

# The Commodity Boom and Global Economies



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## The Commodity Boom and Global Economies

Dr. Sherry Cooper Global Economic Strategist & Executive VP, BMO Financial Group



## North America in 2005



- Expansion in 3% Range
- Inflation Uptick
- Rising U.S. Rates
- Currencies Realign
- Stocks Outperform Bonds
- Commodity Prices Up

## Canadian Markets Outperform

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## Decision Coming

Canada



### General Election:

- June 2005
- February 2006

## PM Paul Martin on Borrowed Time?

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## Canadian Politics Heat Up



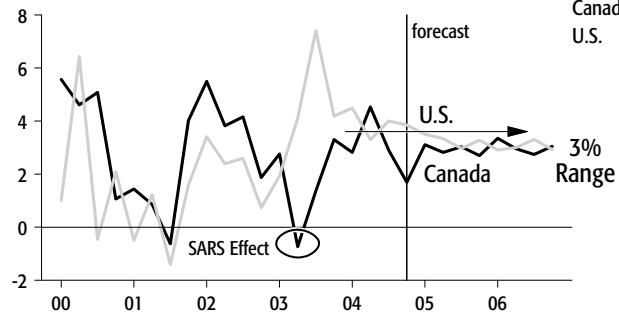
## Martin Minority Under Siege

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## Expansion in 2004/05

(q/q % chng : a.r.)

### Real GDP



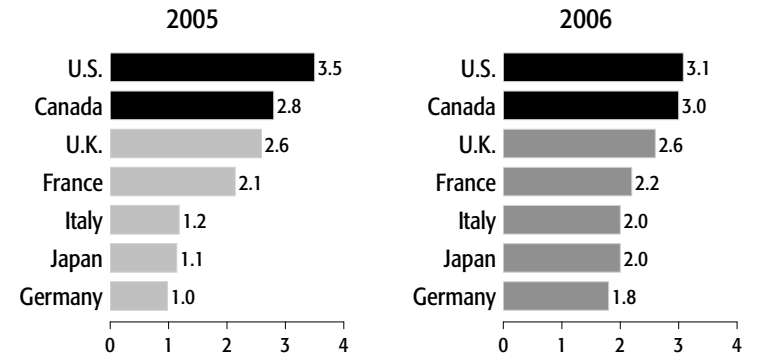
	04	05	06
Canada	2.8	2.8	3.0
U.S.	4.4	3.5	3.1

**SOLID . . . But U.S. Cooling**

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## U.S. and Canada Lead G-7

Real GDP – G-7 (y/y % chng)

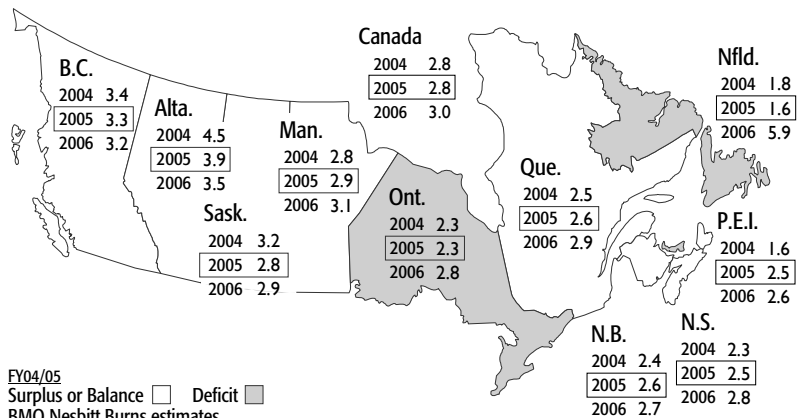


Source: BMO Nesbitt Burns forecasts

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## Provincial Growth Rates

Real GDP Growth Rates – Canada (percent)

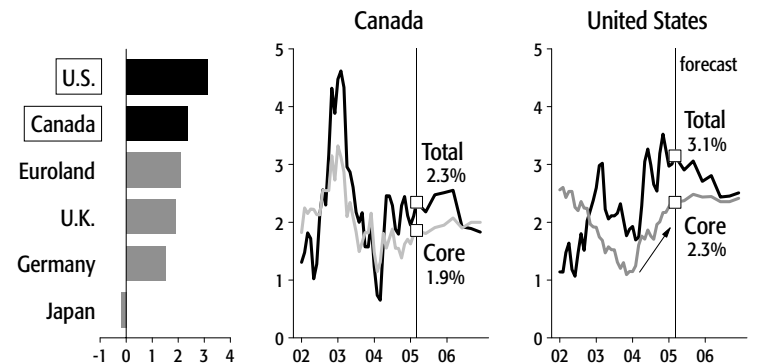


FY04/05  
 Surplus or Balance □ Deficit ■  
 BMO Nesbitt Burns estimates

© BMO Nesbitt Burns Inc.

## Inflation Moderate

Consumer Price Index (y/y % chng)



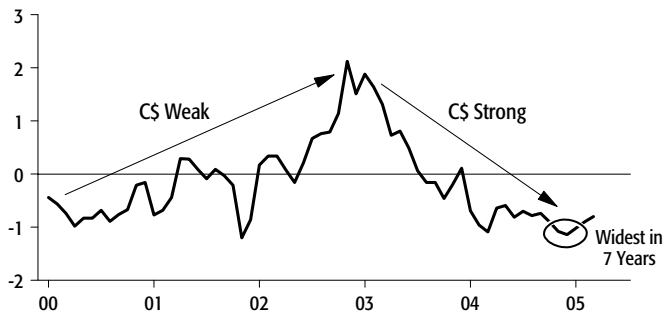
**Core Inflation Still Low . . . But Rising**

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## Canadian & U.S. Inflation ... Mind the Gap

(ppts)

Total Inflation – Canada minus U.S.



