

U.S. and Canadian Economic Outlook: Growth to Strengthen as Downside Risks Ease

Presentation to the MEARIE Conference 2014

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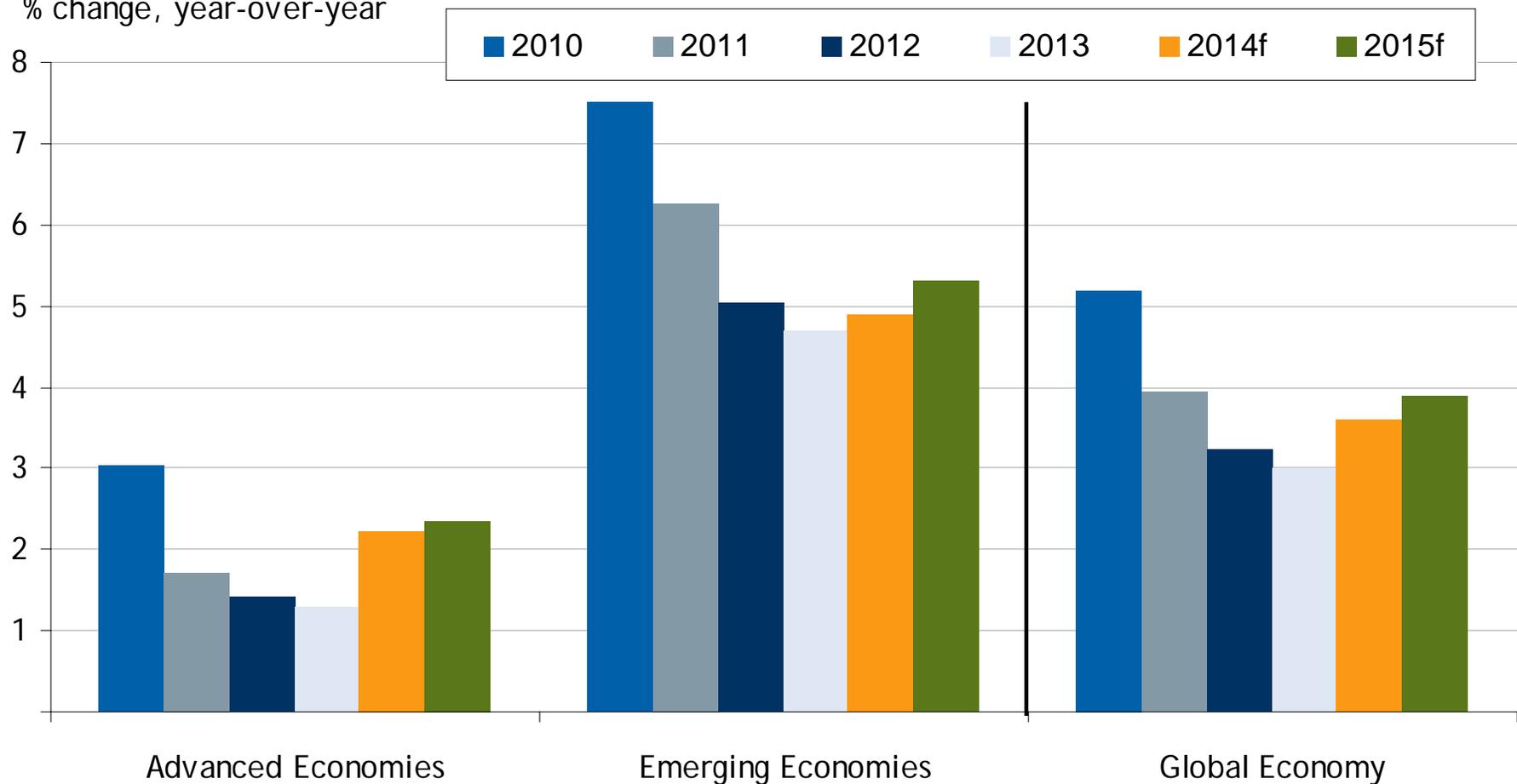
Global Economic Outlook:

**Advanced Economies are Expected to Take
the Lead in Boosting Global Growth**

The recovery in the U.S. is expected to boost activity among both advanced and emerging economies.

GDP growth

% change, year-over-year

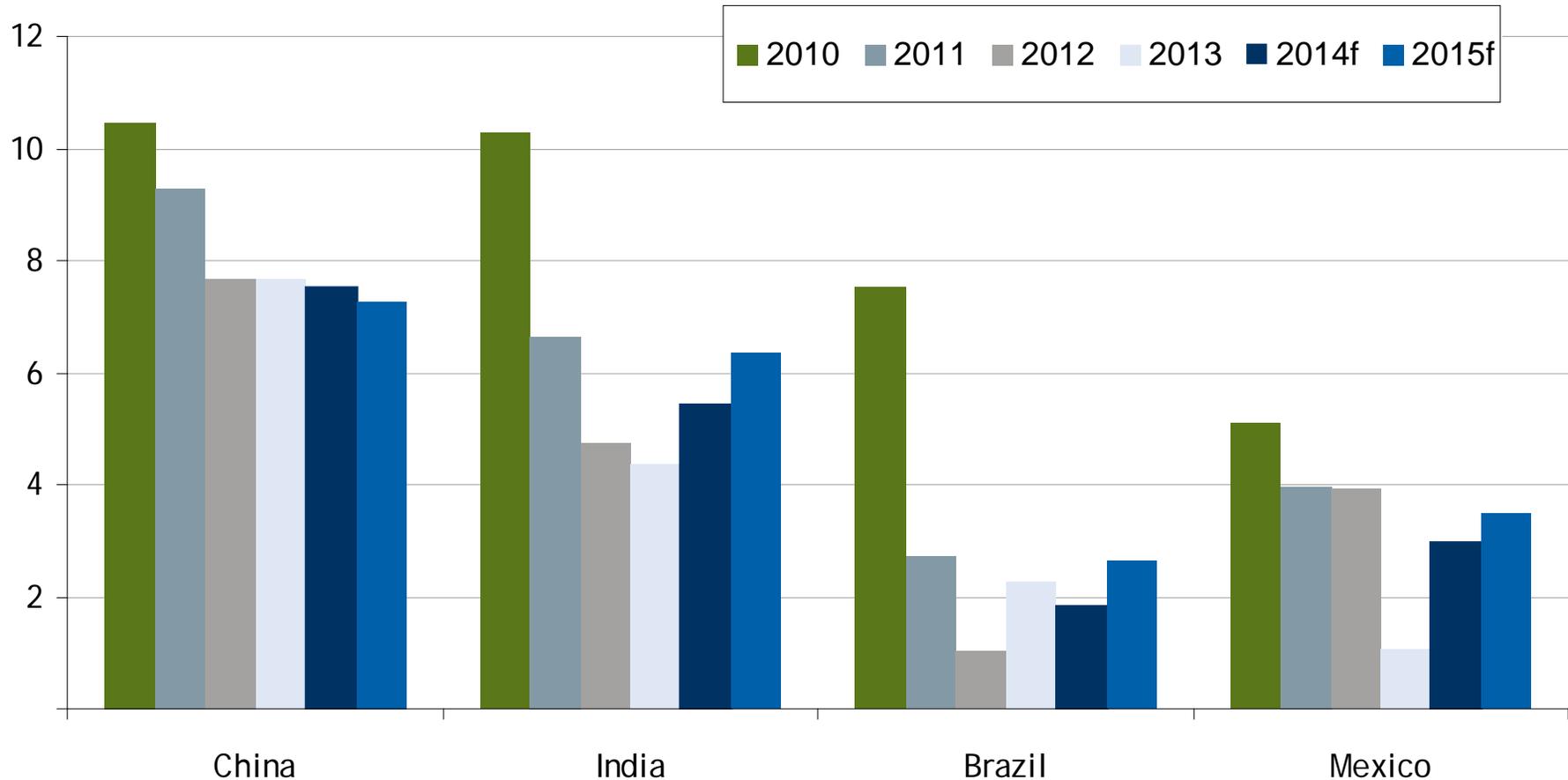


Source: International Monetary Fund, RBC Economics Research

Strengthening activity among emerging economies to be restrained by moderating growth in China.

Emerging Economies

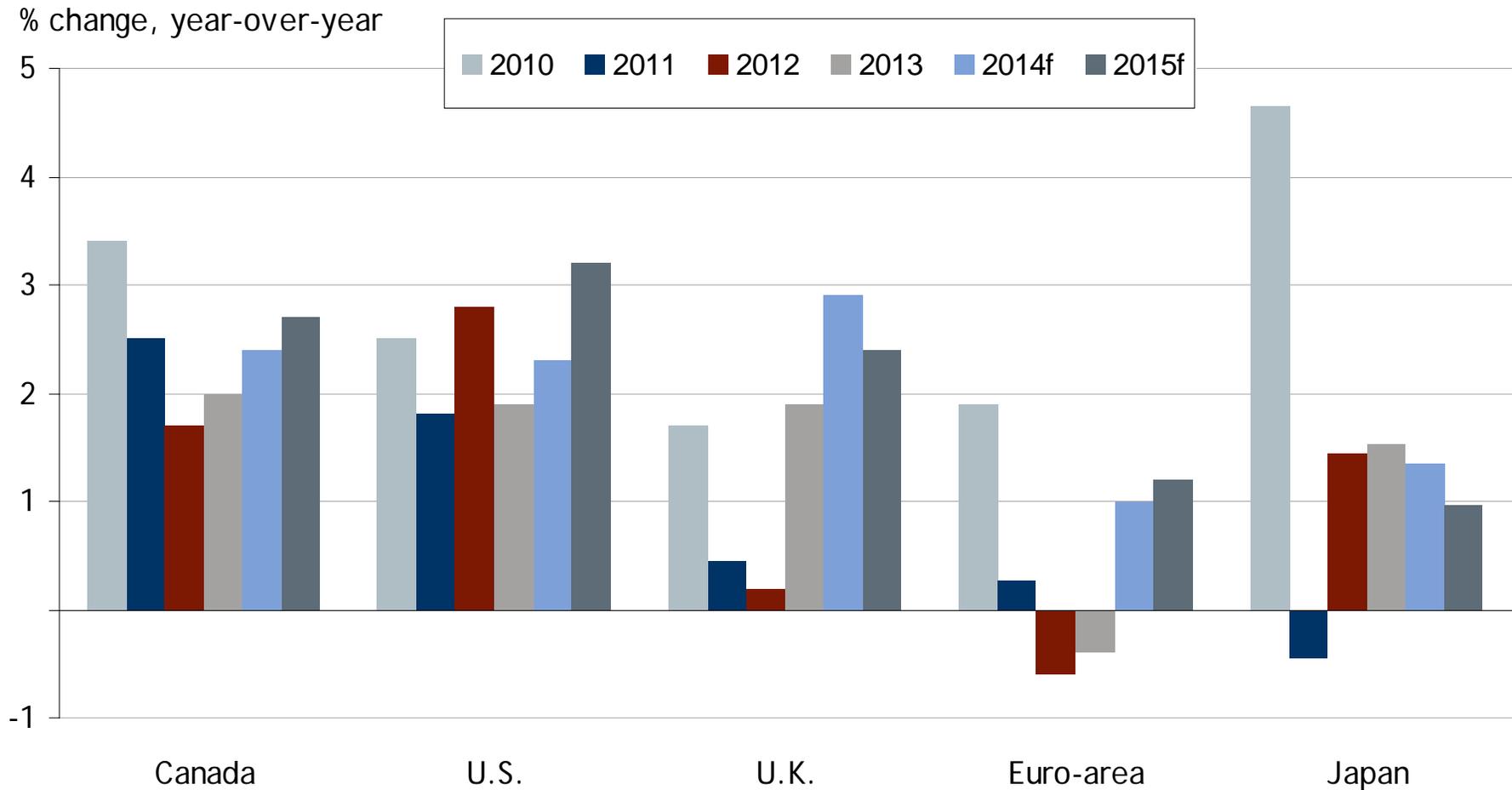
% change, year-over-year



Source: International Monetary Fund, RBC Economics Research

Strengthening growth among advanced economies in 2014 is expected to be relatively broad based though with Japan being an exception

Advanced Economies



Source: International Monetary Fund, RBC Economics Research

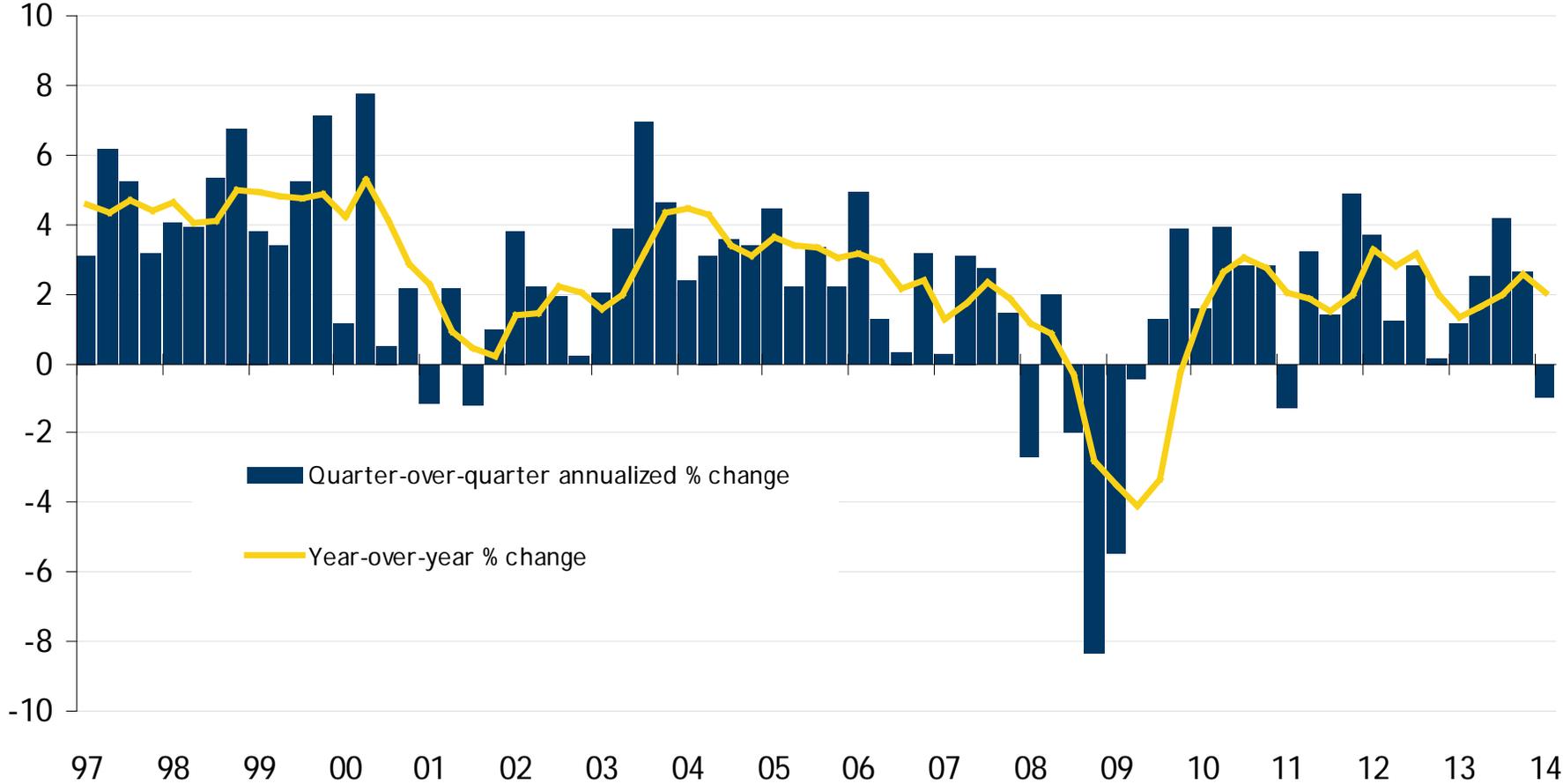
U.S. Economic Outlook:

**Growth to Strengthen as Budgetary
Uncertainties Ease and Stimulative Monetary
Conditions Prevail**

Though U.S. growth declined in Q1, it largely reflected the transitory effect of the severe winter weather with activity expected to rebound in Q2.

U.S real GDP growth

Quarter-over-quarter annualized % change



Source: Bureau of Economic Analysis, RBC Economics Research

With progress in both the U.S. Congress and the Euro-area to address fiscal issues, the tone in financial markets remains positive despite varied problems among a number of emerging economies both political (e.g. Ukraine, Middle East) and economic (e.g. stalling growth in China).

