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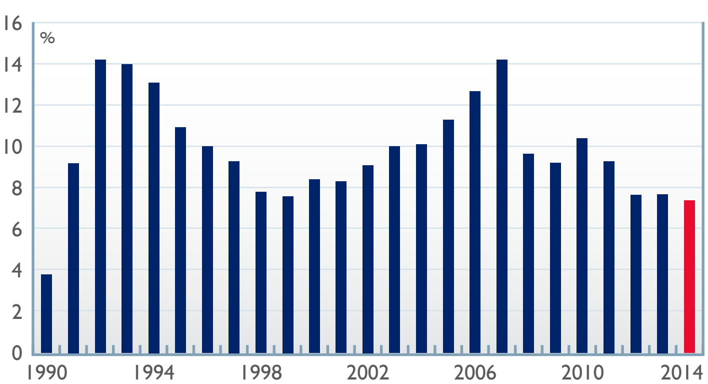
economic LETTER

APRIL 2015

CHINA: ECONOMIC GROWTH THAT IS NOT AS FAST, BUT PERHAPS MORE SUSTAINABLE

After skyrocketing since the country opened its doors to the world at the beginning of the 2000s, China's real GDP has returned to a more moderate pace of growth. In 2014, Chinese real GDP rose by 7.4%, its weakest growth since 1990 (graph). The real estate market has cooled, investments have pulled back, domestic consumption has slowed—partly due to reduced spending on housing—and the pace of export growth has diminished.

Chinese economic growth has slowed but is still strong
(Annual change in real GDP, 1990 to 2014)



Source : International Monetary Funds

Generally speaking, analysts believe that this slowdown is good news. After years of overheating in the real estate sector and industrial overproduction, economic activity has adopted a pace of growth that is more balanced, and probably more sustainable. And this should continue in the years to come. Indeed, the Chinese government has announced that it will focus on quality growth and restructuring of the economy, instead of pursuing GDP growth at any cost.[1] Since that announcement, this has been referred to as the "new normal" of Chinese economic growth.

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- Exports increase in value but fall in terms of volume
- Housing starts follow a downward trend

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- A modest increase in employment
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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 April 11. Reliance on and use of this information is the reader's responsibility.

1 Top 10 economic news stories of 2014 http://m.french.china.org.cn/french/doc_1_26363_185923.html

Major reforms are underway in the People's Republic of China. The government has announced the consolidation of state-owned enterprises, in particular those in the transportation and energy sectors, to make them more competitive in the global marketplace. This restructuring process entails changes in the management of state-owned enterprises, such as introducing performance based compensation and eliminating many of the benefits granted to employees, like housing.

At the same time, the Chinese government is making more room for private companies in the economy. At the beginning of 2014, the process for creating a company was simplified, and 3.7 million new firms were created last year—47% more than in 2013.[2] Private companies are far more productive than state-owned enterprises, and account for 90% of the country's job creation.

Urbanization is continuing. While it currently stands at 55%, the government is aiming for an urbanization rate of 60% (comparable with that of advanced economies) by 2020.[3] Education levels are improving, but capital investments in education are still far below those of advanced economies. In fact, investments in physical capital have been far greater than those in human capital in recent decades.[4]

In short, China is continuing to develop. In 2014, the International Monetary Fund declared that China had surpassed the United States as the largest economy in the world based on gross domestic product (GDP) measured according to purchasing power parity.[5] But the average Chinese citizen is far less wealthy than the average American. In fact, China's GDP per capita is four times lower than that of the United States. Moreover, when expressed in U.S. dollars, China's GDP is the second largest in the world and is equivalent to just 56% of U.S. GDP.

