

# **Global Economic Outlook: Shifting Tectonic Plates**

**October 2008**



**Patricia Croft, Vice President & Chief Economist  
Phillips, Hager & North Investment Management Limited**

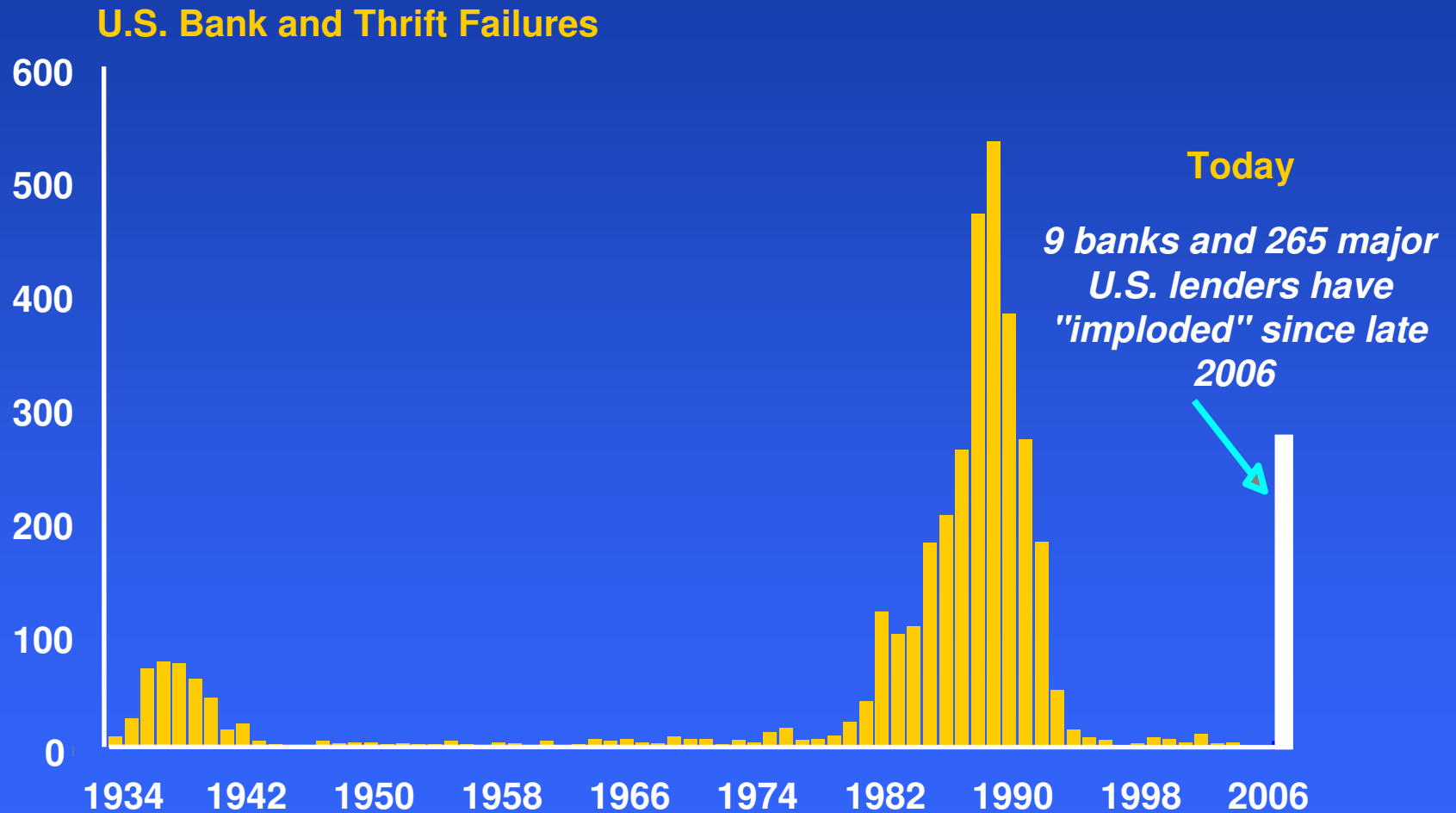
# The Greatest Credit Bubble of All Time



1. Liquidity – too much and too cheap
2. Trend to deregulation
3. Boom in securitization
  - ♦ Democratized credit provision but disconnected lender and borrower
4. Overconfidence in financial models

**Result: A fundamental change to world financial system**

# Third Banking Crisis Since 1930s



Source: Federal Deposit Insurance Corp., The Mortgage Lender Implode-O-Meter.com

# (Un)Happy Anniversary



- ◆ Problem confined to sub prime
- ◆ Problem confined to the US
- ◆ Minimal losses
- ◆ No impact on the real economy
- ◆ Global decoupling
- ◆ Cross product contagion to ABCP, MBS, SIVs, monoline insurers, auction rate securities, LIBOR financing
- ◆ Problem now global
- ◆ Writedowns to date \$500 bn – estimates of \$1 trillion ++
- ◆ US in recession – UK, Japan and Europe heading that way
- ◆ Global recoupling – China, India slowing

# Unprecedented Actions



**December – Fed allows banks to borrow using wider range of collateral**

**January – Fed makes emergency  $\frac{3}{4}\%$  cut in fed funds**

**March – Fed and Treasury broker sale of Bear Stearns to JP Morgan**

**July – SEC curbs improper short selling of Fannie/Freddie**

**September – Federal government takes control of F&F  
pledging to provide up to \$200 billion**

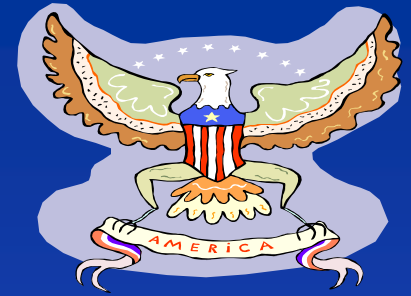
**WHAT'S NEXT??**

# The Credit Crisis Is Not Over



- ◆ Bailout of Fannie/Freddie will reduce the cost of borrowing but will not end the credit crisis nor rescue the US economy
- ◆ European/UK banks under pressure
- ◆ Emerging market stock markets plunge – risk appetite goes into reverse
- ◆ Deleveraging is a painful prolonged process

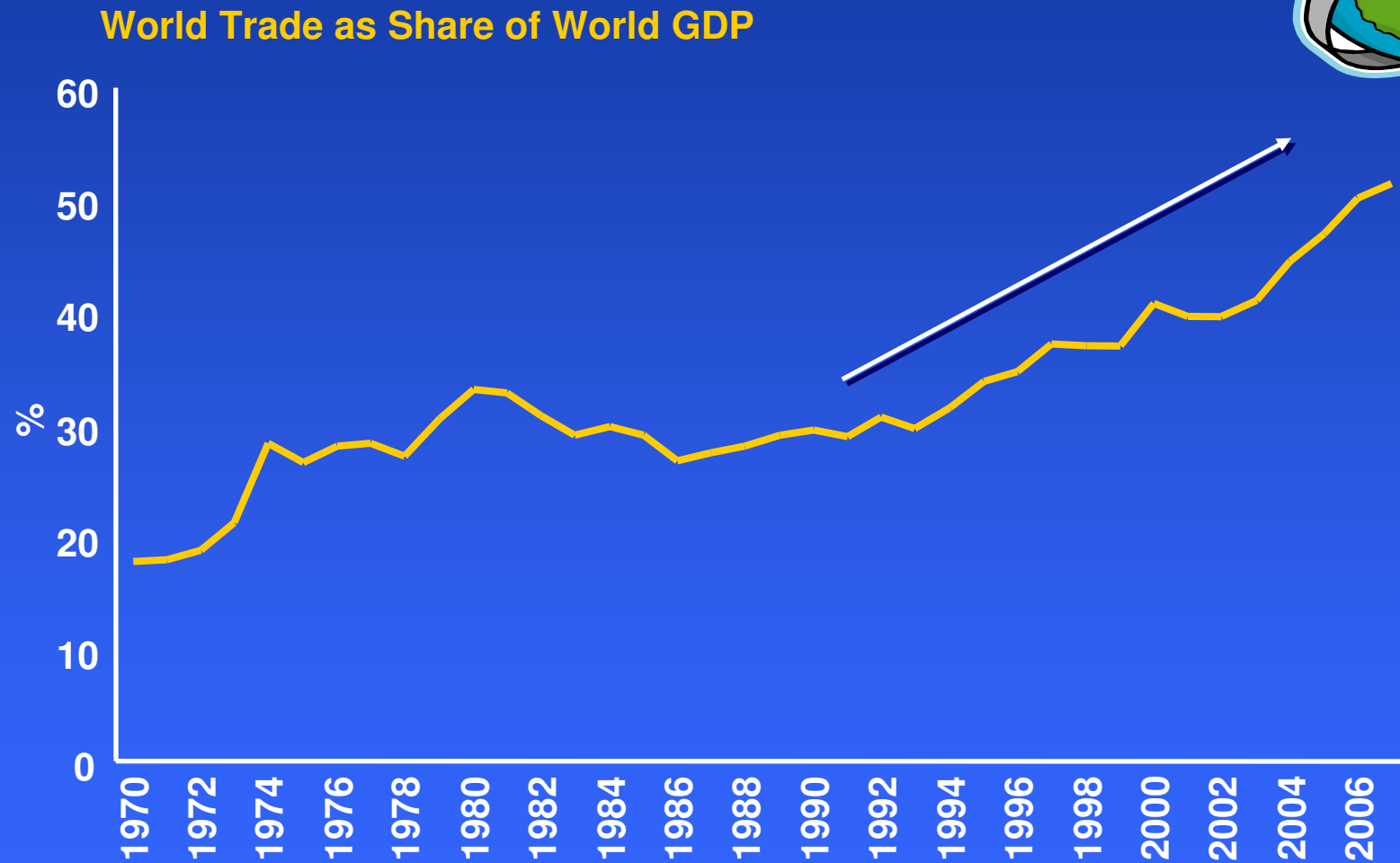
# The World is Changing



- ◆ China now world's fourth largest economy
- ◆ Potential growth in China and India far superior
  - Lower labour costs
  - Growing middle class & market reforms
- ◆ Long-term potential growth rate in G-7 is falling due to demographics – 2% or lower
- ◆ Canada risks falling further behind

