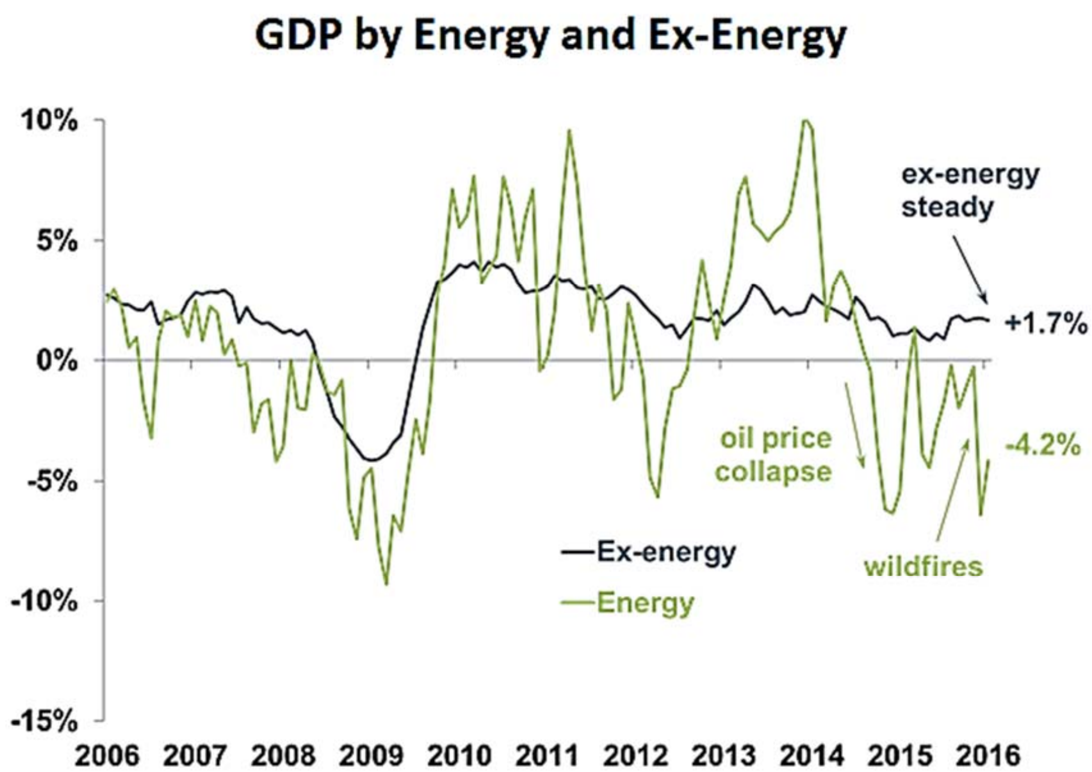
Canadian Economy Set to Rebound in 2017

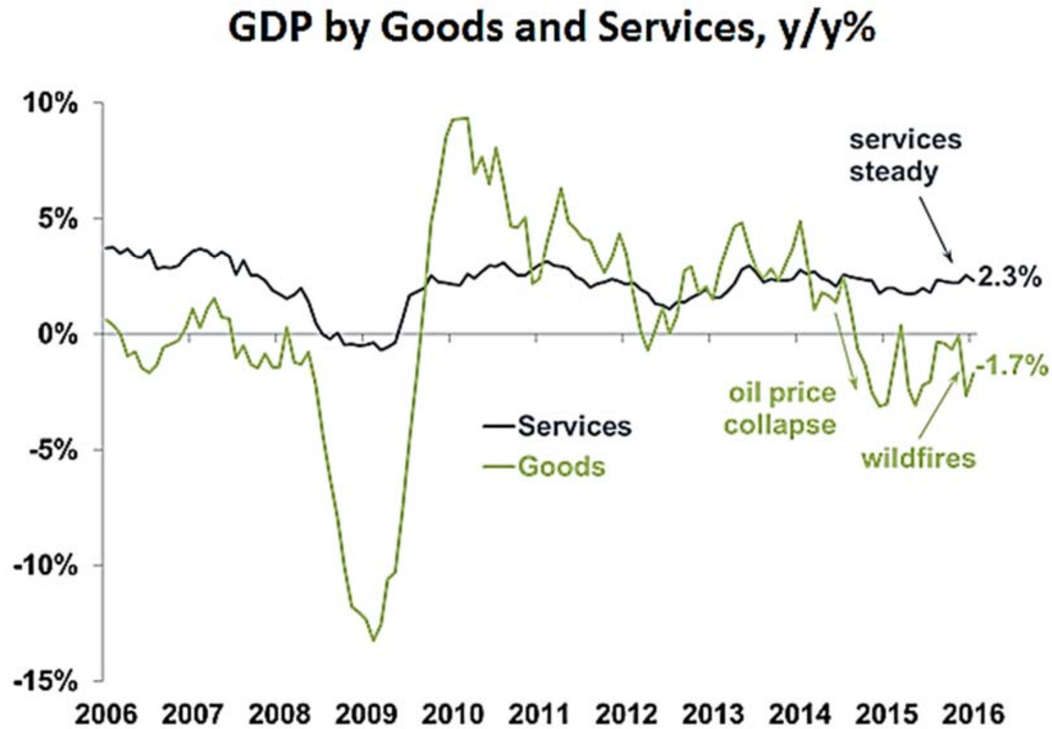
By: Dan North, Chief Economist for Euler Hermes North America

The last two years have been challenging for the Canadian economy, producing GDP growth of only 1.1% in 2015 and an estimated 1.3% in 2016. However, the economy has remained remarkably resilient in the face of collapsing oil prices, devastating wildfires, and disappointing exports, setting the stage for a rebound in 2017 to a forecasted growth rate of 2.2% - close to the average since the 80's of 2.4%.