Nevertheless, according to the OECD the country is "on course to come close to achieving its goal of doubling GDP per capita between 2010 and 2020, by which time China could be considered a 'moderately prosperous society'."[6] In the meantime, it already enjoys enormous purchasing power in international markets, with imports amounting to US$1.41 trillion, of which 1.4% originates from Canada (a value of $19.3 billion Canadian in 2014). As the Chinese middle class expands, demand for imported goods is expected to increase considerably. According to a study by Ernst and Young, approximately 150 million Chinese were earning between US$10 and US$100 per day in 2013, and that number should reach 500 million in 2023.[7]

Canadian companies would therefore be well advised to continue their efforts to attract Chinese buyers. Canada supplies many raw materials to China, but agricultural and consumer products are capturing a growing share of Canadian exports to that country. For example, between 2005 and 2014, exports of oil-bearing plants (soybeans, canola, linseed, etc.) to China increased by an average of 40% per year; exports of meat products rose by 13% per year, and wine by 39% per year. The same is true of motor vehicles and aerospace products, which expanded by averages of 37% and 14% per year, respectively, during that period. Demand for these types of products will keep growing as the Chinese standard of living rises, enabling them to acquire luxury goods and to travel. In short, the Chinese market represents a promising outlet for many Canadian exporters. ■

2 Embassy of the People's Republic of China in France, press release dated January 30, 2015 http://www.amb-chine.fr/fra/zgyw/t1233002.htm
3 OECD Economic Surveys: China, March 2015, Overview, page 30.
4 Ibid, page 57.
5 Purchasing power parity is a method used to compare the purchasing power of the currencies of various countries. It measures the extent to which a currency can be used to purchase goods and services in each of the countries being compared.
6 Op. cit. note 3, page 6.
7 Ernst and Young, "Hitting the sweet spot; The growth of the middle class in emerging markets", 2013, page 5. According to the authors, individuals whose income is within the range of US$10 to US$100 per day can buy products such as cars and TV sets, which are the basic products consumed by middle class people in the western countries over the past 60 years.

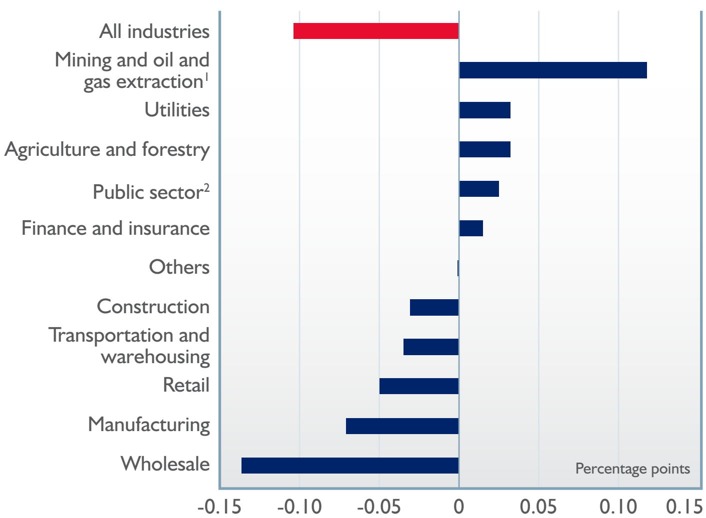
In January, real GDP contracted slightly. In February, exports pulled back in terms of volume, and housing starts were down. These results appear to indicate flagging economic growth in the first quarter. The robustness of the U.S. economy and a more favourable exchange rate for the loonie should, however, stimulate the economy in the upcoming quarters.

GDP shrinks somewhat

Real GDP shrank by 0.1% in January after a 0.3% uptick in December and a 0.2% dip in November. It was wholesale trade that contributed the most to January's contraction. Production also declined in the manufacturing sector: January's 0.7% pullback came on the heels of a 2.1% increase in December. On the other hand, production was up in the mining, oil and gas extraction sector, curtailing the decline in GDP. Oil and gas production, which had dropped by 2.1% in December, rebounded in January with an increase of 2.6%, while mining output slipped by 0.4%. Despite the plunge in oil prices since the summer of 2014, oil production has held steady. The National Energy Board predicts that it will expand by 3.5% in 2015 compared with the previous year.

Wholesale trade was the largest contributor to January's contraction in GDP

(Contribution by the main industries to the month-over-month change in real GDP in January 2015)



1. Includes quarrying
2. Education, health and public administration

Source: Statistics Canada

Employment is up again

After taking a break in February, employment started growing again in March, recording a gain of 28,700 jobs. The unemployment rate held steady at 6.8%. The March upturn in employment comes entirely from part-time jobs, as full-time employment lost ground. Retail and wholesale trade, which employs a large number of part-time workers, is the sector that achieved the largest gain, followed by that of transportation and warehousing. After two straight monthly declines, employment in the natural resources sector expanded in March. The pullback in that sector in January and February was no doubt attributable to oil extraction, since the plunge in oil prices encouraged businesses to rein in their costs.