***“There is a fundamental shift in global economic tectonic plates”  
The Conference Board of Canada***

# Globalization – An Integrated World Economy

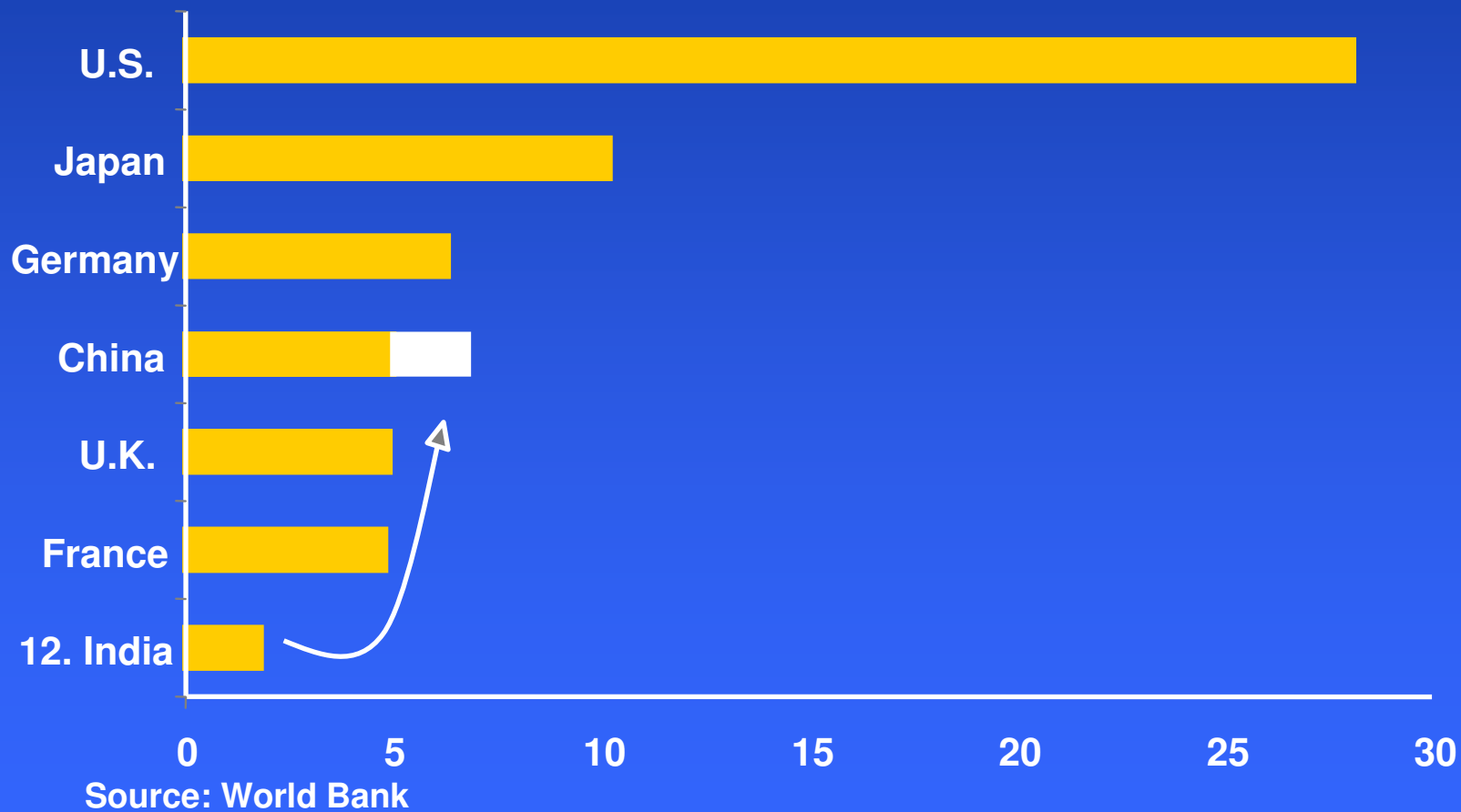


Source: IMF, Economist Intelligence Unit

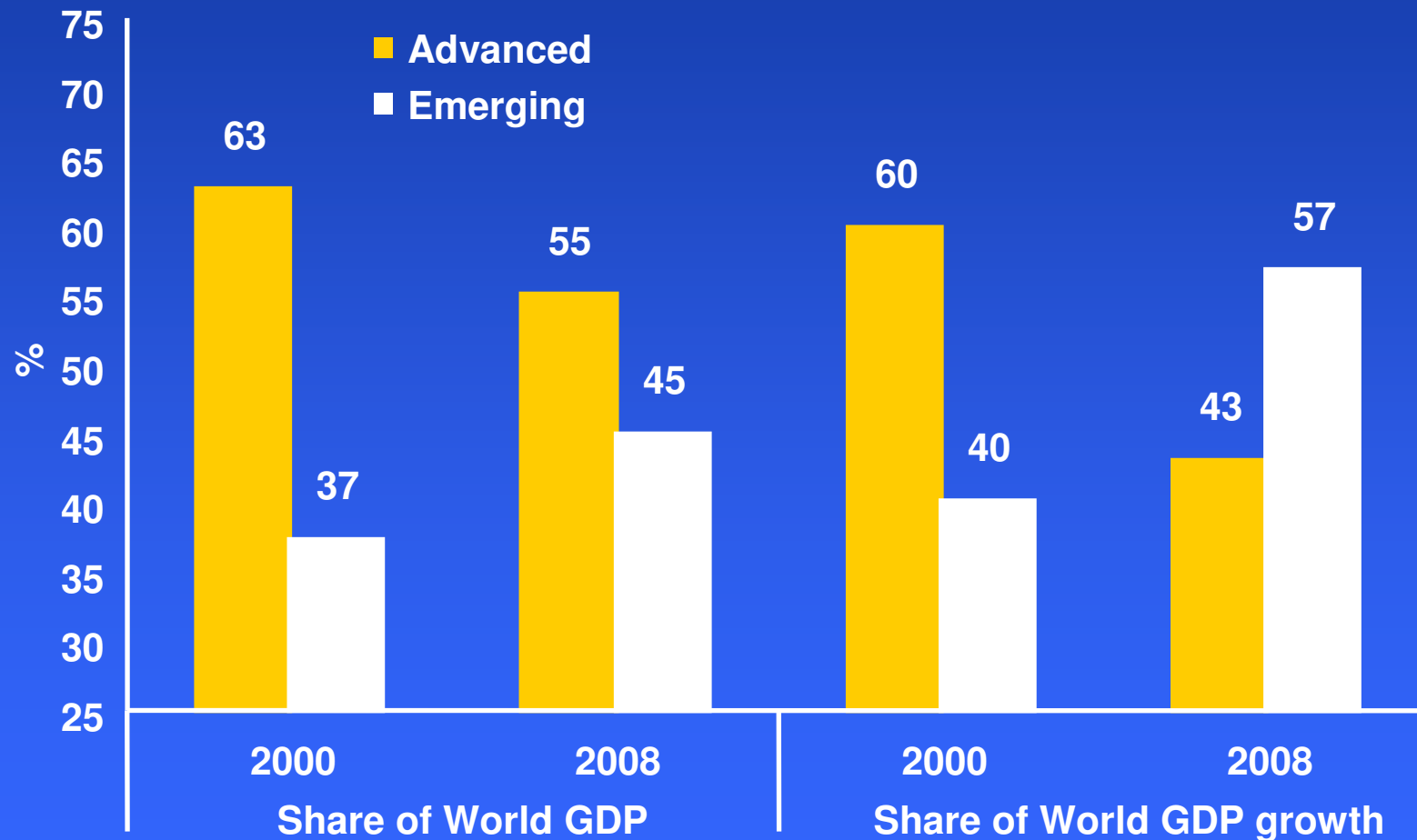
# Chindia: Bigger than U.K. & France on a Nominal GDP Basis



Proportion of world GDP, % (2005, nominal)

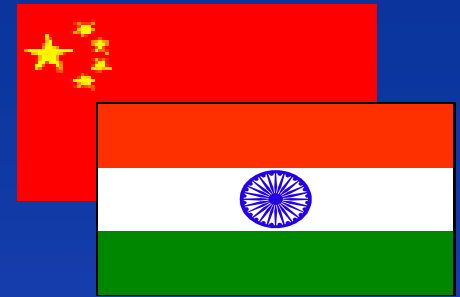


# Emerging Economies Key to Global Growth Outlook

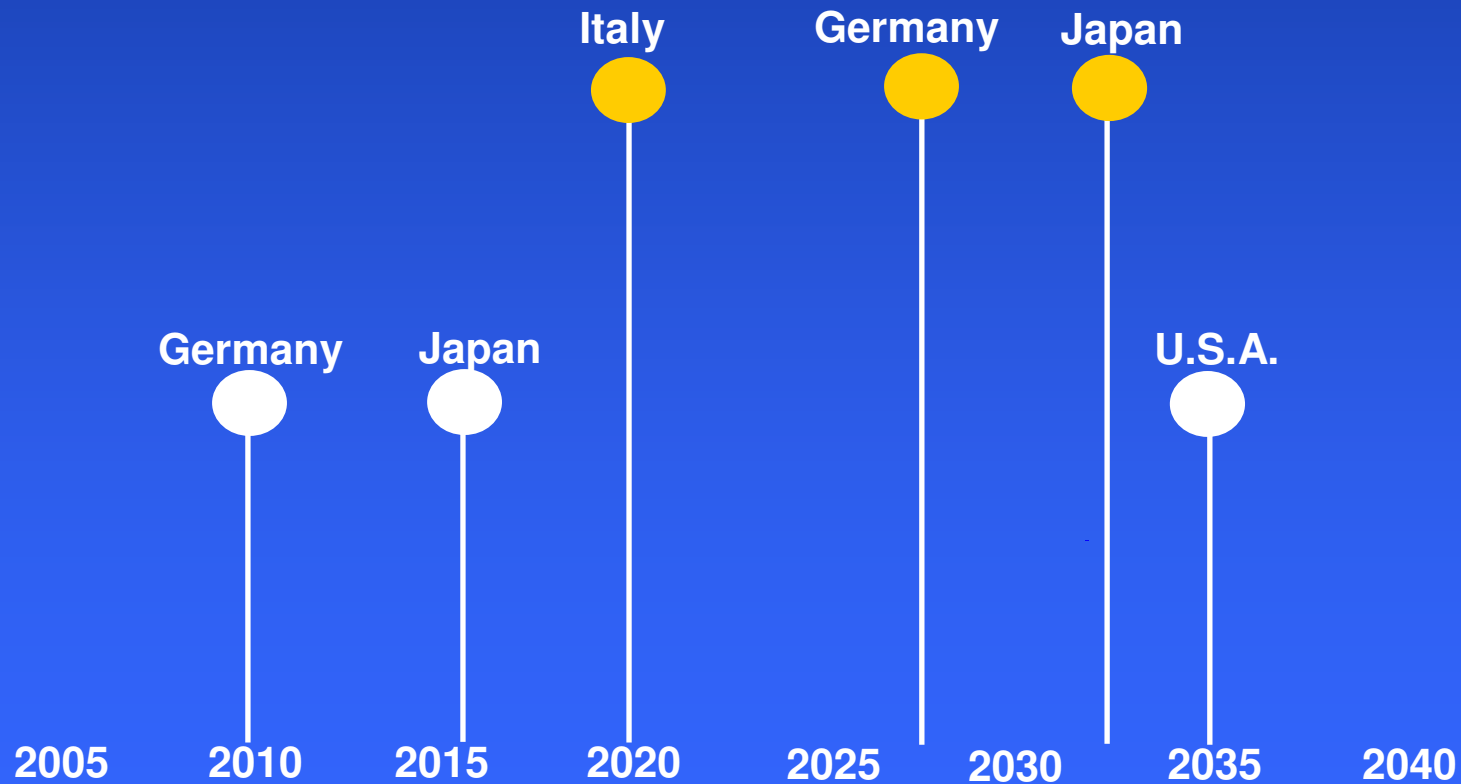


Source: International Monetary Fund

# Catching Up



- Year that India overtakes individual economies
- Year that China overtakes individual economies



Source: Globe & Mail



# 2050: A Different World

## World's Ten Largest Countries in Population (millions)

2007 Rank	Country	Population	2050 Rank	Country	Population
1	China	1,318	1	India	1,747
2	India	1,132	2	China	1,437
3	U.S.	302	3	U.S.	420
4	Indonesia	232	4	Indonesia	297
5	Brazil	189	5	Pakistan	295
6	Pakistan	169	6	Nigeria	282
7	Bangladesh	149	7	Brazil	260
8	Nigeria	144	8	Bangladesh	231
9	Russia	142	9	Dem Rep of Congo	187
10	Japan	128	10	Philippines	150
	Canada	32.9		Canada	41.6

Source: Population Reference Bureau

# The World is Changing

World's tallest building?

Dubai



World's largest publicly traded company?

China



World's largest investment fund?

Abu Dhabi



Biggest movie industry?

Bollywood



Largest casino?

Macao



Largest roller coaster?

Singapore









Largest shopping mall?

China

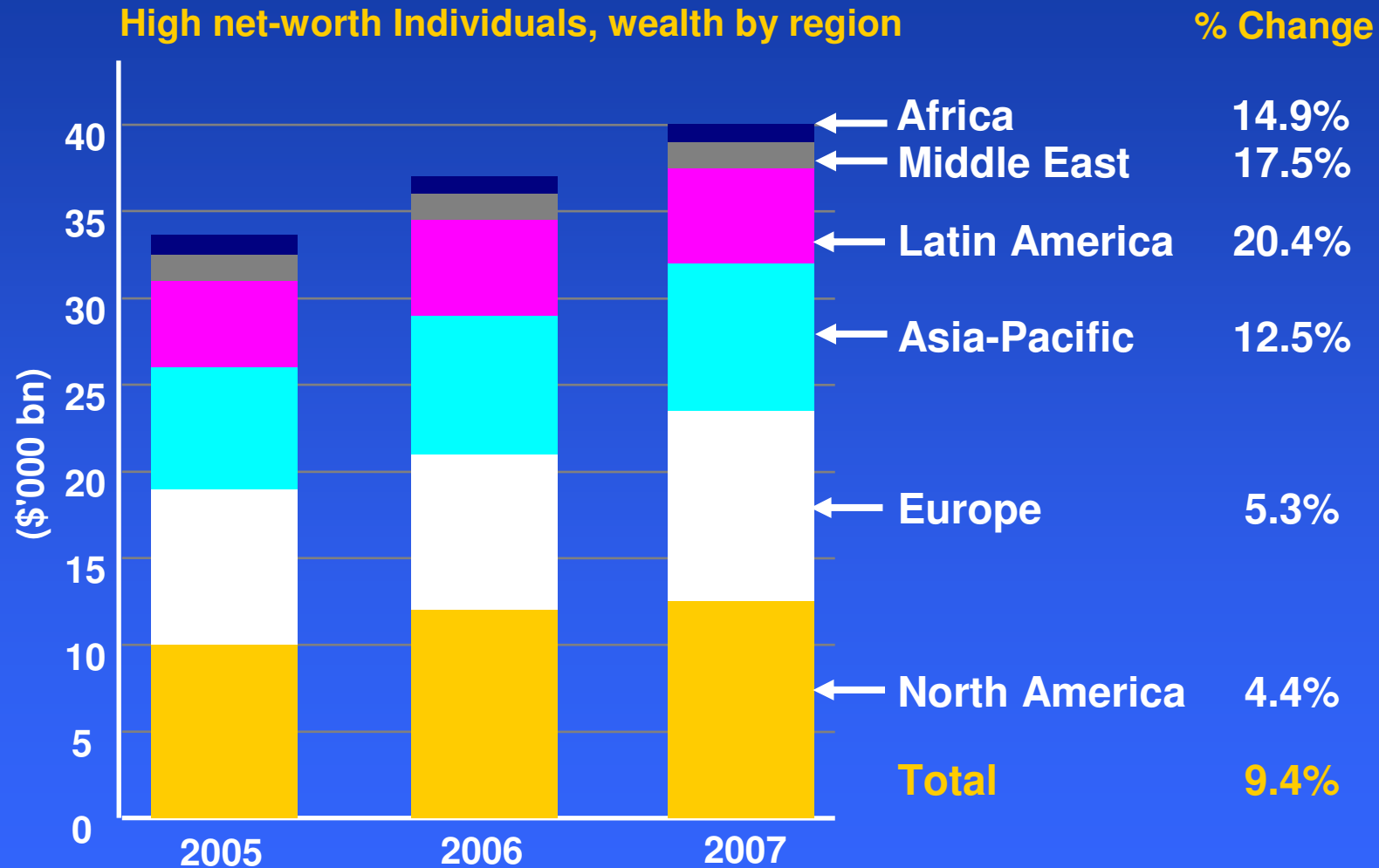


# World's Top Ten - 2008



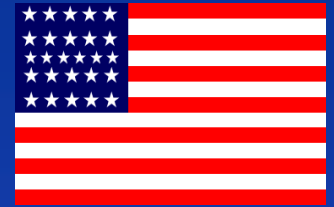
1.	Warren Buffet	US	\$62 bn	
2.	Carlos Slim Helu	Mexico	\$60 bn	
3.	Bill Gates	US	\$58 bn	
4.	Lakshmi Mittal	India	\$45 bn	
5.	Mukesh Ambani	India	\$43 bn	
6.	Anil Ambani	India	\$42 bn	
7.	Ingvar Kamprad	Sweden	\$31 bn	
8.	KP Singh	India	\$30 bn	
9.	Oleg Deripaska	Russia	\$28 bn	
10.	Karl Albrecht	Germany	\$27 bn	

