Global Economic Environment

The global economy recorded modest growth in 2014. Real GDP rose by 3.4%, however, economic performance varied by country and region (see table).

Several regions turned in a lackluster performance. The euro area and Japan were particularly weak, and given their influence on the global economy, this dampened global growth. China, though still growing, has seen its economic growth decelerate in the last two years. This gave rise to large commodity market imbalances about mid-way through 2014. With commodity supply increases outpacing demand growth, major commodity price corrections took place in 2014. Large commodity exporters like Canada, Brazil and Australia have seen their growth prospects erode in the face of these price declines.

However, sizeable economies such as the United States, India and the United Kingdom (see chart) continue to demonstrate strengthening growth prospects. The U.S. and UK central banks are among the few major central banks expecting to raise interest rates in 2015. Most, like the European, Chinese and Japanese central banks, are expected to continue to provide expansionary monetary policy support designed to stimulate their economies.

Real GDP Growth (%)

	2013	2014e	2015f
World	**3.4**	**3.4**	**3.5**
Brazil	2.7	0.1	-1.0
India	6.9	7.2	7.5
Russia	1.3	0.6	-3.8
China	7.8	7.4	6.8
Canada	**2.0**	**2.5**	**2.0**
United States	**2.2**	**2.4**	**3.2**
Japan	1.6	-0.1	1.0
Australia	2.1	2.7	2.8
European Union	0.1	1.4	1.8
United Kingdom	1.7	2.6	2.7
Euro Area	-0.5	0.9	1.5
Ireland	0.2	4.8	3.9
Germany	0.2	1.6	1.6
France	0.3	0.4	1.2
Spain	-1.2	1.4	2.5
Portugal	-1.6	0.9	1.6
Italy	-1.7	-0.4	0.5
Greece	-3.9	0.8	2.5

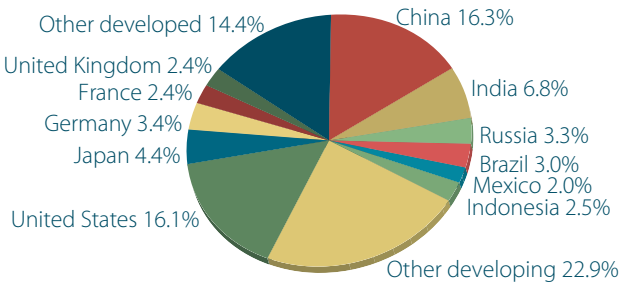
e: estimate; f: forecast

Source: Canada - average forecast of major Canadian banks; U.S. - Survey of Professional Forecasters, U.S. Federal Reserve Bank of Philadelphia; all other jurisdictions - International Monetary Fund, April 2015

The global economy is expected to exhibit moderate improvement in 2015. While lower commodity prices will present real challenges for commodity producers, in particular, oil exporters, the combination of prevailing low energy prices and interest rates will serve to boost demand in oil importing countries. In addition, increasing demand in large economies like the U.S. will contribute to a modest acceleration in global economic activity. Overall, global GDP is expected to increase by 3.5% in 2015 before ramping up to 3.8% in 2016.

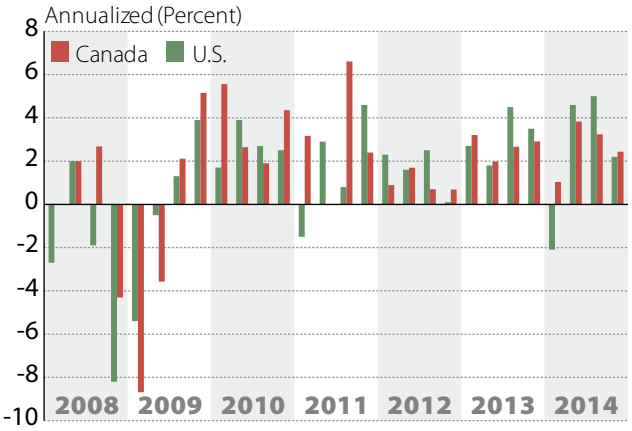
There are, however, significant risks present which could reduce global growth. Abnormally low inflation, low interest rates (sometimes negative in real terms) and inflated asset prices pose continued uncertainty. A delicate balancing act exists for central banks between coaxing growth and staving off destabilizing forces in currency and financial markets.

Share of Global GDP, 2014



Note: Shares are calculated using purchasing power parity basis data.
Source: International Monetary Fund

Quarterly Real GDP Growth



Source: U.S. Bureau of Economic Analysis; Statistics Canada

United States

The U.S. economy is currently the world's second largest, after China, and accounted for 16.1% of world GDP in 2014 on a purchasing power parity basis. The U.S. economy continued to expand in 2014, and many indicators suggest that the country has nearly recovered from the 2008-09 recession. Private sector growth is gaining momentum, driven by solid employment gains, increased consumer expenditure and strong private domestic investment.

