

economic LETTER

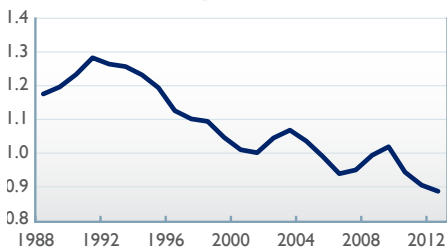
MAY 2013



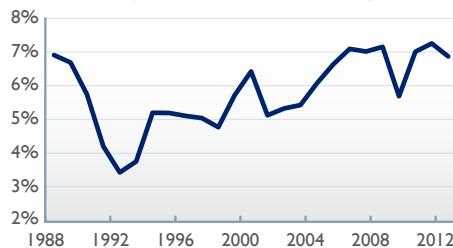
CANADIAN BUSINESSES ARE IN FINE FORM

Canadian businesses are doing very well, to say the least. Their debt ratio is at its lowest point in 24 years, their profit margin has been rising since 1992, and the number of bankruptcies has not stopped falling since the beginning of the decade (see charts).¹

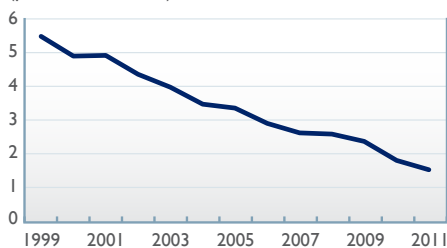
Debt to Equity Ratio, Non financial Enterprises



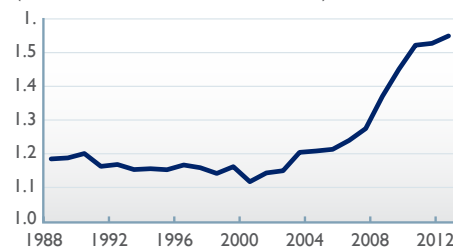
Benefit Margin, Non financial Enterprises



Business Failures (per 1,000 businesses)



Liquidity Ratio, Non financial Enterprises (short term assets / short term liabilities)



Sources: Quarterly balance sheet and income statement, by North American Industry Classification System (NAICS); Office of the Superintendent of Bankruptcy Canada.

Furthermore, this finding is common to businesses in almost all sectors of the Canadian economy, as shown by the table below. In fact, apart from oil and natural gas extraction and transportation, all the sectors show an increase in businesses' average profit margin over the past 10 years... even the manufacturing sector, which has gone through a rough patch due to the strong appreciation of the Canadian dollar and competition from emerging countries. Furthermore, the vast majority of sectors report a decline in business debt ratios over that period. ▼

Canada

- > Real GDP maintains a healthy pace of growth
- > Employment expands slightly
- > A surplus in the balance of trade
- > Housing starts continue their downwards trend

United States

- > A rebound in real GDP growth
- > Employment is still heading up
- > Housing starts increase, and the real estate market regains momentum

Interest rates

The key interest rate remains stable at 1.0%

Oil and dollar

SME confidence

Credit conditions

Key indicators

BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to May 11. Reliance on and use of this information is the reader's responsibility.

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¹ The analysis pertains to non-financial businesses, but for the sake of brevity, this is not specified repeatedly. Financial businesses (i.e. financial institutions and insurance companies) are also doing very well overall.

Lastly, the liquidity ratio of businesses has increased in all sectors, without exception. It has soared since the financial crisis of 2008 (see the chart on page 1).

Nearly a year ago, the Governor of the Bank of Canada described the large accumulations of liquidity held by businesses as “dead money” because this money, not being invested, was not helping to stimulate the Canadian economy. Entrepreneurs took exception to that comment, feeling that, on the contrary, they had amply supported the economic recovery. In fact, after consumption, it is private sector business investment that has contributed the most to economic growth since the end of the recession.

The fact remains that businesses have abundant liquidity available and could invest more. As we mentioned in the previous economic letter, investment in machinery and

equipment needs to accelerate in order to improve Canada’s labour productivity growth, which is lagging behind that of other industrialized countries. Having said that, businesses no doubt have good reason for having built up so much liquidity since 2008. The financial crisis may have made them more cautious, and they are just waiting for lasting improvement in economic outlooks in order to invest. Admittedly, these outlooks have been uncertain to say the least since 2008, in particular due to the sovereign debt crisis in Europe.

