



cutting through complexity

2014 Federal Budget Breakfast

February 12, 2014

kpmg.ca/budget2014



Economic Outlook

Economic Outlook, Jock Finlayson



Jock Finlayson
Executive Vice President
and Chief Policy Officer
Business Council of British Columbia

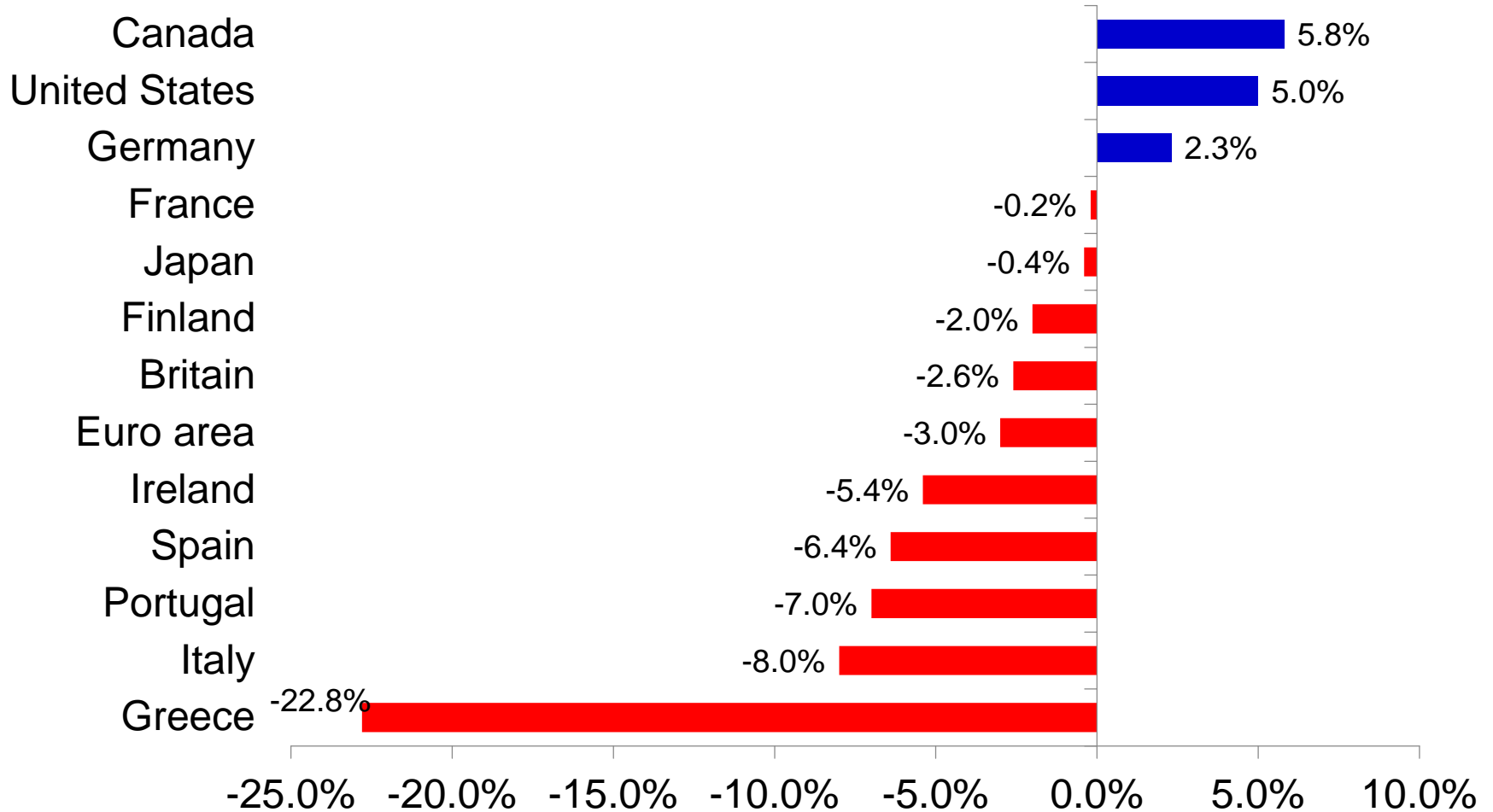
Some Improvement in the Overall Global Economic Picture

- Underlying pace of economic growth in the US is **accelerating**
- Eurozone has finally **emerged from recession** – although growth remains anemic across much of Europe
- Japan is seeing **positive GDP growth** and seems to be emerging from a long period of deflation
- UK economy has also been **gaining strength**

However...