Real GDP in the U.S. grew by 2.4% in 2014. Growth for the year was dampened by a 2.1% contraction in the first quarter caused by harsh winter weather and a large inventory correction. In the last three quarters of the year, however, real GDP growth averaged about 3.9% on an annualized basis. Consumer expenditure grew at a healthy pace, as lower oil prices bolstered gains in household spending power. Real consumption expenditure grew by 2.5% in 2014 and private domestic investment increased by 5.9%. Similarly, housing sector activity, which has been a crucial indicator of economic recovery in recent years, continued to increase. Housing starts grew by 8.5%, surpassing one million units for the first time since 2007 and housing prices increased by 2.6%. International trade, however, was a drag on growth in 2014. The U.S. trade deficit grew by about 8% to $454 billion (in real terms), as Americans consumed more imported goods due to their greater international purchasing power, consistent with the appreciating dollar and growing consumer spending.

The labour market continued to improve in 2014, as the prolonged effect of the last recession gradually receded. Employment increased by 1.7%, or about 2.4 million, while the unemployment rate averaged 6.2%, down 1.2 percentage points from 7.4% in 2013. Towards the end of year, the unemployment rate reached 5.6%, close to pre-recession levels. Nevertheless, the employment rate (the ratio of employed persons to those of labour force age) remained well below the pre-recession level, indicating that, while the recovery is ongoing, job growth has not kept pace with population growth. Median weekly earnings in 2014 grew to $791, a 1.9% increase compared to 2013.

While growth in the core Consumer Price Index (excluding food and energy) remained below 2% last year, strong job gains and a falling unemployment rate is raising concern about future U.S. inflation. With economic growth expected to gain momentum, many analysts expect the Federal Reserve to raise its policy interest rate in 2015 to stem the possibility of excessive inflation. However, the appreciation of the American dollar against the currencies of its major trading partners and low oil prices have somewhat reduced concerns of inflation in the short-term. It is reasonable to expect the Federal Reserve to remain cautious with respect to raising the prime rate.

Similar to 2014, weather posed some economic concern early in 2015. Retail sales fell unexpectedly in February, and consumer spending is expected to fall in the first quarter of the year after strong growth in the last quarter of 2014. However, most forecasters are predicting a rebound in growth in the second quarter of 2015.

For the year as a whole, economic growth is expected to be stronger. Real GDP is expected to increase by 3.2%. Strong growth is consistent with the rebounding housing market and accelerating employment and wage growth. The unemployment rate is expected to fall further, reaching 5.4%. Strong growth in the U.S. is expected to be a substantial driver of world economic growth in 2015, as well as a stabilizing presence on the world economic stage.

China

China is currently the largest economy in the world, accounting for 16.3% of global GDP in 2014. The country experienced a long period of strong economic growth from the early 1990s to 2008, driven by rapid growth in exports to major markets around the world. The 2008-09 recession caused a significant decline in export demand and, to maintain strong economic growth, the Government of China increased infrastructure spending and loosened lending restrictions. This led to a massive construction boom in the country over the past five years which resulted in increased demand and consequently higher prices for commodities such as iron ore and oil.

In recent years, the Chinese government has been introducing policies designed to transition the economy from investment-based growth to domestic consumption-based growth and an expanded service sector. The government has also taken steps to reduce pollution and reduce excess capacity in the economy. As a result of these actions, economic growth slowed in recent quarters, but rates of growth remain elevated in comparison to other major economies. Slowing economic growth in China, combined with higher than expected supply growth, were the major factors behind the collapse of oil and iron ore prices late last year.

Fears that growth was slowing too quickly prompted the People's Bank of China to lower interest rates twice in recent months—the first time in November 2014 and the second in late February

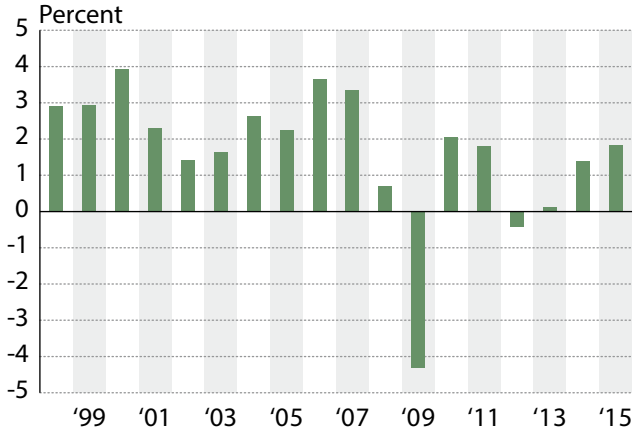
2015. However, the government is pressing ahead with further reforms including plans of gradual adjustments in the hukou or household registration system and the introduction of a bank deposit insurance program on May 1st. The current hukou system restricts rural citizens' access to government services if they migrate to urban areas. Changes to this system should lead to more efficient use of labour while deposit insurance should encourage more competition in the banking sector.

