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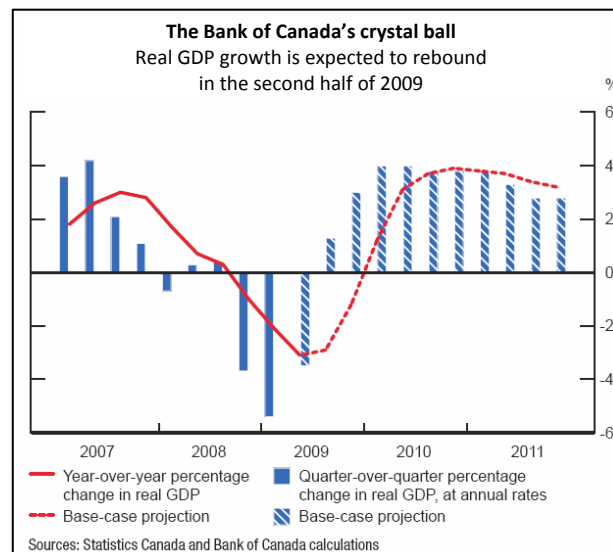
## **It's 'official' – recession over** *Bank of Canada predicts growth through second half*

*July 24, 2009* – Somewhere along the way, the recession ended. The economy is expected to return to growth in the second half of this year. That's good news for investors, of course, and something frequently predicted in these comments for the second half of this year. Recessions don't last forever, and their progress is broadly predictable. It's not really rocket science – “dismal” science, perhaps, but not rocket science. It might be said that Bank of Canada Governor Mark Carney was the first monetary authority to officially declare the end of the recession last Thursday, amidst generally buoyant markets both in Canada and the US.

In remarks introducing the most recent BoC Monetary Policy Report, Mr. Carney said that “global economic activity appears to be nearing its trough” and that “growth in Canada should resume this quarter.” He added the proviso, if proviso it was, saying, “However, this recovery is nascent.”

Analysts and pundits and various deep thinkers attempted to make sense of that last statement. The word “nascent” means “recently having come into existence” – “newborn,” in other words. That implies that the Bank of Canada believes that the economy is now no longer contracting, but is “in recovery.” The conditional “however” therefore indicates that the BoC believes the newborn recovery is so fragile that it could be snuffed out by ill-conceived or badly timed changes in monetary policy abroad – a not-so-subtle reminder that any further lunacy south of the border could plunge us back into deep trouble.

With the host of cautions, caveats, provisos, conditionals, and warnings out of the way, Mr. Carney predicted that Canada's economy would return to growth in the third quarter, with gross domestic product expanding at an annualized 1.3%, climbing to around 3% in the last quarter. Overall for the year, the BoC expects Canada's economy to post a -2.3% contraction. In 2010, GDP



Courtesy Bank of Canada, *Monetary Policy Report*, July 2009

should return to full-year growth of 3.0%, as excess capacity in the economy comes back into use, spurred by growth of domestic demand – which means simply that people will be willing to buy more stuff as jobs become easier to find.

The BoC does not see inflation as a problem in the near term, and expects so-called “headline” consumer prices (which include such volatile items as energy and food) to “trough” in the third quarter. Presumably that means a continuation of the soft deflationary trend that saw consumer prices fall –0.3% in June. The Bank expects CPI to climb back to its mid-point target of 2% by the second quarter of 2011. It expects core inflation (which excludes food and gas prices) to soften slightly from its current 1.9% rate, before climbing again to 2% in 2011. Consequently, the Bank left its target overnight rate unchanged at 0.25% and said it still expects to keep that rate until the second quarter of 2010.

All in all, the BoC painted a picture of Canadian monetary prudence amidst a calamity of global financial destruction. Indeed, with only three consecutive quarters of contraction, this recession will go down in the books as one of the shortest on Canada’s economic record. For those of us down on the ground, though, the recession won’t really be over until there are a whole lot fewer than two or three hundred applications for every job. And until individual investors feel a lot more comfortable shifting out of our money market funds back into equities.

Now, admittedly, Mr. Carney speaks only for the Canadian viewpoint. Ben Bernanke, the embattled Chairman of the US Federal Reserve Board, on Tuesday made similar noises at his semi-annual dog-and-pony show to a highly unreceptive Democrat-controlled Congress. (In fact, until the next election, Democrats undeniably and absolutely control the House of Representatives, a filibuster-proof Senate, and the White House. Which makes you wonder why, with their fondest desires handed to them on a silver platter last November, they can’t get things going as promised. The “blame Bush” gambit is starting to wear really, really thin in the minds of most voters. It’s all about Obamanomics now.)

Mr. Bernanke, speaking for the Fed, said that the US economy will be growing again by year-end, with a return to positive annual growth of somewhere between 2% and 3% in 2010. The US job market, however, currently saddled with a 9.5% unemployment rate, is still expected to lag any economic recovery, well into next year. That alone could create a significant drag on GDP growth, as consumer spending remains dead in the water.

With monetary risks still tilting towards the deflationary, the Fed said it plans to keep its target overnight rate close to zero for the foreseeable future.

Stock markets are behaving pretty much as expected during an early recovery phase – which is to say somewhat schizophrenically. After sliding anywhere from 8% to 10% from their early June peaks, North America’s major stock indexes rallied strongly from last Friday’s close and approached or exceeded year-to-date highs.

Profit surprises from companies like Ford, AT&T, and eBay helped push the big US indexes to robust week-over-week gains. And stronger-than-expected results from Caterpillar Inc., Halliburton Co., Kellogg Co., Boeing Co., and Coca-Cola Co. bolstered investor optimism following the previous week's profit surprises from Goldman Sachs Group Inc. and J.P. Morgan Chase & Co.

The Dow Jones Industrial Average had climbed 4% week over week by the time the closing bell sounded on Friday. The S&P 500 Composite recorded a 4% advance as well. Toronto's S&P/TSX Composite Index joined in the fun with a 3% weekly surge.

Right now, investors are beginning to regain some confidence in the earnings outlook, despite those niggling concerns that most profit "surprises" for the second quarter resulted from massive cost-cutting efforts rather than massive revenue increases. The renewed confidence that bid up stock prices across the board last week builds on expectations that revenue growth is bound to return, now that the recovery is "official." And coming on top of leaner operating costs and higher labor productivity rates achieved through the crucible of the recession, those revenues are expected to flow to the bottom line in a big way over the next few quarters as economic growth gets going into 2010.

We can't help but reiterate, in case you missed it: It's buying time again. ■

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