

# The Economic and Financial Outlook

Presentation to MacDougall, MacDougall & MacTier Inc.

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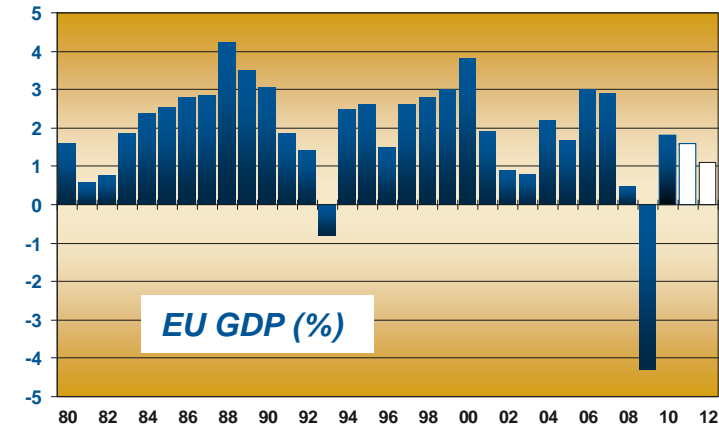
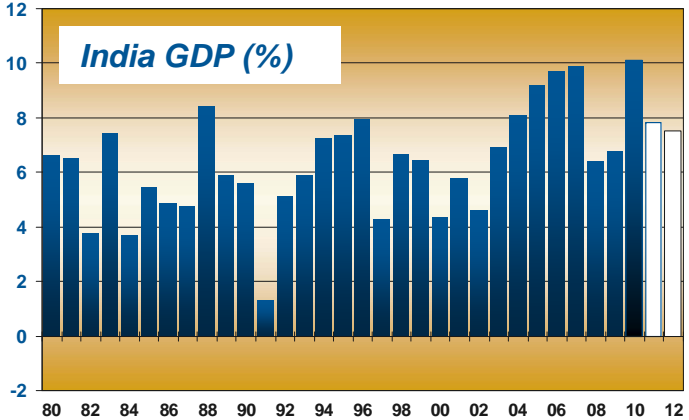
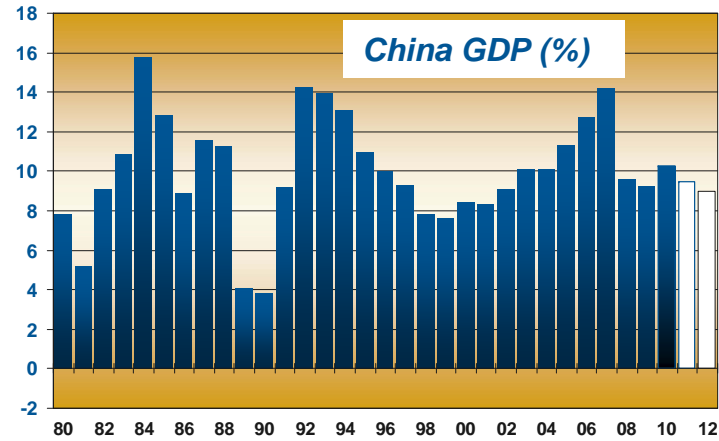
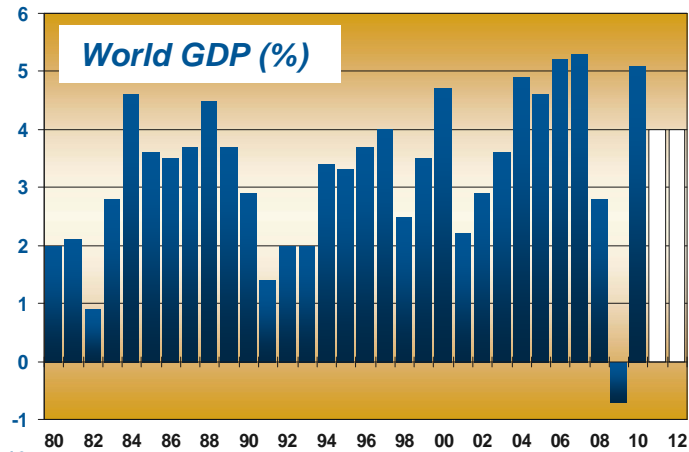
# Overview:

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1. *The IMF expects the world economy to grow 4.0% in 2011 and 2012 (but this is still too optimistic in our view)*
2. *US economy will most likely not slip back into outright recession (but there will be fiscal drag)*
3. *The US Senate would like to devalue the Dollar (but it could trigger a trade war)*
4. *The Canadian economic outlook calls for only modest expansion (but a Chinese slowdown is a worry)*
5. *Equity markets are “undervalued” (but Eurozone risks and US political standoffs cloud the outlook)*
6. *Government debt is likely “over-valued” (but investors are risk-averse and recession risks are significant)*
7. *Commodities remain in a long-term bull market (but setbacks on weak growth are inevitable)*
8. *The sovereign debt crisis will continue for the next 5-10 years (no “buts” here)*

# The World Economy

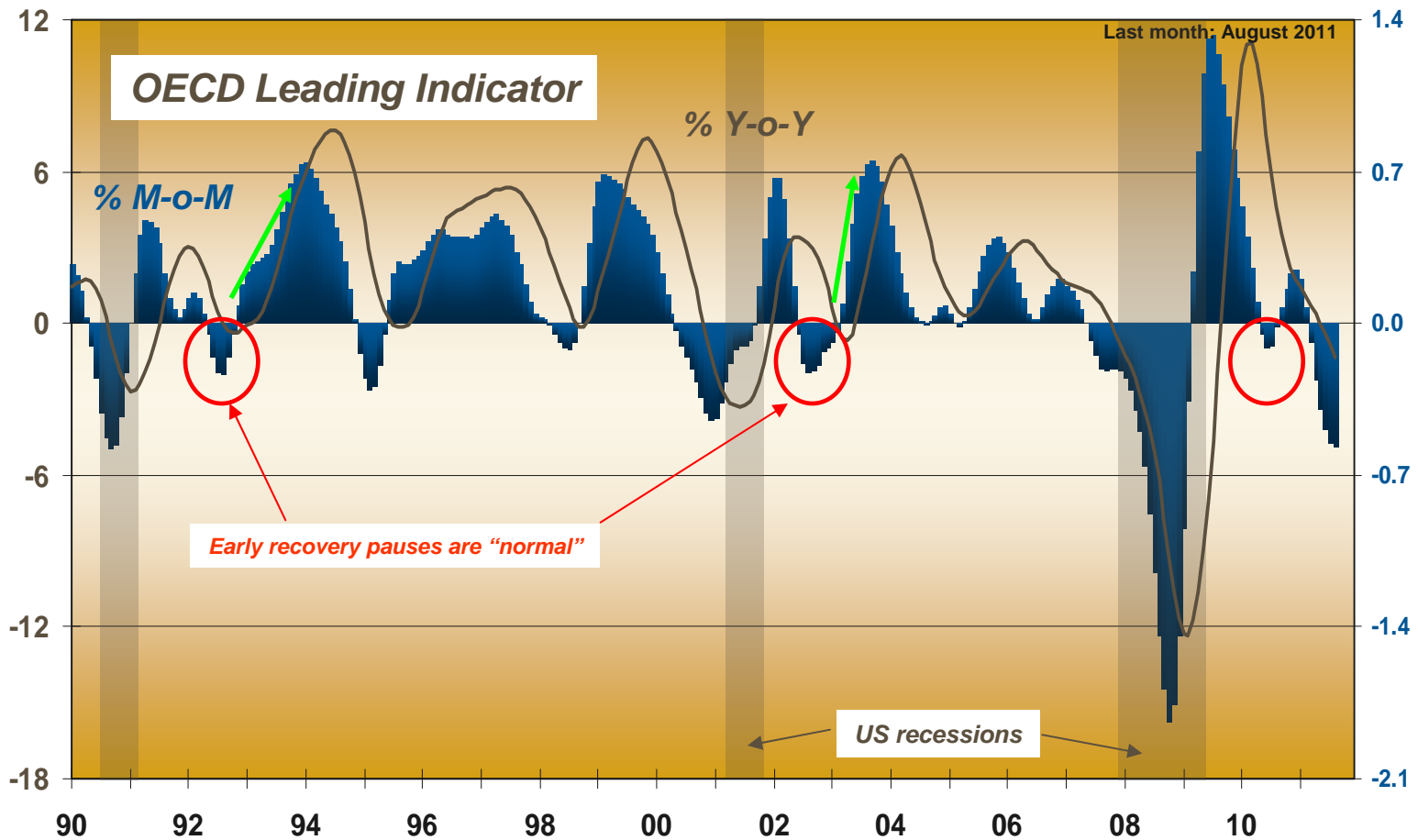
The IMF now forecasts a 4% growth rate ...



Source: IMF, September 2011

# The World Economy

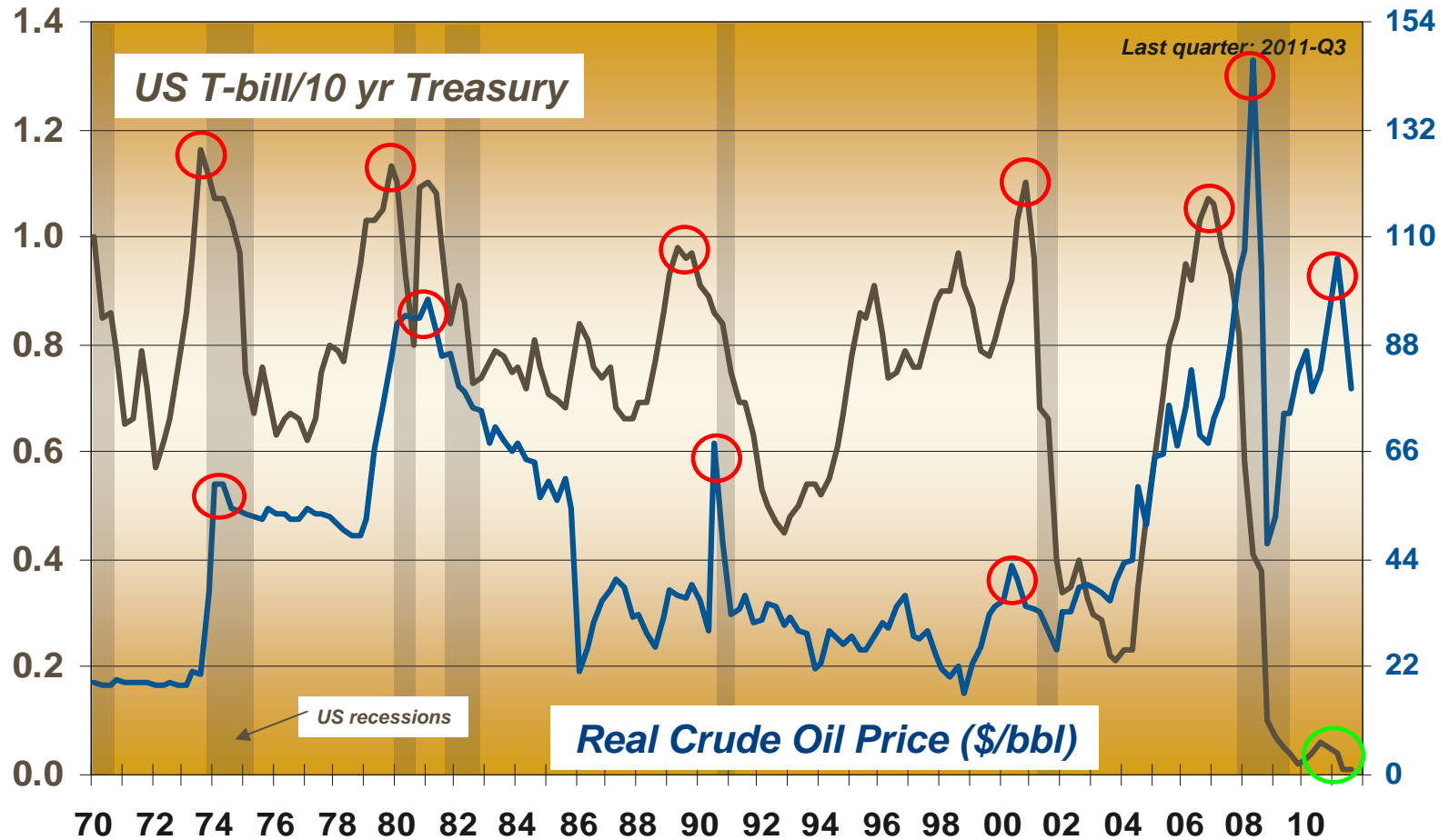
But the OECD\* LI points to something worse ...