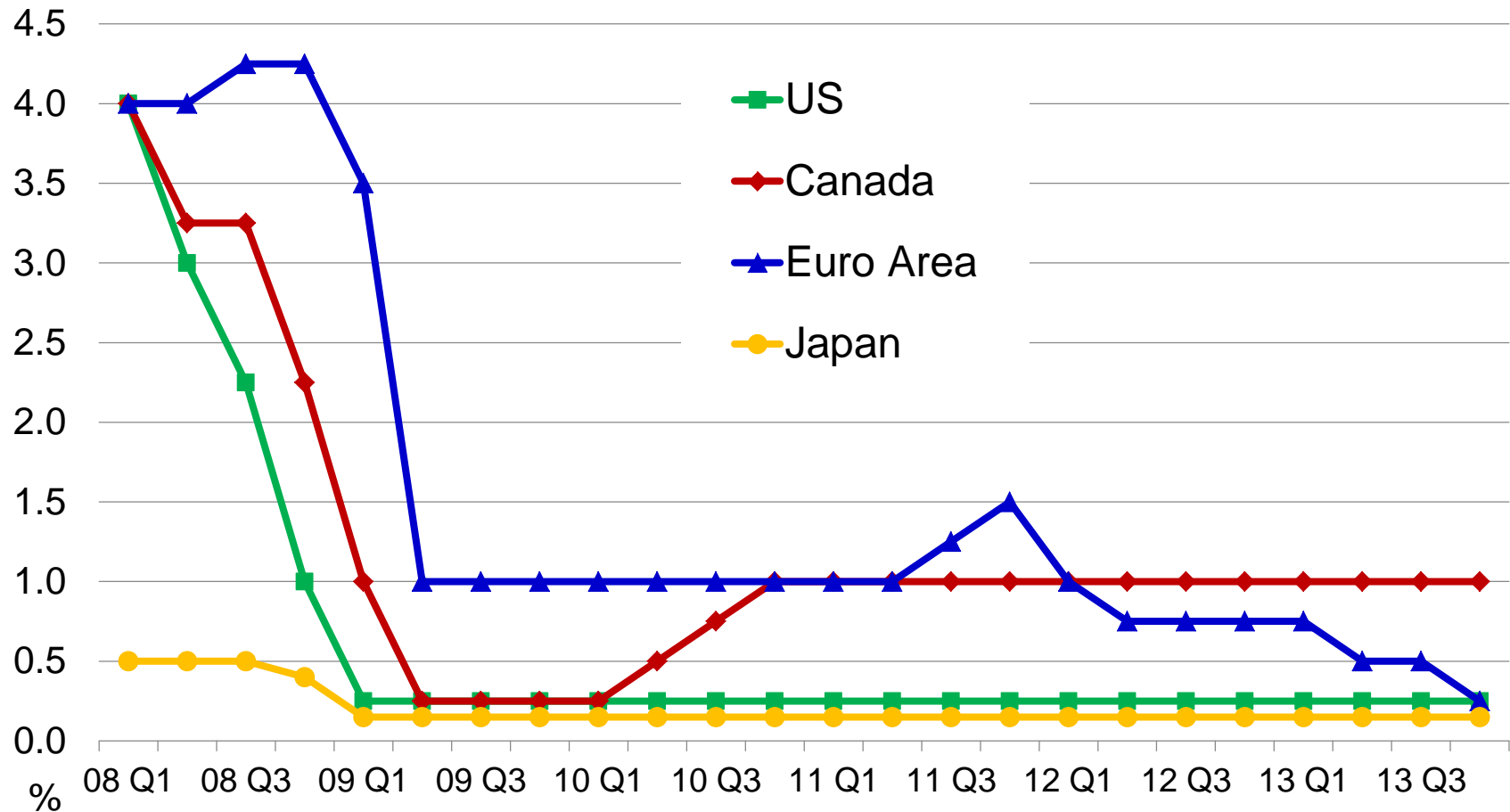
- Economic activity has **slowed** across the emerging markets
- Inflation is running **below** the levels targeted by central banks in most advanced economies – Canada included
- Commodity prices have **weakened** significantly since late 2011

Change in Real GDP from the Pre-Recession Peak (2007 or 2008) to Q3 2013



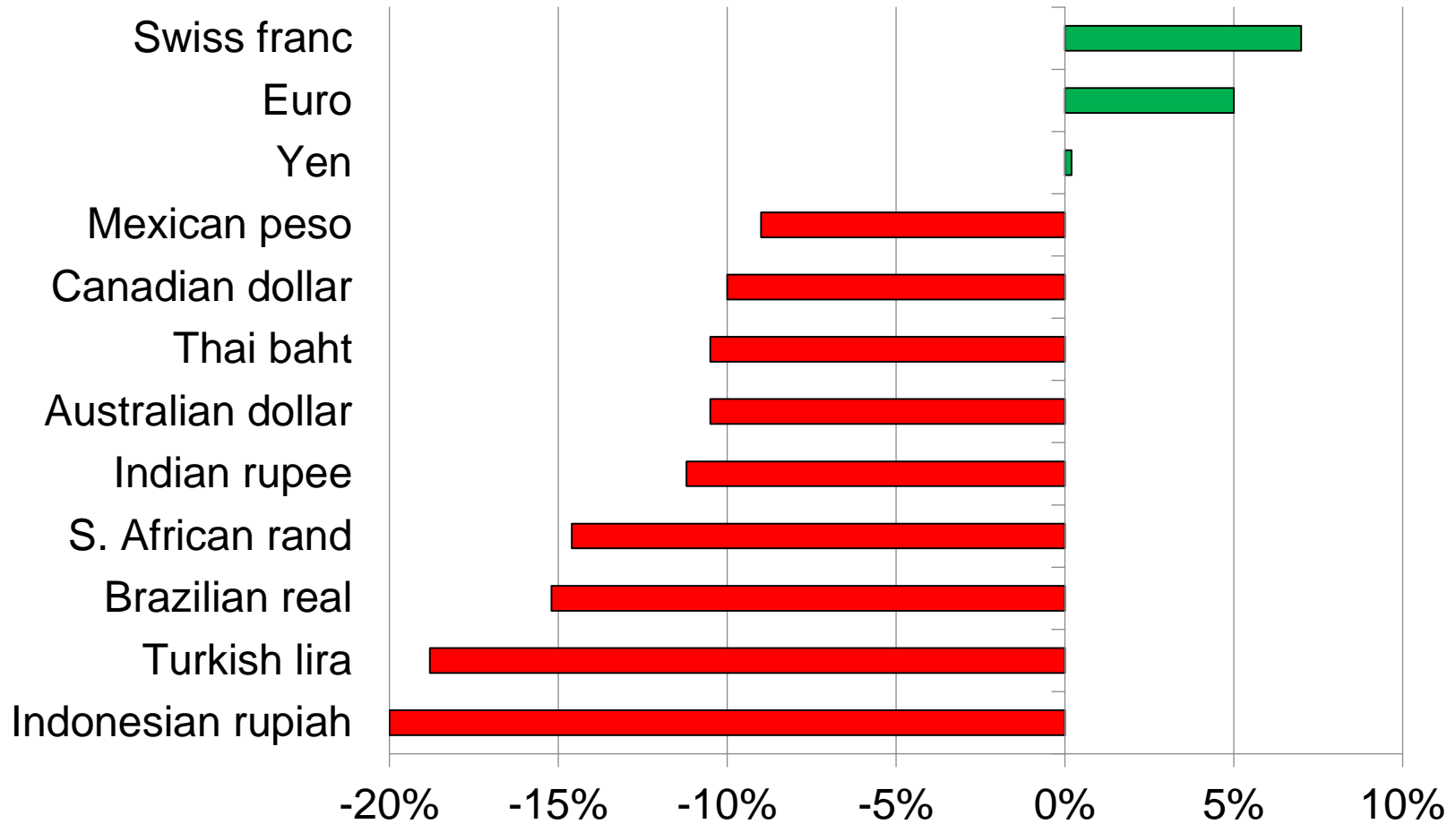
Source: IMF; Eurostat.