Weekly observation

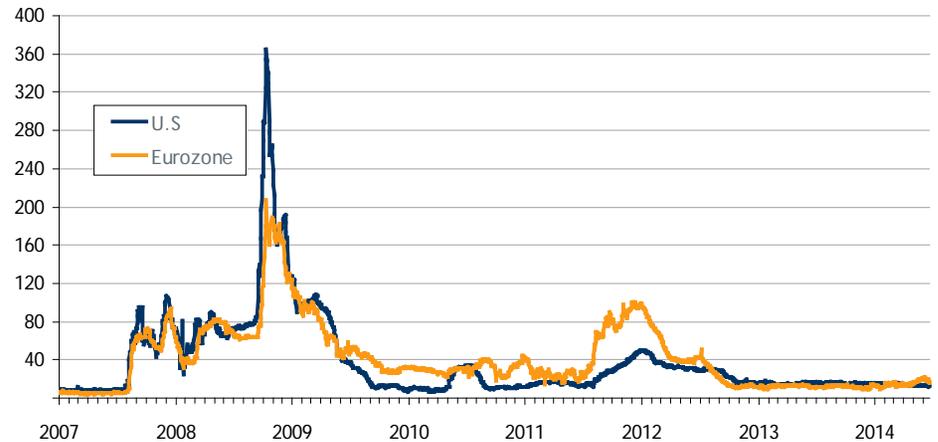
S&P 500 composite index



Source: Bloomberg, RBC Economics Research

Short term funding spreads

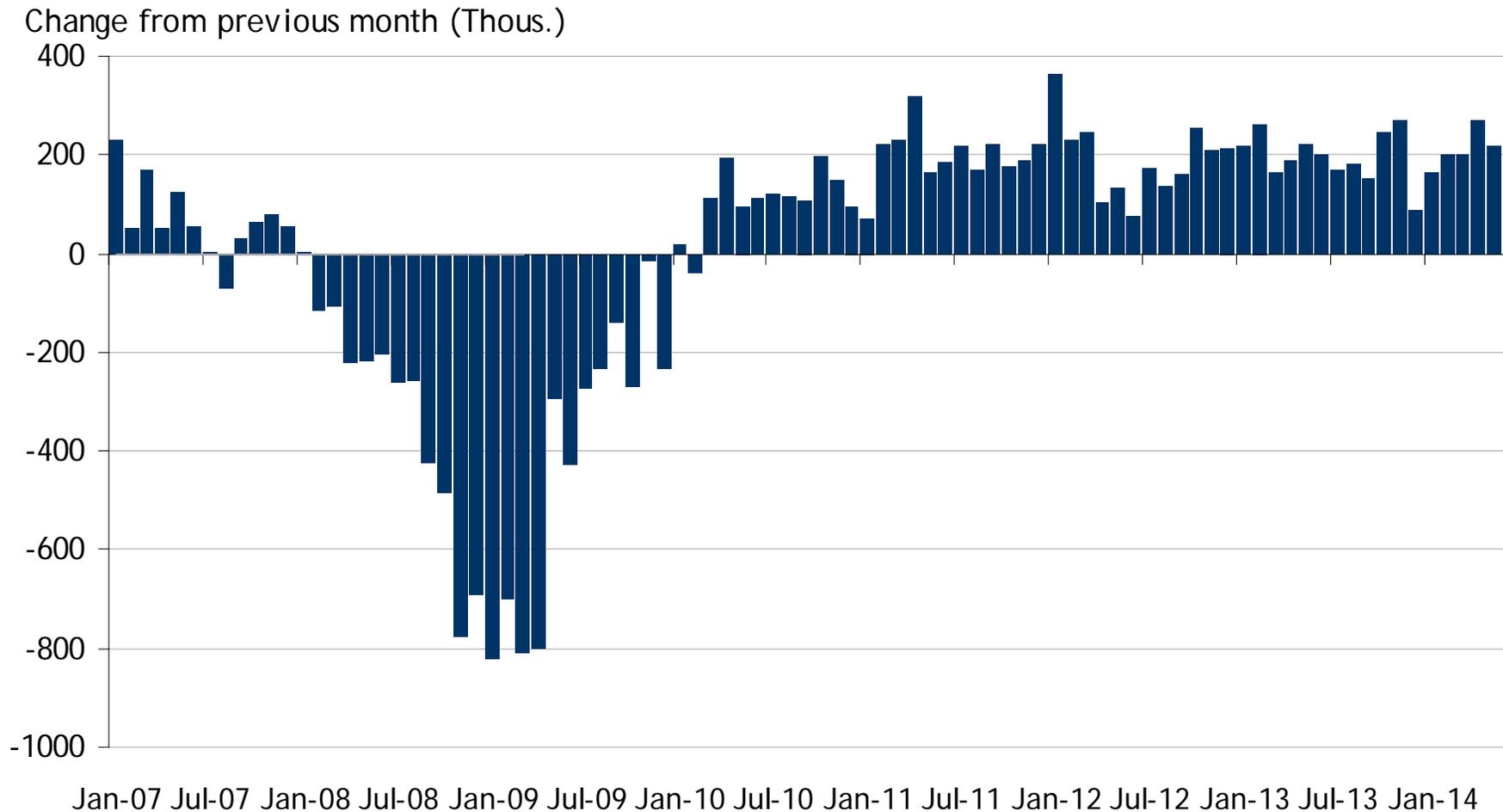
3 month Libor-OIS / Euribor-EONIA spread in basis points



Source: Bloomberg, RBC Economics Research

Employment growth sank the end of last year, likely related to extreme winter conditions, though this has started to reverse as we move into 2014.

Private sector employment growth*: U.S.



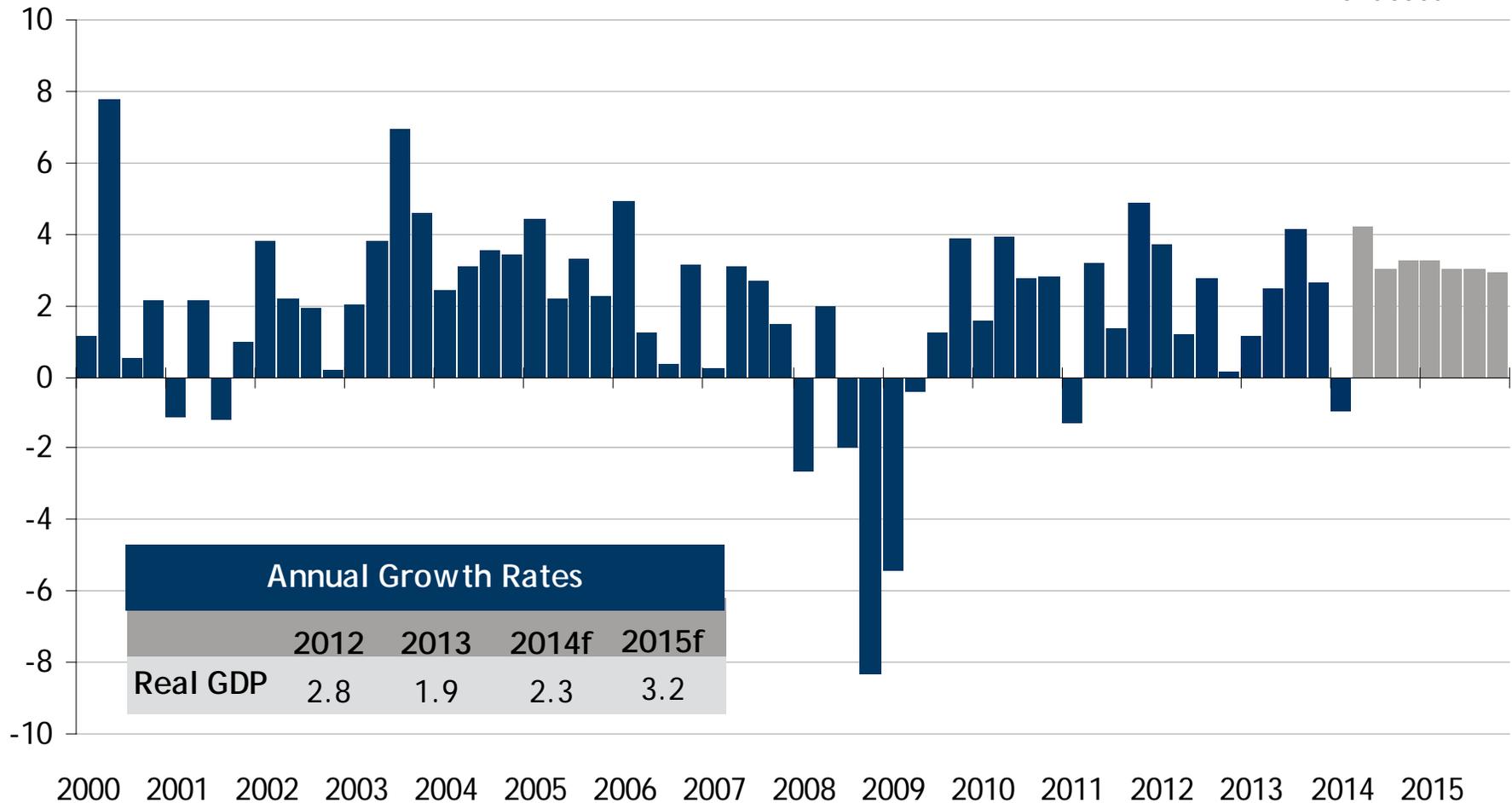
*Excludes the impact of the Verizon strike in August 2011
Source: Bureau of Labor Statistics, RBC Economics Research

Though the adverse weather weighed on Q1 growth, an easing in fiscal restraint and still highly stimulative monetary conditions are expected to result in a modest strengthening in U.S. growth this year and next on an average annual basis.

U.S. real GDP

Quarter-over-quarter annualized % change

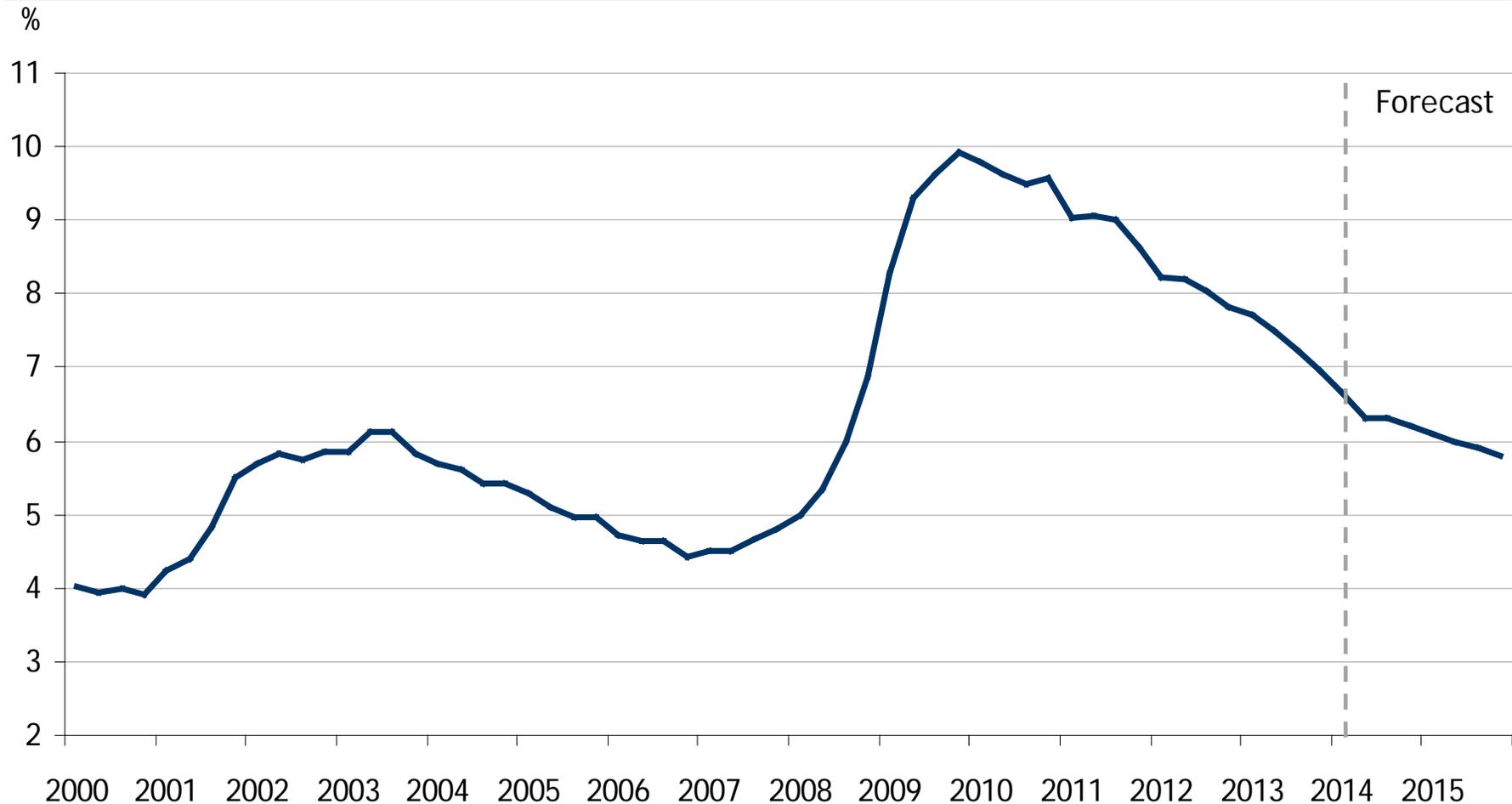
Forecast: ■



Source: Bureau of Economic Analysis, RBC Economics Research

This growth outlook will provide further modest downward pressure on the unemployment rate though it is expected to remain above pre-recession lows.

Unemployment rate: U.S.

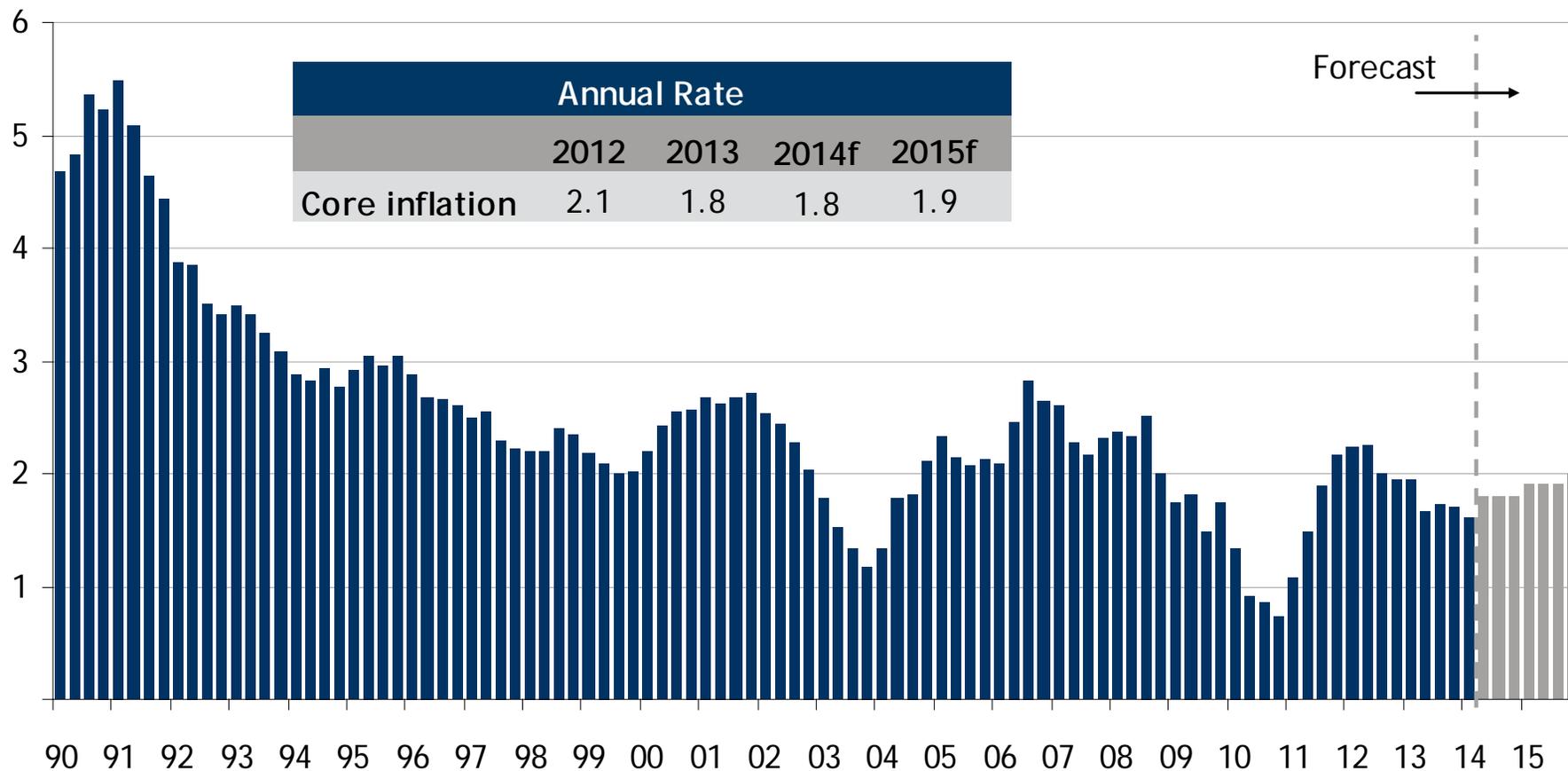


Source: Bureau of Labor Statistics, RBC Economics Research

The slack in the labour markets is expected to keep inflation quiescent.

Core inflation : U.S.

