THE GREAT HESITATION

Global Export Forecast
Fall 2016 – Executive Summary

Canada

EDC
Realize a World of Opportunity

Growth remains elusive. Hopes for the world economy still rise and fall with the latest piece of data, but the sad fact is that more than seven years beyond the Great Recession – almost a standard growth cycle – we still haven't "arrived". Through this protracted spell, experts have argued over both the cause and continuity of stagnation. Optimists have been repeatedly wrong, and the "new normal" camp seems vindicated by serially disappointing numbers.

The facts seem to speak for themselves. While there have been some high points along the way, it stands that since an abortive attempt at rebooting the economy in 2009, there has been little in the way of growth. Today, the standard policy responses appear tapped out, and our attempts to leverage them have compromised public sector balance sheets. The global financial system is still under repair. Unsure of what this means or where things are really headed, consumers and businesses the world over are reticent. It seems no-one wants to take the first step.

Frustration has now hit the mainstream. Popular discontent with economic sluggishness is nothing new, but it has now made major headway into developed economies. The world was thunderstruck in June when Britain voted to exit the EU, in spite of the fact that the campaign was a close race throughout. It's still not entirely clear what the majority were truly voting for, but the referendum exposed an exasperation with existing conditions, concluding that the current structure must in some way be at fault.

Britain is not alone. The electorate in that other bastion of free markets, the US, is equally unhappy. There, the discourse has set new standards for acrimony, and it has played to an audience that was primed for it. In spite of America's relative success, it seems that the army of those left behind by the recession, and those close to them, are unimpressed. The unfortunate lightning rods? Leadership, institutions, corporations and even globalization itself. Discontent has thrust the world into an existential debate that has added great risk to the very economic structure that gave rise to the great success of the last cycle.

The debate is already proving costly. Uncertainty is leading to a significant write-down of European growth, effective immediately. Although we are a long way from knowing what the new deal between Britain and the Continent will look like, the interim no-man's land has dented both the pound sterling and the euro, and will lead to near-term delays, deferrals and outright cancellations of investment projects. Euro Area growth for 2017, forecast last spring to reach 1.8 per cent, is now expected to ring in at just 1.2 per cent, with risk tilting to the downside.

US economic fallout is less clear. Experts are divided on whether the rancorous "fortress America" pronouncements are largely rhetoric, or a looming reality. Border walls, whether notional or actual, protectionist policies, scuttled trade talks, abrogation of existing free trade agreements, and similarly shocking electoral pronouncements, would all have to pass through an electoral process that may well be as acrimonious and gridlocked as the election itself. However, it is crystal clear that the disaffected are debating the merits of the current economic system.

It could hardly come at a more inopportune moment. The world's protracted sluggishness has created a groundswell of pent-up demand in both the US and the EU. In the US, it is most evident in the housing market, where construction of new dwellings still falls well below basic demographic demand. The longer this persists, the more pent-up demand grows. Couple that with a consumer whose average income is growing smartly thanks to robust job growth, real wage increases and sharply lower gasoline prices, and the spending potential is clearly there. The US business sector has lots of cash, but has been hard-pressed to part with it. However, strip out the resource sector and there is evidence that capacity constraints are leading to a ramp-up of investment activity. And there is potential for a lot more investment activity.

Europe seems too focused on its problems to see its potential. But pent-up demand is also evident there. Construction activity in both the residential and non-residential markets has been excessively weak through the entire post-recession period. The need for new space is rising, and in recent months, building permits have been on the upswing. If this is indeed sustained, there's no question that the aggressive growth will spill into other areas of the economy. Unfortunately, non-residential investment is particularly affected by the kind of uncertainty the Brexit vote engenders, so the nascent rebound is likely to fall victim to the vote's consequent uncertainty.

Pent-up demand is a – probably the – essential ingredient in the economic growth recipe. Trouble is, it remains inactive if you don't know it's there. Our interminable stagnation has created the perception that low growth is a new and permanent feature of the economy, and collectively we have adjusted our behaviour to suit. What's vexing is that we have seen this all before. It's a Great Depression redux: John Maynard Keynes himself agonized years into that stagnation that the economy had long since worked off the excesses of the Roaring 20s, but was failing to reboot itself. Then, as now, it was a "psycho cycle" – when together we believe that what we see is really all we can expect to get, we all adjust our behaviour to a new, low cadence, and effectively psyche ourselves out of growth.