Rock Bottom Central Bank Policy Interest Rates



Source: Bank of Canada.

Currency Shifts Against US Dollar Since May 2013 (through February 4, 2014)



Source: Bloomberg.

Global Economic Forecast (per cent change in real GDP)

| | 2012 | 2013 | 2014f | 2015f |
|--------------|------------|------------|------------|------------|
| US | 1.7 | 1.9 | 3.0 | 3.0 |
| Eurozone | 1.8 | -0.5 | 0.9 | 1.3 |
| UK | 0.2 | 1.9 | 2.5 | 1.8 |
| Japan | -0.7 | 1.8 | 1.8 | 1.2 |
| China | 9.3 | 7.7 | 7.3 | 7.0 |
| <i>World</i> | 3.7 | 2.9 | 3.5 | 3.6 |

.f=forecast

Source: IMF for history; Scotiabank Economics

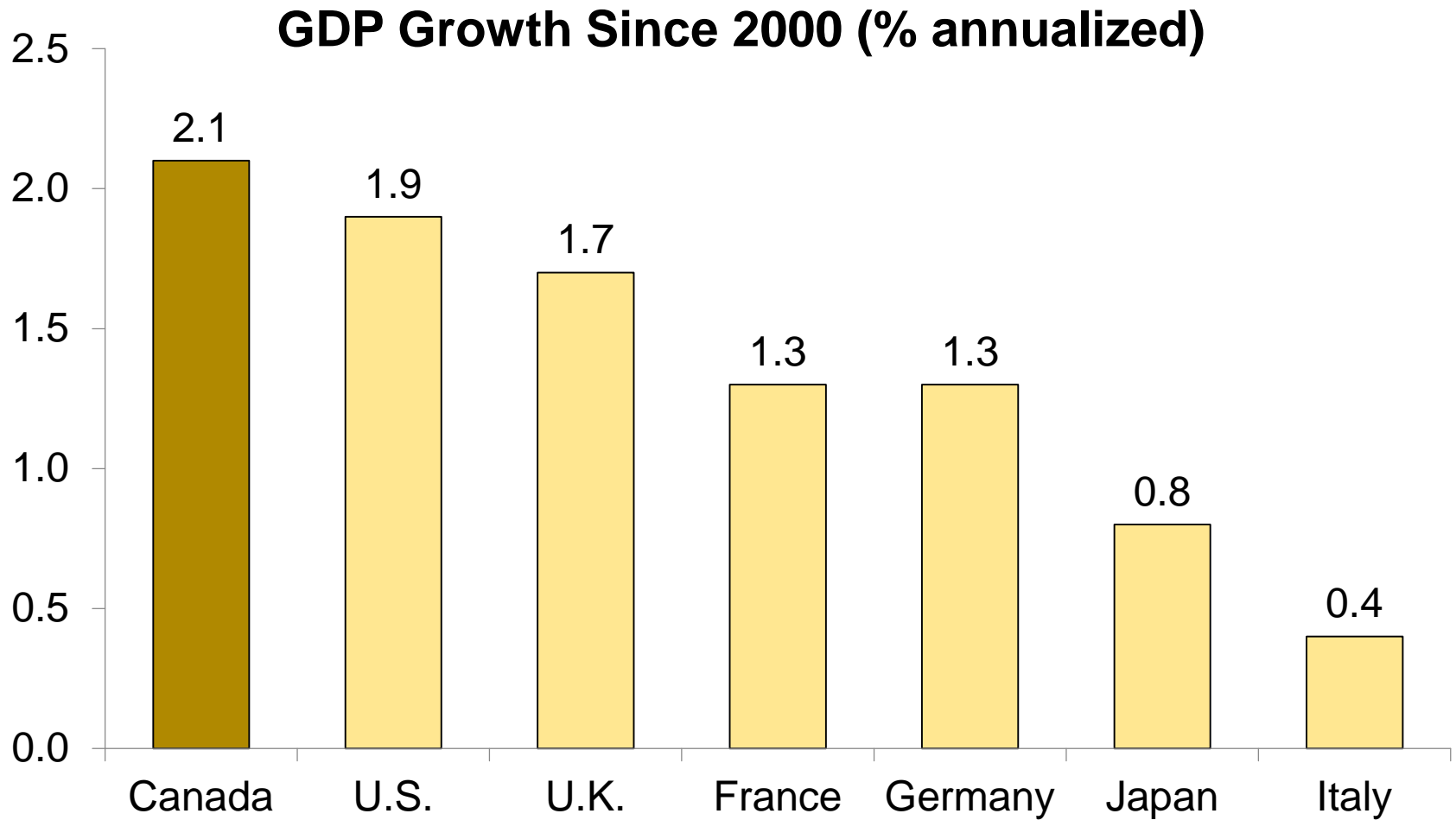
US Expansion is Gaining Traction

- Q4 2013 real GDP growth reached 3.2% (annualized); Q3 growth was 4.1% (annualized)
 - decent job gains (>2 million last year)
 - significant household balance sheet repair; Americans' net worth now at an all time high
 - large US corporations in excellent financial shape
 - housing starts project to exceed 1 million in 2014
 - government 'fiscal drag' is diminishing
- US Federal Reserve is now reducing QE ('tapering')...but its key policy interest rate is expected to remain unchanged in 2014

A Young Ben Bernanke... Practicing for his Future Role as Fed Chairman



Canada Led the G7 in Economic Growth in Past Decade



Source: RBC Global Asset Management.

