

# economic LETTER

SEPTEMBER 2013

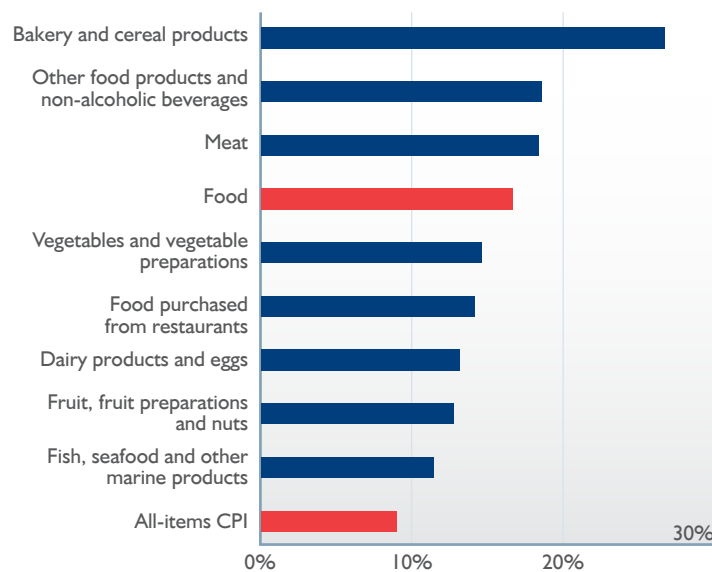


## A QUICK LOOK AT FOOD PRICES

Food prices have risen significantly in Canada in recent years.<sup>1</sup> Between January 2007 and July 2013, the food prices index was the component of the Consumer Price Index (CPI) that recorded the strongest growth: 19.4%, compared with 11.1% for the CPI excluding food. Food products represent approximately 17% of the total goods and services consumed by a Canadian household.<sup>2</sup> This is the third highest expenditure after housing (27%) and transportation (20%). Consequently, an increase in food prices has a significant impact on the household budget.

All the main food product groups rose in price at a faster pace than the all-items CPI between 2007 and 2012 (graph). Bakery and cereal products led the way with an increase of nearly 27% during this period, that is, 5% per year, on average. ▼

### Change in food prices from 2007 to 2012, by product group



Source: Statistics Canada, table CANSIM 326-0021

### Canada

- > Moderate real GDP growth
- > Employment rebounds
- > Housing starts and home sales remain stable
- > The trade deficit deepens

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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 September 7. Reliance on and use of this information is the reader's responsibility.

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<sup>1</sup> This text was inspired to a large degree by the Statistics Canada analytical brief entitled *The Increase in Food Prices Between 2007 and 2012*, by Anne-Marie Rollin, Analytical Studies Branch, Economic Analysis Division, No 11 626 X in the catalogue—No 027.

<sup>2</sup> This is an average. For some households, especially disadvantaged ones, food accounts for a larger share of consumer spending.

Food prices have risen not just in Canada. According to data from the Organisation for Economic Co-operation and Development (OECD), out of 39 countries (34 OECD members and 5 non members), 24 have seen cumulative food price inflation greater than 15% between 2007 and 2012. In each of those countries, food price inflation exceeded that of overall consumer prices.

The Food and Agriculture Organization of the United Nations (FAO) compiles a global food prices index which measures the monthly variation in the international prices of a basket of foodstuffs. It is based on the average price indexes of five categories of products: meat, dairy, cereals, oils and sugar. The FAO index jumped initially during the period referred to as the “world food crisis of 2007-2008.” After a brief lull, prices resumed their upwards trend in 2009 and reached a new peak at the beginning of 2011. Since then they have subsided, but are still high (graph).

**FAO Food Price Index**  
(2002-2004 = 100)



Source : Food and Agriculture Organization of the United Nations

There are many causes behind this surge in food prices. First, global demand has risen considerably, but the supply has not kept pace. In fact, demand has shot up faster than the global population, mainly for two reasons, according to the World Bank.<sup>3</sup> One reason is that rising household income in the emerging countries has triggered an increase in the per capita consumption of many foods, especially meat; another is that rising gasoline prices have promoted the use of some crops (corn in particular) for biofuel production. However, the supply has not increased sufficiently. During the period from 2001 to 2011, cereal production grew by 1.6% per year, while consumption rose by 1.9% per year. This led to a significant reduction in global stockpiles. There are many reasons for this, including a series of poor harvests due to climate conditions and a scarcity of water, which adversely impacts crops in many countries. Lastly, rising prices for energy (affecting transportation costs) and for fertilizer have also played a role in making food more expensive.