Back then, it birthed a novel solution: the government could borrow money, spend it to reboot the economy, then tax it back when things improved. Prominent economists still see this as today's solution. Unfortunately, our capacity to do that today is seriously depleted. Absent a comparable out-of-box solution, it seems for now we are faced with stagnation, and ever-rising public frustration – which itself is hobbling growth. The outcome? We are moving into a dangerous phase we might well label the Great Hesitation, with developed markets at the forefront of the movement.

The Hesitation is hitting emerging markets. Dependent on OECD markets to drive global commerce, emerging markets have for years being filling growth gaps with aggressive stimulus. It's a modern marvel that thus far, China and India have succeeded. However, for China, multi-year stimulus has not only hit its limits, but it has also come up against the daunting demographic wall caused by the one-child policy. Even so, growth at the 6% level is still pumping out as much incremental GDP as China saw at 18% growth just a few years ago. Also, if China succeeds in shifting to a more consumer-based economy, sustainable growth closer to 8% is still achievable.

Others are having a rougher ride. Hobbled by sanctions, Russia is experiencing a serious decline in its GDP. The commodity price plunge isn't helping, and could hardly have come at a more delicate time. Brazil's internal infrastructure logjam, exacerbated by the corruption scandal plaguing the construction sector, is a key cause of its serious economic tumble. In both cases, decline is largely self-inflicted. But current woes run counter to both countries' true potential. Clear up the main problems – arguably easier for Russia than Brazil – and both countries face impressive economic rebounds.

India is the anomaly; growth there is actually increasing, and has now eclipsed China's rate. With a vast and growing population, near- and longer-term prospects remain very strong.

Global hesitation suggests that commodity prices are not in for an imminent revival. Ample supplies of oil, gas and base metals suggest that we are years away from large price gains. However, with the overreaction to the plunge now behind us, it is safe to say that the worst is over for commodity producers. We expect to see a modest turnaround in most prices in the coming two years in energy and base metals prices.

Moderate conditions will put the brakes on the actions of most central banks over the near term. They have arguably been in hesitation mode for years. In fact, the European Central Bank, the Bank of England and the Bank of Japan will likely continue with their particular versions of quantitative easing through this interim period of uncertainty. In contrast, with demand putting pressure on economic capacity, the Fed is expected to resume tightening in December, and will raise rates more consistently through 2017 and beyond, the surest sign yet that US economic growth is entrenched.

Weak consumer and housing market fundamentals together with price-induced suppression of the resource sector will put paid to near-term interest rate moves by the Bank of Canada this year and next. As such, widening spreads with the US, coupled with weak commodity prices and a steady stream of shelter-seeking capital going to US-dollar assets, add up to a persistently weak Canadian dollar outlook for the near term. Our dollar is forecast to average USD 0.76 this year and USD 0.77 in 2017.

The generally softer currency outlook together with ongoing progress in the US economy will spur Canada's near-term export performance. Bottom-line growth suffered this year as weakness in the energy and mining sectors offset very positive stories in the automotive and consumer goods industries. Growth in 2017 will be fed by a sharp rebound in energy shipments following this year's production shutdowns during the Alberta wildfires. The aerospace industry will see a similar ramp-up toward the end of 2016, which will carry forward into next year. Performance in the automotive, forestry, agri-food and consumer products industries is expected to continue contributing to overall strength. The outlook pegs no growth this year, rising to 3% in 2017. Fallout from the uncertainty created by anti-trade sentiment in the US and the UK poses the biggest threat to Canada's near-term export outlook.

The story could stop here, with the main message being one of caution during a global inflection point. That would be true if the world economy was at the peak of the economic cycle with manifold evidence of pre-recession excesses. But that is definitely not where we find ourselves. Today's Great Hesitation is occurring amid ample evidence of pent-up demand, especially among Canada's key export customers. While others are running for cover, the message for Canadian exporters is that the competition may well be abandoning some of this growth cycle's best opportunities – and that a good, hard second look is absolutely warranted. As risks rise, there will be a need to look to EDC and others for risk mitigation solutions, but for those with an appetite for growth, there are plenty of opportunities.

The bottom line? Public frustration with economic sluggishness has hit the mainstream, and is lashing out at politicians, institutions, large corporations and even globalization itself in a way that poses key risks to near-term international trade. But it's happening at a time where there is a notable groundswell of demand, where opportunities are great. Prudent investigation of the opportunities others are waiving could pay off handsomely. Amid the world's hesitation, it's a great moment of opportunity.