But...Canada is Now Poised to Trail the US

- Despite rebounding quickly from the 2008-09 global downturn, Canada's economy has lost momentum, in part due to weaker global commodity markets
- Canada is likely to lag the US on many economic performance metrics – GDP, employment, retail sales, trade, business investment, and housing market activity – over 2014-16
- US is better positioned in three important respects:
 - Household finances and the outlook for consumer spending
 - Housing markets and prospects for residential investment
 - Exports and the trend in overall industrial competitiveness
- Canada will still benefit from stronger US growth and improving American economic fundamentals

Snapshot of North American Household Finances (Q2, 2013)

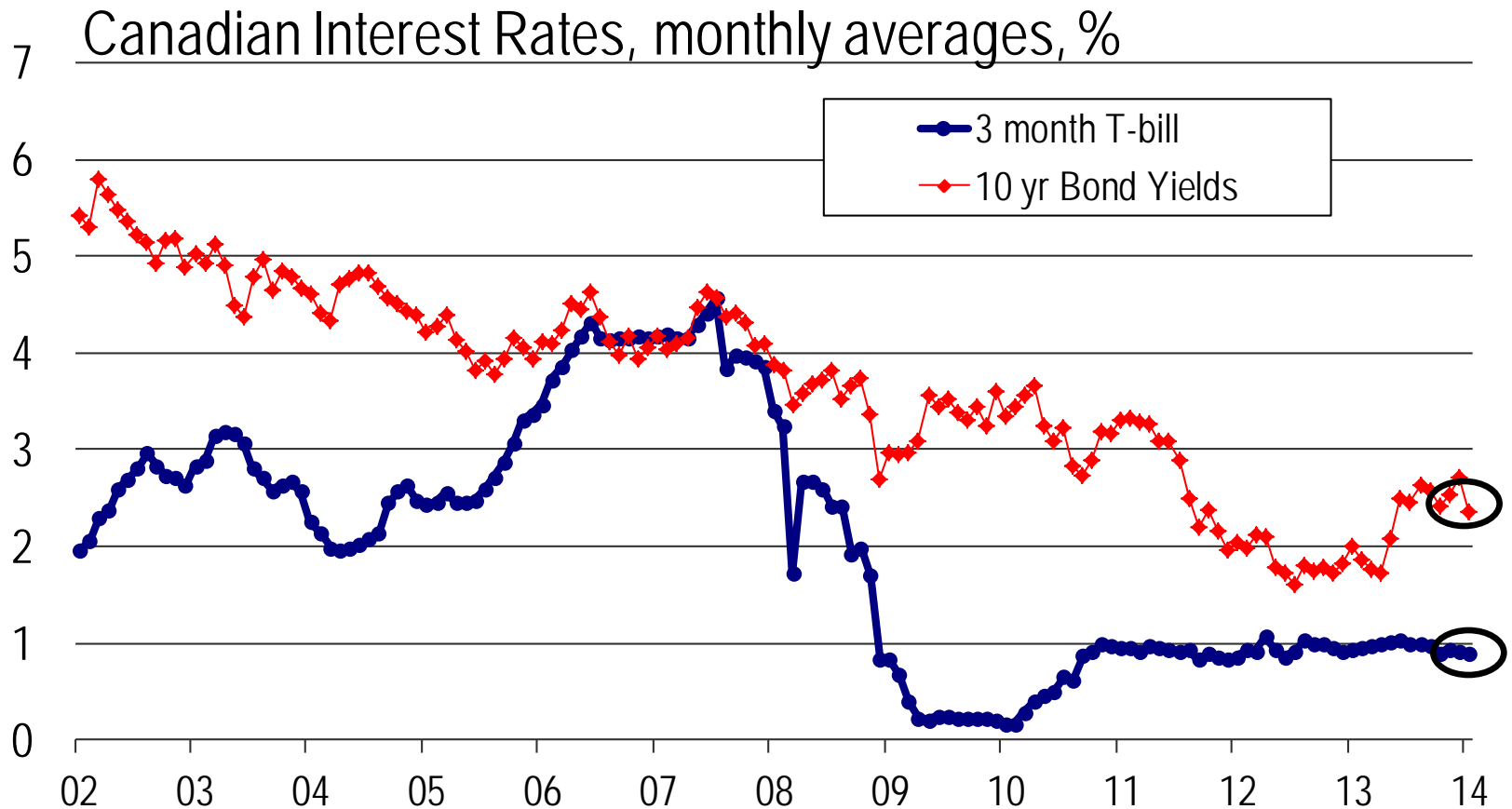
| | Canada | USA |
|--|-------------|-------------|
| Credit market debt as % of disposable income | 152% | 137% |
| Net worth as % of disposable income | 650% | 685% |
| Savings as % of disposable income | 5.4% | 5.0% |
| Mortgages 90+ days delinquent (% of all mortgages) | 0% | 2.6% |
| Credit card 90+ days delinquent (% of total balances outstanding) | 1% | 9% |

Source: RBC Economics.

