# Weekly Updates Issue # 666

**1. Weekly Markets Changes**
**2. Ottawa pledges to protect jobs in Canadian aluminum, steel**
**3. Canada's Q1 GDP growth lowest in almost two years**
**4. U.S. removes steel, aluminum tariff exemption for Canada, Mexico**
**5. Taxpayers on the hook for federal pension shortfall: report**
**6. BoC holds key rate at 1.25%, but hints at hikes to come**
**7. Liberals' $4.5B Trans Mountain purchase 'an investment in Canada's future': Morneau**
**8. Corporations cautious on Canadian economy: surveys**
**9. Loonie could drop to nearly US$0.70 if export woes continue: report**

## 1. Weekly Markets Changes

**[June 1, 2018]**

| S&P TSX | S&P 500 | Dow Jones | NASDAQ | CAD/USD | Gold | WTI Crude |
|---|---|---|---|---|---|---|
| 16,043.54<br>-32.13 -0.20% | 2,734.62<br>+13.29 +0.49% | 24,635.21<br>-117.88 -0.48% | 7,554.33<br>+199.99 +2.72% | $0.7714<br>+0.06c +0.08% | $1,293.40<br>-8.85 -0.68% | $65.81<br>-2.07 -3.05% |

## 2. Ottawa pledges to protect jobs in Canadian aluminum, steel

**[June 1, 2018]** Prime Minister Justin Trudeau says he will work with Canadian steel and aluminum companies hit by punishing U.S. tariffs to make sure jobs and workers north of the border are protected.

In a CBC radio interview in Halifax this morning, Trudeau said he had spoken with steel and aluminum producers and assured them "that Canadian workers and communities continue to do OK despite these unnecessary and punitive actions from the United States."

Trudeau didn't specify what that might mean in the wake of U.S. measures aimed at Canada, Mexico and the European Union that slap import duties of 25% on steel and 10% on aluminum.

Asked about how the measures affect relations with the United States and President Donald Trump, Trudeau said it marked "a bit of a turning point, but we've always known that this administration is unpredictable."

Canada has responded by imposing dollar-for-dollar tariff "countermeasures" on up to $16.6 billion worth of U.S. imports.

They come as the two countries, along with Mexico, are trying to hammer out a renegotiated North American Free Trade Agreement and after Trump sent a

warning to Trudeau late Thursday that the days of the U.S. being taken advantage of in trade deals "are over."
Trudeau was in Halifax to speak to the annual conference of the Federation of Canadian Municipalities.

## 3. Canada's Q1 GDP growth lowest in almost two years

**[May 31, 2018]** The pace of economic growth in Canada slowed in the first quarter of this year to its lowest rate in nearly two years as housing investment pulled back amid new mortgage stress test rules and a cooling housing market.
Statistics Canada said Thursday the economy grew at an annualized pace of 1.3% for the first three months of the year. That compared with an annual pace of 1.7% in the final three months of 2017.
Economists had expected growth to come in at an annualized rate of 1.8% for the first quarter of 2018, according to Thomson Reuters Eikon.
The rate of growth for real gross domestic product in the first quarter was the slowest pace since the economy contracted in the second quarter of 2016 due to forest fires that destroyed parts of Fort McMurray, Alta., and forced the shutdown of several oil sands operations in the region.
In the most recent quarter, investment in housing fell 1.9%, the largest decline since the first quarter of 2009, due to a drop in ownership transfer costs as the pace of home sales slowed at the start of the year.
Meanwhile, household spending increased 0.3%, the slowest pace since the first quarter of 2015, while household spending on services increased 0.5% and spending on goods was unchanged.
Growth in export volumes slowed to 0.4% compared with 1% in the fourth quarter of 2017. The gains were mainly contributed by crude oil and bitumen and the export of services. Imports rose 1.2% in the quarter.
Business investment in machinery and equipment rose 4.2%, while intellectual property products rose 3.3%.
Looking back at 2017, Statistics Canada revised its real GDP numbers upward for the second and third quarters.
For the second quarter of 2017, the estimate for the annualized growth rate was increased to 4.6% compared with a March estimate of 4.4%, while the estimate for the third quarter was increased to 1.7% from 1.5%.
The latest reading on the economy follows the Bank of Canada's decision to keep its key interest rate on hold.
"The first quarter wasn't something to remember for the Canadian economy, but things are looking up from here," said Royce Mendes, senior economist at CIBC Economics, in a note.