\* Thirty-four developed countries

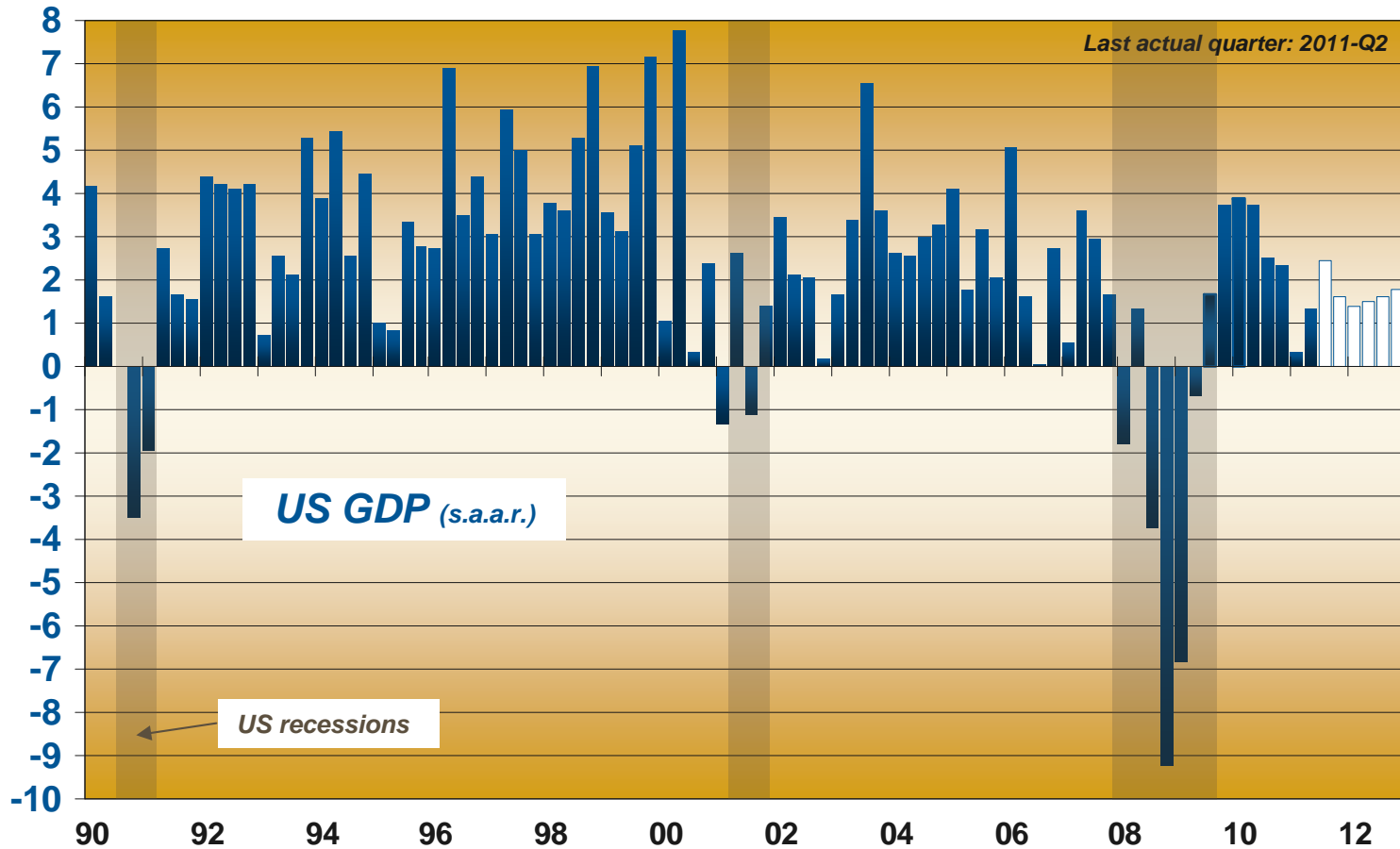
# World Economy – is recession likely?

High oil prices AND rate hikes are typically needed



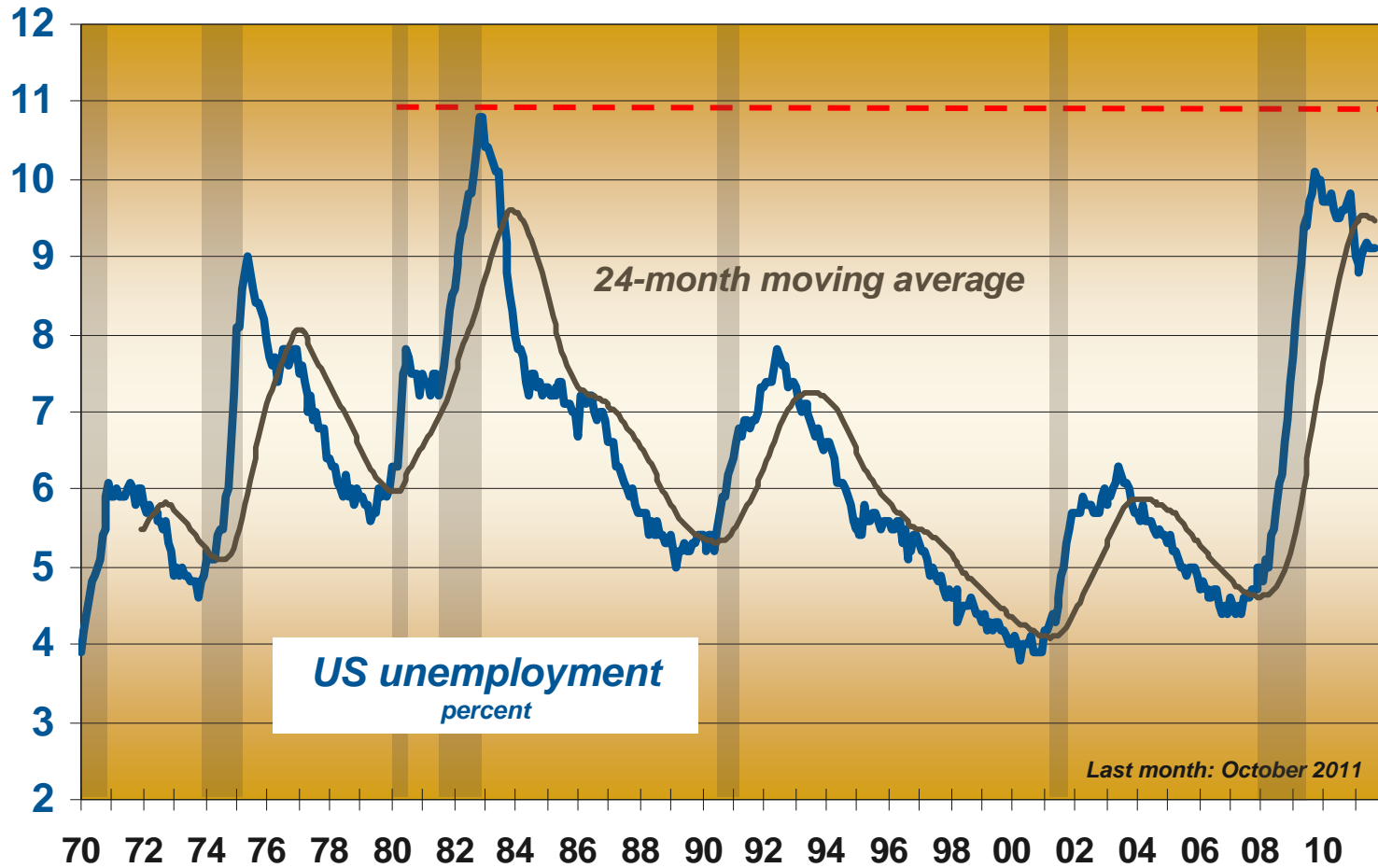
# US Economy

The outlook: low growth (-.5 to 2.0%)