# Show Me the Money!



Sources: Capgemini; Merrill Lynch

# Why is the World So Pessimistic About the US?



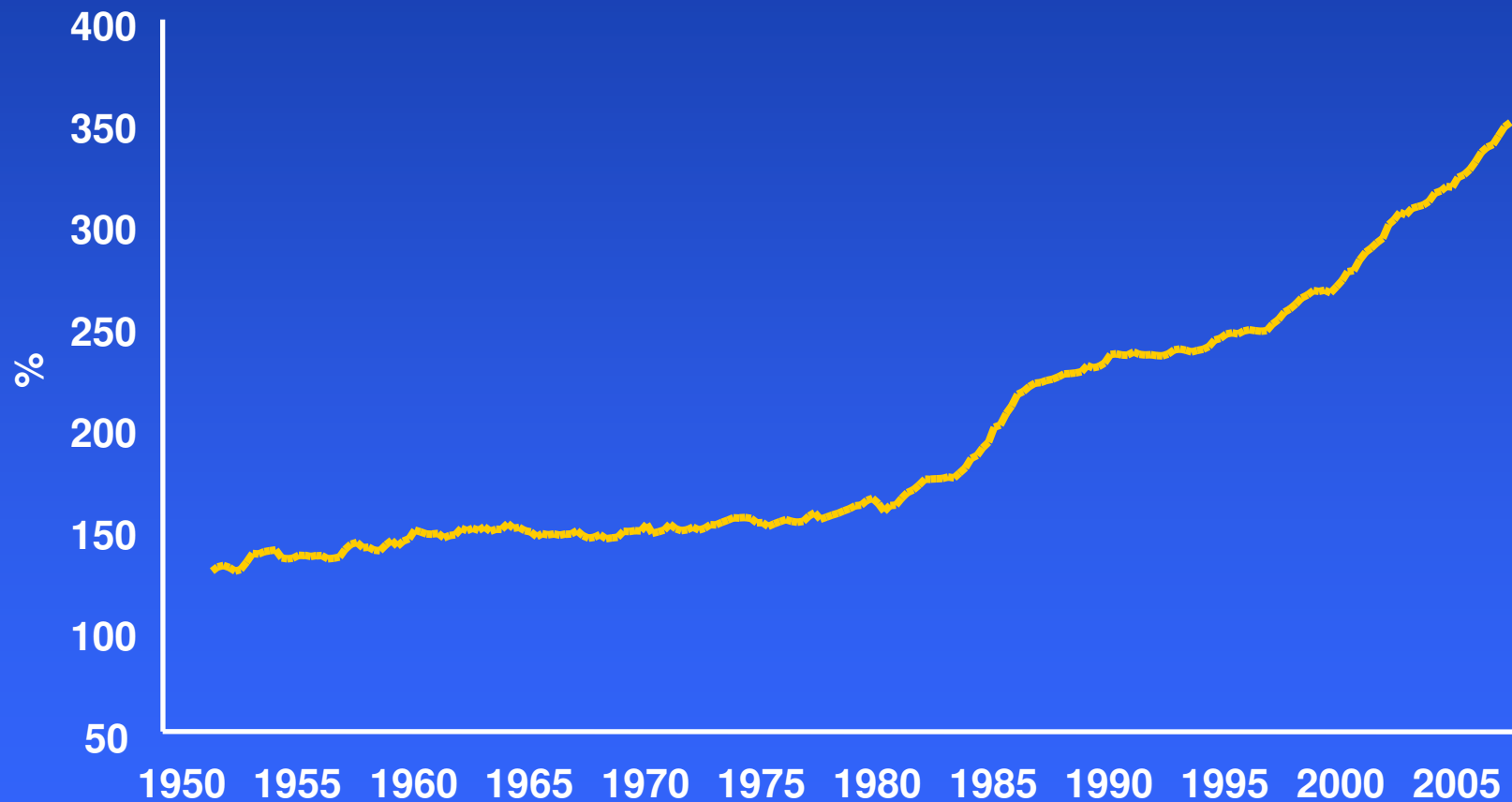
- ◆ World's largest debtor nation – sizeable current account and federal budget deficits
- ◆ A consuming society that is running out of steam
- ◆ Political power waning?

*“The US economy is on a road to disaster and the dollar along with it”  
Jim Rogers*

# US is World's Largest Debtor Nation

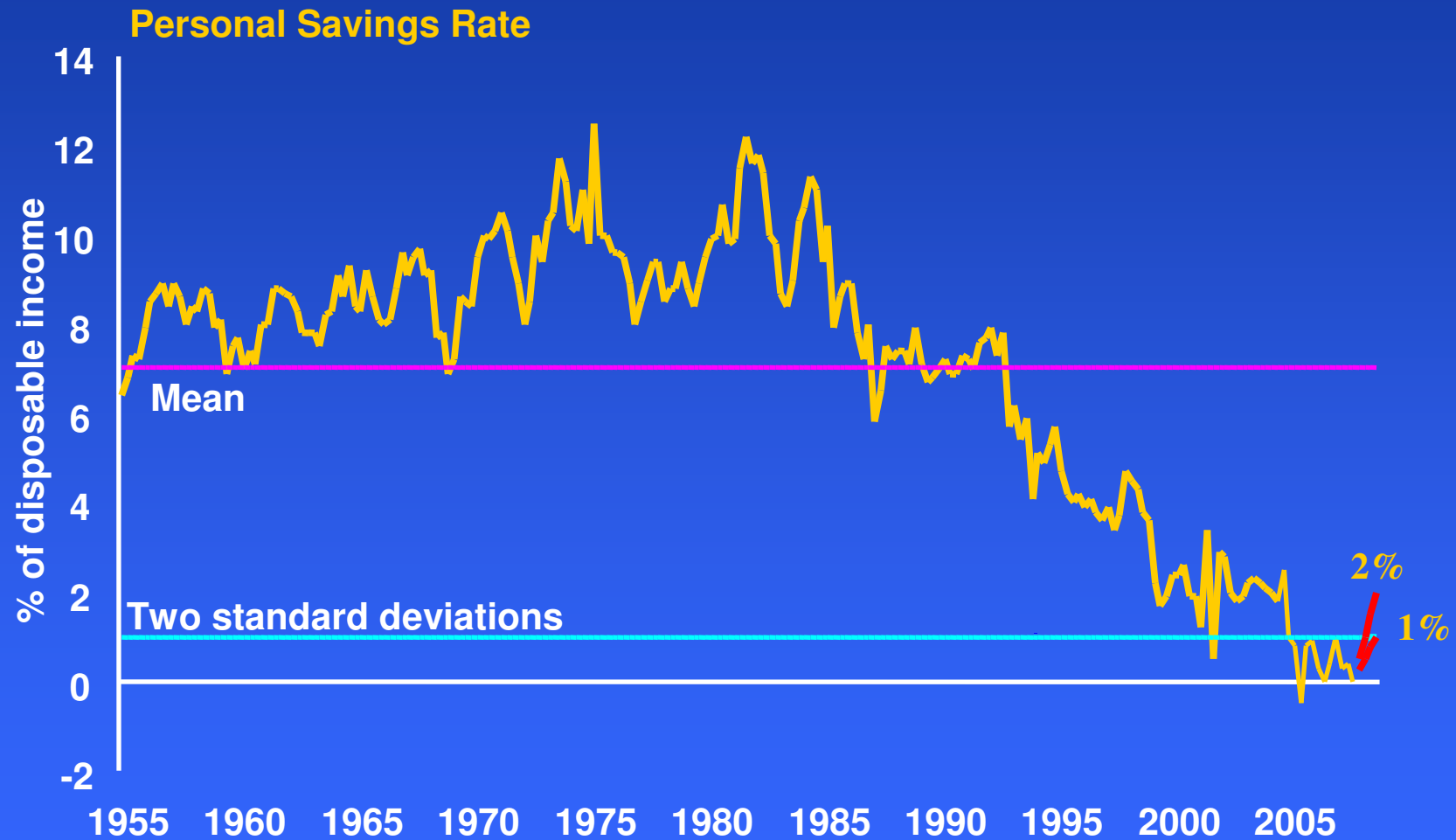


**U.S. Credit Market Liabilities, % of GDP**



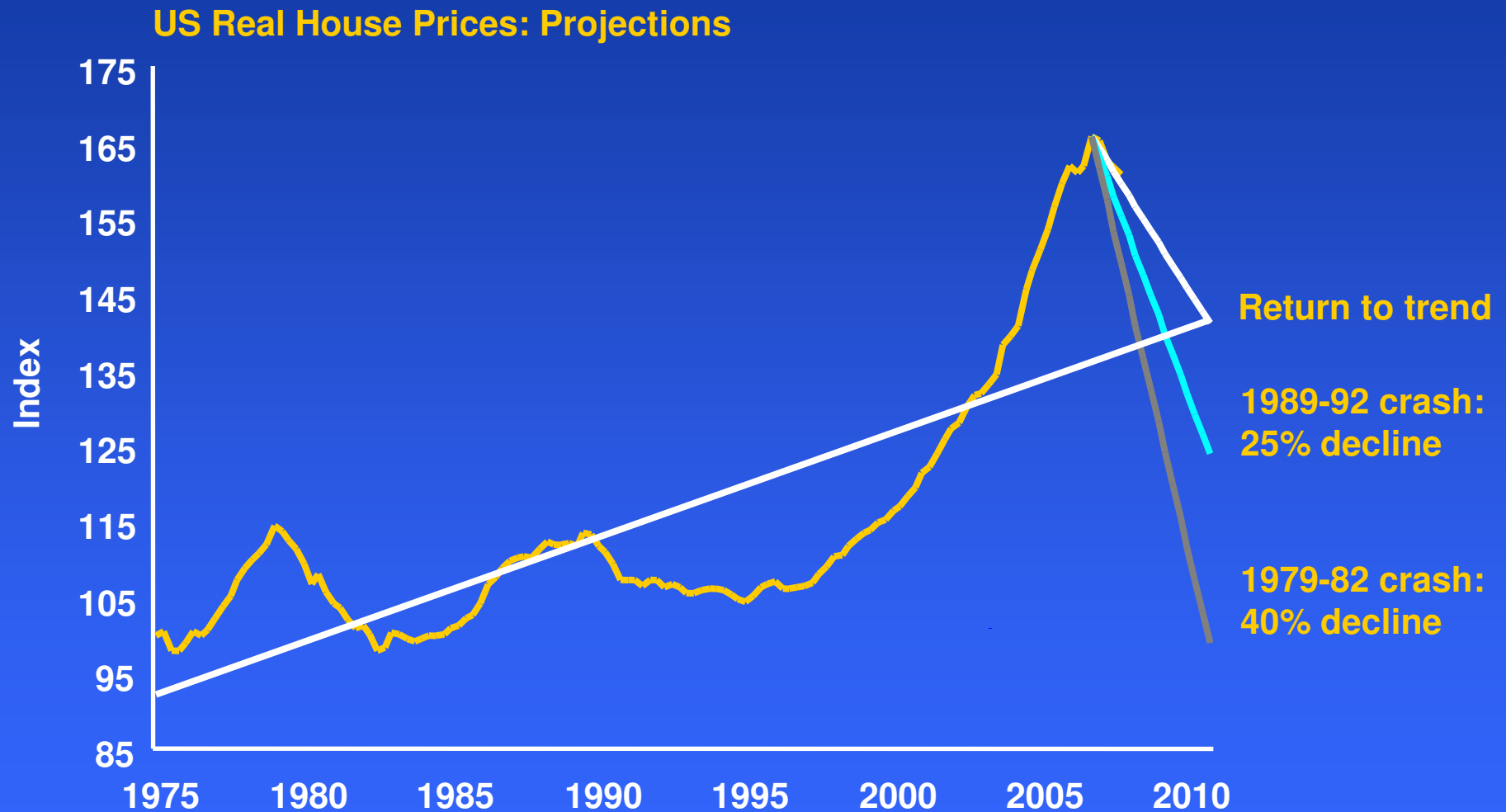
Source: U.S. BEA

# Personal Savings Rate Near Record Low



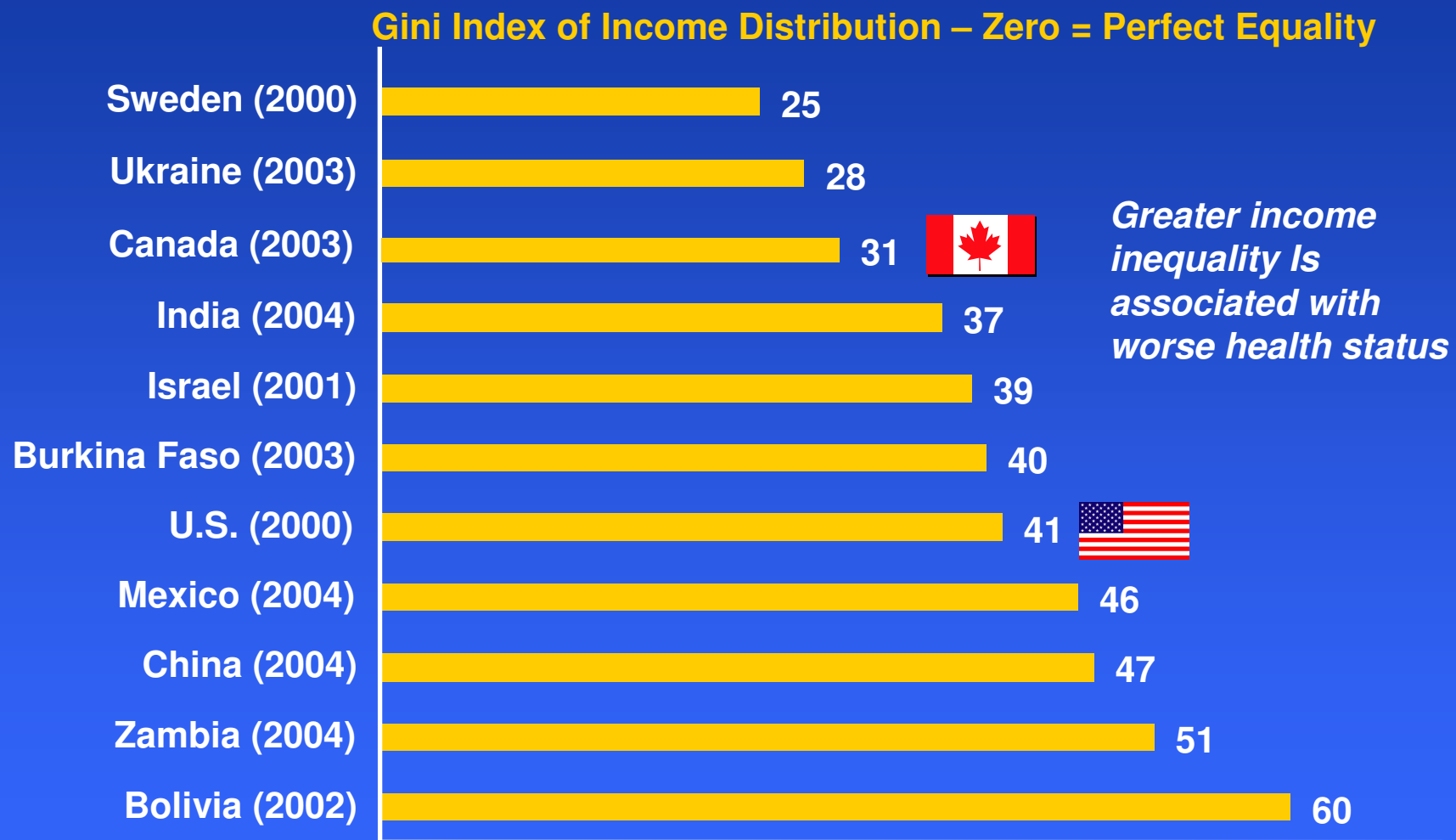
Source: US Bureau of Economic Analysis, NBF Financial