"While the Q1 numbers as a whole didn't have much to cheer about, outside of a healthy gain in business capital spending, March data suggests that momentum reaccelerated at the end of the period. That has us upgrading our second quarter GDP forecast to 2.8%.

## 4. U.S. removes steel, aluminum tariff exemption for Canada, Mexico

**[May 31, 2018]** The Trump administration kept its threat to slap Canada with hefty steel and aluminum tariffs, setting the stage for a possible trade war and leaving Prime Minister Justin Trudeau in the middle of a very divided group of leaders at next week's G7 summit.

Commerce Secretary Wilbur Ross announced Thursday that the United States will end the temporary exemption on Canadian, Mexican and European Union steel and aluminum as of midnight, as scheduled.

That means that President Donald Trump will be facing a group of leaders who will likely have taken retaliatory action against the United States when he makes his closely watched Canadian debut at the G7 next week in Quebec.

Prior to Ross's announcement, a senior Canadian official, speaking on condition of anonymity citing the sensitivity of the situation, confirmed Canada has prepared a list of U.S. products that might face retaliatory tariffs, but declined to give further details.

Canada, Mexico and Europe had been exempted until June 1 from import duties of 25% on steel and 10% on aluminum when they were first imposed in March. Barring an 11th-hour reprieve, those exemptions will expire as scheduled.

During a conference call early Thursday, Ross shrugged off questions about the U.S. facing possible retaliation, or whether the move would negatively affect the G7 meeting. And he said that while he was looking forward to continuing negotiations, the U.S. is making its decision in the interest of national security—a justification Foreign Affairs Minister Chrystia Freeland has dismissed as absurd.

In the case of Canada and Mexico, Ross said the decision was based on a lack of progress in the ongoing talks to update the North American Free Trade Agreement.

"As to Canada, Mexico, you will recall that the reason for the deferral had been pending the outcome of the NAFTA talks," he said.

"Those talks are taking longer than we had hoped. There is no longer a very precise date when they may be concluded and therefore they were added into the list of those who will bear tariffs."

If Canada and Mexico choose to take retaliatory measures, it will not affect the ability to keep renegotiating NAFTA as a separate track, he added.

"If any of these parties does retaliate, that does not mean that there cannot be continuing negotiations," Ross said. "They're not mutually exclusive behaviours."

On Wednesday, the Trudeau government said it would take additional steps to prevent foreign steel and aluminum from being dumped into the North American market—news that appeared designed to try to head off the tariff decision.

Trudeau, who was expected to respond to the decision later Thursday, spoke with Trump by phone earlier this week to counter the national-security argument, and made the same pitch Wednesday to U.S. Vice President Mike Pence.

"He seemed to understand very clearly that national-security issues don't really apply when you talk about steel or aluminum from Canada," Trudeau said.

But the U.S. is pressing ahead nonetheless, a long-threatened tactic sure to cast a pall over the G7 summit Trudeau is hosting next week in Quebec. Some observers say a G6-plus-one scenario is already shaping up, with Trump as the outlier.

Ross played down the divisions.

"There are periodic disagreements between any two countries on any given set of topics. That doesn't necessarily mean that it derails other discussions at all," he said.

"It all depends on how the various parties react to the circumstances."

European Commission President Jean-Claude Juncker, who will be at the G7 table with the seven other country leaders, expressed strong opposition to Thursday's decision.

"The EU believes these unilateral U.S. tariffs are unjustified and at odds with World Trade Organization rules. This is protectionism, pure and simple."

Trump had been widely expected to impose tariffs on European steel and aluminum imports after failing to win concessions from the European Union. Canada and its European allies have spent recent days making a concerted effort to head off the move.

Trudeau and French President Emmanuel Macron made their cases separately Wednesday to dissuade Trump, who is using a national-security clause in U.S. trade law to justify the move. Trudeau and Macron will meet next week in Ottawa before the G7 to talk strategy.

The prime minister also spoke by phone Wednesday with the premiers of Ontario, Quebec and Saskatchewan.

