BDC
Entrepreneurs first

economic LETTER

OCTOBER 2015

WHAT IS THE REASON FOR THE LETHARGY OF CANADIAN BUSINESS INVESTMENT?

Business investment in the non-residential sector fell significantly during the first half of 2015.[1] In fact, it was the slump in that component that caused real GDP to contract during that period. The Canadian economic accounts do not specify in which industries non-residential investment declined, but clearly the oil sector is chiefly responsible. According to a recent Statistics Canada survey, investments are likely to tumble by nearly 20% in that sector in 2015. Given that the investments in that industry represented over one third of all investments in 2014, their decline has a substantial negative effect on the Canadian economy. This state of affairs is obviously linked to the collapse in crude oil prices, which has reined in the oil companies' exploration and development projects.

Since the recession, it is mainly the mining, oil and gas sector that has supported growth in business investment

In previous years, it was mainly the mining and oil and gas extraction sector that supported non-residential investment growth. Investment rallied strongly in that sector once the recession was over, and expanded sharply after that (Graph 1). In all the other industries, investment has yet to return to where it stood prior to the recession, and has been stagnating since 2012. Investment in machinery and equipment in particular has remained soft: in 2014, it was 7% below where it stood in 2008.

In order to invest, businesses need to expect favourable economic outlooks

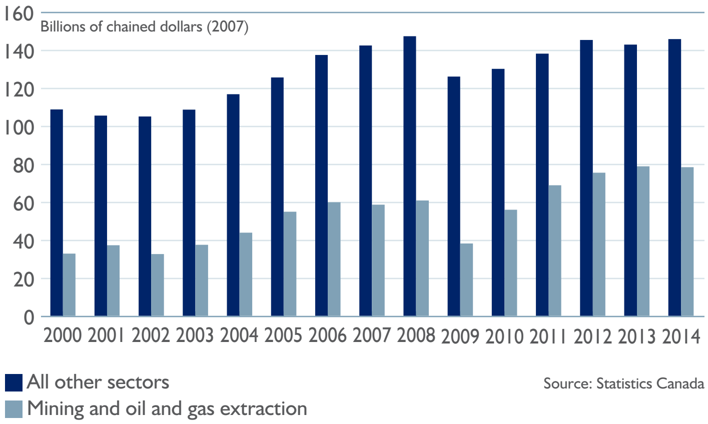
Why have Canadian businesses (apart from the mining and oil and gas extraction sector) not invested more in recent years? Many theories can be put forward to explain this phenomenon. The first has to do with confidence. Businesses invest when growth outlooks seem promising. Since the 2009 recession, many events have undermined business confidence: the sovereign debt crisis drove Europe into recession, while economic growth has proven to be very modest in Canada and the United States, and has been gradually slowing in emerging and developing countries (EDCs). In these conditions, business owners are apt to stay on the sidelines, and wait for economic conditions to improve. ▼

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 October 10. Reliance on and use of this information is the reader's responsibility.

1 Non-residential investment consists of investments in non-residential construction, machinery and equipment and intellectual property products.

Graph 1: Non-residential investment (excluding the mining, oil and gas sector) has not increased much since 2009

(Business non-residential investment: mining, oil and gas sector and all other sectors)



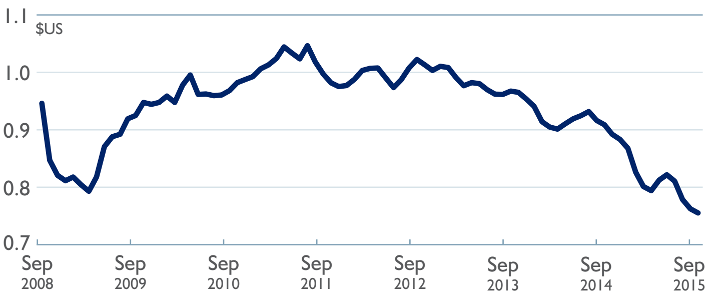
Source: Statistics Canada

The depreciation of the dollar may discourage some investors

The Canadian dollar has depreciated significantly against the U.S. dollar since 2012 (Graph 2). For business owners who import machinery and equipment from the United States, this means higher costs. Given that the imported content of Canadian investments is approximately 40%, the depreciation of the loonie has no doubt helped to curtail business investment in recent years.

