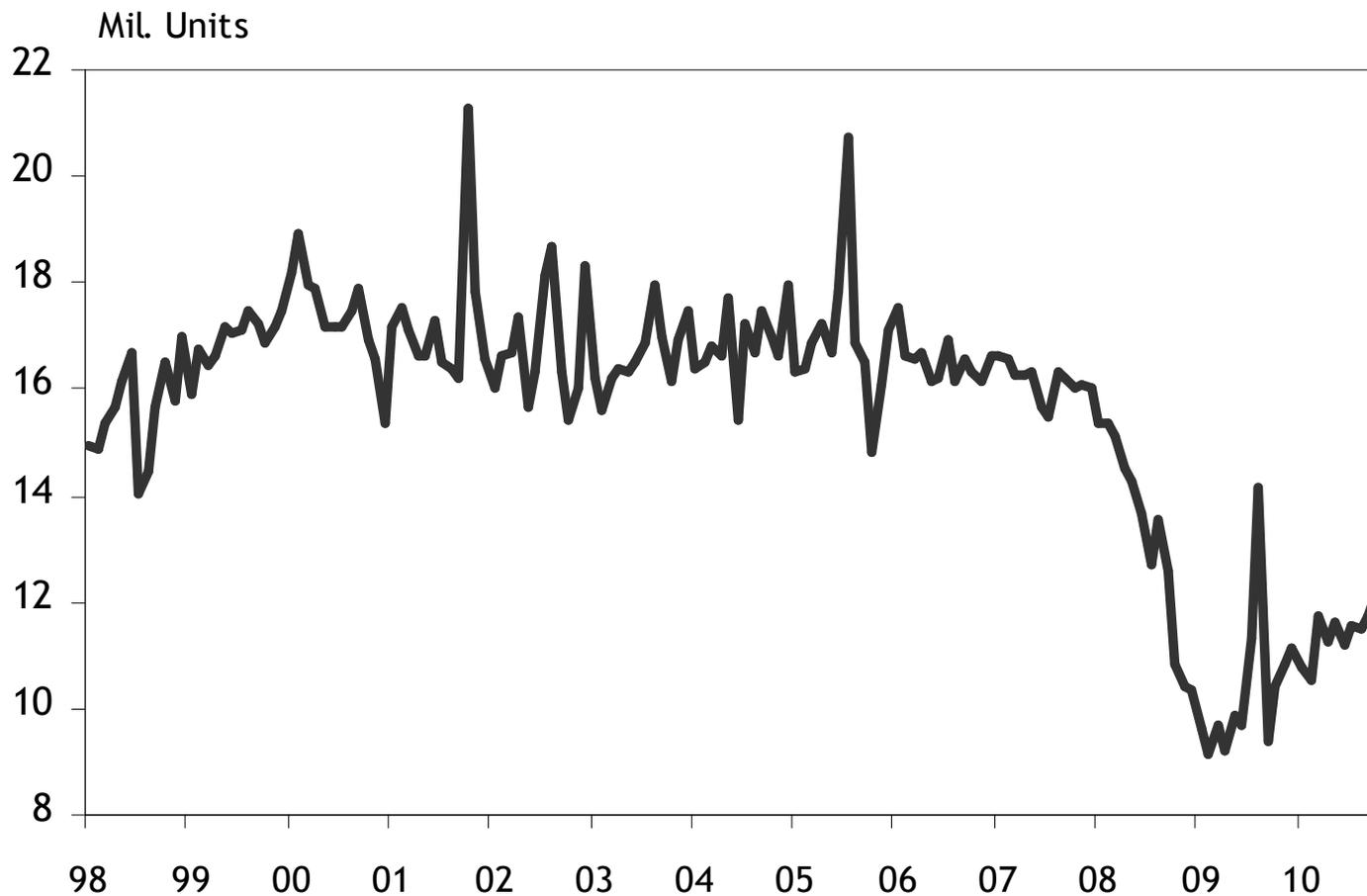
Ontario manufacturing



Source: Statistics Canada, RBC Economics Research

The weakness in manufacturing resulted from Ontario feeling the full brunt of slumping U.S. demand in 2009, particularly for autos ...