**Justifies Negative Rate Spreads**

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## Monetary and Fiscal Policy Tightening



- Fed Tightens
- BoC Pauses

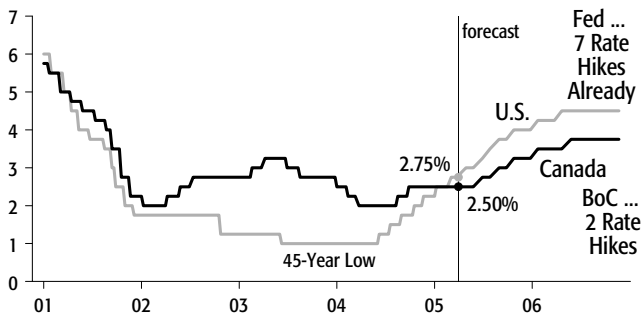
**Fed Has Inflation Concerns**

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## Fed Tightens

(% : as of April 26, 2005)

Overnight Rates



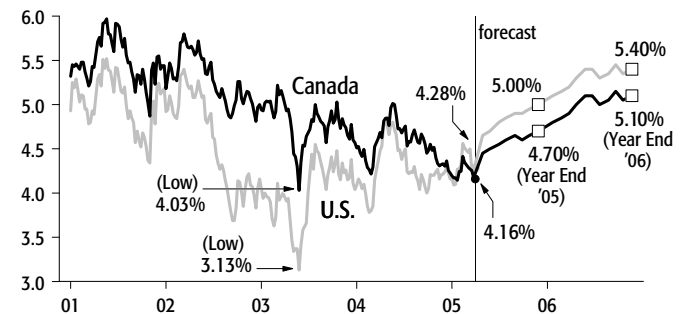
**BoC ... Next Move is to Tighten**

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## Long-Term Interest Rates to Rise Moderately

(% : as of April 26, 2005)

10-Year Bonds



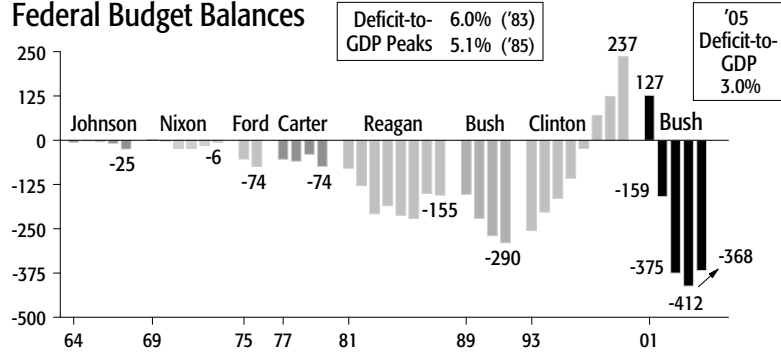
**Canadian Bonds Outperform U.S.**

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## U.S. Budget Deficit Moderates a Bit

United States (US\$ blns)

### Federal Budget Balances



### Fiscal Tightening

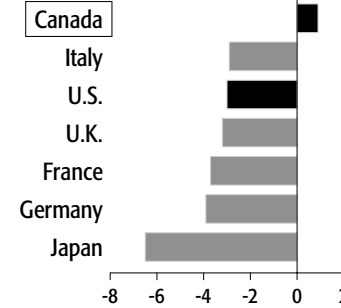
2005 = CBO forecast

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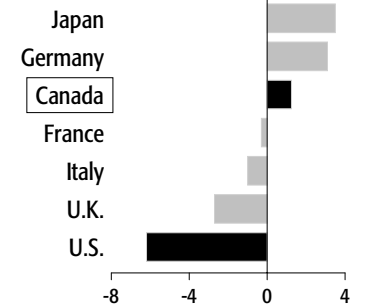
## Only Canada Has Twin Surpluses

G-7 – 2005 (% of GDP)

### Total Budget Balance



### Current Account



### Balanced Budgets for Next Few Years

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## Risks to Global Outlook



- Foreign Bond Sales
- Oil, Gasoline
- Currencies
- Reflation
- Rising Rates
- Triple Deficits
- U.S. Slowdown

Airlines, Autos, GSEs, Housing, Sub-Prime Loans

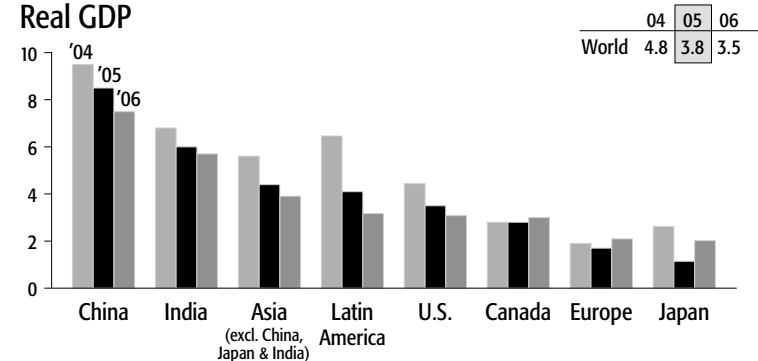
*Terrorism*

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## Global Growth Slowdown

(ann % chng)

### Real GDP



### China the Global Growth Leader

Ranked by '05

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## Commodity Boom



- Commodity Price Breakout
- Slowing Developing World Demand
- But Supply Limited

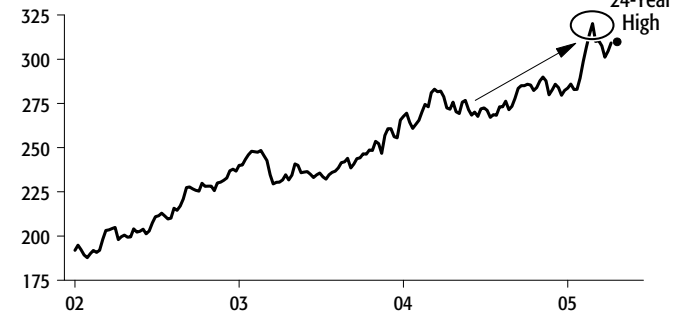
**Is it Sustainable?**

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## CRB Hit 24-Year High!

