

# WEEKLY ECONOMIC BULLETIN

**ATB Financial**<sup>®</sup>

Economist Dan Sumner

October 30, 2009

- **Canadian economy shrinks in August**
- **Alberta wage growth slows down**
- **US housing prices rising from the depths**
- **Fewer Albertans receiving E.I.**

## Canadian GDP Dissapoints

Data released this morning perfectly embodies the saying "when the US sneezes, Canada catches a cold."

Canadian economic output fell by 0.1% in August, a more negative reading than expected by a consensus of economists' who predicted Canadian GDP would be +0.1% in the late summer month.

Today's Canadian GDP report comes on the heels of yesterday's US GDP announcement, where it was reported the US economy expanded at faster rate than expected for the entire third quarter (+3.5%). Although we don't have full third quarter Canadian GDP data yet, with output flat in July and negative in August, it appears increasingly likely that Canadian output will lag behind the US's during the period.

Although monthly GDP is not available at the provincial level, August's numbers did not look good for Wild Rose Country. The main contributor to August's decline was output in Canada's oil and gas sector,

the majority of which is concentrated in Alberta. The report did note that support activity for energy extraction picked up, although its "level remained near half that of a year ago."

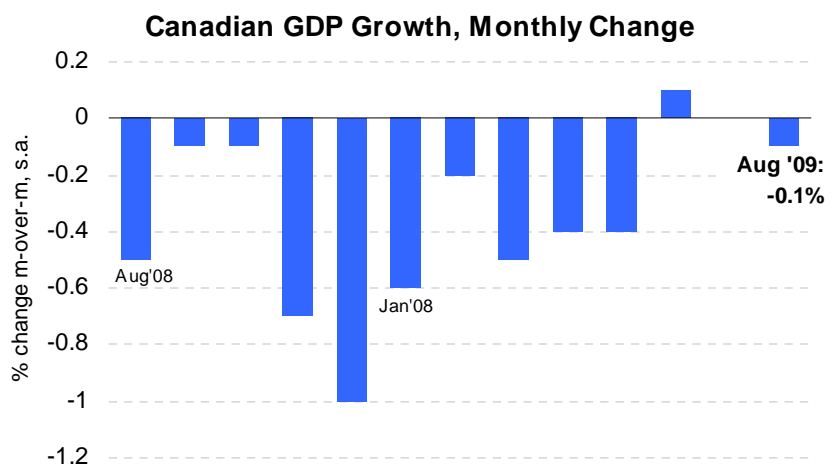
On the more positive side, GDP in Canada's construction industry grew for the first time since October 2008 (+0.2%), possibly buoyed by low interest rates and a strong rebound in the residential real estate sector.

Today's report may have surprised the Bank of Canada, which had predicted Canadian GDP would be +2% in the third quarter. Although that

prediction could still turn out to be correct, it increasingly appears to be overly optimistic and would require a very strong rebound in September activity.

Although the Canadian economy is expected to emerge from recession sometime in the third quarter, today's report indicates that recovery might be pushed back. It also underscores how long lasting the impacts of a US recession can be on the small, open Canadian economy.

