Country report

CANADA

Summary

Canada remains a well governed country and boasts a strong economy. The economic recovery is underway and risks to household finances are acknowledged and addressed. The political unstable status-quo is set to remain in place, but the end of fiscal stimulus and the economic recovery will lower the government budget deficit and stabilize the debt ratio. High household indebtedness is a concern, but unlikely to lead to a financial crisis. Export dependence on both the US and commodities leads to the risk of economic shocks.

Things to watch:

- Developments in the high degree of household indebtedness
- Commodity price risks given strong energy export dependence
- Risks resulting from the large trade dependence on the US

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Canada

National facts	
Type of government	Parliamentary democracy
Capital	Ottawa
Surface area (thousand sq km)	9,984.67
Population (millions)	33.68
Main languages	English (58.5%)
	French (21.6%)
Main religions	Roman Catholic (42.6%)
	Protestant (23.3%)
Head of State	Queen Elizabeth II
Head of Government (prime-minister)	Stephen Joseph Harper
Monetary unit	CAD

Economy	2010	
Economic size	*bn USD*	*% world total*
Nominal GDP	1574	2.53
Nominal GDP at PPP	1328	1.79
Export value of goods and services	461	2.48
IMF quotum (in mln SDR)	6369	2.93
Economic structure	*2010*	*5-year av.*
Real GDP growth	3.1	1.2
Agriculture (% of GDP)	2	2
Industry (% of GDP)	27	29
Services (% of GDP)	49	55
Standards of living	*USD*	*% world av.*
Nominal GDP per head	46294	470
Nominal GDP per head at PPP	39059	334
Real GDP per head	35412	442

Social and governance indicators	rank / total
Human Development Index (rank)	8 / 169
Ease of doing business (rank)	7 / 183
Economic freedom index (rank)	6 / 179
Corruption perceptions index (rank)	6 / 178
Press freedom index (rank)	21 / 178
Gini index (income distribution)	32.6

Foreign trade			2008/09
Main export partners (%)		*Main import partners (%)*	
US	75	US	51
UK	3	China	11
China	3	Mexico	5
Japan	2	Japan	3
Main export products (%)			
Energy products			26
Industrial goods			23
Machinery and equipment			19
Automobile products			13
Main import products (%)			
Machinery and equipment			28
Industrial goods			21
Automobile products			17
Consumer goods			13
Openness of the economy			
Export value of G&S (% of GDP)			29
Import value of G&S (% of GDP)			30
Inward FDI (% of GDP)			1.4

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic growth set to continue…

Canadian GDP grew by 3.1% in 2010, more than making up for the 2.5% contraction in the year before and making it one of the best performers of the industrialised world. Employment has similarly regained pre-recession levels over the past year. Because the labour force has also been growing steadily the unemployment rate is still significantly higher at 7.8% compared to 6% observed in the year before recession hit. Economic growth was aided by the recovery in the US (the main export partner), a sharp rise in commodity prices, record low interest rates and a two year fiscal stimulus. In light of the economic recovery and rising consumer prices, the central bank has raised interest rates. This fiscal stimulus ended in March 2011. Coupled with continued economic growth this should lead to a reduction in the government budget deficit. Given the reduction in both monetary and fiscal stimulus, economic growth is expected to slow down to 2.5% this year and next. This pace of expansion should be enough to gradually bring down unemployment.

… as is political instability

The current budget deficits follow on an average budget surplus of almost 1% in 1997-2008. This brought down gross public debt to 67% of GDP in 2008. Against this gross debt, the government has sizeable financial assets, so that net debt is expected to be limited to 34% of GDP in 2012. On March 25 2011 the conservative minority government collapsed after losing a no-confidence vote. According to political analysts, the May 2 elections may well result in a new conservative minority government and will in any case not significantly change the balance of power between political parties. An alternative to a conservative minority government could be a coalition between the Liberals and the New Democratic Party. But given fundamental differences of opinion, this is unlikely to be a stable government. As such, political instability is unlikely to be resolved any time soon. Fortunately, this is generally not considered a big risk to the sustainability of government finances as the need for fiscal prudence is endorsed along the political spectrum.

High household debt and rising house prices are key concerns

The economic resilience and record low interest rates have pushed up house prices and household debt. The latter is now higher relative to disposable income than in the US. In response, in January 2011 the government has implemented stricter mortgage rules, after having taken steps to cool the housing market last year as well. Along with higher interest rates, this should reduce credit- and house price growth. The IMF argues that house prices are overvalued, but only moderately so. In general, the mortgage market is conservative when compared to what we have seen in the US in the years before the financial crisis. This is also an important reason for the resilience shown by the Canadian banking sector during the global financial crisis. Still, the developments in house prices and household debt warrant close attention for some time to come.