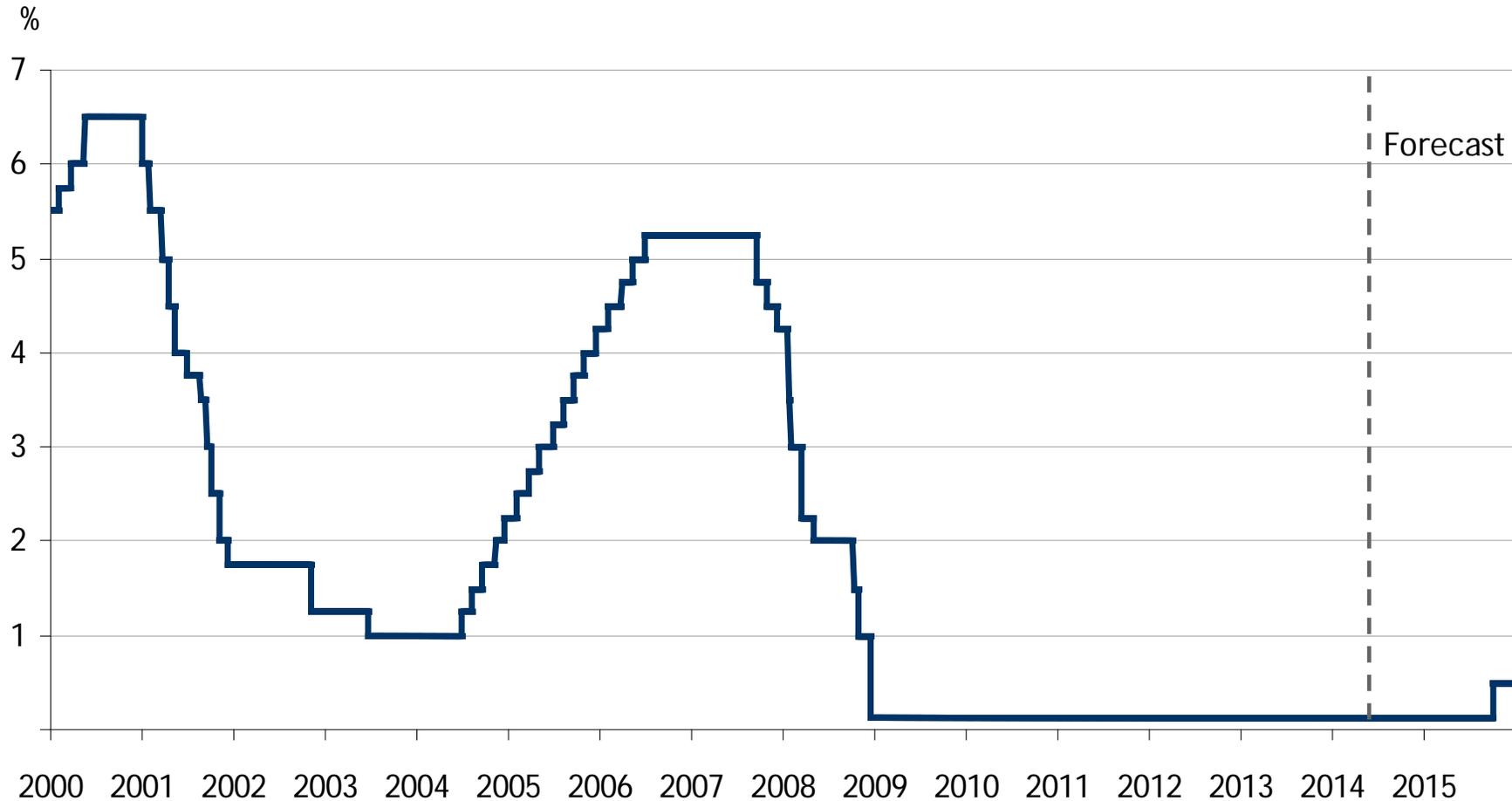
% change, year-over-year



Source: Bureau of Labor Statistics, RBC Economics Research

Low inflation will result in Fed funds holding steady at current highly stimulative levels until the fourth quarter of 2015 though strengthening growth will result in a cessation of “quantitative easing” by the end of 2014.

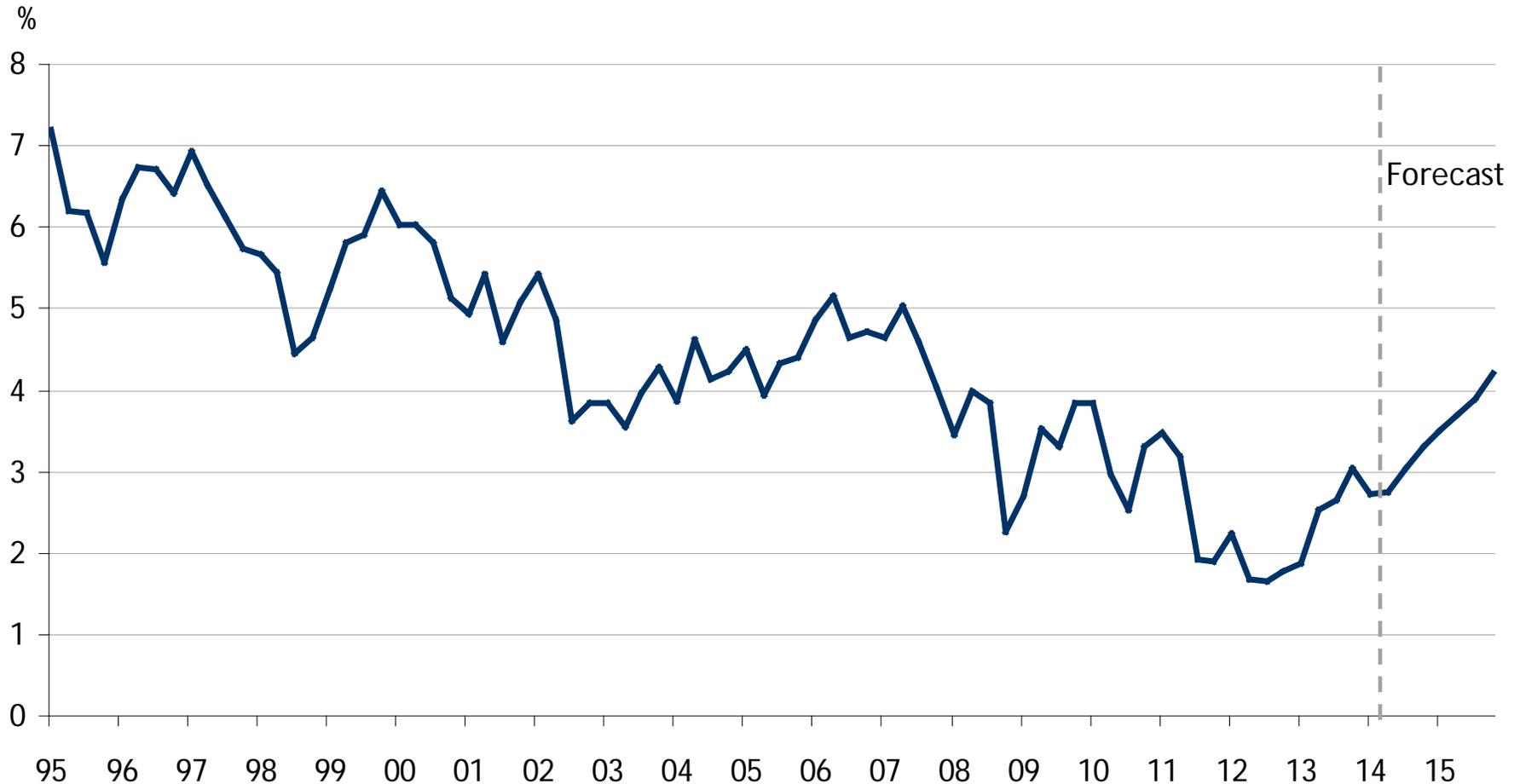
Fed Funds Rate



Source: Federal Reserve Board, RBC Economics Research

The prospect of asset purchases being scaled back through 2014 has started to put, and is expected to continue to apply, upward pressure on bond yields that will be sustained next year once Fed tightening commences.

10 year bond yield: U.S.



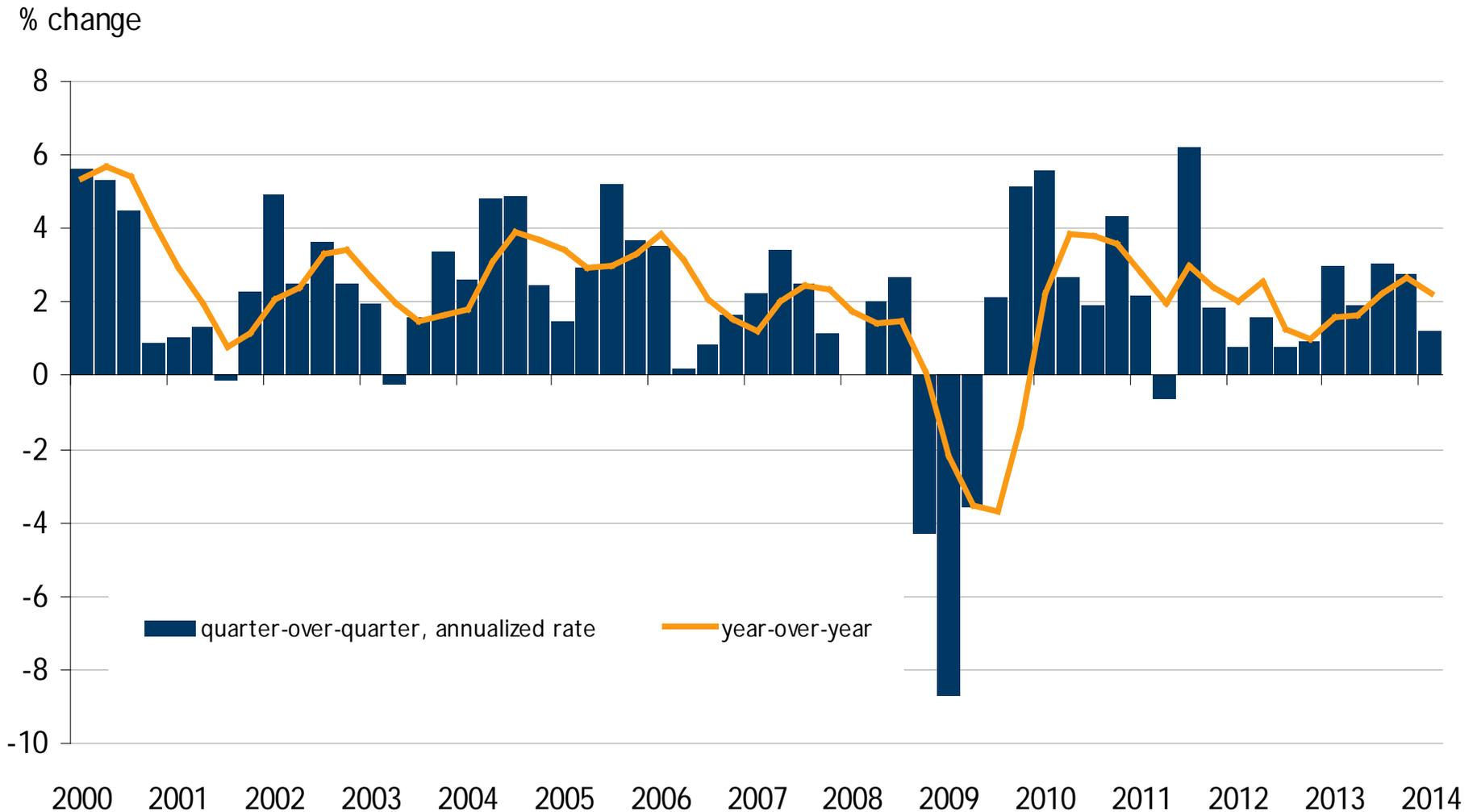
Source: Bank of Canada, RBC Economics Research

Canadian Economic Outlook:

**A Strengthening U.S. Economy Along With
the Recent Depreciation of the Canadian
Dollar Will Provide Greater Support to
Exports**

Fourth quarter growth last year finished at a strong 2.9% though the extreme winter weather temporarily pushed Q1 growth down to 1.2%.

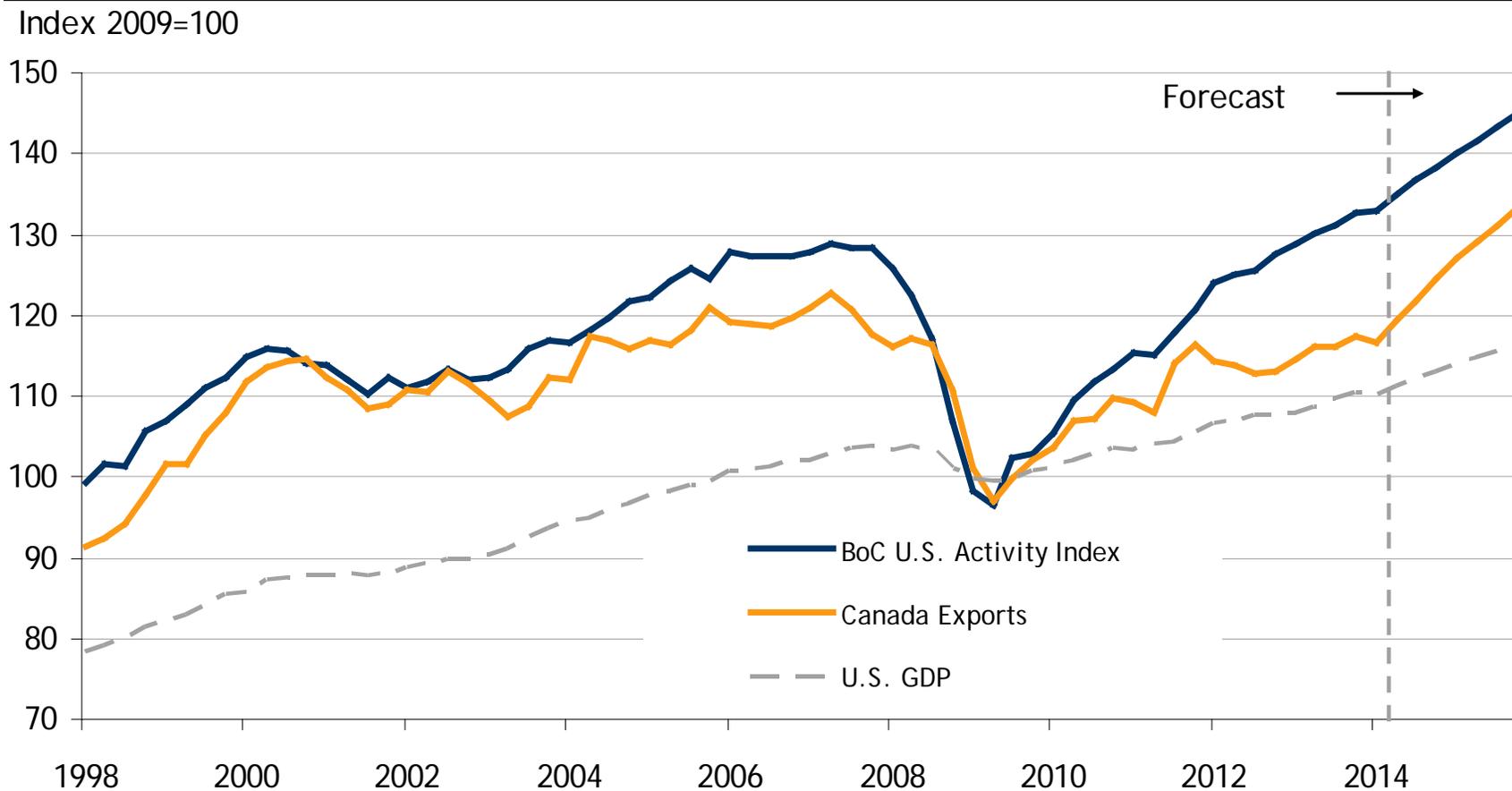
Canada's real GDP



Source: Statistics Canada, RBC Economics Research

Export growth has under-performed relative to U.S. growth though the recent depreciation of the Canadian dollar is expected to help close that gap.

Canadian exports and U.S. activity

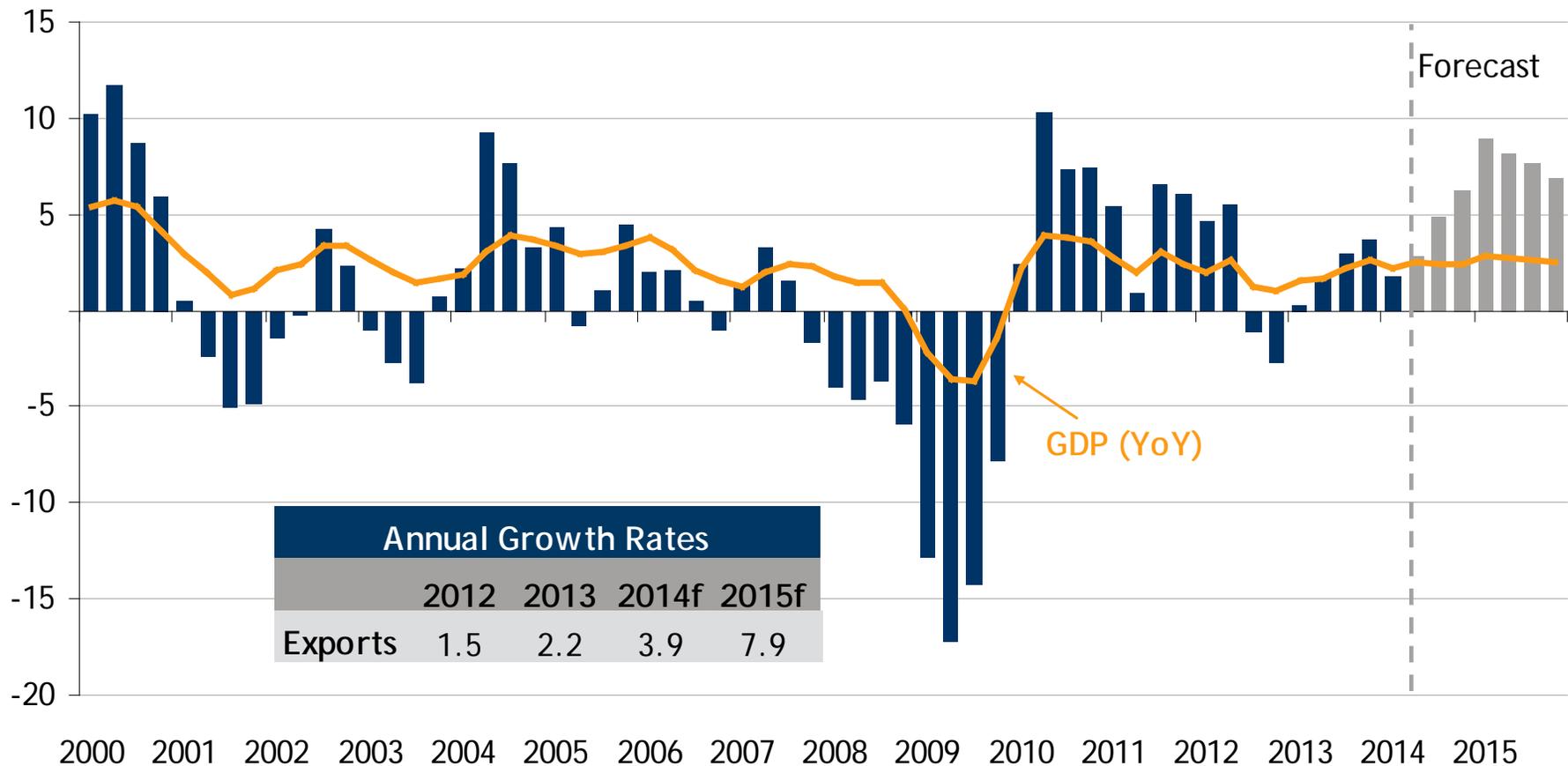


Source: Statistics Canada, Bureau of Economics Analysis, Bank of Canada, RBC Economics Research

The closing of this gap is expected to be reflected in strengthening export growth over the forecast.