# House Prices to Fall Further



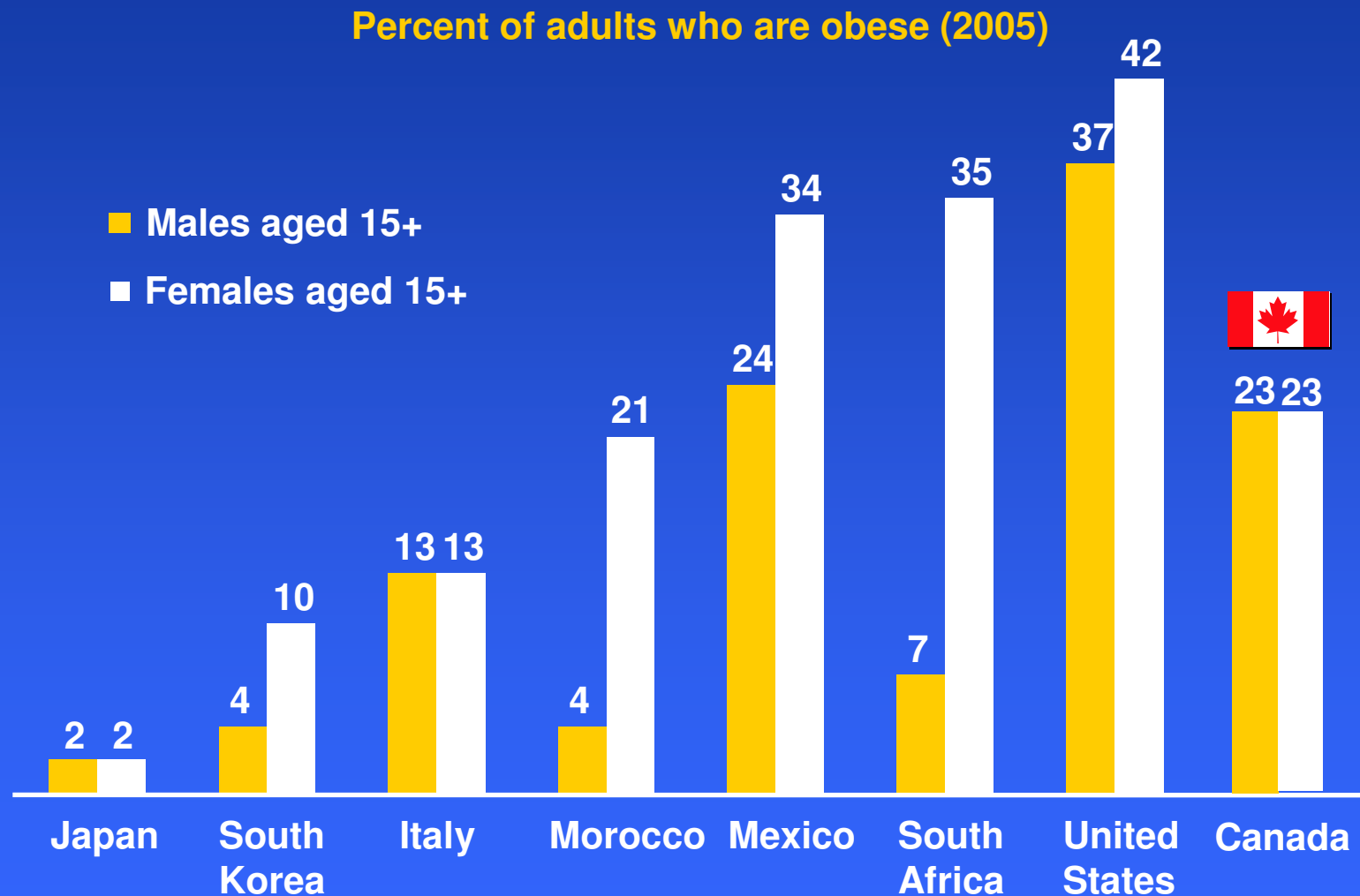
Source: Office of Federal Housing Enterprise Oversight, Bureau of Labor Statistics, PH&N

# US Has Greater Income Inequality Than Other Developed Countries



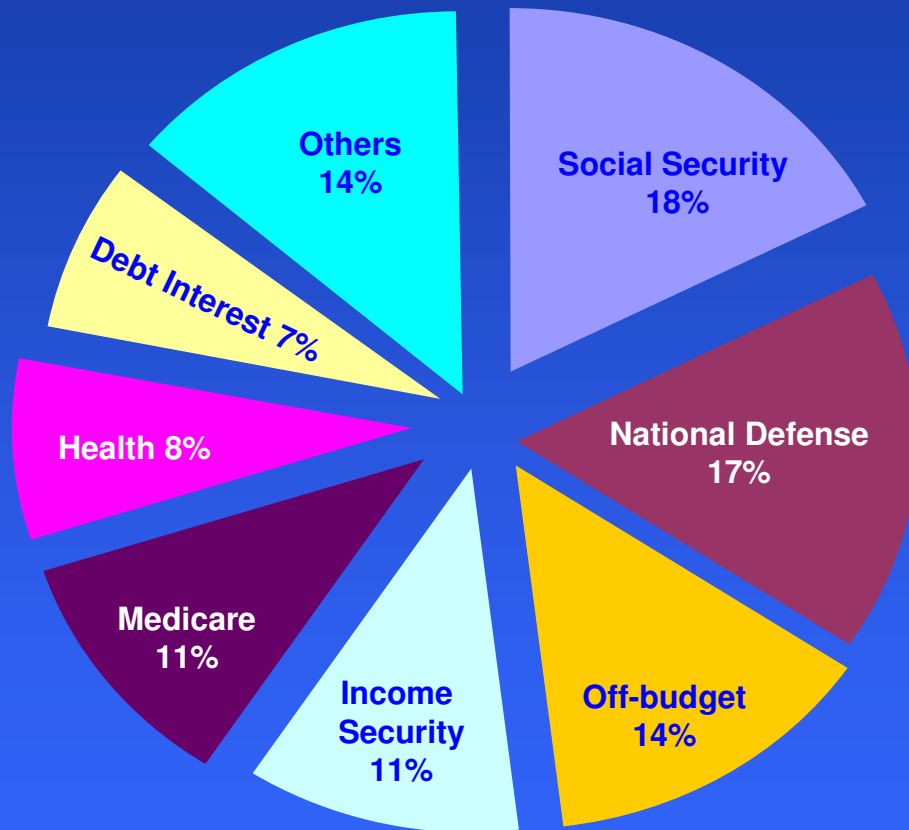
Source: 2007 Population Reference Bureau

# Obesity Has Become A Global Problem



Source: 2007 Population Reference Bureau

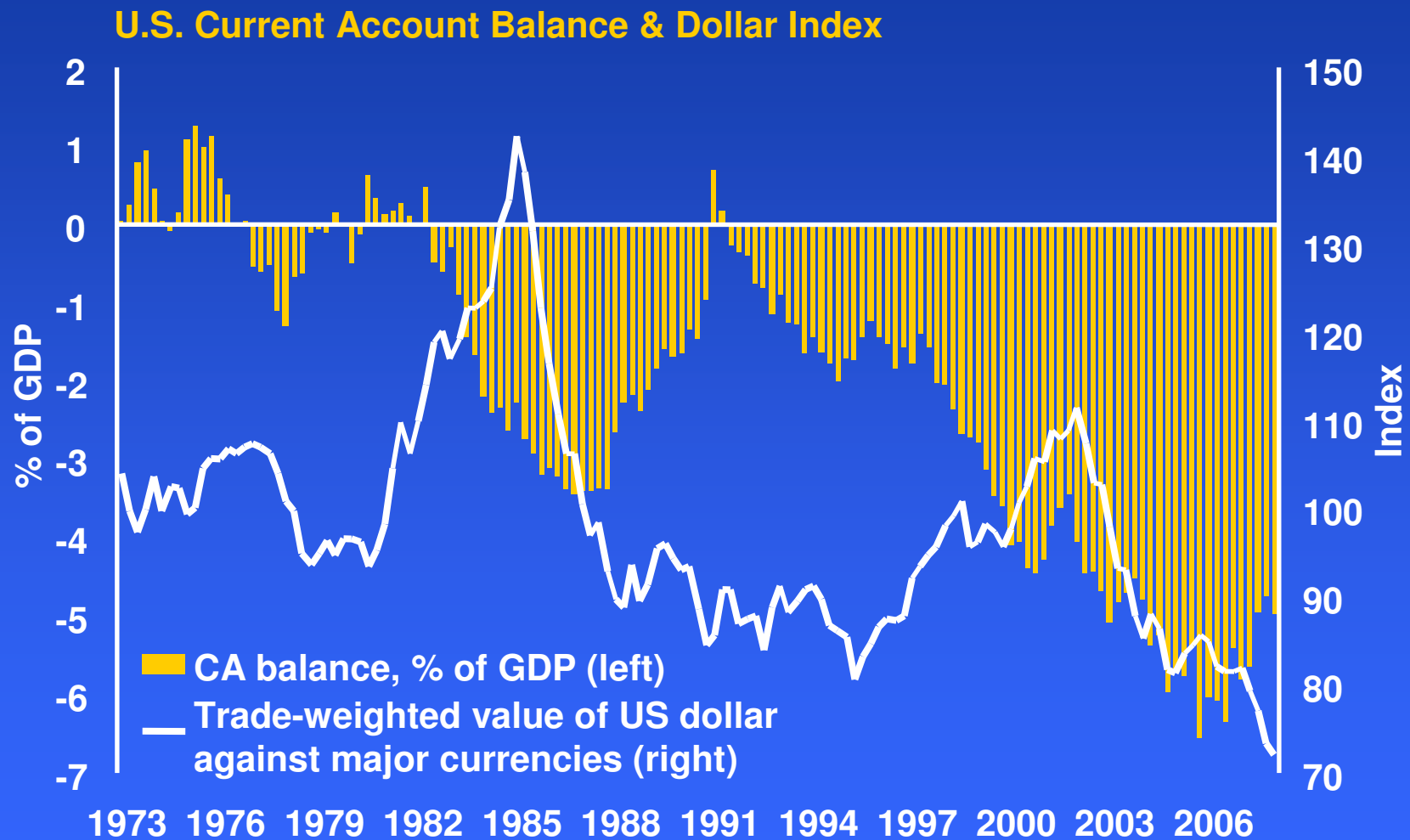
# Health Care & Defense Will Put Pressure on the Deficit



## Others include:

- Educ, Training & Soc. Svcs. 3%
- Veterans Benefits 2%
- Transportation 2%
- Justice 1%
- Natural Resources & Environment 1%
- International Affairs 1%
- Science, Space & Tech 1%
- Agriculture 1%