In any event, with such sound financial health and the liquidity they have at their disposal, Canadian businesses are in an excellent position to invest. We can only hope that they will move into action. ■

Financial indicators by sector (compound annual growth rates 2002-12)

	Profit margin	Operating profit	Debt to equity ratio	Liquidity ratio
Total, non-financial industries	2.6	6.4	-1.6	3.0
Oil and gas extraction and support activities	-13.4	-7.0	-7.0	2.6
Mining and quarrying	8.3	16.0	2.7	3.0
Construction	4.6	11.1	-4.7	6.4
Manufacturing	1.5	2.9	0.8	1.3
Wholesale trade	3.6	8.6	-2.7	1.8
Retail trade	3.7	6.8	-3.7	2.3
Transportation and warehousing	-0.1	5.1	0.2	2.9
Information and cultural industries	9.7	13.6	-0.4	0.4
Real estate and rental and leasing	1.4	6.5	-4.2	5.9
Professional, scientific and technical services	17.7	23.9	2.1	4.7
Administrative and support, waste management and remediation services	4.8	10.9	-10.5	3.7
Arts, entertainment and recreation	12.3	15.0	-4.8	2.9
Accommodation and food services	3.3	5.8	5.0	2.3

Source: Quarterly balance sheet and income statement, by North American Industry Classification System (NAICS).



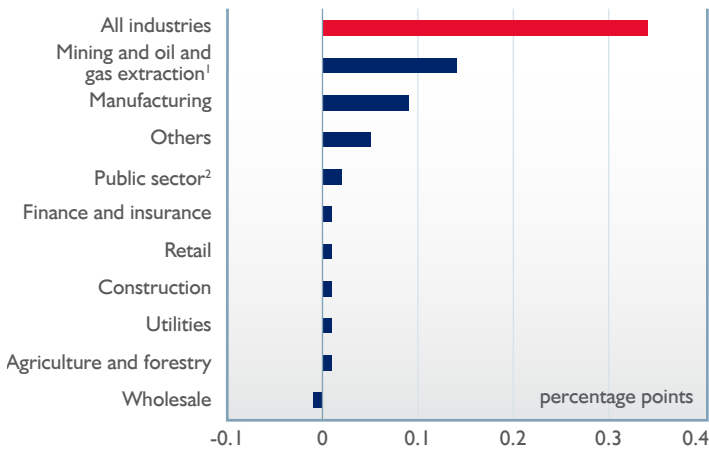
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The year started off fine as far as real GDP growth is concerned, but this was not the case for employment, which pulled back in the first quarter. The second quarter is getting underway with modest job growth and another downturn in housing starts. In general, the latest indicators confirm expectations of moderate economic growth in 2013.

Real GDP maintains a healthy pace of growth

Real GDP rose by 0.3% in February, the same rate as in January. It was the mining, oil and gas extraction and manufacturing sectors that contributed the most to growth in February (Graph). The contributions by the other major sectors were weak, and that of wholesale trade was negative. The January and February data bode well for the first quarter of 2013. Keep in mind that the Consensus is expecting real GDP growth of just 1.6% in 2013. ▼

Main industrial sectors' contribution to the percent change in real GDP, February 2013



1. Including quarrying.

2. Education, health and public administration.

Source: Statistics Canada

Employment expands slightly

After a downturn in March, employment edged up slightly in April and the unemployment rate held steady at 7.2%. The creation of 36,000 full-time jobs and the loss of 23,600 part-time jobs provided a net gain of 12,500 jobs. Employment expanded in the goods sector but lost ground in the service sector. The manufacturing sector gained 20,600 new jobs; this is the first month-over-month increase in this sector since December 2012 and the largest since March 2012. Looking at the regions, Alberta reported the largest job growth, while Manitoba and Newfoundland and Labrador saw the biggest losses.

