

## Innovations in Business Banking

## InterAction



InterAction met with warren jestin to discuss the flight of the loonie, emerging markets and the effect the U.S. economy will have on Canada in the coming year.

## Scotiabank's Chief Economist's outlook for 2008

**IA:** How will the Canadian economy perform overall in 2008?

**Jestin:** Growth here and in other developed nations will likely be fairly subdued through 2008. While the leaping loonie will act as a big drag on Canada's manufacturing and tourism sectors, resource producers will be buoyed by strong demand for energy and industrial materials from China and other emerging industrial nations. Unlike governments in most developed nations, Ottawa and the Provinces are running surpluses that are allowing them to cut taxes and increase spending on infrastructure, giving our economy important support. Canadian consumers also have more equity invested in their homes and lower debt service burdens than their U.S. neighbours. Adding up the pluses and minuses, we still have the potential to lead G7 nations in growth, although next year the pace of the race will be very subdued.

**IA:** Will the regional economic differences continue in 2008?

**Jestin:** Growth will remain "best in the West" next year and probably for the balance of the decade. The Ontario/Manitoba border has tended to be a dividing line for economic performance – to the West, most economic indicators have been stronger than the national average and to the East, the trend has been average at best and most often sub-par. Growth in Alberta and B.C. may well be double the outcome for Ontario and Quebec as manufacturers in Central Canada adjust to a much more challenging competitive environment.

**IA:** What are the factors behind the flight of the loonie? Is parity with the U.S. dollar sustainable in your view?

**Jestin:** Canadians may have to get used to a high-flying loonie because the fundamentals supporting our currency are strong and those undermining the U.S. greenback won't improve anytime soon. On this side of the border, we have trade and fiscal surpluses and a more cautious monetary policy. In contrast, the U.S. has fiscal and trade deficits and is running a much more accommodative monetary policy. Globally, investors are increasingly nervous about holding overweight U.S. dollar positions and are seeking to diversify their portfolios. While periodic shifts in investor confidence will add to currency volatility, we expect the U.S. dollar to weaken further against major currencies and the Canadian dollar to show a continuing upward bias. There is a good chance that the loonie will average above parity with the greenback next year and beyond.

**IA:** What are the implications of the U.S. economic forecast for Canada in 2008, particularly among export-sensitive manufacturers?

**Jestin:** Roughly 80% of our exports go to the U.S. and, outside the commodity sector, heightened competition from low-cost offshore imports and the soaring loonie have been eroding our market share. This trend will continue, with our manufacturers likely to increasingly focus on niche, high-value-added products, or becoming distributors of low-cost imports to sustain their export markets. The good news is that this restructuring is occurring at a time when other sectors of the economy – construction,



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services and commodity production – are doing quite well. As a result, Canadian growth will probably exceed 2% next year, with the jobless rate continuing to hover near the lowest levels in three decades, particularly in the high-growth Western provinces.

**IA:** Will consumer spending in Canada continue to increase at the pace we experienced in 2007?

**Jestin:** While consumers are expected to be a bit more cautious, overall spending will be supported by high levels of employment. Canadians are not as over-levered and over-bought as their U.S. counterparts. Our housing market is in much better shape. The GST cut also works to support spending to a minor degree. The real uncertainty is the trend to cross-border shopping. As domestic distributors begin to pass along the savings from currency appreciation, retail prices will adjust and we may find that consumer inflation recedes significantly. Lower inflation opens up room for the Bank of Canada to cut interest rates which also is positive for consumer spending. Overall, 2008 won't be a banner year in the retail sector, but sales should hold up reasonably well.

**IA:** What global trends will impact the worldwide economy in 2008?

**Jestin:** There is a great divide between the growth prospects for traditional developed nations and those of the emerging economic powerhouses. Taken as a group, the developed nations in North America, Europe and Japan will probably grow by about 2% in 2008. While activity in China and India will moderate, the expansion is expected to be roughly four times the average pace of the developed nations, supported by their increasing share in global markets and strong domestic growth. However, the growth risks are skewed downward if the global credit market problems that have surfaced in the wake of the U.S. sub-prime mortgage crisis linger on. Another hallmark of 2008 is likely to be ongoing volatility in the currency markets, with the Canadian dollar, Euro, Japanese yen and Australian dollar having a tendency to appreciate against the U.S. dollar benchmark.

**IA:** You have been quoted as saying that the unprecedented growth in China will change the global landscape. What lies ahead for this powerhouse and other emerging markets?

**Jestin:** China is on the fast track because it is gaining market share in Europe, the U.S. and Asia, while its domestic economy is growing rapidly with huge investments in infrastructure. Consumer spending also is increasing very rapidly as household income ramps up. India, Russia and many emerging nations also have good medium-term growth prospects.

**IA:** How would you sum up Canada's economic position in the global economy?

**Jestin:** All developed nations are being challenged to deal with enormous changes to the global economic and financial market landscape. While the needed adjustments will be difficult for many businesses, our country's macro-economic fundamentals are very strong. We live in a resource-rich country in a resource-short world and both our labour force and infrastructure are world class. Compared to their U.S. counterparts, our households have been more cautious borrowers and spenders. The past fiscal prudence of our governments is also paying important dividends in supporting growth and the adjustment process. Among the developed nations, Canada is one of the best places to be when dealing with the extraordinary global change occurring all around us.

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