# Drop in US Dollar Reflects Global Pessimism

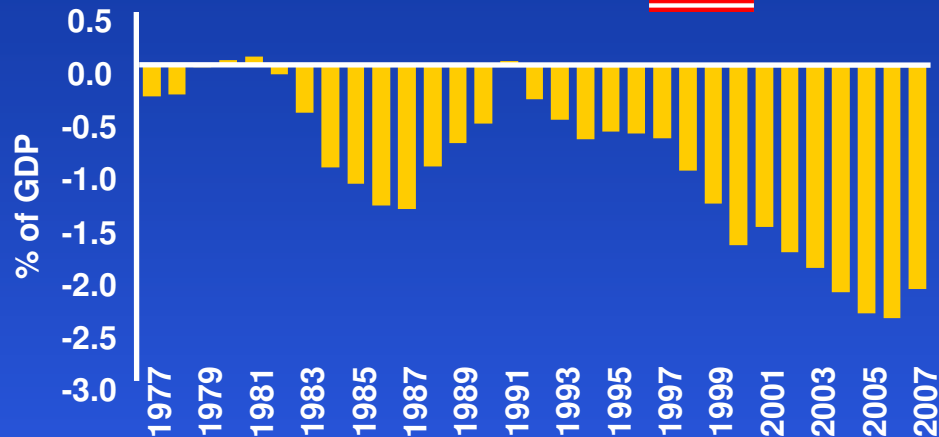


Source: U.S. BEA, Federal Reserve

# World Happy to Cover US Shortfall for Now

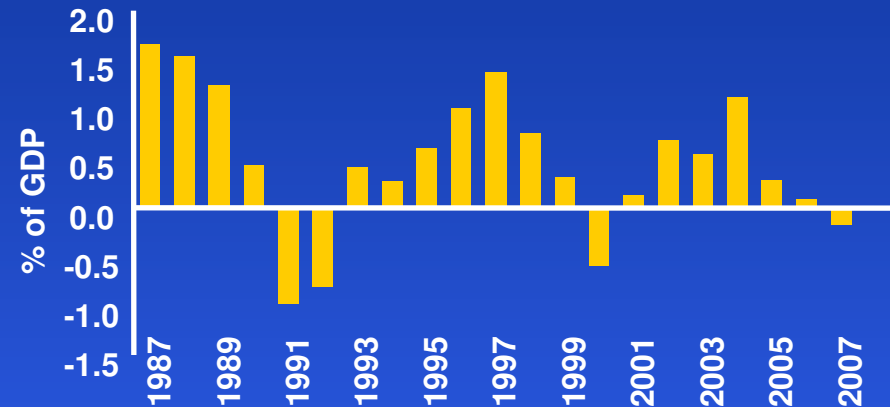
## Current Account Balances, % of GDP

### United States



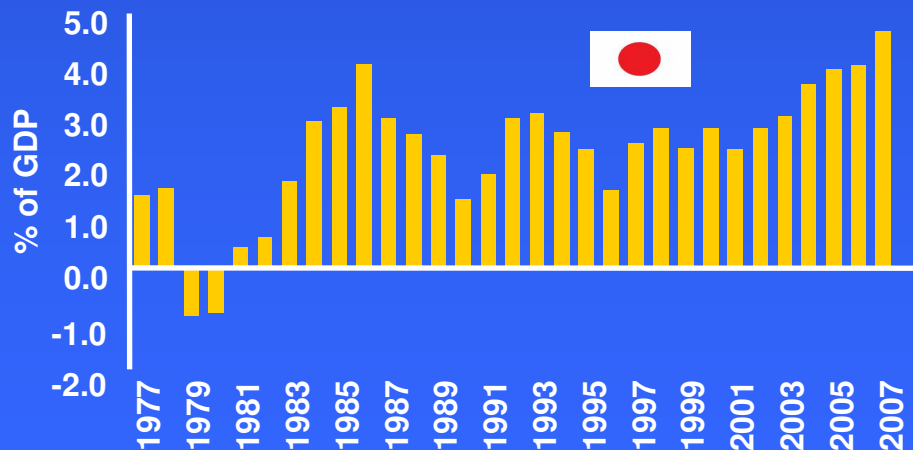
Source: Bureau of Economic Analysis

### Europe



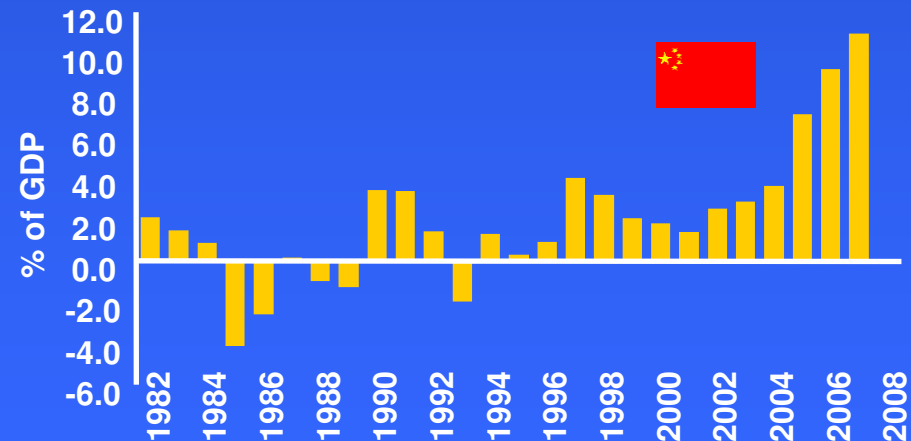
Source: IMF

### Japan



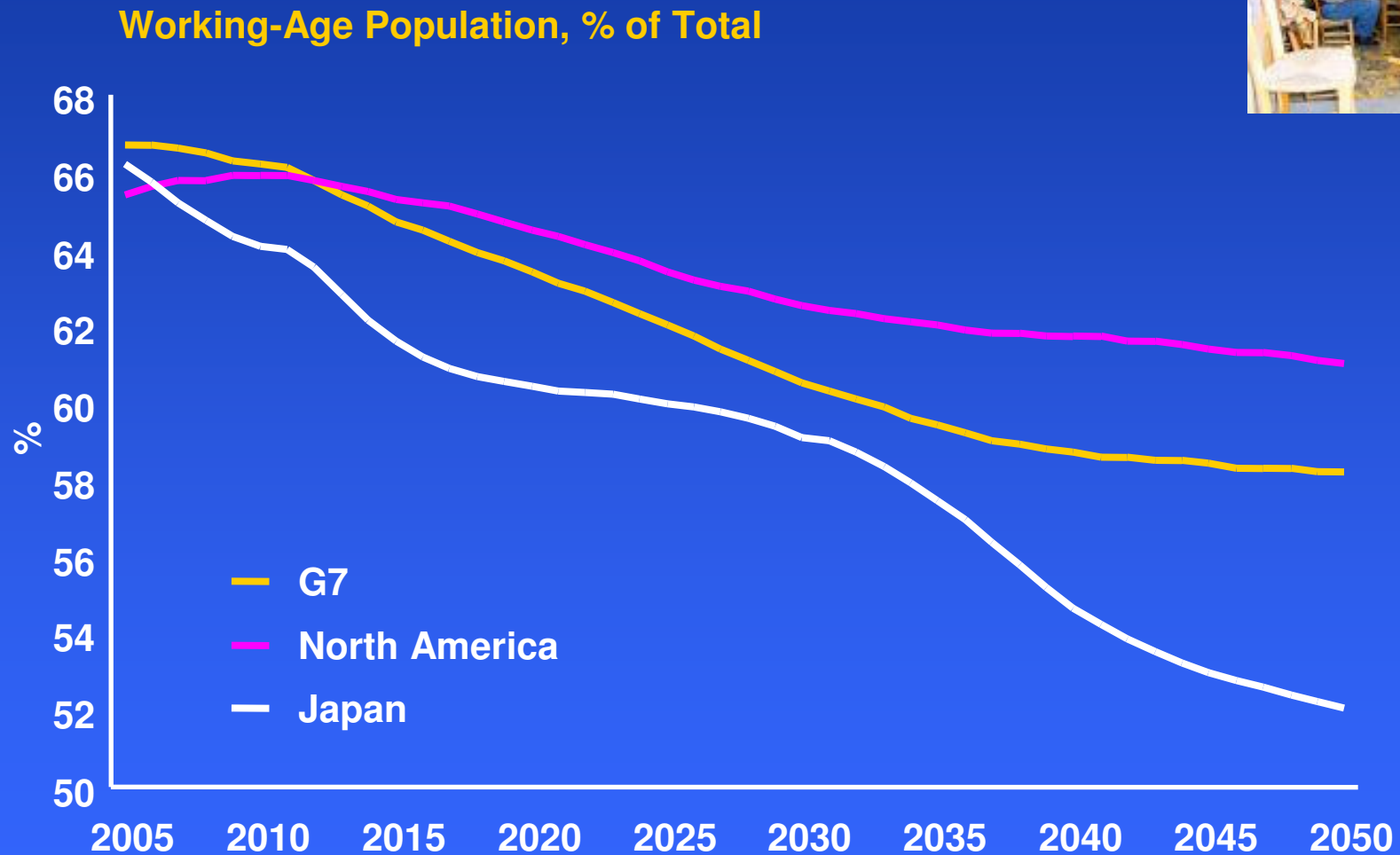
Source: IMF

### China



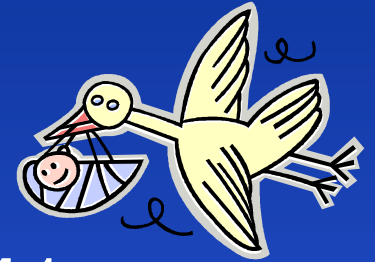
Source: IMF, Datastream

# Demographics Suggest Shrinking Labour Supply



Source: US Census Bureau, PH&N

# Fertility Rates – 2.1 Is The Magic Number



## Fertility Rates, 2007

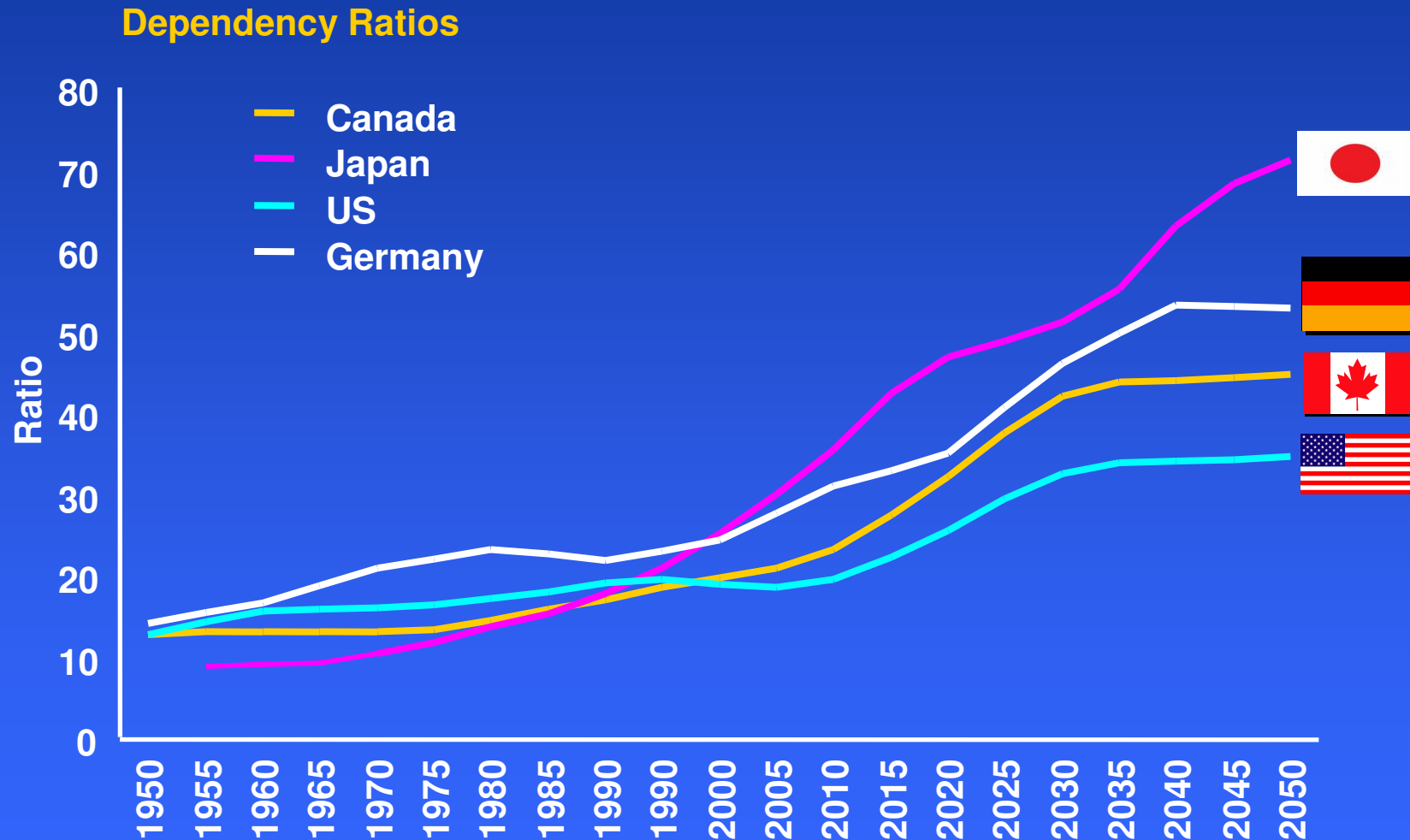
United States	2.1	Pakistan	4.1
France	2.0	Saudi Arabia	4.1
UK	1.8	India	2.9
Canada	1.5	Brazil	2.3
<i>Aboriginal</i>	2.6	China	1.6
Italy	1.4	Russia	1.3
Spain	1.4		
Japan	1.3		
Germany	1.3		

Source: 2007 Population Reference Bureau, Statistics Canada

Fertility Rate = average number of children born to a woman in her lifetime

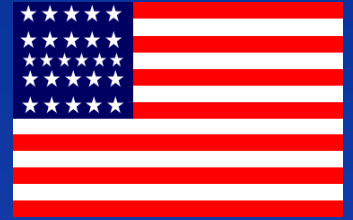
# US In Better Shape Than Japan

Ratio of 65+ To Working Age Population: Dependency Ratio



Source: U.S. Census Bureau

# US Growth Could be Sub Par for Some Time



- ◆ Housing market will be a multi-year work out process
- ◆ Consumer spending set to slow but...
- ◆ ...it has been a mistake to short the US consumer
- ◆ Don't underestimate the willingness of the rest of the world to invest in the US

# Another Way to Look At This Issue

Instead of Decline of the American Empire...

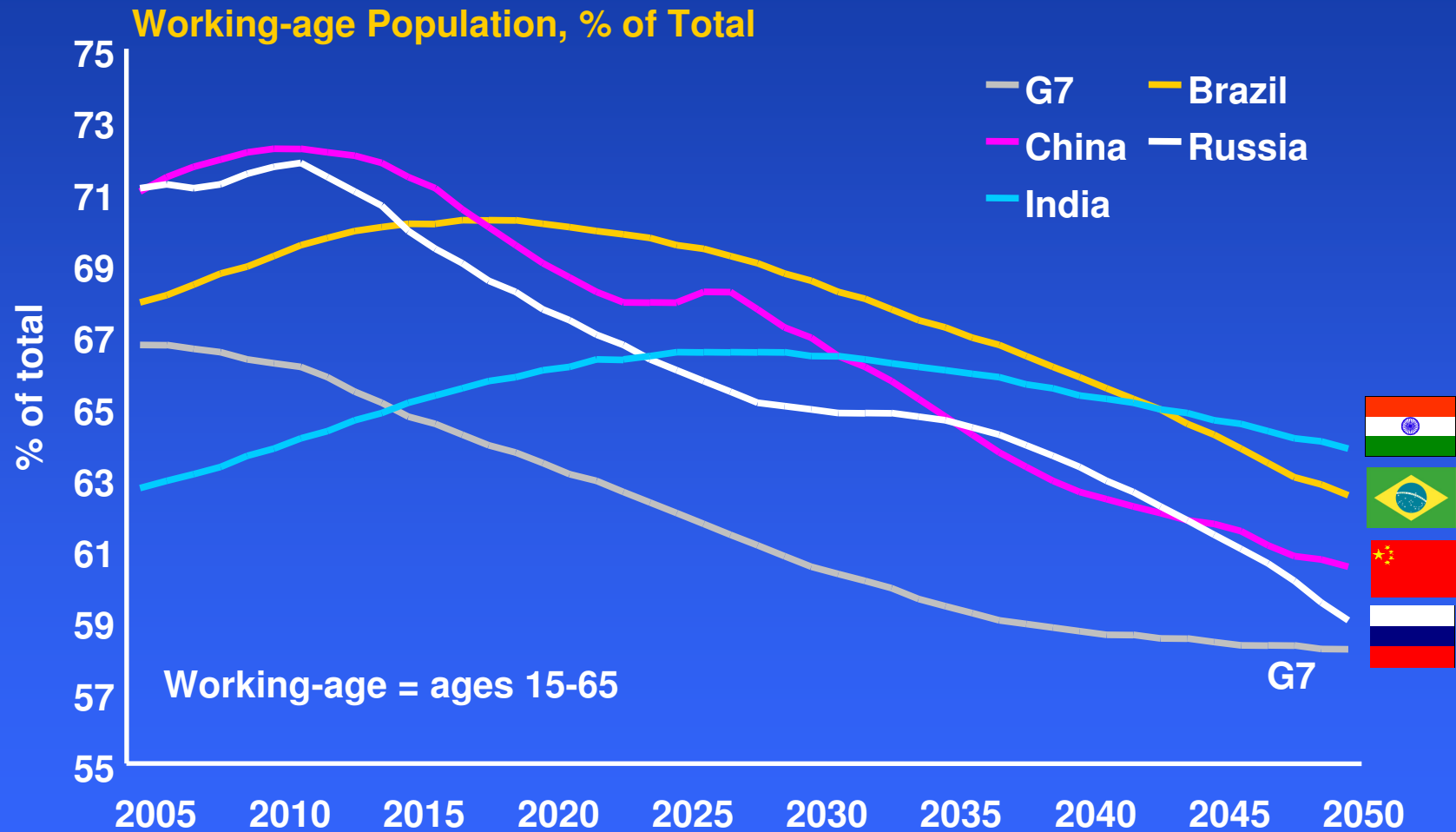
What about the rise of the rest?