What lies ahead? According to the World Bank, prices will likely remain high in the medium term. Global inventories are at relatively low levels, and aggregate demand will probably keep rising. Production gains are likely to be more difficult to achieve than in the past, because the possibility of expanding agricultural lands is more limited, and because climate conditions are increasingly variable. In the longer term, everything will depend on what action is taken. To prevent prices from rising further, investments will have to be made, among other things, to improve productivity. ■

 **CANADA**

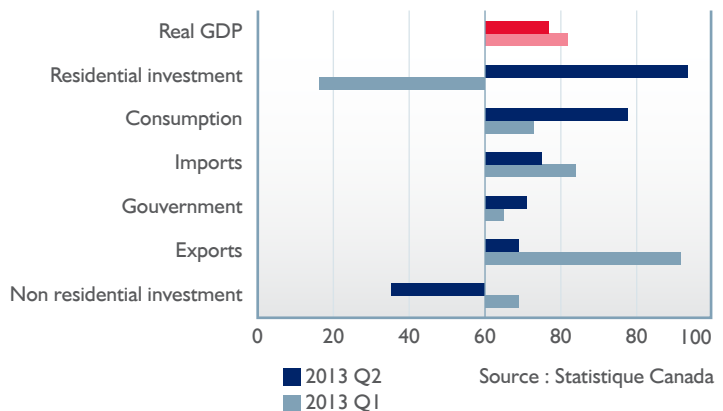
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Although it has accelerated compared with the last two quarters of 2012, real GDP growth has been moderate during the first half of 2013. Still, the numbers are in line with the consensus forecast, which is just 1.7% for the current year. Job creation has slowed in recent months, but it could accelerate if growth in non-residential investment (which was disappointing in the second quarter) picks up steam.

**Moderate real GDP growth**

Real GDP grew by 1.7% in the second quarter of 2013 after 2.2% growth in the first quarter. Homebuilding investments turned the corner after three quarters of decline. Consumer spending escalated sharply, largely thanks to purchases of motor vehicles. Growth in government spending and ▼

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



Source : Statistique Canada

<sup>3</sup> World Bank (2012), Responding to higher and more volatile world food prices, Report no. 68420–GLB.

investment accelerated. Exports, which had rebounded sharply in the first quarter, expanded moderately in the second quarter, while growth in imports slowed slightly. Lastly, non-residential investment by businesses fell back in the second quarter. Both of its components (investment in non-residential construction and investment in machinery and materials) recorded downturns. If real GDP maintains the pace of growth observed in the first two quarters for the rest of this year, the consensus forecast (1.7% for 2013) should be borne out.

## Employment rebounds

After dropping by 39,400 jobs in July, employment rebounded in August with an advance of 59,200 jobs. Full-time employment rose by 17,400 jobs and part-time employment by 41,800. The unemployment rate dipped by a tenth of a percentage point, to 7.1%. Despite the acceleration observed in August, job growth was much slower in the past six months compared with the previous six months: the average monthly variation tumbled from 29,000 to just 12,000. Gains in full-time jobs in particular were significantly smaller, falling from a monthly average of 25,000 to a little over 4,000 during these periods.

## Housing starts and home sales remain stable

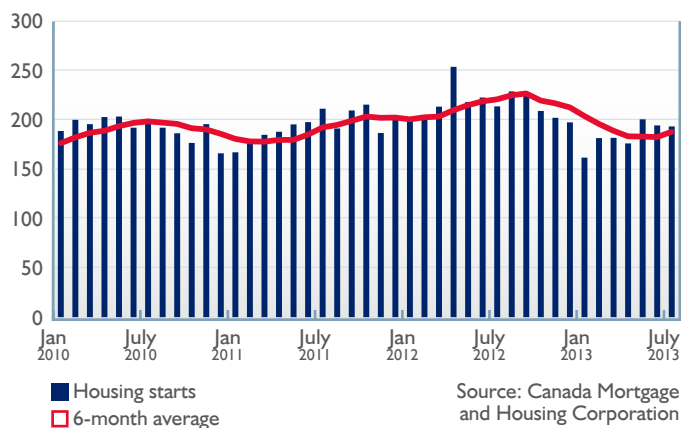
In July, single-family home starts fell by 5.5% in urban centres, while multiple-unit starts remained stable. The average housing starts over six months, used by the Canada Mortgage and Housing Corporation (CMHC) to estimate the trend, rose from 182,142 units in June to 187,416 units in July. The trend has been stable for several months now, oscillating within a narrow range between 182,000 and 188,000 units (graph). According to the CMHC, housing starts should remain relatively stable between now and the end of the year and then head up in 2014, as economic conditions improve. As for home sales, they were practically flat in July, but the number of homes listed declined. The Canadian Real Estate Association estimates that the resale market has tightened up, but is still balanced.