Canadian Exports and GDP

Year-over-year % change

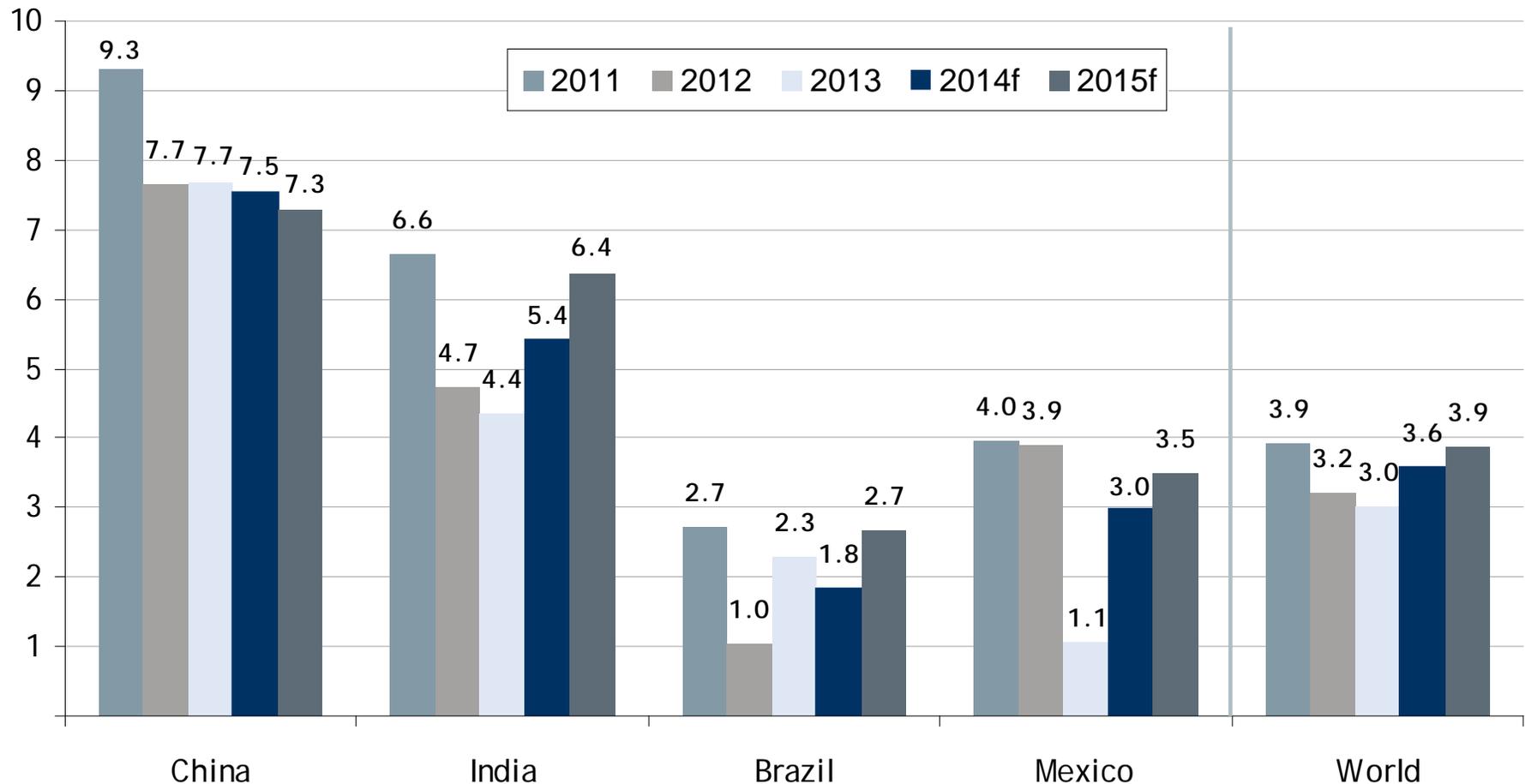


Source: Statistics Canada, RBC Economics Research

Canadian exports globally will also be helped by continuing and, in most cases strengthening, growth among emerging economies.

Major emerging economics

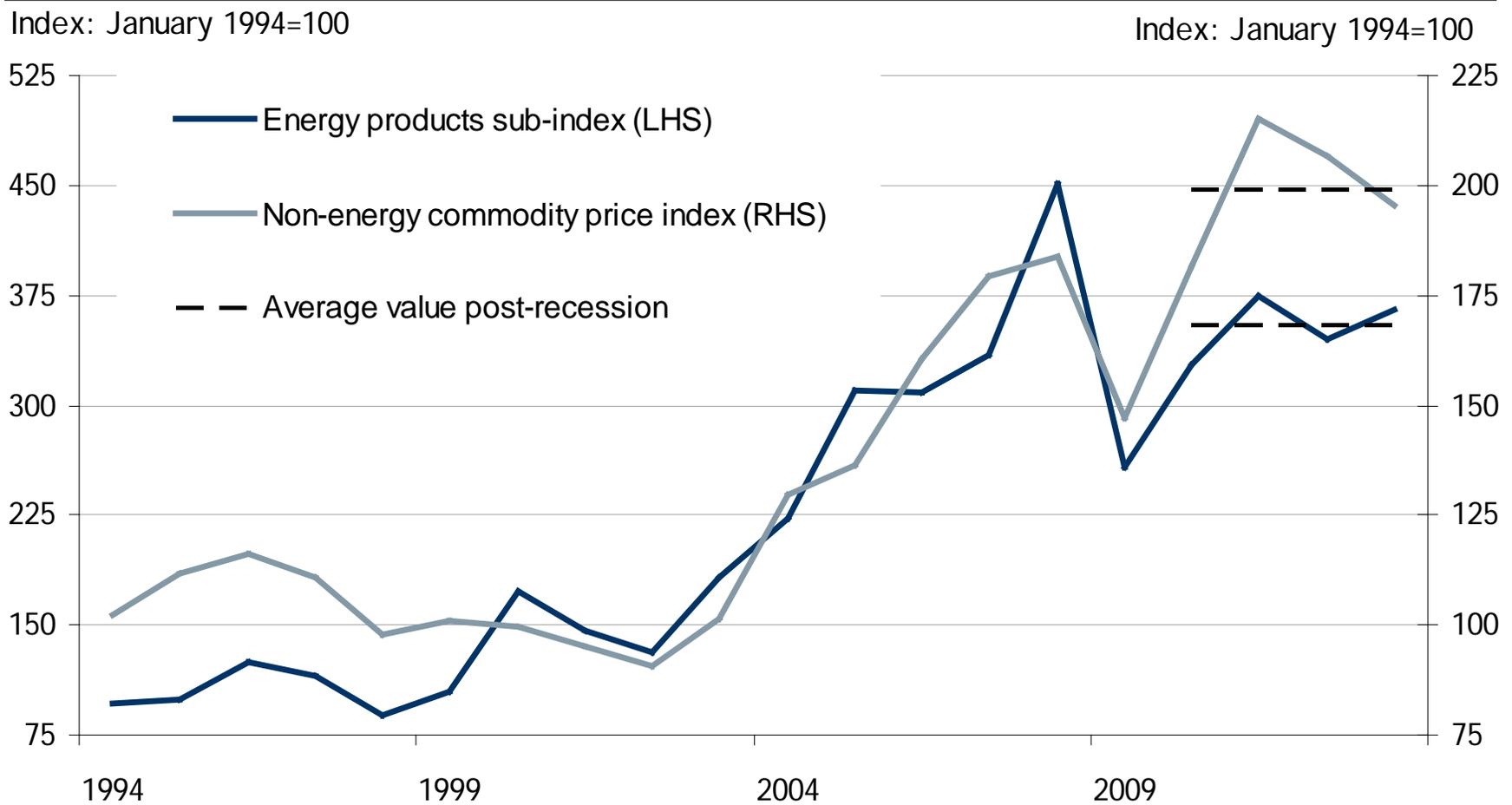
% change in real GDP



Source: International Monetary Fund, RBC Emerging Markets Research, RBC Economics Research

As well, continuing strong demand among emerging economies is expected to keep commodity prices historically high.

RBC Commodity Price Indices

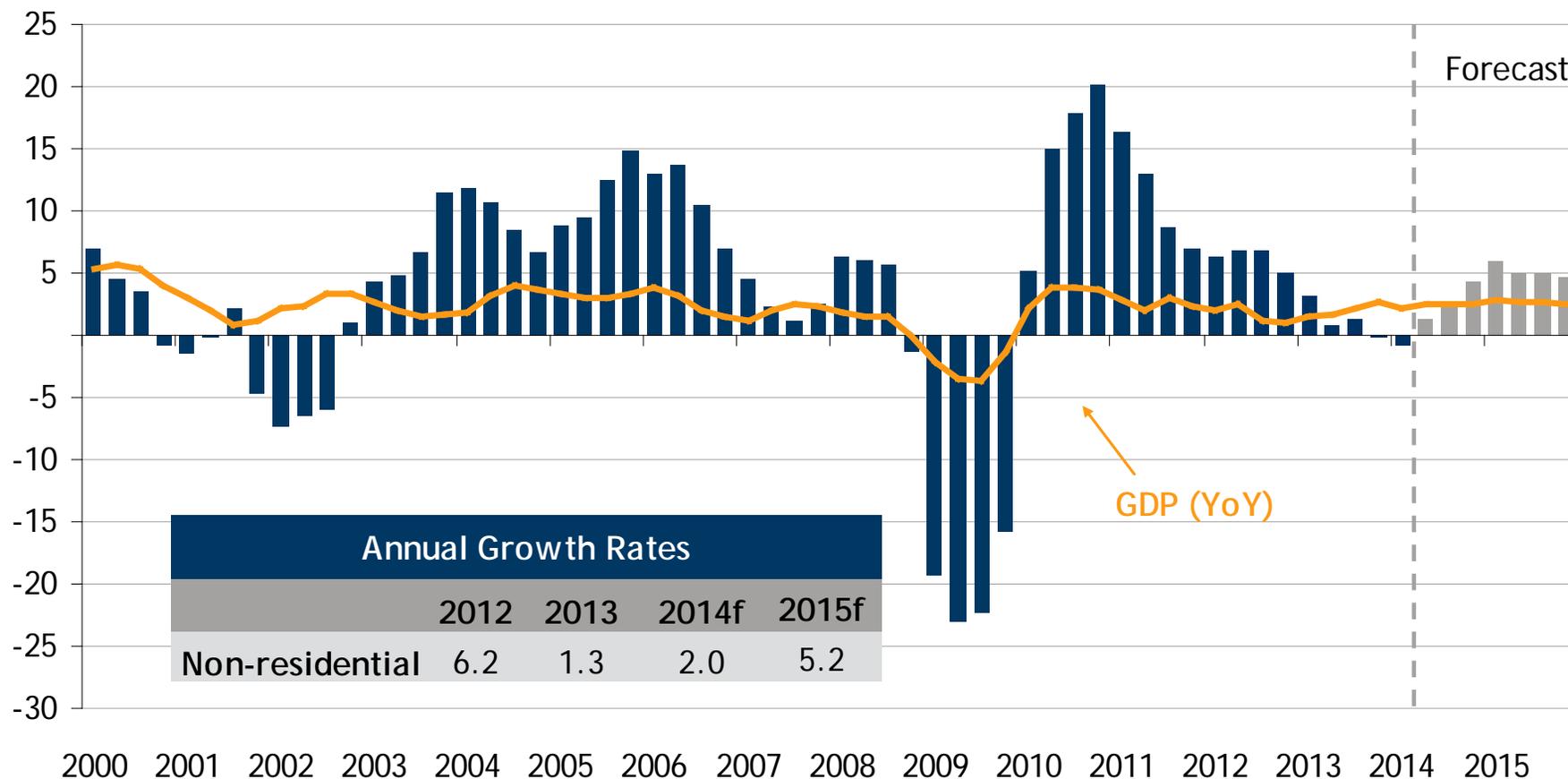


Source: RBC Economics Research

Continuing demand for natural resources and strong business balance sheets are expected to contribute to a strengthening in business investment.

Non-residential investment in Canada

Year-over-year % change

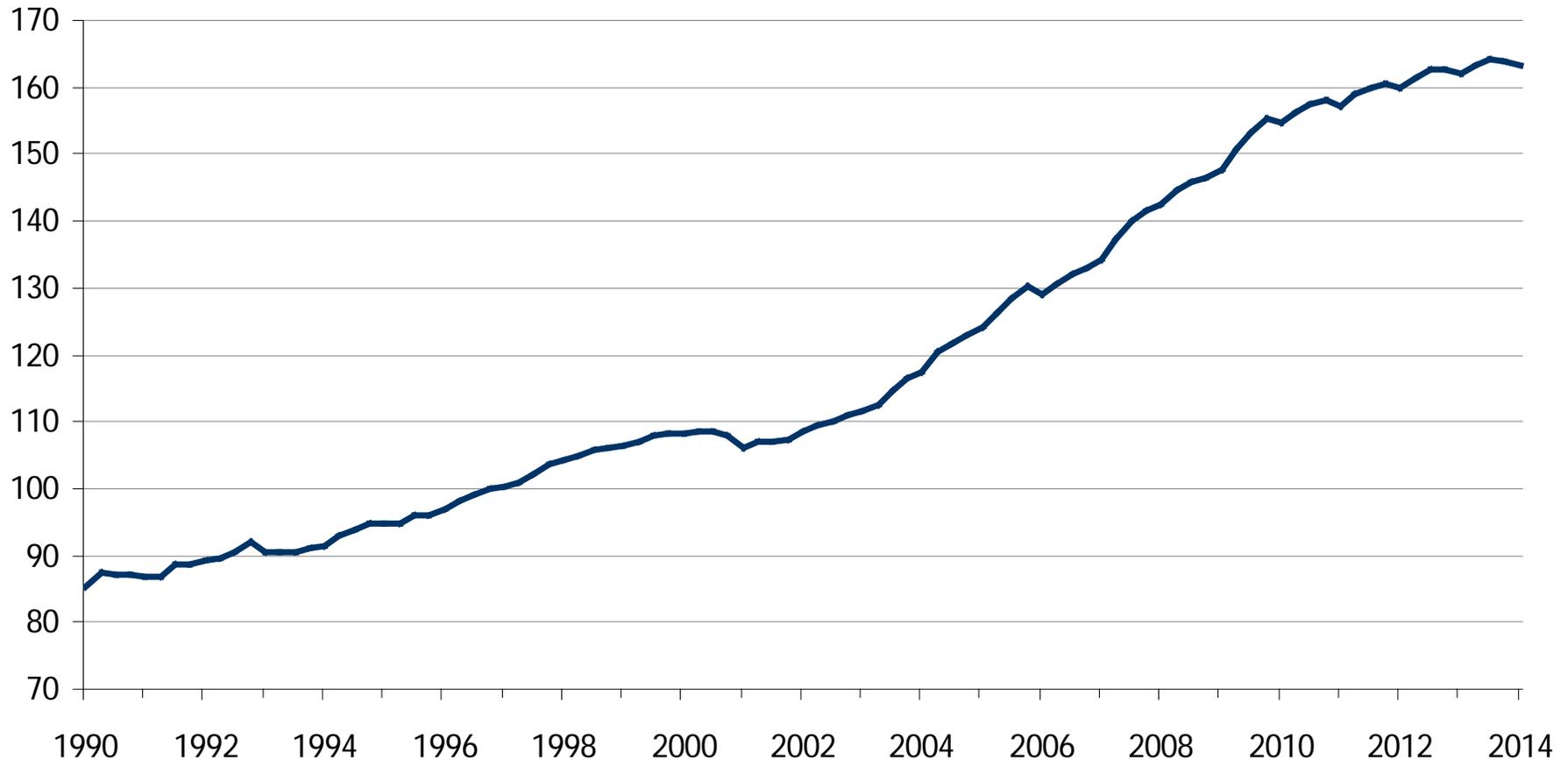


Source: Statistics Canada, RBC Economics Research

High levels of Canadian household debt as a share of income are expected to weigh on consumer spending...