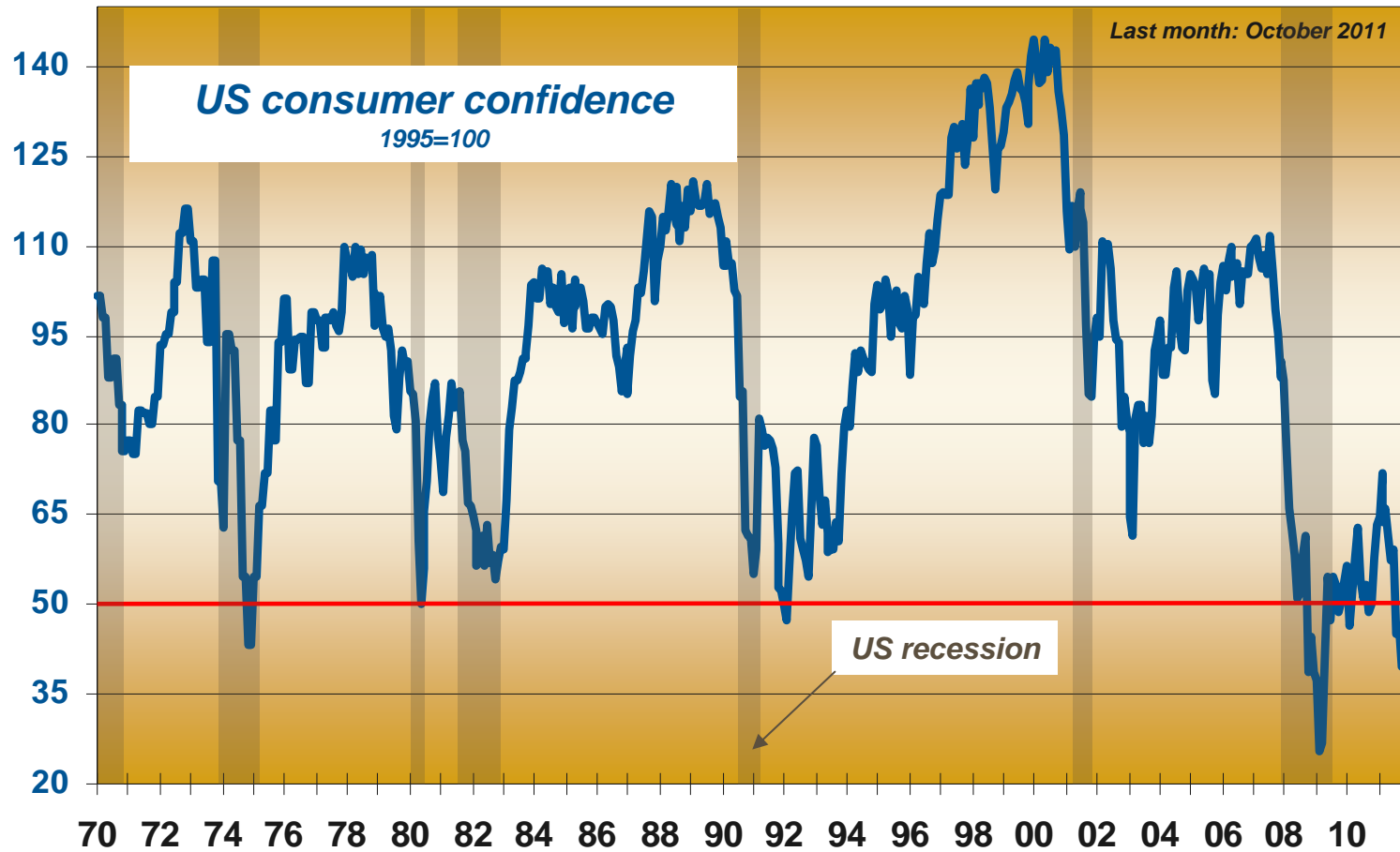
# US Economy

*Decline in unemployment rate is stalling ...*



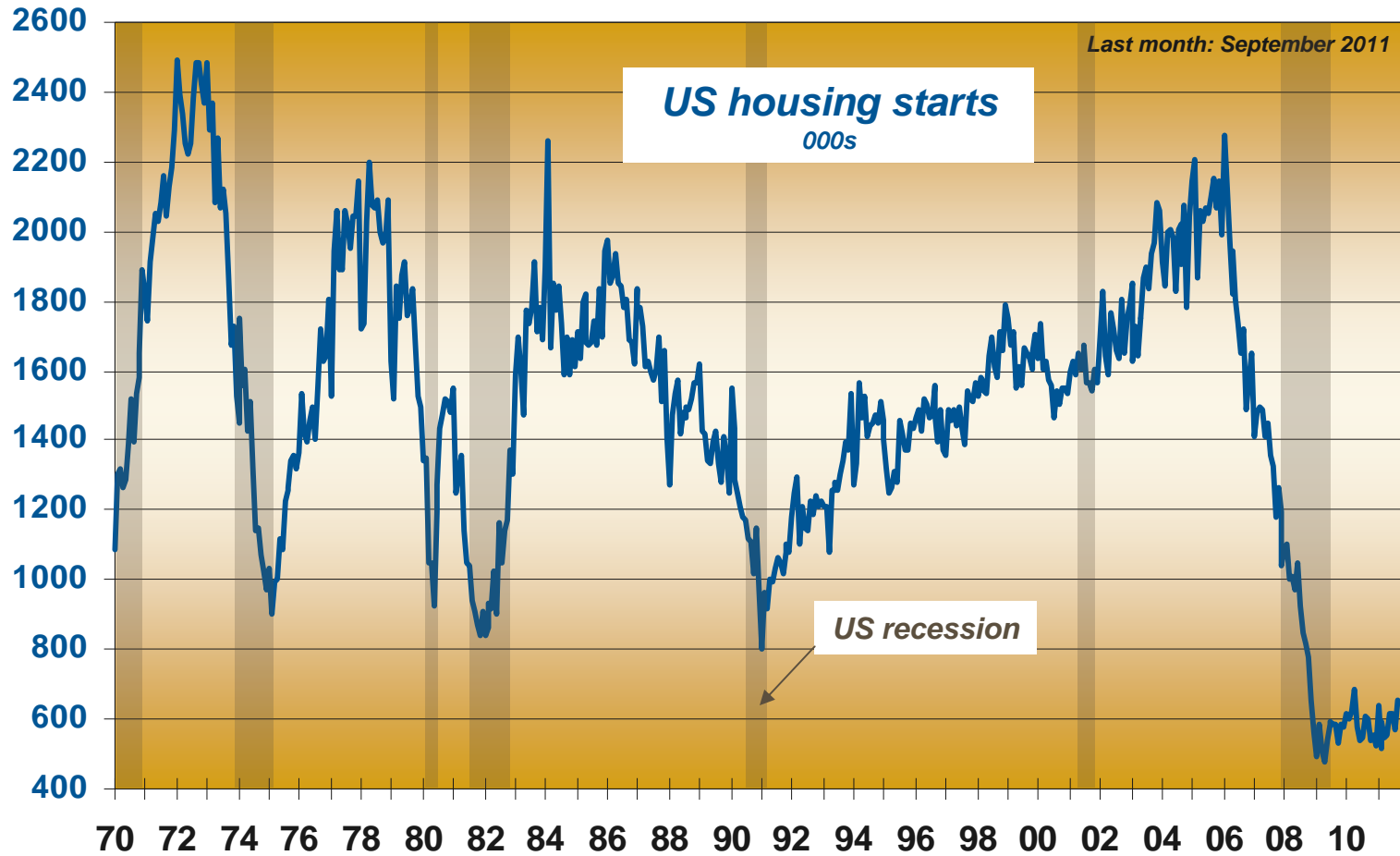
# US Economy

Consumer confidence is down ... again



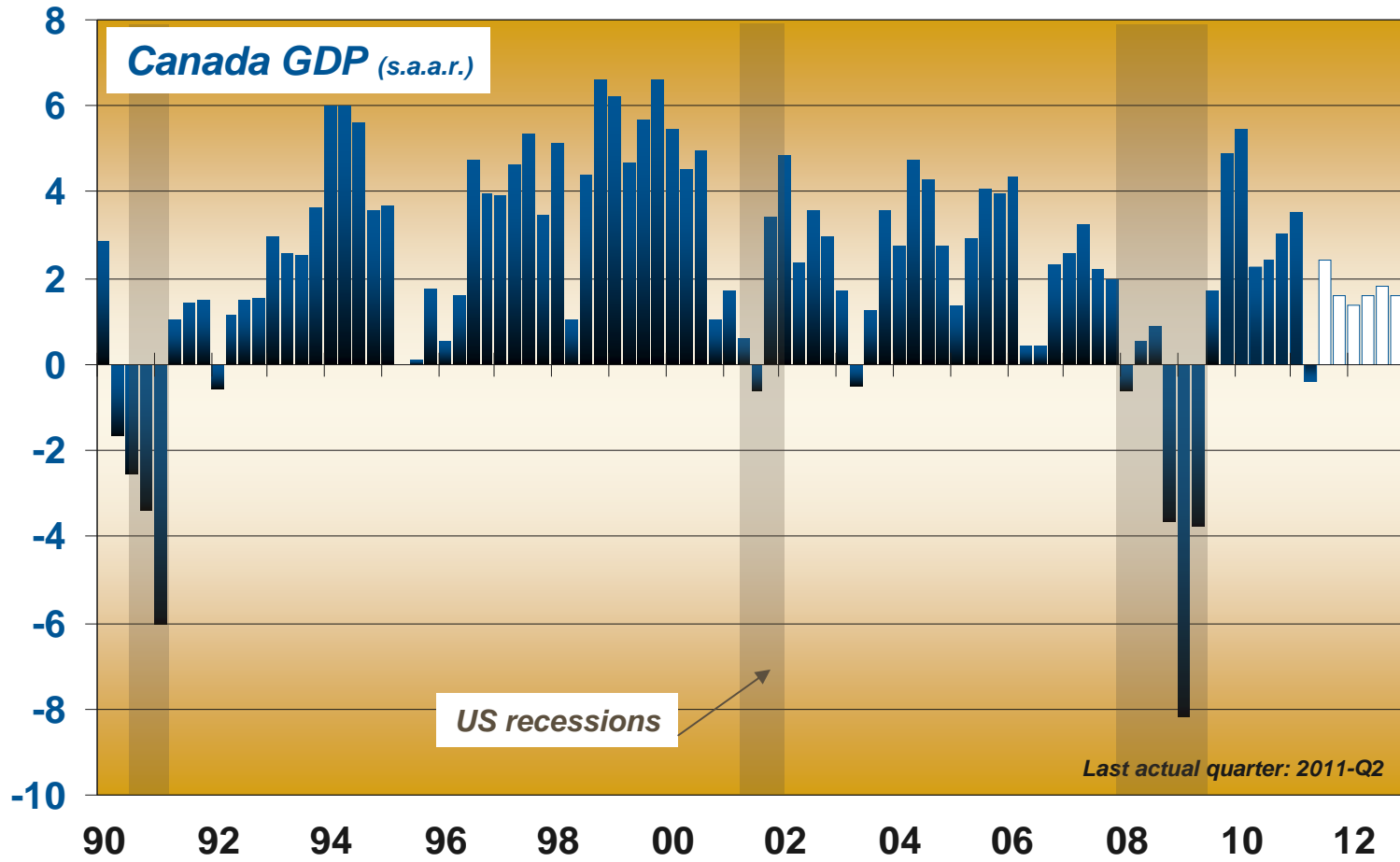
# US Economy

*... and housing starts are at record lows*



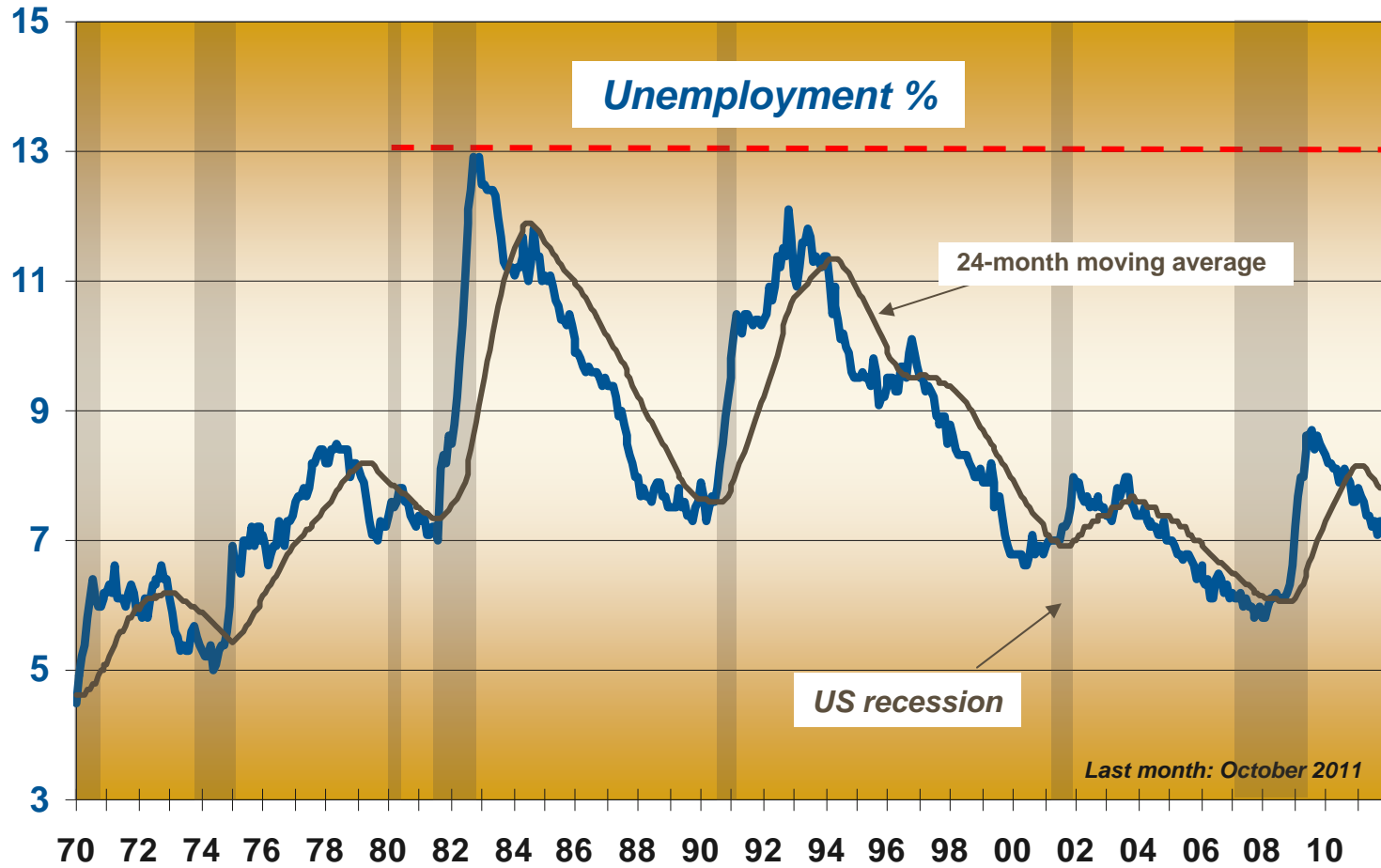
# Canadian Economy

Outlook calls for **-0.5% to 2.0%** growth ...



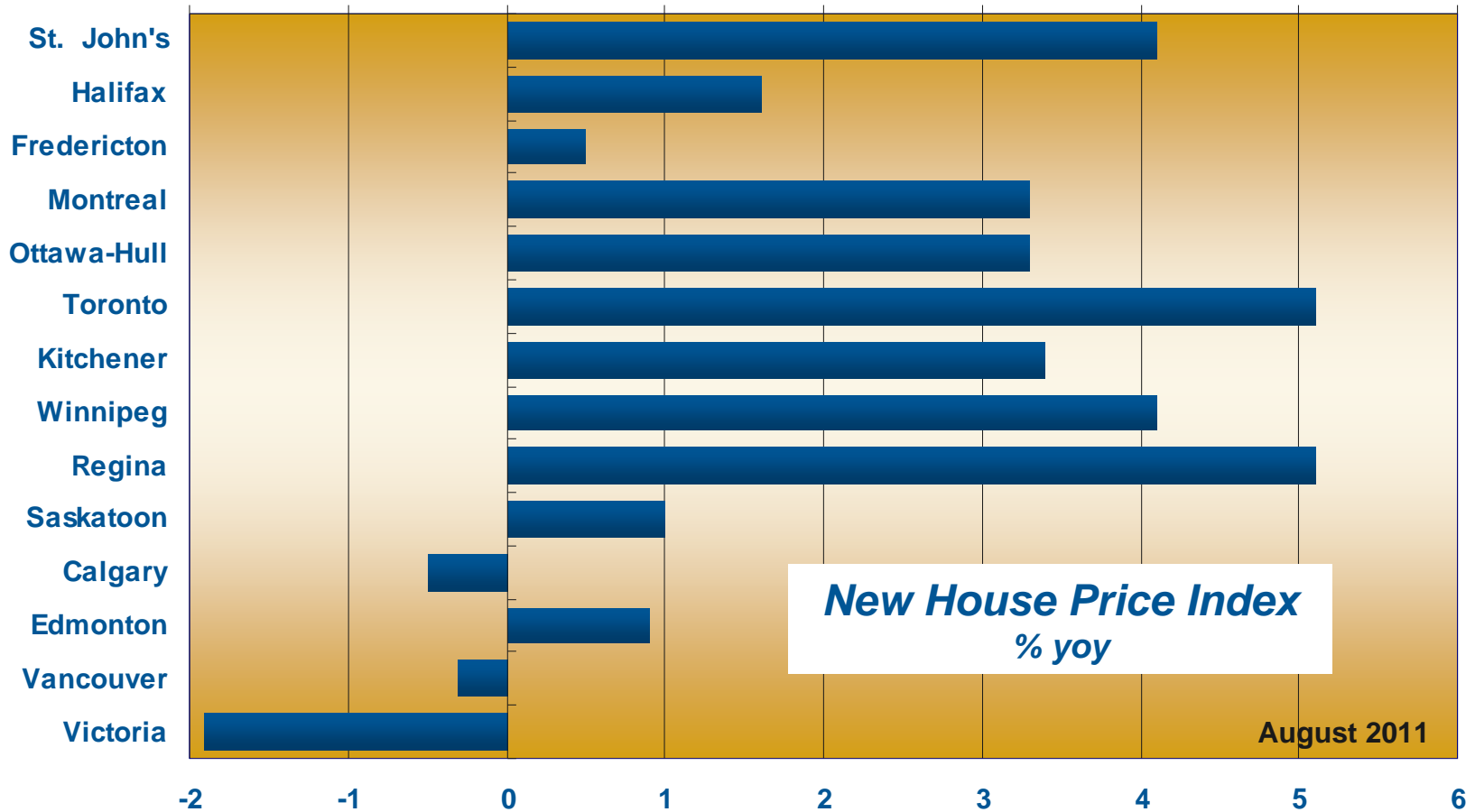
# Canadian Economy

*Unemployment has peaked ...*



# Canadian Economy

*New house prices are down in Vancouver & Victoria*



# Canadian Economy

## Canadian houses among most expensive in OECD

### The Economist house-price indicators

% change

	Latest on a year earlier	Q1 2010	2006- 2011*	Under(-)/ over(+) valued†	
Hong Kong	23.9	30.3	96	63.7	●
Singapore	10.1	25.1	63	17.3	
France	8.7	1.4	11	48.5	●
