CIBC

Economic Insights

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Why Tyler and Chloe Can't Get a Job

by Avery Shenfeld

Economics

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" ...it's no longer the pimply-faced kid asking you whether you want fries with that."

http://research.cibcwm.com/res/Eco/EcoResearch.html

It's back to school time, and also time to start hunting for an after-school job. But these days, that's hard to find. In contrast to the national unemployment rate, which has been falling, the jobless rate among students 15-18 years old seeking part-time work sits at over 20%, the highest on record. That captures a stunning 22% drop in employment in their age group since 2007, far outstripping the 4% drop in their population over that period.

Why can't your precious Tyler and Chloe find an after-school job? Because you're in it.

While Canada's unemployment rate is well off its recession highs, the quality of new jobs has left much to be desired. Manufacturing has been steadily shrinking its share of the workforce, and of late, governments are also paring back. CIBC's job quality index has captured that trend decline. The lack of higher paying work has forced Tyler and Chloe's parents into taking the kind of employment previously reserved for teenage students.

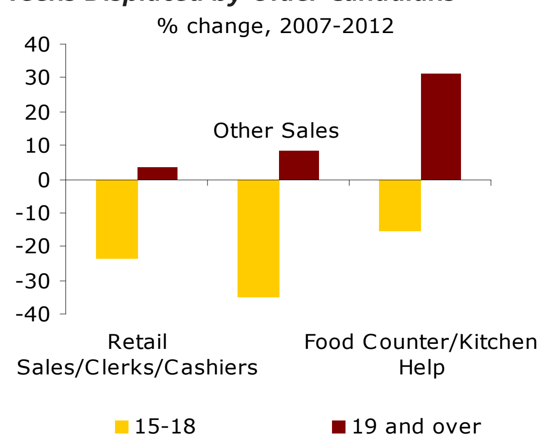
The most significant employers of young Canadians have been in the retail and food service sectors. Increasingly, however, it's no longer the pimply-faced kid asking you whether you want fries with that. Food counter and kitchen help employment has plunged among those under 19, but soared for other age groups, including a huge climb for those 25 and over. It's been much the same for lower level retail sales and cashier positions. Young adults, displaced older workers, or immigrants whose education and skills are not always fully rewarded in the job market have been pushed into low-wage work during what has been a fairly lacklustre economic recovery.

Some might dismiss the absence of student jobs as no big deal. True, there's less foregone income than in the loss of full-time adult positions. But student jobs are not just about being able to splurge for designer jeans. For lower income, single parent households, those extra dollars can be material, and are a source of savings for higher education.

And the real story is that the job market has not been strong enough to generate higher quality employment for older workers. Average weekly wages are up by only 1.7% in the last 12 months, providing no material lift to spending power. A better job mix, along with productivity growth at existing jobs, is key to being able to pay older Canadians more generously, and open up the food counter job for Tyler and Chloe.

For that, we need faster global growth to propel the export-oriented industries that typically generate higher quality positions. Struggling EM countries are part of why that isn't yet happening (see pages 6-8), but we're keeping a closer eye on the US budget debate, which far more than Fed tapering, will set Canada's fate in 2014.

Teens Displaced by Older Canadians



Source: Statistics Canada

MARKET CALL

- Fed tapering is now fully priced in. Although we aren't as confident as the market about it being announced in September, given the lack of a budget deal, a one-month delay won't mean anything for year-end levels. Yields could temporarily overshoot as growth picks up in Q1 next year, but a target of mid-3½% for US 10-years looks reasonable as we extend our projections out a further quarter with this publication. While some are fretting about who gets the job, our view is that the outlook wouldn't be materially changed if it's Summers, Yellen or another Democrat getting Obama's nod for the Fed chairmanship.
- We see some risk that North American central banks will be hiking in late 2014 rather than early 2015, although low core inflation buys some time. The Bank of Canada will roughly match the Fed's timetable, given that the hurdle needed for GDP growth to meaningfully narrow the output gap is lower north of the border due to less initial slack. Remember that using the US methodology, Canada's unemployment rate would be only 6.4% today.
- A US growth pick-up will be a positive backdrop for the greenback against the euro and yen. Europe and Japan had their largest upside surprise in growth in the last quarter or two; it will be America's turn late this year and in early 2014. The Canadian dollar should be one of the exceptions—while it could see a touch more weakness on Fed tapering, it stands to benefit from the lift of firmer global growth to commodity prices next year.

INTEREST & FOREIGN EXCHANGE RATES

		2013		2014				2015	
END OF PERIOD:		**4-Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**
CDA	Overnight target rate	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.50
	98-Day Treasury Bills	0.99	0.95	0.95	0.95	0.95	1.05	1.25	1.45
	2-Year Gov't Bond	1.24	1.20	1.20	1.40	1.45	1.50	1.85	2.20
	10-Year Gov't Bond	2.72	2.70	2.80	2.85	2.90	3.00	3.20	3.40
	30-Year Gov't Bond	3.18	3.10	3.15	3.15	3.20	3.30	3.45	3.55
U.S.	Federal Funds Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.50
	91-Day Treasury Bills	0.02	0.08	0.08	0.15	0.15	0.15	0.20	0.40
	2-Year Gov't Note	0.47	0.40	0.45	0.60	0.80	1.10	1.30	1.55
	10-Year Gov't Note	2.90	2.85	2.90	2.95	3.00	3.05	3.25	3.50
	30-Year Gov't Bond	3.79	3.80	3.85	3.85	3.90	3.90	4.00	4.10
Canada - US T-Bill Spread		0.98	0.87	0.87	0.80	0.80	0.90	1.05	1.05
Canada - US 10-Year Bond Spread		-0.18	-0.15	-0.10	-0.10	-0.10	-0.05	-0.05	-0.10
Canada Yield Curve (30-Year — 2-Year)		1.94	1.90	1.95	1.75	1.75	1.80	1.60	1.35
US Yield Curve (30-Year — 2-Year)		3.32	3.40	3.40	3.25	3.10	2.80	2.70	2.55
EXCHANGE RATES	CADUSD	0.95	0.94	0.96	0.97	0.98	0.99	0.99	1.00
	USDCAD	1.05	1.06	1.04	1.03	1.02	1.01	1.01	1.00
	USDJPY	100	102	102	103	100	98	98	97
	EURUSD	1.32	1.27	1.23	1.22	1.23	1.25	1.27	1.28
	GBPUSD	1.56	1.52	1.50	1.50	1.50	1.52	1.55	1.56
	AUDUSD	0.92	0.88	0.87	0.85	0.88	0.90	0.92	0.93
	USDCHF	0.94	0.97	1.00	1.01	1.01	1.02	1.01	1.00
	USDBRL	2.36	2.11	2.05	2.06	2.09	2.08	2.07	2.06
	USDMXN	13.30	12.55	12.50	12.52	12.53	12.62	12.65	12.68

Aging Boomers and Canadian Stocks

Peter Buchanan

Tapering and Middle East concerns have overshadowed longer term drivers of asset performance. Among these, demographic developments are of importance not only to public investment decisions, but increasingly private ones as well. From an equity perspective, that includes repercussions on both the market as a whole and more detailed, sector level asset allocation decisions. In Canada, as in other countries, there's a tendency to portray an aging population as a challenge. But for investors and firms it also represents an opportunity to cash in on sectors that will benefit from the expanding "grey" market.