Canada's Economic Growth Dynamic: Time to Shift Gears

- Consumer spending has been running ***above its long-term average*** as a proportion of GDP
- Household debt/disposable income ratio at a ***record high*** (although credit growth has slowed)
- Residential investment as % of GDP also ***above the long-term average*** (almost 6.8%, versus 5.8%)
- Ratios of housing prices to i) incomes and ii) rents are ***near all time highs***
- So...future economic growth will have to ***rely more on net exports and business investment*** – and less on consumer- and housing-related spending

Interest Rates Stay Low

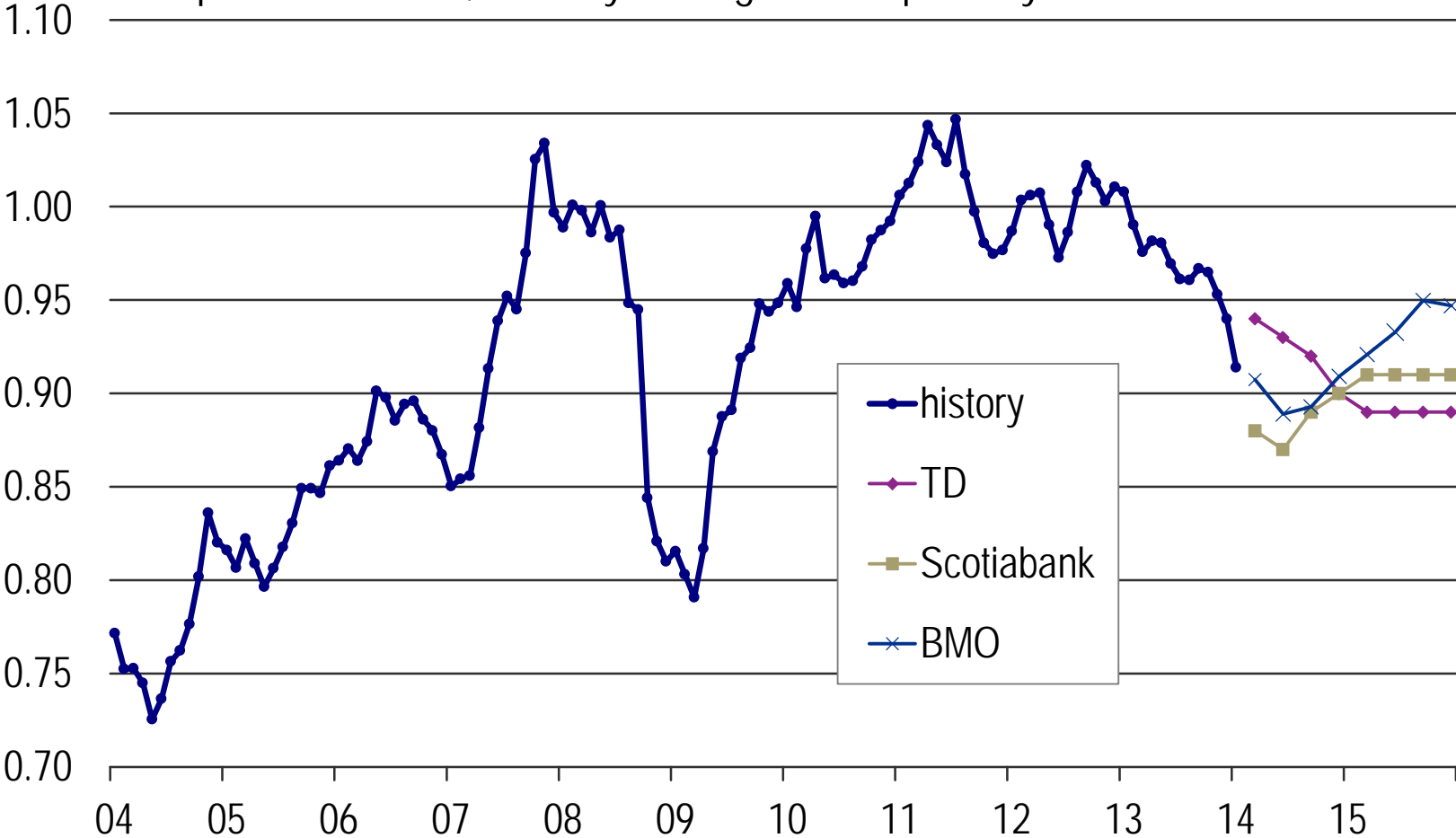


Latest: January 2014.

Source: Bank of Canada.

The Sinking Loonie

US \$ per Canadian \$, monthly averages with quarterly forecasts



Latest: January 2014.

Source: Bank of Canada, noon rate.

Federal Budget 2014: Key Themes

- Stay tuned and wait for ***next year's budget*** – it will have more content
- Confirms the government's #1 priority: eliminating the deficit and providing room to fund new initiatives in 2015
- Fiscal restraint is focused on direct Ministry spending (two year freeze on departmental budgets), payroll costs, and defence procurement
- Taxation tweaks, nothing significant in overall economic terms
- Matching employers with qualified workers remains an area of concern for federal policymakers
- Various steps to enhance market competition and benefit Canadian consumers

The Budget's Economic Assumptions for Canada

| | 2013 | 2014 | 2015 |
|---|-------------|-------------|-------------|
| Real GDP Growth | 1.7% | 2.3 | 2.5% |
| Nominal GDP Growth | 3.2% | 3.9% | 4.5% |
| CPI Inflation rate | 1.0% | 1.5% | 1.9% |
| Unemployment rate | 7.1% | 6.8% | 6.6% |
| 3-month T-bill rate | 1.0% | 1.0% | 1.5% |
| 10-yr gov't bond rate | 2.3% | 3.0% | 3.5% |
| Exchange rate (US cents/C\$) | 96.8 | 93.7 | 95.3 |