*For more on Canadian and US GDP see today's Economically Speaking, page 5.*

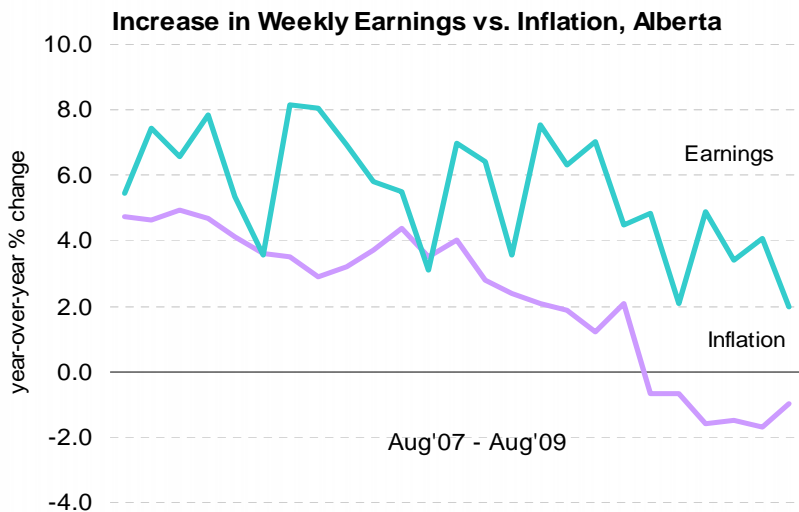


Source: Statistics Canada The Daily, Oct. 30, 2009

## Earnings Growth Finally Cooling in Alberta

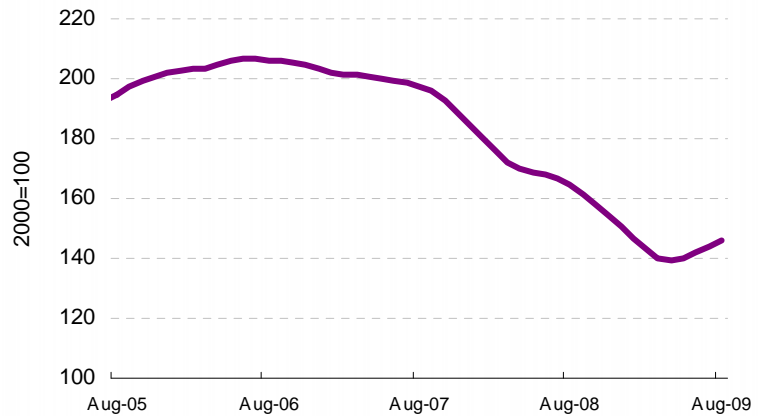
The average weekly wage for workers in Alberta shrunk by 0.2% in August 2009, down to \$941.80. Year-over-year wage growth remained in positive territory at +2.0%, the lowest yearly growth rate for wages since at least the beginning of 2006. Despite the slowdown in nominal wage growth, with inflation running at -1.0%, real wage growth remains quite strong in Alberta.

Nationally, average weekly earnings also advanced 2.0% year-over-year to \$828.14. It was one of the first times in the past few years that Alberta earnings growth failed to rise at a faster rate than the national average. This could signal a trend that the record setting pace of wage increases seen in Alberta during the mid 2000s is set to moderate towards levels more consistent with that in the rest of Canada.



Source: Statistics Canada, The Daily, October 29, 2009

## S&P Case-Shiller US Home Price Index



Source: Standard & Poor's, October 27, 2009

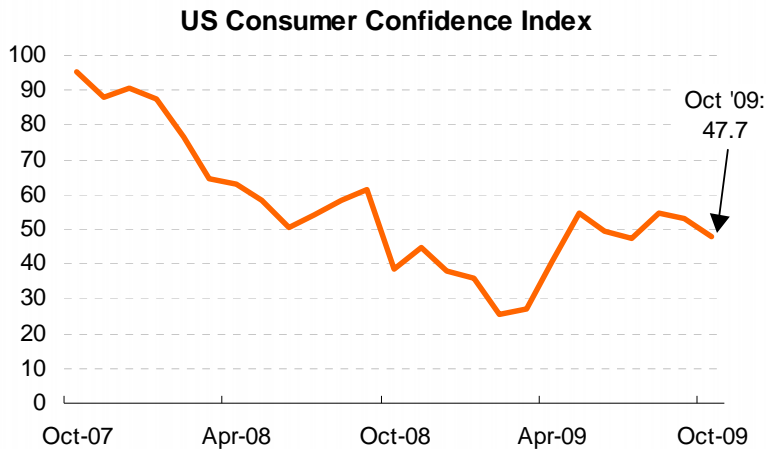
## US Home Prices Rise from the Depths

According to the most recent reading of the S&P Case Shiller, US home prices in the 20 largest US cities have advanced by nearly 5% from their lows made in April 2009, as of August.