Household debt-to-income ratio: Canada

Credit market debt as a % of personal disposable income

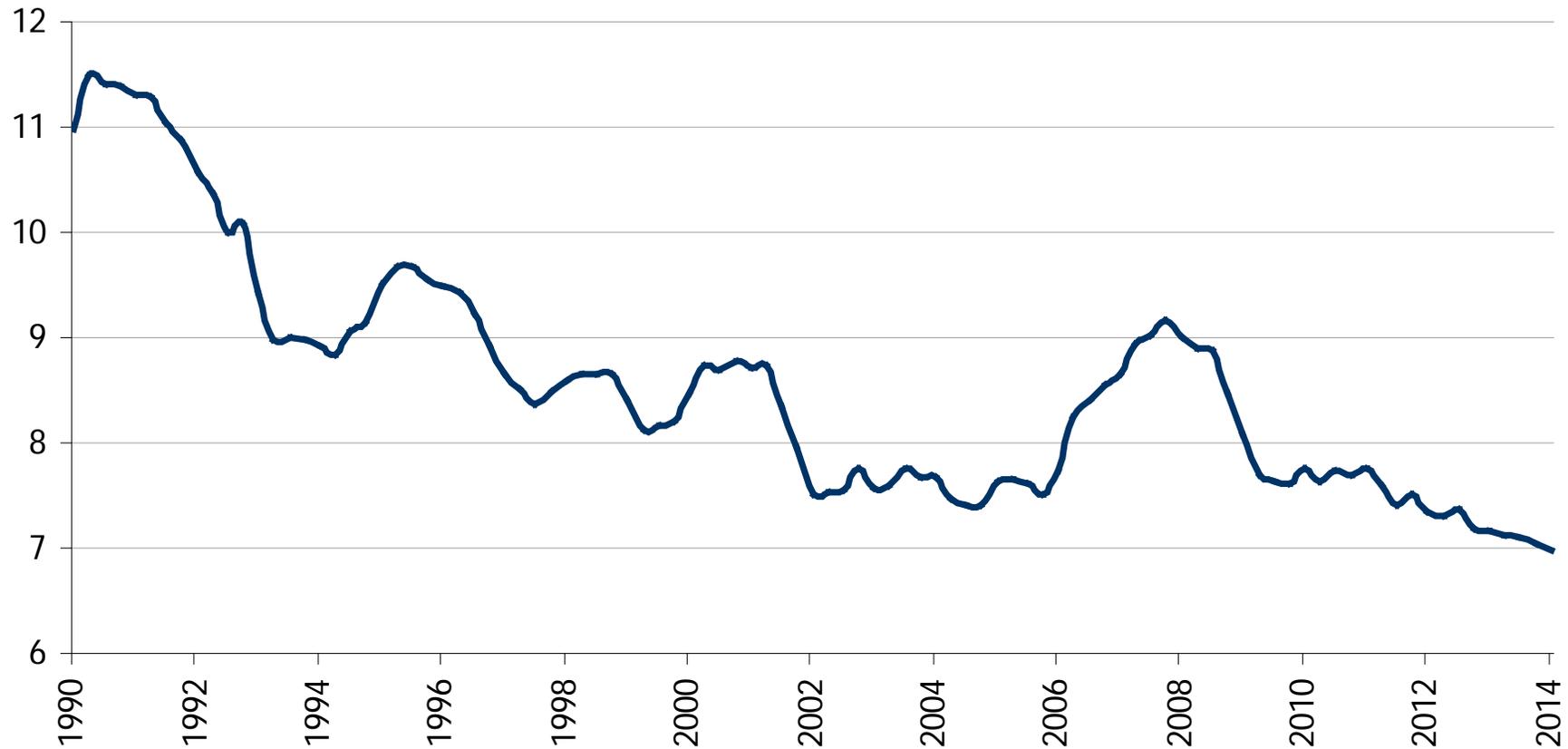


Source: Statistics Canada, RBC Economics Research

...though debt-servicing costs remain historically low.

Household debt service ratio: Canada

Mortgage & nonmortgage interest payments as a % of PDI

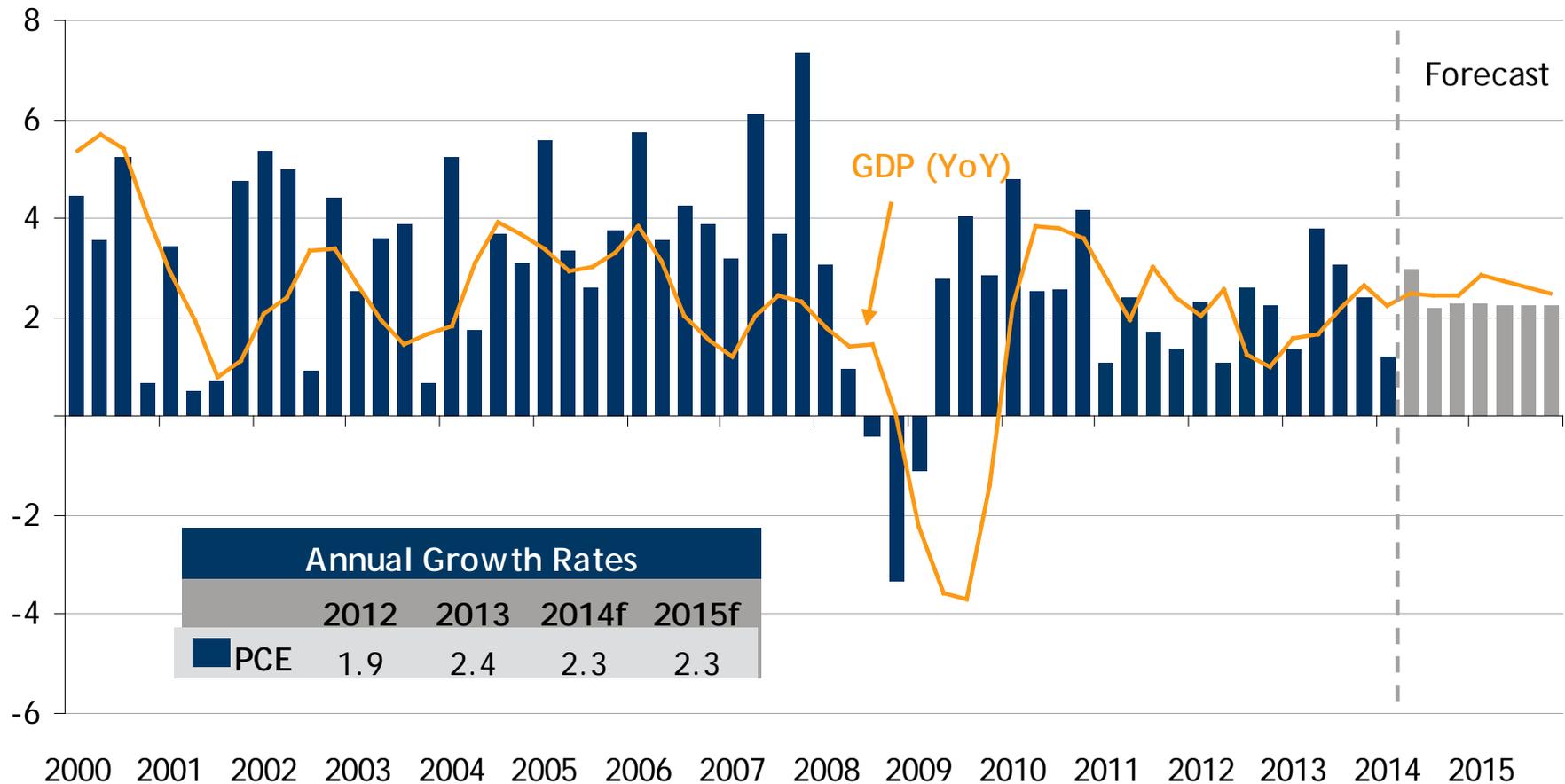


Source: Statistics Canada, RBC Economics Research

Thus we are assuming that these balancesheet constraints will limit, though not prevent, continued modest growth in consumer spending

Consumer expenditures in Canada

Quarter-over-quarter % change, annualized



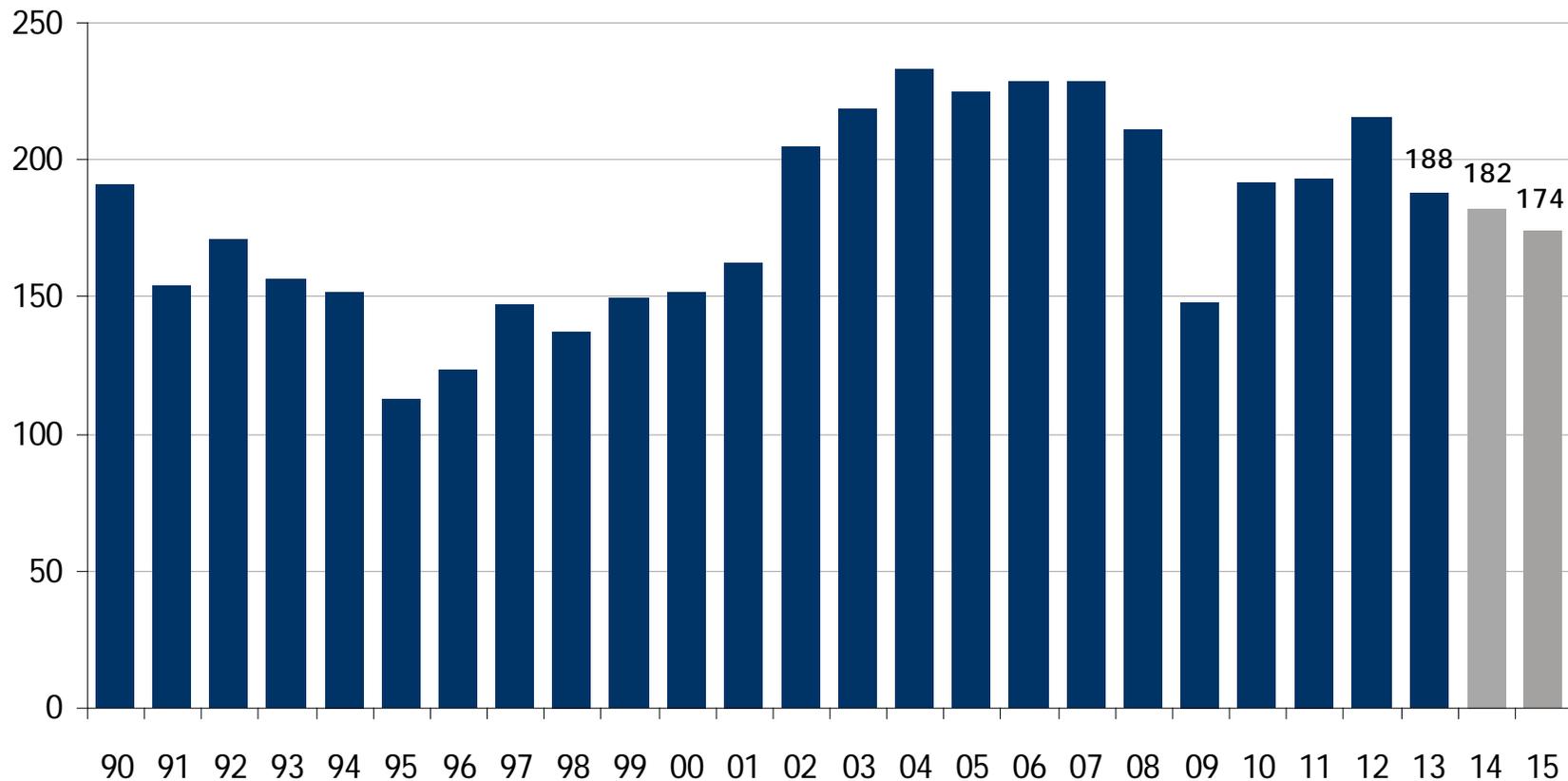
Source: Statistics Canada, RBC Economics Research

High debt levels are expected to keep demand for new housing starts subdued with the prospects of higher rates and announced mortgage rules changes having advanced some activity to 2012 at the expense of activity in 2013 to 2015.

Housing starts: Canada

SAAR, thousands of units

Forecast: ■

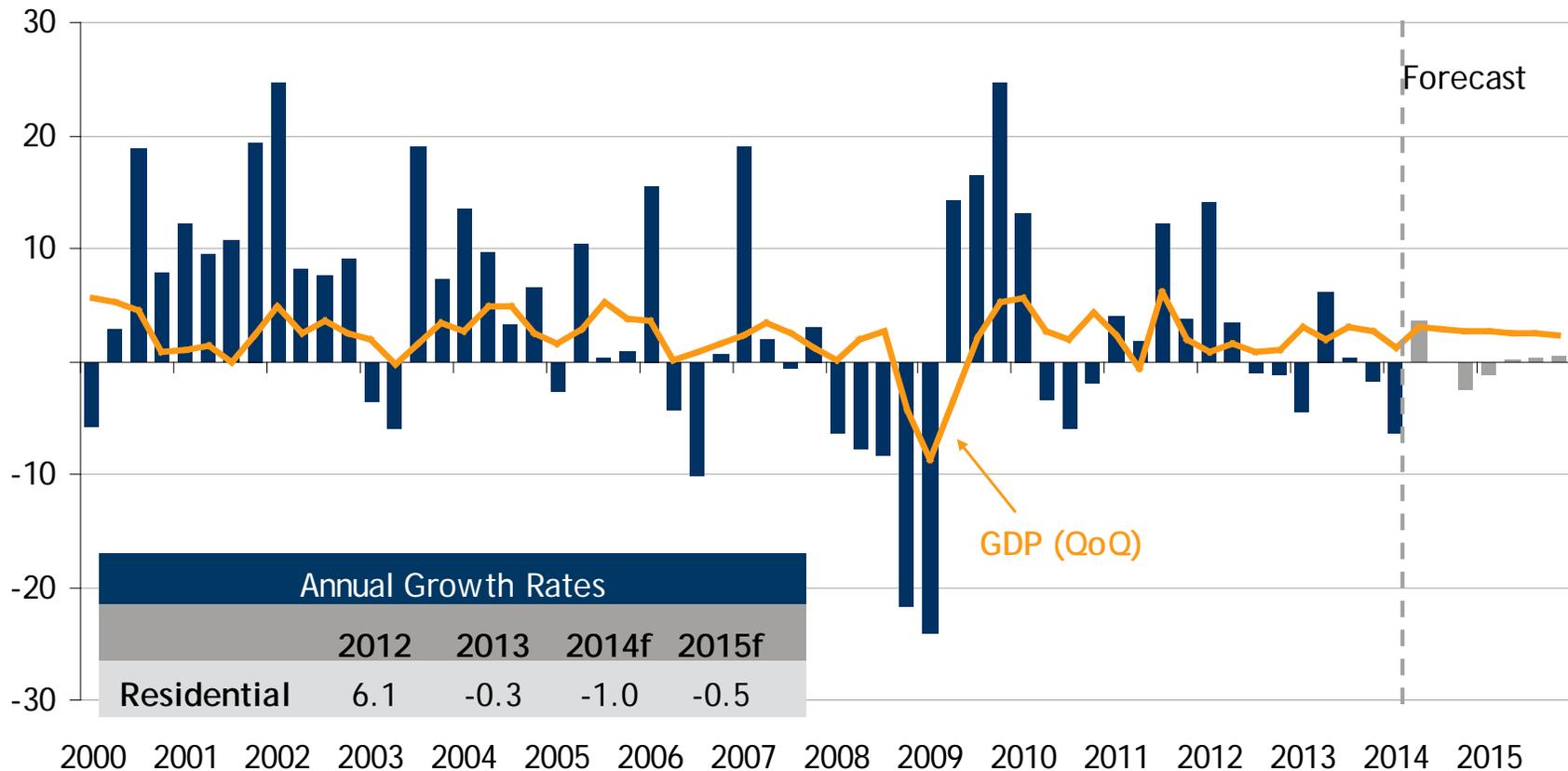


Source: Canada Mortgage and Housing Corporation, RBC Economics Research

The payback for some of the overstated strength in housing in 2012 will contribute to modestly declining residential investment continuing this year and next.

Residential investment in Canada

Quarter-over-quarter % change, annualized rate

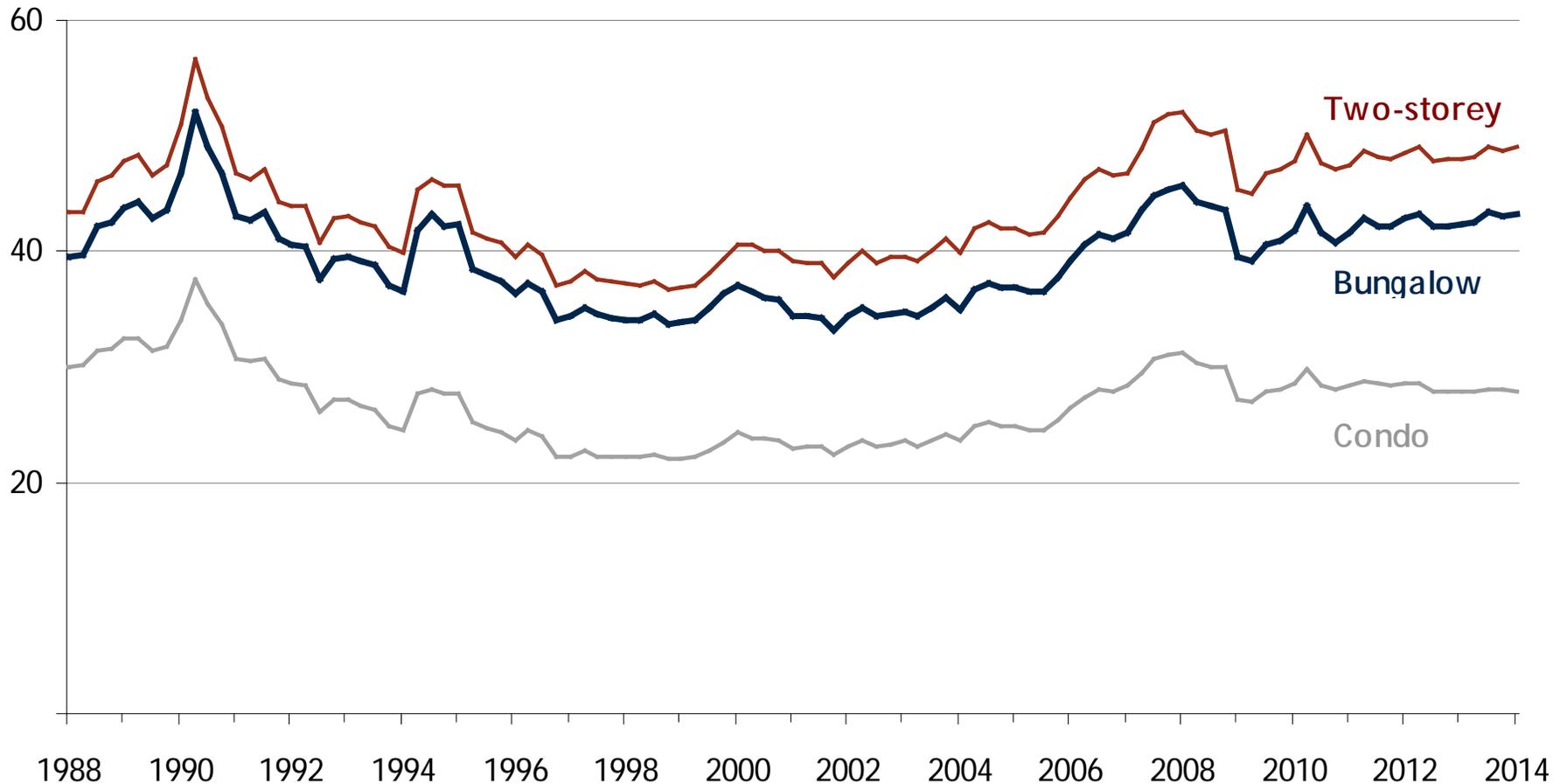


Source: Statistics Canada, RBC Economics Research

RBC's housing affordability measure, though indicative of poor affordability historically, is not flagging any marked deterioration.

