Focus on Small Business

INSIGHTS AND INFORMATION FROM TD CANADA TRUST SMALL BUSINESS BANKING

Once credit conditions begin to improve, markets should turn their attention back to economic fundamentals.

# Forecasting in uncertain times

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The global financial system has recently suffered a severe and virtually unprecedented blow. Over the next 12 months, four factors need to fall into place to provide the foundation for an economic recovery in 2010:

1. Home prices must hit bottom.
2. The cost of funds to financial institutions must fall.
3. The worst in corporate failures will need to be in the rearview mirror.
4. The process of recapitalizing the financial system must be well under way.

Even under these assumptions, we don't expect a return to the status quo. While the financial constraints on the economy will gradually abate, financing costs will probably remain higher than the low levels that prevailed earlier in the decade. In addition, the improved balance sheets of financial firms will mean credit will be tighter.

**Go big or go home.** After a lengthy period of financial difficulty, there's always the risk that credit availability will dry up, with consumers and businesses paying the ultimate price. So far, the Federal Reserve and the U.S. government have taken aggressive action to mitigate that risk. However, financial and fiscal stimulus measures aren't a magic wand that will make the problems go away instantly. The U.S. economy is still on course for the recession that began in 2008 to spill into 2009, before a modest recovery can take hold in 2010.

**We're in this together.** The U.S., by far Canada's largest trading partner, accounts for three-quarters of all Canadian trade. Combine that relationship with the slump in commodity prices and it is clear that the Canadian economy will continue to be rocked by association.

As well, domestic headwinds are blowing: Canadian real estate prices are coming off the boil, and the painful adjustments in our manufacturing sector are not yet completed. All of this suggests that the Canadian economy will also be in a recession in late 2008 and early 2009, before a meaningful recovery materializes in 2010.

In response, the Bank of Canada is likely to keep interest rates low throughout 2009. However, once a sustained recovery becomes apparent, it will be quick to raise rates in 2010 from historic lows. On the dollar front, as long as financial markets are in "crisis mode," the Canadian dollar will remain a slave to global developments, which could result in further near-term softness. But, once credit conditions begin to improve, markets should turn their attention back toward economic fundamentals, which would be positive for the Canadian dollar. Canada came into this crisis on a much more solid footing than the U.S., and should be able to pull out much faster.



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