US trade and commodity dependence

The economy remains vulnerable to developments in the US economy and oil prices. A significant deterioration in US economic growth and/or a sharp drop in commodity prices will dampen prospects for economic growth. Export reliance on the US has been reduced somewhat in recent years, with export to the US as a share of total Canadian exports falling from 87.5% in 2000 to 75% in 2009 and with China and the UK taking up an increasing share. Also, with foreign trade in total at 30% of GDP, the domestic market is an important driving force total demand growth. On the other hand, dependence on commodities has increased significantly over the past decade. A steady rise in the exchange rate of the Canadian dollar and the focus on commodity industries has lead to lower competitiveness of the non-commodity manufacturing sector, a clear case of Dutch disease. Although the government has been running budget surpluses in the past decade, and hence has had the flexibility to cushion the impact of the worldwide recession and the sharp drop in commodity prices, the cyclically adjusted deficit (as calculated by the OECD) has been in deficit since the early 2000's. In other words: elevated government income from the commodity boom has not been used to run substantial budget surpluses. The experience of Ireland and Spain provides a clear case of what can happen to government budgets when a period of elevated but temporary tax intake (in that case from the booming real estate market) comes to an end. Given that the government is not planning on pushing back its budget balance into positive territory on the back of the current commodity boom, they are foregoing the opportunity to build ample buffers that can be used should a sharp reduction in commodity prices occur.

Canada

Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	2.8	2.2	0.5	-2.5	3.1	2.5	2.4
Consumer prices (average % change pa)	2.0	2.1	2.4	0.3	1.8	2.3	2.0
Current account balance (% of GDP)	1.4	0.8	0.4	-2.9	-3.1	-2.0	-2.8
Economic growth							
GDP (% real change pa)	2.8	2.2	0.5	-2.5	3.1	2.5	2.4
Gross fixed investment (% real change pa)	7.1	3.5	1.4	-11.8	8.3	5.4	5.2
Private consumption (real % change pa)	4.2	4.6	2.9	0.4	3.4	2.7	2.4
Government consumption (% real change pa)	3.0	2.7	3.9	3.5	3.4	0.8	1.1
Exports of G&S (% real change pa)	0.6	1.2	-4.6	-14.2	6.4	3.8	3.1
Imports of G&S (% real change pa)	4.9	5.9	1.2	-13.9	13.4	3.5	4.2
Economic policy							
Budget balance (% of GDP)	1.5	1.3	-0.2	-5.6	-3.9	-2.1	-1.0
Public debt (% of GDP)	70	67	71	83	82	79	77
Money market interest rate (%)	4.2	4.6	3.2	0.6	0.8	1.4	2.4
M2 growth (% change pa)	8	8	13	7	17	8	5
Consumer prices (average % change pa)	2.0	2.1	2.4	0.3	1.8	2.3	2.0
Exchange rate LCU to USD (average)	1.1	1.1	1.1	1.1	1.0	1.0	1.0
Recorded unemployment (%)	6.3	6.1	6.2	8.3	8.0	7.3	6.8
Balance of payments (mln USD)							
Current account balance	18063	11889	6476	-38080	-48400	-35300	-51000
Trade balance	43733	44158	43344	-3998	-8300	10100	7700
Export value of goods	400176	431183	459214	323276	392700	460900	468800
Import value of goods	356440	387010	415870	327270	401000	450900	461200
Services balance	-12456	-17494	-20918	-19823	-22600	-19000	-22900
Income balance	-11918	-12923	-15398	-12379	-15300	-23900	-33100
Transfer balance	-1296	-1871	-544	-1881	-2200	-2500	-2600
Net direct investment flows	14082	56928	-25528	-20175	-3120	6360	5100
Net portfolio investment flows	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
External position (mln USD)							
Total foreign exchange reserves	34994	40991	43778	54238	57000	n.a.	n.a.
International investment position	-72620	-127230	5500	-114010	n.a.	n.a.	n.a.
Total assets	1019570	1213080	1213610	1357090	n.a.	n.a.	n.a.
Total liabilities	1092190	1340310	1208110	1471100	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	3.4	3.1	2.9	-0.3	-0.5	0.6	0.4
Current account balance (% of GDP)	1.4	0.8	0.4	-2.9	-3.1	-2.0	-2.8
Inward FDI (% of GDP)	4.7	8.1	3.7	1.4	1.3	2.6	3.2
International investment position (% of GDP)	-5.7	-8.9	0.4	-8.5	n.a.	n.a.	n.a.

Source: EIU