

economic LETTER

APRIL 2013



BUSINESS INVESTMENT HEADS WEST

The business investment share of gross domestic product has remained fairly stable over the past decade, at around 20%. But its make-up has changed quite a bit over that period, according to a recent analysis by Statistics Canada.¹ To understand this, we must break the total business investment down into several components. We start by separating private business investment from that of businesses in the public sector. Private business investment is then divided between investment in the residential construction sector and investment in all other sectors, referred to as non-residential investment. Lastly, non-residential investment is divided into two components, i.e. investment in non-residential construction (factories, commercial buildings, engineering work, etc.) and investment in machinery and equipment (M&E). The table below will help you better understand the breakdown of investment into its components.

Business investment and its components, annual average growth rate (AAGR) from 2000 to 2011 and share of the main components in the total investment

	Value in billions of dollars		%	Share of total investment (%)	
	2000	2011		TCAM	2000
Total business investment	194.9	365.2	5.9		
1-Public sector business investment	24.3	57.8	8.2	12.5	15.8
2-Private business investment	170.6	307.4	5.5		
2.1-Residential construction investment	41.2	95.6	7.9	21.1	26.2
2.2-Non-residential investment	129.4	211.8	4.6	66.4	58.0
2.2.1-Investment in non-residential construction	48.8	120.7	8.6		
2.2.2-Investment in machinery and equipment	80.6	91.1	1.1		

Source: Statistics Canada, CANSIM table 029-0005.

Total business investment increased by 5.9% per year, on average, between 2000 and 2011. Of its three main components, non-residential investment recorded the weakest annual average growth rate during this period, i.e. 4.6%, while public investment and investment in residential construction increased by an average of 8.2% and 7.9% per year, respectively. As a result, the proportion of non-residential investment in the total investment decreased, from 66% in 2000 to 58% in 2011. ▼

¹ Bloskie, Cyndi, V. Gaudreault and Guy Gellatly (2013), "Changes in the Composition of Aggregate Investment", Economic Insights, catalog No. 11 626 x–No. 022, Statistics Canada.

Canada

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The composition of non-residential investment also changed considerably during this period. Investment in non-residential construction grew steadily, at an average annual pace of 8.6%, compared with just 1.1% for investment in M&E. This is largely due to increased activity in the mining and oil and gas extraction sector in the first decade of the 2000s, combined with a slowdown of activity in the manufacturing sector. Investment in the mining, oil and gas sector expanded by 10.9% per year, on average, between 2000 and 2011. In this sector, construction investment (factories and engineering work) is approximately four times greater than investment in M&E. In the manufacturing sector, the reverse is true: construction investment is four times smaller than investment in M&E. In fact, in the manufacturing sector, investment diminished by 2.4% per year, on average, over this period. As a result, the proportion of M&E investment in non-residential investment contracted significantly, from 62% in 2000, to just 43% in 2011.

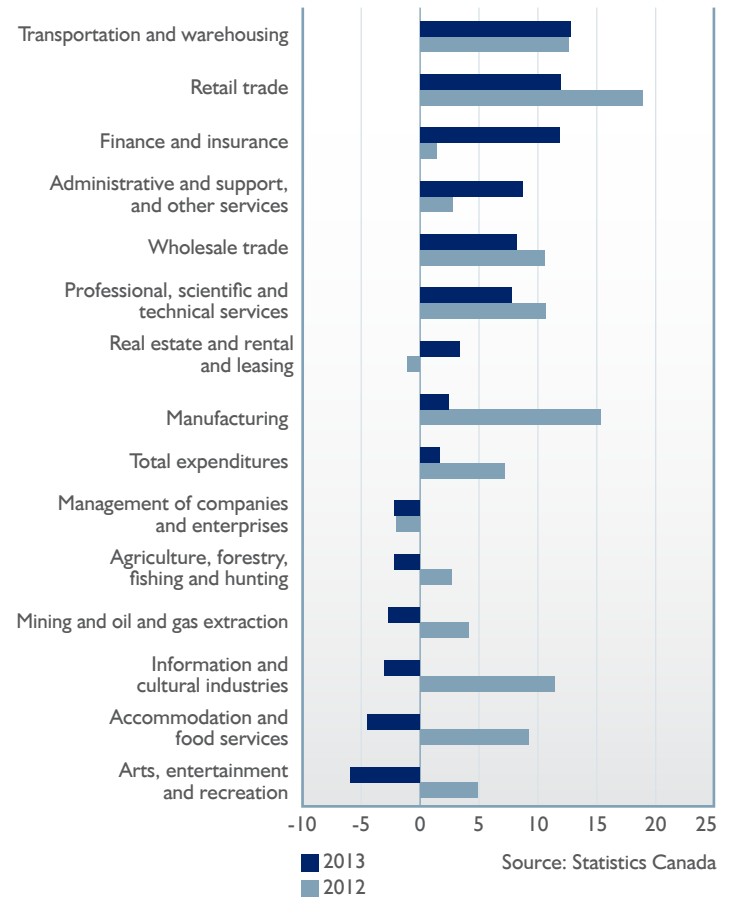
Since mining, oil and gas activities are concentrated in the western part of the country, and the manufacturing sector carries more weight in the east, it follows that non-residential investment has migrated towards the western provinces. In fact, Alberta's share of total Canadian non residential investment even surpassed that of Ontario in 2011 (32.7% versus 25.8%).