Exports increase in value but fall in terms of volume

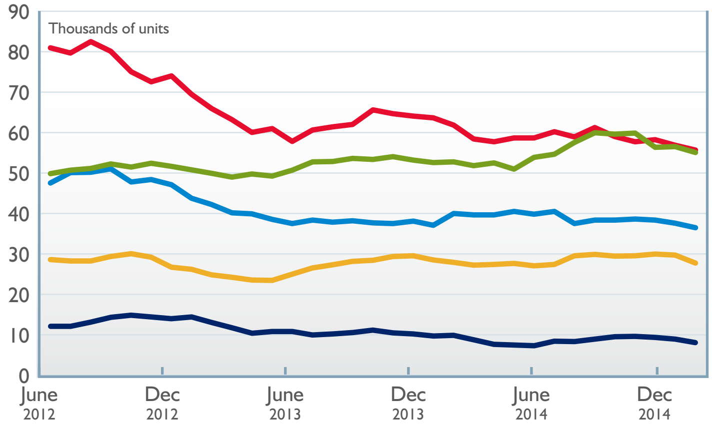
In February, imports dipped by 0.7% compared with the previous month, while exports ticked up by 0.4%, resulting in a narrowing of the trade deficit from $1.5 billion in January to $985 million in February. The volume of imports was down by 1.7%, while prices rose by 1.0%. Imports declined in most industries, but the downturn was more pronounced in the motor vehicles and parts sector. The volume of exports fell by 3.3% but prices increased to a greater extent, by 3.7%. It was energy products that led the increase in exports in February. The higher price of crude oil in February, after a slump of several months, contributed to that outcome.

Housing starts follow a downward trend

The number of housing starts tumbled by 16.4% in February, compared with the previous month. The drop was sharper in the multiple-unit segment than in that of single-family homes, i.e. 25.1% versus 4.1%. Measured in terms of the six-month moving average, the trend in housing starts has been heading down since September 2014. From a regional perspective, starts have been on a downward slope across the country in the past few months, but that slope is a little steeper in Ontario and the Prairies (graph). In the latter region, housing starts had peaked in the summer of 2014, so a slowdown should help rebalance the housing market. ■

Housing starts are down across the country

(Six-month moving average of housing starts by region, June 2012 to February 2015)



Source: Canada Mortgage and Housing Corporation

UNITED STATES

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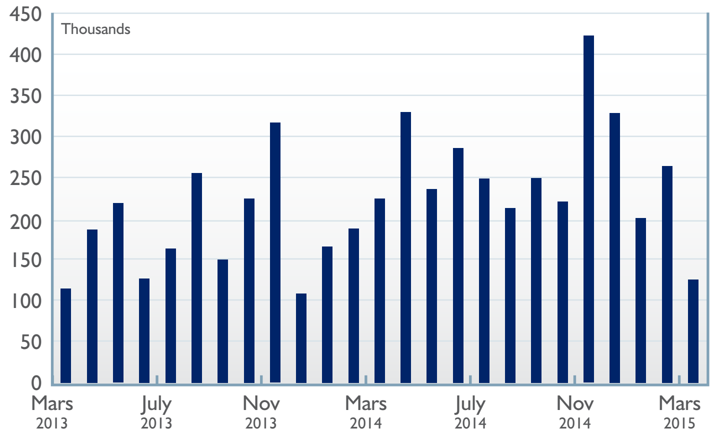
The latest indicators show a slowdown in economic activity in the first quarter, mainly caused by the exceptionally cold weather. History is repeating itself, since the year 2014 started off the same way. If this is indeed a seasonal effect, growth should rebound in the second quarter.