(1967 = 100 : as of April 26, 2005)

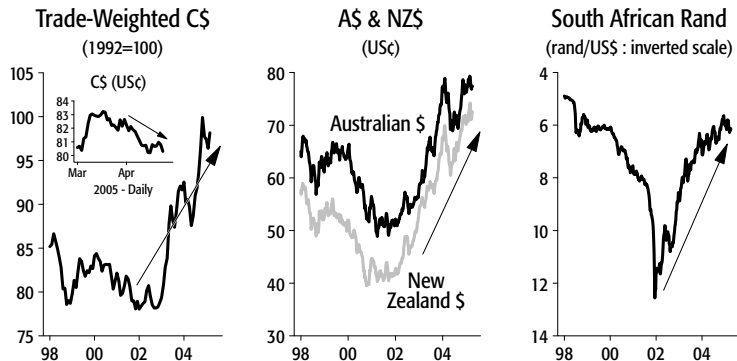
### CRB Futures Index



**Driven by the Developing World**

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## Commodity Currencies Robust

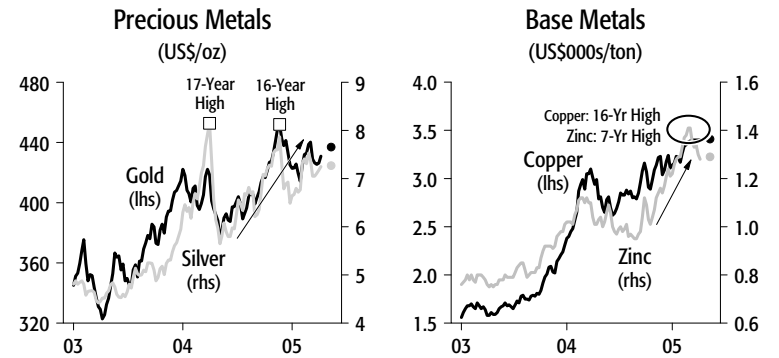


**Political Uncertainty Plagues C\$**

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## Metals Prices Surged

(as of April 26, 2005)

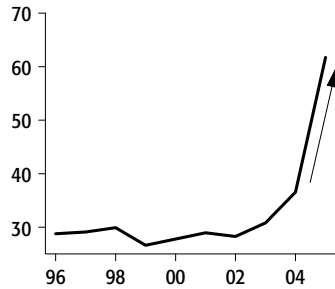


**Demand Greater than Supply Until At Least Late 2006**

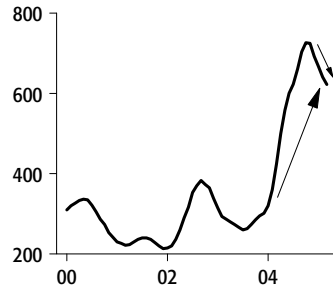
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## Big Global Demand for Steel

Iron Ore  
(US\$/dltu)



Hot Rolled Sheet Steel  
(US\$/ton : 3-mnth m.a.)

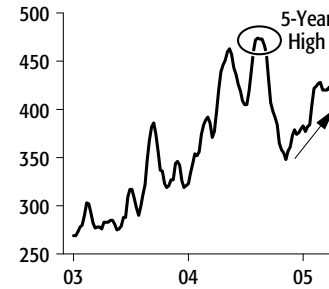


**China: Largest Net Importer of Steel . . .  
Will Add to Steelmaking Capacity in Next 3 Years**

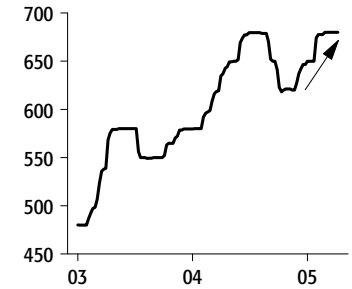
© BMO Nesbitt Burns Inc.

## Forest Product Prices Rise

Lumber  
(US\$/1000 brd ft)



Pulp & Paper  
(US\$/ton)



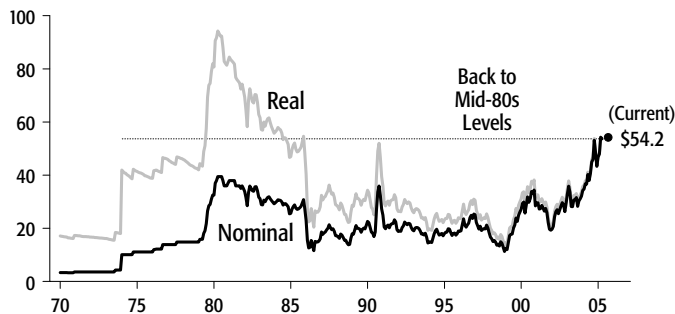
**Largest Canadian  
Export to China**

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## Nominal Oil Prices Hit Record . . . Real Oil Prices Below Peaks

(US\$/bbl : as of April 26, 2005)

Oil Prices



**Supply Concerns . . . Beyond Hubbert's Peak?**

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## China's Huge Demand for Resources

China

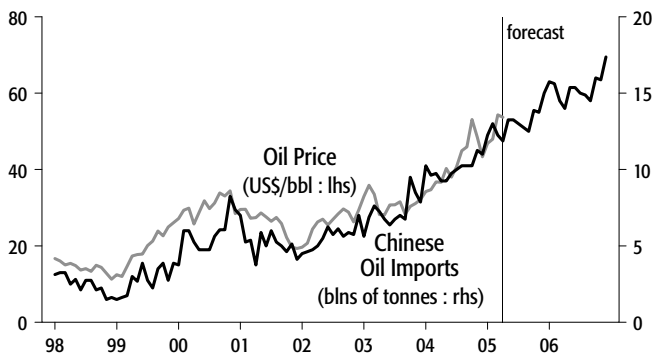
**China's Use of  
World's Supply:**

- Cement 40%
- Coal 31%
- Iron Ore 30%
- Steel 27%
- Aluminum 25%
- Energy 12%

**Shortages and Capacity Constraints  
. . . Government Tightens**

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## Chinese Demand Pushing Up Prices