A surplus in the balance of trade

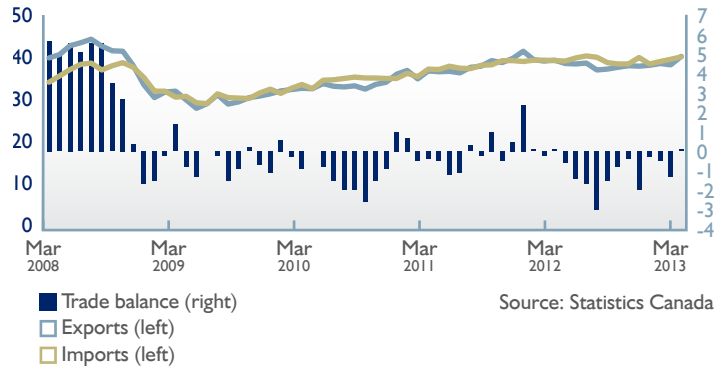
In March, exports climbed by 5.1% while imports rose by just 1.7%, reversing the balance of trade from a deficit of \$1.2 billion to a surplus of \$24 million. This is the first trade surplus since March 2012 (Graph). The increase

★ UNITED STATES

After the sluggish real GDP growth recorded in the last quarter of 2012, the rally seen in the first quarter of 2013 was expected, but it was not as strong as anticipated. On the other hand, the March employment data were better than expected, especially since the data of the two previous months were revised upwards. Lastly, the real estate market seems to be back to normal, and residential construction keeps climbing.

in exports extends across all the main sectors and is attributable to an increase in the volume of exports, rather than prices. On the other hand, the growth in imports comes mainly from higher prices. These international trade data suggest that exports will make a positive contribution to real GDP growth in the first quarter of 2013.

International Trade (billions of dollars)



Source: Statistics Canada

Housing starts continue their downwards trend

The number of housing starts fell from 181,146 units in March to 174,858 in April. The 2.5% decline in housing starts in urban areas in April is mainly attributable to the multiple-unit segment, where the number of starts pulled back by 3.5% compared with the previous month. In the single-family homes segment, housing starts were practically flat from March to April. The Canada Mortgage and Housing Corporation considers that the downward trend in housing starts is consistent with estimates of household formation and therefore in line with expectations. ■

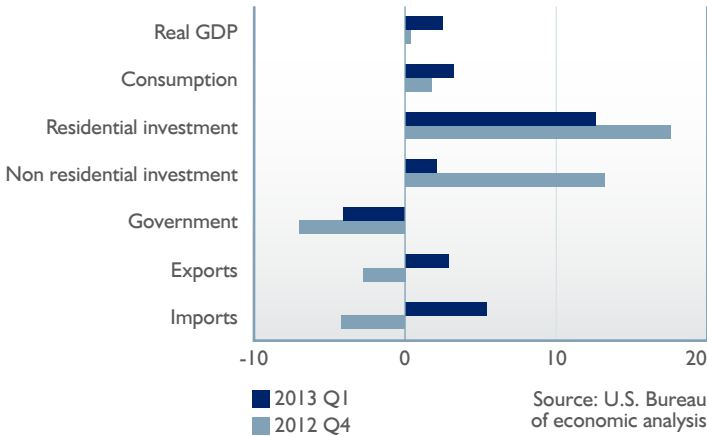
A rebound in real GDP growth

Real GDP rose by 2.5% in the first quarter of 2013 (quarterly percentage change, at annual rate), after gaining a mere 0.4% in the last quarter of 2012. Growth in consumer spending accelerated, from 1.8% to 3.2%, and exports advanced by 2.9% after retreating by 2.8% in the previous quarter (Graph). Government spending lost ground, but less than in the previous quarter (-4.1% versus -7.0%). Residential investment growth dipped slightly, while non-residential investment plunged from 13.2% in the fourth quarter of 2012 to just 2.1% in the first quarter of 2013. Imports, which had dropped by 4.2% ▼

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in the previous quarter, surged by 5.4% in the first quarter, curbing real GDP growth. The numbers are slightly below the Consensus forecast, which was calling for 3.0% real GDP growth in the first quarter.

