Euler Hermes Economic Research

Country Report

Canada

Canadian Economy to Improve in 2017 after a Resilient 2016

General Information

GDP	USD1,551 bn (World ranking 10, World Bank 2015)
Population	35.9 mn (World ranking 38, World Bank 2015)
Form of state	Federal Parliamentary (Constitutional Monarchy)
Head of government	Justin TRUDEAU (Liberal)
Next elections	2019 federal, legislative

Strengths

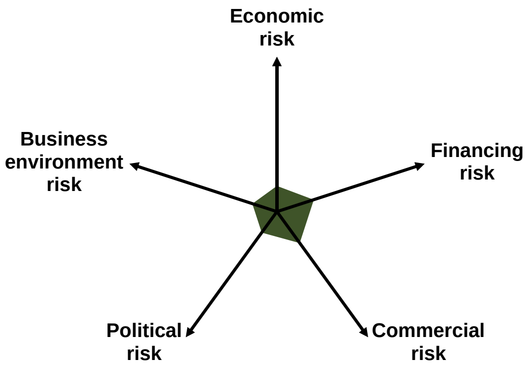
- Politically stable
- High per capita GDP
- Resilient services sector
- Strong banking system
- Accommodative monetary policy
- High data transparency
- Large oil and gas reserves
- Diverse GDP

Weaknesses

- Risk of housing bubble in some regions
- Sensitive to commodity prices
- Dependence on exports
- High exposure to the U.S. economy
- High personal debt
- Government revenues dependent on oil
- Slow wage growth

Country Rating

AA1



Source: Euler Hermes

Trade structure

By destination/origin (% of total)

Exports		Rank		Imports
United States	75%	1	52%	United States
China	4%	2	12%	China
United Kingdom	3%	3	6%	Mexico
Japan	2%	4	4%	Germany
Mexico	1%	5	3%	Japan

By product (% of total)

Exports		Rank		Imports
Crude Oil	13%	1	7%	Cars And Cycles
Cars And Cycles	11%	2	5%	Miscellaneous Hardware
Aeronautics	4%	3	5%	Engines
Paper	4%	4	4%	Vehicles Components
Non Ferrous Metals	4%	5	4%	N.E.S. Products

Source: Chelem (2015)

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Economic Overview

Continued resilience with one major risk

The Canadian economy was resilient in 2016 despite still low oil prices, and the Alberta wildfires which were the costliest natural disaster in Canadian history. The fires caused Q2 GDP to fall -1.2% q/q annualized and drove the full year rate down to only +1.4%, masking the strength the rest of the year which provided numerous upside surprises. The factors which created those upside surprises will also lay a foundation for continued strength in 2017, which we expect to grow +2.1%.

The services sector has been very stable throughout the recovery and will provide a basis for continued growth in 2017. The energy sector, which finished the year growing +5.5% y/y might have hit bottom as the majority of bankruptcies and consolidations may have worked their way through the system. Commodity prices are rebounding, typically a strong sign for Canada. Leading indicators from the Bank of Canada (BoC) Business Outlook Survey and the CFIB Business Barometer point to strength through the year.

On the manufacturing side, leading indicators are also robust with new orders up +6.8% y/y in December and the inventory/sales ratio down at the lowest level in six years. The employment situation is encouraging as job growth is actually accelerating from only +0.4% y/y in July '16 to +1.6% y/y in February '17. At the same time, the unemployment rate is historically low at 6.9% vs a long-term average of 7.7%, while the participation rate remains near average at 65.8%, all of which will promote robust consumer spending which grew +2.2% in 2016. Fiscal policy remains stimulative.

Monetary policy is very accommodative and will remain so through 2017 as the BoC faces stubbornly low inflation. In turn, a loose BoC and a tightening Fed will also keep the CAD weak vs. the USD, making Canadian exports more competitive. Exports will also benefit from a stronger US economy in 2017 which will stimulate demand for Canadian goods. Clearly the outlook for 2017 is brighter, and as a result we expect bankruptcies to continue to creep down, falling -1% through the year.