Graph 2: Between August 2012 and August 2015, the Canadian dollar depreciated by 25%

(Canada/United States exchange rate, September 2008 to September 2015)



Source: Bank of Canada

The stimulating effect of a weak loonie on Canadian exports may be more limited than in the past

Depreciation of the loonie can also promote investment because it stimulates exports and discourages imports. In response to the resulting higher demand, businesses normally tend to invest.

However, the depreciation of the loonie did not generate any significant upturn in exports before 2014. There may be several reasons for this. First of all, in 2012 and 2013, economic growth was quite sluggish in the United States, so the depreciation of the loonie had a limited effect on exports south of the border. Second, since the start of the 2000s, Canada's share of U.S. imports has declined considerably in favour of EDCs.[2] Consequently, the effect of the loonie's depreciation on exports to the United States is weaker than it used to be. Third, in the past few months, the Canadian dollar is not the only currency to have depreciated against the greenback. As a result, Canada is not gaining as much of a competitive advantage from the loonie's recent depreciation.

Improving growth outlooks in the United States should stimulate Canadian business investment

In short, the impact of the exchange rate on Canadian exports may have softened, and Canada's competitiveness in the U.S. market may have diminished over time. That said, Canada is still a primary economic partner for the United States due to its geographic proximity and the trade ties that have existed between the two countries for so long. In 2014, the U.S. economy picked up steam, and this generated a significant increase in Canadian exports. Therefore, the expected acceleration in growth in the U.S. in 2015 and 2016 bodes well for the Canadian economy. Canadian business leaders should not hesitate to invest, in order to gain maximum benefit from the business opportunities that are opening up to them. ■

2 See the newsletter of November 2013: China and Mexico eat away at Canada's share of the American market.

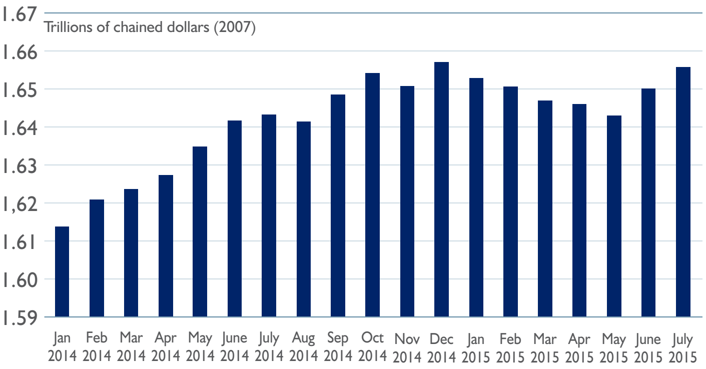
A second monthly upturn in GDP in a row in July indicates that economic growth has indeed picked up after losing steam during the first half of the year. That said, the effects of the oil price slump on the economy are not over yet, as may be seen from the decline in the value of exports in August, which was mainly due to the lower prices of energy product exports.

GDP keeps growing

Real GDP was up by 0.3% in July after a gain of 0.4% in June, which came on the heels of five straight months of contraction. Output in the mining, quarrying and oil and gas extraction sector advanced for the second month in a row in July, after seven consecutive monthly declines. In June and July, real GDP gained back nearly all the ground that had been lost from January to May (graph). Thanks to the vitality of the U.S. economy and to an exchange rate that is favourable for exports, economic activity probably continued to expand in Canada in August and September.

