OUTLOOK POSITIVE FOR SMALL BUSINESS BUT CHALLENGES REMAIN: TD ECONOMICS

TORONTO – Canada's economic and financial forecast bodes well for small business owners in 2007/08, but tight labour market conditions will remain a key challenge for many firms, according to a report published today by TD Economics.

TD's Deputy Chief Economist and author of the report, Craig Alexander, states: "The economic backdrop, including solid domestic demand and historically low interest rates, should be generally supportive for small business, particularly those serving local markets. And, while export-oriented firms will face headwinds from U.S. weakness, their fortunes will improve in 2008."

TD Economics expects the Canadian economy to grow by an annual average of 2.4 percent in 2007, and further strengthen to 2.9 percent in 2008. While this year's pace of expansion is sub-par, it is the result of a "poor handoff" created by extremely weak economic performance in the fourth quarter of 2006.

Domestic demand – which encompasses spending and investment by households, businesses and governments – is expected to experience a robust 3.3 percent increase in 2007/08. This is slower, however, than the unsustainable 4.7 percent gain experienced in 2006.

Other positive indicators include the national unemployment rate, which is forecasted to remain at near a 30-year low, and real personal disposable income (i.e. after inflation and after-tax income), which is expected to rise by close to two percent annually during the next two years.

The west will remain the growth leader by a wide margin until manufacturing conditions improve in central Canada. The latter is likely to occur when the U.S. economy is on the mend – expected in late 2007 or early 2008. "The gap between regional economic growth rates will narrow as the U.S. economy firms, commodity prices flatten out and some moderation occurs in the unsustainable pace of the housing boom and personal spending in the west," observed Alexander.

TD Economics anticipates that interest rates will remain close to current levels, which is supportive to businesses. Although economic growth has recently slowed, very little economic slack is being accumulated, implying that the Bank of Canada is likely to leave short-term interest rates unchanged. Similarly, longer-term interest rates also appear range bound, since bond markets have already priced in the near- and mid-term economic conditions that are in store.

On the currency front, the Canadian dollar is forecast to remain in a range of 84 to 89 U.S. cents over the two-year forecast horizon, with a bias to strength late in the period. This is based on two key factors influencing the exchange rate: the difference between U.S. and Canadian short-term interest rates and the direction of commodity prices. Interest rates are not expected to change materially in either country, and the composite TD Commodity Price Index is expected to be relatively flat this year, before rising modestly in 2008.

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Impact on small business

Given the concentration in services-related and domestically focused industries, small businesses will largely benefit from robust domestic demand and will be insulated to the near-term weakness in the export sector.

Specifically, retailers are likely to experience a softer pace of sales, but the high employment rate and growth of personal income will keep Canadians shopping at the malls. The accommodation and food industry will benefit from a healthy domestic economy, but growth in the sector may be tempered by a strong Canadian dollar and the new passport requirements for individuals crossing the U.S./Canada border, which will take effect for ground travel in 2008, both of which may constrain tourism.

A decline in housing starts and a cooling in the resale market will impact the construction and real estate industries, but both will still produce solid results. Moreover, resale prices are still expected to climb at a national average rate of approximately five percent, illustrating the prospects for continued strong demand for real estate services.

Wholesalers and manufacturers will be greatly affected by their exposure to international trade, with importers faring well and exporters experiencing challenges. For example, many small businesses are related to forestry, which is being hard hit by the on-going housing correction in the United States. There are other considerations as well. Small and medium-sized businesses related to the auto industry and with strong ties to the North American Big Three assemblers will likely continue to face challenging times due to on-going restructuring in the industry.

Tight labour markets

Small businesses will continue to be challenged by tight labour market conditions. The national unemployment rate will stay at close to a 30-year low over the forecast horizon and this is likely to put upward pressure on wages. The situation will be most acute in western Canada. The unemployment rate in Alberta will remain below four percent, while it is projected to stay below five percent in British Columbia. However, this is not just a western story. For example, unemployment in Ontario is forecast to peak at less than seven percent in 2007, which is still quite low by historical standards.

"This is not to diminish the labour market difficulties in some sectors, like manufacturing, but for many other industries the greatest hurdle in recent years has been finding adequate staff with the necessary skills, and this appears likely to continue," said Mr. Alexander.

Other challenges include high input costs and increasing competition from both domestic and foreign competitors. The good news is that the upside to material and energy costs is likely limited from current levels, but the bad news is that they are unlikely to decline significantly over the forecast horizon. Competition will remain fierce, and that means businesses will need to be nimble and adaptive. Mr. Alexander goes on to say small businesses should consider increasing their investments in productivity-enhancing machinery and equipment to help on this front, given that the Canadian dollar's strength has reduce the cost of imported capital.

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Moreover, the 2007 Federal Budget allows manufacturers to write-off their investment in machinery and equipment faster, which lowers the cost of capital purchases for small businesses in this sector, plus all firms are allowed to write-off computers more quickly.

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For full details of the forecast, please refer to “Economic Outlook Remains Supportive to Small Business in Canada” available at www.td.com/economics.

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