One major risk

Canadian housing prices grew 13.4% y/y in February vs. a long-term average of only +6.6%, creating the risk of a bubble. Prices in Toronto and Hamilton are now growing at record rates of 23% y/y and 20% y/y respectively. Housing prices in Vancouver were rising at 26% y/y last August as Chinese investors had poured into the market, parking money offshore. Recognizing the danger of an asset bubble, measures were put into place to cool the market. The British Columbia government imposed a 15% tax on foreign purchases in Vancouver in August '16. This did drive prices down – for three months. The federal government made mortgages less accessible nationwide in October '16. These measures also slowed the market, but just for a few months.

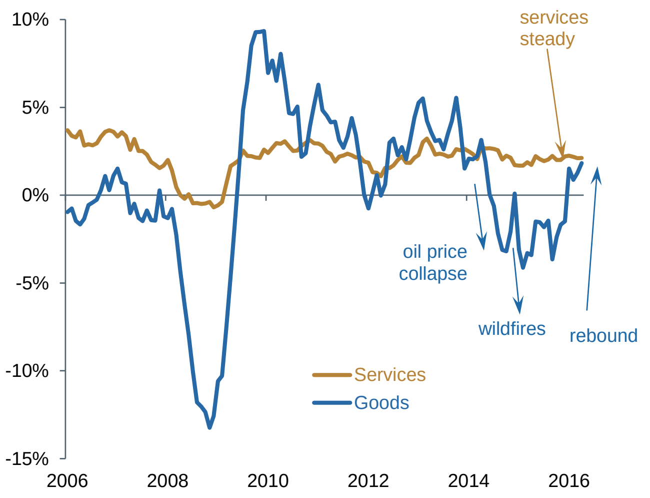
Overly rapid price inflation, combined with record-high personal debt levels are a dangerous combination, and a burst bubble could cause a wave of defaults and a massive loss of wealth. We expect the government to take more measures soon to slow the market, but it will have to delicately balance the goal of slowing the market while avoiding bursting the bubble.

Key economic forecasts

	2015	2016	2017f	2017f
GDP growth (% change)	0.9	1.4	2.1	2.0
Inflation (% end-year)	1.2	1.4	2.3	2.1
Fiscal balance (% of GDP)	-1.3	-2.5	-2.3	-2.0
Public balance (% of GDP)	91.5	92.1	90.5	90.1
Current account (% of GDP)	-3.4	-3.3	-1.6	-1.3
External debt (% of GDP)	1592.1	1716.1	1629.7	1623.6

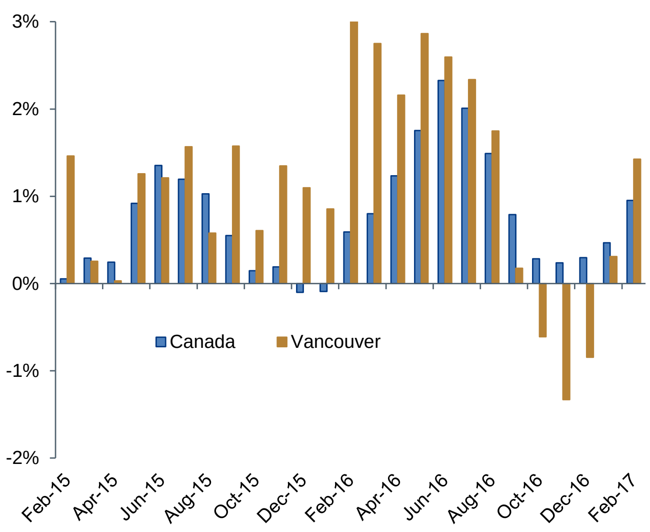
Sources: IHS, national sources, Euler Hermes

GDP by Goods and Services, y/y%



Sources: IHS, CANSIM, Euler Hermes

Housing Prices, m/m%



Sources: Teranet, Euler Hermes

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