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THE EFFECT OF EUROPEAN DEBT CRISIS ON CANADIAN BUSINESS

This article was written by Tina Tehranchian and was originally published in the June 2012 issue of The Canadian Business Journal and has been reprinted with permission.

We live in an interconnected world where a financial crisis spreads like wild fire and markets in different continents move up and down in tandem. So it is no surprise that the European debt crisis is causing anxiety thousands of kilometers away from its source on this side of the ocean in North America.

In January 2012, the Bank of Canada for the first time attempted to put a hard number to the effect of the European debt crisis on Canada. According to the bank's estimates, the loss to economic output this year could amount to 0.6 per cent, or about $10 billion.

The Bank estimates that the costs to the global and American economies are even greater, at more than one per cent of gross domestic product and 0.8 per cent respectively.

In its winter quarterly outlook, the Bank of Canada policy council, headed by governor Mark Carney, stated that "Thus far, the impact on global financial conditions from the strains in Europe has consisted mostly of a general retrenchment from risk taking...Over the projection period, the impact is expected

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"Bank of Canada has predicted that the economic impact of the European debt crisis will limit economic growth in Canada in 2012 to a modest pace."

to become more widespread, however, and to take the form of increased funding pressures, adverse confidence effects and reduced availability of credit. In particular, deteriorating funding conditions are projected to push banks to restrict access to credit for households and businesses in Europe and the United States, adding to the drag on economic growth."

On the positive side, because Canadian banks have had much less exposure to European banks and sovereign debt and are financially sound and have healthy lending practices, Canada has been affected less by the European debt crisis than the US and the rest of the world in general.

However, Canada can still be affected through lower consumer and business confidence and lower commodity prices. Given the fact that commodities are one of the main sources of export for Canada and a major component of the Canadian market, lower commodity prices can have a ripple effect on many parts of the Canadian economy.

Bank of Canada has predicted that the economic impact of the European debt crisis will limit economic growth in Canada in 2012 to a modest pace and the economy is unlikely to return to full capacity until the third quarter of 2013.

Interest rates have stayed low in Canada mainly due to worries about the negative impact that the European debt crisis could have on the Canadian economy. This low interest rate policy is encouraging more Canadians to take on greater debt, particularly to purchase homes and this has been a cause of worry for the governor of Bank of Canada as well as the Minister of Finance.

However, there is an upside to the sky-high household debt levels feared by the central bankers. It is largely due to the strong demand from consumers continuing to purchase everything from clothes to cars and homes that the economy is not doing worse than it is now. Housing and consumption account for 70 per cent of this year's growth. The low mortgage interest rates and favourable mortgage financing conditions bode well for the housing market and it is likely that the momentum will continue in terms of investment in residential properties. Given the fact that the housing market supports so many industries, a strong housing market bodes well for the economy as a whole.

With double dip recession in Europe and deceleration of growth in China and the dampening effects of the European debt crisis on world economic growth, the demand for commodities has decreased and the prices of most commodities have suffered declines in the past few months. This has also caused the Canadian dollar to weaken (even though it is still relatively strong) as its fortunes are closely correlated to the price of energy in particular. A weak Canadian dollar can be a boon for Canadian exports and can partially offset the effect of the decline in the price of commodities. Also, lower energy prices will cause transportation costs to drop and profitability of companies to improve and can help stimulate the U.S. economy. This in turn will help boost the Canadian economy and help offset some of the lost profits in the energy sector in Canada.

Despite the debt worries in Europe, recent economic numbers out of the US have been encouraging. According to the Globe and Mail (Friday May 11, 2012, pageB5), “real or after-inflation imports surged nearly 6 per cent in the United States in March. And imports of consumer goods were even better – up 8 per cent. US consumers who make up 70 per cent of the economy, are clearly feeling more confident.” Also, according to the latest economic forecast released by the Federal Reserve Board in the U.S. in April, GDP growth rate expectations have been increased to 2.4% to 2.9% range, which paints a rosier picture compared to the figures released in January 2012.

This is good news for Canada as 70 percent of our exports are to the United States. The fact that the world’s largest economy is healthy bodes well for the global economy as a whole.

Another encouraging sign in Canada is that over the first three months of 2012, imports of machinery and equipment increased at an annual rate of 3.4 per cent, suggesting businesses are taking advantage of the high dollar to retool their plants and invest in technology.

Another testament to the strength of the Canadian economy is the fact that over 58,000 jobs were created in April, far exceeding the forecast of 10,000 jobs and following the stunning 82,000 jobs that were created in March. With most of these jobs being full time jobs, this represented the best two month gain in job numbers in three decades. The jobs created were mostly in the construction, manufacturing, natural resources and agriculture industries. A surge in activity in the mining and energy sectors has caused a boost in the recruitment efforts of many companies in Western Canada. In addition, some factories in Central Canada are ramping up production as demand increases in the U.S.