The 20 city index reached 146 in August, up from 139 in April but down from a peak of 207 in July 2007 (index scaled so that it equaled 100 in the year 2000). August marked the third consecutive monthly gain for US home prices, which may have been buoyed substantially by recent US Federal Government legislation that provided tax credits for first time homebuyers. Nonetheless, the bottom seems to have come and gone for US home prices, although much like activity in the broader economy, the recovery back to the peak of the summer of 2006 will probably be a slow, arduous ascent.

## US Consumers Keep Optimism in Check

US consumer confidence experienced its first major slip since June in October 2009, according to the most recent reading of confidence by the Conference Board. The index slipped to 47.7 in October, down from 53.1 in July as stock markets slipped from their highs and



Source: The Conference Board, October 27, 2009

conditions in the labour markets failed to improve. Lynn Franco, economist at the Conference Board noted in an online press release "The short-term outlook has also grown more negative, as a greater proportion of consumers anticipate business and labor market conditions will worsen in the months ahead. Consumers also remain quite pessimistic about their future earnings, a sentiment that will likely constrain spending during the holidays."

programs come to an end. And with a 9.8% unemployment rate and governments and consumers that are shackled with debt, the US economy is far from being out of the woods yet.

### Fewer Albertans Claiming E.I.

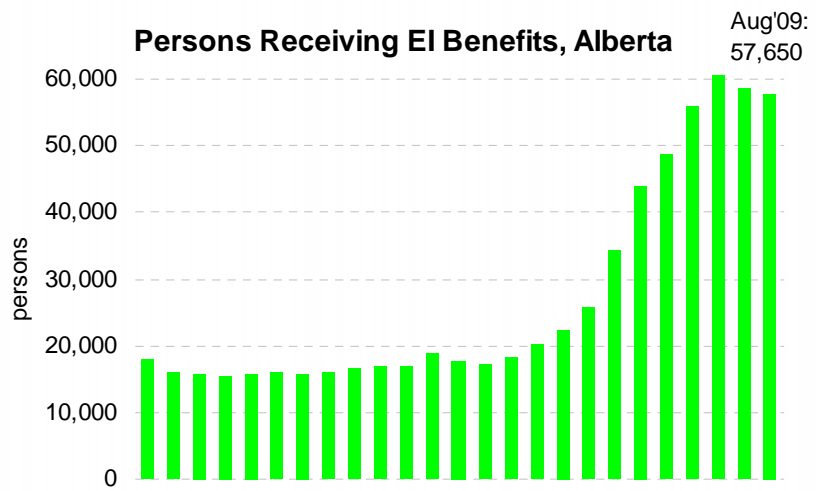
There were 57,650 Albertans receiving E.I. in August, down marginally from July's 58,720 (-1.87%) beneficiaries, but up significantly from August 2008's 18,660 recipients (+228%). Alberta

has still seen by far the largest relative increase in E.I. beneficiaries of any province over the past year, followed by BC (+108%). All figures have been adjusted for seasonality.

The most recent Labour Force Survey showed Alberta's unemployment rate declined by 0.3 percentage points to 7.1% in September. Combined with Tuesday's data, which showed beneficiaries topped out as well, Alberta's labour markets are probably in the very early stages of a recovery. However, the maximum length for E.I. claims in Alberta is just over eleven months, which probably means the fall in claimants has a lot to do with benefits running out, as opposed to people finding jobs.

