



## ECONOMICS DIGEST

August 2009

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Current trends...

**Canada's economy still mired in recession**

▲ GDP output fell by 0.5% in May on the back of a very weak performance by goods-producing industries. This was a step back from the 0.2% average decline during the prior three months, although it still marked an improvement from the average monthly drop of 0.8% from November through January.

▲ The labour market was weaker than expected in July, shedding another 44,500 jobs, but we anticipate that the pace of decline will slow going forward as the worst of the global recession passes.

▲ May's strong retail sales numbers are expected to help limit the drop in real GDP to 0.5% in May. This is consistent with our current forecast showing second-quarter growth declining 3.2%, at an annual rate, an improvement over the 5.4% contraction in the first quarter.

▲ The pace of housing starts eased up in July, but housing market is showing signs of emerging from its slump with the July level of housing starts putting the economy on track to record a quarterly increase in the third quarter for the first time since early 2008.

▲ Rising exports and falling imports resulted in a significant narrowing in Canada's trade deficit in June, which came in at C\$55 million, much smaller than May's revised C\$1.1 billion trade shortfall.

▲ The inflation rate was in deflationary territory again in July with downward pressure coming mostly coming from volatile energy prices. Going forward, we look for the headline CPI rate to continue to be buffeted by energy price movements, while underlying weakness in the economy weighs on core prices.

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Financial markets...

**Inching toward a global recovery**

The prognosis for the global economy has improved, but conditions are still weak and we are anxiously waiting for fiscal and monetary medicine to restore the world economy to good health. Recent data reports have been “less bad” but still not strong enough to signal an unequivocal turn in the major industrialized economies. But, we are optimistic that the steady stream of fiscal stimulus and easy monetary policy will result in the spate of “less bad” data turning into more tangible signs of recovery, although the fragile nature of the prospective upturn points to global interest rates staying low.

**U.S. economy's decline moderates with positive growth around the corner**

▲ The U.S. economy continued to contract in the second quarter, with output falling by 1% at an annualized rate — a sharp improvement from the 5.5% and 6.4% drops recorded in the prior two quarters — but marking the first time in history that the U.S. economy posted four consecutive quarterly declines.

▲ However, we believe that the worst has passed and look for the economy to return to positive growth in the third quarter. We have revised up our third-quarter forecast to show a 1.3% annualized gain from our previous projection of a 0.5% increase.

Canada's economy is on track for a second-half recovery

- ▲ May's 0.5% decline in real GDP was a step back from the 0.2% average dip during the prior three months, but was still an improvement from the average monthly drop of 0.8% from November through January.
- ▲ The data point to Canada's economy contracting at a 3.2% annualized pace in the second quarter, slower than the first quarter's 5.4% drop, but still showing that the economy was still mired in recession as the year's first half came to a close.
- ▲ Looking ahead, the recent easing in financial conditions, low interest rates, recovering U.S. demand and a boost from fiscal stimulus are expected to result in an improving trend in growth in the second half of this year and into next.
- ▲ That said, near-term weakness and lingering concerns about the fate of the U.S. financial system will see the Bank of Canada maintain its commitment to holding the overnight rate at 0.25% through the end of the second quarter of next year (albeit conditional on inflation) to ensure that the prospective recovery materializes.

## Canadian dollar – Riding high

- ▲ Canada's dollar put in a very strong performance in July as investors' appetite for risk picked up. The loonie managed to outperform all other G10 currencies in the month as higher commodity prices lifted the economy's prospects.
- ▲ Going forward, the ebb and flow of monthly economic news will likely result in periods of risk aversion that will lead investors back to the safety of the large, liquid U.S.-dollar market.
- ▲ However, the medium-term prospects favour the Canadian dollar trading toward 95 U.S. cents as rebounding global demand for commodities sparks interest in the currency as well.

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