RBC Housing Affordability Measures - Canada

Ownership costs as % of household income



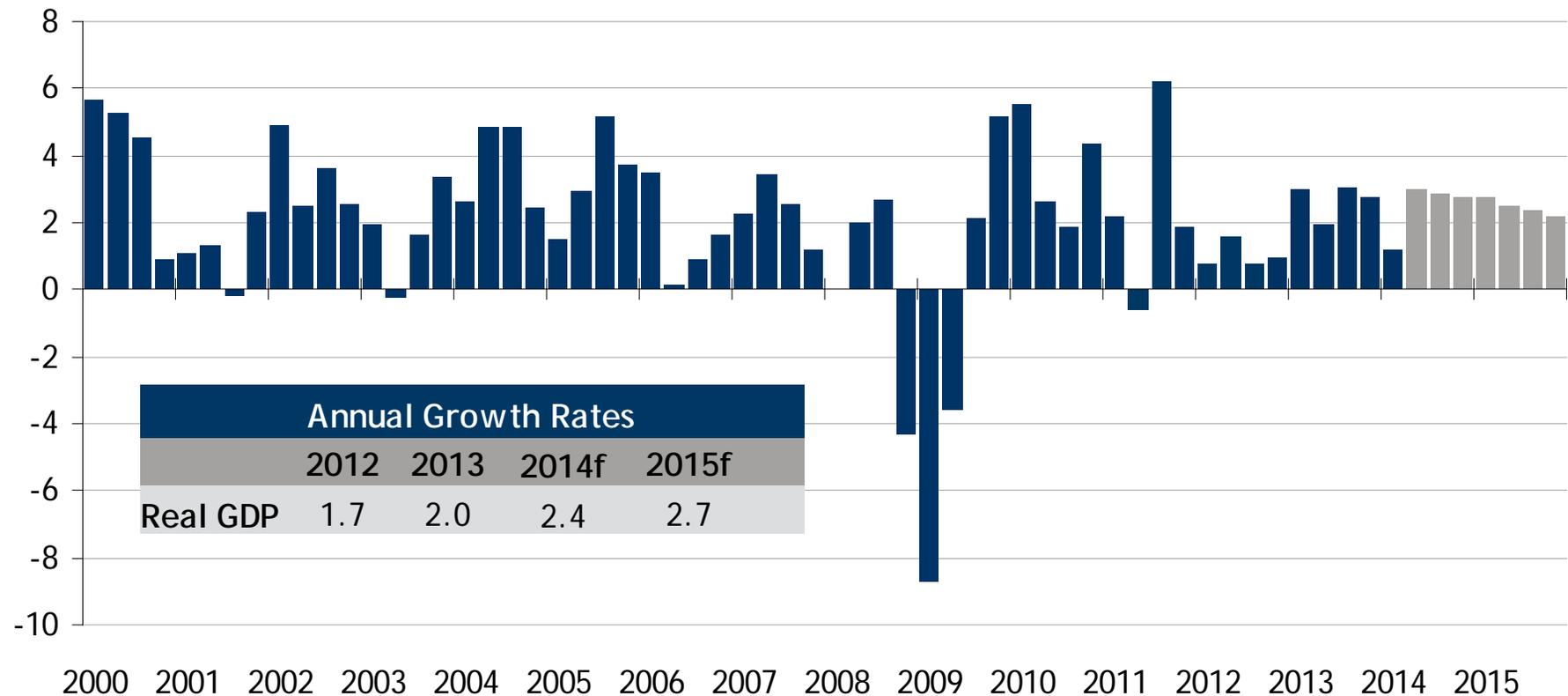
Source: Statistics Canada, Royal LePage, RBC Economics Research

Though the colder-than-usual winter weather weighed on Q1 growth, rising exports and modest increases in business investment will help ensure growth strengthens on an annual average basis this year and next.

Canada's real GDP

Quarter-over-quarter % change, annualized rate

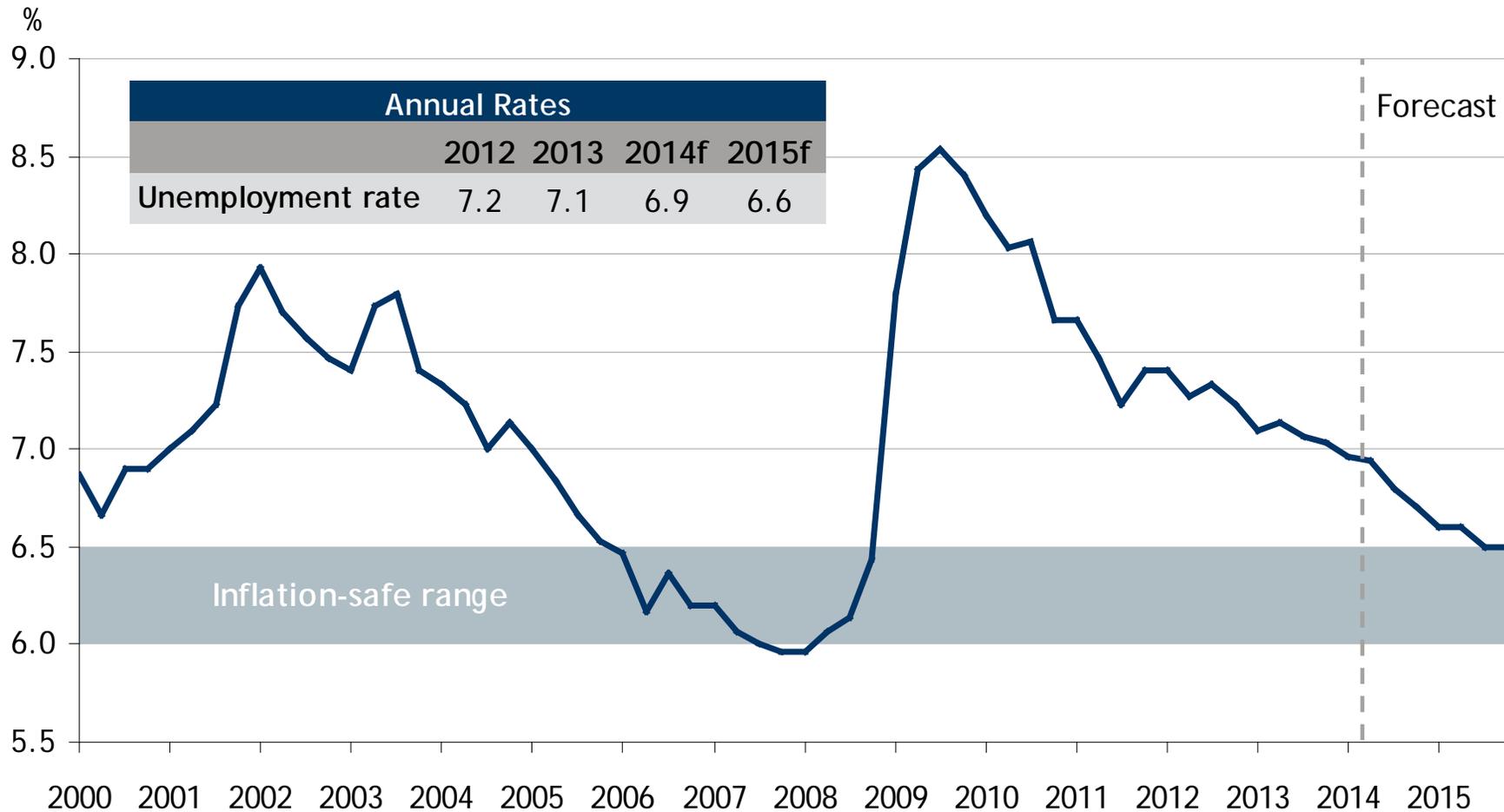
Forecast: ■



Source: Statistics Canada, RBC Economics Research Forecasts

Economic growth is expected to be sufficiently strong to put further downward pressure on the unemployment rate through the forecast

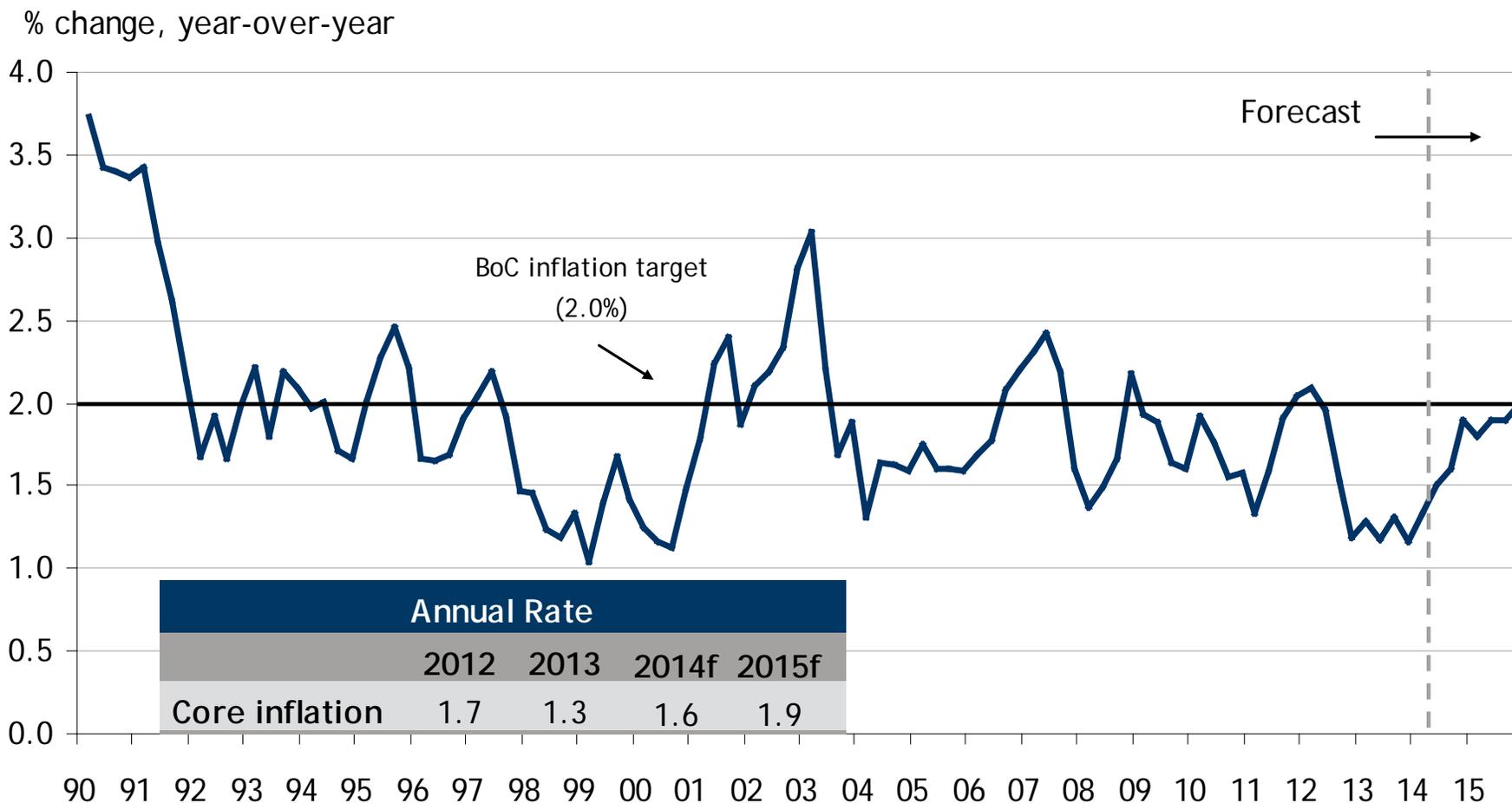
Unemployment rate: Canada



Source: Statistics Canada, RBC Economics Research

Though the unemployment rate has moved lower, there remains sufficient slack in the economy to keep core inflation below target this year and next though returning to 2% by the end of 2015

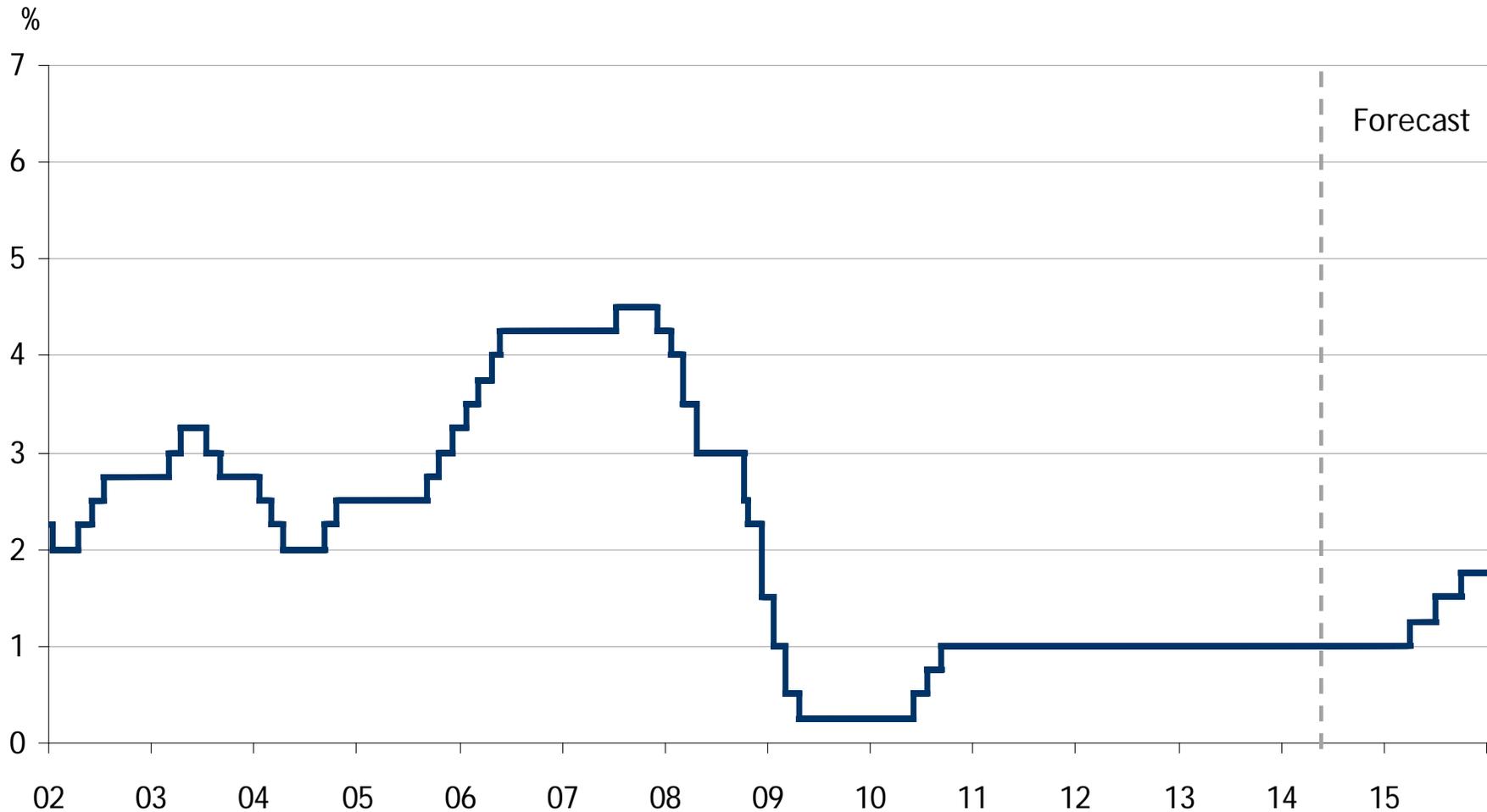
Core inflation: Canada



Source: Statistics Canada, RBC Economics Research

To sustain growth, and in the absence of inflationary pressures, the Bank of Canada is expected to maintain the overnight rate at 1.00% until the second quarter of 2015 before rising gradually to 1.75% by the end of 2015.