Change in the main components of Real GDP (quarterly change at annual rate, %)



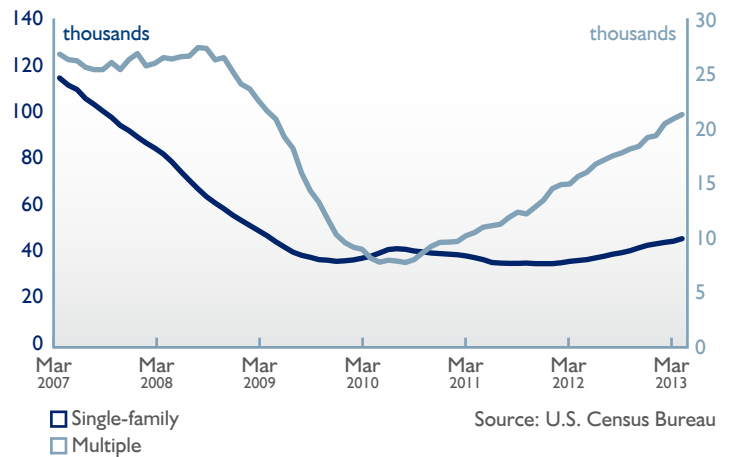
Employment is still heading up

The situation on the jobs front continues to improve: in April, 165,000 jobs were created, and the data of the two preceding months were revised upwards significantly. Based on these revisions, the average monthly change in employment now stands at 196,000 jobs for the first four months of 2013, compared with 183,000 for the year 2012. The unemployment rate did not change much in April compared with the previous month; it slipped from 7.6% to 7.5%, but has lost 0.4% since January.

Housing starts increase, and the real estate market regains momentum

Housing starts surged by 7.0% in March compared with the previous month and have skyrocketed by 46.7% since March 2012. Multiple-unit starts soared by 26.9% compared with February, while single-family home starts retreated by 4.8%. Thus the recovery in housing starts is continuing, but is stronger in the multiple-units segment than in the single-family category (Graph). As far as residential real estate transactions are concerned, sales dipped by 0.6% in March compared with the previous month, but are up by 10.3% over March 2012. According to the chief economist of the National Association of Realtors, the demand has overtaken the supply, since the inventory of homes for sale stood at 4.7 months in March, whereas it would be more than 6 months in a balanced market. The vitality of the market is also reflected in the average selling time, which has dropped from 91 days to 62 days over the past 12 months. Moreover, 37% of the sales closed in March took less than one month. ■

Residential Housing Starts



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The key interest rate remains stable

On April 17 the Bank of Canada, once again and to no-one's surprise, left its key interest rate untouched at 1.0%. It also revised its forecasts of real GDP growth for 2013 downwards, from 2.0% to 1.5% (see Table). The central bank anticipates that government spending will continue to make a small contribution to growth, while the contributions by net exports and non-residential investment by businesses will increase over time. The decline in investment in housing construction will put a damper on growth in 2013 and in 2014, and consumer spending will increase moderately. In the press release that accompanied its decision, the central bank stated, as it has done for the past year, that the key interest rate should remain stable for a while yet, after which it will probably be raised modestly to enable inflation to return to the 2% target. ■

Contribution to average annual real GDP growth (Percentage Points)

	2012	2013	2014	2015
Consumption	1.2 (1.1)	1.2 (1.1)	1.3 (1.3)	1.4
Housing	0.4 (0.4)	-0.2 (-0.1)	-0.1 (-0.1)	0.0
Government	-0.1 (-0.2)	0.1 (0.3)	0.1 (0.3)	0.1
Business fixed investment	0.6 (0.6)	0.4 (0.5)	0.8 (0.9)	0.8
Net Exports	-0.5 (-0.4)	0.1 (0.1)	0.5 (0.3)	0.4
Exports	0.5 (0.4)	0.7 (0.6)	1.5 (1.5)	1.4
Imports	-1.0 (-0.8)	-0.6 (-0.5)	-1.0 (-1.2)	-1.0
Inventories	0.3 (0.4)	-0.1 (0.1)	0.2 (0.0)	0.0
GDP	1.8 (1.9)	1.5 (2.0)	2.8 (2.7)	2.7