Every few decades a significant shift occurs in the world economy with far reaching implications



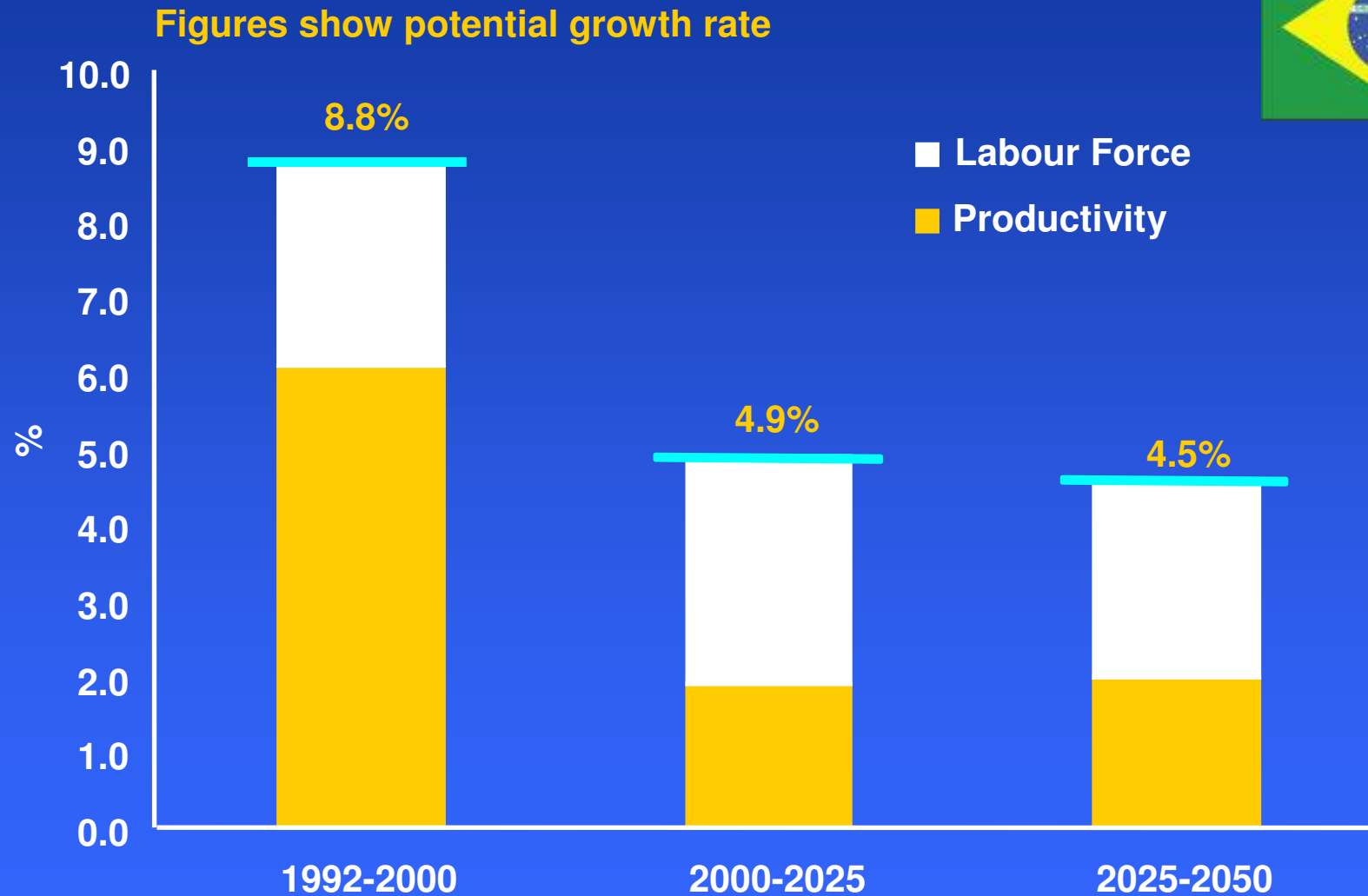
*Today it could be the BRICs*

# Youthful BRICs

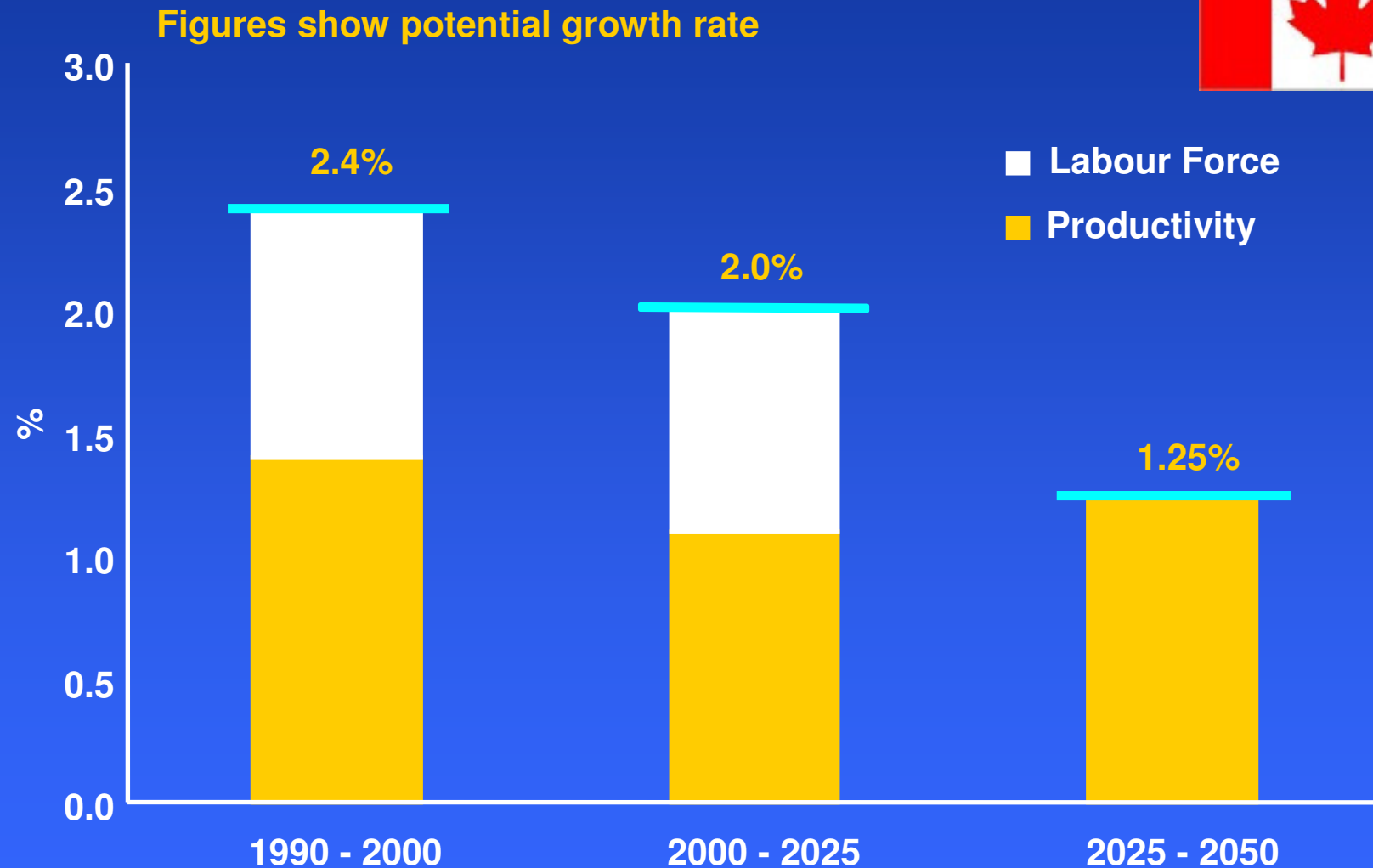


Source: Goldman Sachs

# Brazil's Potential Growth Rate Much Higher



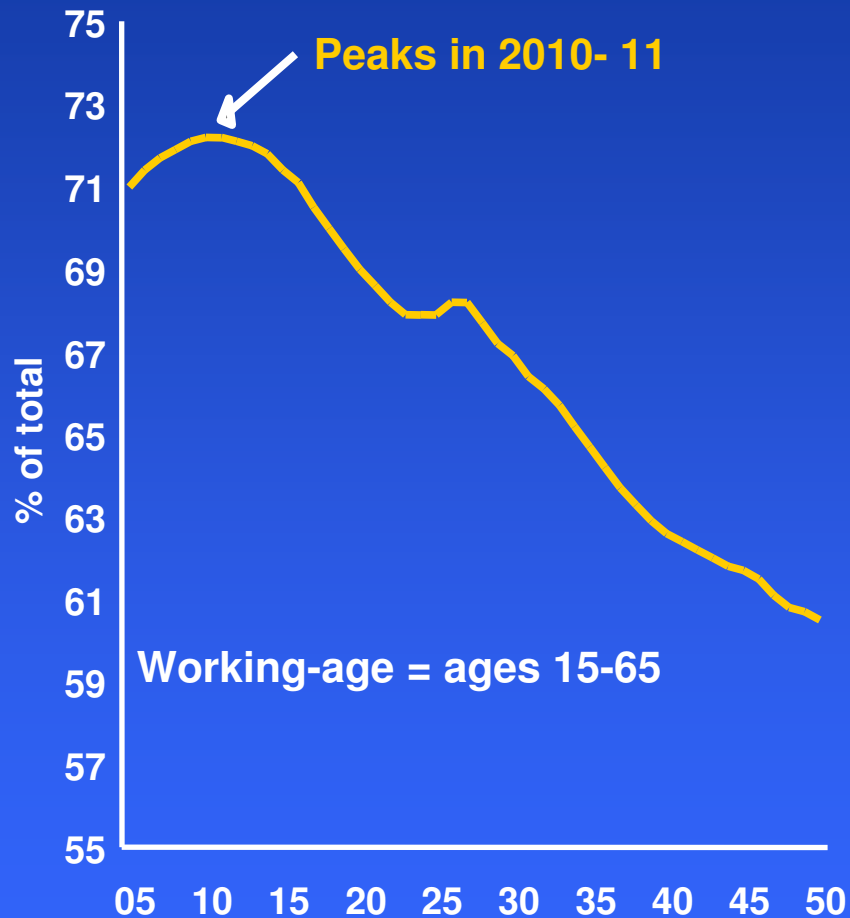
# Canada's Long Term Potential Just 1.25%



Source: BCA Research

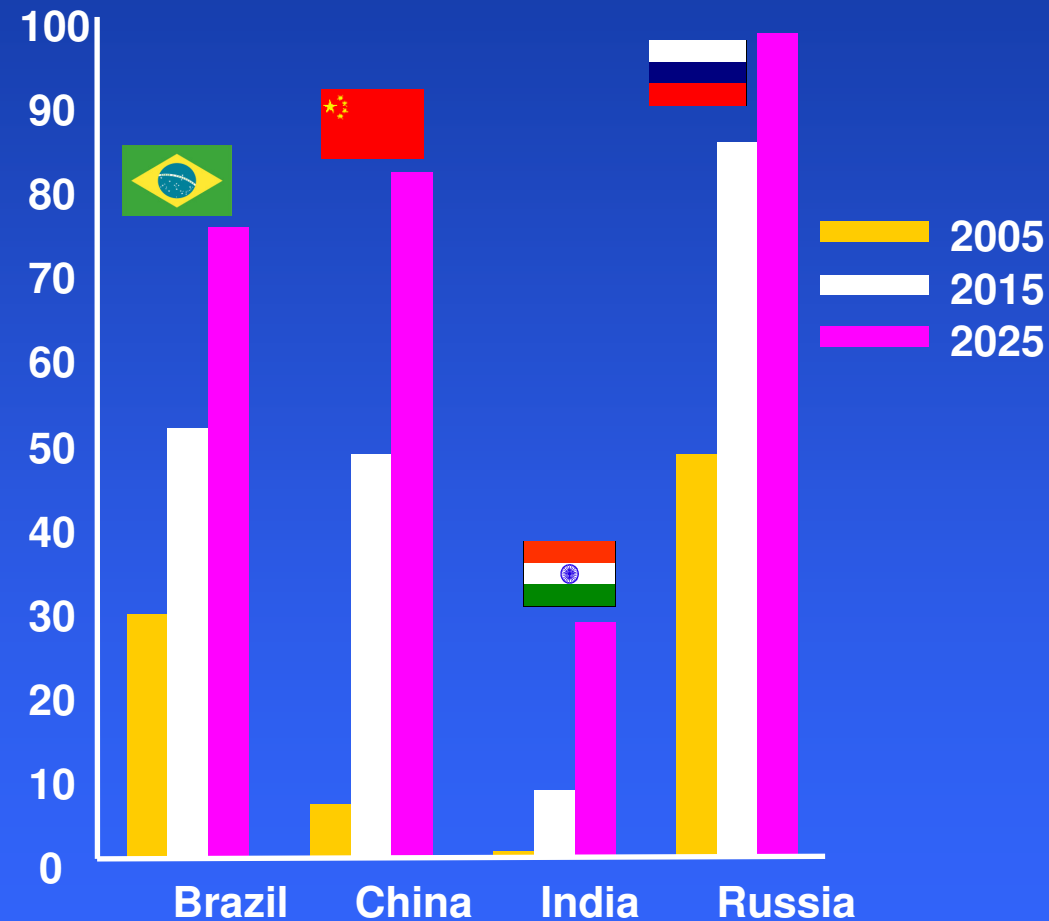
# China's Demographics Negative - Consumer Potential Enormous

China's Working-Age Population, % of Total



Source: Goldman Sachs Research "Dreaming with BRICs: The Path to 2050", U.S. Census Bureau, PH&N