Real GDP has won back nearly all the ground that was lost

Real GDP, January 2014 to July 2015



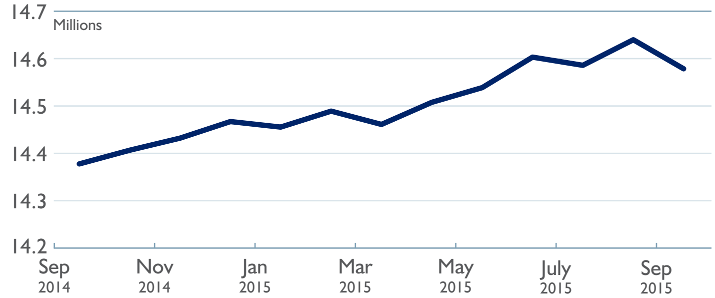
Source: Statistics Canada

A moderate advance in employment

September saw the creation of 12,100 new jobs, a gain similar to that of the previous month. Part-time jobs, which expanded by 74,000, were entirely responsible for the increase, while full-time jobs declined by 61,900. But these numbers do not reflect what has happened over the past 12 months. Between September 2014 and September 2015, it was only full-time employment that went up (by 1.4%) while part-time employment pulled back by 1.2%. Full-time job growth was particularly strong between March and August 2015 (graph). As for the unemployment rate, it ticked up by 0.1 % in September, reaching 7.1%.

Full-time jobs have increased significantly over the past 12 months

Full-time jobs, September 2014 to September 2015



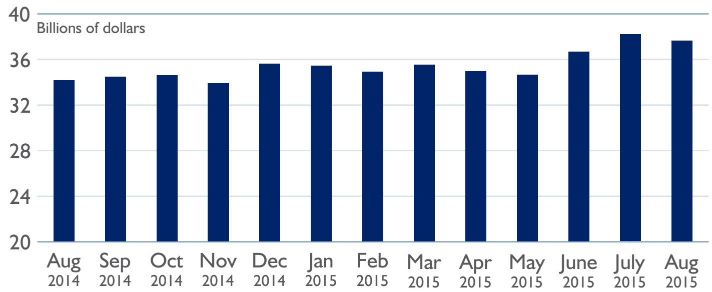
Source: Statistics Canada

The balance of trade deteriorates

A 3.6% drop in exports, combined with a 0.2% increase in imports, widened Canada's trade deficit with the world. It expanded from $817 million in July to $2.5 billion in August. A large share of the August decline in exports comes from energy products, especially crude oil: the value of crude exports plunged by 21% compared with the previous month, due to lower prices. Exports of metal products and non-metallic mineral products also tumbled sharply (-9.7%). Despite the decline recorded in August, exports excluding energy products remained high (graph).

Exports of non-energy products remained high, despite their decline in August

Exports excluding energy products, August 2014 to August 2015



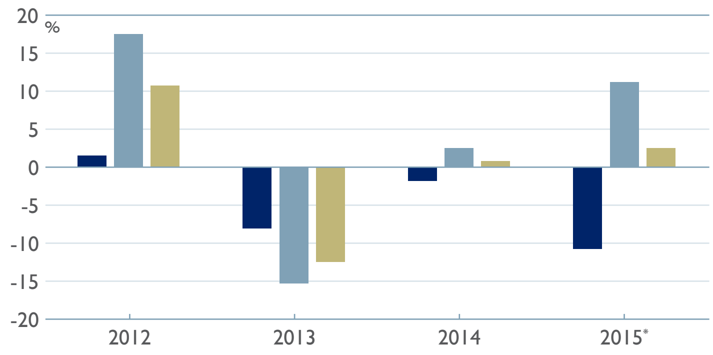
Source: Statistics Canada

Multiple-dwelling housing starts soar

Housing starts surged in September, to 230,701 units from 214,255 units in August. Starts of multiple-unit homes increased by 10.5% during the month, while starts of single-family homes ticked up by just 0.8%. During the first three quarters of the year, starts of multiple-unit projects soared compared to the same quarter the year before, while starts of single-family homes tumbled (graph). According to the Canada Mortgage and Housing Corporation, the housing start trend is strong because of the launch of large rental projects and the continued vitality of condo construction, and it appears to be outstripping the pace of household growth.