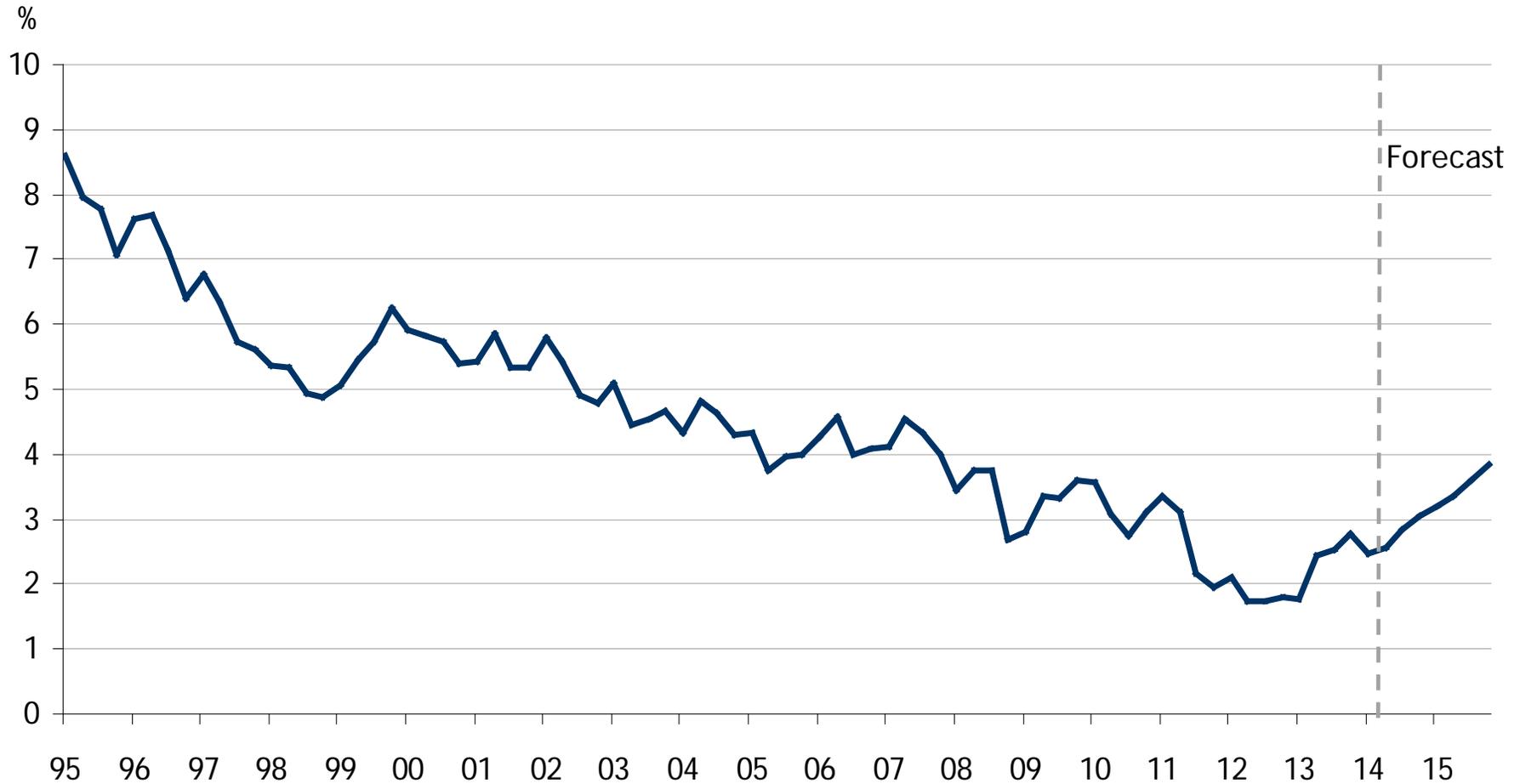
Bank of Canada overnight rate



Source: Bank of Canada, RBC Economics Research

Bond yields are projected to rise as financial markets anticipate eventual central bank tightening in both Canada and the U.S. though to levels that remain historically low.

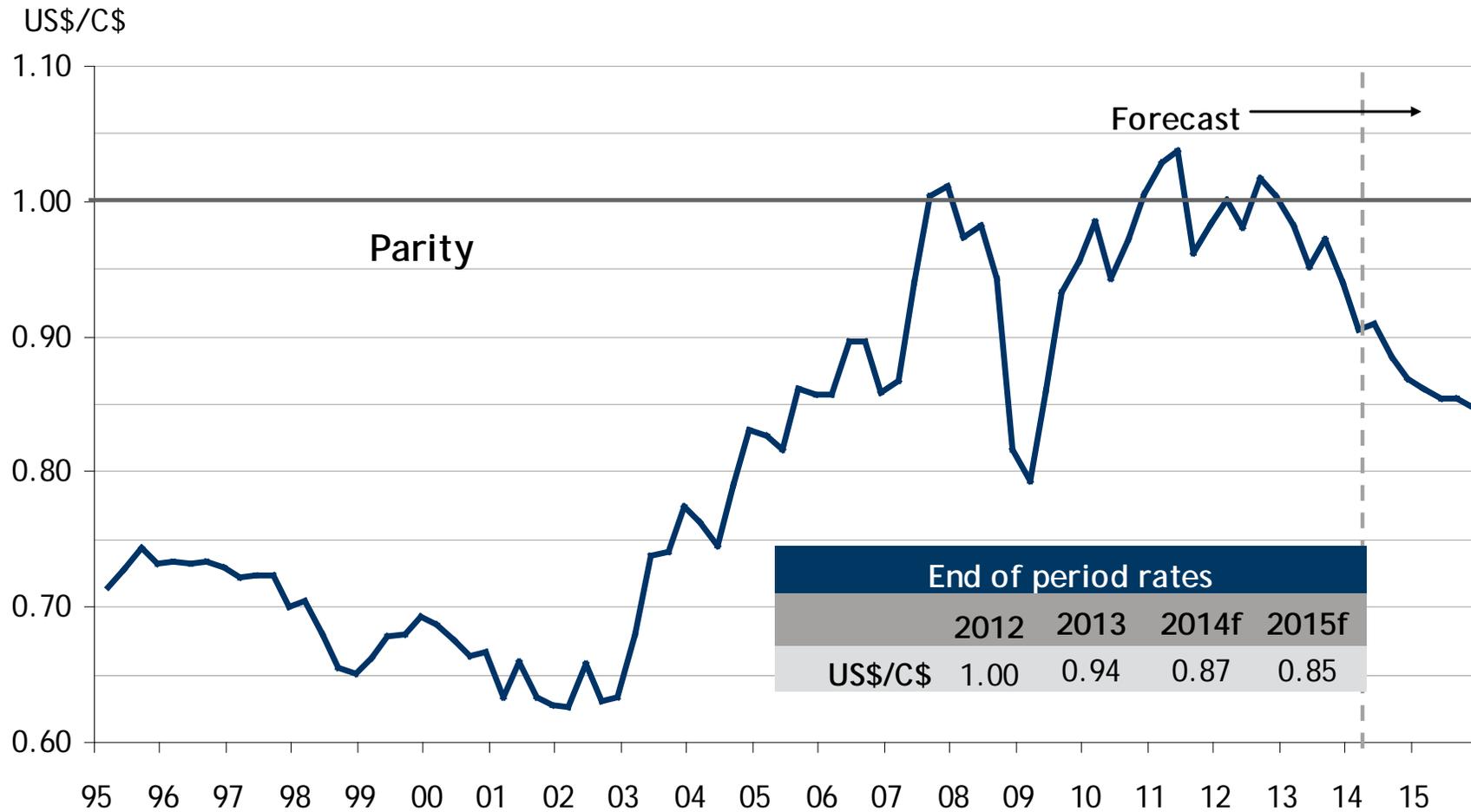
10 year bond yield: Canada



Source: Bank of Canada, RBC Economics Research

The Canadian dollar to remain historically high, supported by still strong commodity prices, though on a depreciating trend reflecting the recent weakness in export growth.

Canadian dollar forecast



Source: Bank of Canada, RBC Economics Research Forecasts

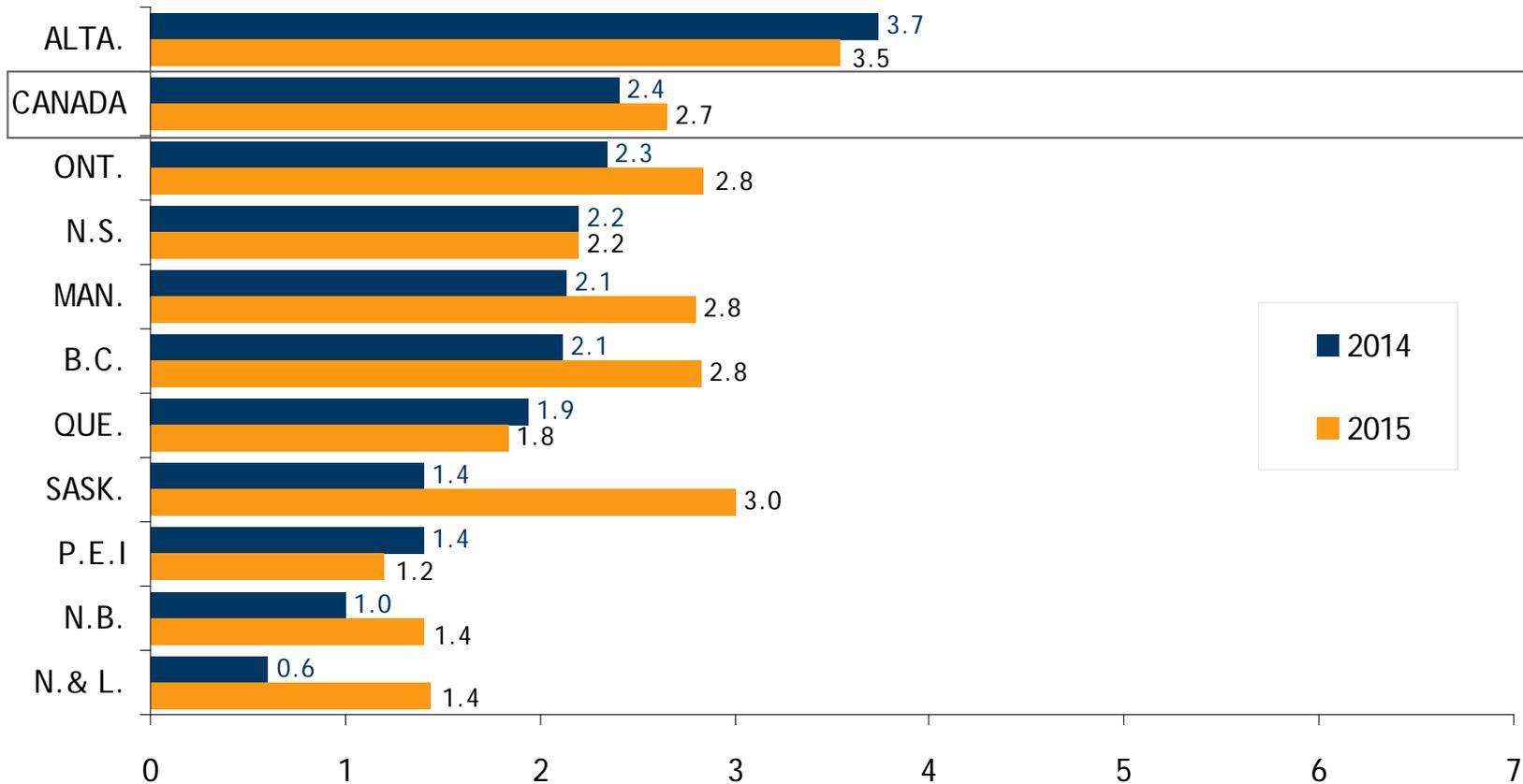
Ontario Economic Outlook:

Ontario to Benefit From a Strengthening U.S. Economy

Continuing historically strong commodity prices will have a varying impact among the provinces though with Alberta clearly benefitting

Provincial real GDP growth

Annual % change, ranked by 2014 growth



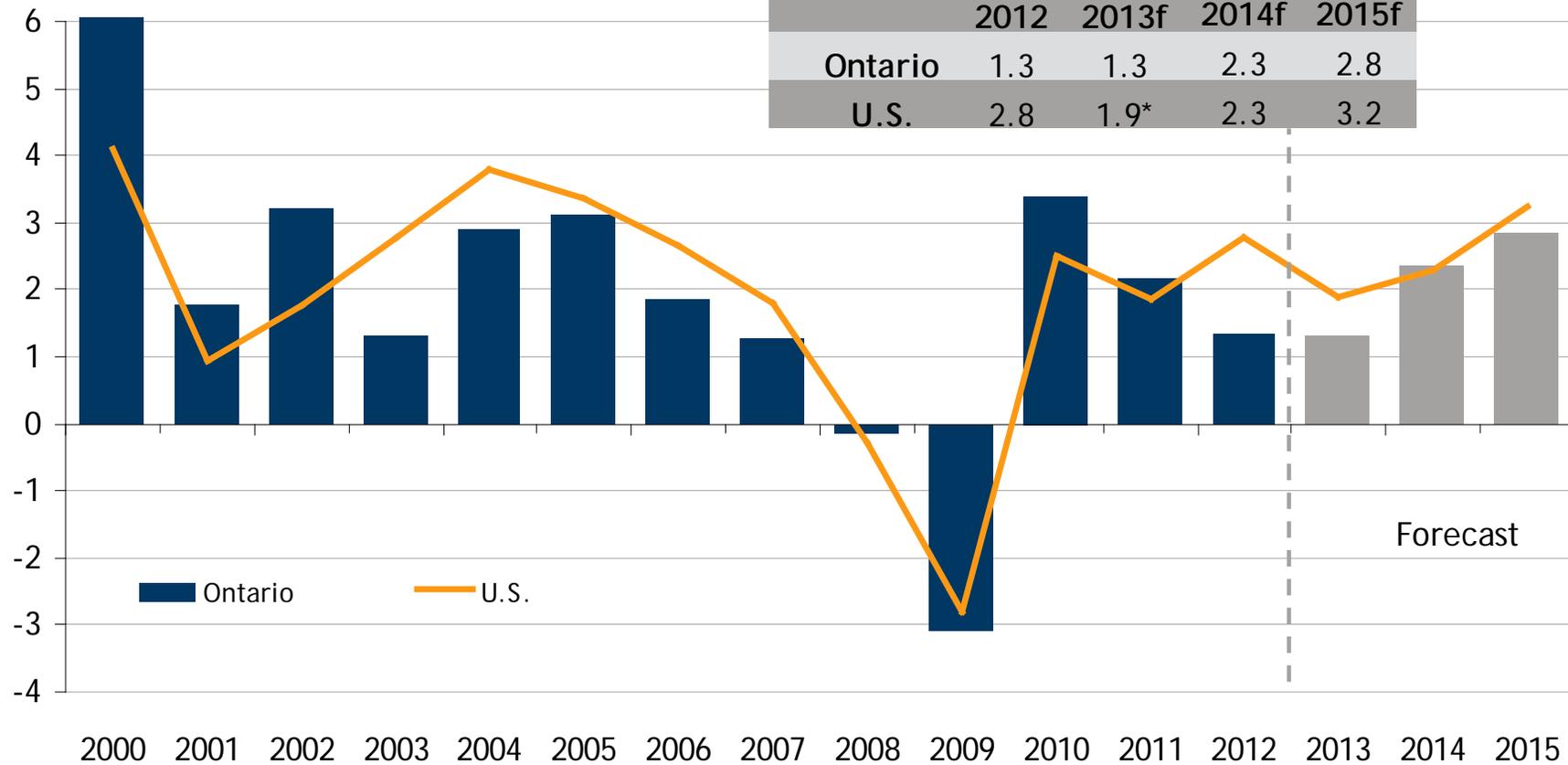
Sources: Statistics Canada, RBC Economics Research

Ontario's growth will be much more driven by a strengthening U.S. economy

Real GDP: U.S. and Ontario

% change, year-over-year

Annual Growth Rates				
	2012	2013f	2014f	2015f
Ontario	1.3	1.3	2.3	2.8
U.S.	2.8	1.9*	2.3	3.2

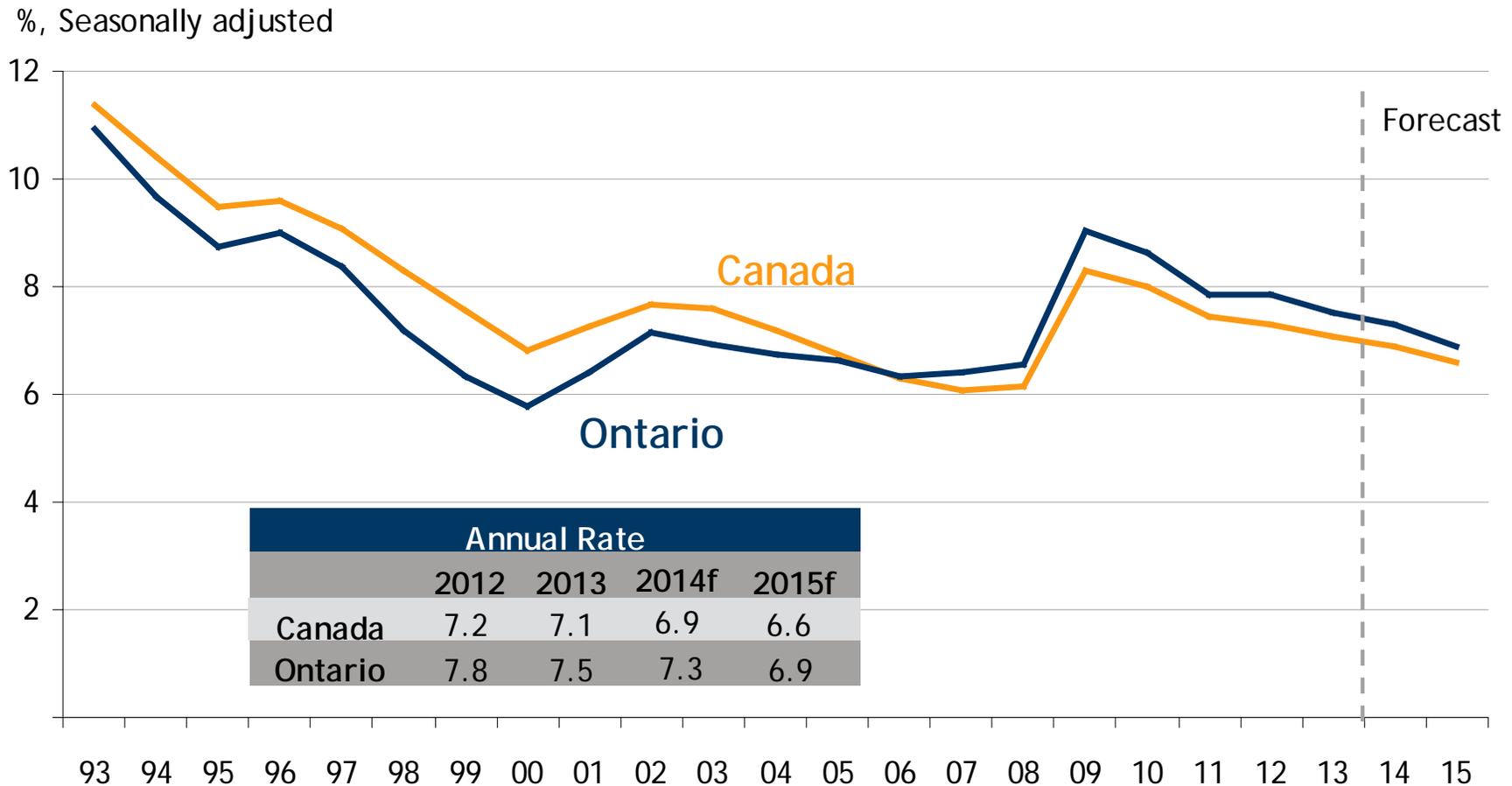


* U.S. GDP for 2013 is actual data.