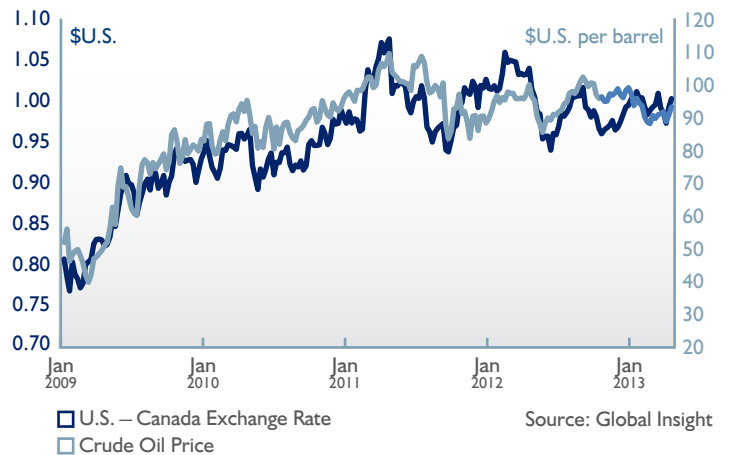
Source: Monetary Policy Report (MPR), Bank of Canada, April 2013; Figures in parentheses are from the January 2013 MPR.

OIL AND THE LOONIE

The price of oil loses ground; the Canadian dollar appreciates slightly

The release of data indicating a slowdown in the Chinese economy and weaker-than-expected real GDP growth in the United States in the first quarter of 2013 raised concerns about outlooks for global demand for oil, driving the price of crude down in April. But prices won back much of the ground that was lost following the European Central Bank's decision to lower its key interest rate to give a little boost to the European economy, and the release of better-than-expected employment data in the United States. The Canadian dollar appreciated slightly, benefiting from renewed optimism about the U.S. economy. ■

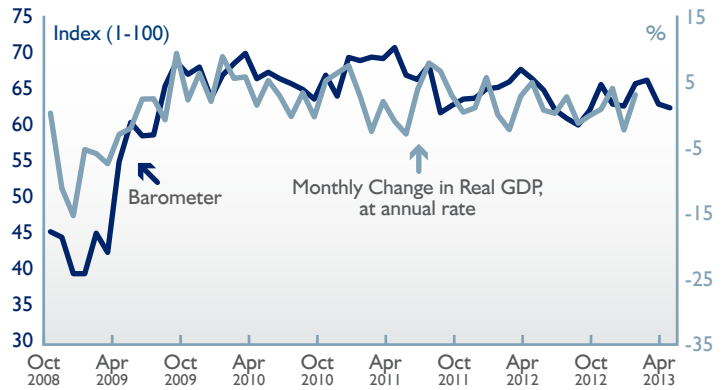
Exchange Rate and Crude Oil Price



Business confidence wavers a bit

After a sharp drop of 3.3% in March, the Canadian Federation of Independent Business (CFIB) Business Barometer Index dwindled by another half percentage point from the previous month in April, reaching 62.4. The gains achieved in the first two months of the year were wiped out in the next two months (Graph). The percentage of business owners who believe that the general state of health of their business is good diminished in April. Business owners also appear to be less confident about outlooks for growth, as seen by new orders and accounts receivable, which are in decline. Meanwhile, hiring intentions, which were extremely positive a few months ago, are still good, but much more moderate. Looking at the regions, the decline in confidence was widely shared: only business owners in Ontario and British Columbia showed greater optimism than in the previous month. ■

Business Barometer



Source: Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

SME credit conditions remain practically unchanged

According to the Bank of Canada's Senior Loan Officer Survey, the credit conditions facing small businesses remained unchanged during the first quarter of the year. On the other hand, according to the Business Outlook Survey, they tightened slightly (Graph). Companies reporting tighter credit conditions were affected by minor, non-price changes; their loan conditions were subjected to a greater degree of oversight from lending institutions. Short-term credit granted to businesses by the chartered banks surged by 14.1% in March compared with the previous month, while long-term credit rose by 8.1%. ■

Business Credit Conditions
balance of opinions (%)



Source: Bank of Canada

Key indicators – Canada	Historical ¹				2012 ²				2013 ³	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		

1. Annual growth rate

2. Quarterly growth, at annual rate

3. Month-over-month growth

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business.