In 2012, business investment growth in the mining and oil and gas extraction sector slowed considerably and is likely to be negative in 2013, according to the data on investment intentions. In the manufacturing sector, business investment expanded at a good pace in 2012, but growth in 2013 will probably be weak (Graph).

For businesses overall, growth in M&E investment accelerated a little in 2012, but will slow its pace in 2013, which is disquieting. By enabling businesses to integrate the most up-to-date technologies into their production processes, this type of investment makes workers more efficient, thereby improving labour productivity. It is important to realize that Canada's

slow growth in labour productivity since the beginning of this millennium, compared with many other industrialized countries, is due in large measure to a lack of investment in M&E. It is to be hoped that this trend will reverse course in the long term, because Canadian businesses need to increase their productivity, at all costs, in order to remain competitive. ■

Capital expenditures: estimates for 2012 and intentions for 2013 (annual change)



We have no choice but to note that the Canadian economy has been quite lethargic in the past few months. Production is stagnating, consumption is weak and employment is on a downwards path. Business confidence has also flagged recently. Things should improve in the months ahead, but according to the forecasters, we will have to wait until 2014 for the economy to get back to full throttle.

The decline in real GDP was temporary

After a downturn of 0.2% in December, real GDP rose by 0.2% in January. Manufacturing was the sector that recorded the strongest monthly growth, i.e. 1.2%, but this was on the heels of a 1.9% drop in December. Manufacturing production, which accounts for 11% of total production, has recovered quite a bit of the ground lost in 2010 during the recession, but made little headway in 2011 and has been stagnating since the beginning of 2012 (Graph). Wholesale trade also rallied in January, posting 0.9% growth after an equivalent decline in December. The mining and oil and gas extraction sector gained 0.2%, its fourth consecutive rise. ▼

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Manufacturing Output (billions of chained (2007) dollars)



Employment loses ground

After gaining 50,700 jobs in February, the labour market lost 54,500 jobs in March, nearly all of them in full-time work (-54,000). The unemployment rate edged up from 7.0% to 7.2%. This drop in employment is mainly attributable to three sectors: public administration, accommodation and food services, and manufacturing. In the latter sector, this is the third straight monthly decline: 71,400 jobs have been lost in manufacturing since the beginning of 2013. Given the appreciation of the Canadian dollar and competition from emerging countries, the last decade has been very challenging for the manufacturing sector. Job losses have been heavy, and the sector's share of total employment, which stood at 15% in 2003, fell below the 10% mark in 2013 (Graph).

Manufacturing Employment and Share of Manufacturing Employment in Total Employment



The balance of trade deteriorates slightly

A 0.6% dip in exports from January to February, combined with a 0.1% increase in imports during the same period, drove the trade deficit up from \$746 million in January to \$1.0 billion in February. The largest contribution to the decline in exports came from metal products and non-metallic mineral products. Imports rose in many sectors, but the increase was largely cancelled out by a significant downturn in imports of energy products. The trade surplus with the United States narrowed, from \$3.9 billion in January to \$3.4 billion in February, while the trade deficit with countries other than the United States shrank from \$4.6 billion to \$4.4 billion.

Retail sales win back some of their lost ground

Retail sales gained back some of the ground lost in December, advancing by 1.0% in January after a slump of 2.4% in the previous month. Sales of motor vehicles and parts surged by 2.8%, partly neutralizing the 6.5% plunge recorded in December. In real terms, that is, adjusted to take price variations into account, retail sales remained stable in January. Retail sales nearly match household consumption of goods, which accounts for 45% of households' total spending on goods and services. After a post-recession rally, growth in consumption of goods has been gradually slowing down (Graph). Household debt levels, which are very high, may be curbing consumption. ■

Retail sales and household spending on goods (quarterly data, annual change)

