Economics

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ECONOMIC INSIGHTS

November 29, 2012

Look on the Bright Side

by Avery Shenfeld

The evident slowing in Canadian home sales will take a bite out of domestic economic growth. Fewer houses built, and slower turnover to drive related sales of furniture and appliances, could chop nearly a percentage point from growth. But another dimension of the recent trend, a cooling in house prices, is less of an unambiguous negative as it's often made out to be.

For one, a retreat today could be the preferred alternative to a harder landing from even higher prices down the road. Less understood is that cheaper home prices could bring winners as well as losers across the economy.

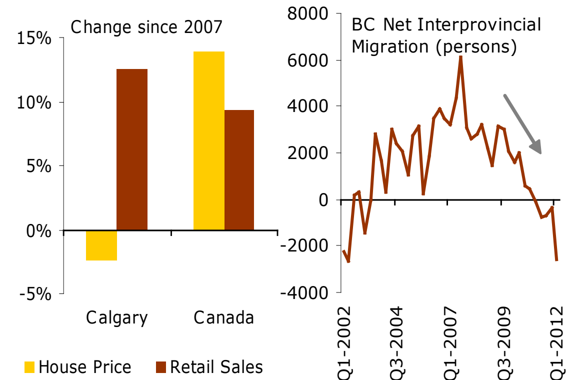
The latter get all the headlines. A home owner that counted on downsizing to fund her retirement might have to pare spending plans. While a month ago we quoted widely cited estimates of the wealth effect on spending, it's difficult to disentangle them from the data. Most historic wealth declines coincided with other sources of economic weakness, including rising unemployment or high interest rates that depress consumption. Calgary house prices have trailed other cities, including a near-15% dip in 2008, yet retail spending outperformed (Chart, left).

And what of the young newlyweds scraping by on mac and cheese in order to save for their first home? A slip in prices could ease that task, freeing up spending power in the process.

Regionally, the implications are also not that cut-and-dried. British Columbia house prices led on the way up and now down. But affordability issues have been a drag on BC growth; the rapid run-up in prices was one factor turning the province from a beneficiary of in-migration to a net source of emigration (Chart, right). Dreams of retiring in BC, and taking one's spending money to that province, might be back in vogue if relative prices of housing are better in line with other provinces.

Didn't house deflations sink the US and Ireland? Not on their own. It was the accompanying wave of defaults that devastated the financial system in both countries. Canada hasn't lent as aggressively to its lower-income home buyers, and a correction in house prices caused by a tighter regulatory environment and earlier price overshooting, rather than by defaults, would not on its own generate that same banking system shock.

As a home owner, I'd prefer that one particular Toronto street stays insulated from any house price declines. But to look on the bright side, a gradual cooling in house prices, one early enough to avoid a larger financial sector shock, will look good in hindsight if Canada gets more support from global growth in the next two years.



MARKET CALL

- The pending change at the Bank of Canada's helm is unlikely to alter policy direction, which depends more on fundamentals than personalities. Although household debt remains a concern, below-potential Q3 GDP growth is another sign that the economy is too subdued for an early hike. Below-target inflation and headwinds from budgetary tightening should also keep the Bank sidelined until early 2014.

- Beyond tame performance at home, the C$ faces challenges from both an uninspiring global economy and soft commodity prices in the first half of 2013. That raises the risk of a re-test of parity.

- US fiscal worries, a weak growth environment and a potential extension of the Fed's soon-to-expire Treasury-buying program should support bonds in the next 3-4 months. A firming US recovery and stabilization overseas adds to risks beyond mid-year.

INTEREST & FOREIGN EXCHANGE RATES

		2012		2013				2014
END OF PERIOD:		**28-Nov**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**
CDA	Overnight target rate	1.00	1.00	1.00	1.00	1.00	1.00	1.25
	98-Day Treasury Bills	0.95	0.95	0.95	0.95	0.95	1.20	1.45
	2-Year Gov't Bond	1.09	1.10	1.20	1.35	1.40	1.65	1.75
	10-Year Gov't Bond	1.72	1.80	2.00	2.25	2.55	2.60	2.65
	30-Year Gov't Bond	2.30	2.40	2.60	2.85	3.00	3.10	3.10
U.S.	Federal Funds Rate	0.16	0.10	0.10	0.10	0.10	0.10	0.10
	91-Day Treasury Bills	0.10	0.10	0.10	0.15	0.15	0.15	0.15
	2-Year Gov't Note	0.26	0.30	0.30	0.35	0.40	0.45	0.45
	10-Year Gov't Note	1.63	1.65	1.85	2.15	2.45	2.55	2.65
	30-Year Gov't Bond	2.80	2.65	2.90	3.20	3.40	3.65	3.70
Canada - US T-Bill Spread		0.85	0.85	0.85	0.80	0.80	1.05	1.30
Canada - US 10-Year Bond Spread		0.08	0.15	0.15	0.10	0.10	0.05	0.00
Canada Yield Curve (30-Year — 2-Year)		1.21	1.30	1.40	1.50	1.60	1.45	1.35
US Yield Curve (30-Year — 2-Year)		2.54	2.35	2.60	2.85	3.00	3.20	3.25
EXCHANGE RATES	CADUSD	1.01	1.02	1.00	0.98	1.00	1.02	1.03
	USDCAD	0.99	0.98	1.00	1.02	1.00	0.98	0.97
	USDJPY	82	81	82	83	82	81	80
	EURUSD	1.29	1.29	1.27	1.25	1.25	1.28	1.31
	GBPUSD	1.60	1.59	1.58	1.56	1.57	1.61	1.63
	AUDUSD	1.05	1.01	0.99	0.97	0.97	0.99	1.01
	USDCHF	0.93	0.94	0.95	0.97	0.98	0.98	0.95
	USDBRL	2.09	2.02	2.02	2.04	2.07	2.05	2.08
	USDMXN	12.98	12.85	12.85	13.05	13.30	13.38	13.48

Corporations: The US Recovery's Weak Link

Peter Buchanan

If housing is the US economy's hearty side these days, business spending is its fast cooling one. Corporate capital outlays led the recovery's early stages, growing at a near-9% annualized tempo in the first two calendar years of the recovery, quadruple GDP growth (Chart 1). That's twice the pace seen after the last recession, a decade ago. Helping to bolster an already healthy performance on the productivity side, the main driver was equipment spending.