U.S. auto sales

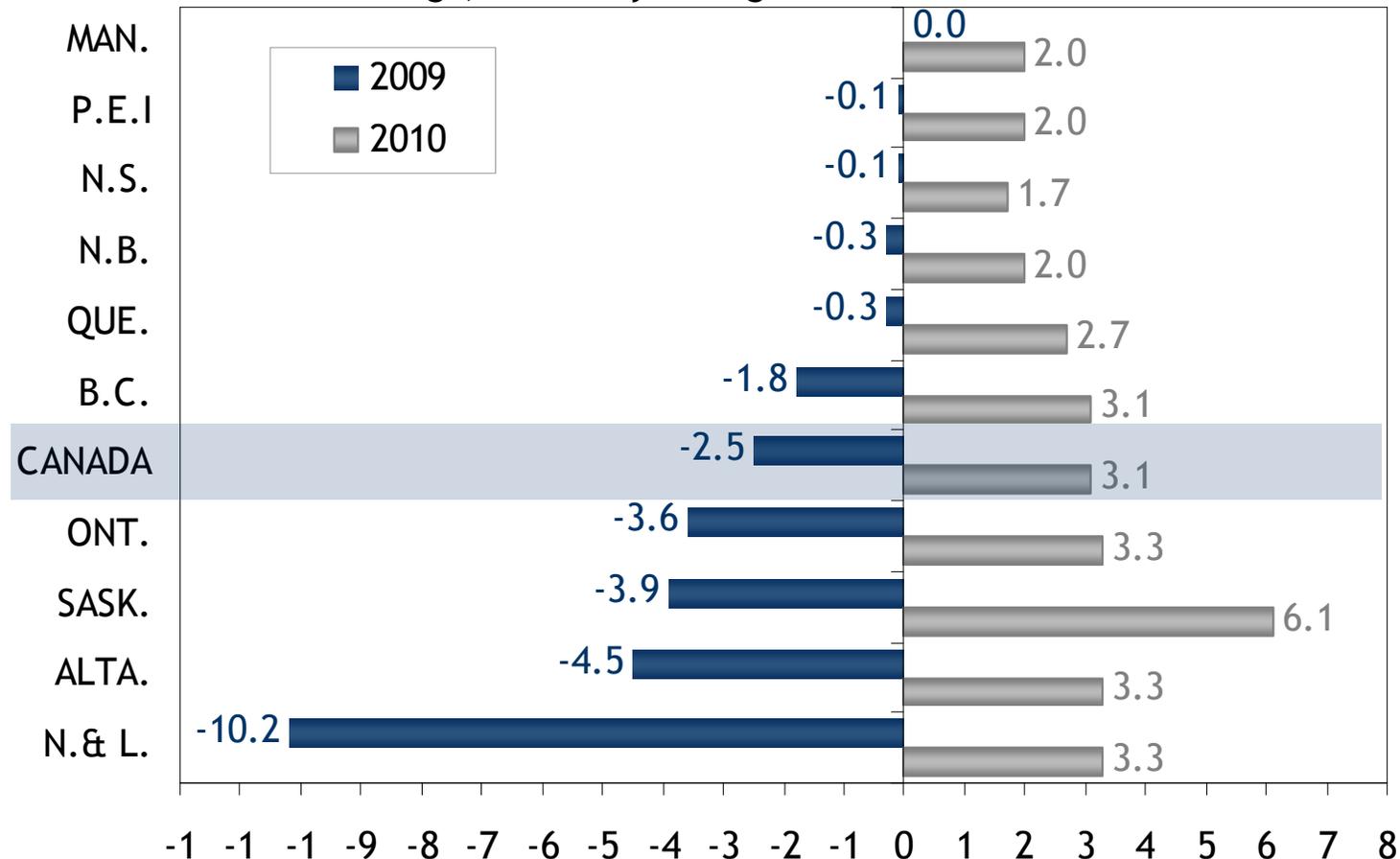


Source: BEA, RBC Economics Research

...resulting in Ontario declining more last year than the country as a whole

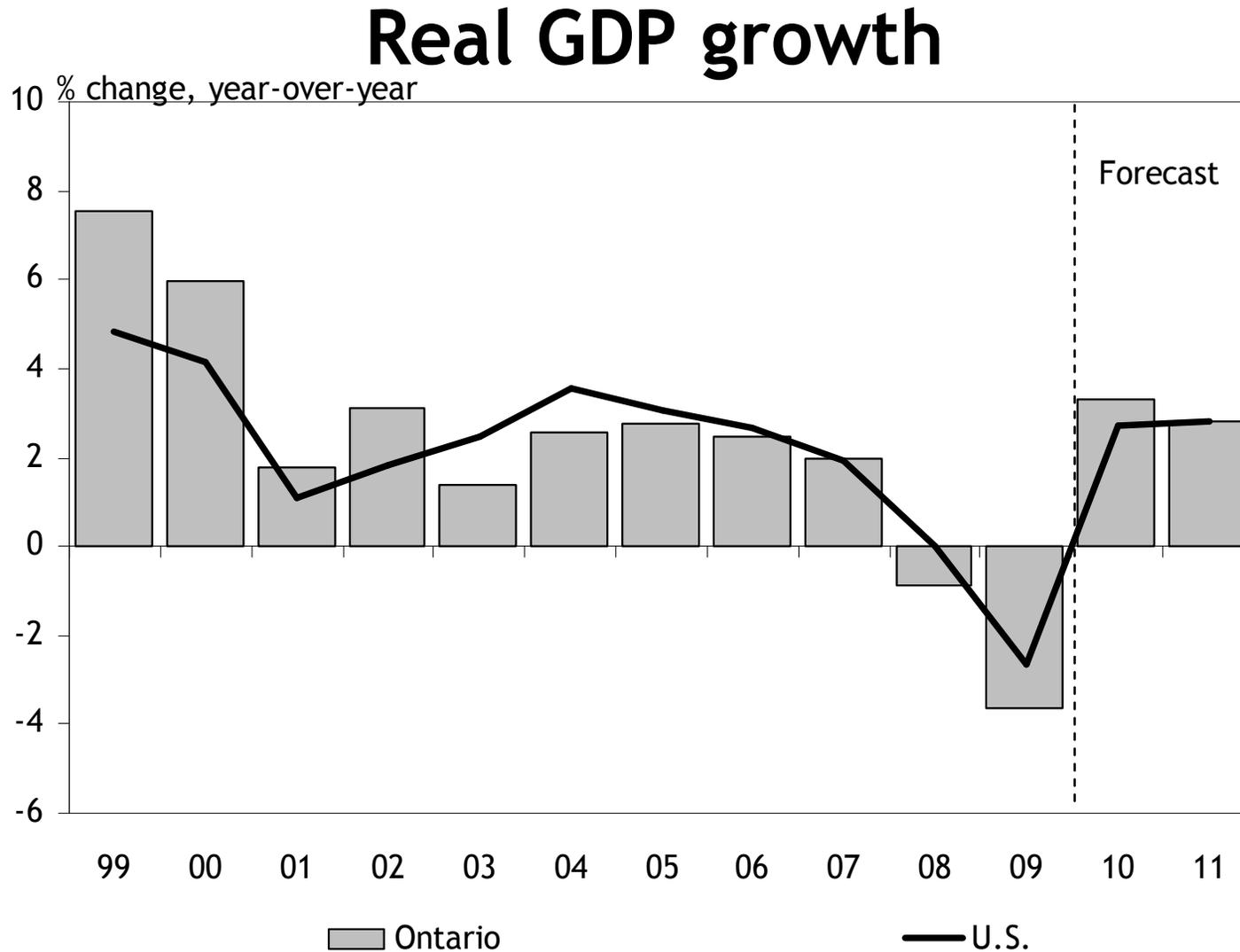