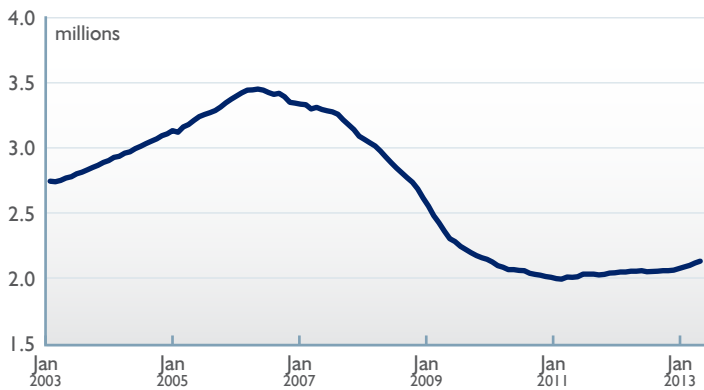


According to the most recent indicators, the U.S. economy is gathering strength, but slowly. Even though the labour market is still precarious and consumer confidence is feeling the effects, employment is still following an upwards path. At the same time, the housing market is gradually rebounding. Forecasters are still optimistic and are looking for accelerated growth later this year.

Job growth slows

Non-farm employment rose by 88,000 jobs in March, after gains of 148,000 in January and 268,000 in February. The unemployment rate slipped from 7.7% in February to 7.6% in March. The number of discouraged workers, i.e. those who have withdrawn from the labour force because they are convinced they will not find a job, stood at 803,000 in March, about the same level as a year ago. Employment expanded by 14,800 jobs in residential construction in the past month. Despite the upwards trend in employment that has materialized in that sector recently, the current level is far from where it was before the real estate bubble formed (Graph).

Employment in Residential Construction



Source: U.S. Bureau of Labour Statistics

An uphill climb for the housing market

After tumbling by 7.3% in January compared with the previous month, housing starts recorded monthly growth of just 0.8% in February. But over a longer horizon, looking at the average of the past six months, the upwards trend in housing starts is continuing, in both the single-family and multiple-dwelling segments. Home sales also rose by 0.8% in February compared with the previous month. At the current pace of sales, it would take 4.7 months to sell off the inventory of homes on the market; this is practically the same time span that was seen before the real estate bubble started (Graph).

Housing Inventory

(month's supply at the current sales pace)



Source: U.S. National Association of Realtors

Consumer confidence remains weak

The Conference Board's Consumer Confidence Index fell from 68.0 in February, to 59.7 in March (1985=100). Consumers are still pessimistic: the percentage of those who feel that the economic situation is bad is nearly twice as high as the percentage of those who feel that it is good, i.e. 29.3% versus 16.0%. The perception of the job market is also very negative: a mere 9.4% of respondents believe that jobs are plentiful, while 36.2% believe that it is very difficult to find a job. Lastly, the respondents who anticipate a deterioration of outlooks in the short term outnumber those who expect improvement (18.3% versus 14.4%). ■

The key interest rate is unlikely to be raised in 2013

The Bank of Canada's next rate-setting date is April 17. On that date, it will also issue its Monetary Policy Report containing the Bank's forecasts of real GDP growth and the inflation rate. According to the Consensus, which combines the forecasts of a large number of Canadian financial institu-

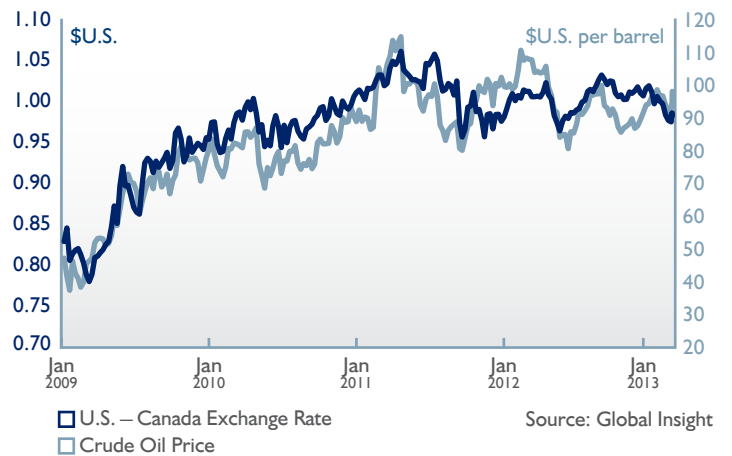
tions, economic growth will remain sluggish in 2013: real GDP should grow by just 1.6% compared with last year. In such conditions, the central bank will certainly not be raising the interest rate in 2013. In fact, the majority of forecasters do not anticipate any rate hike before the third quarter of 2014. ■

OIL AND THE LOONIE

The price of oil heads up, the Canadian dollar remains stable

Better-than-expected data on employment and industrial production in the United States in February sent the price of a barrel of oil climbing at the beginning of March. But the upwards trend was held in check mid-month by concerns about the financial situation in Cyprus and the parliament's rejection of the rescue plan proposed by the euro zone and the IMF. Once an agreement was reached between the Cypriot government and its international partners, the price of crude oil began heading up again. Meanwhile, the value of the Canadian dollar remained stable, hovering around US\$0.98. ■