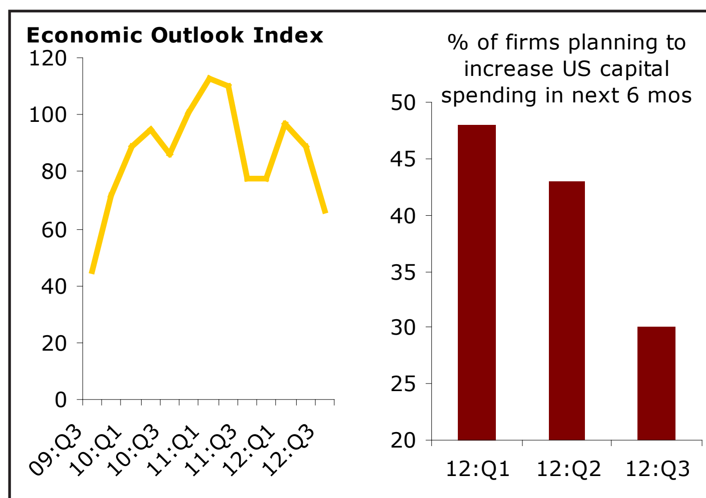
Of late, a fair bit of air has gone out of the balloon. Capital outlays fell outright in Q3, after waning momentum earlier in 2012. Since business investment represents 11% of GDP—and has accounted for fully 30-40% of quarterly output swings given its greater volatility—the mood in boardrooms is of great importance to the growth outlook. That's all the truer given headwinds on the trade and budgetary sides, even in the likely case politicians cut the fiscal cliff down to a less threatening size.

Fiscal Cliff Uncertainties, or Something More?

Received wisdom, reinforced by some recent surveys (Chart 2) and CEO musings, attributes corporations' recent belt-tightening proclivities to budgetary uncertainties. If you're uncertain as to your own future taxes and those of your customers, why not park your cash until the dust settles. To the degree the spending slowdown is fiscal cliff-related, resolving the impasse there could theoretically get the ball rolling quickly again. If other factors are involved—as we believe—the pickup could be more gradual. A misfiring growth driver could leave the US recovery struggling for another year to generate the lift needed to cut still-high joblessness, even if some earlier trouble spots like housing are now looking the best in years.

Chart 2

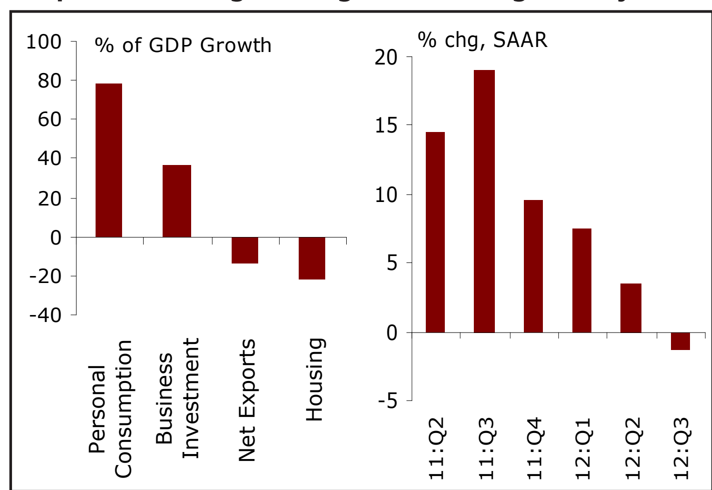
US CEOs' Anxieties (L) Cloud Capital Spending Outlook (R)



Source: Business Roundtable

Chart 1

Drivers of Recovery's First Two Years (L); Corporations' Tightening Purse Strings Lately (R)

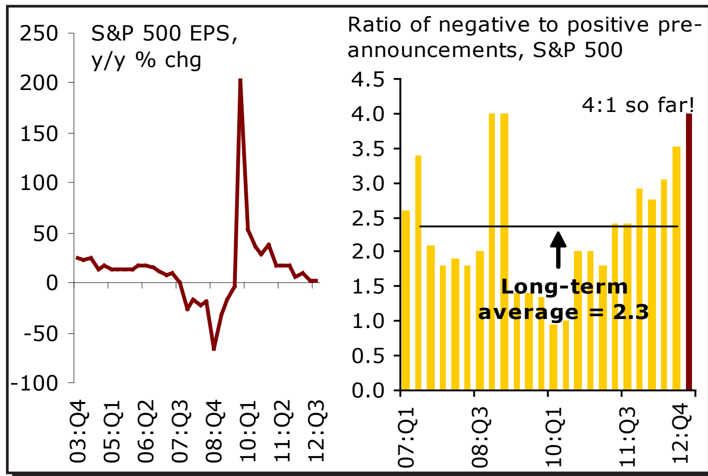


Source: BEA, CIBC

A Hot Earnings Recovery Turns Cold

One obvious leash on corporate spending—beyond acrimonious Beltway politics—is a sputtering earnings recovery. More corporations once again surpassed than missed the street's expectations in Q3. That's more a tribute though to scaled-back expectations, than any sparkle in the figures themselves. In year-over-year terms, earnings showed little change for a second quarter running (Chart 3, left). Nor are sunnier times obviously just around the bend. Europe alone accounts for a good 15% of the S&P 500 earnings pie, and ongoing troubles there have helped to lift the ratio of negative-to-positive guidance for the current quarter to a decade high of 4:1 (Chart 3, right). Corporations are also having more difficulty matching the street on sales than earnings, but the last 3-4 years of aggressive cost-cutting limits room for

Chart 3
Stalled Earnings Recovery (L); Weak Forward Guidance (R)

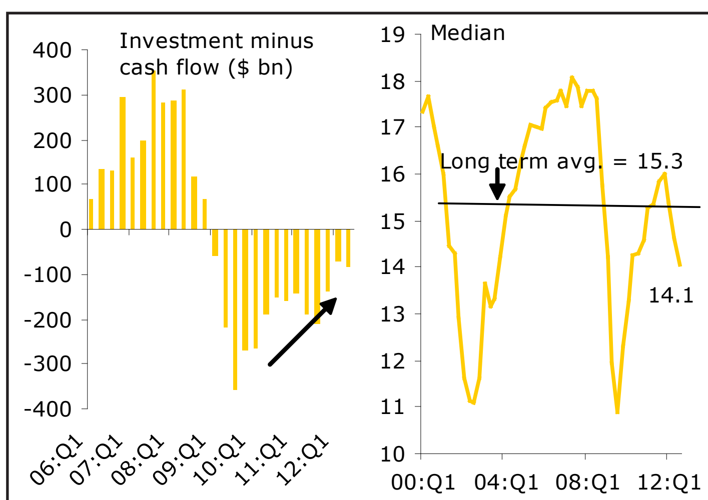


Source: Bloomberg, Thomson Reuters

improvement in that critical area. Slower earnings growth, meanwhile, has put downward pressure on the corporate financing gap, a key measure of corporations' ability to finance spending internally. The return on equity has also slipped, after rising earlier in the recovery (Chart 4).

Turning to other spending influences, the strong performance of dividend stocks, which have resumed their outperformance since the election, suggests that investors are continuing to demand a financial bird in the hand rather than one in the bush. That gives firms an incentive to keep a rein on their outlays to bolster shareholder payouts. Though Corporate America's cash mountain remains appreciable at around $3 trillion, as much as four-fifths of the holdings of some high profile

Chart 4
Corporate Financing Gap (L) and S&P 500 Return on Equity (R)



Source: Federal Reserve Board, Bloomberg, CIBC

firms are held offshore, and cannot be repatriated as such without incurring domestic tax liabilities. Capital access troubles during the Great Recession also give firms an incentive for keeping more cash on the balance sheet than in the past.