The Prime Minister's Office said they "all agreed to continue to defend the Canadian steel and aluminum industry from unwarranted tariffs and to stand up for the best interests of all Canadian workers and businesses."
Finance Minister Bill Morneau said in a statement late Wednesday that Canada has expanded the scope of its country of origin marking regime for steel and aluminum products to better determine where they come from.
The expansion builds on new funding announced in late April of an initial outlay of more than $30 million over five years to hire 40 new officers to investigate trade-related complaints, including those linked to steel and aluminum.
That announcement came about a month after the Canada Border Services Agency was granted extra powers to identify businesses that try to dodge import duties and ship cheap foreign steel and aluminum through the Canadian market.
Ross said the U.S. would consider the effect of those measures. He reiterated the U.S. concerns over the indirect flow of cheap Chinese steel into the U.S. through other countries.
"We will consider whatever actions they do take but our focus is as mentioned on national security aspects of steel and aluminum," he said.
"To the degree they are able to do a better job or more effective job of controlling transhipments, that certainly is a welcome development and something we would look at."

## 5. Taxpayers on the hook for federal pension shortfall: report

**[May 31, 2018]** Taxpayers are on the hook for the unfunded liability of federal pension plans, says a new report by the C.D. Howe Institute.
The report, Retiring Employees, Unretired Debt: The Surprising Hidden Cost of Federal Employee Pensions, by William B.P. Robson and Alexandre Laurin, argues that the official figures for the federal pension obligations understate future costs.
"The federal government in particular presents a misleadingly rosy picture of the situation of its plans," says a release, quoting Robson. "Ottawa's unfunded pension liability is nearly $100 billion worse than stated."
These defined-benefit pensions have pension promises guaranteed by taxpayers, and the pensions are indexed to inflation.
The official figures on the current cost of these plans and their accumulated obligations are based on notional interest rates that are too high for this kind of commitment, says the release. The report suggests that the appropriate rate

for discounting the value of future payments should be based on the yield of the federal government's real-return bonds, which have been lower than the assumed rate in the official figures.

Adjusting for the interest rates "would produce a fair-value estimate of $245.9 billion for Ottawa's unfunded pension liability at the end of 2016/17—around 27,000 per family of four and $96 billion higher than the reported figure," says the report.

The report recommends the federal government change to a different type of pension plan with benefits based on the plan's funded status, in addition to salary and years of service. Such plans are commonly used in the provincial public sector, says the report, and have a variety of labels, including shared-risk and target-benefit. The plan sponsor and the employees share the costs and benefits of a new situation when things don't go as planned. The federal government could also protect taxpayers from liability risk by capping employee contributions at a fixed share of pensionable pay.

"More economically meaningful reporting of the plans' benefits values and their cost to taxpayers would foster improvements in Canada's retirement saving and income system generally," says the report. "And it would foster reforms that would provide federal employees with better-funded pensions and taxpayers with protection against risks too few know they face."

## 6. BoC holds key rate at 1.25%, but hints at hikes to come

**[May 30, 2018]** The Bank of Canada kept its key interest rate target on hold Wednesday, but hinted that rate hikes could be coming as it noted the Canadian economy was a little stronger than expected in the first quarter.

The central bank held its target for the overnight rate—a key financial benchmark that influences the prime lending rates at the country's big banks—steady at 1.25%.

"Exports of goods were more robust than forecast, and data on imports of machinery and equipment suggest continued recovery in investment," the Bank of Canada said in a statement.

"Housing resale activity has remained soft into the second quarter, as the housing market continues to adjust to new mortgage guidelines and higher borrowing rates. Going forward, solid labour income growth supports the expectation that housing activity will pick up and consumption will continue to contribute importantly to growth in 2018."

The central bank also said global economic activity remains broadly on track, but added that ongoing uncertainty about trade policies is dampening global