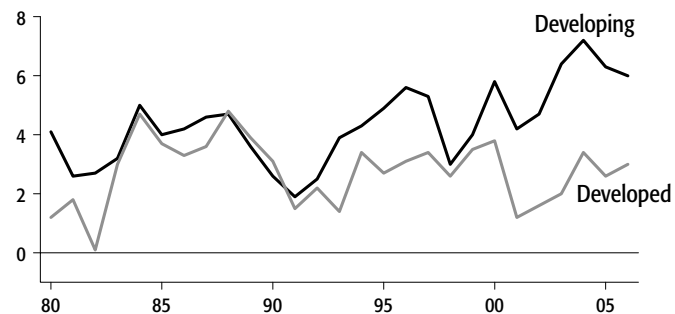
Chinese Oil Imports – Source: Financial Times

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## Growth in Developing World Boosts Commodity Prices

(y/y % chng)

### World Real GDP

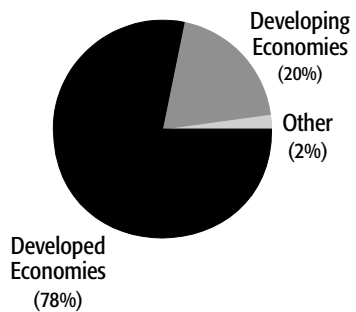


Source: IMF  
2005-2006 = forecast

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## The \$9 trln Developing World

World GDP  
(2005 : % of world nominal GDP)



### Developing World:

- One-Fifth of World GDP
- 87% of World's Population
- Growing Twice as Fast
- Uses Twice as much Raw Materials/\$ of GDP

### Does it Drive Commodity Prices?

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## Running on Empty



### Developing Countries Must:

- Boost Domestic Output
- Stockpile Oil
- Widen Supply Sources
- Buy Resource Companies
- Improve Energy Efficiency

Source: Financial Times

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## The China Factor



China

### Factory of the World:

- Low Wages
- Overheated Coastal Provinces
- Massive Direct Investment

**Major Source of Global Growth**

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## China: Second Largest Economy

GDP (percent)

	Today	1989	
U.S.	21	22	Big Jump!
China	14	6	
Japan	7	8	
India	6	4	
Germany	4	5	
U.K.	3	4	
France	3	4	
Italy	3	4	
Brazil	3	3	
Russia	3	5	
Canada	2	2	

Based on PPP  
Exchange Rates  
Source: IMF

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## Average Auto Wage Rates

Labour Rates (US\$/hr)

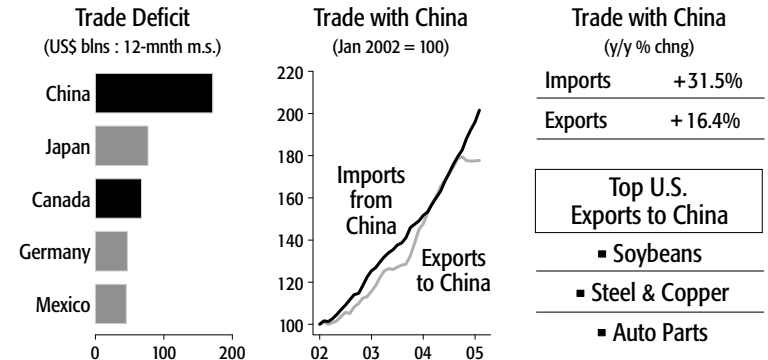
Germany	\$49.60
Japan	\$40.96
U.S.	\$36.50
Canada	\$23.80
Korea	\$11.20
Mexico	\$3.20
China	\$1.96

**Average \$70k per year in Canada  
... \$2k per year in China**

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## China Important to U.S.

United States (as of February 2005)



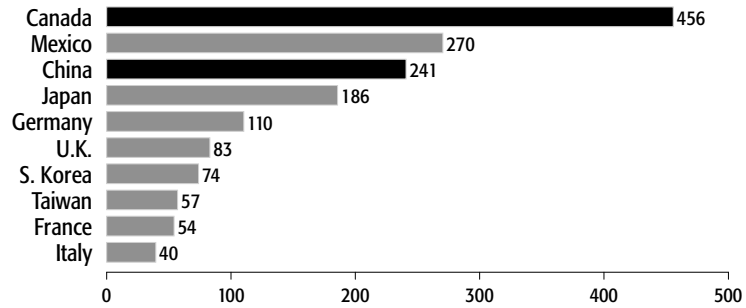
**Yuan Tied to Dollar**

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## Top U.S. Trading Partners

United States (US\$ blns : 12 mnths to February 2005)

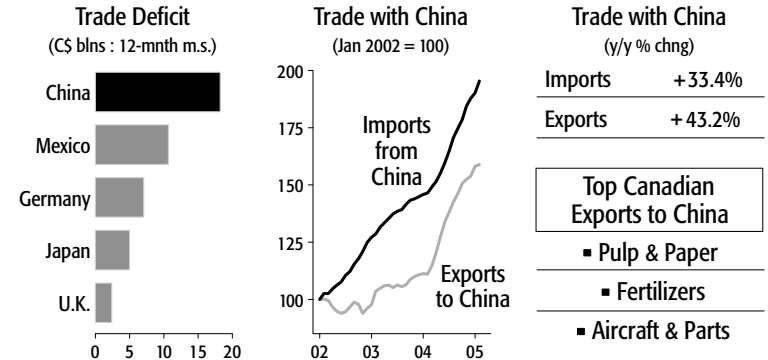
### Exports + Imports



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## China: Trade with Canada

Canada (as of February 2005)