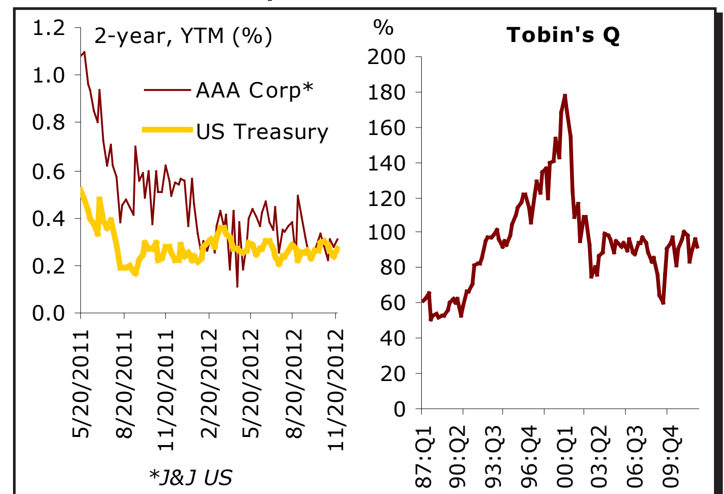
President Obama's re-election allays fears of the Fed prematurely hiking rates. While that could theoretically help investment, rates are already so low they are almost certainly less of an obstacle than other factors. A few top tier credits are actually paying less than the US Treasury to borrow (Chart 5, left). Even in normal times, bond yields typically have not been as important a factor driving investment[1] as other variables, including growth prospects, and available slack. Still ample levels of spare capacity in key capital intensive sectors like primary metals, chemicals and motor vehicles, give firms there a reason not to rush headlong into expansion.

Relative to the late 1990s, when the market was afire and valuations stretched, it's also cheaper in many cases to "grow" the firm by acquiring a competitor than building out your own capacity. Tobin's Q, a widely known stock market valuation metric, measures the cost of buying new assets in the market relative to creating them. That measure is far below past cyclical highs (Chart 5, right).

Enriched Depreciation Pulled Spending Forward

The "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010" permitted 100% bonus

Chart 5
Lower Rates Unlikely to Help Much (L); Cheaper in Some Cases to Acquire Than Build (R)

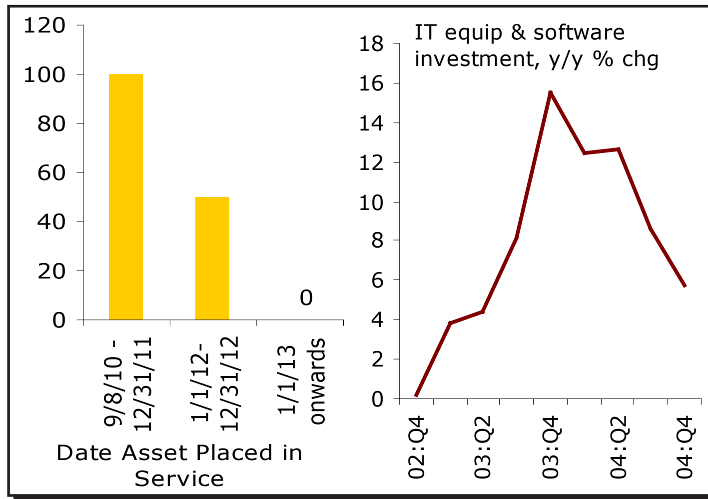


Source: Bloomberg, Federal Reserve Board, CIBC

[1] See for example, Snyder and Paterson, "Do Federal Budget Deficits Cause Crowding Out", Research in Business and Economics Journal, 2010. The authors found that yields have accounted for well under 10% of business investment volatility.

Chart 6

Bonus Depreciation (L); Lift from Similar 2002-03 Incentive Faded Quickly (R)



Source: BEA, IRS

depreciation for machinery, IT and similar limited-life assets placed in service after September 8, 2010 and before December 31, 2011. That declined to 50% for investments in 2012, and will fall to zero for tax years 2013 and beyond, unless current legislation is changed (Chart 6, left). That's also likely to contribute to a cooler investment climate, much as occurred when a similar incentive lapsed during the first Bush term (Chart 6, right).

Finally, IT and resource-related investment cuts have contributed centrally to the slowdown (Chart 7). Headwinds in both areas could linger.

IT and software spending accounts for over 40% of US fixed corporate outlays these days, making it a key determinant of overall business spending. There have been three major IT spending cycles in the last three decades (Chart 8, left), driven respectively by the PC wave in the 1980s, the dot-com boom and more recently, in the last decade, the financial sector's rapid growth and need for greater processing capacity. These days the winds are blowing the other way. Deteriorating fundamentals in the traditional PC market continue to weigh on the companies in that sector. Atop this, tight budgets and cost pressures continue to limit investment by government and the financial services industry. The latter alone has accounted for nearly a quarter of overall IT outlays in recent years (Chart 8, right).

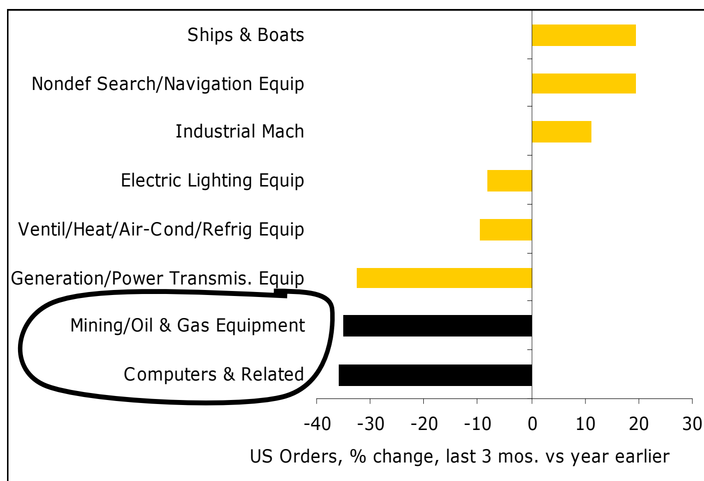
Reinforcing weaker IT spending, softer prices appear to be taking a toll on resource outlays. A vivid example is the recent dive in the natural gas rig count to 13-year lows.

Don't Get Too Excited About the Recovery Just Yet

As housing anxieties have eased and consumers have returned to the aisles, attention has shifted to Corporate America's spending habits. With weaker growth in key markets like China and Europe and a fast-slowing earnings recovery, corporate CFOs have lots to worry about beyond the immediate perils of the fiscal cliff. Continued softness in corporate spending is clearly one of the larger risks in the outlook and another reason why it may be 2014 before the economy regains cruising speed.