Provincial real GDP growth

Annual % change, ranked by 2009 growth



Sources: Statistics Canada, RBC Economics Research

However, as the U.S. recovers so should the Ontario economy

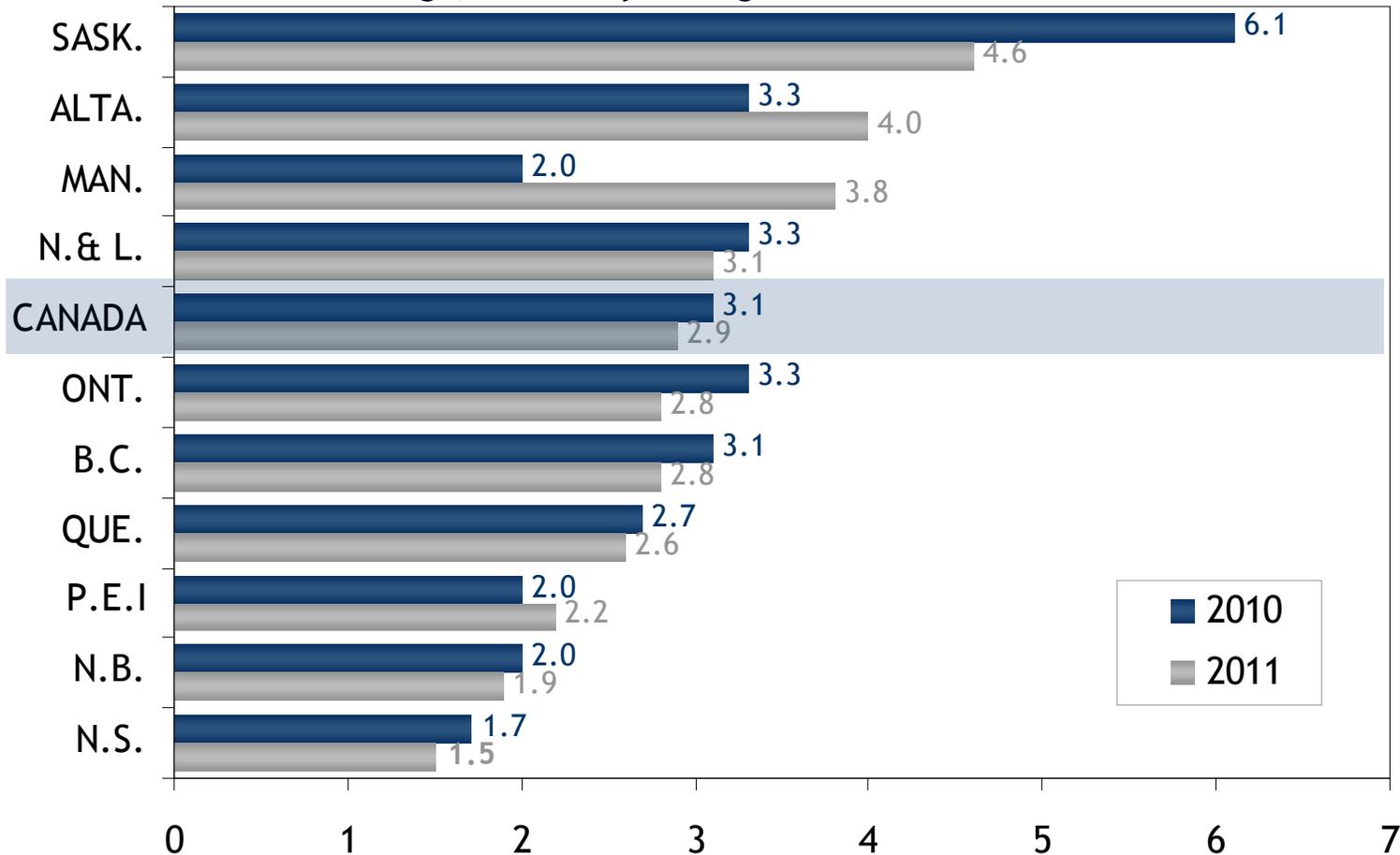