Canada is Aging Faster Than Many Countries

Starting with the basics, Canada's population is aging, faster than is often recognized. Though not about to overtake fast-greying Japan, the ratio of Canada's 65+ to working age population will increase a bit faster in the next decade or two than in the US. Aging will also outpace two countries often identified as facing demographic challenges, China and Russia, as well as a number of major western European countries (Chart 1).

Demographic factors typically play out over a span of decades. Today's population depends on fertility and other developments years ago. As such, demographic changes tend to be predictable, limiting their ability to jar markets. Notwithstanding a slightly faster aging process, Canada's population pyramid broadly resembles the US (Chart 2). Such differences as exist are primarily at the curve's extremities. Canada has comparatively fewer people than the US in the under 20 segment but 10% more people proportionately aged over 70, favouring investments in a range of other areas.

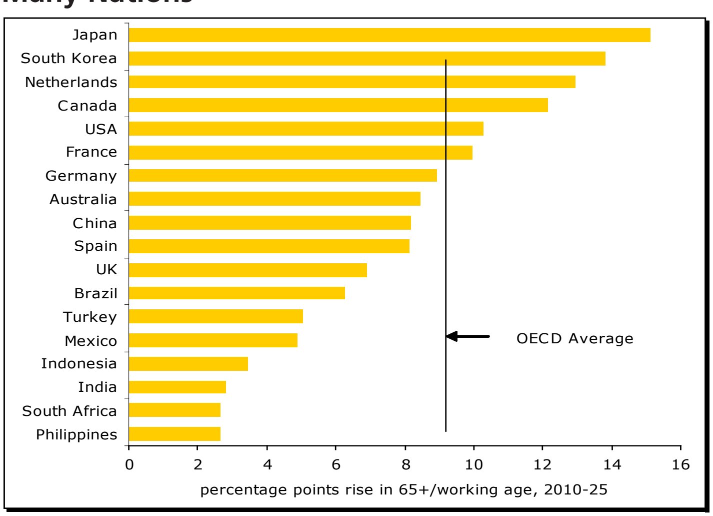
Fears of a Hard Hit to PE Ratios are Overdone

According to life cycle theory, attitudes towards risk and savings vary with age. Consonant with some earlier results and the pattern in other countries, our analysis suggests that Canadian households with young family heads have low or even negative savings. The proportion of income saved rises monotonically through the late 50s, declining after that, as individuals cut back on active work and begin tapping their assets, to finance ongoing consumption (Chart 3).

A key related question is the impact on market valuations of baby boomers' pending transition from employment to retirement. The issue has been most intensively studied in the US, with attention there focusing on the nexus between the trailing 12-month operating PE and so-called MO ratio. That's the ratio of the relatively high

Chart 1

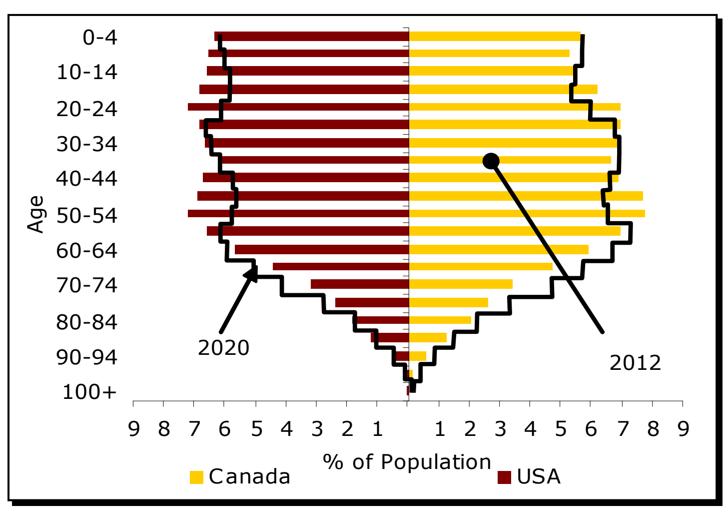
Canada's Population to Age Faster Than Many Nations



Source: UN, CIBC

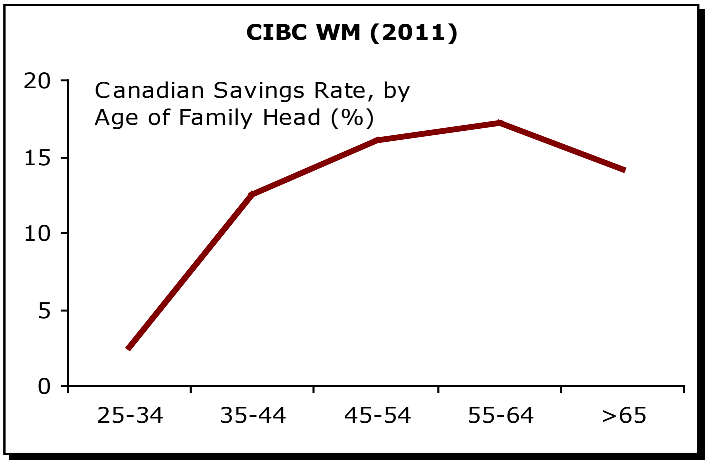
Chart 2

Canadian vs US Population Pyramids, 2012 and 2020



Source: Census Bureau, Statistics Canada

Chart 3
Life Cycle Model: Asset Accumulation Rises with Age, then Declines



Source: Statistics Canada, CIBC

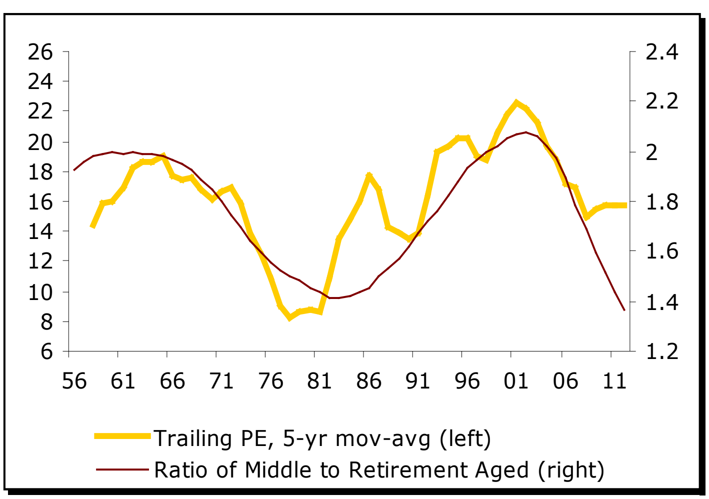
earnings, high savings 40-49 age cohort, to the pre/early retirement cohort, aged 60-69. That metric peaked at just over 2 early in the last decade in Canada and the US. It is expected to fall further in both countries in coming years, declining to just over 1.0 by decade's end north of the border. An examination of the evidence for Canada shows a similar though not quite so strong relationship between the TSX's lagged PE ratio and MO ratio here (Charts 4 & Chart 5, left).