Chart 7

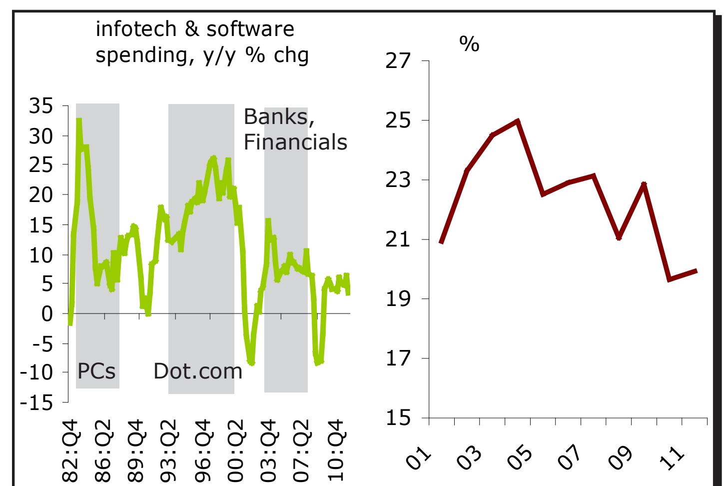
Infotech, Resource Equipment Driving Investment Slowdown



Source: Census Bureau, CIBC

Chart 8

Past IT Spending Waves (L), Financial Sector's Share (R)



Source: BEA, CIBC

Eurozone Recovery: Arrested Development

Emanuella Enenajor and Andrew Grantham

Don't cheer too loudly if the Eurozone starts to post positive growth quarters in late 2013. While government fiscal drag may lighten up, dented private sector confidence and continued banking sector deleveraging could see overall 2013 GDP fall by 0.1%, weaker than our previous forecast. More meaningful growth will have to wait until 2014, when we expect a 0.8% increase in real output. But for peripheral Europe, ongoing competitive challenges mean a sustainable recovery there could still be several years away.

Eurozone Recession: Not Just Fiscal Drag

The Eurozone recession isn't just a story of government fiscal headwinds. A forecasted 0.4% drop in economic activity this year follows growth in 2011, despite official estimates that the fiscal drag actually eased this year (Chart 1, left). But even with a less severe fiscal adjustment, the economy still sunk on a weakening private sector. Ongoing private sector balance sheet repair has dented demand for credit (Chart 1, left) while tightening lending standards and rising economic uncertainty continues to drive restrained lending.

While the IMF and ECB peg credit contraction as a small element of overall European bank deleveraging (Chart 2, left), that factor is still hitting the economy. Indeed, the decline in bank credit appears to be deepening, particularly for private businesses—approaching the pace of pull-back seen during the Great Recession (Chart 2, right). With bank balance sheet repair likely to stretch on for a few more years, the Eurozone's credit challenges could persist for some time yet.

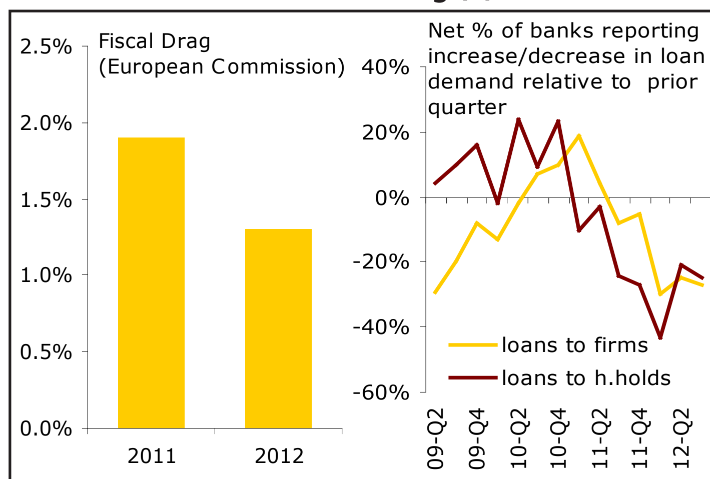
Interestingly, household savings rates have actually been declining over the past year, suggesting that even though credit demand is falling, Europeans are being forced to draw down on savings to cope with plummeting disposable incomes. Much of that has been driven by weaker labour incomes and a rising tax burden due to government austerity. The good news is that massive income tax increases such as those seen in Spain in 2012 are unlikely to be repeated next year, potentially lightening the austerity load. However, ongoing public sector hiring restraint and higher taxes in Portugal, Greece and even France mean that drag won't disappear altogether.

Structural Challenges

Recessionary conditions have fed through to even greater austerity in a vicious circle. Weaker private sector demand has crimped government receipts, requiring further austerity cuts to bridge larger-than-expected budget gaps. The inability to find external sources of growth via heightened exports has restricted the ability of peripheral countries to grow out of deficits.

Chart 1

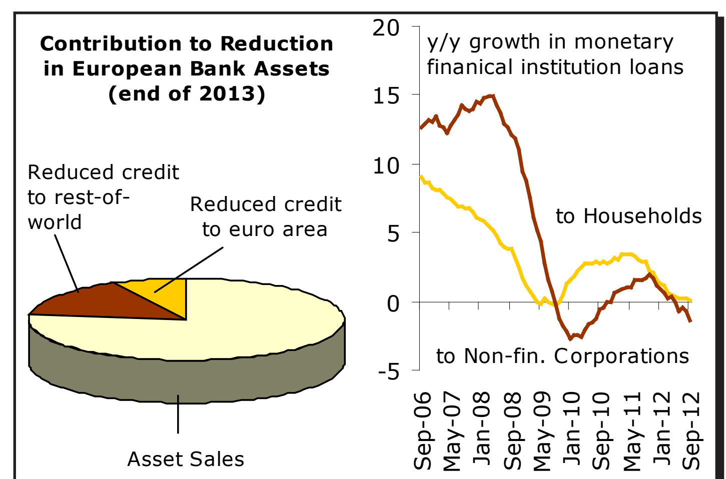
Fiscal Drag Has Eased (L), But Private Sector Still Recoiling (R)



Source: European Central Bank, CIBC

Chart 2

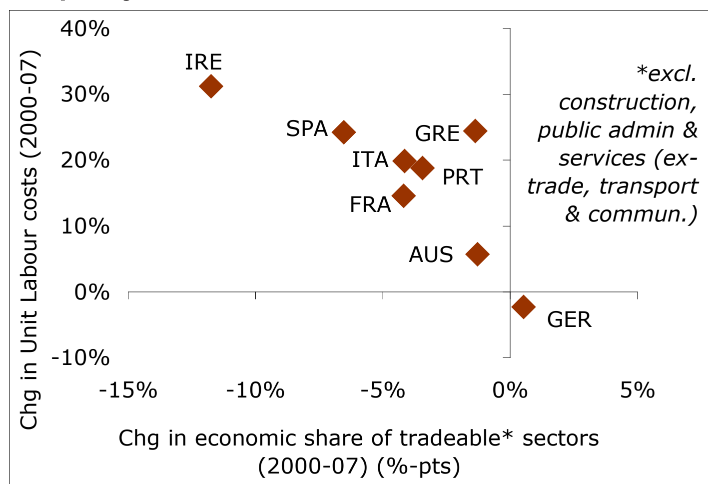
Deleveraging: Eurozone Credit Reduction a Small (L) But Potent Element (R)