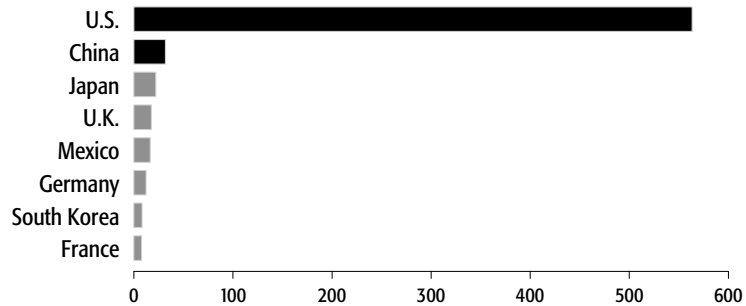


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## Top Canadian Trading Partners

Canada (C\$ blns : 12 mnths to February 2005)

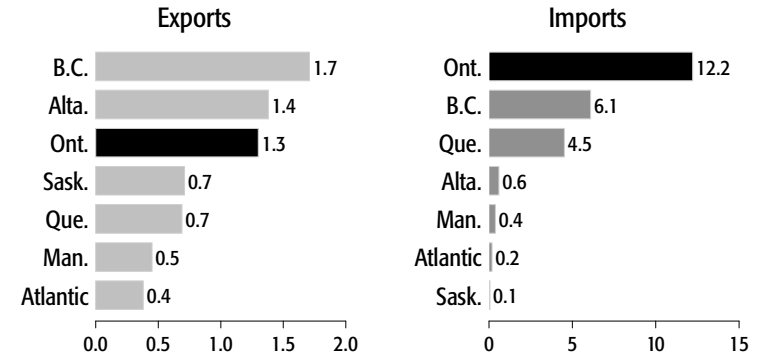
### Exports + Imports



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## Provincial Trade with China

Canada – 2004 (C\$ blns)



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## Ontario Merchandise Exports

Ontario (1997 = 100)

### Top Ontario Exports

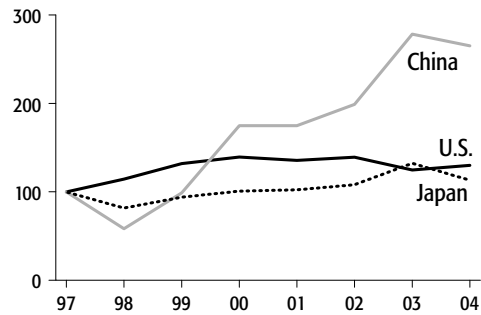
#### To China:

- 1) Autos and Parts
- 2) Nickel
- 3) Steel

#### To U.S.:

- 1) Autos and Parts
- 2) Prescription Drugs
- 3) Newsprint

### Ontario Merchandise Export Growth

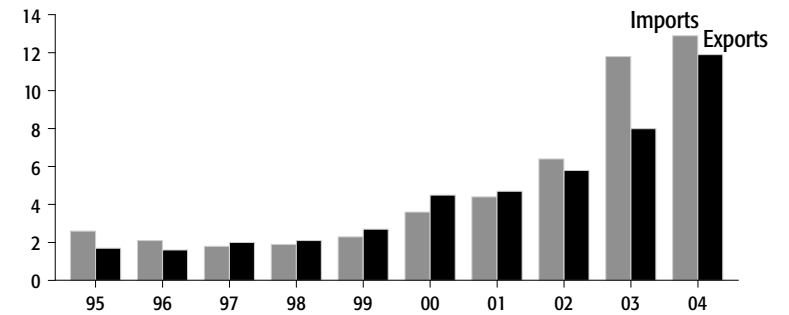


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## China's Imports and Exports of Vehicles and Vehicle Parts

China (US\$ blns)

### Vehicles and Vehicle Parts



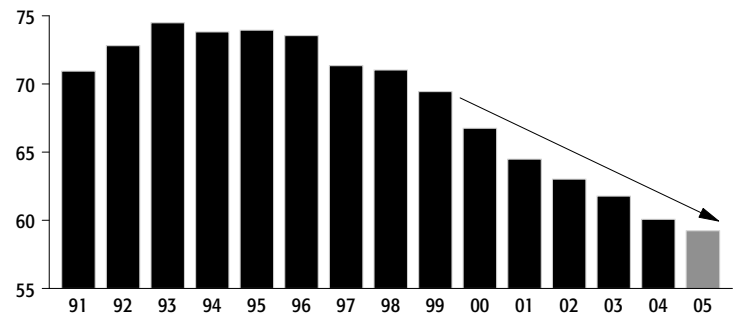
Sources: DaimlerChrysler; Global Trade Information Services; New York Times

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## Big Three's Declining Share of U.S. Auto Market

Big Three Auto Makers – United States (% of total)

### Car and Light Truck Sales



2005 = Q1

Source: Ward's Automotive

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## U.S. Dollar Trends Downward



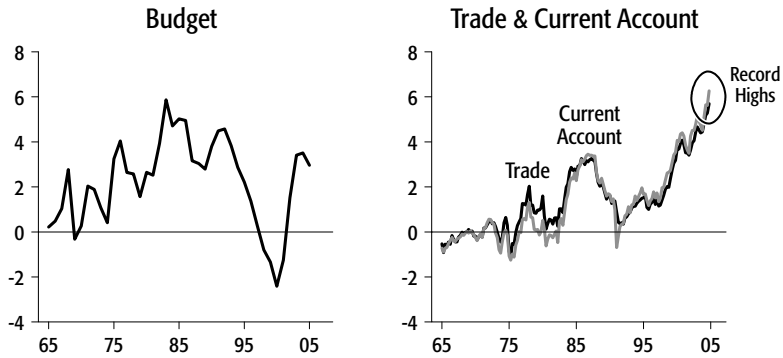
United States

- Record Current Account Deficit

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# Triple Deficits

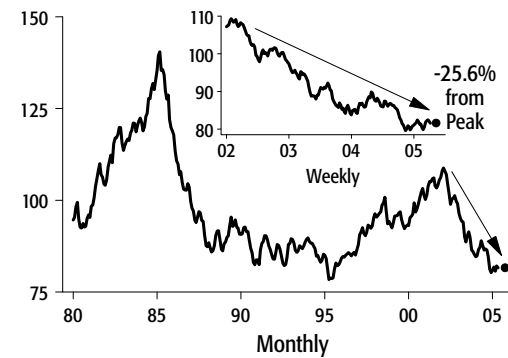
Deficits – United States (% of GDP)