Source: Statistics Canada, RBC Economics Research

High commodity prices will have a varying impact among the provinces

Provincial real GDP growth

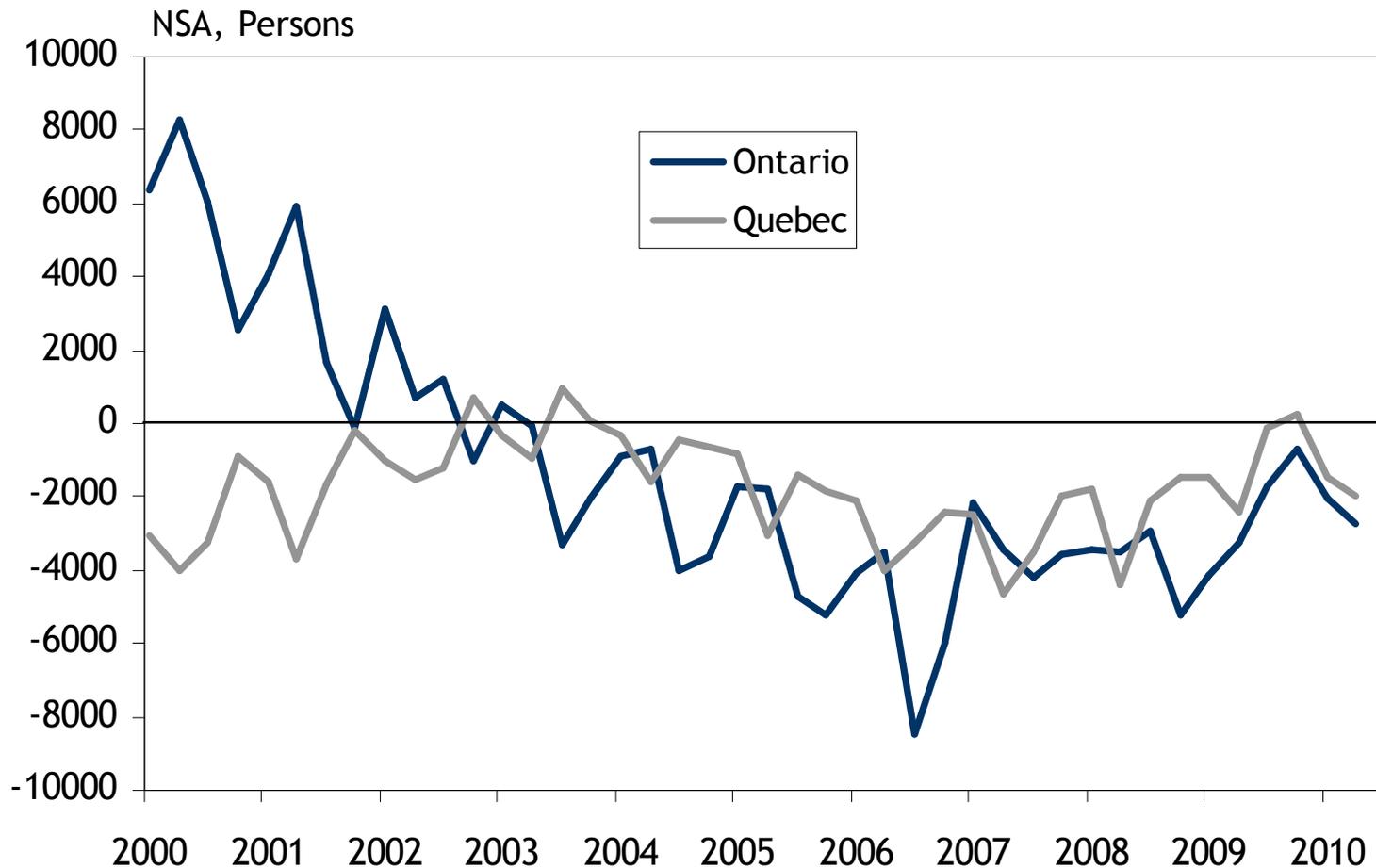
Annual % change, ranked by 2011 growth



Sources: Statistics Canada, RBC Economics Research

The impact of high commodity prices will likely reinforce the recent pattern of intra-provincial outflows from Ontario and Quebec...