Belgium	5.5	5.1	22	20.5	●
Switzerland	4.4	4.9	18	5.5	
China‡	3.9	10.6	34	13.9	
Denmark	2.2	1.3	-10	18.3	
Sweden	2.1	10.7	25	35.8	●
Canada	2.0	1.9	13	21.2	●
Germany	0.9	-0.7	-4	-12.8	
Australia	-0.2	18.8	33	50.1	●
South Africa	-0.3	10.2	29	na	
Britain	-1.2	9.1	nil	27.8	●
Italy	-1.6	-3.4	1	8.7	
New Zealand	-1.6	6.4	6	17.6	
Netherlands	-2.1	6.0	-4	16.9	
United States (Case-Shiller ten-city index)	-3.1	1.5	-32	-0.5	
United States (FHFA)	-3.1	-6.4	-13	4.8	
Japan	-3.3	-4.0	-12	-35.8	
Spain	-4.7	-4.7	-9	39.2	●
United States (Case-Shiller national index)	-5.1	2.3	-33	-11.4	
Ireland‡	-12.2	-16.6	-35	22.9	●

● More than 20% overvalued

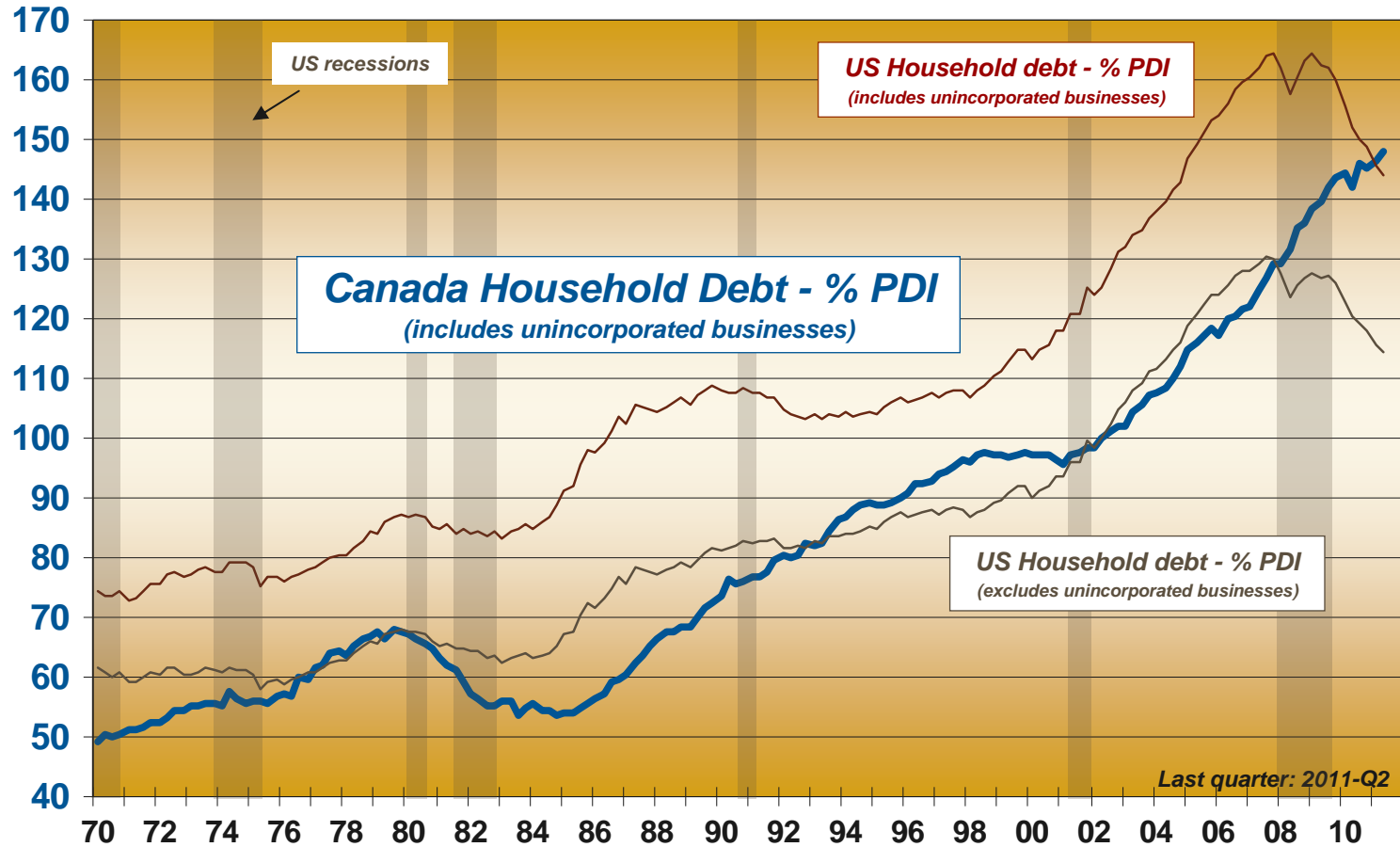
Sources: ABSA; Hypoport; Japan Real Estate Institute; Nationwide; Nomisma; NVM; FHFA; PropertyIQ; Stadim; Swiss National Bank; Standard & Poor's; Thomson Reuters; government offices; *The Economist*