Peter G. Hall

Vice-President and Chief Economist

Table 1: Key Economic Estimates (KEEs)

EXPORT FORECAST OVERVIEW	2013	2014	2015	2016 (f)	2017 (f)
GDP (% y/y)					
Canada	2.2	2.5	1.1	1.3	2.0
United States	1.5	2.4	2.4	1.5	2.4
Euro Area	-0.3	0.9	1.7	1.5	1.2
Japan	1.4	0.0	0.5	0.5	0.8
Developed Markets	**1.2**	**1.9**	**1.9**	**1.5**	**1.8**
Emerging Asia	6.9	6.8	6.6	6.4	6.4
Latin America and the Caribbean	3.0	1.3	0.0	-0.5	1.7
Emerging Europe	4.1	3.4	2.0	1.0	1.9
Africa and Middle East	3.1	3.4	2.6	2.8	3.3
Emerging Markets	**4.9**	**4.6**	**4.0**	**4.0**	**4.6**
World Total	**3.3**	**3.4**	**3.1**	**3.0**	**3.4**
Currencies					
USD/CAD	0.97	0.91	0.78	0.76	0.77
Commodity Prices					
WTI (US$ per barrel)	$98	$93	$49	$42	$45
Lumber (WSPF, US$ per thbf)	$355	$349	$278	$313	$335
Copper (USD/MT, LME)	$7,322	$6,862	$5,494	$4,739	$5,127
Other					
US Housing Starts ('000s)	925	1,003	1,112	1,190	1,350

Sources: Statistics Canada, EDC Economics

Table 2: Canadian Merchandise Export Forecast by Region

EXPORT FORECAST OVERVIEW	CAD bn 2015	% Share of Total 2015	Export Outlook (% growth) 2015	2016 (f)	2017 (f)
Developed Markets					
United States	366.5	76.1	-2.6	0	2
Western Europe	37.2	7.7	-5.2	-2	3
Japan, Oceania and Developed Asia	22.0	4.6	-6.2	-4	2
Emerging Markets					
Latin America and the Caribbean	13.9	2.9	4.2	1	3
Emerging Europe and Central Asia	3.0	0.6	-14.6	2	2
Africa and the Middle East	8.3	1.7	-1.7	-3	4
Emerging Asia	30.8	6.4	10.1	-3	4
Total Goods Exports	**481.7**	**100.0**	**-2.1**	**0**	**3**
Total Emerging Markets	**56.0**	**11.6**	**5.1**	**-2**	**4**
Total Developed Markets	**425.7**	**88.4**	**-3.0**	**0**	**3**

Sources: Statistics Canada, EDC Economics

Canadian exports of goods and services are projected to see zero growth in 2016, followed by a 3% rise in 2017. It is services exports that will provide lift, while goods exports are forecast to remain flat due to significant contractions registered in three sectors: energy, fertilizers, and metals and ores.

While price declines have in most cases chipped away at goods exports in 2016, growing US demand and the weaker Canadian dollar are moderating the decline to some degree. This year, the contraction in energy and fertilizers, for example, will be partially offset by strong growth in motor vehicles and parts 16% and consumer goods 11%.

The 3% recovery in goods exports growth next year will be supported by a 3% gain in sales to developed markets and 4% gain to emerging markets. Energy export growth will rebound strongly in 2017 due to ongoing price recovery coupled with a bounce-back in volumes compared with 2016, when production was negatively affected by the Alberta wildfires.

Aerospace, fertilizers and consumer goods will all post solid growth next year as well, owing to the recovery in US demand. Notwithstanding the US consumer appetite for new cars, motor vehicles and parts are in for a decline in export volumes due to the expected shutdown of some GM model lines in Oshawa. The forestry sector will also see a decline, due in part to the likely imposition of new duties on Canadian softwood lumber and the ongoing global decline in demand for paper.