A modest increase in employment

Non-farm employment expanded by 126,000 jobs in March, which is rather modest growth compared with the average monthly gain of 265,000 observed during the three previous months (graph). The unemployment rate held steady at 5.5%. Employment was up mainly in professional and business services, retail trade and health care services. It was down mainly in the support services component of the mining sector, which includes oil extraction. ▼

Job growth was modest in March

(Monthly change in employment in the United States, March 2013 to March 2015)



Source: U.S. Bureau of Labor Statistics

Housing starts plunge

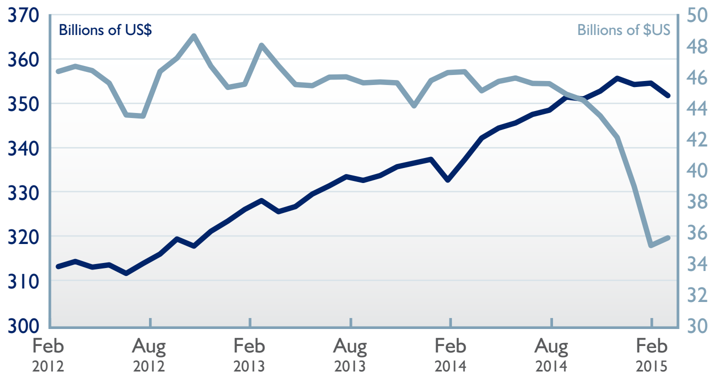
The number of housing starts plunged by 17.0% in February compared with the previous month. The drop in the single-family homes segment was 14.9%, while that of the multiple-unit segment was 21.6%. The exceptionally cold weather seems to have disrupted homebuilding in February. If that is the case, starts should rebound in the months ahead. Meanwhile, sales of existing homes rose by 1.2% in February compared with the previous month. Inventories are still limited and are continuing to push prices up. The median price is up again, and now stands 7.5% above where it was in February 2014.

Retail sales are down

Retail sales slipped by 0.6% in February; this is the third monthly drop in a row. This three month slump is partly attributable to gas station sales, the value of which fell due to the plunge in gasoline prices (graph). That said, sales in the other retail businesses have also declined in recent months. It is possible that the exceptionally cold weather affected not only homebuilding, but retail sales as well. The data of the months to come will enable us to verify the accuracy of this hypothesis. ■

The decline in gas station sales reflects that of gasoline prices

(Retail sales, United States, February 2012 to February 2015)



Retail stores excluding gasoline stations (left)
Gasoline stations (right)
Source: U.S. Census Bureau

INTEREST RATES

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The key interest rate should hold steady at 0.75%

The Bank of Canada's next rate-setting date will be April 15. Readers will recall that in January, the central bank cut the key interest rate by 25 basis points to mitigate the negative impact of plunging oil prices on the Canadian economy. This monetary easing did not continue: on March 4, the Bank decided to leave the trendsetting interest rate unchanged. Most forecasters are expecting the central bank to do the same on April 15. ■

OIL PRICE

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Crude oil prices have stabilized

The price of oil was quite volatile in March, playing yo-yo from one day to the next; but its monthly average was stable compared with that of February. The fact that the supply is still so abundant is keeping downward pressure on prices, especially since the supply could expand further should the negotiations to persuade Iran to renounce nuclear weapons reach a successful conclusion, and the sanctions against that country (including those relating to the oil sector) be lifted. Meanwhile, new political tensions in the Middle East have put upward pressure on oil prices. Saudi Arabia and its allies launched a military strike in Yemen, rekindling fears that some important straits through which millions of barrels of oil are carried every day may be blocked. ■

Crude oil prices have stabilized

(Crude oil prices, March 2008 to March 2015)

West Texas Intermediate
Western Canada Select
Sources: Global Insight et Baytex Energy Corp

CANADIAN DOLLAR

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The Canadian dollar has depreciated slightly

The Canadian dollar depreciated further against the U.S. currency in March. The loonie has lost 15% of its value over the past eight months. It is mainly the divergences in monetary policy between the two countries that are weighing the Canadian currency down. Forecasters are anticipating that the Federal Reserve will raise interest rates a few months from now, probably in the fall. Meanwhile, they are expecting that the Bank of Canada, which cut its key interest rate in January to mitigate the negative impact of the oil price slump on the Canadian economy, will leave that interest rate unchanged for a good while longer. ■