### US Recession Comes to an End

The US economy grew by 3.5% (annualized) in third quarter of 2009, the fastest pace of quarterly growth since the third quarter 2007. US government stimulus programs such as "cash-for clunkers" and the first time homebuyer credit played a major role in moving the world's largest economy into the black for the July-September period. Looking ahead, the US economy is predicted to continue growing in the fourth quarter, but at a more moderate pace as government stimulus



\* seasonally adjusted  
Source: Statistics Canada, The Daily, October 27, 2009

## TECHNICALLY SPEAKING

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*by Will Van't Veld*

### Fundamentals, Deflation & the Loonie

The Canadian dollar (CAD) has appreciated substantially against the United States Dollar (USD) causing Mark Carney, Governor of the Bank of Canada, to accuse financial markets of having lost their focus, with the Governor reiterating his commitment to keep prices stable. This is not the first time that the value of the loonie has been debated and it raises an old question: how do you determine what the value of a currency should be?

Between 2003 and 2005 Canada's currency appreciated about 25%, from 65 cents to 82 cents, causing researchers at the Bank of Canada to comment on the matter in their '05 Autumn review entitled 'What Drives Movements in Exchange Rates?' The authors reveal that many of the models used by the dismal science to forecast exchange rate movements aren't 100% satisfactory.

The traditional approach to modeling exchange rates is a simple supply and demand model, with the exchange rate being simply the price for one currency in terms of the other. Two important assumptions in this model are purchasing power and interest rate parity. That is to say, the exchange rate should reflect any difference in the relative price of tradable goods and services or investment opportunities. These assumptions don't always hold, particularly in the short run. Models have been developed to try and account for this, but the explanatory power of these models has nonetheless been questionable.

Two economists at the Bank of Canada, Amano and van Norden, developed the model that is used by the central bank. The model (known as AVN) is an error correction specification model and is uniquely Canadian. The long run value of the relative real exchange rate (i.e. inflation adjusted) being determined by the difference between energy versus non-energy commodities and the short run change being determined by the interest rate differential.

According to the authors, the AVN model did a relatively good job at determining exchange rate changes between the countries up until 2003, when it appears to have broken down. It's assumed that it might be related to the fact that recent energy exports have been far higher than in the past; that the American trade imbalance is currently too large to be left out of any model; and that the relative productivity rate in the US has been substantially higher. New models have tried to incorporate these changes, slightly improving results, but the '03-'05 appreciation remains an anomaly.

A relatively new methodology has been developed for forecasting exchange rates that focuses on currency traders. These models don't look at the big picture of global trade imbalances and relative prices, but rather focus on information and cost constraints faced by the people that move markets. The authors state that the exchange rate is tightly related to the order flow of trading activity, with its explanatory power coming from the fact that the traders are reacting to actual or anticipated changes in the economy. On the other hand, if the flow is related to institutions rebalancing based on liquidity needs then the explanatory power is nonexistent.

One thing that is very apparent from the central bank's own literature review on exchange rate models is that the actual value of the currency and the theory of what the value should be rarely coincide.

The fact is the value of the currency almost always under or over shoots what a model would predict its fundamentals would merit, so why is Mr. Carney so vocal about actively intervening in the market this time? It's because even if, which is a big IF, we admit that fundamentals mean a secular decline in the USD is justifiable, the concurrent drop in export led demand and lower import prices would exasperate the deflationary problem that already exists due to the recession.

Essentially, Mr. Carney's mandate isn't to make sure the exchange rate follows its fundamentals, as its the market that is supposed to figure this out on its own; his mandate is to ensure price stability. Will the market heed his words of warning or force his hand?

# ECONOMICALLY SPEAKING...

ATB Financial Economist Dan Sumner

## Who Really Cares About GDP Growth Anyway?

October 30, 2009

Economists around the world have been in consensus (which is very rare for economists) that the US is largely to blame for the Great Recession of 2008/'09. The problems were all rooted in the US housing market, which then spread to the highly integrated world financial markets, sending economies from Germany to Japan into a tailspin.

So if the US is, in fact, in the most trouble and if they are at the root of the problem, then why is their economy growing by 3.5% in the third quarter and the Canadian economy contracting by 0.1% in August? According to the IMF, the US economy will contract by 2.7% in 2009 compared to 5.4% for Japan and 5.3% for Germany. Heck, even Canadian gross domestic product is forecast to fall by 2.5%, despite the fact that experts have been telling us how much better shape the Canadian economy was in compared to our irresponsible neighbors to the south. How does this make sense?