Correlation doesn't of course imply causality, and there are other reasons for remaining skeptical of the more extreme projections of demographically inspired stock market horror. The unknown moves markets most. Compared to other developments, demographic shifts are, as already noted, relatively predictable. Our previous research suggests the resource-skewed TSX is more sensitive to global growth and other external developments than domestic ones, including demographics. Moreover, providing potentially offsetting support to valuations (Chart 5, right), muted inflation expectations and appreciable slack suggest long term interest rates are likely to remain below historic averages, even with the recent climb. Contrary to a key presumption of the Asset Meltdown Hypothesis, which sees near-retirement asset unloading slamming markets, the evidence suggests Canadian household savings patterns adjust gradually with age. Last but not least, an aging society is likely to need more rather than less capital. The resulting bidding up of required returns could help to temper an age-related savings decline, as could flows into Canada from higher savings countries, given demographic differences between jurisdictions.

Gauging the Outlook/Size for Canada's "Silver" Market

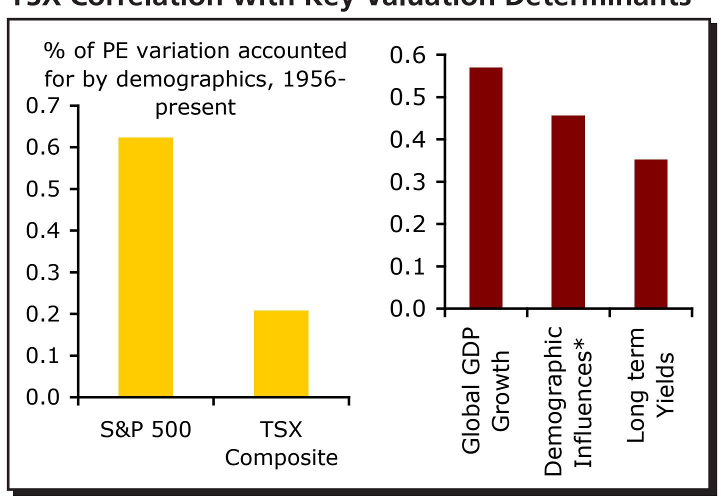
Even if the market doom projections are ultimately proven wrong, as we expect, the ongoing aging of the population is a tremendously important development, one that neither firms, investors, nor government officials, for that matter, can afford to ignore. The proportion of spending accounted for by seniors, aged 65 and over, is expected to grow at roughly twice the pace as overall Canadian household outlays through decade's end. Under reasonable assumptions, that segment will account for about 3%-pts more of the overall spending pie than currently, by far the largest increase of any age group (Chart 6). That's not of course to suggest that retirement is likely to be bliss for all Canadians, without appropriate

Chart 4
TSX Composition PE vs M/O Ratio, Causality or Coincidence?



Source: Statistics Canada, Thomson Reuters, CIBC

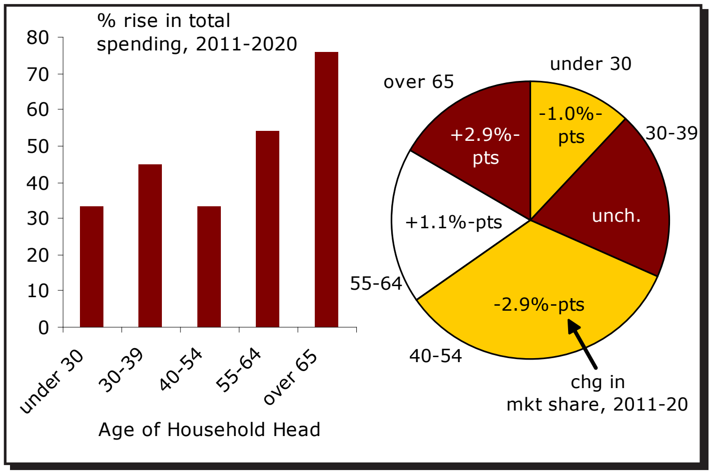
Chart 5
TSX Correlation with Key Valuation Determinants



Source: Bloombertg, IMF, CIBC
** MO Ratio*

Chart 6

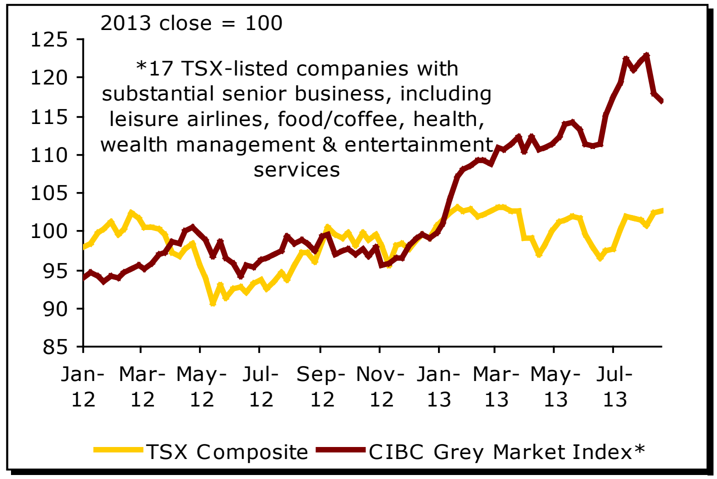
Spending Growth by Age of Household Head (L); Projected Share of Spending Total by Age, 2020 (R)



Source: Statistics Canada, CIBC

Chart 8

Grey Market Stocks Have Outperformed Recently



Source: CIBC, Bloomberg

forethought and planning, as well as attention to key issues, like Canada's retirement savings programs.

A range of areas stand to benefit from an expected surge in age-related demand. Today's seniors are healthier than those past. Beyond things traditionally associated with the aging process, like health care, the list of spending areas likely to see a fillip includes experiential services and goods, including varied leisure activities, travel, entertainment and tourism (Chart 7). It also includes financial products and services geared to the needs of a longer lifespan, as well as things like continuing education and age-friendly consumer goods.