In 2015, starts of multiple-unit projects are soaring while starts of single-family homes are dropping

Annual change in housing starts, total and by type of dwelling, 2012 to 2015*



Source: Statistics Canada

*First three quarters of 2015

UNITED STATES

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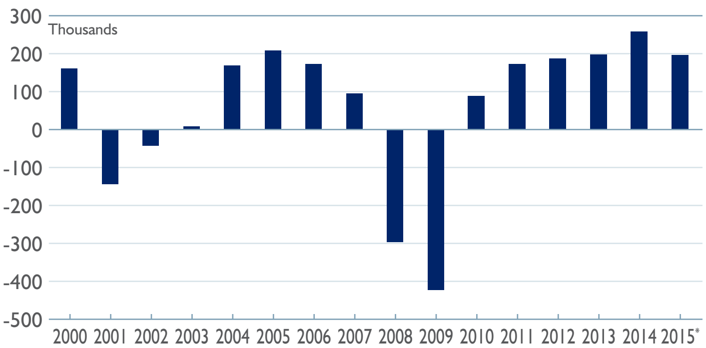
Apart from the Institute for Supply Management's purchasing managers' index, which is reporting a decline in business confidence, the latest data show that economic growth is still robust. Job growth is slowing but is still strong, housing start trends are still positive, and consumer confidence is rising.

Slowing job growth

Non-farm employment expanded by 143,000 jobs in September. Job growth has slowed in 2015 compared with last year: the average monthly gain has fallen from 260,000 in 2014, to 198,000 for the period from January to September 2015, but this is still high from a historical perspective (graph). The unemployment rate was unchanged, at 5.1%.

Job growth has slowed in 2015

Average monthly change in employment, 2006 to 2015*



Source : U.S. Bureau of Labor Statistics

*January to September 2015

Housing starts and existing home sales pull back, but are still high

Housing starts dipped by 3.0% in August after a 4.1% decline in the previous month. Despite these pullbacks, the housing start trend according to the six-month rolling average is still positive. Sales of existing homes also dropped in August, by 4.8%, after three straight monthly gains. Even though they were down in August, home sales are still high (graph).

Despite a pullback in August, home sales are still high

Sales of existing homes, August 2011 to August 2015

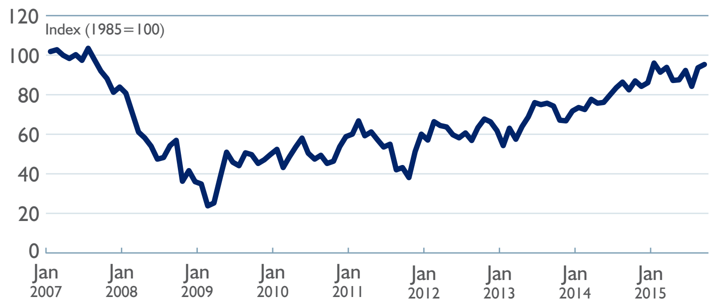
Source: U.S. National Association of Realtors

Business confidence declines, but consumer confidence is still robust

Business confidence, as measured by the Institute for Supply Management's purchasing managers' index, is in decline. The index lost ground for the third straight month in September, reaching 50.2, its lowest level since May 2013. Nevertheless, at that level, the index is telling us that manufacturing output is still growing. As for consumer confidence, it is still strong. The Conference Board's consumer confidence index is up, from 101.3 in July to 103.0 in August (graph). ■

Consumer confidence is nearly as high as before the recession

Consumer confidence index, January 2007 to September 2015



Source: U.S. Conference Board

INTEREST RATES

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The key interest rate should hold steady over the next 12 months

The Bank of Canada left the key interest rate unchanged on September 9. The central bank believes that it will take time for the Canadian economy to adjust to the lower prices of oil and some other commodities. On the other hand, the strength of the recovery in the United States should promote exports from Canada and stimulate economic activity in this country. The next rate-setting date is October 21. In general, forecasters do not anticipate any hike in the overnight rate before the last quarter of 2016. Their expectations for interest rates in the United States are quite different. South of the border, the economy has definitely revived in recent quarters, and the unemployment rate has returned to where it stood before the recession. Under these conditions, observers are predicting that the Federal Reserve will start raising the federal fund target rate either in December, or at the beginning of next year. ■