Source: European Central Bank, IMF, CIBC

Chart 3

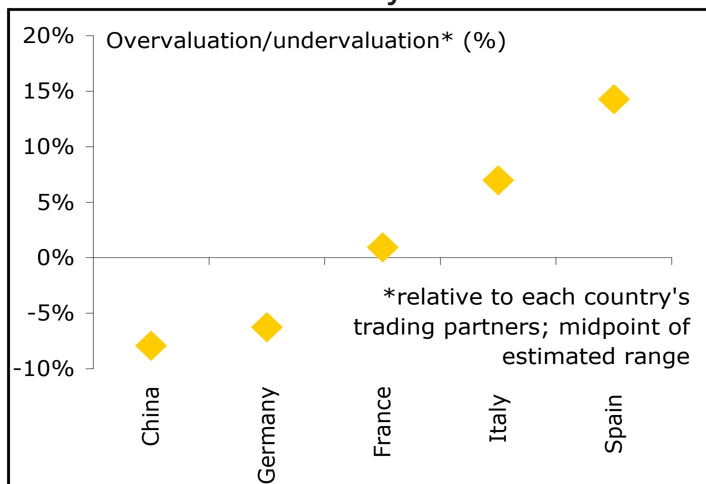
Export Sectors Shrink as Euro Too Strong for Periphery



Source: Eurostat, CIBC

Chart 4

Euro is Overvalued for Many Eurozone Countries



Source: IMF, CIBC

Part of the problem is that, prior to the crisis, run-ups in relative unit labour costs made the peripheral Eurozone economies relatively uncompetitive—resulting in growth driven not by exports, but by an inflating domestic market, often via real estate bubbles or rising government spending. That decline in competitiveness led to a hemorrhaging of their exportable sectors as a share of the economy (Chart 3). Normally, free-floating exchange rates would depreciate in response to such economic weakness, but for the likes of Greece and Spain, being euro-locked meant living with an exchange rate that was overvalued for their economies, resulting in persistent trade gaps funded by large and destabilizing foreign borrowing.

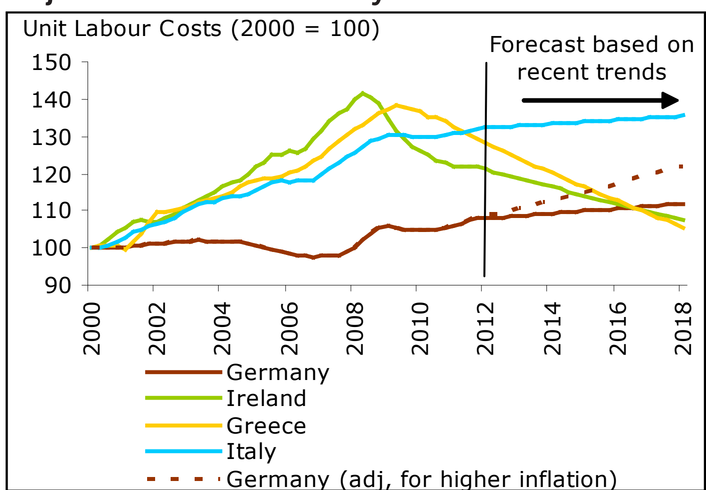
For now, the euro is still too dear for peripheral economies like Spain and Italy based on fundamentals, according to the IMF. But a region like Germany—that could actually tolerate a stronger euro—is enjoying the thrust to exports from a fundamentally undervalued currency. By the IMF's measure, such an advantage may be on par with export giants like China (Chart 4). While prices of Eurozone goods can adjust against global prices via currency depreciation—boosting competitiveness—relative prices within the single currency zone can only adjust down via recessions that depress relative unit labour costs. In other words, high unemployment has to painfully force down wages in peripheral countries, relative to economic stars like Germany.

Most peripheral countries, with the exception of Italy, have made progress on that front. However, even if recent trends were to continue, it would be another 4-5 years before even the first country (likely Ireland) sees a reduction in unit labour costs that restores the same level of competitiveness, versus Germany, as when the euro was conceived (Chart 5). Such adjustments may become increasingly hard to achieve, requiring governments to endure painful recessions and even higher levels of joblessness.

But if Germany were to tolerate say, 2% higher unit labour cost inflation per year, they would bear some of the "adjustment", shortening the process by a year or two. And we are already seeing signs that Germany

Chart 5

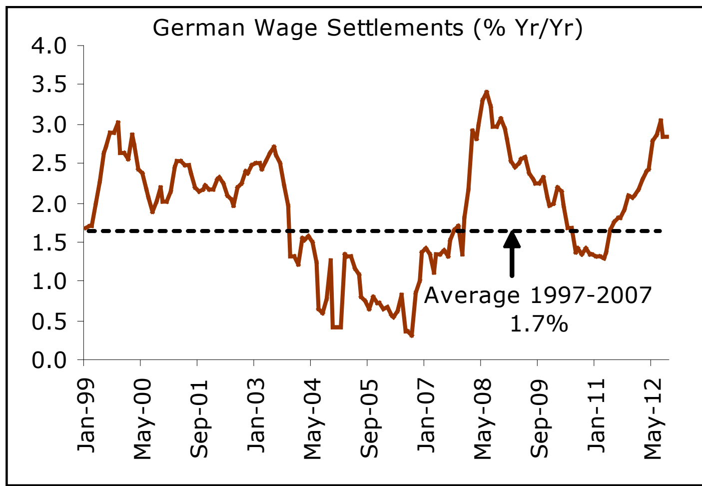
Adjustment Will Take Many More Years



Source: Eurostat, CIBC

Chart 6

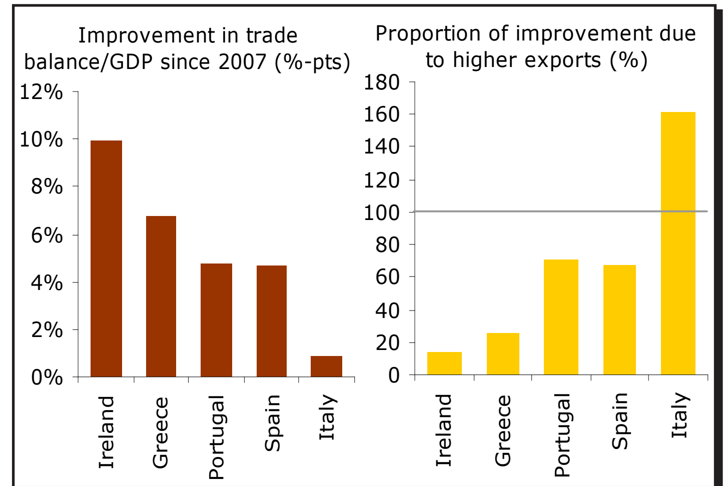
German Wage Settlements Have Picked Up



Source: Bundesbank, CIBC

Chart 7

Trade Positions Have Improved (L), But Not Often for the Right Reasons (R)



Source: Eurostat, CIBC

is shouldering some of that burden, with faster wage settlements helping to narrow that country's cost edge versus the rest of Europe (Chart 6).