Therefore, while worry about European debt woes will rule the markets in 2012, and recession in Europe can have a dampening effect on world economic growth, the current strengthening trend in the U.S. economy bodes well for Canada as the bulk of our exports are to the U.S.

The strong housing market in Canada and healthy levels of consumer spending are keeping the Canadian economy buoyant for the time being.

What may be more worrisome than the European debt crisis is the “fiscal cliff” in the U.S. This refers to the fact that an estimated half a trillion dollars worth of stimulus to the U.S. economy in the form of tax cuts and government spending is scheduled to disappear at the end of 2012.

While this may seem like a U.S. problem, the fact of the matter is that the Canadian and U.S. economies are so intertwined that this will inevitably have an impact on Canada.

Some of the programs set to expire toward the end of this year include: The Bush-era tax cuts; the 2 per cent payroll tax holiday; extended unemployment compensation; and the end of temporary spending and tax cuts agreed to last year as part of the deal to raise the U.S. debt ceiling.

It is estimated that the withdrawal of all these stimulative measures can drain $500 billion or 3.5% of gross domestic product (GDP) out of the U.S. economy, causing growth to come to a standstill and possibly push the U.S. into recession.

“Despite the debt worries in Europe, recent economic numbers out of the US have been encouraging.”

The International Monetary Fund (IMF) has compared the threat posed by the fiscal cliff to the European debt crisis and even the Bank of Canada has factored it into its projections. A slowdown in the economy of our major trading partner can cause the volume of our exports to shrink.

With the help of politicians in Washington, crisis can be averted by deferring at least some of the cuts. However, it is an election year in the U.S. and congress can easily get logjammed with Democrats insisting on raising taxes on the rich and the Republicans intent on cutting social programs.

The fate of the European Union and resolution of the European debt crisis also lies in the hands of the politicians. As with most political solutions, patience is key as things take much longer to come to fruition in the political arena than they do in the business arena. With new leaders at the helm in France and Greece, there is even more uncertainty about the future in Europe.

For the time being, despite the worrisome situation in Europe, the economic recovery in the U.S. and Canada seems to be intact and even though it is not robust it is on track.

SMART TIPS FOR WHAT TO DO WITH YOUR TAX REFUND

By now, you should have received your notice of assessment from the Canada Revenue Agency (CRA) and possibly a tax refund cheque accompanying it as well.

Here are a few tips for you to make the best use of your tax refund:

1. **Pay down your high interest debt.** This is usually credit card debt that you may have accumulated as a result of your personal purchases. The interest rate on this kind of date is usually quite high (currently most major credit cards charge 19.99% per year). In addition, because you incurred the debt for personal consumption and not for investment purposes you would not be able to write off the interest and save on your taxes. Therefore, targeting this debt and paying it down would be the best strategy. By doing so you will generate a guaranteed after-tax rate of return which would be the equivalent of the interest rate you pay on your debt. In the current low interest rate environment no other investment return can rival this.

2. **Get a head start on your RRSP contributions.** You don't need to wait until February of 2013 to make your 2012 RRSP contribution. The sooner you save and invest the money the longer you will have it tax sheltered and hopefully if you buy at a weak point in the markets, you can also benefit from the potential capital appreciation. Using your tax refund to contribute to your RRSP will also help save taxes and meet your retirement goals.

3. **Make a contribution to your TFSA**. You can contribute up to $5000 each year to your TFSA account. This money will be invested on a tax-free basis and you can withdraw it at any time without tax. The TFSA is a very tax effective savings vehicle and you can use your tax refund to take advantage of the contribution room you have available. Of course, you should consult your financial advisor to see if it makes sense for you to contribute to your RRSP or TFSA or both when it comes to your particular circumstances.

4. **Contribute to an RESP.** The cost of higher education has been steadily increasing over the past decade so using your tax refund to save for the post-secondary education of your child or grandchild is a prudent strategy. Each year, you can get a 20% matching Canada Education Savings Grant (CESG) on $2500 of your contributions to your RESP. This can go a long any in helping with the exorbitant cost of higher education of your offspring in the future.

5. **Invest in a universal life insurance policy.** Life insurance can help provide protection for your loved ones and pay down debt in the event of your premature death and minimize the taxes on your estate. However, universal life insurance policies also allow you to save money inside the policy that will grow on a tax sheltered basis and can be accessed at retirement or should an emergency arise. If you already have a universal life policy you can use your tax refund to make a lump sum deposit to your policy. If you do not have one then you can use your tax refund to purchase a policy.