Price of Oil and the Canada – U.S. Exchange Rate

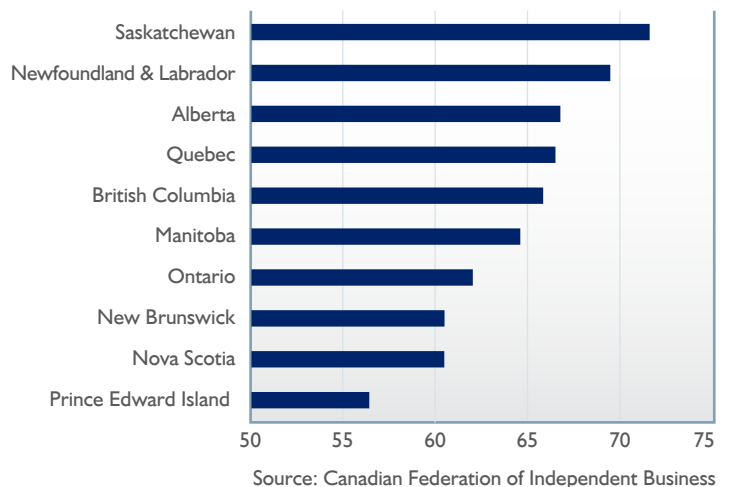


SME CONFIDENCE

Business confidence falters

In March, the Canadian Federation of Independent Business (CFIB) Business Barometer Index lost the ground it had gained in the two previous months. The index fell by 3.3 points to reach 62.9, which is slightly above where it stood in December 2012 (62.6). The confidence of SME owners deteriorated in four provinces: Nova Scotia, New Brunswick, Ontario and Alberta. Alberta nevertheless remains one of the provinces where businesses are most optimistic, but Ontario is now at the back of the pack, just ahead of the Maritimes (Graph). As for Quebec, it has recorded its third straight monthly increase, propelling the confidence of its SMEs to its highest level since March 2011. ■

Business Barometer, by province (March 2013)





BUSINESS CREDIT CONDITIONS

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Growth in bank credit remains firm

Short-term credit granted to businesses by the chartered banks expanded by 7.9% in February compared with the previous month, while long-term credit rose by 7.4%. Over a twelve-month horizon, growth in bank credit granted to businesses has been following an upwards trend since June 2011 (Graph). The effective interest rate (a weighted average of various bank and market interest rates that apply to new loans granted to non-financial businesses) has remained low and stable in recent weeks. It stood at 3.2% at the end of March. ■

Business Credit from Chartered Banks



KEY INDICATORS – CANADA

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Key indicators – Canada	Historical				2012				2013	Forecasts		
	2009	2010	2011	2012	Q1	Q2	Q3	Q4	Latest	2013	2014	
Real GDP (% growth)	-2.8	3.2	2.6	1.8	1.2	1.9	0.7	0.6	Jan	0.2	1.6	2.4
Machinery and Equipment Expenditures (% growth)	-20.4	13.7	10.7	3.7	6.5	0.1	2.1	1.2			3.1	6.1
Pre-Tax Corporate Profits (% growth)	-48.9	70.4	22.8	-3.1	-24.0	-19.4	1.3	18.2			1.2	5.7
Industrial Production (% growth)	-10.9	6.3	3.8	1.1	-0.7	1.5	-2.4	-0.6	Jan	0.7	0.8	2.7
Industrial Product Prices (% growth)	-3.5	1.0	4.6	0.6	0.9	0.9	-2.5	0.2	Feb	1.4	0.8	2.1
Non-Residential Construction (% growth)	-18.6	15.0	10.2	8.0	9.2	14.5	-2.1	6.5				
Housing Starts ('000 units)	148	191	193	215	205	231	222	202	Feb	178	176	173
Personal Expenditures (% growth)	0.1	3.5	2.4	1.9	2.2	0.5	2.8	2.7			2.0	2.2
Consumer Price (% growth)	0.3	1.8	2.9	1.5	2.0	0.2	0.1	1.4	Feb	1.2	1.3	2.0
Employment (% growth)	-1.6	1.4	1.5	1.2	0.8	2.6	0.6	2.4	Mar	-0.3		
Unemployment Rate (%)	8.3	8.0	7.5	7.3	7.4	7.3	7.3	7.2	Mar	7.2	7.1	6.9
SMEs Confidence Index (CFIB)	57.7	66.7	66.4	63.9	66.3	64.4	61.0	63.7	Mar	62.9		
Manufacturers Confidence Index (CFIB)	56.0	68.6	67.2	66.7	69.0	67.2	65.3	65.2	Mar	63.5		

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business. Annual growth, quarterly growth at annual rate and month-over-month growth.