OIL PRICE

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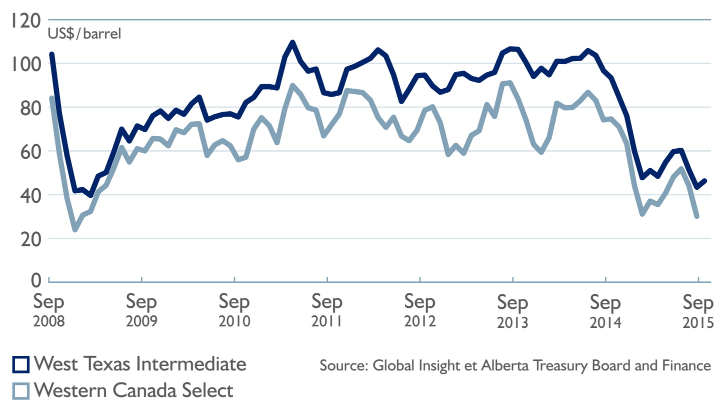
Crude oil prices stabilize

In September, the price of crude oil (West Texas Intermediate) stabilized, after dropping significantly in the previous month. The price stayed around US$45 per barrel from the beginning to the end of September, despite considerable daily fluctuations from time to time. The global oil supply is still overabundant, but some indicators suggest that the excess supply is diminishing. According to a report from the Energy Information Administration, U.S. production fell by 12,000 barrels per day between August and September and should keep declining up until next year. This piece of news helped push the price of WTI up to US$48 per barrel at the beginning of October. ■

Crude oil prices stabilize

(Prices of West Texas Intermediate and of Western Canada Select, September 2008 to September 2015)



Source: Global Insight et Alberta Treasury Board and Finance

CANADIAN DOLLAR

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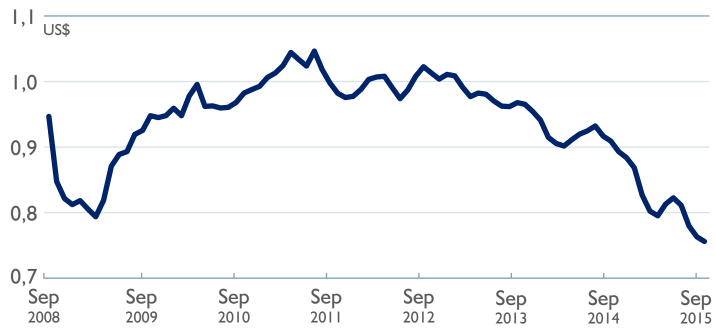
The Canadian dollar depreciates slightly

In September, the Canadian dollar depreciated against the U.S. dollar for the fourth month in a row. However, the pace of its depreciation slowed in September compared to the previous months, suggesting that the exchange rate is in the process of stabilizing. Low commodity prices (including that of crude oil) and the divergences between expected interest rate developments in Canada and the United States are continuing to put downwards pressure on the loonie in relation to the U.S. currency. ■

The loonie has depreciated further against the greenback

(Canada/United States exchange rate, September 2008 to September 2015)



Source: Bank of Canada

SME CONFIDENCE

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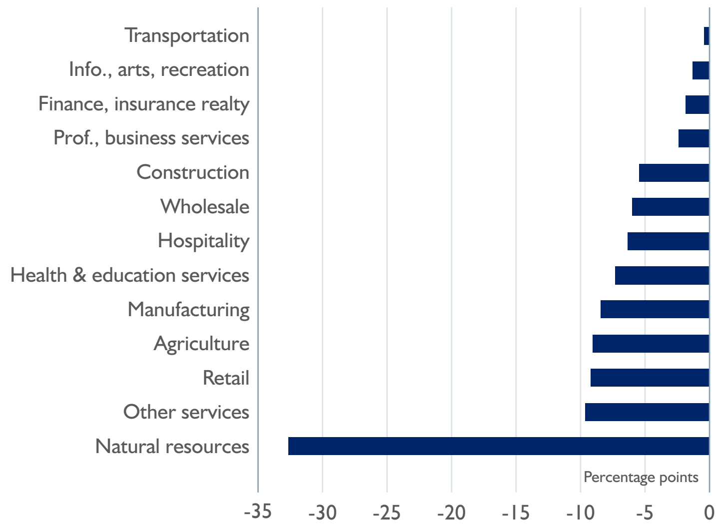
SMEs' confidence weakens again