Real GDP in China grew by 7.4% in 2014 compared to 7.8% in 2013. Lower oil prices, fiscal stimulus measures and lower interest rates should support growth in 2015. The International Monetary Fund (IMF) is currently forecasting that China's real GDP will grow by 6.8% in 2015 and 6.3% in 2016.

European Union

The European Union (EU) consists of 28 countries. Collectively, these countries comprised 17.2% of global GDP in 2014, with the largest economies being that of Germany (3.4% of world GDP), France (2.4%), the United Kingdom (2.4%), and Italy (2.0%). Within the EU, 19 jurisdictions have adopted the euro as their currency—these regions are often referred to as the euro area or the Eurozone.

European Union Real GDP Growth



Source: International Monetary Fund

The EU continues to struggle to gain economic momentum following the 2008-09 recession and the ensuing sovereign debt crisis. The EU economy contracted in 2012 and recorded minimal growth in 2013 (see chart). While real GDP growth increased in 2014, it remained low in a historical context. Furthermore, growth has varied considerably among countries—economic performance in the United Kingdom and Germany has been better than some of the other large economies, notably France and Italy. Continued sluggish growth and the risk of deflation have spurred the European Central Bank (ECB) to initiate a quantitative easing (QE) program in an attempt to boost economic activity.

However, because of the common currency, individual countries in the euro area have restricted monetary policy options available to address their economic and fiscal difficulties. This has led to speculation that some highly indebted countries, in particular Greece, may leave the euro area. The possibility of Greece exiting the Eurozone and creating financial instability is a real risk for EU economic growth.

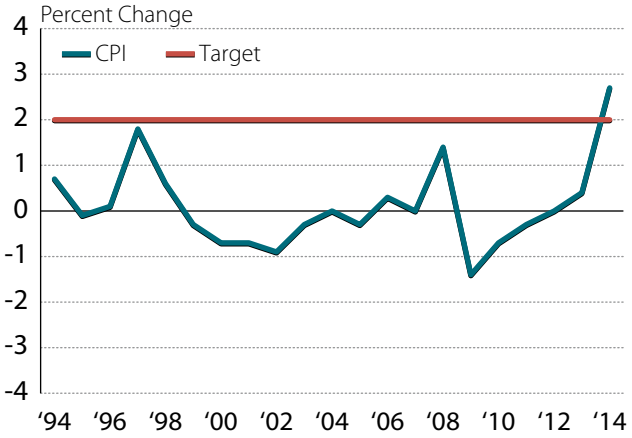
Overall, low oil prices, the QE program introduced by the ECB, and a depreciation of the Euro are expected to improve the EU's short term prospects. However, structural issues like high unemployment and sovereign debt challenges continue to be an impediment to long-term economic growth. For 2015, the IMF forecasts growth of 1.8% for the EU, with growth rates varying among countries—from 0.2% in Cyprus to 3.9% in Ireland.

Japan

Japan is currently the fourth largest economy in the world on a purchasing power parity basis, accounting for 4.4% of global GDP in 2014. The country has experienced a number of serious economic difficulties over the past two decades with persistently low inflation/deflation (see chart), increasingly high levels of government debt and weak private sector growth. In addition, Japan has the fastest aging population in the world, which continues to put pressure on its social security system and constrain labour supply. In 2013, the Government of Japan launched a three-pronged approach for economic recovery through monetary, fiscal, and structural policies, commonly referred to as "Abenomics" after Prime Minister Shinzo Abe. These policies included a large fiscal stimulus program; measures by Bank of Japan to increase the money supply; and structural reforms such as reducing protectionism for selected industries and reducing labour market rigidities. Thus far, these policies have had only limited success.

Japan's Inflation Rate

All Items CPI



Note: The higher inflation rate in 2014 was mainly the result of a 3.0 percentage point increase in sales tax which took effect in April of last year.