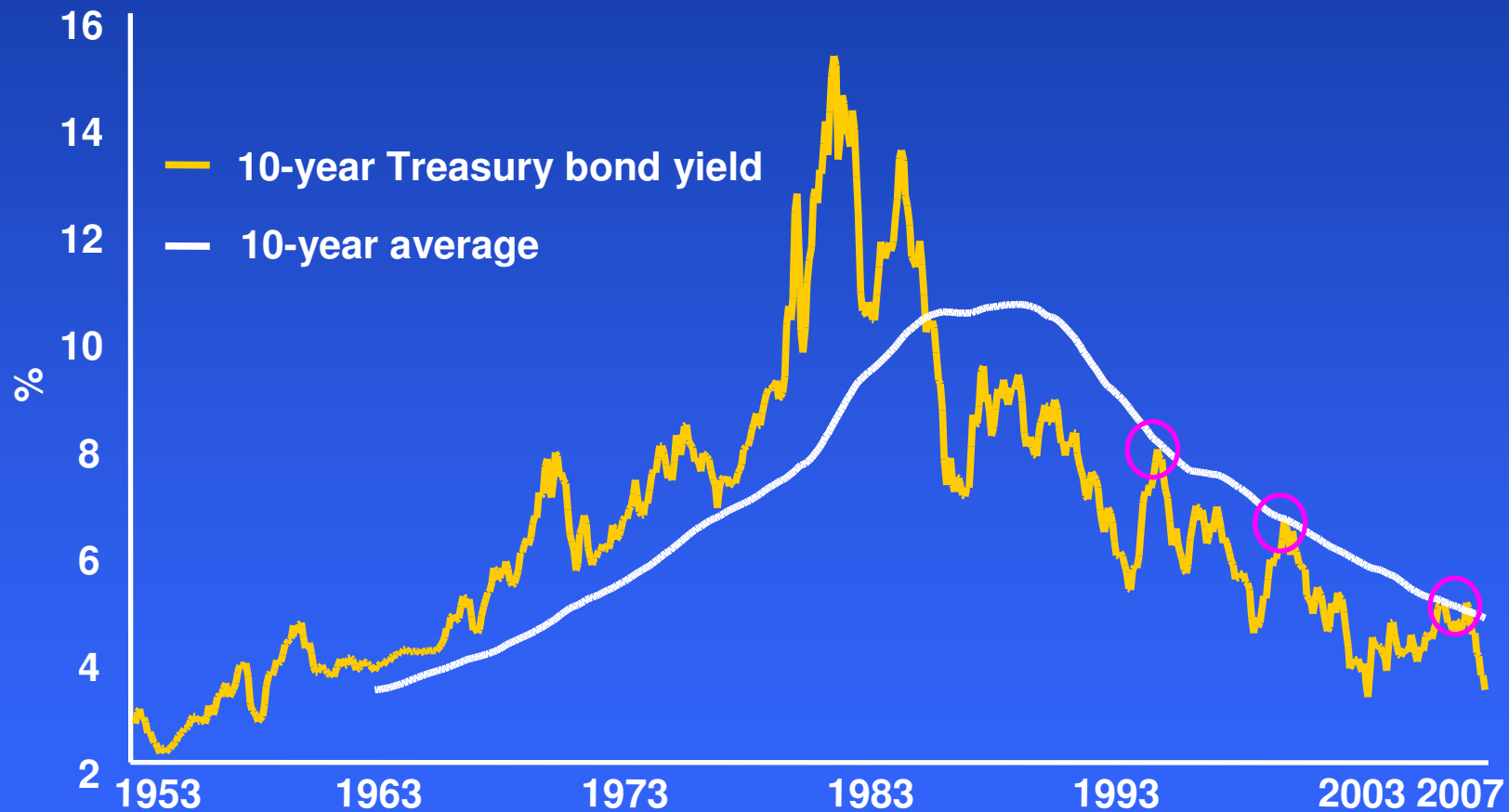
Population with income above U.S. \$3,000 as % of total



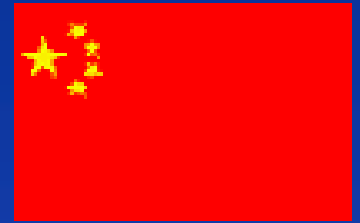
Source: UN

***At Some Point China Will Move from Supplier Of Labour to Demander of Consumer Goods***

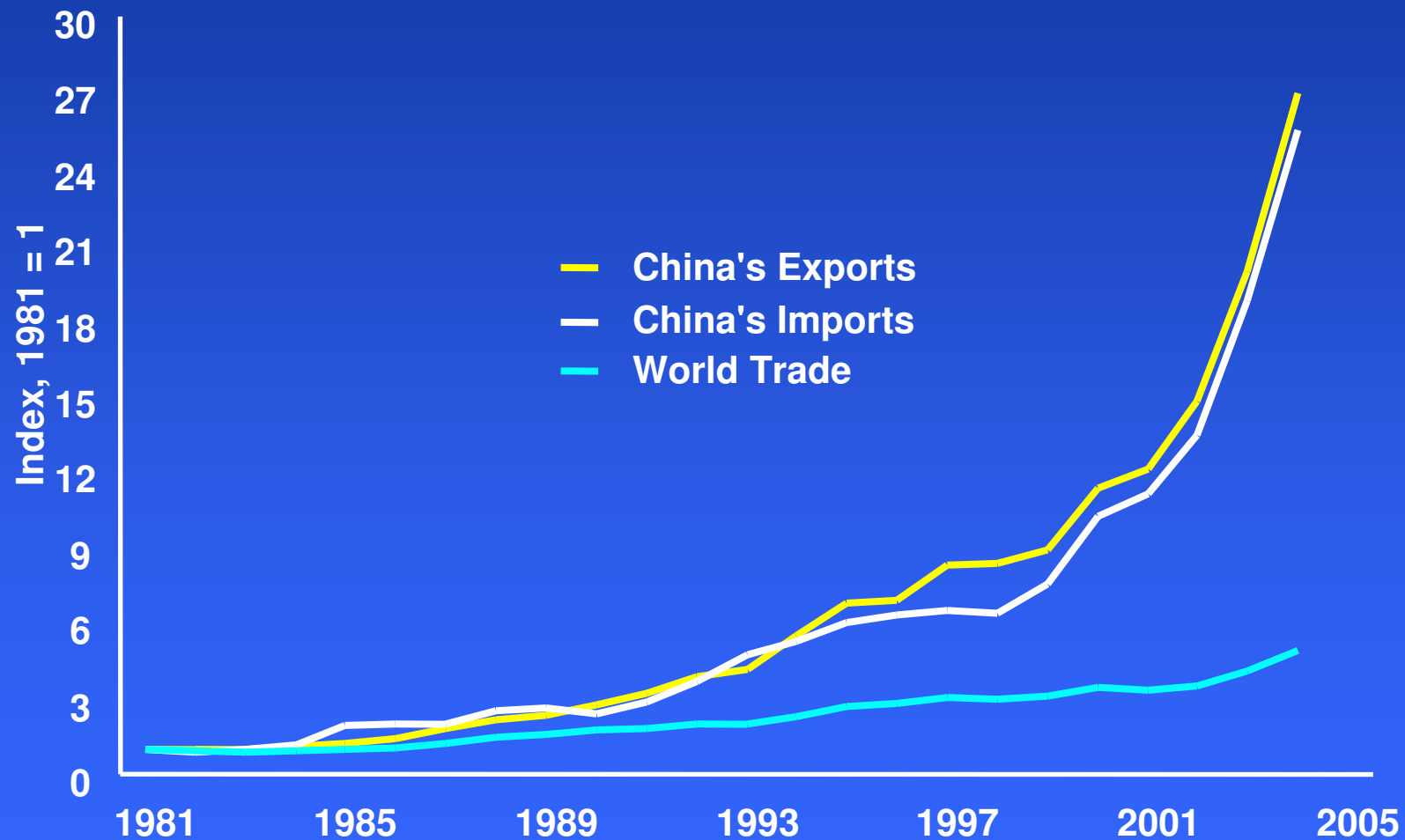
# Bond Market Trend Intact – For Now



Source: U.S. Federal Reserve

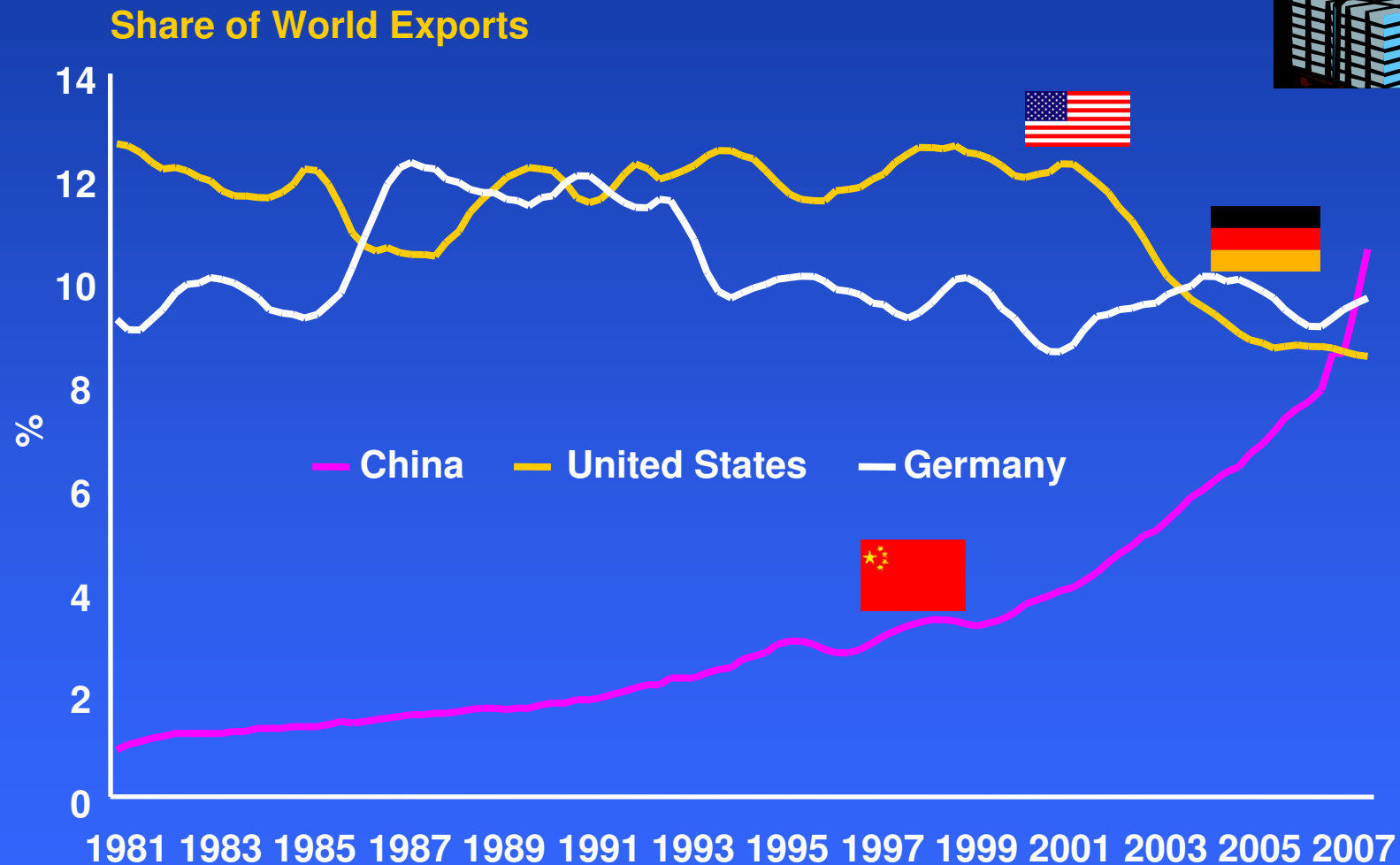
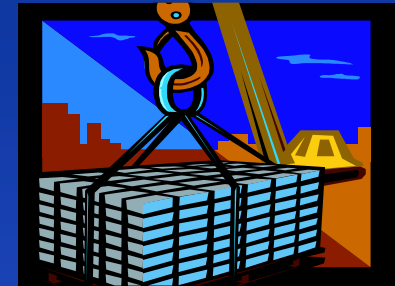


# China Is A Trading Giant



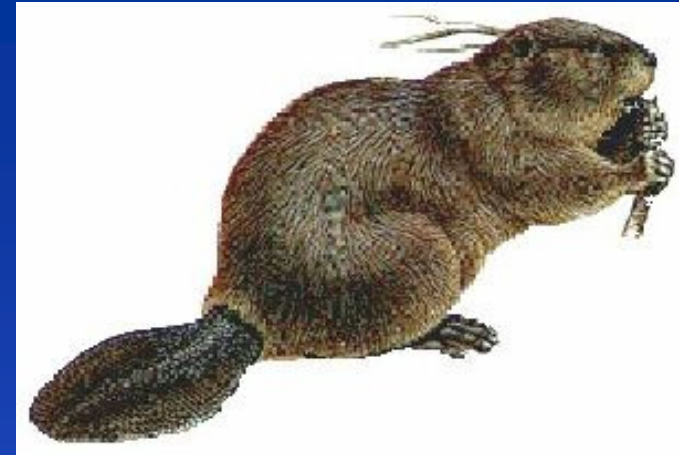
Source: IMF International Financial Statistics

# China Now World's Second Largest Exporter



Source: IMF Direction of Trade Statistics

# A Made In Canada Dichotomy



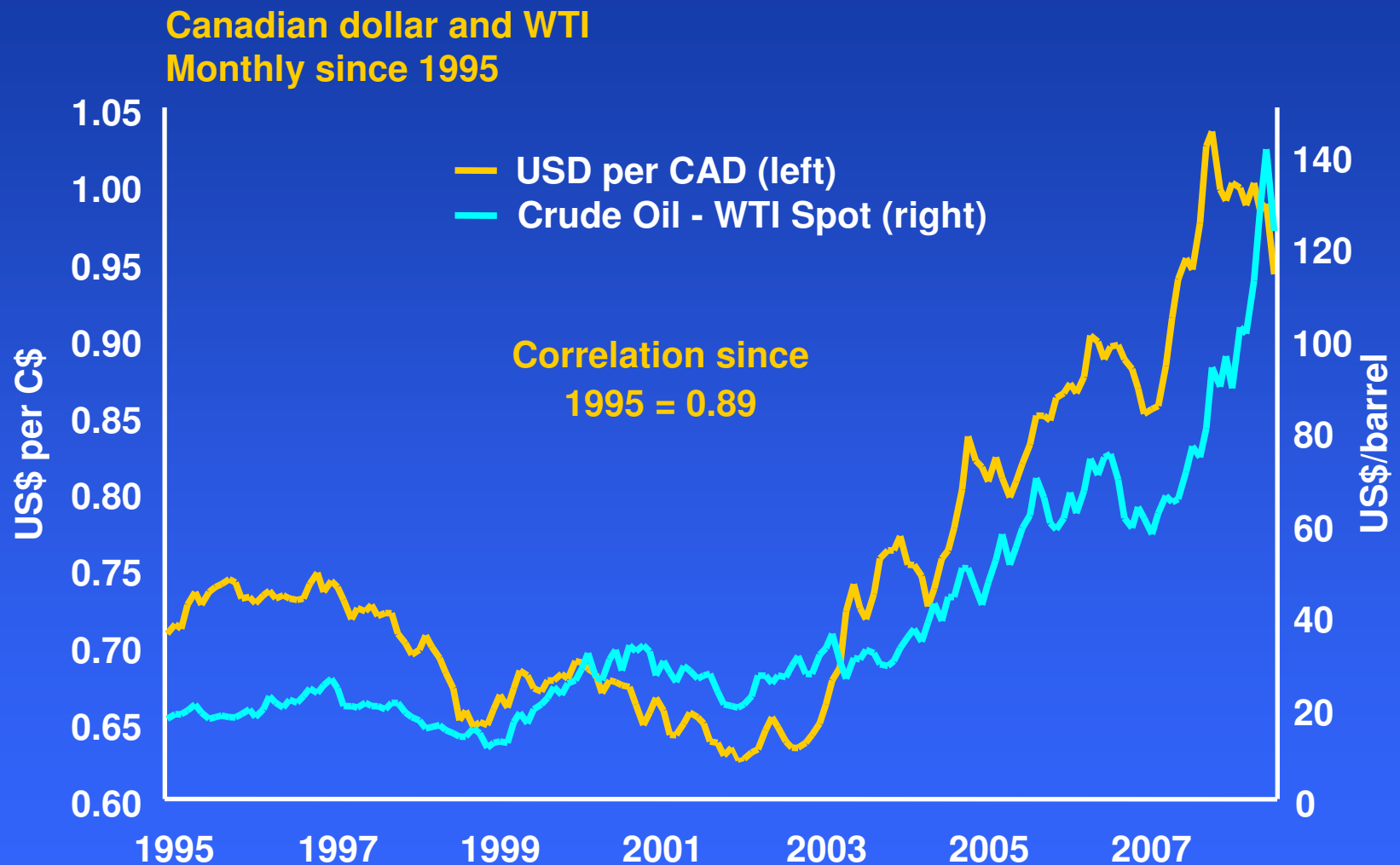
## ◆ It's Canada's time to shine...