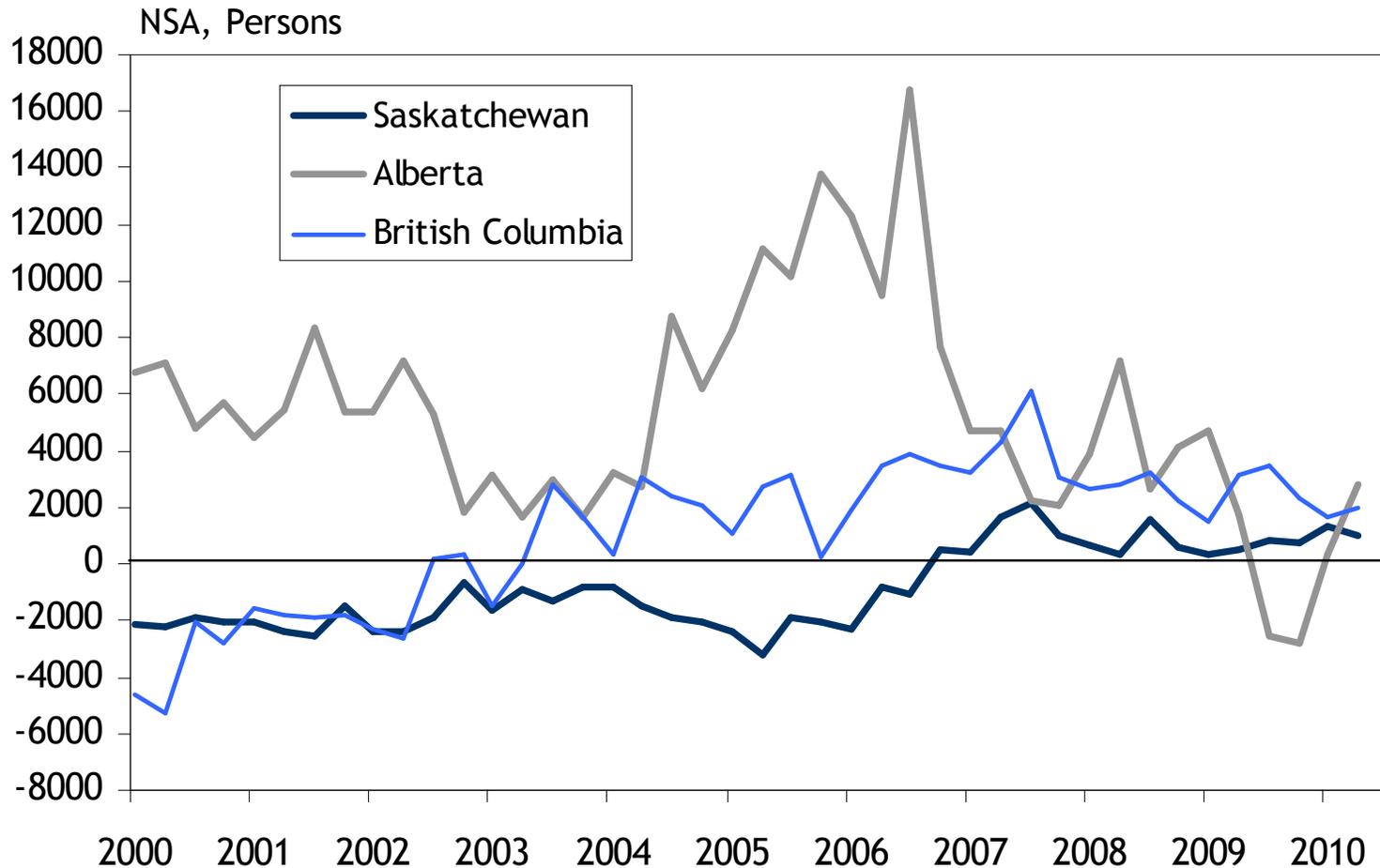
Inter-provincial migration



Source: Statistics Canada, RBC Economics Research

...into Saskatchewan, Alberta, and B.C.

Inter-provincial migration



Source: Statistics Canada, RBC Economics Research

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