business investment, and stresses are developing in some emerging market economies.
It noted that recent developments have reinforced its view that higher rates will be warranted to keep inflation near its target, but added that it will take a gradual approach and be guided by the economic data.
"In particular, the bank will continue to assess the economy's sensitivity to interest rate movements and the evolution of economic capacity," it said.
Economists had predicted the Bank of Canada would keep its key rate on hold Wednesday, but many have suggested the rate may be headed higher later this year.
In emailed commentary to clients, CIBC director and senior economist Royce Mendes says the central bank appears more comfortable with tightening policy in the coming months. For example, the bank dropped the words "over time" after indicating that higher rates would be warranted, he notes.
However, in stressing a gradual pace of tighter policy, a July rate hike could be the central bank's final move for this year, suggests Mendes.
"As the Bank contends with trade uncertainties, competitiveness issues and a shaky housing market, we're sticking to our forecast that Governor Poloz moves once more in July before taking an extended break," says Mendes.
The central bank's decision to keep its trend-setting rate on hold came as inflation sits above the 2% midpoint of its target range of 1% to 3%, and core inflation has crept past the 2% mark for the first time since 2012.
It noted that inflation will likely be a bit higher in the near term than was forecast in its April monetary policy report due to recent increases in gasoline prices, but that it will look through the transitory impact of the fluctuations at the pump. Overlooking a slight overshoot in inflation further supports Mendes' forecast for only one more hike this year.
As for today's announcement moving markets, Mendes says, "The Canadian dollar is stronger on the day, given the hints at a near-term hike, which was only partially priced into markets."
The central bank has raised its key rate three times since last summer, increases that have prompted the big Canadian banks to raise their prime rates, which are used to set the rates charged for variable-rate mortgages and other variable-rate loans.
Its next scheduled interest rate decision is set for July 11 when it will also update its outlook for the economy and inflation in its monetary policy report.

## 7. Liberals' $4.5B Trans Mountain purchase 'an investment in Canada's future': Morneau

**[May 29, 2018]** The federal Liberal government is spending $4.5 billion to buy Trans Mountain and all of Kinder Morgan Canada's core assets, Finance Minister Bill Morneau said Tuesday as he unveiled the government's long-awaited, big-budget strategy to save the plan to expand the oilsands pipeline.
In return, Kinder Morgan will go ahead with its original plan to twin the pipeline this summer while the sale is finalized, which likely won't happen until August, Morneau told a news conference in Ottawa.
Once the sale is complete, he said, Canada will continue the construction on its own, with a view to eventually selling the whole thing down the road, once market conditions would allow it to get the best price.
Morneau presented the options during an early-morning cabinet meeting Tuesday before ministers signed off on the chosen option, which comes just days before the company's self-imposed May 31 deadline and is still subject to the approval of Kinder Morgan shareholders.
"We believe this is the best way to protect thousands of well-paying jobs and the safest and most effective way to get our resources to world markets," Morneau told a news conference in Ottawa after the meeting, Natural Resources Minister Jim Carr at his side.
"Make no mistake: this is an investment in Canada's future."
Pressed about why the federal government's $4.5-billion price tag was so much lower than Kinder Morgan's stated $7.4-billion project value, Morneau said Ottawa was purchasing all the relevant assets—but he studiously avoided saying whether construction would increase costs.
"We are purchasing the assets; we are purchasing the existing assets, and the investment in the twinning of that pipeline, and those assets are what is required for us to move forward with the expansion," he said.
"It allows us to move forward with the investments required to get the expansion completed and delivering the value that we know it can deliver to the Canadian economy."
He hinted, however, that there would be additional costs, to be defrayed by the revenue generated by the pipeline itself.
"It creates effectively a toll, a user-pay, to be paid by the oil companies. So the additional investments will be dealt with in that way," Morneau said.
"This is a project that will not have a fiscal impact. When you're making an investment, you're buying an asset, and that is something that goes on the balance sheet. So there is no fiscal hit with this purchase."
Export Development Canada will finance the purchase, which includes the pipeline, pumping stations and rights of way along the route between Edmonton and Vancouver, as well as the marine terminal in Burnaby, B.C., where oil is loaded onto tankers for export.

Morneau said the federal government does not plan to be a long-term owner and is in negotiations with interested investors, including Indigenous communities, pension funds and the Alberta government, which will provide funding for any unexpected costs that arise during construction.
“To investors considering Canada as a place to build big, important, transformative projects like the Trans Mountain expansion, we want you to know that you have a partner in Ottawa,” Morneau said.
“One who not only respects the rule of law, but who understands the challenges you are up against and will work with you to find solutions that work for everyone.”
Alberta Premier Rachel Notley cheered the news on Twitter.
“This is a major step forward for all Canadians. We have met the deadline,” she tweeted. “This project has more certainty than ever before. We won’t stop until the job is done!”
The plan—similar to how Canada financed and managed shares in General Motors and Chrysler in 2009 during the financial crisis—will include a new Crown corporation to manage the project.
The deal brings some certainty to an expansion project that has been on the rocks ever since B.C. went to court in hopes of blocking it, fearing the impact of a spill of diluted bitumen, the raw output from Alberta’s oilsands.
Steve Kean, chairman and chief executive of Kinder Morgan Canada Ltd., said the deal represents the best opportunity to complete the expansion project.
“We’ve agreed to a fair price for our shareholders and we’ve found a way forward for this national interest project,” he told a conference call with financial analysts.
Ottawa has the constitutional authority to build interprovincial projects like pipelines, but B.C. Premier John Horgan has gone to court to get a judge to weigh in on whether B.C.’s jurisdiction for the environment would allow him to regulate what flows through the pipeline.
The ensuing uncertainty, paired with vociferous opposition from environmental groups and some Indigenous communities in B.C., prompted Kinder Morgan to halt investment until the federal government could inject some certainty into the project.
“The previous government spent 10 years pitting the environment and the economy against each other; they pitted us against each other. It polarized us. That is not who we are,” Carr told the news conference.
“The majority of Canadians support this project. The majority of Canadians understand that we are in a transition to a clean-growth century, and we will not get there overnight. But we will get there.”