Source: Statistics Canada, Bureau of Economic Analysis, RBC Economics Research

The subdued recovery will allow for only a modest improvement in the unemployment rate in Ontario

Unemployment rate: Ontario and Canada

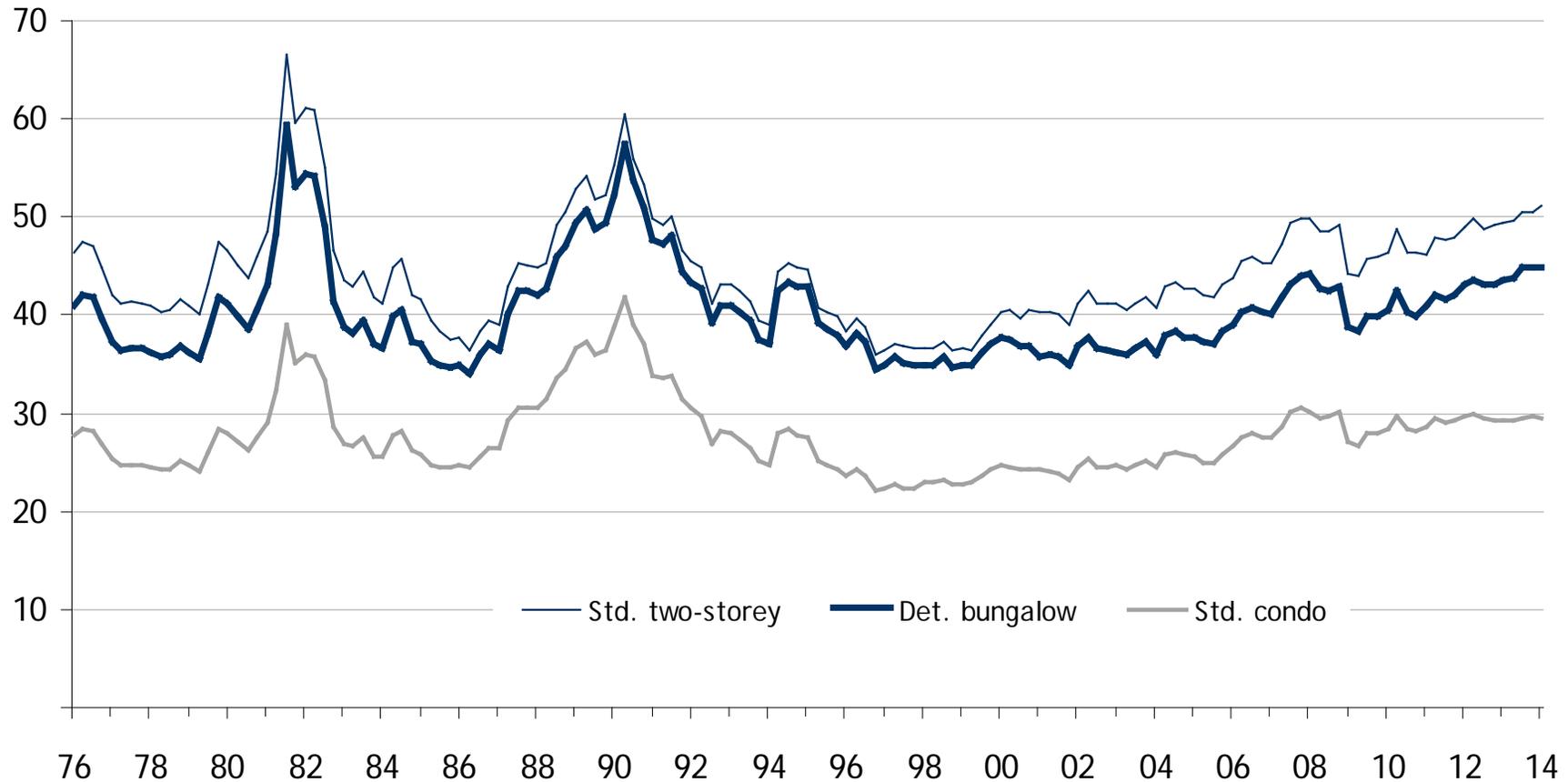


Source: Statistics Canada, RBC Economics Research

The modest recovery has resulted in limited pricing imbalances in the Ontario housing market though affordability has continued to gradually deteriorate coming out of the last recession

Housing affordability index: Ontario

% of household income taken up by ownership costs



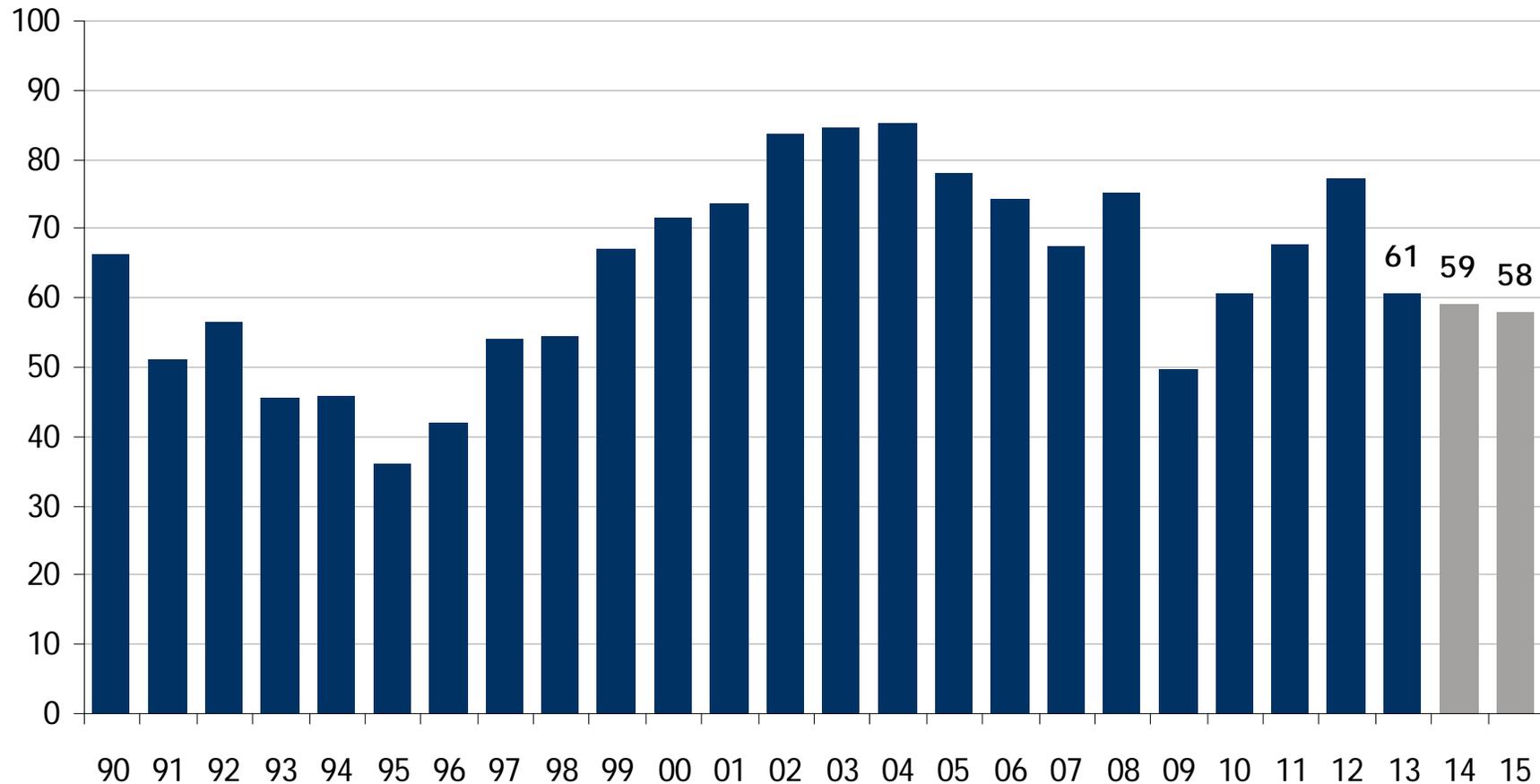
Source: Statistics Canada, RBC Economics Research

The modest pace of growth in Ontario, rising interest rates and the advancing of housing activity into 2012 will contribute to a lower level of new residential construction through the forecast.

Housing starts: Ontario

SAAR, Thousands of units

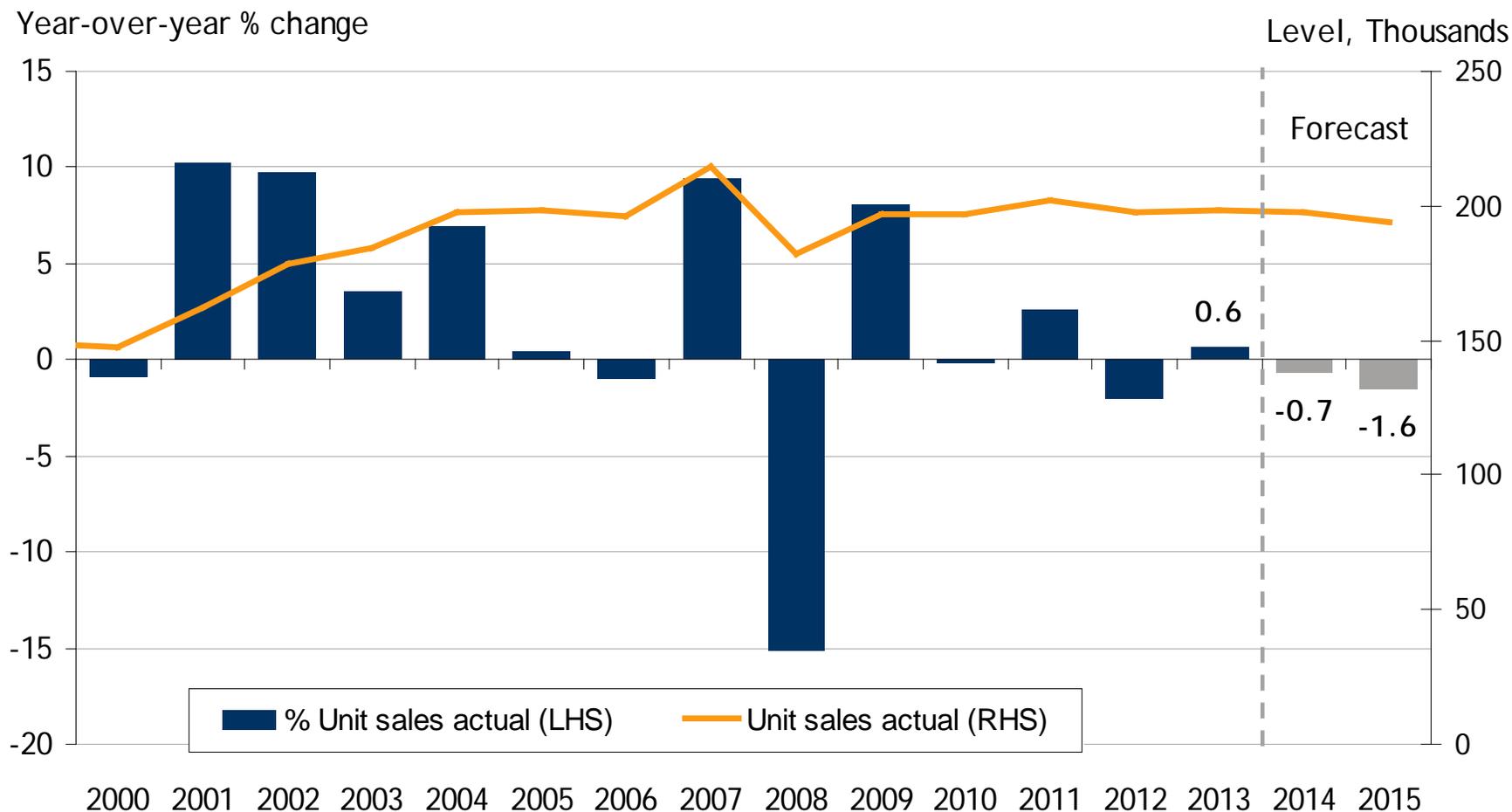
Forecasted Values: ■



Source: Canada Mortgage and Housing Corporation, RBC Economics Research

Deteriorating housing affordability is expected to apply modest downward pressure on housing resales in Ontario ...

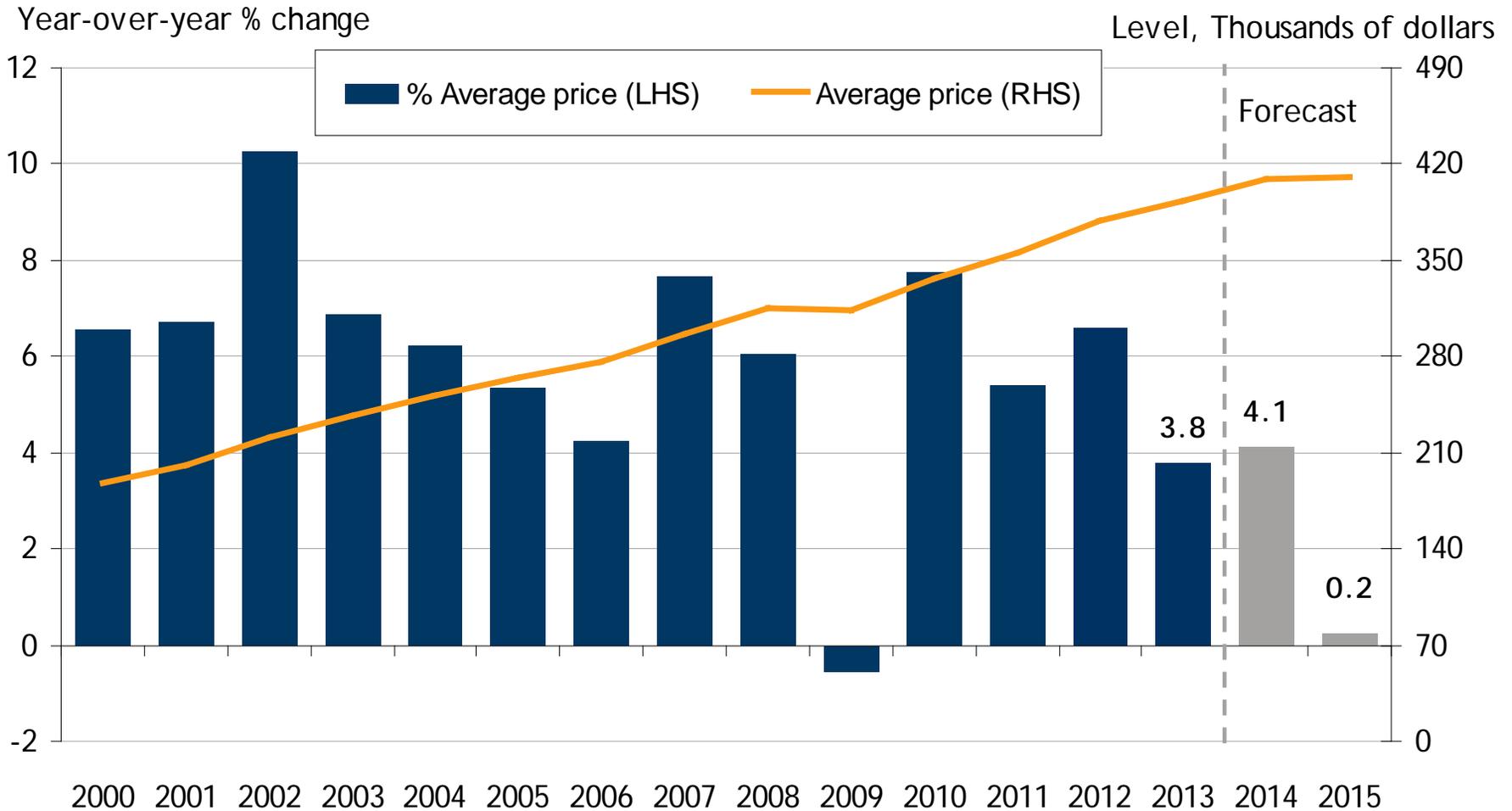
Housing resales: Ontario



Source: CREA, RBC Economics Research

... and an eventual flattening out in housing prices in 2015.

Housing prices: Ontario



Source: Royal LePage, Statistics Canada, RBC Economics Research

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