\*Or latest available figure  
†Against long-run average of price-to-rents ratio  
‡New series

Source: *The Economist*, July 7, 2011

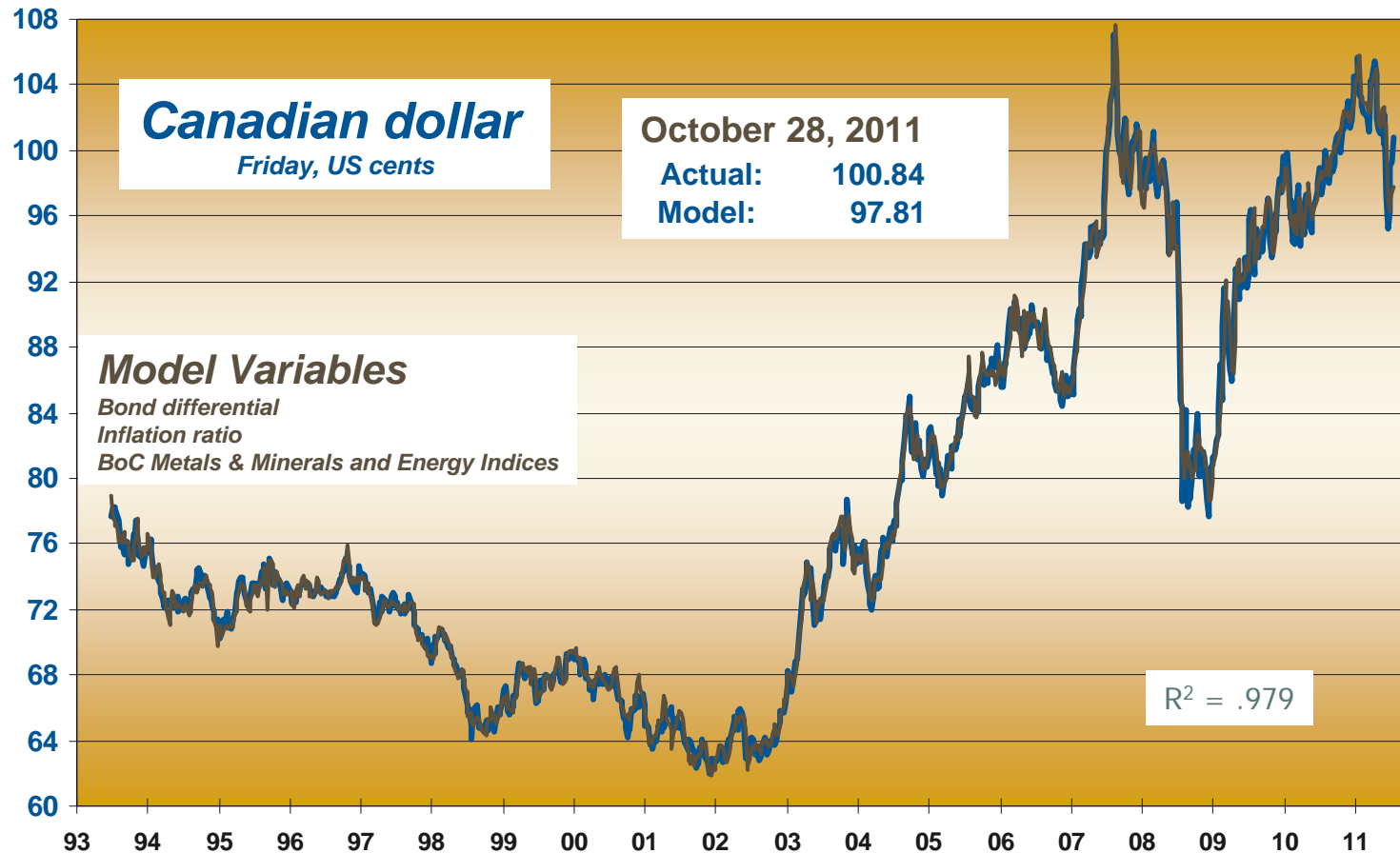
# Canadian Economy

Household debt remains much too high ...