Too Early to Call a Recovery

Thus far, relative cost shifts have been too modest to generate the trade lift to growth needed in the periphery. Only in the case of Italy, has the improvement in trade position been solely a reflection of higher exports. The trends are more worrying with respect to Greece, Portugal and Spain. Indeed, the majority of the shrinkage in Greece's trade deficit is due to slumping imports, owing to the country's deepening recession (Chart 7). If domestic demand in those regions were to improve next year, that would lead to an increase in imports, exacerbating trade imbalances and potentially building towards the next crisis.

Ireland may be an exception, set to post 0.4% growth this year, following the prior year's contraction. The nation's reliance on imports to rebalance trade is largely a reflection of a deflating real estate bubble. But with a trade surplus already the highest in Europe as a proportion of GDP, markets have bought into the recovery there—resulting in a decline in the nation's borrowing costs and market access, allowing a reasonably priced Irish bond issue just a few months ago.

After roughly a decade of mounting debt burdens and building economic misalignments, it's still far too soon to say the woes of the Eurozone are over. Beyond the upcoming hurdles of crafting a banking union and getting through the coming year's elections in Italy and Germany, the region faces the continued unwinding of roughly a decade of mounting economic and trade imbalances.

A more aggressive ECB or fiscal shifts supporting growth, leading to higher inflation in Germany, could better re-align inter-euro trade imbalances and speed up the painful adjustment process. But the central bank seems reluctant to reach for a tool like QE, and Merkel remains tight-fisted. Other solutions bandied about, including Eurobonds, may remain difficult for the German public to swallow. However, relying on ongoing economic contractions to "adjust" peripheral economies risks social unrest that could tear apart the Eurozone.

A rising global tide could support better times in 2014, but in 2013 growth weighed down by the region's economic laggards will leave the market concerned about the ability to stick with austere budgets and meet deficit targets.

Assessing Labour Market Mismatch

Benjamin Tal

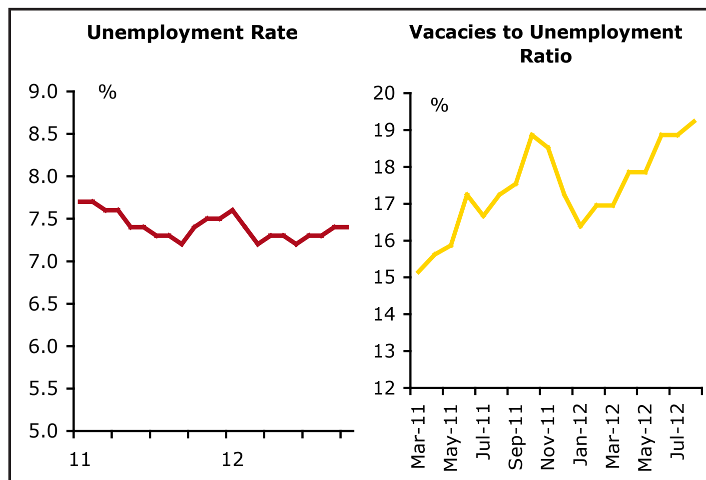
The Prime Minister has recently described skills shortages in the Canadian labour market as "the biggest challenge our country faces". Recent adjustments to the immigration system are clearly designed to ease the pain, but they are probably too small to deal with the current skill gap in the Canadian labour market. On the other end of the labour market spectrum, there is growing evidence that the size of the labour surplus pool is also on the rise. This labour market mismatch is big enough not only to reduce the effectiveness of monetary policy, but also to limit the growth potential of the labour market and the economy as a whole.

Skilled Labour Mismatch: How Big is the Problem?

No less than 30% of businesses indicate that they face a skilled labour shortage. This number is double the rate seen in early 2010. And the recent acceleration in that ratio has coincided with a stagnating employment rate—loosely illustrating the negative impact of skill shortages on employment growth (Chart 1). What's more, while you will not see it in the relatively stable trajectory of the unemployment rate, the number of job vacancies reported by firms has risen by close to 16% over the past year—bringing the vacancy-to-unemployment ratio to its highest level since Statistics Canada started publishing vacancy information (Chart 2). It is hardly a surprise that the highest vacancy rate is in Alberta, followed by Saskatchewan (Chart 3).

Chart 2

Stable Unemployment Masks Rising Vacancies

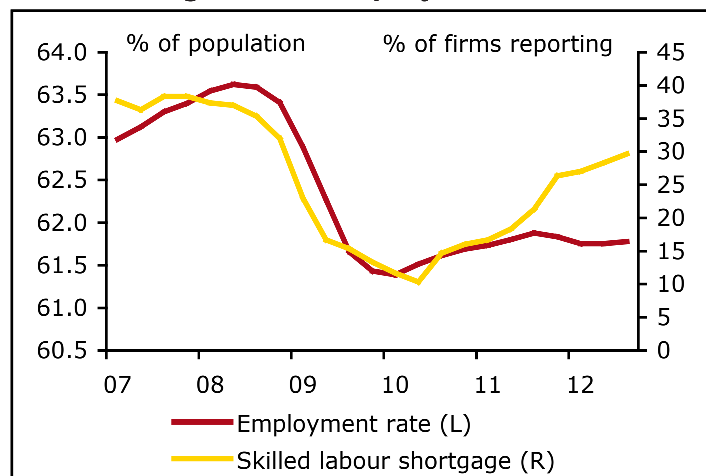


Source: Statistics Canada, CIBC

But assessing the skilled labour shortage based on subjective business responses to questioners is hardly satisfying. Yes, a CEO might indicate that her company is facing a skilled labour shortage, but is it severe enough to force her to raise wages and/or increase on-the-job training activity? Actions speak louder than words. And in this context, it is better to assess the skilled labour shortage by focusing on occupations that experience both rapidly rising wages and low or falling unemployment rates. Based on this matrix, we have identified 25