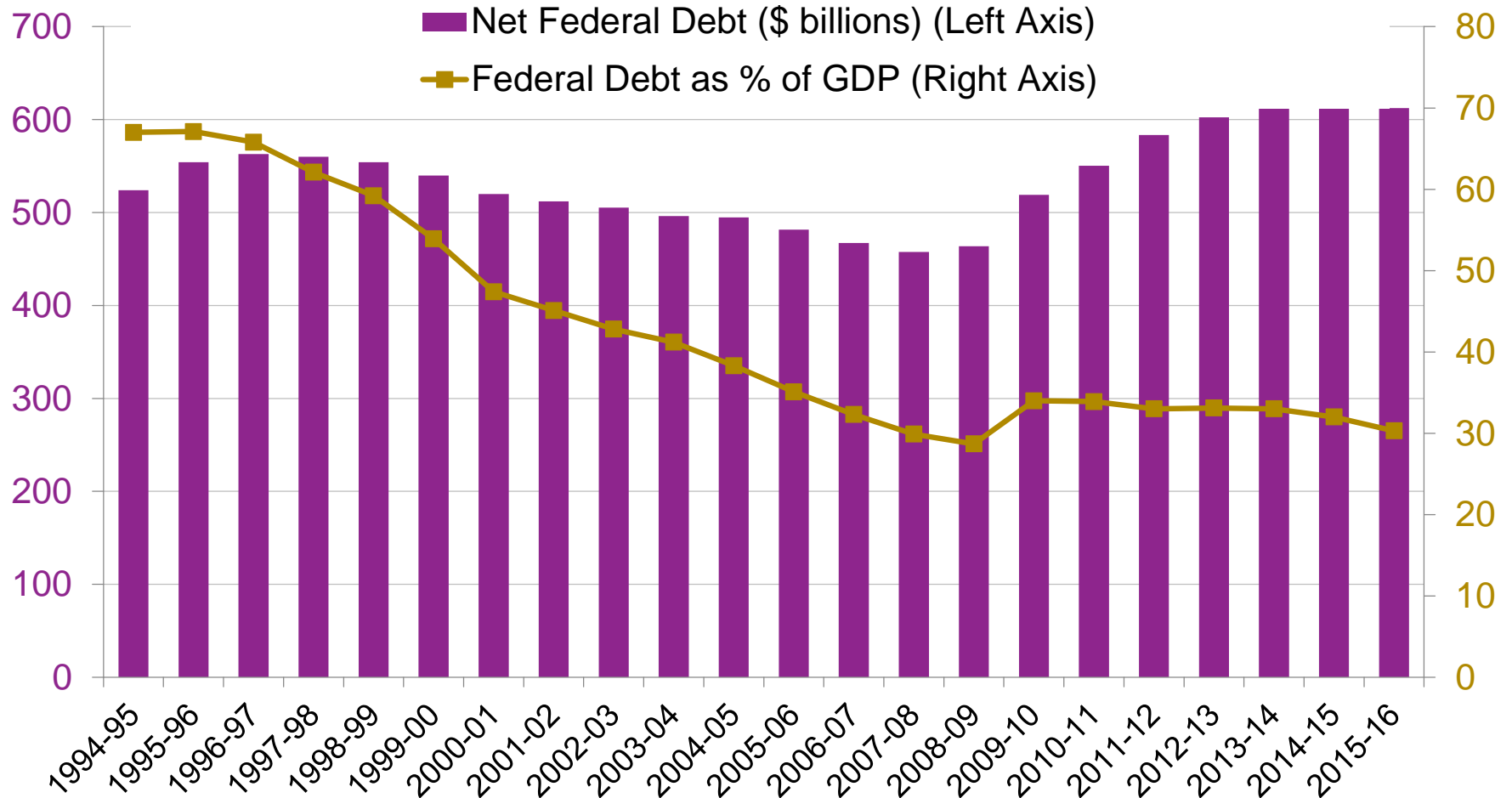
Source: Federal Budget 2014.

Updated Federal Fiscal Plan (C\$ billions)

| | 2012/13 | 2013/14 | 2014/15 | 2015/16 |
|--------------------------|---------------|---------------|--------------|--------------|
| Revenues | 256.6 | 264.0 | 276.3 | 293.3 |
| Expenditures | 275.6 | 280.5 | 286.2 | 279.2 |
| Program Spending | 246.4 | 251.2 | 250.2 | 256.9 |
| Public Debt Charges | 29.2 | 29.3 | 29.0 | 30.0 |
| | | | | |
| Budgetary Balance | - 18.9 | - 16.6 | - 2.9 | + 6.4 |
| Net Federal Debt | 602.4 | 616.0 | 618.9 | 612.4 |

