Euler Hermes Economic Research

Country Report

Canada

A tale of two Canadas: the two-speed economy

General Information

GDP	USD1,785bn (World ranking 11, World Bank 2014)
Population	35.5mn (World ranking 37, World Bank 2014)
Form of state	Federal Parliamentary (Constitutional Monarchy)
Head of government	Justin TRUDEAU (Liberal)
Next elections	2019 federal, legislative

Strengths

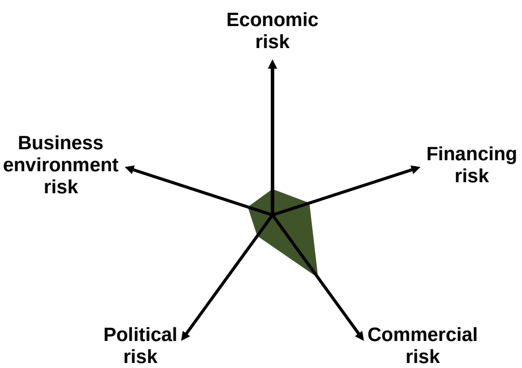
- Politically stable
- High per capita GDP
- Resilient services sector
- Strong banking system
- Conservative monetary policy
- High data transparency
- Large oil and gas reserves
- Diverse GDP

Weaknesses

- Sensitive to commodity prices
- Dependence on exports
- High exposure to the U.S. economy
- High personal debt
- Elevated housing prices
- Government revenues dependent on oil
- Deflationary pressures

Country Rating

AA1



Source: Euler Hermes

Trade structure

By destination/origin (% of total)

Exports		Rank		Imports
United States	74%	1	50%	United States
China	4%	2	11%	China
United Kingdom	4%	3	5%	Mexico
Japan	3%	4	4%	Japan
Mexico	1%	5	4%	Germany

By product (% of total)

Exports		Rank		Imports
Crude Oil	17%	1	7%	Cars And Cycles
Cars And Cycles	11%	2	6%	Crude Oil
Refined Petroleum Products	5%	3	4%	Engines
Non-Monetary Gold	4%	4	4%	Vehicles Components
Non Ferrous Metals	4%	5	4%	Commercial Vehicles

Source: Chelem

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Economic Overview

Two Economies

Falling energy prices have impaired the Canadian economy, putting GDP growth at only 1.2% in 2015 after having grown 2.5% in 2014. However the damage has been isolated to those parts of the economy associated with the energy sector. The rest of the Canadian economy is doing reasonably well and we expect it to continue to do so. In effect there are really two Canadian economies.

Energy will struggle, services to remain resilient

The energy sector has come under severe stress due to the collapse in oil prices, with increased bankruptcies, job losses, and falling housing values. In fact the damage so far has actually been somewhat less than might be expected. For all of 2015, the energy sector shrank -2.8%. Job losses in the three major oil patch provinces of Saskatchewan, Newfoundland & Labrador, and Alberta amounted to -26,500 in the most recent 12 months ending in February 2016. But the energy sector accounts for only about 10% of total GDP, and the three oil patch provinces account for only about 17% of total employment. By contrast the ex-energy sector of the economy is more services oriented and is reasonably robust. Services account for about 70% of the total economy. The three largest provinces by population, Ontario, Quebec, and British Columbia are heavily oriented towards services (with some manufacturing, particularly autos) and grew +159,600 jobs in the last 12 months. Output in the non-energy sector grew +1.6% last year.

Looking into 2016, Euler Hermes believes that both sectors will improve somewhat. The energy sector will enjoy easier comparisons to the sharp contractions in 2014 and 2015 and as a result will shrink only -2.3% in 2016. The non-energy sector will benefit from government stimulus (see below), resulting in 1.9% growth. Overall in 2016 the economy will grow +1.5 % and insolvencies will rise +2%.