Table 3: Canadian Merchandise Export Forecast by Sector

EXPORT FORECAST OVERVIEW	CAD bn	% Share of Total Exports	Export Outlook (% growth)		
	2015	2015	2015	2016 (f)	2017 (f)
Agri-Food	61.4	10.6	9	3	3
Energy	98.9	17.0	-30	-15	12
Forestry	34.7	6.0	7	7	-1
Chemical and Plastics	45.1	7.8	8	3	4
Fertilizers	8.8	1.5	29	-28	6
Metals, Ores and Other Industrial Products	73.0	12.5	0	-7	3
Industrial Machinery and Equipment	33.3	5.7	9	0	4
Aircraft and Parts	16.5	2.8	14	6	7
Advanced Technology	16.1	2.8	11	2	1
Motor Vehicles and Parts	78.2	13.4	15	16	-7
Consumer Goods	10.0	1.7	30	11	6
Special Transactions*	5.6	1.0	34	9	3
Total Goods Sector	**481.7**	**82.8**	**-2**	**0**	**3**
Total Services Sector	**100.1**	**17.2**	**5**	**4**	**5**
Total Exports	**581.8**	**100.0**	**-1**	**0**	**3**
Memorandum					
Total Volumes			**5**	**2**	**2**
Total Goods Nominal (excl. Energy)	**382.8**	**65.8**	**9**	**3**	**1**
Total Goods Nominal (excl. Autos and Energy)	**304.5**	**52.3**	**8**	**0**	**3**

Sources: Statistics Canada, EDC Economics, 2015 is actual data while 2016 and 2017 are forecast.

Special transactions* mainly low-valued transactions, value of repairs to equipment and goods returned to country of origin.

PROVINCIAL OVERVIEWS

Canadian merchandise export growth is forecast to remain flat in 2016, with contractions in energy, fertilizer and metals-exporting provinces overshadowing positive momentum from provinces with larger manufacturing sectors. In 2017, the baton will again pass to the energy and metal and ore exporters. Gradually recovering prices for these commodities will nudge Canadian exports to a modest 3% gain.

Exports in almost every one of Canada's energy-rich provinces will shrink in 2016. **Saskatchewan** and **Alberta**'s exports will be hardest hit, losing 15% and 10%, respectively, with Saskatchewan doubly penalized by collapsing fertilizer prices. Low oil prices will also drive export contractions for **Newfoundland and Labrador** and **New Brunswick**. Only **British Columbia**'s more diversified exports will escape the same fate and grow 3%.

The outlook for manufacturing provinces and Atlantic Canada's non-energy exporters is more positive for 2016. **Ontario** will lead with 7% growth driven by rising volumes in auto and other manufacturing. For **Quebec** and **Manitoba**, growth will be a more modest 1%. Both provinces will be held back by low metals prices that mask strong results in manufacturing, chemicals and plastics. **Nova Scotia** and **Prince Edward Island** are benefiting from high lobster prices and will record export growth of 3% and 2%, respectively, in 2016.

In 2017, exports from the energy-rich provinces will recover in tandem with oil prices. Newfoundland and Labrador will lead the charge with a 12% export gain, boosted further by increased mining output. Following closely, Alberta exports will expand 10% due to oil and gas price increases and higher output following last year's wildfires. In Saskatchewan, energy and fertilizers will power a 5% export expansion. New Brunswick and British Columbia, which have sizable forestry sectors, are forecast to lag with export growth reaching only 3% and 2%, respectively, as the US will likely impose softwood lumber duties.