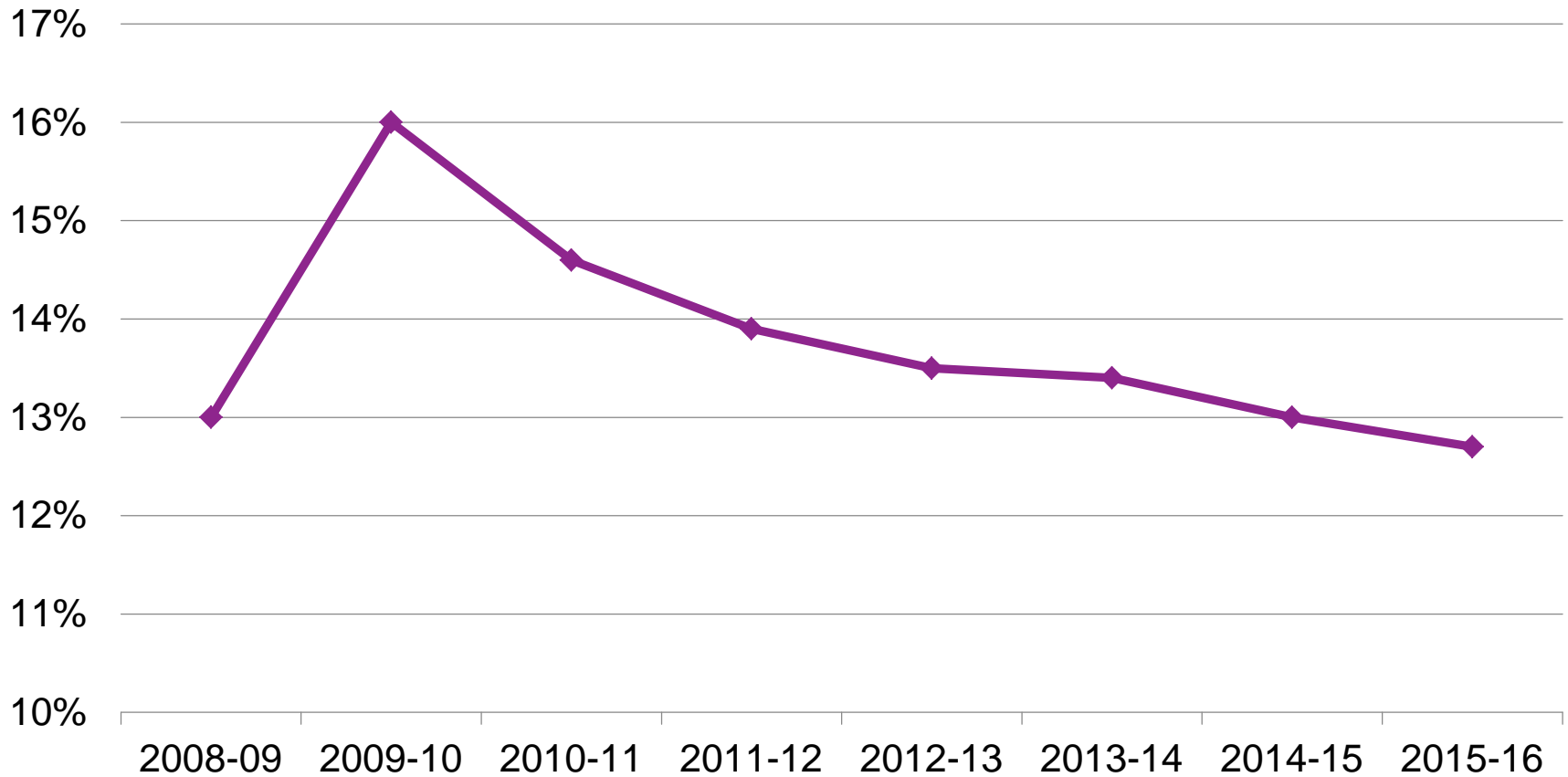
Source: Federal Budget 2014

Federal Debt Burden Easing



Source: Department of Finance.

Federal Program Spending Falls as Share of GDP



Source: Federal Budget 2014.

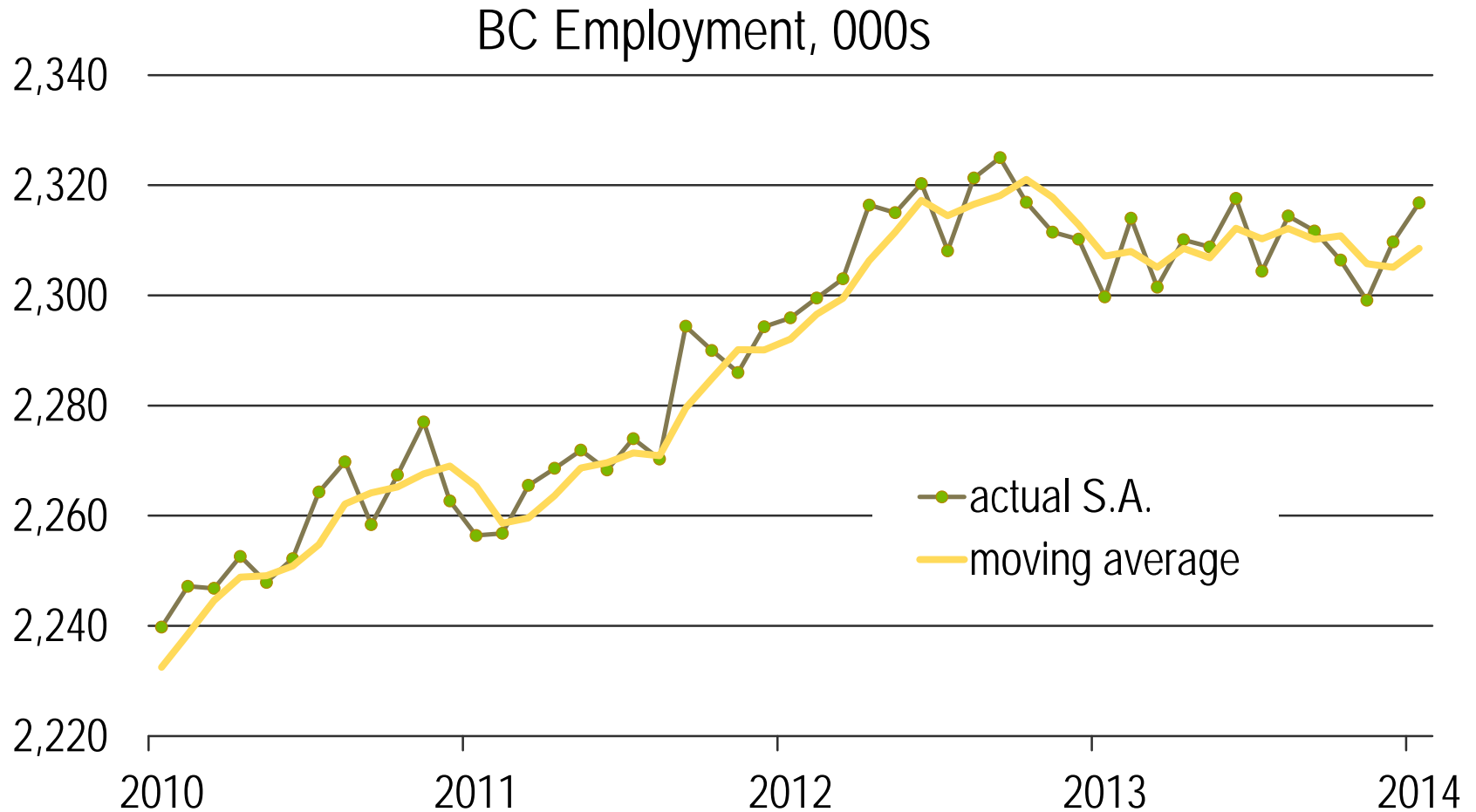
Budget 2014: Some Positive Measures

- An additional \$1.5 billion (over ten years) for university research in fields “that create long-term competitive advantage for Canada”
- Public infrastructure investment (very little seems aimed at BC)
- Reform First Nations K-12 education; more federal resources for this area
- Support for the automobile industry (\$500 million over two years)
- Increased funding for apprenticeship training and internships
- Canada Accelerator and Incubator Program (\$40 million) for high tech sector
- Canada Job Grant – Ottawa is preparing to implement without the provinces. How will it work in practice? What are the criteria?