## ★ UNITED STATES

The latest indicators show that economic activity is struggling to really get back on track. The real GDP and employment data, for example, which appeared encouraging when they were first released, were later revised downwards. The situation is indeed improving on nearly all fronts (employment, production, housing starts, etc.), but far more slowly than had been hoped for.

## Housing Starts

(January 2010 to July 2013, thousands of units)



## The trade deficit deepens

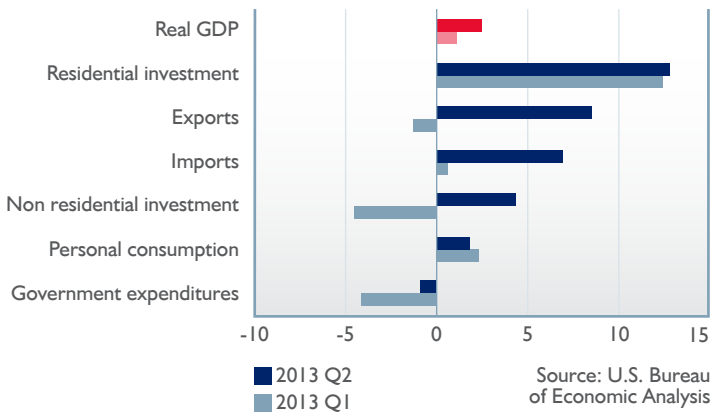
In July, imports were up by 0.6% and exports declined by the same percentage, sending the trade deficit soaring from \$460 million in June to \$931 million in July. It was metal ores and non-metallic minerals, basic chemicals and industrial chemical products, plastic and rubber products, metal and non-metallic mineral products that made the greatest contribution to the increase in imports. The decline in exports is mainly attributable to contractions in exports of aircraft, precious metals and alloys of precious metals in unwrought form. Canada's trade surplus with the United States narrowed, from \$3.6 billion in June to \$3.2 billion in July, while the trade deficit with countries other than the United States was fairly stable, at \$4.1 billion. ■

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## Real GDP growth accelerates

Real GDP grew by 2.5% in the second quarter. This is a higher figure than the forecasters were expecting, but the Bureau of Economic Analysis in the United States revised the first-quarter growth downwards significantly, from 2.4% to just 1.1%. Consequently, the growth forecast for the year 2013 as a whole has been lowered from 1.8% to 1.5%. After downturns in the first quarter, non-residential investment and exports showed a good pace of growth in the second quarter (graph). On the other hand, growth in consumer spending slowed, while that of residential investment remained strong. Government spending diminished, but to a much smaller extent than in the previous quarter. Lastly, imports accelerated sharply. ▼

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



## Employment keeps gaining ground

Employment expanded by 169,000 jobs in August, but the gains of the two previous months were revised downwards: that of June from 188,000 to 172,000, and that of July from 162,000 to 104,000. The unemployment rate lost a tenth of a percentage point to reach 7.3% in August. As was the case in Canada, job growth in the United States was slower during the past six months than in the previous six months, with average monthly gains dropping from 207,000 to 160,000. Nevertheless, employment has expanded every month in the past three years and has now gained back over three quarters of the ground that was lost since the beginning of 2008. The job market is improving slowly, but steadily.

## Housing starts are flat, but home sales keep rising

After falling by 7.9% in June, housing starts rose by 5.9% in July. The growth seen in July is entirely attributable to multiple-unit starts, which rebounded by 25.5% after a slump of the same scope in the previous month. Meanwhile, starts of single-family homes dropped by 2.2% in July. The housing start trend (measured by the six-month average), which had been positive since the beginning of 2011, has