Chart 1

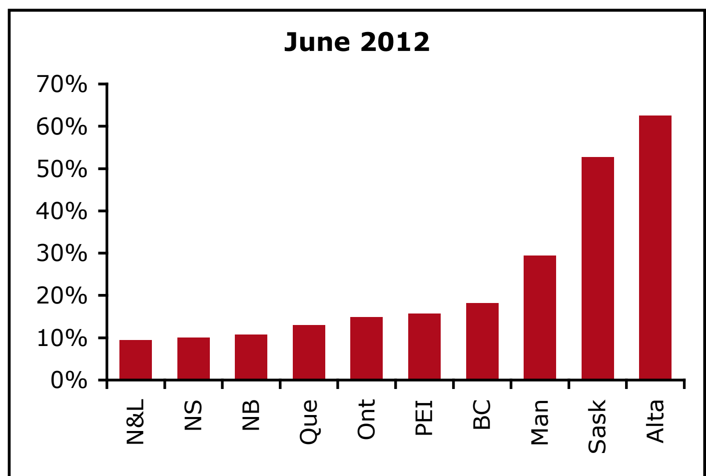
Skill Shortage Limits Employment Growth



Source: Statistics Canada, Bank of Canada, CIBC

Chart 3

Vacancy to Unemployment Ratio



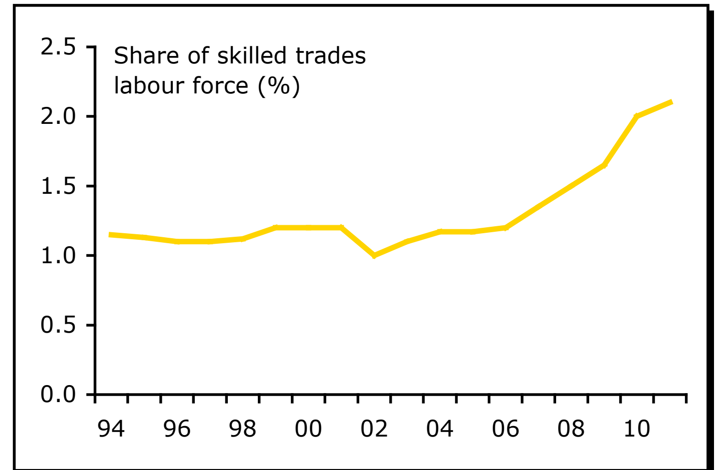
Source: Statistics Canada, CIBC

occupations that have recently demonstrated consistent signs of labour shortage. By far, the largest skill shortage was found in health-related occupations, the mining industry, advanced manufacturing and business services. Put together, those occupations account for 21% of total employment in Canada (Chart 4, left). That is, one-fifth of the Canadian labour market is currently showing signs of skilled labour shortage. The average unemployment rate of this pool of occupations is just over 1% and their wages are now rising by an average annual rate of 3.2% — almost double the rate seen in the economy as a whole. Note that overall employment in this group is rising by 2.1% — much faster than the speed seen in the rest of the market (Chart 4, right), but obviously not fast enough to dent the labour market skill scarcity.

In this context, the recently announced government plans to admit between 53,000 and 55,000 new Canadians in 2013 through an overhauled federal skilled worker program is a welcome development. However, it's simply not large enough to turn things around. Ditto for the increased focus on apprenticeship as a possible solution to the chronic shortage in skilled trades. As illustrated in Chart 5, despite recent program improvements, the number of certificates granted to apprentices is still a fraction of the overall size of the skilled trades labour pool.

Chart 5

Certificates Granted to Apprentices



Source: Statistics Canada, CIBC

Labour Surplus

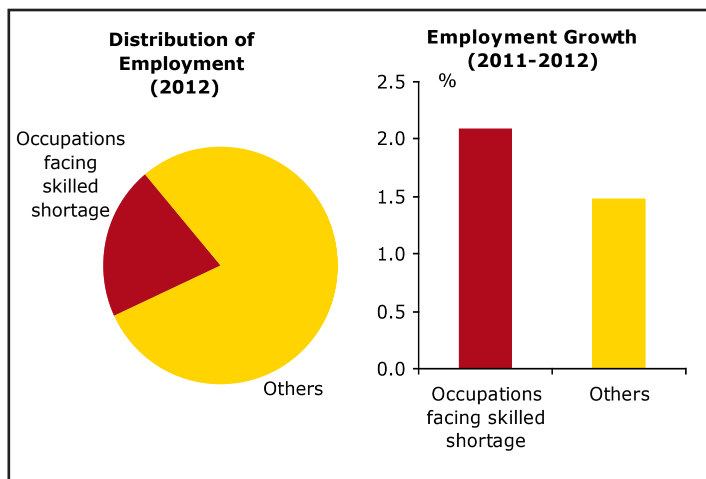
Skill shortage is not the only problem facing the labour market. At the other end of the spectrum, there is a sizable segment of the market that is in a surplus supply position. Employing similar methodology used to assess skilled labour shortage, we identified 20 occupations that through the combination of higher/rising unemployment rate and decelerating wage growth show consistent signs of labour surplus. This pool, which includes occupations in fields such as clerical, food services, recreational guides, personal services and sales and services, accounts for 16% of total unemployment (Chart 6, left) while their real wage growth was nil over the past year. Excluding this pool of unemployed, the national unemployment rate would have been almost 1.3 percentage points lower (Chart 6, right).

Staying Unemployed

This labour market mismatch carries significant implications for the unemployment rate and its composition. At any point in time, the jobless rate encompasses both the number of unemployed people who recently became unemployed and the number of those who have been

Chart 4

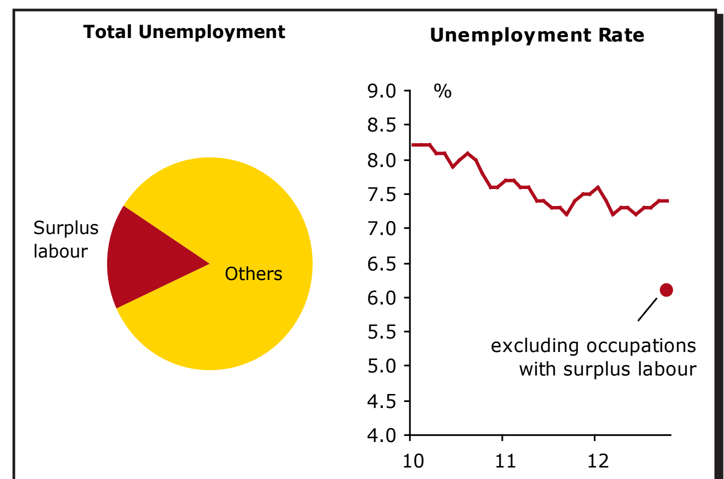
Skill Shortage



Source: Statistics Canada, CIBC calculations

Chart 6

Surplus Labour



Source: Statistics Canada, CIBC

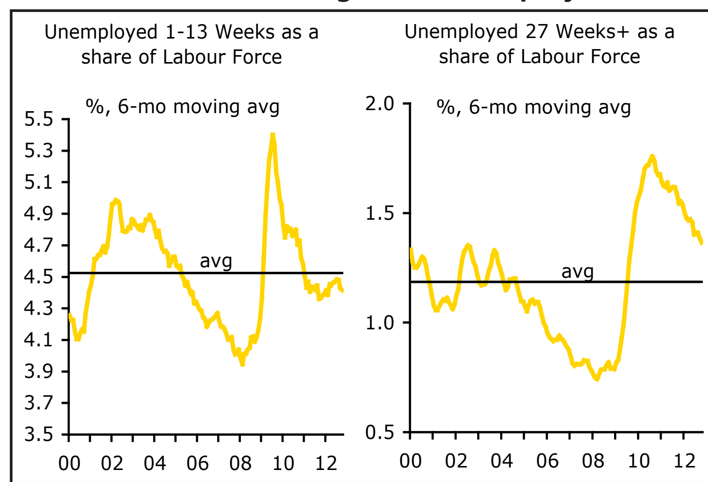
unemployed for a period of time. Accordingly, an increase in the unemployment rate can occur not just because of an increase in the rate at which people are losing their jobs, but also because of the fact that on average, people are unemployed for longer periods of time. The statistic aimed at capturing this distinction is the average duration of unemployment, which currently stands at 16 weeks. That is not only 5 weeks above the prerecession level, but also two full weeks above the average rate seen since the early 2000s (Chart 7).