Ottawa is pressing ahead, firmly of the opinion there is no doubt about its jurisdiction. It is also confident it will prevail in a Federal Court challenge by some Indigenous communities over its approval of the pipeline, a ruling on which is due any day.
A Finance Department official says that as a Crown project in the national interest, Canada has special allowances to proceed that may not be available to a private-sector company.
Canada approved the project in November 2016, following an expanded environmental review process that included additional consultations with Indigenous communities and assessing the amount of additional emissions likely to result from additional production.
Prime Minister Justin Trudeau has long insisted the project is in Canada's national interest and is a pivotal part of the country's economic future.
Canada loses $15 billion every year on the sale of oil because the U.S. remains its only export customer, resulting in a lower price, Trudeau argues. A lack of capacity in pipelines or in rail cars to ship oil produced in Alberta is also hurting Canada's energy sector.

**Kinder Morgan shares rise**

Kinder Morgan Canada Ltd.'s shares traded higher after the announcement.
The shares were up 47 cents or about 3% at $17.06 in early trading on the Toronto Stock Exchange after going as high as $18. The company's stock had been halted prior to the announcement.
The company estimated the deal is worth about $12 per restricted voting share, after capital gains tax. It expects its approximately 30% share of after-tax proceeds to be approximately $1.25 billion.
Kinder Morgan Canada will continue to hold an integrated network of crude tank storage and rail terminals in Alberta. It will also own a terminal in Vancouver and the Cochin Pipeline system, which transports light condensate from the United States to Fort Saskatchewan, Alta.
The company had ceased all non-essential spending on the project until it receives assurances it can proceed without delays, setting a May 31 deadline on getting those guarantees.

## 8. Corporations cautious on Canadian economy: surveys

**[May 28, 2018]** Canadian corporate directors have a cautious outlook on the Canadian economy in the near term.
In a survey commissioned by the Institute of Corporate Directors (ICD), only 34% of survey respondents believe the Canadian economy will improve over the next two to five years. That's down from 52% in a fall 2017 survey.

While uncertainty over NAFTA negotiations may be a contributing factor, concern about Canadian political stability may be even more influential, says ICD in a release.

The proportion of directors who feel NAFTA won't be renegotiated successfully remains steady at 51%, but there was an increase in respondents worried about Canadian political stability, with 34% saying it will worsen in the next two to five years—up nine percentage points in six months. Potential contributing factors influencing this sentiment include interprovincial political and trade disputes and populist challenges to incumbents in upcoming provincial elections.

An EY survey on capital allocation and Canadian competitiveness likewise paints a cautious picture of the Canadian economy. In that survey, 61% of respondents agree that U.S. tax reform will have negative repercussions for the Canadian economy. Further, 51% believe their U.S.-based competitors may now have an edge when it comes to competing for new business.

In contrast, only 24% of respondents to the ICD survey view recent U.S. corporate tax cuts as having a negative impact on their organizations. The survey, quoting a respondent, says, "The reduction in U.S. corporate tax rates is somewhat positive because we are actively eyeing expansion into the U.S."

For EY respondents, concern isn't focused solely on the Trump administration. Executives are equally concerned about recent changes to Canadian tax, regulatory and fiscal policies, with 59% citing their potentially negative impact on Canadian companies and, for 61%, the overall economy.