The Business Barometer Index compiled by the Canadian Federation of Independent Business dipped by 0.7 points to reach 56.0 in September, its lowest level since April 2009. Over the past 12 months, business owners' confidence has dropped sharply in the natural resources sector due to the collapse in crude oil prices (graph). The index has also lost ground in all the other sectors, although to a lesser extent. The economic slowdown caused by the plunge in oil prices has undermined the confidence of SME owners in all sectors of the Canadian economy. ■

The Business Barometer has declined in all sectors since September 2014

Change in the Business Barometer Index between September 2014 and September 2015



Source: Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

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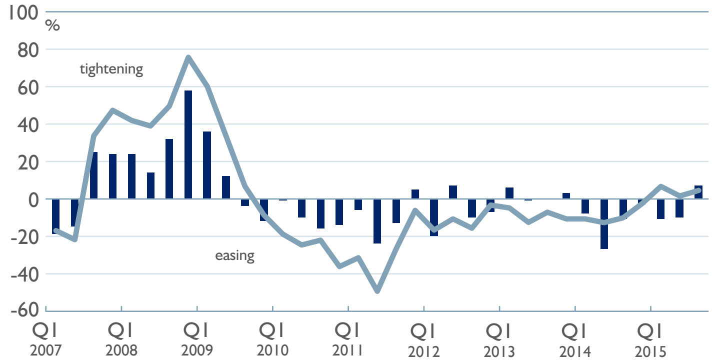
Credit conditions have tightened a bit, especially for companies tied to the oil sector

According to the Senior Loan Officer Survey and to the Business Outlook Survey conducted by the Bank of Canada, business credit conditions tightened slightly in the third quarter of 2015 (graph). It was mainly companies tied to the oil sector that were subject to tougher credit conditions. ■

Business credit conditions tightened slightly in the 3rd quarter of 2015

(Credit conditions, balance of opinions, Q1 2007 to Q3 2015)



Business Outlook Survey
Senior Loan Officer Survey

Source: Bank of Canada

KEY INDICATORS—CANADA

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Key indicators—Canada

	Historical[1]				2015[2]				2015		Forecast	
	2011	2012	2013	2014	Q1	Q2	Q3	Q4	Latest[3]		2015	2016
Real GDP (% growth)	3.0	1.9	2.0	2.4	-0.8	-0.5			Jul	0.3	1.1	2.0
Machinery and Equipment Expenditures (% growth)	8.1	1.9	1.0	1.0	-6.2	-17.1					-4.6	1.0
Pre-Tax Corporate Profits (% growth)	23.3	-6.7	0.7	10.8	-48.5	6.8					-11.2	6.9
Industrial Production (% growth)	4.1	1.4	1.8	4.1	-4.1	-9.4			Jul	1.2	-1.4	1.6
Industrial Product Prices (% growth)	6.9	1.1	0.4	2.5	-0.4	1.7			Aug	-0.3	-0.9	2.5
Non-Residential Construction (% growth)	15.9	13.5	5.0	-0.1	-23.5	-8.8						
Housing Starts (' 000 units)	193	215	188	189	175	193			Sep	231	185	182
Personal Expenditures (% growth)	2.2	1.9	2.5	2.7	0.5	2.3					2.0	2.1
Consumer Price (% growth)	2.9	1.5	1.0	1.9	-0.2	2.5			Aug	0.0	1.2	2.0
Employment (% growth)	1.5	1.3	1.4	0.6	0.7	0.8			Sep	0.1		
Unemployment Rate (%)	7.5	7.3	7.1	6.9	6.7	6.8			Sep	7.1	6.8	6.8
SMEs Confidence Index (CFIB)	66.3	63.9	63.9	64.9	61.4	60.2			Sep	56.0		
Manufacturers Confidence Index (CFIB)	67.3	66.5	63.8	65.8	61.9	57.8			Sep	58.7		

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.