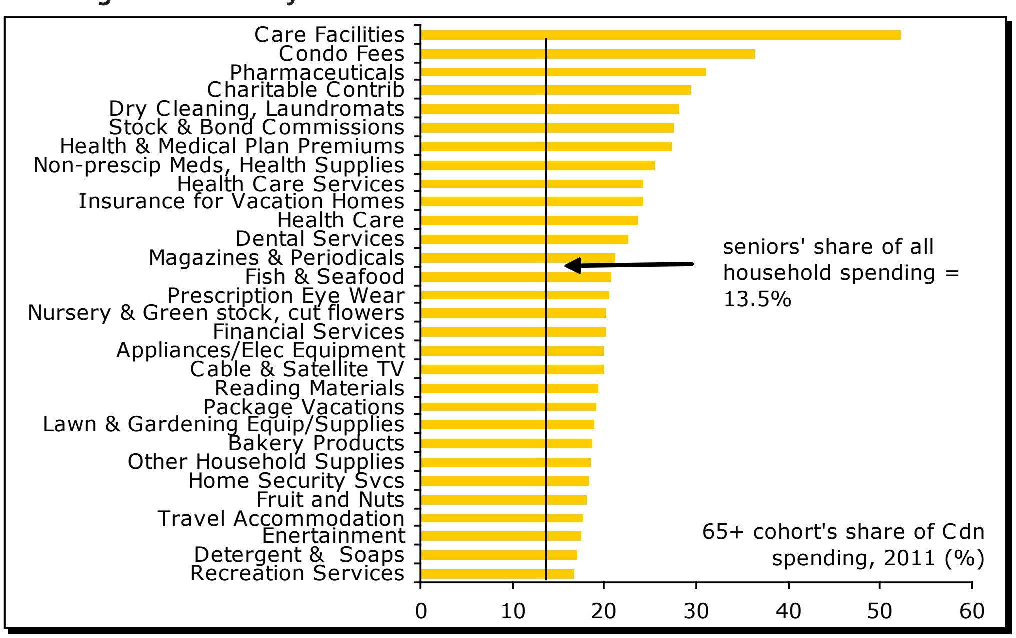
Demographically Driven Stocks Have Outperformed Recently

Demographic shifts occur gradually. While it's unlikely that the market suddenly awoke to developments on that front, grey stocks have for various reasons outperformed the broader TSX recently. Our grey index is up by about 17% this year, and nearly 30% since early 2012. That's appreciably stronger in both cases than the overall TSX's performance (Chart 8). As noted, the index consists of health care, travel, entertainment and other companies with a positive potential exposure to ongoing demographic changes.

The emerging markets drove equity performance in the last decade. Opportunities there will be complemented by ones near home, as the industrial countries lead the recovery. Canada's population is aging faster than other countries. Demographic shifts will consequently contribute to opportunities for firms and investors on the domestic front.

Chart 7

Defining Canada's Grey Market



Source: Statistics Canada, CIBC

ROW, ROW, ROW Your Boat: *R*est *O*f *W*orld Outlook

Avery Shenfeld and Peter Buchanan

An easing US fiscal drag is poised to accelerate growth in North America, and we've also called attention to recent positive turning points in Europe and Japan. But news from the Rest of the World (ROW), dominated by emerging markets, has generally had a negative tone. Could a slower rowing of EM boats offset better growth in the G-7, forestalling the above-consensus global growth pick-up we've called for in 2014?

In fact, the growth slowdown in parts of Latin America and Asia isn't a new story, but one that is if anything nearing its final chapters. Ignoring the natural easing up of growth after the unsustainable post-recession surge, the deceleration dates back to two years ago, making it already twice as long as the late-90s Asian crisis (Chart 1). Instead of talking about a new slowdown, we should be asking whether this one will soon have run its course. Indeed, our analysis points to accelerating growth come 2014, with better growth in the advanced economies, and more competitive exchange rates in some countries, allowing exports to lead an EM rebound.

Tapering Opened Eyes to Old News

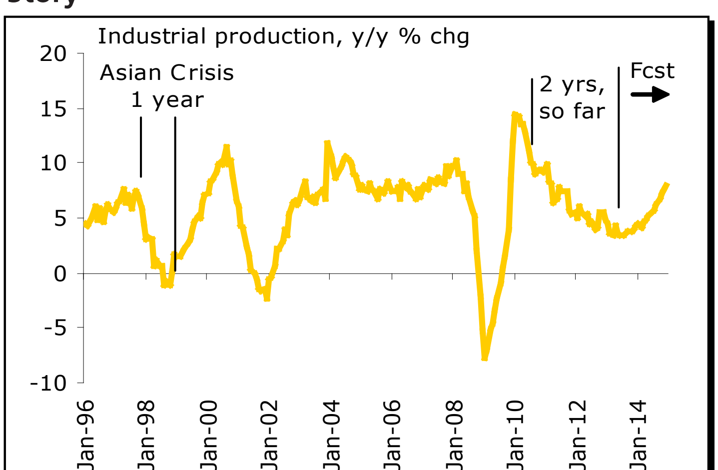
So why the recent headlines? Many investors in the west only opened their eyes to the issue when, as Fed tapering discussions heated up, rising US yields reduced investors' temptation to move out the credit curve into higher yielding EM issues. The turn in capital flows sent some EM currencies into a tailspin. India, Brazil, Indonesia, Malaysia, Turkey and South Africa have been front and centre in that process.

The economic weakness that made these countries vulnerable, particularly those with gaping current account deficits relative to the size of their trade flows, had already been in place. The result is that while financial market indicators like CDS spreads were deteriorating in sync with the foreign exchange dive in the last three months, changes in consensus economic forecasts were barely correlated with these currency developments (Chart 2).

If anything, recent economic news has seen less dramatic downside surprises than where we were a year ago (Chart 3). In part, of course, that reflects dampened expectations for growth. But looking back at the Asian crisis, sharp currency depreciations went a long way to curing what ailed the affected economies, generating sharp rebounds. Unlike debt-plagued Greece, or Spain with its troubled banking sector, which are locked into a fixed exchange rate with their Eurozone partners, countries like Thailand used cheap currencies to lever up trade in a V-shaped recovery after 1998.

Chart 1

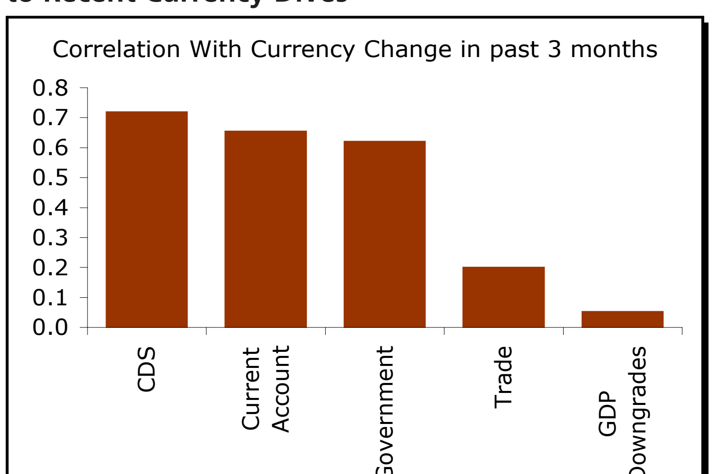
Emerging Market Slowdown—Not Such a New Story



Source: CPB, CIBC

Chart 2

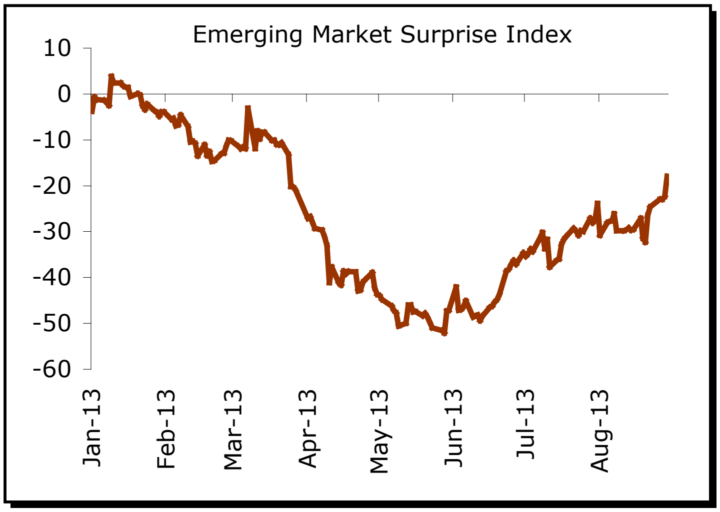
Credit Views, Not Growth Outlooks, Most Linked to Recent Currency Dives