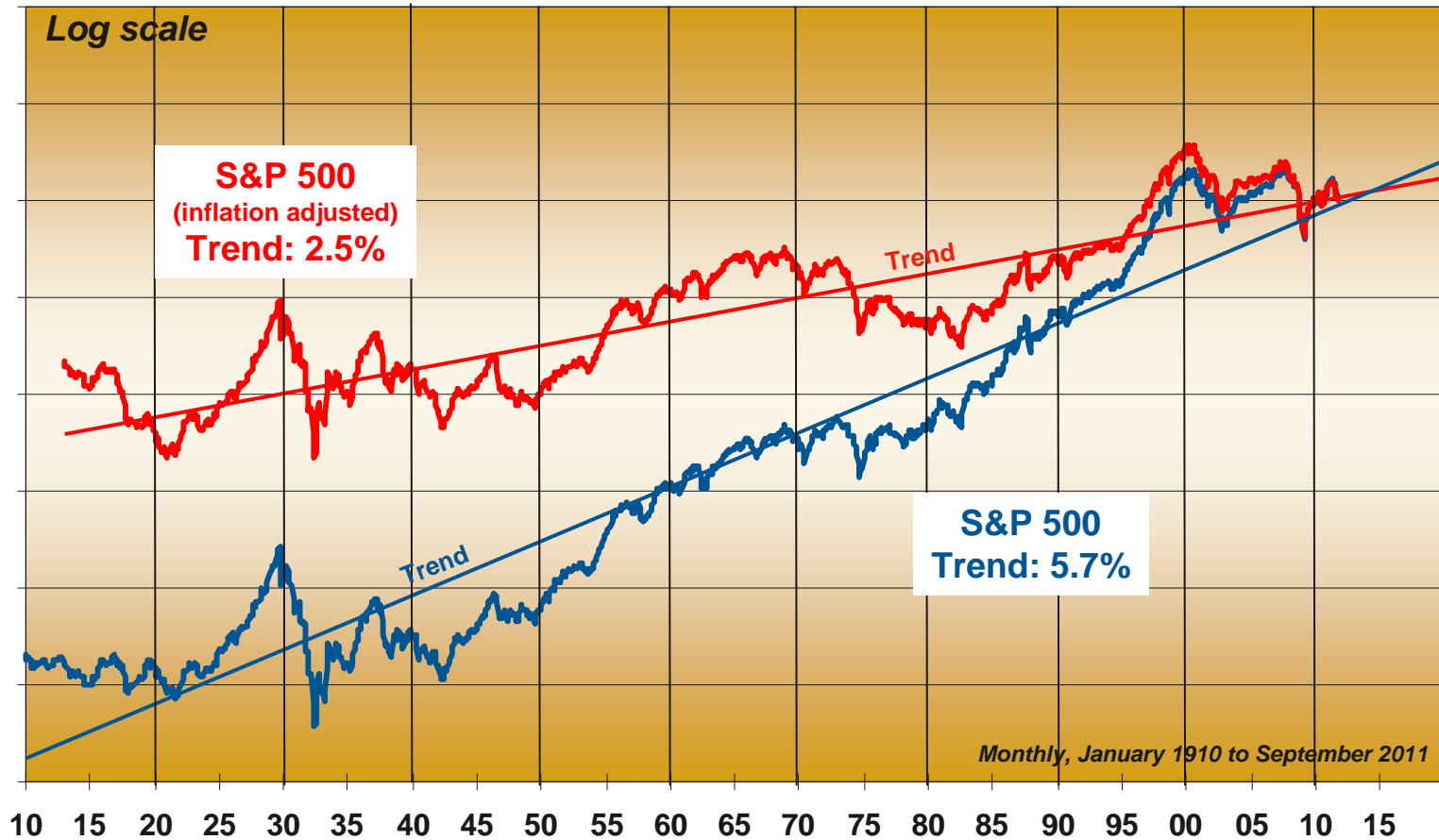
# Canadian Dollar

*Cdn\$ supported by commodities and investments ...*



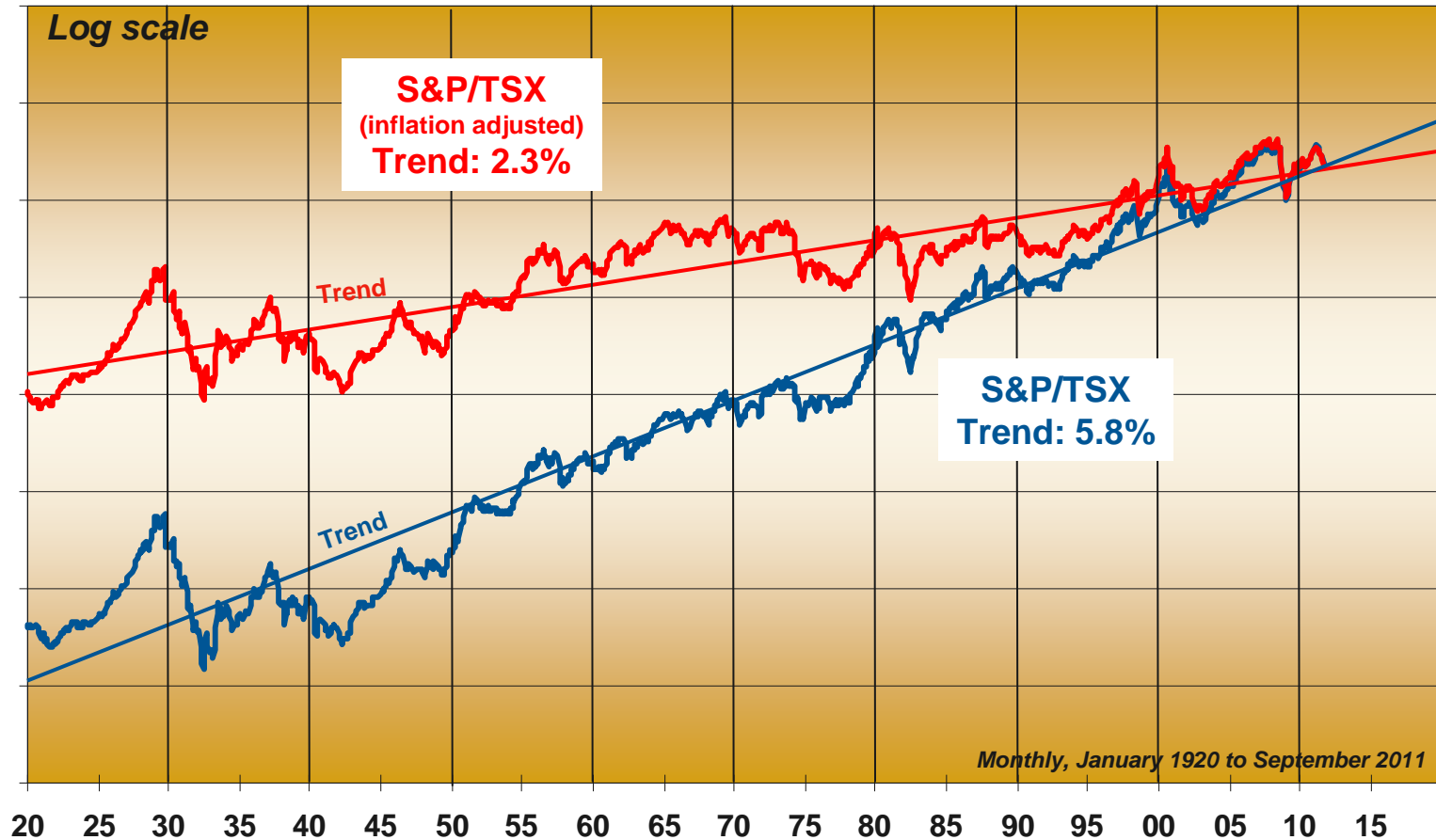
# Equity Markets – S&P 500

The long-run trend is 5.7%



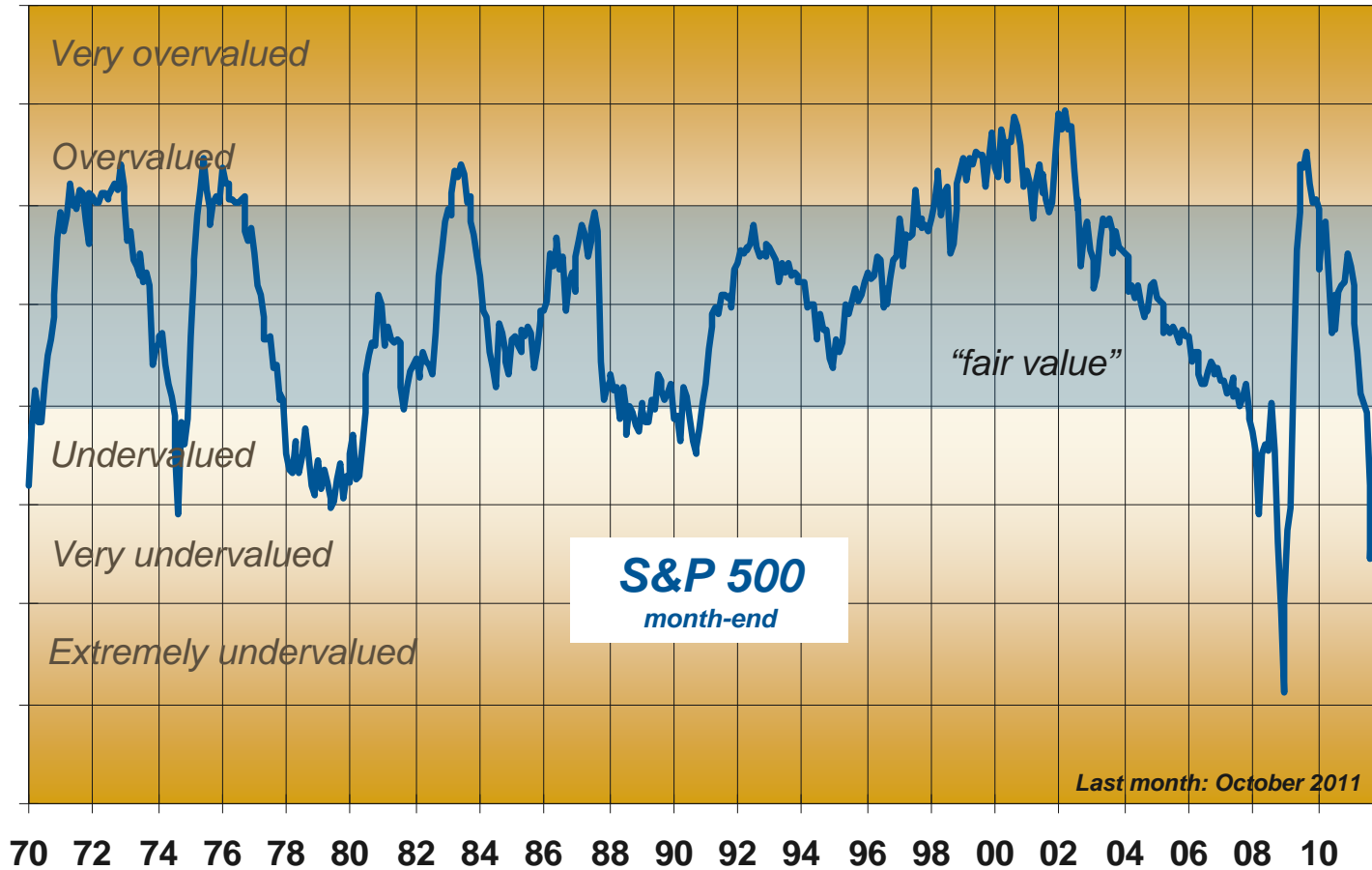
# Equity Markets – S&P/TSX Composite

The long-run trend is 5.8%



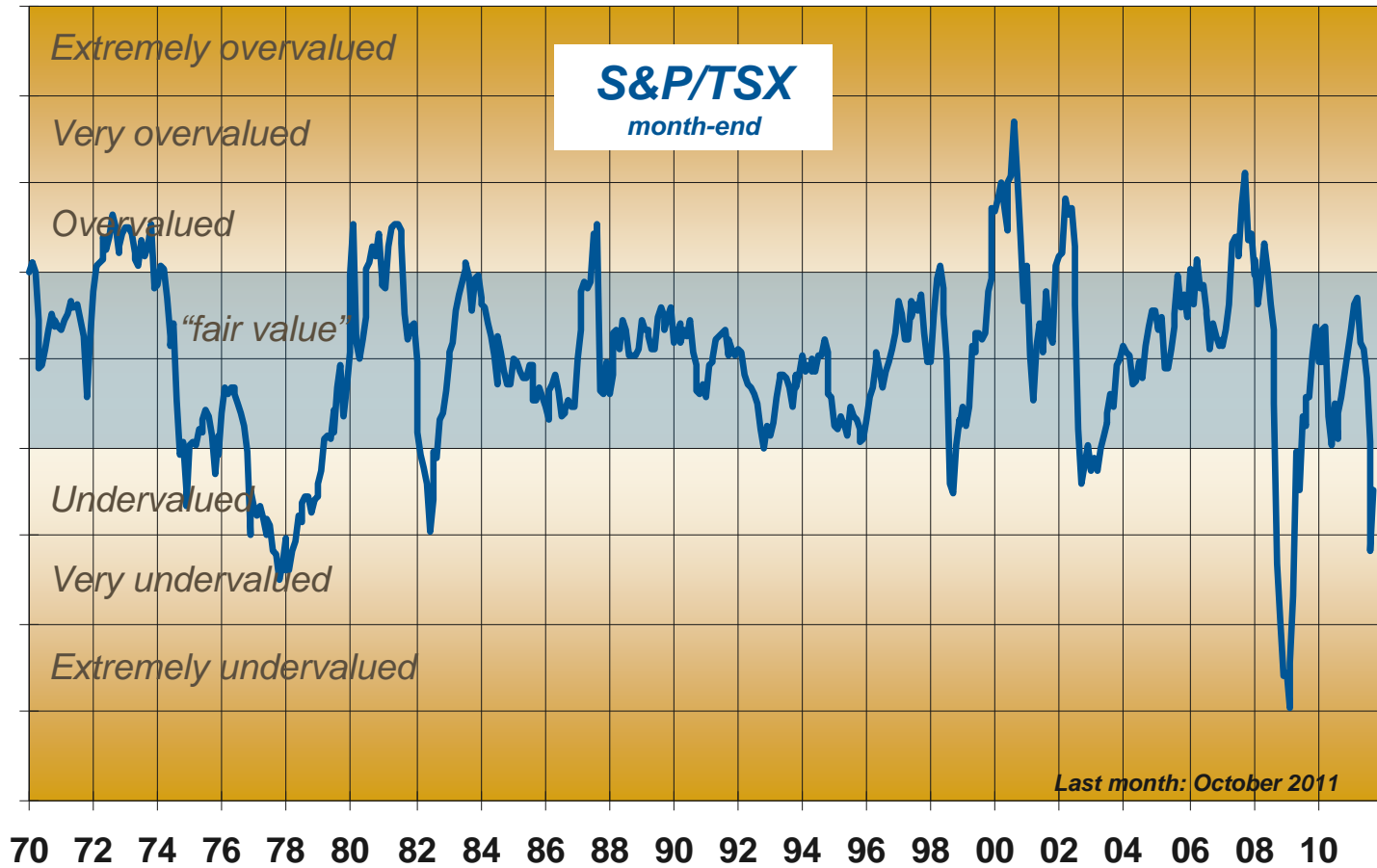