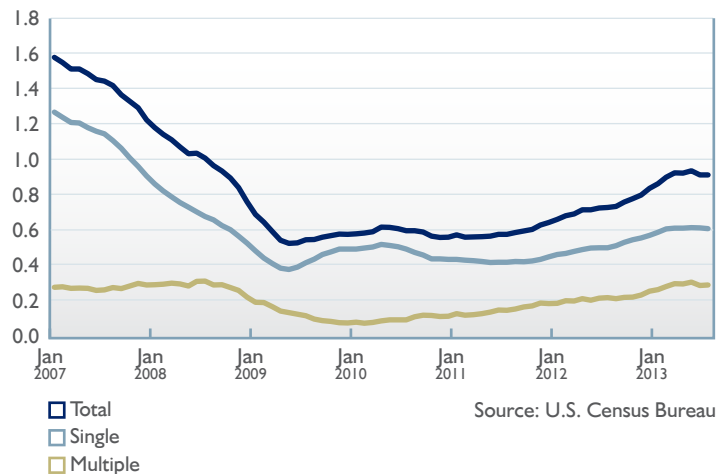
## INTEREST RATES

### No change to the key interest rate expected before mid-2014

It came as no surprise when the Bank of Canada left its key interest rate unchanged, at 1.0%, on September 4. The central bank considers that the size of Canada's GDP is consistent with its forecasts, but that the uncertainty prevailing over the global economy is preventing Canadian exports and investments from contributing as much as expected to economic growth. As long as the current conditions continue (expected

been stuck in neutral for the past few months (graph). As for the resale market, it is doing well: home sales were up by 6.5% in July compared with the previous month and by 17.2% compared with July 2012. At the current pace of sales, it would take 5.1 months to sell off the inventory of homes on the market, compared with 6.3 months a year ago. However, mortgage rates are now higher than they have been in two years, and this could cool the market down.

## Trend in Housing Starts (6-month moving average, millions of units)



## The manufacturing sector gathers steam

The purchasing managers' index in the manufacturing sector, compiled by the Institute for Supply Management (ISM), which fell below the 50 mark in May, rallied sharply in July, reaching 55.4, its highest level so far this year. The main components of the index, i.e. production, new orders and employment, all gained ground in July. We remind readers that this index is also a good leading indicator of economic growth. According to the ISM, the average of the index since the beginning of the year corresponds to annual real GDP growth of 3.1% in 2013. ■

inflation is low, there is an abundance of unused production capacity and household credit keeps subsiding), the current monetary policy will remain appropriate, according to the Bank. Since it does not expect the excess production capacity to start diminishing before 2014, we can expect the trend-setting interest rate to stay where it is for a long time to come. In fact, nearly all the forecasters are expecting no increase before June 2014. ■

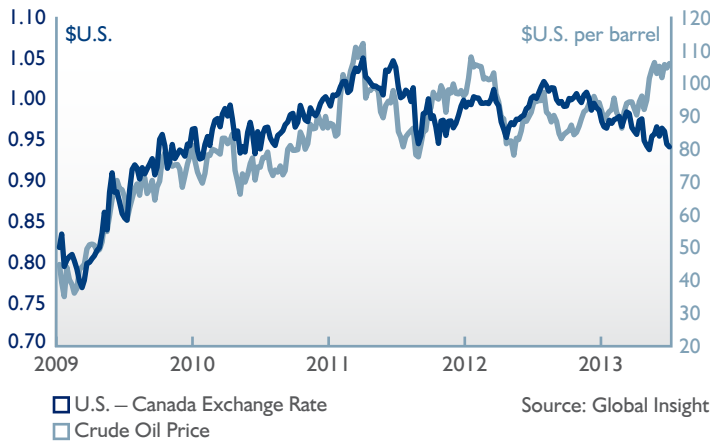
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## The price of oil stays high; the Canadian dollar stabilizes

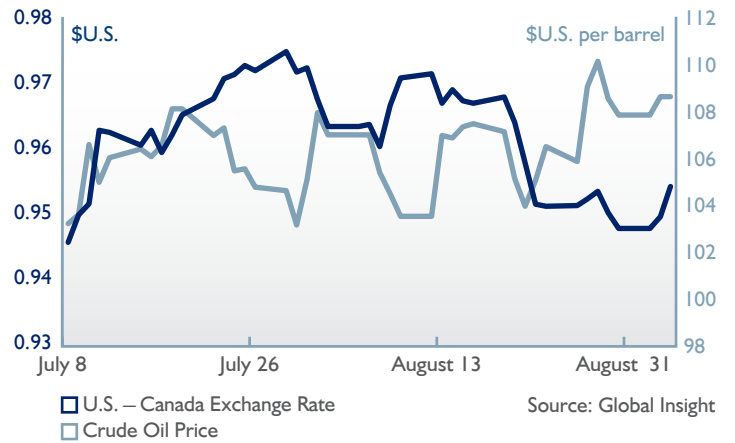
The price of crude oil was driven upwards in recent weeks by the possibility of military action against the Syrian regime after an alleged chemical attack against civilians. It subsequently

stabilized as fears of quick intervention abated. The Canadian dollar appreciated slightly over the past two months thanks to the favourable statistics of its main trading partner. However, it lost ground when Canadian employment data for the month of July were released; they were disappointing. ■