Source: Bloomberg, CIBC, Focus Economics

Chart 3

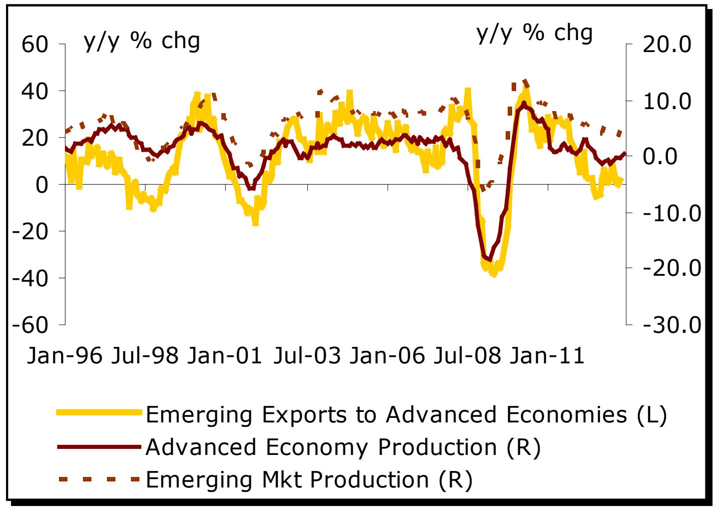
Downside Growth Surprises are Abating



Source: Citigroup

Chart 5

'Normalization' in Advanced Economies Will Also Lift Emerging World Given Strong Linkage



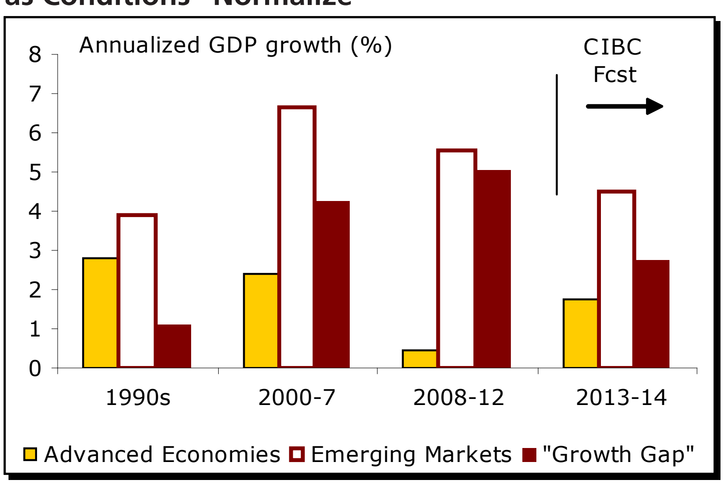
Source: IMF, CPB, CIBC

Don't underestimate the role that sluggish growth in major western economies played in setting the EM world up for disappointment. Many of these countries, including China, whose currency has been stable, are still levered to exports to the G-7. While China's economy was dominated by capital spending, prior to the global slowdown, much of that was directed at adding capacity to serve foreign markets.

Indeed, the massive gap in growth between EM countries and those in the West was simply unsustainable (Chart 4). While EMs have led the way for decades, the scale of the gap soared after 2007. It was when world growth slumped that China directed capital to domestic-oriented local government projects and housing, where excesses appear to have developed.

Chart 4

Growth Gap Will Shrink but Not Disappear, as Conditions "Normalize"



Source: IMF, CIBC

Better growth in the advanced countries in 2014 will boost exports and support export prices for major EM economies in Asia and Latin America. Exports to developed economies is a major driver of overall industrial output in the EM world, and both in turn move in line with developed economy growth (Chart 5). Look for industrial activity in EM countries as a group to pick up in the coming quarters as the acceleration in the US and Europe draws in imports.

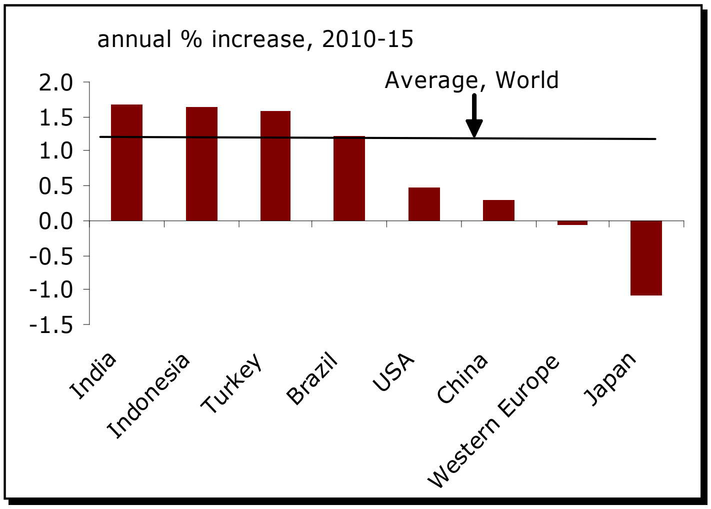
EM Countries are Still Growth Markets

That will still entail a narrower growth differential in 2013-14, with that gap narrowing towards historic norms. But make no mistake, EM countries will continue to outpace the developed world over the medium term, and that includes large players like China and India.

Paul Krugman, noted economist, has fretted that China had already completed so much of the transformation from undeveloped to industrialized that it was now doomed to western-style, low single-digit growth rates, or worse. Its working age population is indeed now growing more slowly than that of the US, but it still is no Europe or Japan, and other emerging markets still have ample labour market additions ahead (Chart 6).

Chart 6

Above-Average Working Population Growth, Except China

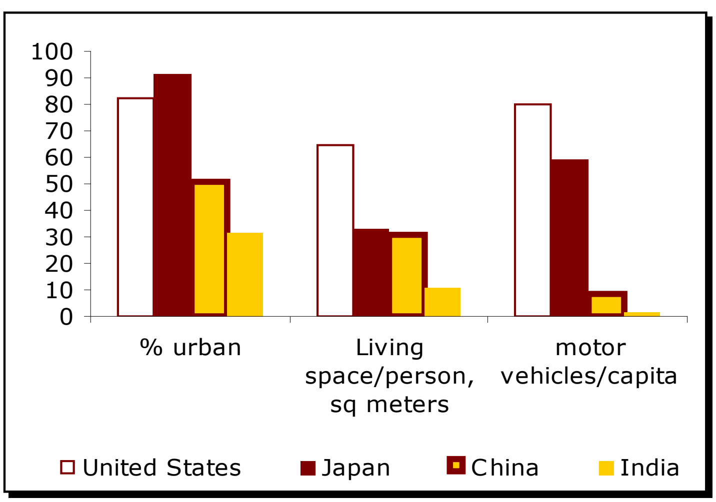


Source: UN, CIBC

More to the point, benchmarked against advanced economies, China and other EM countries still have a very long march to reach western standards for urbanization and consumption (Chart 7). The days of easy 10-12% growth, generated by turning peasants to higher (but still low-paid) industrial workers may be over for China. But China still has a much larger low-productivity rural population than major western economies. Its 7½% growth target is not out of reach, and indeed, we expect it to top 8% in 2014 as exports and industrial output see renewed vigour, signs of which are already emerging in PMI and trade data.