6. **Lend the money to your lower-income spouse.** This is a great time to implement an income splitting strategy by lending money to your lower-income spouse. The reason is that you can charge the prescribed rate of interest on the loan. This rate is currently only 1% and you can lock it in indefinitely. By doing this your spouse can invest the money and all the income earned on the investments will be taxable in his/her hands and hence taxed at a lower rate.

7. **Invest your tax refund in an In Trust Account.** If you have maximized your RRSP, TFSA and RESP contributions, then you can consider investing your tax refund in a non-registered account in trust for your children to help supplement the cost of their education or help them get started in their career or buy their first home. The advantage of setting up an in trust account is that any capital gains accrued on the investments in this type of account will be taxable in the hands of the beneficiaries of the trust. Since your children will most likely be in a lower tax bracket than you when they start withdrawing money from this account in their youth, you can ensure that the capital gains are taxed at the lowest possible tax rate.

8. **Make a charitable donation**. By using all or part of your tax refund to make a donation to a charity of your choice, you will not only generate more tax savings, but will also help a good cause.

Of course, most people like the option of spending their tax refund the best. This would be fine if you have no high interest debt and have adequate funds set aside for your retirement and education of your children.

While most people are thrilled to receive a tax refund in reality it is your own money that was held by the CRA with no interest and is now being returned to you. So if your tax refund was sizeable it is a warning sign that you need to do better tax planning in the future to make sure more of your money stays in your own hands throughout the year so you can make it work for you.

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FASHION AS ART:EXPOSED! FUNDRAISER FOR THE MCMICHAEL – A TREMENDOUS SUCCESS

Lucian Matis, Comrags' Joyce Gunhouse and Judy Cornish, D'Arcy Moses, Thien Le, Jeanne Beker, Joeffer Caoc, Greta Constantine's Kirk Pickersgill and Stephen Wong, David Dixon

Photograph by George Pimentel.

I had the honour of chairing the organizing event committee for a unique and exciting fundraiser, Fashion as Art: EXPOSED!, in support of the McMichael Canadian Art Collection, that took place on Saturday June 16, 2012. This inaugural fundraising event was held on the grounds of the McMichael in Kleinburg and was attended by over 400 guests. The event was hosted by noted fashion personality Jeanne Beker and was considered by many who attended to be one of the most unique, inventive, lively, and memorable events they have attended.

In collaboration with the Fashion Design Council of Canada, this event celebrated Canada's Group of Seven Fashion Designers and provided a spectacular backdrop to showcase their designs which were specifically created for the evening. Canada is home to some of the most exciting and cutting-edge designers. The seven designers are Joeffer Caoc, Comrags, Greta Constantine, David Dixon, Thien Le, Lucian Matis, and D'Arcy Moses.

Fashion as Art: EXPOSED! was a spectacular success and exceeded our expectations for a first-year event. We were thrilled with the overwhelming support from our guests and sponsors. The beautiful facilities and grounds at the McMichael served as the perfect setting for a celebration of creativity and innovation in Canadian art and fashion.

Fashion as Art: EXPOSED! is the culmination of a bold idea for the McMichael. Along with the concurrent exhibition, Fashionality: Dress and Identity in Contemporary Canadian Art, the McMichael is reaching beyond its familiar audiences to showcase the treasure that exists right here in our community; a treasure that opens up an array of possibilities to excite, entertain, energize, and inform.

The funds raised from this event will be used to advance the future of Canadian art through interactive educational programming and provocative exhibitions at the McMichael Canadian Art Collection.

Bekky Beker, Jeanne Beker, Diana Hamilton (trustee of McMichael), Tina Tehranchian (Gala Chair and Trustee of McMichael), Victoria Dickenson (CEO of McMichael), Diane Wilson (Trustee of McMichael) and Katerina Atanassova (curator of the McMichael)

Photograph by George Pimentel.

We are grateful for the generous support of our sponsors and guests and their contribution to the McMichael's important role in Canadian art and culture.

ABOUT THE EDITOR

Tina Tehranchian MA, CFP, CLU, CHFC, is a branch manager and financial advisor with Assante Capital Management Ltd. Assante Wealth Management is one of Canada's largest wealth management companies, offering integrated financial solutions to create wealth and prosperity for you and your family. Our 800 advisors in 300 offices across Canada take pride in the exceptional service they offer to clients through trusted face-to-face relationships and a level of service excellence second to none. Money Matters is published as a special service for clients of Tina Tehranchian.

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