Source: Statistics Japan

Following two consecutive quarters of negative real GDP growth, Japan's economy came out of recession in the fourth quarter of 2014, as real GDP grew at an annualized rate of 1.5%. For 2014 as a whole, Japan's real GDP was relatively flat, as increased public sector spending and net exports were offset by lower private consumption and residential investment. Employment in Japan increased by 0.6% in 2014 and the labour force increased by 0.2%. Consequently, the country's unemployment rate declined 0.4 percentage points to 3.6%.

In April 2014, Japan raised its sales tax from 5% to 8% in an effort to reduce its deficit; however, private consumption fell dramatically as a result. The government had planned a further 2% sales tax increase in October 2014, but that increase was postponed for 18 months due to concerns that another increase at that time would reduce domestic consumption even further and, in the short term, prolong the country's economic difficulties.

Low inflation remains a serious concern and the Bank of Japan has stated that its policy of quantitative and qualitative monetary easing will continue as long as necessary to maintain the inflation target of 2%. The IMF is forecasting the Japan's real GDP to increase by only 1.0% in 2015 and 1.2% in 2016.

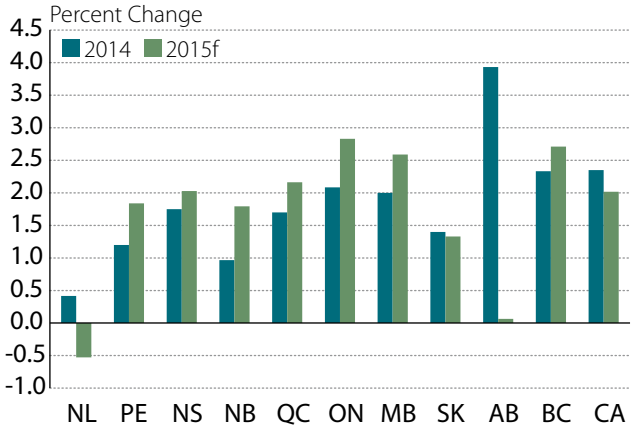
Canada

Canada's economy accounted for 1.5% of global GDP in 2014. Canada's economic growth was solid in 2014, with real GDP expanding by 2.5%. Real GDP increased by just 1.0% (annualized rate) in the first quarter, but improved thereafter to average 3.1% during the remainder of the year. Growth was broad-based, with the largest contributions coming from exports and consumer

expenditures. Among the provinces, Alberta posted the strongest economic growth at 3.9% (see chart).

Employment increased 111,100 in 2014 or 0.6% and the unemployment rate declined 0.5 percentage points to 6.9%. Labour market performance varied significantly across provinces and, as in recent years, western Canada posted above average results. Employment in Alberta grew 2.2%, while Saskatchewan posted growth of 1.0%. Five provinces (NL, PE, NS, NB and QC) reported declines in employment while the remaining three provinces reported employment growth of less than 1.0%.

GDP Growth by Province



f: forecast

Source: Average of Canadian major banks and the Conference Board of Canada

The sharp drop in oil prices in the second half of 2014 prompted the Bank of Canada to cut the overnight rate by 25 basis points in January. Oil accounts for half of the Bank of Canada's production-weighted commodity price index, and its slump has pushed the total commodity price index to its lowest level since 2009. Despite assurance from the Governor of the Bank of Canada that the unexpected 25 basis point cut is sufficient insurance against downside risks in the very short term, the slump in energy prices, together with potentially slower than expected growth in the first half of the year, could prompt the Bank to cut rates again later this year.

Falling oil and commodity prices have exacerbated the decline in the Canadian dollar which, even before the Bank of Canada lowered the overnight rate, had been steadily losing ground against the U.S. dollar for well over a year. The Canadian dollar recently reached its lowest level since March 2009, at US$0.78. Nevertheless, Canada is a major commodity exporting country, and while the country may be negatively impacted by the drop in commodity prices, the slide in the Canadian dollar may be good news for future economic growth (outside the oil and mineral sectors). A strengthening U.S. recovery also bodes well for the Canadian outlook. It is expected that the Canadian dollar will remain near US$0.80 for the remainder of calendar 2015.

Looking forward, the drop in oil prices together with the low dollar should help economic performance in manufacturing-intensive provinces and lead to a rebalancing of regional economic growth. Real GDP growth in Canada is expected to average 2.0% in 2015. Ontario is expected to lead the provinces in real GDP growth for the first time in almost 30 years with 2.8% growth, followed by British Columbia (+2.7%) and Manitoba (+2.6%). Although labour markets are expected to be relatively weak throughout Canada, employment growth in these three provinces is expected to be slightly better than the national average with Manitoba at 1.3%, Ontario at 1.1%, and British Columbia at 1.0%. Canadian employment growth is expected to be relatively low in 2015 at just 0.8%.