Chart 7

Still Room for Catchup/Urbanization Driven Growth



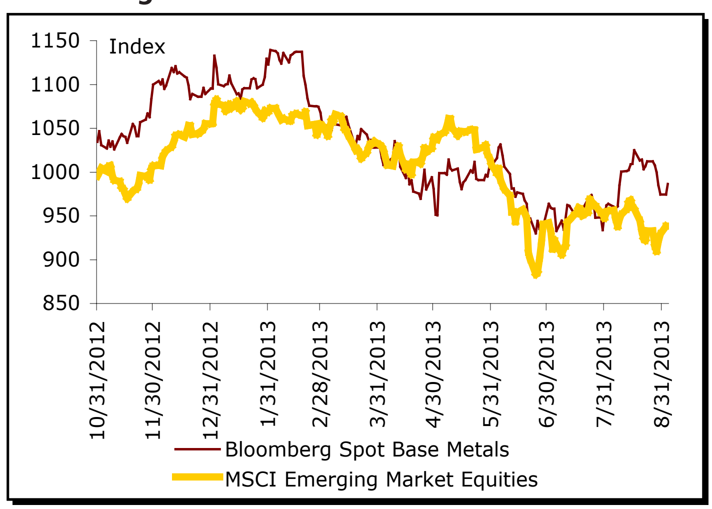
Source: World Bank, country sources

Not all countries in the EM space are in the same boat. Space does not permit a country-by-country analysis here. But India's stagflation could take longer to overcome than the plain-vanilla growth stall in other Asian countries. In Latin America, Mexico is better positioned to accelerate next year than, say, Brazil, owing to politics, a less vulnerable current account gap as a share of trade, and a closer tie to the US. But broadly, growth in the US and Europe will be as much of a plus to the EM world as the absence of such momentum has been a drag in the last few years.

EM equities are still adjusting to the fresh spotlight put on financial market risks in several countries, taking a broad benchmark of growth market stocks lower. But where it counts for Canadian equities, investors are already looking beyond sluggish times towards improved global growth in 2014. Breaking away from their typical link to EM news, commodity prices, even those most tied to global growth like base metals, have headed higher in recent weeks (Chart 8). If, as we expect, the worst of the EM growth story is soon behind us, there's room for Canada's resource-linked equity markets to head higher in the coming year.

Chart 8

Base Metals Prices/EM Stocks Showing Signs of Bottoming



Source: Bloomberg, MSCI, CIBC

Provincial Economic & Fiscal Prospects: Slip Sliding Away?

Warren Lovely and Emanuella Enenajor

A few months ago, we outlined roughly $30 billion in cumulative fiscal upside that Canada's federal and provincial governments were in a position to enjoy once the global economy found a higher gear. But since then, the economic outlook has darkened, domestic inflation has gone MIA and interest rates have shot higher. Making matters worse, a series of shocks have buffeted Canada and its provinces.

How bad is it? Thankfully, cautious budgeting and fiscal shock absorbers offer important near-term protection, while observed strength in some commodities likewise provides relief to select provinces. But as the shocks piled up and as economic momentum has been shed, Canada's once notable fiscal upside has melted away, providing a tougher test of the country's fiscal resolve.

Table 1

Provincial GDP Forecasts

Y/Y % Chg	Real GDP Growth 2010	2011	2012	2013F	2014F
BC	3.2	2.8	1.7	1.5	2.4
Alta	4.0	5.1	3.9	2.8	3.0
Sask	4.4	4.9	2.2	2.4	2.8
Man	2.5	2.0	2.7	1.8	2.2
Ont	3.2	1.8	1.4	1.4	2.3
Qué	2.5	1.9	1.0	1.2	1.9
NB	3.1	0.0	-0.6	1.0	1.6
NS	1.9	0.5	0.2	1.3	2.0
PEI	2.6	1.6	1.2	1.5	1.7
N&L	6.3	3.0	-4.8	5.5	1.5
Cda	**3.4**	**2.5**	**1.7**	**1.7**	**2.3**

Source: Statistics Canada, CIBC

Real and Nominal Growth Loses Altitude

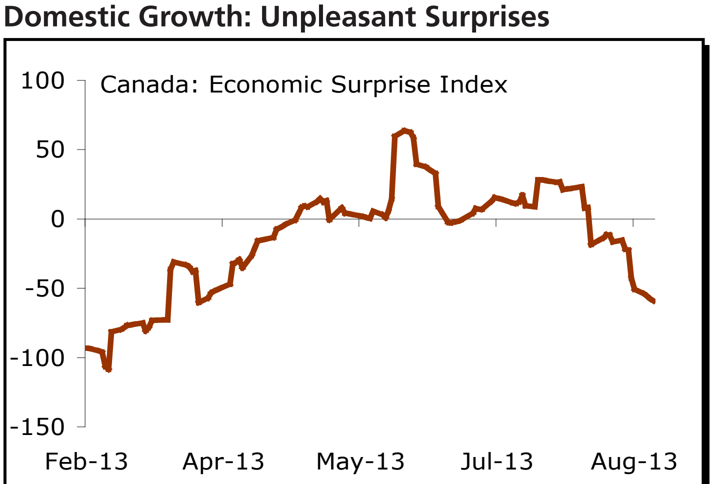
Early this year, consensus thinking had Canada growing by an average annual rate of 2.1% over 2013 and 2014. By early August, a couple ticks had been shaved from that estimate. More recently, Canada has served up some notable economic misses, as evidenced by the sharp erosion in Canada's economic surprise index (Chart 1). While recent weakness in some indicators could prove temporary, Canada's economy simply lacks traction. We've trimmed our growth expectations in most provinces as a result (Table 1) and expect acknowledgements of stiffer headwinds in upcoming fiscal updates.

But it's on the nominal side of the equation where revisions to the outlook have been more unkind. Witness the steady decline in the Bank of Canada's forecast for total CPI (Chart 2) despite a firming in oil prices. Wage growth is muted in much of the country, and non-energy commodities like industrial metals, lumber, and minerals have fallen in price, frustrating governments that had budgeted for a healthier backdrop.