The Canadian dollar depreciated for the 8th straight month in March

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

Source: Bank of Canada

SME CONFIDENCE

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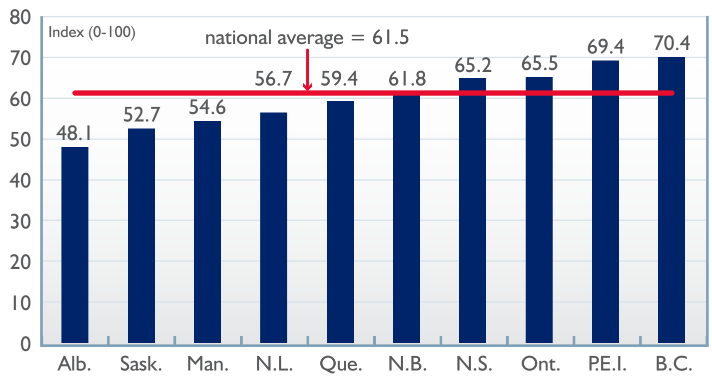
SME owners' confidence heads back up

In March, the Canadian Federation of Independent Business's Business Barometer Index won back some of the ground it had lost in the previous month, posting a reading of 61.5%. The confidence of SME owners in Quebec, British Columbia and especially Ontario firmed up in March. Conversely, that of entrepreneurs in the Atlantic Provinces pulled back. Finally, it stabilized in the oil-producing provinces, after declining considerably since last fall. However, those provinces were still trailing the others in March (graph). ■

SME owners in the oil-producing provinces are less confident

(Business Barometer index by province, March 2015)



Source: Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

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Credit conditions are still easy, but have tightened for businesses linked to the oil sector

The data from the Bank of Canada's Senior Loan Officer Survey show that credit conditions tightened in the first quarter of 2015. This affects only the oil and gas sector, since credit conditions for businesses in other sectors are still practically the same as before, according to the survey report. The results of the Business Outlook Survey show that the percentage of businesses that observed an easing of their credit conditions in the first quarter surpassed the percentage of those that observed tightening. The business owners who reported a tightening of their credit conditions were in many cases linked to the energy and commodities sectors.■

Credit conditions have tightened for businesses linked to the oil sector

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

KEY INDICATORS—CANADA

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Key indicators—Canada

	Historical[1]				2014[2]				Latest[3]		Forecast	
	2011	2012	2013	2014	Q1	Q2	Q3	Q4			2015	2016
Real GDP (% growth)	3.0	1.9	2.0	2.5	1.0	3.8	3.2	2.4	Jan	-0.1	2.1	2.2
Machinery and Equipment Expenditures (% growth)	8.1	1.9	0.7	0.7	-1.1	5.2	9.0	-3.2			-0.5	2.8
Pre-Tax Corporate Profits (% growth)	23.3	-6.7	0.7	11.2	23.4	9.3	8.2	-18.7			-3.8	5.4
Industrial Production (% growth)	4.1	1.4	1.8	4.1	5.5	5.7	1.2	2.7	Jan	0.4	1.2	1.9
Industrial Product Prices (% growth)	6.9	1.1	0.4	2.5	12.7	0.6	-1.2	-5.8	Feb	1.8	-1.6	2.3
Non-Residential Construction (% growth)	15.9	13.5	5.0	-0.1	-1.3	0.4	0.8	-1.8				
Housing Starts (' 000 units)	193	215	188	189	176	196	199	184	Mar	190	181	178
Personal Expenditures (% growth)	2.2	1.9	2.5	2.8	1.3	4.6	2.6	2.0			2.4	2.0
Consumer Price (% growth)	2.9	1.5	1.0	1.9	3.2	3.3	1.2	0.0	Feb	0.2	0.9	2.1
Employment (% growth)	1.5	1.3	1.4	0.6	0.6	0.0	0.7	1.6	Mar	0.2		
Unemployment Rate (%)	7.5	7.3	7.1	6.9	7.0	7.0	7.0	6.7	Mar	6.8	6.7	6.6
SMEs Confidence Index (CFIB)	66.3	63.9	63.9	64.9	64.2	65.5	64.7	65.1	Mar	61.5		
Manufacturers Confidence Index (CFIB)	67.3	66.5	63.8	65.8	65.0	64.3	68.8	64.9	Mar	58.9		

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.