

**ECONOMICS DIGEST**

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Current trends...

Signs of recovery springing up

- ▲ Canada's economy grew for the third-straight month at 0.4% following upwardly revised gains of 0.3% in October (was 0.2%) and 0.5% in September (was 0.4%).
- ▲ Canada's economy created 43,000 new jobs in January. The unemployment rate slipped to 8.3% from a revised 8.4% during December as the strong employment gain outstripped the 18,900 rise in the labour force.
- ▲ November retail sales fell with weakness in clothing sales and general merchandise stores sales attributed to unseasonably warm temperatures in November that affected winter clothing sales
- ▲ Low mortgage rates and improving consumer confidence in the economic recovery continue to provide support for housing demand.

- ▲ The December merchandise trade balance remained in deficit. Exports rose \$0.530 billion (1.7%) while imports rose \$0.575 billion (1.8%).
- ▲ The consumer price report for December showed overall prices fell 0.3%, although the year-over-year rate rose to 1.3%. With so much slack in the economy and a strong currency dampening prices of imported goods, it is likely that both the headline and core rates will remain below the Bank's 2% target throughout 2010.

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Financial markets...

It's looking like the real thing!

Data over the past month largely produced upside surprises relative to market forecasts resulting in a sustained pickup in equity markets and a relatively sharp rise in government bond yields. The improved tone in the economic reports led to upward revisions to projections for U.S. fourth quarter growth with the consensus shifting toward the economy growing at a faster pace than the 3% annualized quarterly rate forecasted in early December 2009.

Canada - recovery confirmed

- ▲ Canada's economy expanded for a third-consecutive month in November with real GDP rising at a stronger-than-expected 0.4% pace, on a monthly basis, accompanied by upward revisions to the previous-two months' data.
- ▲ We've revised our call to show a more robust 4.0% annualized gain for the fourth quarter after positive surprises provided upside risk to our previous 3.4% forecast.

- ▲ The economy's stronger performance in the fourth quarter cleared the hurdle for the recovery, but it will take further sustained growth for the output gap to close and the unemployment rate to move down on a sustained basis.
- ▲ In its January Monetary Policy Report, the Bank of Canada made a slight revision to the growth forecast in 2010 and 2011. These changes, however, had no effect on when it expects the output gap (the difference between actual GDP and an estimate of potential GDP where all inputs are fully utilized) to close and by extension when the inflation rate is forecasted to rise to the 2% target.
- ▲ As the economic recovery picks up pace, the Bank will start to shift the policy rate toward a more neutral stance in order to head off a rise in the inflation rate above its medium term target. Our expectation that the economy will grow at an above-potential pace in the first half of the year suggests that the Bank will begin this process in the summer because of the lags between changes in monetary policy and their effect on the economy. We maintain our view that the overnight rate will rise by 100 basis points this year with another 225 basis points of rate increases expected in 2011.

That's what we're talking about!

- ▲ The first estimate of fourth quarter U.S. real GDP growth showed a stronger-than-expected 5.7% annual rate gain. The increase was dominated by a sizeable add from inventories although final domestic demand rose as well, marking the first back-to-back quarterly increases since the recession began.
- ▲ The stronger growth in the fourth quarter confirmed two main developments. The first is that the consumer, after being in hiding the previous six quarters, reemerged in the second half of 2009. The other development was that business fixed investment turned positive. This reflected a significant rise in spending on equipment and software, and a modest increase in residential investment.
- ▲ To be sure, 2010's growth rate will be slower than the fourth quarter of 2009's robust pace as support from inventories moderates and government spending programs peter out over the course of the year.
- ▲ We remain confident that the economy will not tip back into recession. The improvement in consumer confidence in January, surprisingly robust gain in the manufacturing purchasing managers' index and indications that credit has become more accessible augur well for the U.S. economy to continue to expand.
- ▲ The stronger-than-expected fourth-quarter growth rate trimmed back the 2009 annual decline to 2.4% and supported an upward revision to our 2010 growth forecast to 2.9% from 2.6%.
- ▲ The Fed is unlikely to shift its current policy stance, near-term, given the elevated unemployment rate and well-contained core prices. We look for the Fed to maintain the current low Fed funds rate target and focus on phasing out its less-traditional programs. In the final quarter of the year, as private sector demand takes over from government spending, our baseline view remains that the Fed will be in position to raise the Funds rate.

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Special reports...

Alberta's budget 2010-11... another year of tough slugging

- ▲ Alberta's budget released on February 9th, 2010 projects a deficit of \$4.7 billion for 2010-11. The deficit is forecast to shrink to \$1.1 billion in 2010-12, setting a stage for a small surplus of \$505 million in 2010-12.
- ▲ The Alberta government will continue to dip into the Sustainability Fund to offset the deficits in the next two years. The Fund is projected to decrease from \$15.0 billion at the end of 2009-10 to \$2.8 billion at the end of 2012-13.
- ▲ Total revenues are projected to rise by 1.3% in 2010-11 to \$34 billion. There is an expectation for a much stronger growth of 9.8% in 2011-12.

- ▲ Operating expenses will continue to grow strongly in 2010-11, increasing by \$1.7 billion to \$33.2 billion. A good portion of this increase, however, is due to a one-time \$759 million provision to eliminate Alberta Health Services' accumulated deficit.
- ▲ The provincial government forecasts real GDP at 2.6% this year and 2.9% in 2011.

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