- Strong domestic demand
- Lowest unemployment rate in almost 30 years
- Near record labour force participation rate
- Only G-7 country with twin surpluses

## ◆ But beneath the surface....

- Productivity growth is weak
- Face growing competition from Asia and others
- Soaring C\$ weighs on exports

# C\$ Driven by Oil and Economic Outlook



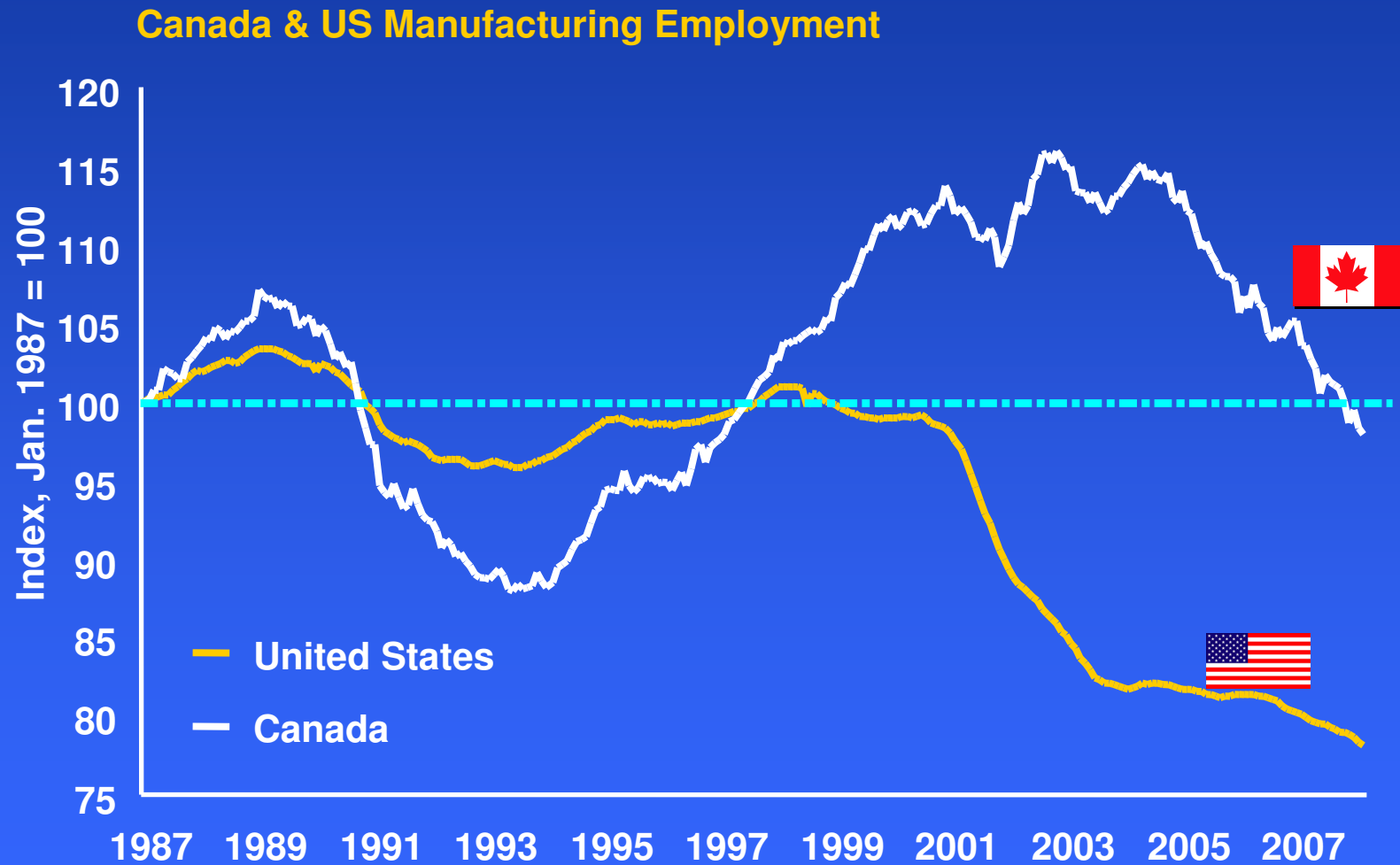
Source: Bank of Canada, Datastream

# Canada Lags In Labour Productivity Growth – Parity Not Justified



Source: The Conference Board of Canada

# The Impact of Globalization?



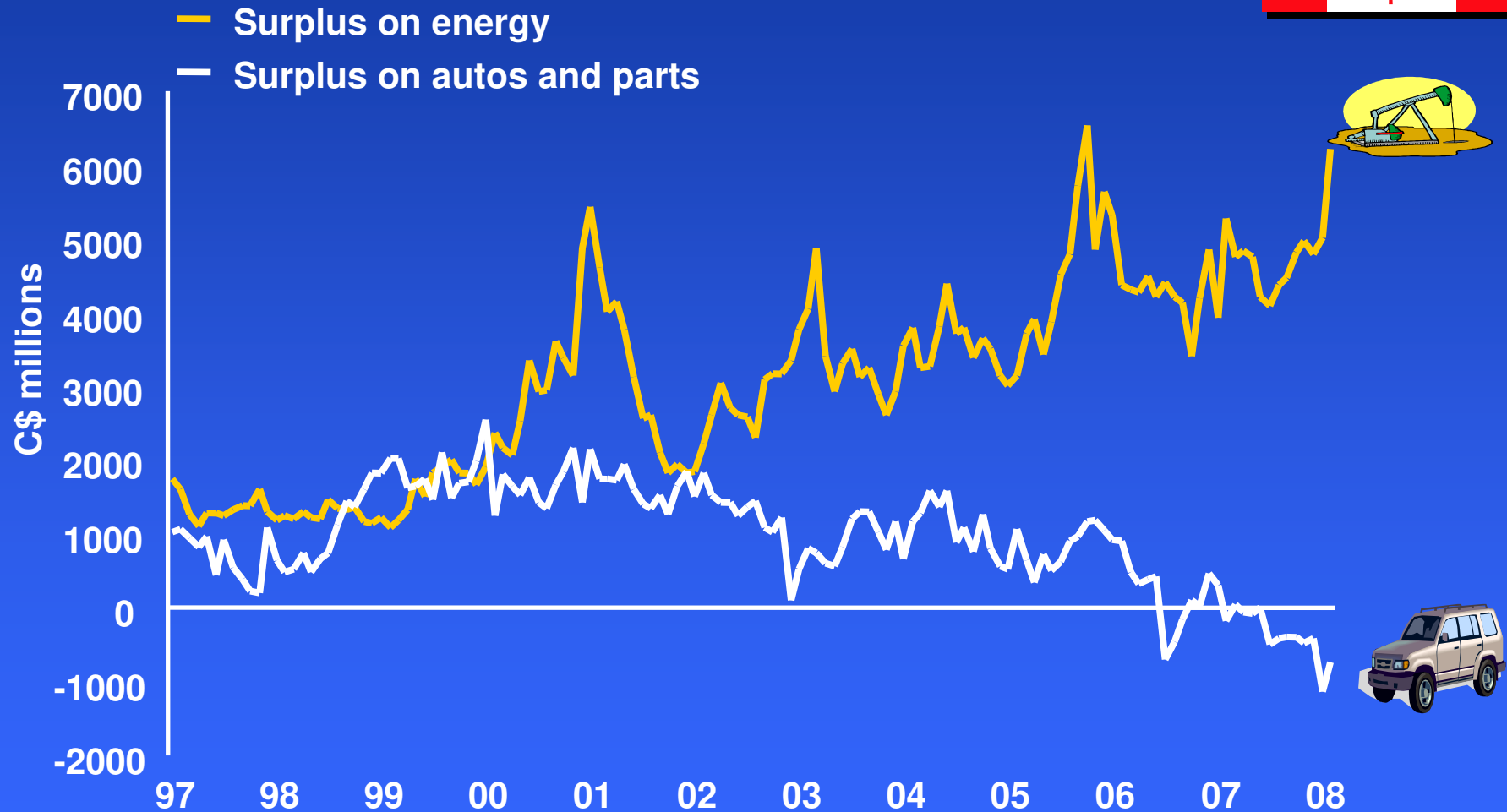
Source: Statistics Canada, US BLS

# Canadian Trade Still Regional Not Global



Exports to China	1990	2007
Exports to the US	73.4%	76.5%
Imports from US	69.2	65.0
Exports to China	1.0	2.0
Imports from China	1.0	9.3

# The Changing Nature of Canadian Trade

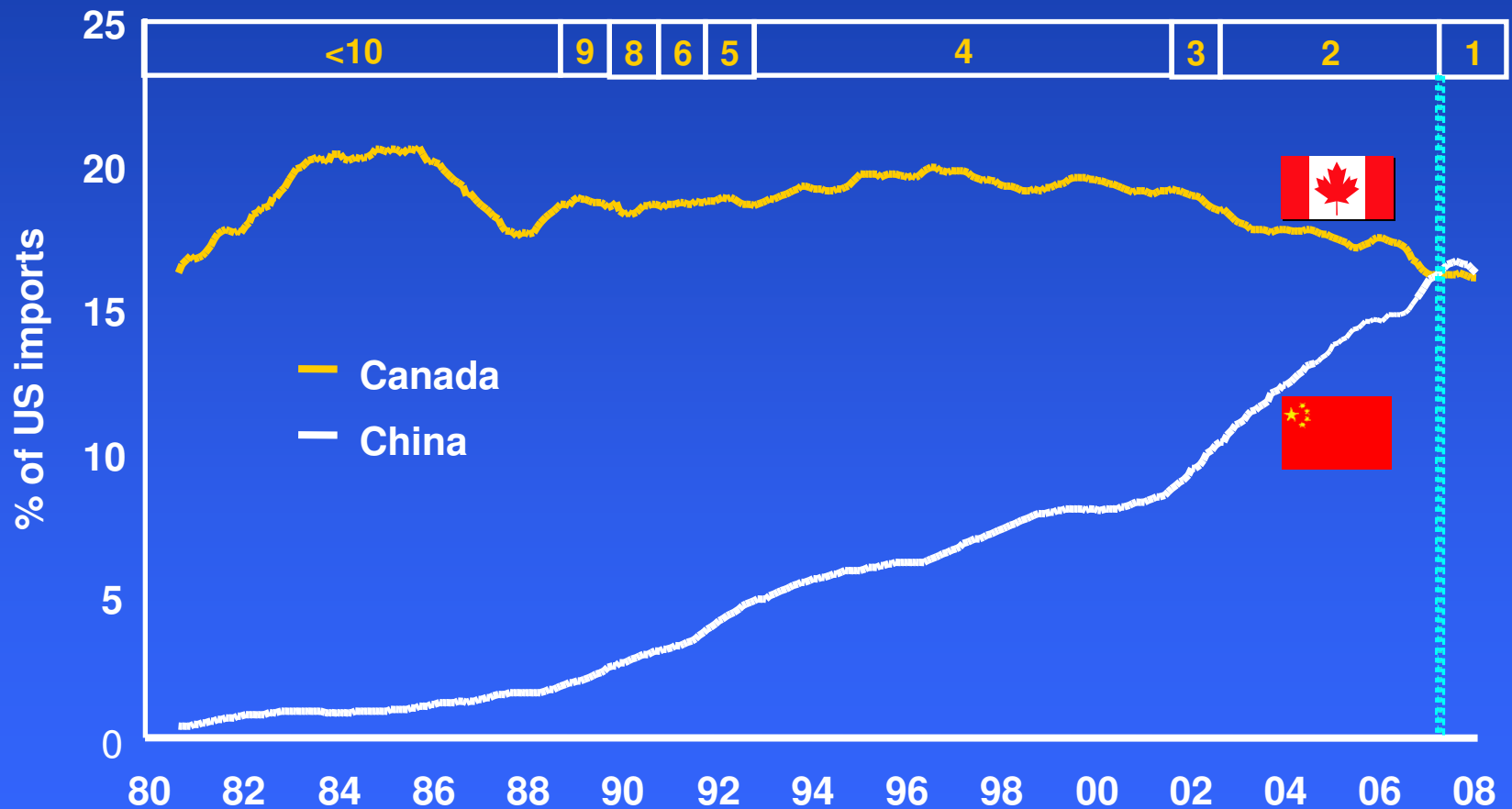


Source: Statistics Canada

# China Has Surpassed Canada In Terms of US Market Share

## Canada & China Share of US Imports

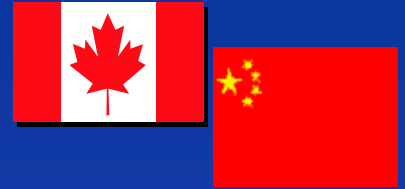
*China's rank:*



Source: US Census Bureau

# Canada and China/India

## Risks and Opportunities



### ◆ Risks

- Competition and loss of market share
- Outsourcing

### ◆ Opportunities

- We have what China wants
- New markets for Canadian products



# Your Questions