BC Economic Setting

- 2013: a disappointing year – weak output growth; **zero** job growth
- Domestic demand hindered by stretched consumer finances, soft retail sales, lower business investment, government fiscal drag
- Conditions should improve over 2014-2015, with stronger global and US growth, rising exports, and some gains in tourism
- Construction investment (non-residential) is expected to provide a major economic boost for the province over the medium-term
- LNG – the opportunity is big, but mainly relevant post-2015
- Federal budget has *no material impact on our BC economic forecast*

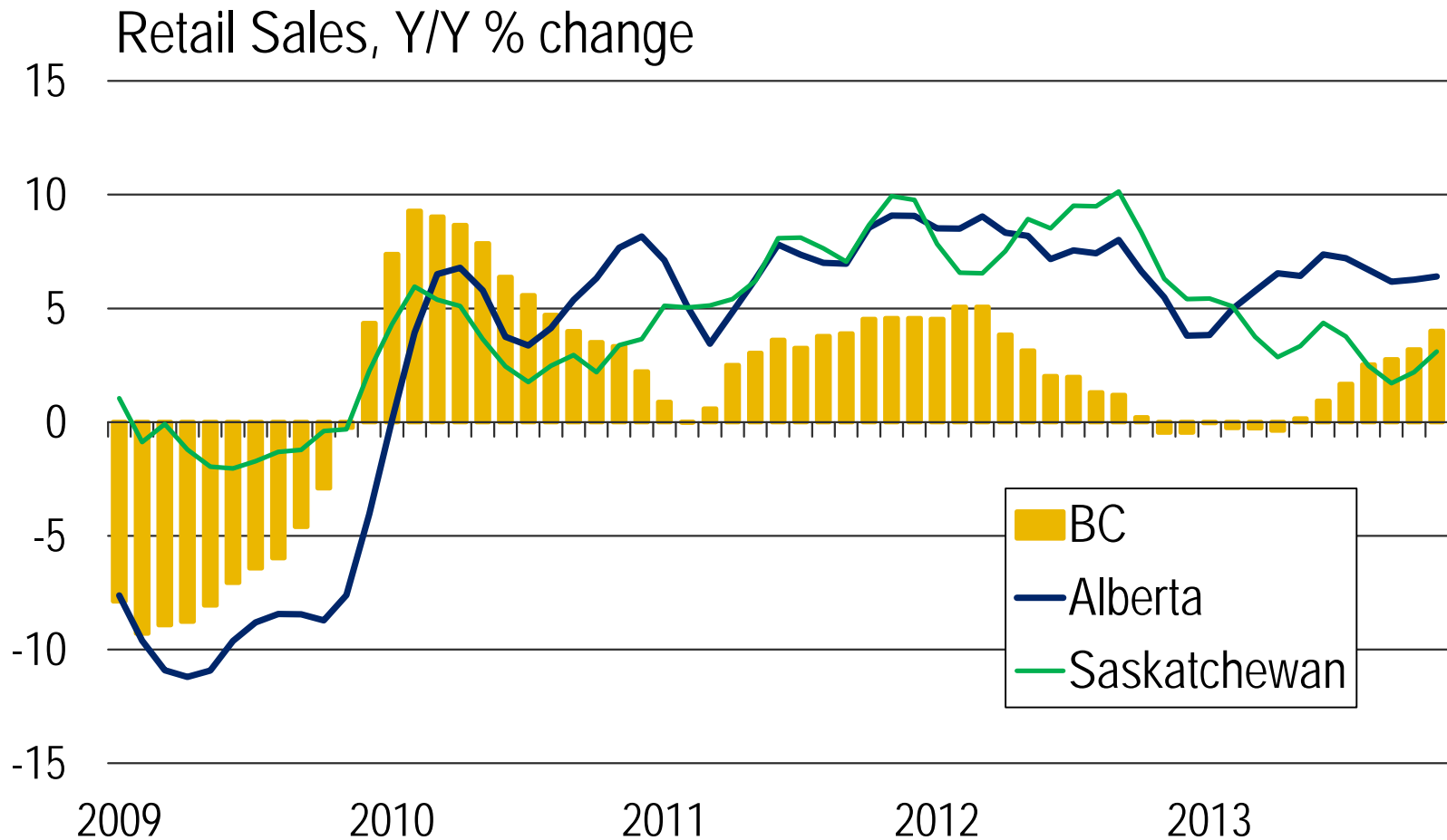
BC' Job Market Stalls in 2013



Latest: January 2014.

Source: Statistics Canada, seasonally adjusted, moving average.

Consumer Spending is Picking Up... After A Period of Weakness



Latest: November 2013.

Source: Statistics Canada, 3 month moving averages.

BC Economic Forecast

(annual per cent change unless otherwise indicated)

| | 2012a | 2013a | 2014f | 2015f |
|---------------------------------------|--------|-------------|------------|------------|
| Real GDP | 1.9 | 1.4e | 2.3 | 3.2 |
| Employment | 1.7 | -0.2 | 1.4 | 1.7 |
| Unemploy. rate (%) | 6.8 | 6.6 | 6.4 | 5.9 |
| Housing starts – all areas (units) | 27,500 | 26,400 | 23,500 | 23,500 |
| Retail sales | 2.8 | 1.6 | 3.0 | 3.0 |
| BC CPI | 1.3 | 0.0 | 1.0 | 1.5 |

a =actual f=forecast e=estimate

Source: Statistics Canada and BC Stats; Business Council for forecasts