Clearly, the collapse in oil prices since the middle of 2014 has had a sharp impact on the economy, and as of June the energy sector is still contracting at a y/y rate of -4.2%. But the 90% of the economy outside of the energy sector has been growing at a solid rate of +1.7% y/y. Similarly, the goods sector has been shrinking at a -1.7% y/y rate, but the 70% of the economy that is in services has been very stable, averaging +2.3%y/y for the past six years and ranging between +1.7% and +2.3% y/y for the past two years. Consumption has also been stable, averaging +2.3% for the past six years, ranging from +2.3% to +2.8% y/y for the past 4.5 years. Indeed, the stability of the services sector and the consumer will provide a strong base for 2017's growth.



Source: IHS, CANSIM, Euler Hermes



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Exports were supposed to have been the basis for a recovery in 2016, but they have proved very disappointing despite a weak Canadian dollar. Instead of growing, exports actually fell $C3.8bn through the first half of the year to a -7.9% y/y rate. Even excluding energy, exports fell $C3.2bn through June. But in July, non-energy exports took a massive $C6.7bn leap - the second largest ever. This increase is likely to continue, although at a slower pace, into 2017 for two reasons. First, as the U.S. Fed continues to lean towards tighter monetary policy, and the Bank of Canada continues to maintain its highly accommodative status, the value of the Canadian dollar may weaken again, making Canadian exports more attractive. Second, a pickup in demand from the U.S. economy, Canada's largest export market, is expected in 2017.

Yet a third setback in 2016 has helped set the stage for a better 2017. The Fort McMurray, Alberta wildfires were the costliest natural disaster in Canadian history, causing $C3.6bn in damage. While the loss of property was devastating, natural disasters do create a spike in demand for rebuilding services that can last for several years. Reconstruction of homes, buildings and infrastructure will significantly boost the Alberta economy, providing some much-needed relief to the region's collapsed oil economy.

Government policies should also provide a boost into 2017. On the fiscal side, the Trudeau Administration has planned new infrastructure spending over the next several years. The Bank of Canada's aforementioned easy money policy has kept interest rates low and has stimulated the mortgage and housing market.

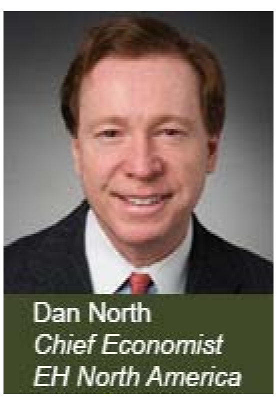
However, there are, of course, downside risks to this forecast. Housing prices are growing so fast that the market may well be in danger of inflating a bubble, if it already hasn't. On a y/y basis according to Teranet, housing prices in eleven major cities are growing at an 11.4% rate - the fastest in six years. By comparison, housing prices in the US are growing approximately 5% y/y. Prices in Vancouver have risen a record 25.8% in just the past year. If there is a bubble and it bursts, it could be devastating to some cities and regions, particularly since Canadians carry large personal debt loads. Another risk is developing in the labor market where employment growth has declined to +0.4% y/y - the slowest since August of 2014. Finally, as the effects of continued low energy prices, disappointing exports and wildfires continue to work their way through the economy, it's unlikely that insolvencies can stay at their current historical lows. Insolvencies will also increase due to tightening lending conditions which make it more difficult for businesses to get funding and survive a cash flow squeeze. Therefore, we expect a slight pickup in insolvencies of +2% in 2017.

What this means for your business

While we expect the Canadian economy to rebound in 2017, there are still significant risks. A burst housing market bubble combined with high personal debt could send a wave of defaults though the economy. The effects of the oil field collapse, the wildfires, and weak exports are yet to work their way through the business community, making it quite likely that insolvencies will rise off of their record lows next year. In these circumstances, businesses face the risk that the customers to whom they sell will become vulnerable to insolvency. A trade credit insurance policy can help mitigate against this risk as well as provide protection against slow payment.

What to watch for

The Canadian government publishes GDP figures, the broadest measure of economic health, on a monthly basis in addition to the more common quarterly reporting. While the monthly data doesn't always align perfectly with the quarterly data, it is timelier and it provides finer detail by industry. Rapidly rising real estate prices are perhaps the biggest risk to the economy, and they are published monthly by several government and private surveys. Oil prices are also critical, and they will need to rise to levels well above the $50 neighborhood for well over a year for there to be a significant recovery in the oil patch. Euler Hermes provides timely analyses on this and other subjects in our Weekly Export Risk Outlook (WERO), as well as monthly and quarterly analyses on the global macroeconomy and specific countries and industry sectors. Visit the Economic Research section of our website to learn more.



Dan North, Chief Economist for Euler Hermes North America, uses macroeconomic and quantitative analysis to help manage Euler Hermes' risk portfolio of more than $250 billion in annual trade transactions within the Americas region. After having predicted the 2008/2009 recession and its implications accurately, Dan was ranked 4th on Bloomberg's list of the 65 top economic forecasters in 2010.