2005 Budget Deficit = CBO forecast  
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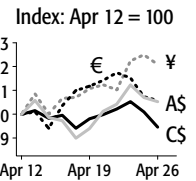
# U.S. Dollar Weakens

Trade-Weighted US\$ (as of April 26, 2005)



% Chng Since Jan 2002 Peak (vs. US\$)

Australian \$	50.8
Euro	50.4
Swiss Franc	43.6
U.K. Pound	35.1
Canadian \$	28.9
Yen	25.7
Mexican Peso	-17.5

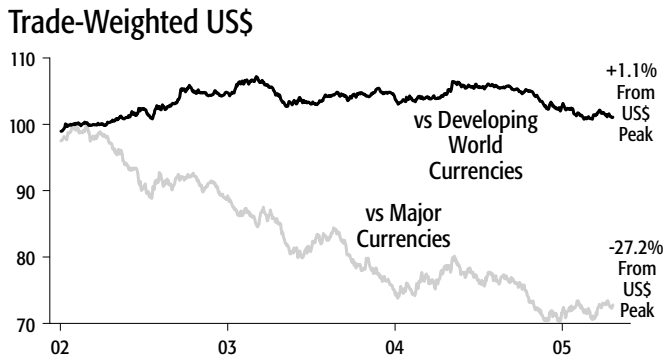


## China Revalues?

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# U.S. Dollar Not Weak vs Developing World

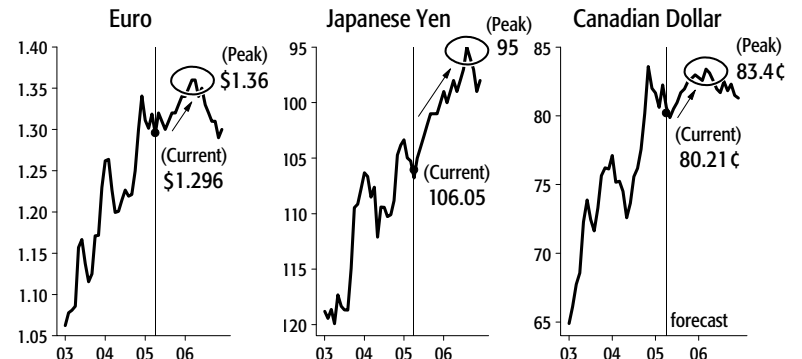
(January 28, 2002 peak against major currencies = 100)



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# Non-U.S. Dollar Currencies . . . Still Some Upside

(as of April 26, 2005)



Yen = inverted scale

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## No True Alternative to U.S. Dollar



### United States

- Only Superpower
- Strong Growth
- Low Inflation
- Deep, Liquid Markets
- Higher Interest Rates
- Cohesive Political System

## How Low Could it Really Go?

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## Consumer Still Solid



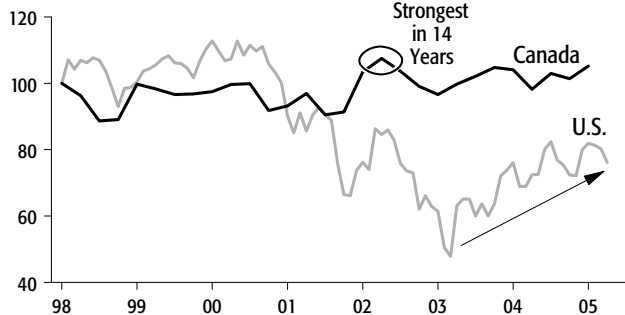
- Borrowing Costs Low
- Income Growth Steady

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## Consumer Confidence

### Conference Board

#### Consumer Confidence Indices



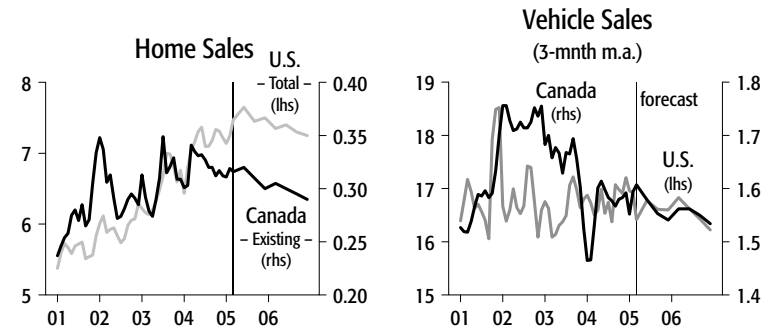
### Strong in Canada

Canada = (1998:Q1 = 100) U.S. = (January 1998 = 100)

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## Housing and Autos: Interest Sensitive

(mlns : a.r.)



House Prices	Canada	U.S.	Windsor
Change in Past Year	8%	11%	10%
5-Year Change	51%	44%	24%

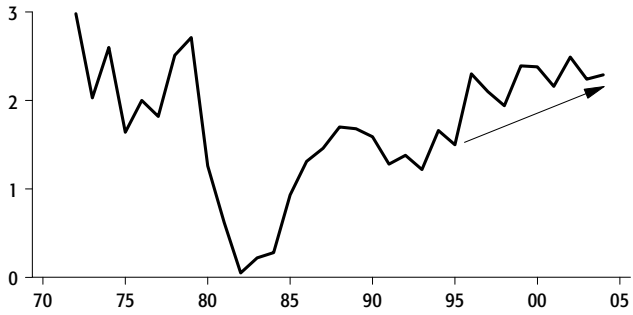
Stocks	TSX	DJIA	S&P
Change in Past Year	10%	-1%	3%
5-Year Change	4%	-6%	-20%