The key is that a country's GDP, or economic growth, does not tell the entire story of a country's economic health. Joe the plumber and Suzy the Dentist don't care whether Canada's economy grows by 1% or 3%. What matters to them are things like: Do I have a job that pays the bills? How much is my house worth? Are my RRSPs and pension plans maintaining and (hopefully) growing in value?

When you look at many of these metrics, it becomes abundantly clear that the US is in way bigger trouble than most of the world, including Canada. GDP on the other hand, which measures the total amount of stuff an economy produces, has not been hit disproportionately hard in the US, but labour markets, housing prices and wealth levels have taken it on the chin.



US consumers' balance sheets have taken a massive hit that is probably difficult for many Canadians to fathom. For many Americans, their largest asset is their home, and according to the most recent S&P/Case Shiller index, if you live in a large American city your home is worth 31% less than it was in 2006. Similarly, if you have your savings invested in a 401k (the US equivalent to an RRSP), it has been walloped as well. Further, since a typical American has most of their assets denominated in US dollars, the falling value of the greenback also takes a bite out of their wealth. For example, in Euro dollar terms, US housing prices are down much more than 31% since 2006. And all this in addition to an unemployment rate of 9.8% and a shaky outlook for wage growth.

Canadians, on the other hand, have seen their balance sheets escape relatively unscathed by the Great Recession. Yes, stock markets and pension plans have been hit in the Great White North as well but housing prices are almost back to where they were at the peak in 2007; and this is in the context of maintaining the huge gains that occurred during much of the 2000's.

So all things considered, why do economists talk so much about GDP? Well in fact, it's probably still the best long-term measure of a country's prosperity and wealth. Yes, in 2009 the US economy is forecast to contract

by around the same amount as Canada, but the impacts of the current state of US wealth will have implications on future US GDP growth. As Americans have to curb their spending and start saving money out of their pay-cheques for retirement and the big-ticket items, that money won't be there to immediately prop up economic growth. In the heydays of the 2000s, Americans barely needed to save to see their nest-eggs grow because with rising stock markets and housing prices, everyone accumulated wealth just by owning assets.

But for the same reason American GDP will be weighed down, dragging out the US economic recovery, the Canadian economy will be set to recover more quickly. Canadians won't need to cut their spending to make up for their lost savings to the same degree and this will put Canada a step ahead over the next few years as the US economy enters an extended period of recovery.

### **Shackled with debt, US economic growth could resemble:**



## Financial Data

Interest Rates	30-Oct-09	23-Oct-09	Equity Markets	30-Oct-09	23-Oct-09	
<i>Note: Data is as of 10 a.m. MST</i>			S&P TSX Composite	11,011.63	11,551.38	
Call Loan	0.20	0.20	Dow Jones Industrial Average	9,887.08	10,092.04	
CAD Prime Rate	2.25	2.25	NASDAQ	2,086.91	2,188.49	
Fed Funds (effective)	0.100	0.100	<b>Commodity Prices</b>	<b>30-Oct-09</b>	<b>23-Oct-09</b>	
USD Prime Rate (base rate)	3.75	3.75	NYMEX MMBTU(USD)	5.139	5.031	
1 month schedule I Bank B.A. (bid)	0.35	0.34	Crude Oil (WTI in USD)	79.20	81.40	
3 month schedule I Bank B.A. (bid)	0.36	0.36	Gold (London A.M. in USD)	1042.90	1066.20	
1 year CAD T-Bill (bid)	0.60	0.61	<b>Prices \$/tonne*</b>	<b>29-Oct-09</b>	<b>22-Oct-09</b>	<b>1 year ago</b>
2 year CAD Bond (bid)	1.429	1.528	<i>*Average elevator bids, Edmonton, unless otherwise noted</i>			
5 year CAD Bond (bid)	2.715	2.773	Canola (crusher FOB)	368.23	383.74	403.8
2 year CAD Swap	1.4220	1.4650	Feed Barley	130.82	130.91	148.7
5 year CAD Swap	2.7880	2.8370	Oats (Red Deer)	108.35	112.62	155.2
Implied 2 year CAD Swap in 1 Year	2.7158	2.8220	Feed Wheat	138	137.3	97.2
Implied 5 year CAD Swap in 1 Year	3.4876	3.5345	<b>Alberta direct cattle sales \$/cwt</b>			
<b>Exchange Rates</b>	<b>30-Oct-09</b>	<b>23-Oct-09</b>	Steers	81.97-84.40	82	95.75-97.50
Canada/U.S.	1.0804	1.0496	Heifers	81.50-85.00	80.6	95.75-97.5
Canada/Euro	1.5951	1.5772	<b>Western Hog Exchange (WHE) base cash price</b>			
Canada/GBP	1.7819	1.7194	Index 100 hogs (\$/kg)	1.013	1.026	1.313
Yen/Canada	84.33	87.50				