Government policies stimulative

The Bank of Canada (BoC) has maintained a highly accommodative monetary policy stance, cutting the overnight rate in January and July of 2015, and it is currently pegged at 0.5%. At the same time the U.S. Federal Reserve has been leaning more towards tightening monetary policy, which sent the value of the Canadian dollar (CAD) down over 15% in 2015, boosting non-energy exports. Although the value of many currencies, including the CAD, has sharply increased against the USD through the first few months of 2016, we do not expect the CAD to appreciate so much that it will significantly hamper exports. But the strengthening CAD combined with a weak economy and slowing inflation will surely keep the BoC from tightening any time soon.

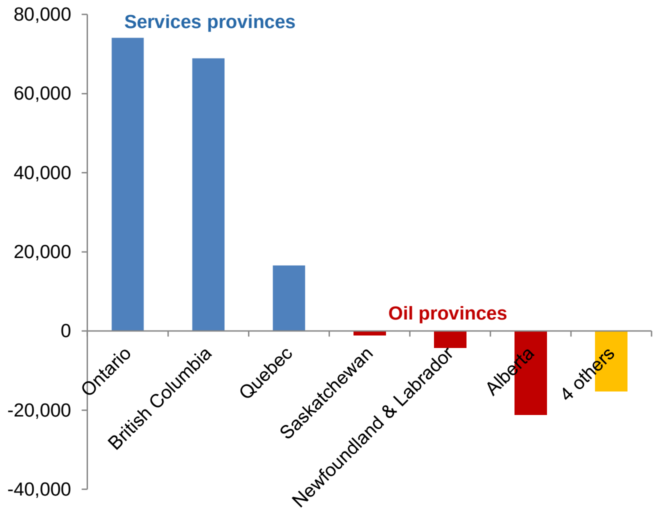
On the fiscal side, the new Liberal Prime Minister Justin Trudeau is proposing a stimulus plan of increased government spending, particularly on infrastructure, in combination with tax reforms. The proposed federal budget would run a deficit of approximately 1.5% for the fiscal year starting in April 2016, and a similar amount in 2017. However Trudeau was left with a very good balance sheet which will enable such spending; Canada's federal debt to GDP ratio is only 31% which is quite low compared to other developed countries.

Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	2.5	1.2	1.5	2.2
Inflation (% end-year)	1.8	1.2	1.6	2.3
Fiscal balance (% of GDP)	-1.8	-1.7	-3.2	-3.2
Public balance (% of GDP)	86.5	87.0	85.0	83.1
Current account (% of GDP)	-2.3	-3.5	-2.9	-1.5
External debt (% of GDP)	73.6	74.0	72.2	70.6

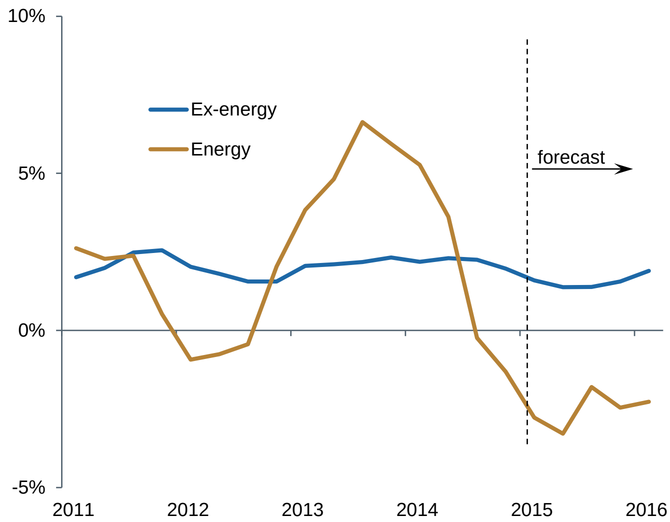
Sources: IHS, national sources, Euler Hermes

Jobs Created in 12 months ending February 2016



Sources: IHS, CANSIM, Euler Hermes

Real GDP growth of Energy and Ex-energy Sectors, full year



Sources: IHS, CANSIM, Euler Hermes

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