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## Windsor Housing Starts

Windsor, Ontario (000s of units)

### Housing Starts

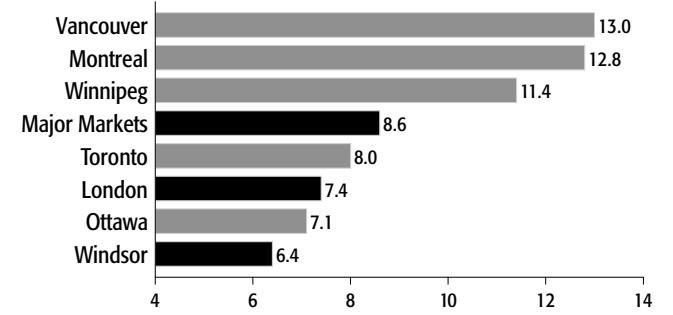


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## House Price Inflation

Canada – Major Markets – 2004/05 (y/y % chng : 12-mnth avg)

### House Prices

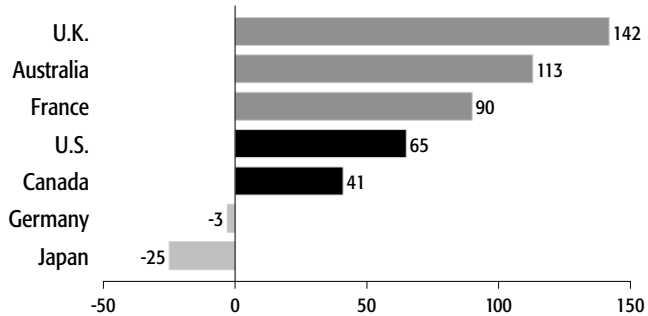


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## North American House Price Growth Not Too High

1997-2004 (% chng)

### House Prices



### Rising Faster Elsewhere

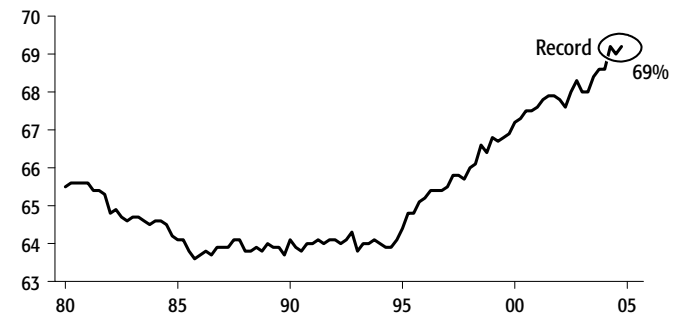
Source: The Economist

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## Home Ownership Surges

United States (%)

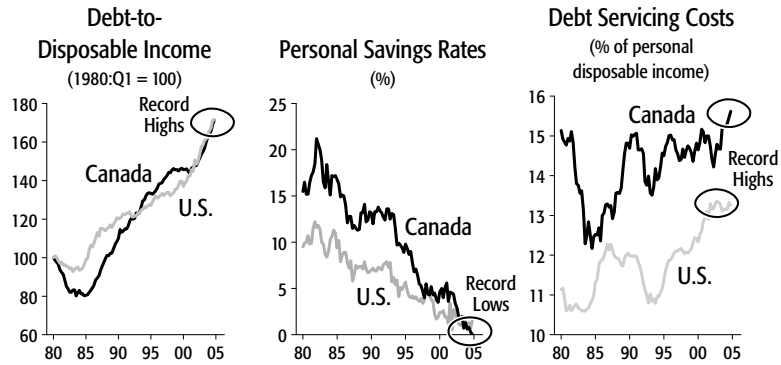
### Homeownership Rate



### Canada at Record 67%

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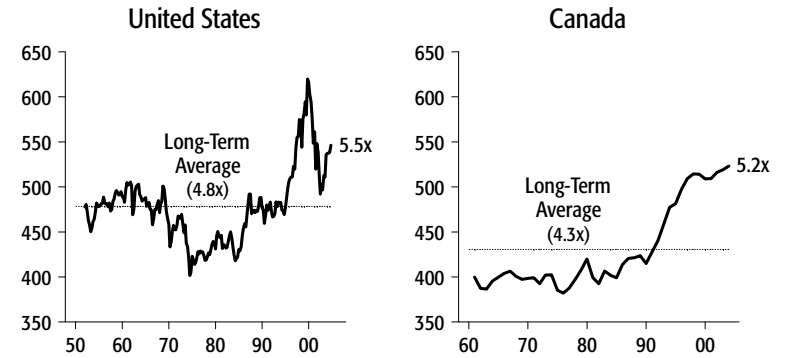
## Household Finances a Concern



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## Consumers' Financial Position Solid

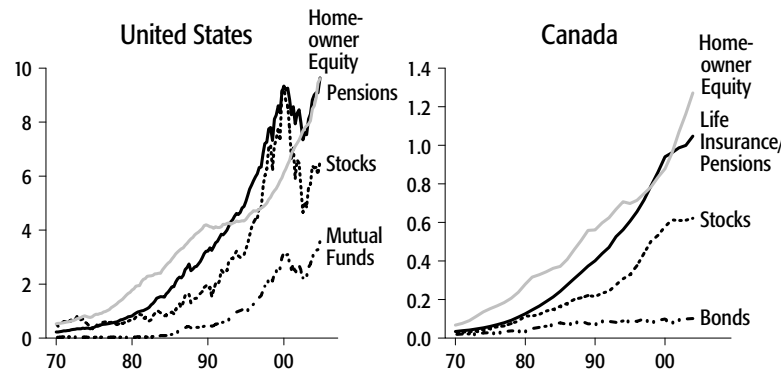
Net Worth (% of personal disposable income)



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## Household Assets

Household Assets (\$ trlns outstanding)



**Homeowner Equity Dominates**

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## Business Revival



- U.S. Profit Growth Cooling
- C\$ Hits Canadian Profits
- Capital Spending Strong

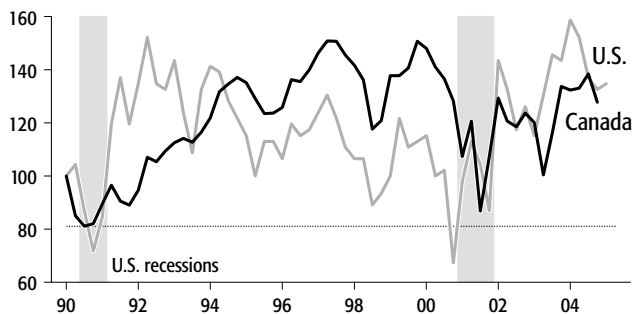
**Canadian Exporters Adjusting**

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## Business Sentiment will Rebound in U.S.