# Equity Markets – S&P 500

*But S&P 500 valuation is “undervalued” ...*



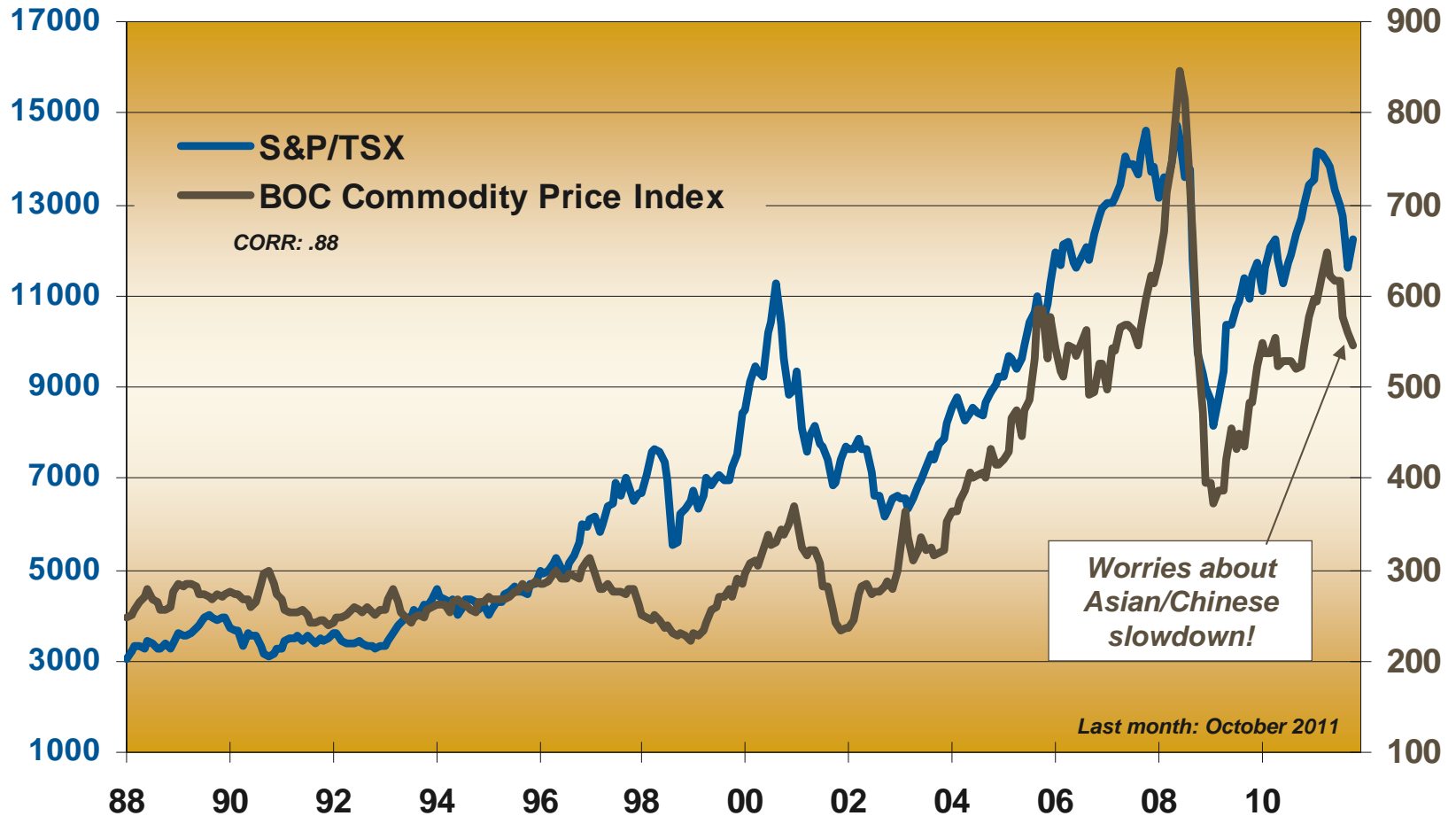
# Equity Markets – S&P/TSX

**S&P/TSX is undervalued ...**



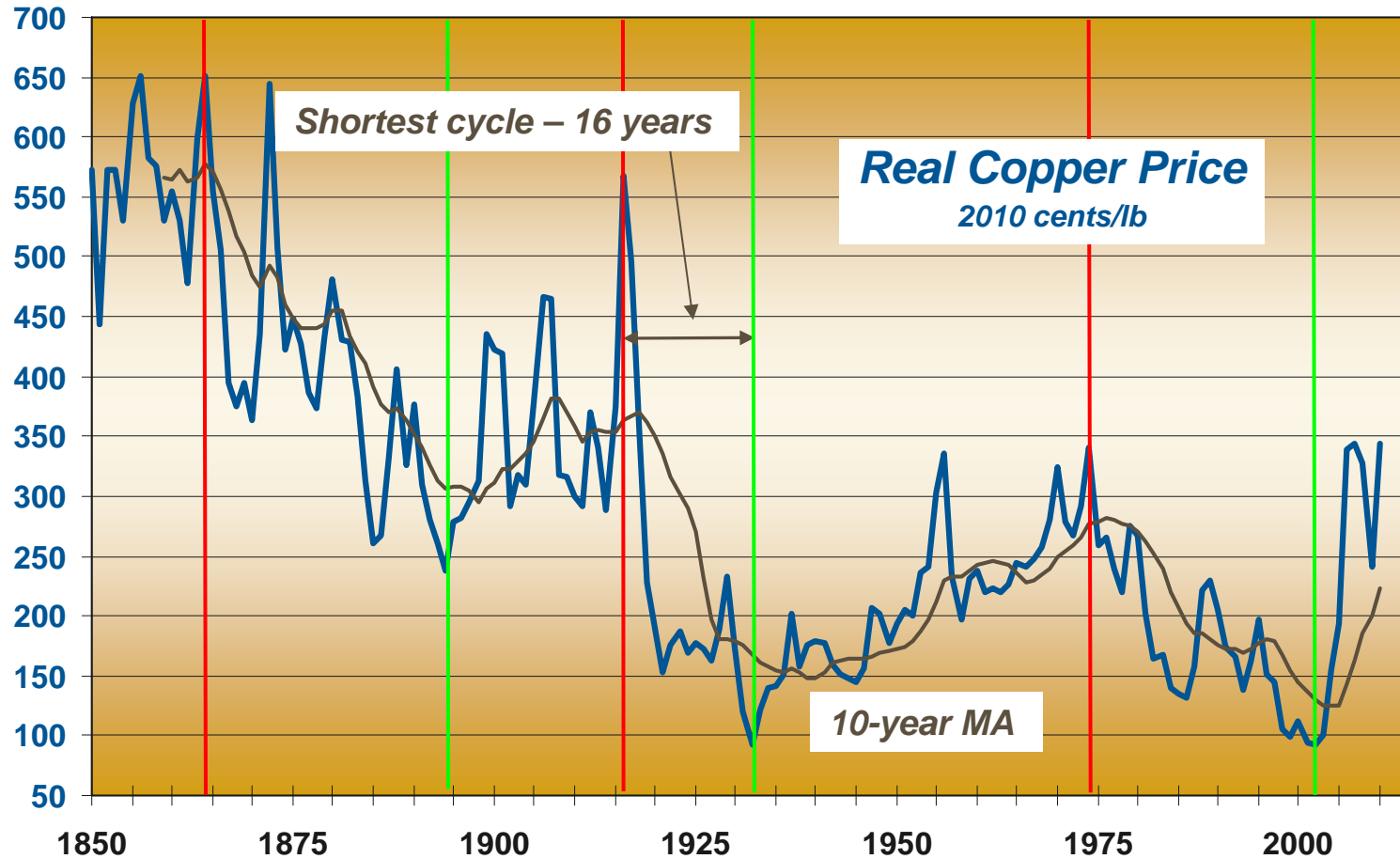
# Equity Markets – S&P/TSX

*Highly correlated with commodity prices ...!*



# Commodities

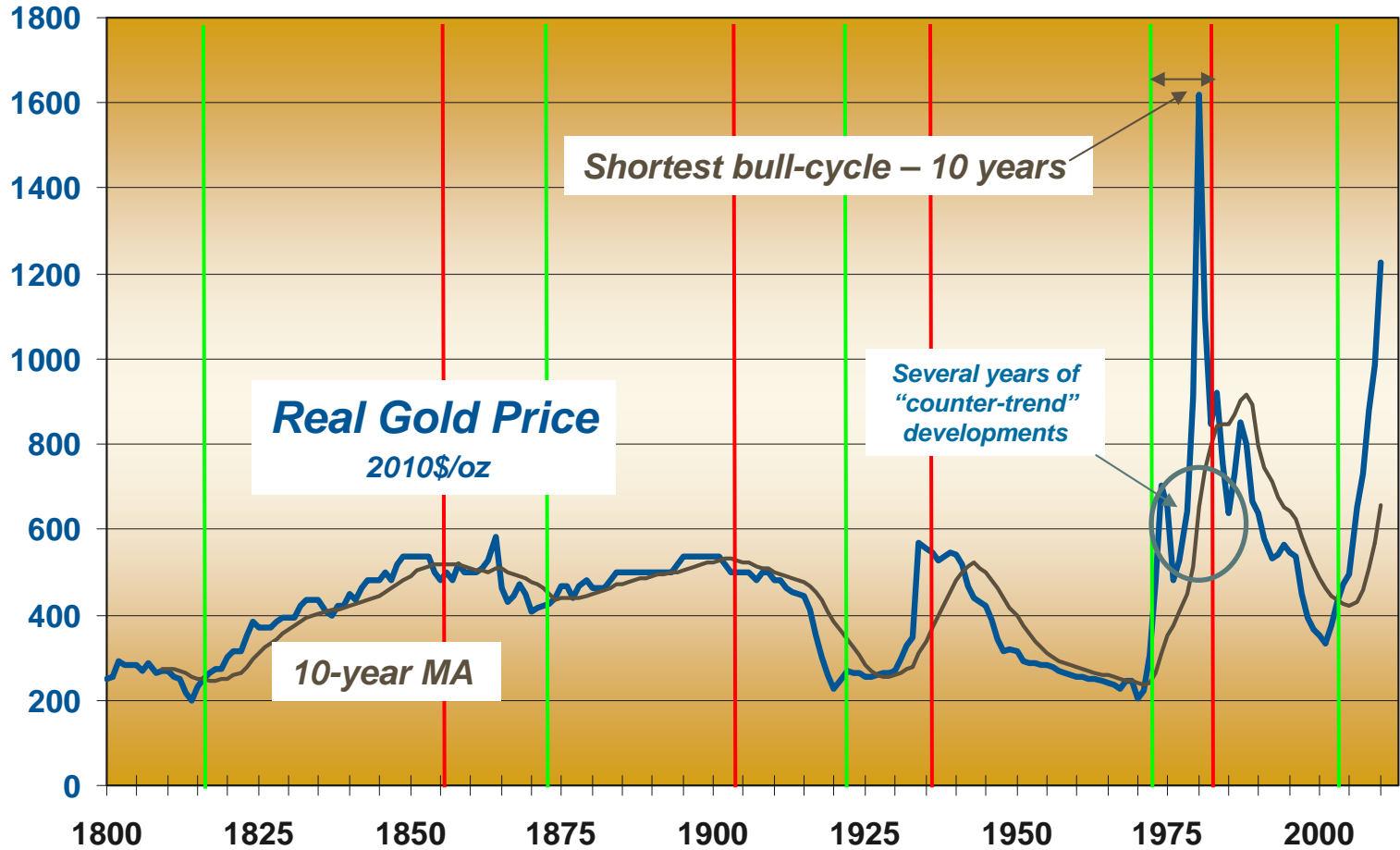
*All commodities are in a long-run bull cycle\* ...*