**Exchange Rate and Crude Oil Price**  
(January 2009 to September 2013)



**Exchange Rate and Crude Oil Price**  
(July 8, 2013 to September 4, 2013)

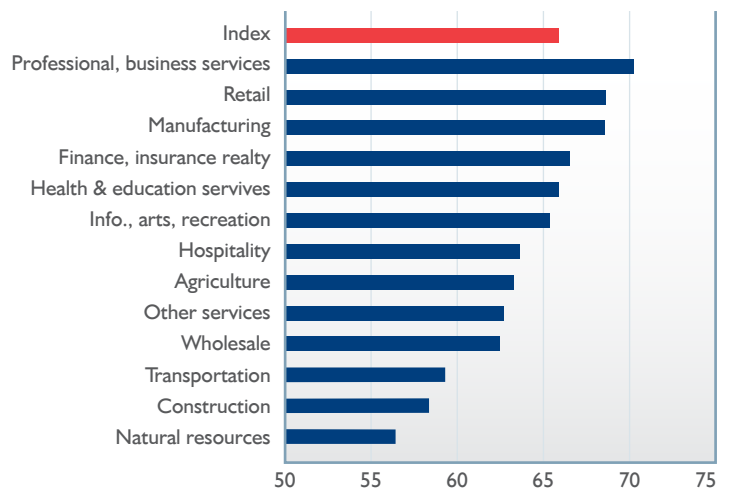


## SME CONFIDENCE

### Small business owners regain confidence

The Business Barometer Index compiled by the Canadian Federation of Independent Business rose for the second month in a row in August: it reached 65.9, gaining back nearly all the ground it had lost since February. The renewed optimism is quite widespread. The indexes are up in 7 of the 10 provinces, and in 9 out of 13 business sectors. The retail sector achieved the largest gain, rising by 10.3 points in August month over month, which puts it in second place after the enterprise services sector (graph). SME business owners in the manufacturing sector are also among the most optimistic in the country. ■

**Business Barometer Index, by sector**  
(August 2013)







# BUSINESS CREDIT CONDITIONS

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## Growth in bank credit to businesses remains firm

Short-term credit granted to businesses by the chartered banks surged by 11.8% in July compared with the previous month, and by 13.3% compared with July 2012. Meanwhile, long term bank credit (which represents 13% of total bank credit) soared by 47.9% in July, for a year-over-year variation of 11.2%. The effective interest rate for businesses (a weighted average of various bank interest rates and market interest rates applicable to new loans granted to non financial businesses) has been rising in recent months. At the end of July, it stood at 3.41% (graph). ■

Effective Business Interest Rate  
(5 January 2007 to 30 August 2013,%)



Source: Bank of Canada



## KEY INDICATORS — CANADA

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Key indicators – Canada	Historical <sup>1</sup>				2013 <sup>2</sup>				2013 <sup>3</sup>	Forecast		
	2009	2010	2011	2012	Q1	Q2	Q3	Q4	Latest	2013	2014	
Real GDP (% growth)	-2.7	3.4	2.5	1.7	2.2	1.7			Jun	-0.5	1.7	2.2
Machinery and Equipment Expenditures (% growth)	-21.2	10.6	8.6	5.2	-0.1	-2.1					1.8	5.3
Pre-Tax Corporate Profits (% growth)	-45.4	61.6	16.6	-8.2	9.6	-32.6					-2.1	4.8
Industrial Production (% growth)	-10.9	6.3	3.8	0.9	4.2	-2.6			Jun	-0.8	1.4	2.4
Industrial Product Prices (% growth)	-3.5	1.0	4.6	0.6	4.2	-1.0			Jul	0.3	0.9	1.9
Non-Residential Construction (% growth)	-19.4	17.3	12.9	6.9	1.5	-2.8						
Housing Starts (' 000 units)	148	191	193	215	174	190			Jul	193	181	172
Personal Expenditures (% growth)	0.3	3.5	2.3	1.9	1.3	3.8					1.8	2.0
Consumer Price (% growth)	0.3	1.8	2.9	1.5	1.6	0.0			Jul	0.2	1.1	1.8
Employment (% growth)	-1.6	1.4	1.5	1.2	0.8	1.3			Aug	0.3		
Unemployment Rate (%)	8.3	8.0	7.5	7.3	7.1	7.1			Aug	7.1	7.1	7.0
SMEs Confidence Index (CFIB)	57.7	66.7	66.4	63.9	64.9	61.3			Aug	65.9		
Manufacturers Confidence Index (CFIB)	56.0	68.6	67.2	66.7	65.7	58.3			Aug	68.5		

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.



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