In a release, Fred O'Riordan, national tax policy leader for EY, says, "The response of the federal government to these concerns, and the speed of that response, will dictate how competitive Canada will remain in the short term, and could have a significant impact on business leaders' decisions to recruit and retain, or even remain in Canada for the long term."

Given that boards approve major capital spending, the drop in economic confidence could have important implications for the Canadian economy in the near- and mid-term, says the ICD survey.

That survey finds that more directors are confident in the global economy, but this number also decreased from fall 2017, to 38% from 43%.

## Other headwinds for business

Rising interest rates are also a top concern for the majority of Canadian directors.

The ICD survey finds that 58% of respondents expect rising rates to have a negative impact on their organizations.

Minimum wage increases were also viewed negatively by 41% of respondents, but more than half felt that the increase would have no impact.

### Trust and workplace culture

An overwhelming majority (90%) of directors in the ICD survey say trust is the defining feature of their organizations' success, and virtually all respondents say their boards influence their organizations to make a positive impact on society (with only 1% disagreeing).

Workplace culture is also a top concern, with three-quarters of respondents either having a process in place for the oversight of workplace culture or having discussed creating a process.

Though 67% of respondents reported their organizations have considered workplace diversity and harassment in the context of organizational strategy, they were less likely to have considered the impact of worker displacement due to technologies such as AI and machine learning. In fact, 54% of those surveyed had not discussed worker displacement as it related to their organizational strategy.

**About the ICD survey:** *ICD commissioned Environics Research to oversee an online survey of its membership, conducted between March 7 and April 4, 2018. A total of 584 responded to the invitation, yielding a response rate of 4.7% overall. A sample of this size produces results that can be considered accurate to within +/-3.8 percentage points, 19 times out of 20.*

**About the EY survey:** *Conducted in spring 2018, the survey gauged the reactions of 165 business leaders on a host of policy developments. The C-suite executives represented companies of different sizes, sectors and Canadian regions.*

## 9. Loonie could drop to nearly US$0.70 if export woes continue: report

**[May 28, 2018]** Canada is falling further behind in the race to supply world markets, and if it doesn't get in the game soon, its dollar could drop to nearly US$0.70 in the next decade, finds a new report from CIBC Capital Markets.

"Since the turn of the millennium, other than in the post-recession bounce-back, Canada has been an also-ran in the race for global and U.S. markets," say CIBC Capital Markets economists Avery Shenfeld and Royce Mendes in the report. "What's been lacking are ribbon-cutting ceremonies at the new facilities—factories, labs and office towers—needed to expand export capacity."

Growth in Canadian exports and industrial capacity has gone missing in all but a few sectors since the late 1990s, leading to the question of whether the country can compete as a location for such facilities today, the report notes.

While there has been much self-congratulation in Canada about a few successes, Canada's share of U.S. goods imports has dropped from nearly 20% at the turn of the millennium to only 13% today, the report finds. In autos,

for example, Canadian assembly plants are producing a million fewer units, with the sector's share of private sector employment tumbling by the equivalent of 100,000 jobs.

Other weaker elements have been a "hodge-podge of manufacturing sectors, which have in many cases seen Canadian activity supplanted in the U.S. market by Mexico or other low-cost competitors," the report states. "Simply put, export volumes have grown at a snail's pace as plants shut their doors in Canada and opened elsewhere."

Meanwhile, some of the same emerging market countries that are challenging Canada in manufacturing are "also banging down the doors in services," where Canada's share of the U.S. import market has eroded more than all other developed economies, the report says.

"If we don't make progress in tilting the playing field back to Canada, there is always the market's invisible hand to do the work for us. A poor current account will, over time, tend to push the Canadian dollar weaker against others," says the report.

It continues: "It would be better if Canada had other advantages to support export growth, rather than rely on a weak loonie that makes us less able to spend abroad. But if that's not forthcoming, the Canadian dollar will bear the burden of adjustment, spurred by a weak current account," dropping its value to US$0.70 in the 2020s.

Potential remedies include targeted support for training and education, particularly in tech-related services, along with a "thinning of the regulatory books, faster government project approvals, lower corporate taxes and improved business infrastructure," the report says.

With Canada now tapping the brakes on debt-financed consumption for financial stability reasons, the country needs exports and related capital spending to help fill the gap, the report adds. "Such a shift to a more balanced economy would also tend to raise productivity, leaving more scope for higher real wages."

## Have a nice and fruitful week!

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