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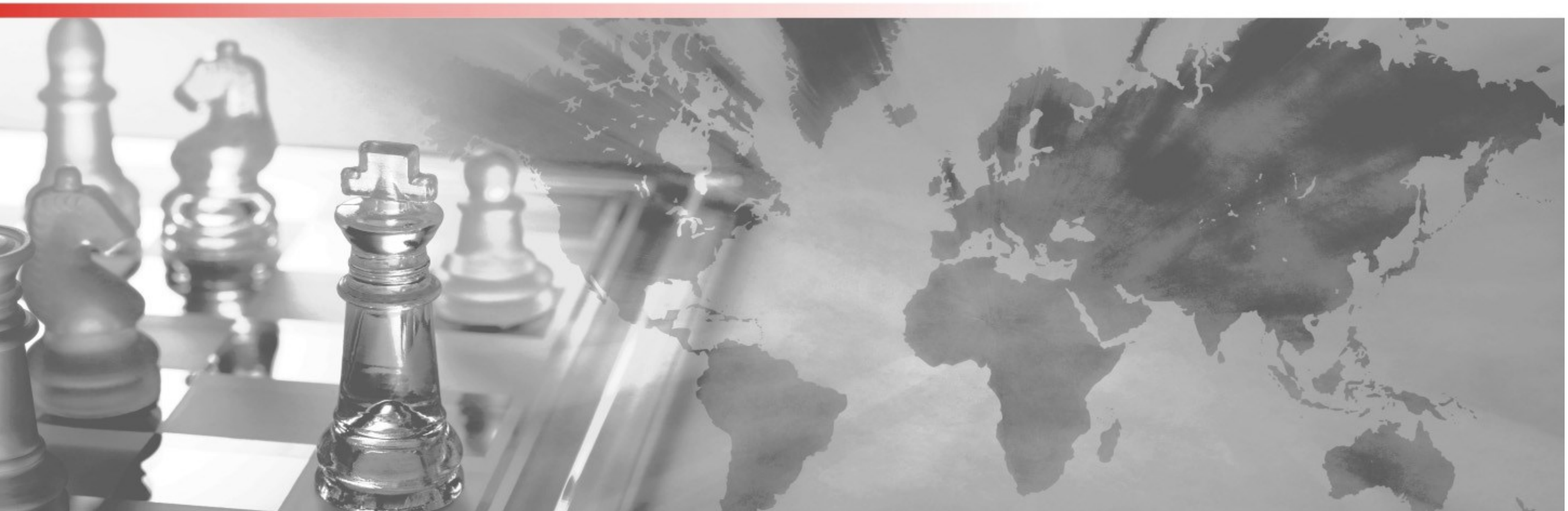

Expert Commentary

Charles St Arnaud, Senior Economist at Nomura Securities Intl Inc, on Canadian economy and CAD

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Charles St Arnaud
Senior Economist
Nomura Securities Intl Inc
UK

Most economists expect the current quarter's output to come in anywhere from 1.5% in line with the Bank of Canada's most recent estimate of 2.8%. Also, analysts mention that Canada is not in a recession, but in a "weak patch", one that will likely continue as long as oil and other commodity prices remain low. What is your thought on the matter, given that Canada is a commodity producer?

To start with the GDP forecast, I think we are seeing a relatively strong rebound in the third quarter. My own expectations are that we could have growth around 2.3% in the Q3. A lot of it was actually driven by commodities. Oil extraction explain roughly 2/3 of the growth in July , and above 50% of the growth in June, hence, a lot of the rebound we are seeing is actually due to the oil industry. We have had some new oil project coming starting production, which has been increasing production and increasing activity in the oil sector.

My big concern going forward is how much of that continues going into Q4, because if you remove contribution to growth from the oil industry - the underlying momentum remains relatively weak. Coming back to the question of recession, it is always a question of how do you define a recession. In case you take a very classic and simple definition, which is two quarters of decline in terms of GDP - technically Canada had a recession.

However, it is hard to call it a recession when at the same time the economy managed to create a 150,000 jobs since the beginning of the year. Therefore, you can almost call that the best recession ever because you have a contraction of the economy but you still have job growth. Hence, it is important as I think that mainly due to the type of shock that the Canadian economy has had. This shock was mainly driven by the oil sector, which is more capital intensive than labour intensive, which means that the adjustment has had to be done mainly through investment, rather than labour. That explains why we have not had that much job losses despite the decline in economic growth. In terms of the outlook, I think at this point the outlook depends as much as some say on the commodity prices.