With nominal growth falling short, some of the cushioning built into federal-provincial forecasts at budget

Chart 1

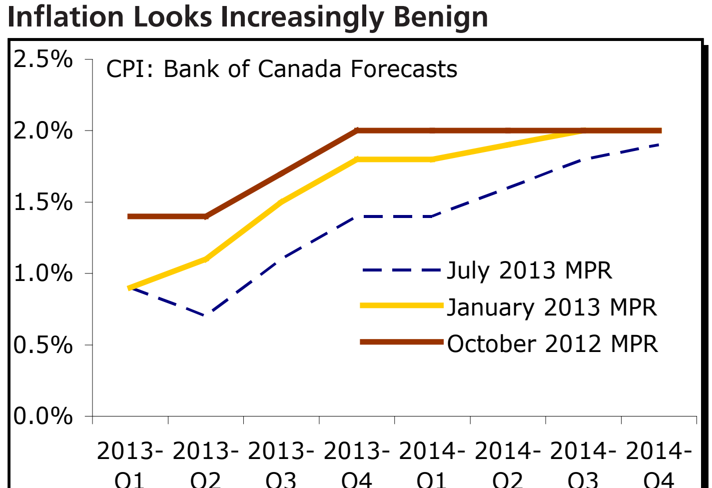
Domestic Growth: Unpleasant Surprises



Source: Citigroup

Chart2

Inflation Looks Increasingly Benign



Source: Bank of Canada

time has dissolved. CIBC now sees nominal growth averaging less than 4% over 2013-14, matching the weighted average call from this year's provincial budgets. In fact, the downgrade to real and nominal growth has erased a cumulative $10 billion in federal-provincial revenue through 2015/16 relative to what we envisioned in the spring, to say nothing of some extraordinary fiscal pressures that have cropped up in select jurisdictions.

Unlucky Breaks in Some Provinces

While the macroeconomic picture hasn't cooperated, some provinces have also grappled with unforeseen shocks. Flooding took a notable toll on Alberta's economy in June, although reconstruction work looks to dull the overall hit to 2013 GDP. The full fiscal impact of the flood won't be known for some time, with Premier Redford hinting at a rebuilding bill north of $5 billion. But as we saw in the wake of Manitoba's devastating flood in 2011, the federal government will provide substantial disaster assistance. Moreover, the combination of higher benchmark oil prices and a narrower discount on Alberta crude points to above-plan resource royalties in 2013/14, providing a partial offset to flood costs.

Saskatchewan potash producers face uncertainty—including the prospect of plunging prices—following the announced break-up of an international cartel. Production curtailments in Q3 could weigh on provincial growth, although the ultimate hit to prices and capital spending are still being worked out. Constructively, one key player recently announced its intention to press ahead with a major development. Moreover, as in Alberta, above-plan oil royalties offset the reduced take from potash—at least for 2013/14.

For its part, British Columbia used a late June budget update to mark down economic and fiscal expectations. Weakness in employment, retail sales, housing starts and non-residential construction is generally consistent with a softer domestic economy—a situation hardly unique to BC, and one likely to prove a feature of the Canadian landscape for the foreseeable future.

Persistent Regional Performance Gap

Notwithstanding the above-noted pressures, the long-standing economic performance gap between Western and Central Canada has shown few signs of fading. Scan the scorecard of year-to-date performance and you'd be hard pressed to find a top-tier showing for either Ontario or Québec (Table 2).

The anemic growth backdrop isn't exactly making Québec's life easier, potentially imperiling efforts to balance the books this fiscal year. While Québec's economic and fiscal health won't suffer much from the June construction strike, the Lac-Mégantic rail disaster could raise costs for the province if other sources of financial support fall short. The bigger question could be what the disaster means in terms of tighter regulations/restrictions on movement of crude by rail.

As for Ontario, the boom in US auto sales has failed to translate into a pick-up in vehicle production. Recent line closures only add to the ongoing loss of US market share in that key sector (Chart 3), signaling a diminished correlation between US and Ontario demand and raising the stakes when it comes to trade diversification efforts. Meanwhile, earlier corporate tax relief, alongside the adoption of a harmonized sales tax, make for a relatively more attractive business investment climate. A weaker loonie is a more recent plus, although given the volatile nature of FX markets and uncertainty regarding Fed

Table 2

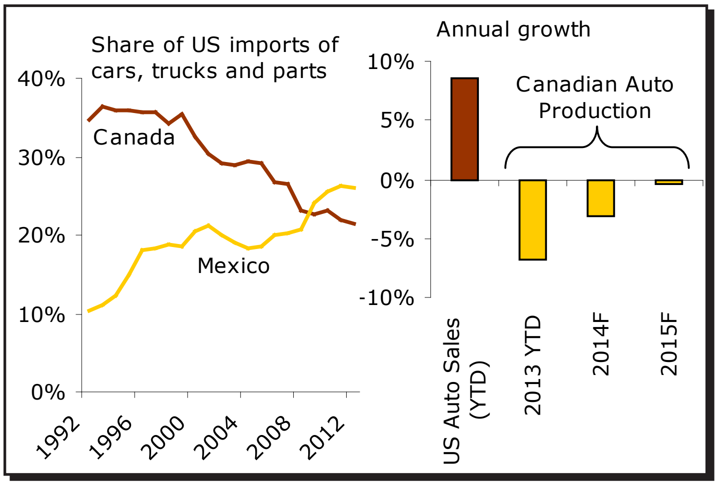
Provincial Scorecard

	Total	Employment		Jobless Rate		Avg Hrly	Mfg	Retail	Wholesale	Housing	Existing Homes		CPI
YTD % Chg	Population	Household	Payroll	Level	Y/Y Chg	Wage	Shipments	Sales	Trade	Starts	Sales	Price	All Items
BC	0.9	0.1	1.7	6.5	**-0.3**	2.5	**1.8**	0.3	**5.4**	-8.2	-5.9	0.2	0.0
Alta	**3.1**	**2.3**	**3.6**	**4.6**	-0.2	**5.4**	-1.4	**6.5**	2.5	**9.2**	**4.6**	4.6	1.4
Sask	**2.0**	**3.8**	**2.2**	**4.0**	**-0.9**	**3.6**	**5.7**	**4.3**	**9.0**	-19.3	-8.4	**5.5**	1.3
Man	**1.2**	1.1	1.7	**5.3**	-0.1	1.8	-0.4	3.0	0.1	**6.2**	**-3.8**	**5.5**	**2.2**
Ont	0.9	1.4	0.7	7.6	-0.2	1.4	-2.6	0.5	-1.8	-26.8	-5.7	2.6	0.9
Qué	0.9	1.8	0.6	7.7	-0.2	1.4	-4.5	1.7	0.5	-22.5	-10.5	-0.1	0.9
NB	-0.2	-0.8	-1.7	10.7	0.8	**2.7**	**4.0**	-1.1	-1.1	-6.8	**-2.5**	-0.2	0.6
NS	-0.3	-0.2	-0.7	9.2	0.2	0.9	-1.7	0.7	-0.6	**10.6**	-17.8	-1.3	1.2
PEI	0.0	**2.6**	-3.3	11.6	0.3	1.8	0.9	0.2	**7.5**	-6.3	-6.8	1.3	**1.7**
N&L	0.1	2.1	**2.1**	11.7	**-1.0**	**2.7**	-16.4	**4.8**	3.9	-27.8	-10.2	**8.0**	**1.5**
Canada	**1.1**	**1.4**	**1.2**	**7.1**	**-0.2**	**2.2**	**-2.3**	**1.8**	**0.4**	**-15.5**	**-5.5**	**2.4**	**0.9**