Digging a bit deeper we find that the inflow rate (a measure aimed at estimating the flow of the newly unemployed into the pool of unemployed) is roughly back to its long-term average (Chart 8, left). But that unfortunately is not the case for long-term unemployment. There are currently 250,000 Canadians who have been unemployed for over 6 months. This number represents 18% of total unemployment in Canada. Clearly the larger this measure is, the more serious are the policy and economic implications of a given unemployment rate. In fact, long-term unemployment reflects underlying labour market deficiencies and can be seen as the core of overall unemployment. Note that longer term unemployment was on a clear downward trend over the past two years, but its current rate is still notably higher than its long-term average. That is mostly the case among Canadians over the age of 45, suggesting that retraining must be an integral part of any solution.

The practical implication of the growing job market mismatch in the Canadian economy is that this measure of long-term unemployment is more likely to start rising

Chart 8

The Inflow Rate (L); Long-Term Unemployment (R)



Source: Statistics Canada, CIBC

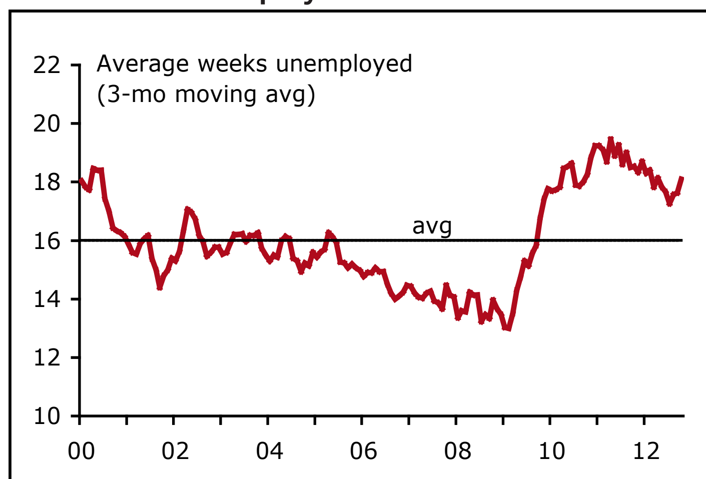
from its already elevated level. In fact, the exit rate from unemployment (the likelihood of exiting unemployment, for a job or for some other reason, within the coming three months after being unemployed for less than three months) is starting to head in the wrong direction (Chart 9), implying an upcoming upward pressure on long-term unemployment.

Note

(1) The methodology used here estimates the average complete duration of unemployment for a sample of individuals that begin their spell of unemployment at the same time. The exit rate is the conditional probability that an individual will exit unemployment at time t after being unemployed for n months.

Chart 7

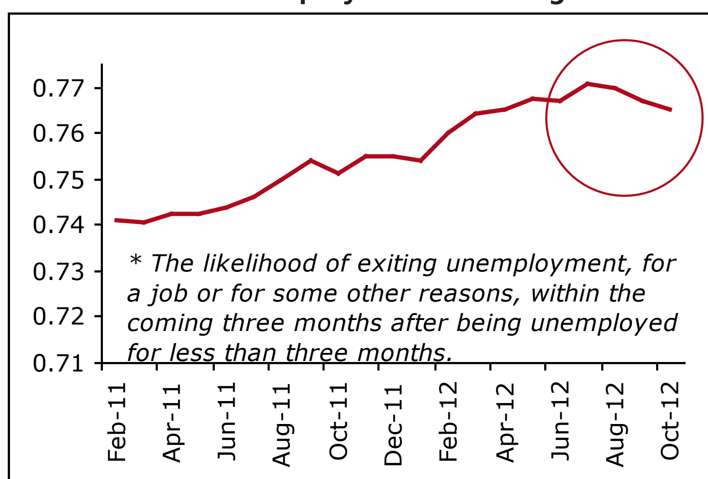
Duration of Unemployment



Source: Statistics Canada, CIBC

Chart 9

Exit Rate From Unemployment* Starting to Fall



Source: Statistics Canada, CIBC calculations

ECONOMIC UPDATE

CANADA	12Q2A	12Q3F	12Q4F	13Q1F	13Q2F	2011A	2012F	2013F
Real GDP Growth (AR)	1.9	0.5	2.3	2.0	2.1	2.6	2.1	2.0
Real Final Domestic Demand (AR)	1.6	1.8	1.8	1.6	1.9	2.7	1.7	1.8
All Items CPI Inflation (Y/Y)	1.6	1.2	1.3	1.3	1.4	2.9	1.6	1.8
Core CPI Ex Indirect Taxes (Y/Y)	2.0	1.5	1.4	1.6	1.7	1.7	1.7	1.8
Unemployment Rate (%)	7.2	7.3	7.4	7.4	7.2	7.5	7.3	7.2

U.S.	12Q2A	12Q3A	12Q4F	13Q1F	13Q2F	2011A	2012F	2013F
Real GDP Growth (AR)	1.3	2.0	1.8	1.5	1.7	1.8	2.2	1.8
Real Final Sales (AR)	1.7	2.1	1.7	1.7	1.8	2.0	2.0	1.9
All Items CPI Inflation (Y/Y)	1.9	1.7	2.3	2.3	2.2	3.2	2.2	2.3
Core CPI Inflation (Y/Y)	2.3	2.0	2.0	2.0	2.0	1.7	2.1	2.0
Unemployment Rate (%)	8.2	8.1	7.9	7.9	7.9	9.0	8.1	7.9

CANADA

Weaker exports linked to sagging US durable goods demand and resource sector outages in Q3, likely saw GDP advance by 0.5% annualized (set to be released shortly after this goes to print), taking the 2012 cruising speed to 2.1%—a touch weaker than our earlier call. Q4 growth should edge higher as commodity output rebounds. In 2013, economic activity is set to return to an underlying 2% pace, as rising business investment offsets slow growth in homebuilding and soft consumer demand. Recent downside inflation surprises have seen us mark down our call for consumer price gains both this year and next.

UNITED STATES

Shortly after we publish, revisions are likely to show the US economy had more momentum in Q3 than was first estimated. And the economy may well have matched that pace in Q4, were it not for Superstorm Sandy taking a bite out of growth. While some of that may be held over until early 2013, the major story for next year is fiscal drag. Even when the "cliff" is likely scaled back, fiscal policy could still slow growth in 2013 before the real recovery begins in 2014.

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