Of course, an increase in commodity prices will help the economy, but at this point I make the assumption that we probably will not see that much input. Thus, most of the growth going forward will likely be driven by better performance in the US, which will help Canadian exports to surge and continue solid upturn or household consumption.

Charles St Arnaud, Senior Economist at Nomura Securities Intl Inc, on Canadian economy and CAD

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On the flip side this investment should remain relatively weak, whilst I believe we still see the continued adjustment in the oil, mining and even manufacturing sector. There still are certain headwinds that prevent old firms to be willing to invest; especially the strong Canadian Dollar is making imports of capital goods more expensive, therefore, raising the cost of making investments.

The BoC has cut interest rates twice this year in an attempt to foster the country's economy that was in a brief recession throughout the first half of the year. Analysts believe that the Central Bank will keep rates at 0.5% during its next meeting in October. Do you share their point of view? Do you believe that the second rate cut in 2015 was justified enough and why?

I think the Bank of Canada will keep its policy rate unchanged for the foreseeable future. I do not expect them to hike rates until at least 2017. Then in terms of the second rate cut, it is very hard to second-guess at the current moment, because we are seeing a recovery in Q3. However, when we got the data in early June, it suggested that the economy was much worse than anticipated and it made sense for the Central Bank to react to the weakness at that point.

To give you a bit more details, the sluggish growth in Q2 and the revision to the first quarter meant that the output gap for the Bank of Canada was wider by about a half of percentage point, which is quite big. Therefore, that is a big change in their forecast and in the perceived state of the Canadian economy. Hence, the Bank had in a way to react to that.

What are your short and long-term forecasts for USD/CAD and EUR/CAD?

We expect the USD/CAD in the long-term to reach 1.35 levels by the end of 2016. As for the EUR/CAD, we see the pair trading at somewhat 1.42 for the same period.

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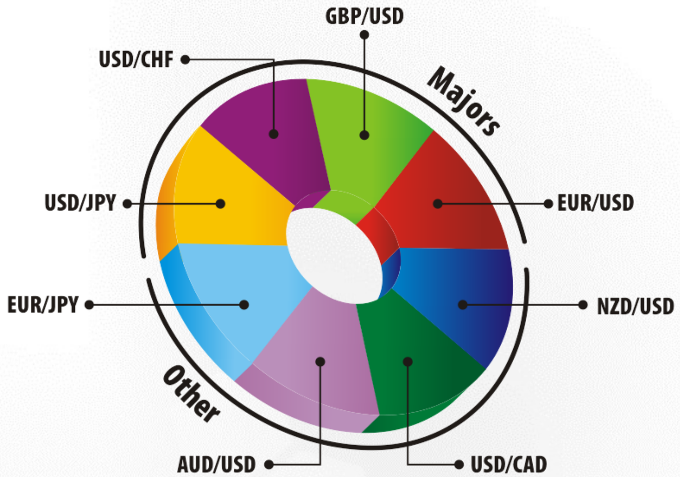

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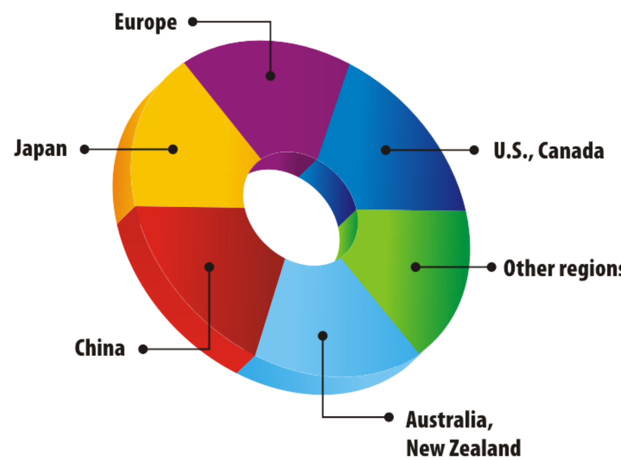

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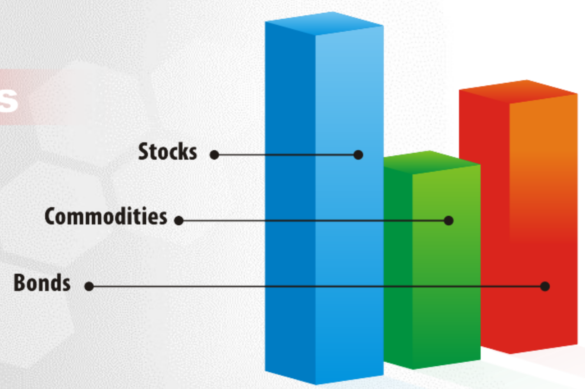

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