*Data as of Thursday, Oct. 29, 2009*

Compass Portfolio Fund Name	1 week % change	30 day % change	YTD % change	Incep (as of Sept. 30)	Compass Portfolio Fund Name	Current yield %
Compass Balanced Growth Portfolio	-1.08	-0.68	16.02	4.77 (12/02)	ATB Money Market Series A	0.13
Compass Balanced Portfolio	-0.69	-0.39	14.78	4.89 (12/02)	ATB Money Market Series I	0.24
Compass Conservative Balanced Portfolio	-0.41	-0.24	14.77	5.08 (12/02)		
Compass Conservative Portfolio	-0.30	-0.18	11.97	4.17 (12/02)		
Compass Growth Portfolio	-1.46	-0.97	16.06	4.25 (12/02)		
Compass Maximum Growth Portfolio	-1.46	-0.87	17.20	3.50 (12/02)		

## Economic Data

Average Weekly Earnings	Jul-08	Jun-08	Jul-09	July '09 to July '09	Jun. '08 - Jun. '09
Seasonally Adj.	Dollars			% change	
Newfoundland and Labrador	759.86	795.85	805.49	1.2	6
Prince Edward Island	671.33	690.46	699.36	1.3	4.2
Nova Scotia	720.47	728.05	733.51	0.7	1.8
New Brunswick	739.51	738.96	754.12	2.1	2
Quebec	769.54	767.12	775.11	1	0.7
Ontario	836.07	841.43	845.17	0.4	1.1
Manitoba	748.04	767.71	780.26	1.6	4.3
Saskatchewan	785.22	801.16	803.9	0.3	2.4
Alberta	906.46	954.57	942.62	-1.3	4
British Columbia	784.2	794.47	799.36	0.6	1.9

*More Data is available in Statistics Canada, The Daily, Sept 30, 2009*

Industrial Product Price Index and Raw Material Price Index (1997 = 100)	Jul-09	Aug-09	Aug '08 - Aug '09	July '09 - July '09
<b>Industrial Product Price Index (IPPI)</b>	115.7	116.3	-6.7	0.5
products	110.6	110.5	-2.4	-0.1
Intermediate Goods	118.4	119.6	-9.5	1.0
First-Stage Intermediate Goods	124.3	130.4	-16.2	4.9
Second-Stage Intermediate Goods	117.5	118.0	-8.2	0.4
Finished Goods	111.7	111.2	-1.9	-0.4
Capital Equipment	102.7	101.4	2.3	-1.3
All Other Finished Goods	113.2	113.0	-5.2	-0.2
<b>Raw Materials Price Index (RMPI)</b>	153.4	159.1	-26.1	3.7
RMPI excluding mineral fuels	116.3	117.2	-8.7	0.8

*More data available from Statistics Canada, The Daily, Sept 30, 2008*

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