Conference Board (1990:Q1 = 100)

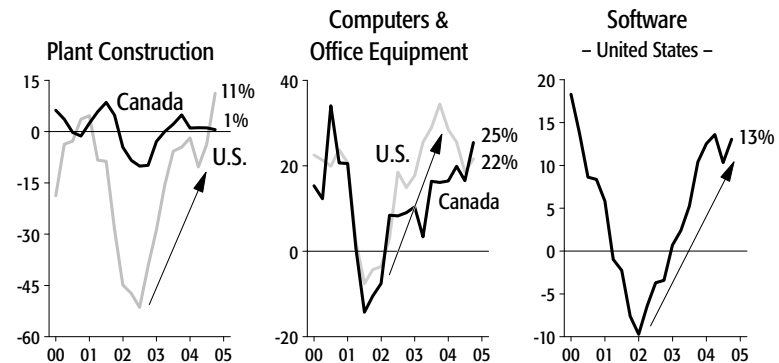
### Business Confidence Indices



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## Capital Spending Strong

Capital Spending (y/y % chng)



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## Profits Growth Slows



### U.S.

- Costs Rising

### Canada

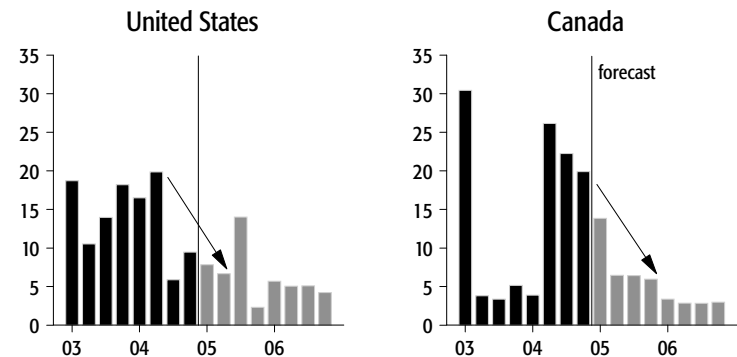
- C\$
- Productivity Challenge

## Canada Adjusts to Stronger C\$

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## Profit Growth Positive . . . But Slowing

Corporate Profits (y/y % chng)



## More Negative Guidance

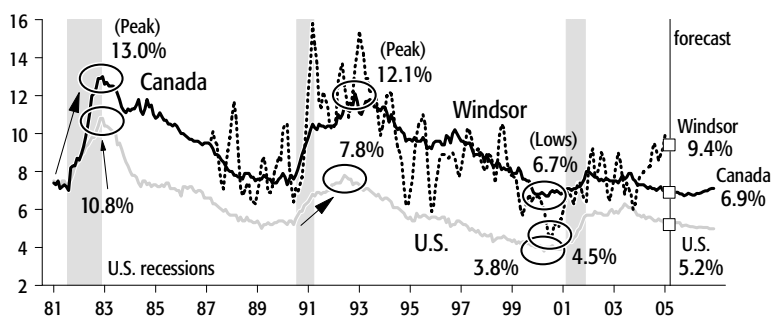
Corporate Profits = NIA basis

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## Jobless Rate a Lagging Indicator

(percent)

### Jobless Rates



Jobless Rates: **Windsor 9.4%, Ontario 6.9%**

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## Equity Markets



- Earnings Growth Slows
- Multiples Fall

**Global Stock Markets: Moderate Gains**

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## Total Returns

Total Returns – Local Currency (% chng : as of April 26, 2005)

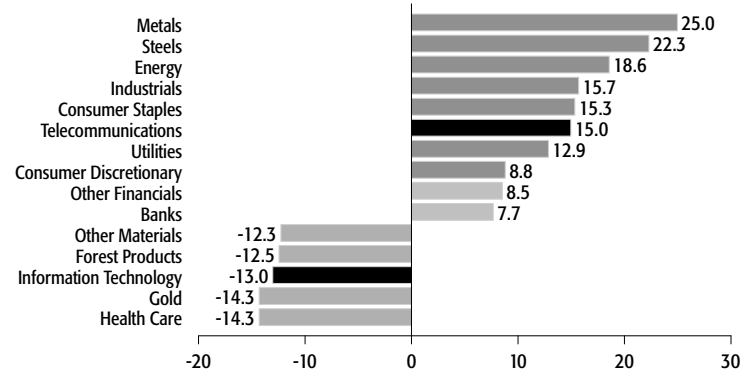
	2005 Y-T-D	2004	2003	From Peak
France	4%	10%	19%	-43%
TSX	3%	15%	27%	-17%
U.K.	1%	12%	18%	-31%
Germany	-2%	7%	37%	-48%
Japan	-4%	9%	26%	-72%
S&P 500	-4%	11%	29%	-25%
DJIA	-5%	5%	28%	-13%
Russell 2000	-9%	18%	47%	-10%
Nasdaq	-11%	9%	51%	-62%
GoCs	2%	7%	6%	39%
U.S. Treasuries	1%	4%	2%	44%
CRB Index	9%	11%	9%	-8%

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## Canadian Sectors . . . 6-Month Performance

(6-mnth % chng : as of April 26, 2005)

### 6-Month TSX Sector Total Returns



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