*\*despite reversals – which are common in all cycles*

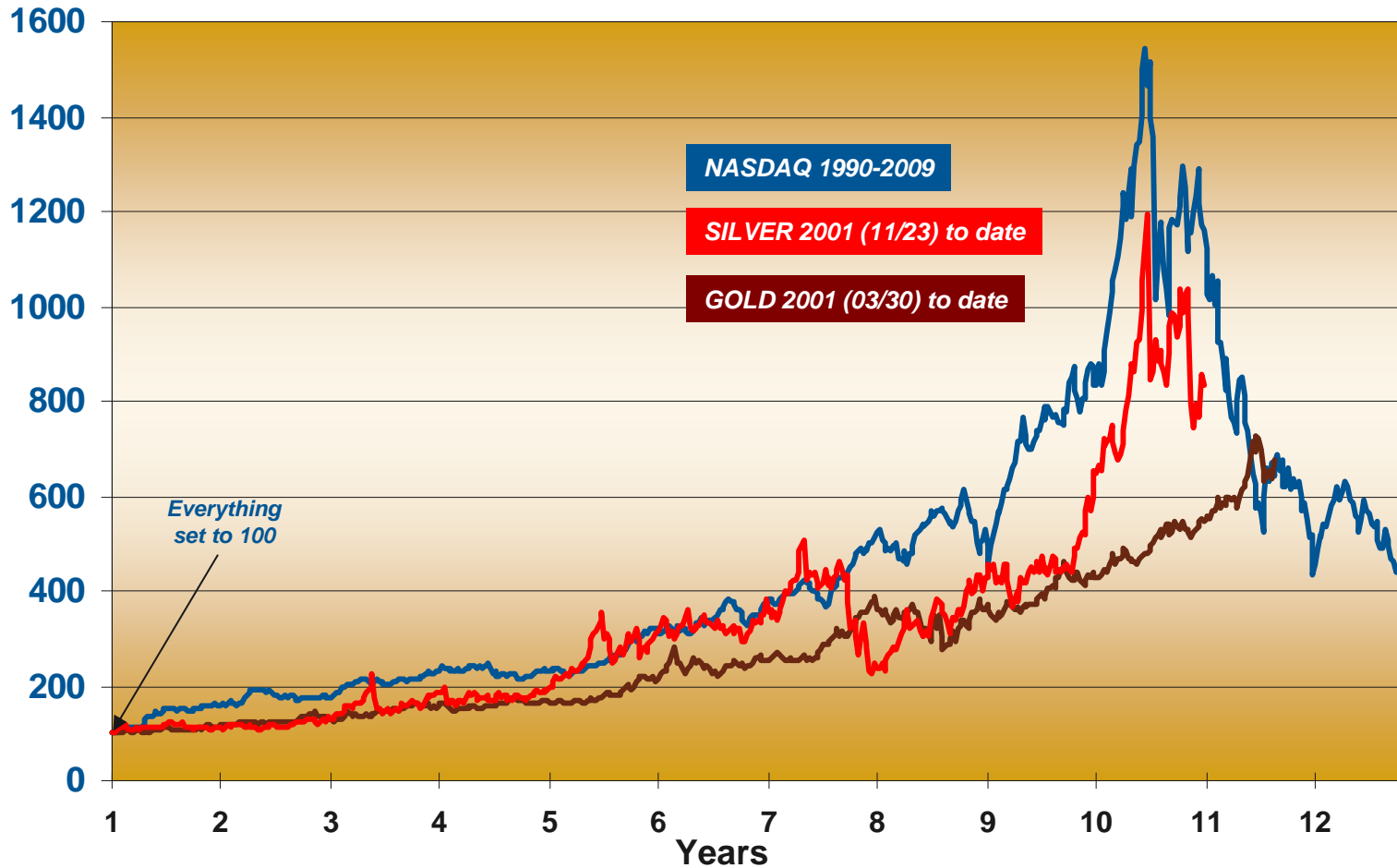
# Commodities

*Gold is into its 10<sup>th</sup> year of the bull cycle*



# Commodities

*Gold not in a bubble - it may one day be ...*



# Commodities

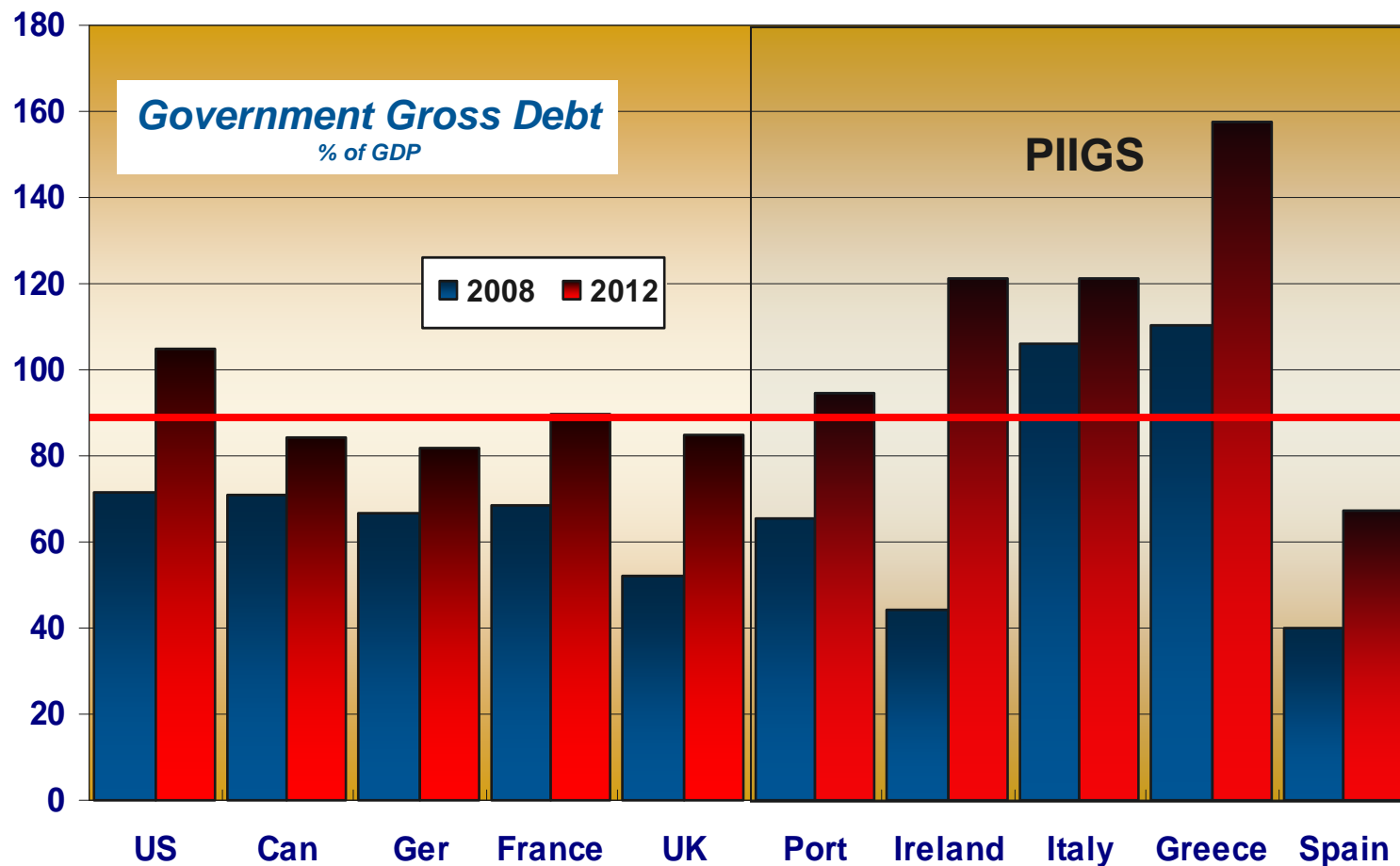
*Supply for most resources appears impaired*

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1. **Difficult governments:** *i.e., Venezuela*
2. **Governments are in debt:** *i.e., Australia has introduced a “resource super-profits tax”...*
3. **Environmental hurdles:** *i.e., The Gulf of Mexico disaster changes the future for off-shore drilling*
4. **“Peak” gold, “peak” oil, peak... :** *The low-hanging fruit has been picked...*

# Sovereign Debt Crisis

*Countries have large debts – over 90% spells trouble!*



Source: IMF Fiscal Monitor, April 2011 and  
IMF World Economic Outlook, Sept 2011

# ***The Sovereign Debt Crisis***

## ***Antecedents of the Sovereign Debt Crisis:***

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- 1. Baby-Boomer Retirements:*** *The fiscal stresses this would cause were visible years ago*
- 2. The Great Recession:*** *Pushed budgets into record deficit – just when the early boomers are about to retire*
- 3. The Euro Common Currency:*** *Membership in the Euro System allowed interest rates to “converge” - and “undisciplined” governments to borrow excessively*

# The Sovereign Debt Crisis - Europe

European banks are on the hook for \$2,274 billion ...

Consolidated foreign claims of reporting banks*							
	Europe	France	Ger.	Italy	Neth.	UK	US
<b>Greece</b>	127	51	34	4	4	13	8
<b>Ireland</b>	467	40	111	16	21	157	66
<b>Italy</b>	832	413	162	-	52	73	45
<b>Portugal</b>	197	26	36	4	5	26	6
<b>Spain</b>	652	152	177	30	78	106	64
<b>Total</b>	2274	682	519	53	160	374	189

\* claims allocated to the country (region) where the original risk lies

End-June 2011, billions US\$

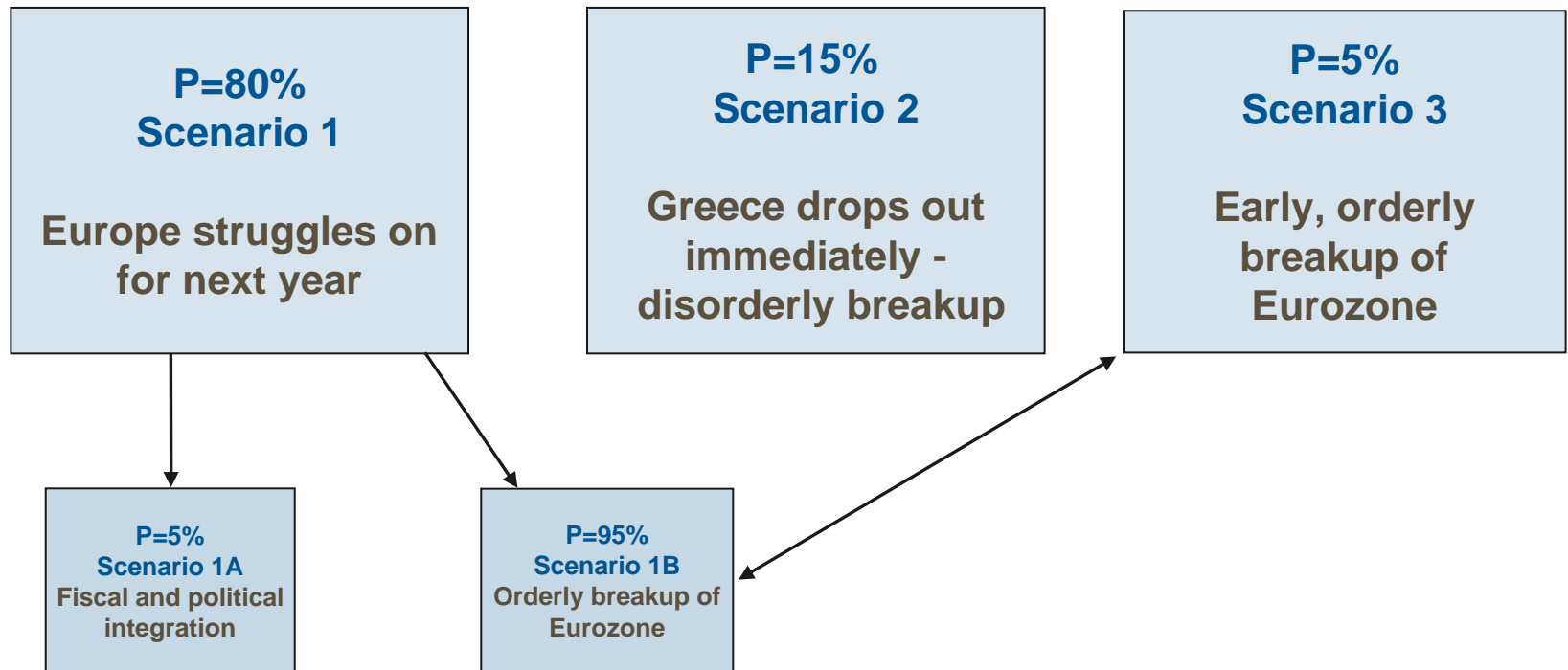
source: Bank for International Settlements

# *The Sovereign Debt Crisis - Europe*

## *Scenarios for the Eurozone:*

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### *Possible Eurozone Outcomes*



# *The Sovereign Debt Crisis*

*How will governments deal with exploding debts?*

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## ***Government Choices:***

***Renege on promises***

***Cut other services***

***Raise taxes***

***Extend borrowing at low rates***

***Print more money?***

## ***Summary:***

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- 1. World economic growth is still slowing***
- 2. The US economic outlook remains problematic***
- 3. The Canadian economy will post only very modest growth – it still benefits from resource demand, but China slowing?***
- 4. The US dollar needs to decline and Congress should overhaul medium/long run fiscal policy***
- 5. The medium/long-term outlook for equity markets is constructive***
- 6. Commodity prices are in a long-run bull cycle – the key risk is OECD-Chinese “slowdown/recession”***
- 7. The sovereign debt crisis will color the next 5-10 years, will likely break the euro, and will likely continue to be quite positive for gold***