Notes: Unless otherwise noted, figures represent % change in 2013YTD vs corresponding 2012YTD period; jobless rate level represents average level for 2013YTD, while jobless rate change represents %-pt change for 2013YTD vs 2012YTD; based on seasonally adjusted monthly data; in all cases, top-3 performances in each category are shaded / bolded

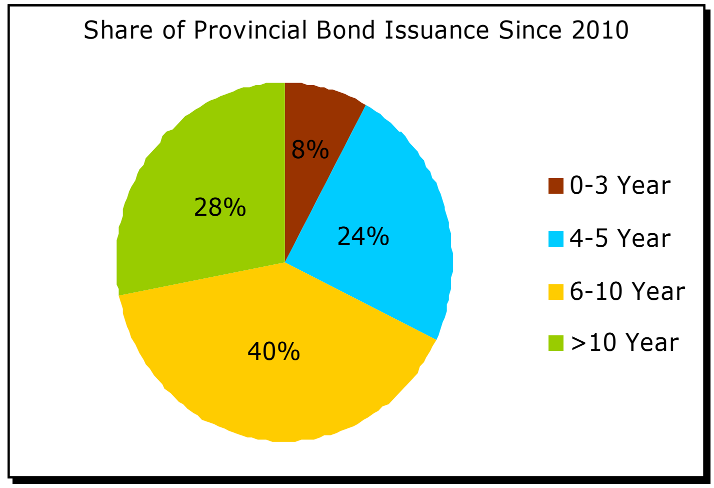
Source: Statistics Canada, CMHC, CREA, CIBC

Chart 3
Canada: Losing Out in the US Auto Space



Source: BEA/Census, Wards Auto, Haver Analytics, CIBC

Chart 4
Provinces Lock In Long-term Funding



Source: CIBC

tapering, recent currency moves might not be enough to permanently shift business investment plans.

Newfoundland and Labrador's economic growth should top the nation on restarting oil production and accelerating construction on the Hebron oil platform, with promising exploration results raising longer-term hopes. New Brunswick is eying a lift from the proposed Energy East pipeline, while Nova Scotia will reap the economic benefits of rising natural gas production as Deep Panuke comes on line. Those factors should see Atlantic Canada's prior-year economic performance gap narrow, although unfavourable demographics and interprovincial outmigration continue to weigh on the region's longer-term outlook.

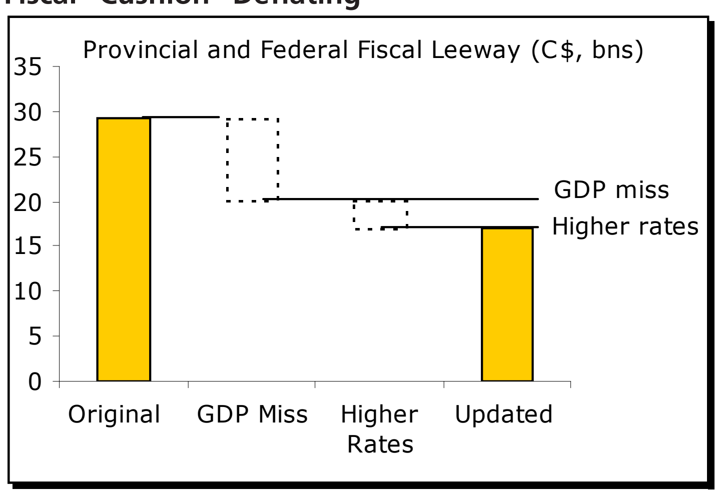
And what of the threat from higher interest rates? The rapid back-up has yet to trigger a slowdown in the consumer or housing sectors, but households could simply be front running the risk that rates could spike even further. In that sense, a rising profile for borrowing costs suggests the housing sector could see a renewed slowdown in 2014—a risk that particularly bears watching in Ontario.

Weighing the Fiscal Fallout

For governments, higher rates aren't an immediate budget buster. Since 2010, nearly 70% of provincial bond issuance has been longer-term (Chart 4), while Ottawa has more recently moved to lock in more of its program longer-term. Still, we estimate that a higher-than-expected profile for rates eliminates roughly $5 billion of budgetary cushioning through 2015/16.

Add in the downgraded growth outlook and nearly half of the $30 billion in fiscal leeway we identified three months ago has now vanished (Chart 5). That needn't mean an immediate repeat of fiscal 2012/13, when Ottawa and most provinces missed their fiscal targets, but it could necessitate even greater restraint for a government sector already struggling to achieve savings. The more growth sours and rates back up, the more the credibility of fiscal plans will be jeopardized, which bears watching as a trigger for credit rating pressure. We're still expecting a global reacceleration come 2014, but we understand that some investors will need to see the evidence of that turn to restore their confidence.

Chart 5
Fiscal "Cushion" Deflating



Source: Federal & provincial budgets, CIBC

ECONOMIC UPDATE

CANADA	13Q1A	13Q2A	13Q3F	13Q4F	14Q1F	14Q2F	2012A	2013F	2014F
Real GDP Growth (AR)	2.2	1.7	2.3	2.2	2.4	2.5	1.7	1.7	2.3
Real Final Domestic Demand (AR)	0.6	2.2	1.3	1.6	1.7	1.5	2.3	1.5	1.7
All Items CPI Inflation (Y/Y)	0.9	0.8	1.2	1.9	1.7	1.9	1.5	1.2	2.0
Core CPI Ex Indirect Taxes (Y/Y)	1.3	1.2	1.4	1.6	1.5	1.6	1.7	1.4	1.7
Unemployment Rate (%)	7.1	7.1	7.2	7.2	7.0	6.8	7.3	7.1	6.8

U.S.	13Q1A	13Q2A	13Q3F	13Q4F	14Q1F	14Q2F	2012A	2013F	2014F
Real GDP Growth (AR)	1.1	2.5	1.6	3.0	3.8	3.8	2.8	1.6	3.3
Real Final Sales (AR)	0.2	1.9	2.2	3.0	3.8	3.8	2.6	1.7	3.3
All Items CPI Inflation (Y/Y)	1.7	1.4	1.6	1.8	1.8	2.0	2.1	1.6	2.1
Core CPI Inflation (Y/Y)	1.9	1.7	1.8	1.8	1.8	1.9	2.1	1.8	2.0
Unemployment Rate (%)	7.7	7.6	7.4	7.2	7.0	6.8	8.1	7.5	6.7

CANADA

Canada's June GDP decline didn't look quite as bad as we had feared, leaving Q2 activity with less bruising than we had initially anticipated. We're still expecting a modest bounce back in Q3, which would leave our call for 2013 growth unchanged. Inflation and the jobless rate have tracked closely to our view.

UNITED STATES

Revisions to net exports and construction lifted Q2 GDP, although firmer inventories could spell less upside for growth in the following quarter. And while Q3 data have been rolling in a touch on the soft side, other indicators, including auto sales and PMIs, support cautious optimism. Trends in inflation have remained subdued, and we've nudged our call down slightly both this year and next.