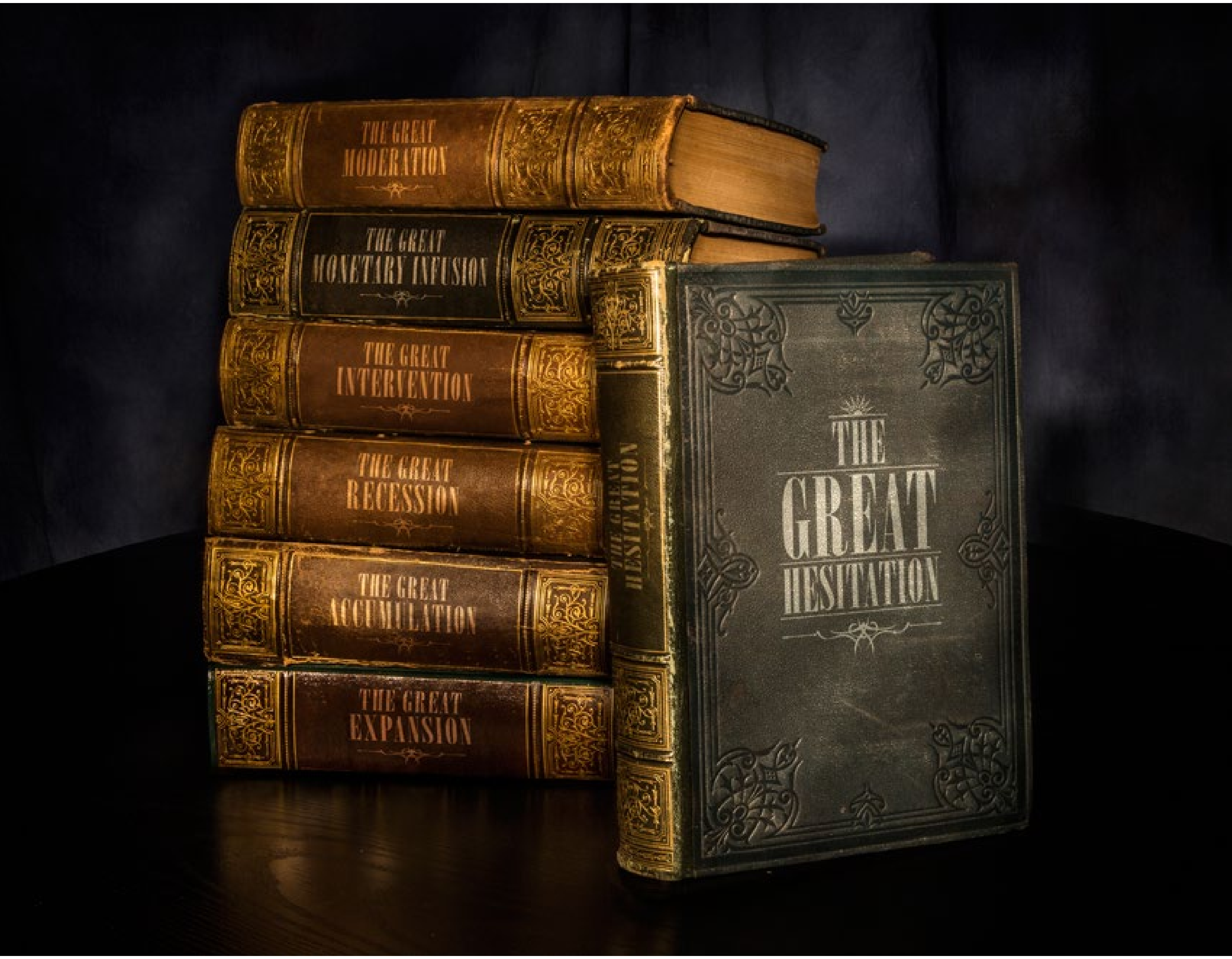
Ontario is set to trail all the other provinces with 0% export growth in 2017; the auto sector lacks capacity to increase exports further. In Quebec, aerospace manufacturing will lift the province to another 3% expansion. Meanwhile, exports from highly diversified Manitoba will increase by 3%, benefiting from increased demand for pharmaceuticals and buses. PEI exports, too, will rise by 6% thanks to pharmaceuticals sales and aerospace. Finally, Nova Scotia exports will remain nearly flat as neither agri-food nor motor vehicles will register growth in 2017.

Table 4: Canadian Merchandise Export Forecast by Province

PROVINCES	CAD bn 2015	% Share of Province's Total Exports 2015	Export Outlook (% growth) 2015	2016 (f)	2017 (f)
Newfoundland and Labrador*	9.1	1.9	-30	-4	12
Prince Edward Island	1.2	0.3	17	2	6
Nova Scotia	5.4	1.1	2	3	1
New Brunswick	12.2	2.5	-6	-8	3
Quebec	80.1	16.6	8	1	3
Ontario	197.0	40.9	11	7	0
Manitoba	13.7	2.8	2	1	3
Saskatchewan	32.6	6.8	-7	-15	5
Alberta	92.4	19.2	-24	-10	10
British Columbia	36.0	7.5	1	3	2
Territories	2.0	0.4	-11	-30	18
Total Goods Exports	**481.7**	**100.0**	**-2**	**0**	**3**

Sources: Statistics Canada, EDC Economics

*Includes EDC estimate for crude oil exports (*not included in national total from Statistics Canada)



For the complete Fall 2016 Global Economic Forecast, visit

www.edc.ca/gef

Canada

EDC

Realize a World of Opportunity