HEALTH OF THE NORTH AMERICAN ECONOMY

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Our performance here in Canada depends crucially on what is going on in the world – 40 percent of what we produce goes abroad, and about three-quarters of that is going to the United States. We are a price-taker in the world, so that doesn't bode all that well.

If one takes what Marty says and tries to put it out in the world, it probably means we are facing a world where economic growth is in the order of two percent for at least the next couple of years. That is not a great outlook for this country. It probably means that, at least for the next couple of years, we are going to have resource prices at the bottom of the cycle, which doesn't do a lot for the cash flow of Canadian firms or indeed for the government's take in terms of revenue. So, world conditions are not great.

In spite of that, where do we stand at the moment? We have had this big reversal of the gains in terms of trade that we had. We had a well over 30 percent improvement in terms of trade between 2002 and 2007. We have given back a little more than half of that so far this year. Profitability is down. Employment is still very high, but will come down.

Of course, we do have automatic things that work to help that. The exchange rate has fallen back from close to a dollar at this time last year to about 80 cents U.S. And that is a natural equilibrator in the economy. It works in the right direction. Unlike the United States, our banks are in a position where they do continue to lend. Indeed, if you look at the numbers from the last quarter or so, bank lending to households continues to grow at an average rate of about ten to twelve percent, so it is quite a different situation than that we see south of the border in that regard.

The Canadian mortgage market continues to function. It is structured really quite differently than the U.S. mortgage market. And while house prices have come down and will come down a bit further, the risk that that poses to the financial system in this country is actually relatively low.

The automatic stabilizing elements in the system are there. Nevertheless, of course, we can't escape the fact that the world will not be such a nice place for the next couple of years.

What are the policy issues involved? Let me deal with the short-term first. In terms of fiscal management, governments will go into deficit automatically. Indeed, the structure of revenues is such that revenues will fall away quite sharply, both in terms of corporate income tax receipts and in terms of personal income tax receipts that depended on capital gains. Those will fall away quite sharply, automatically and
appropriately, and that will push governments into deficit. That is not the end of the world by any matter of means, since we have done an awful lot to improve the both federal and provincial fiscal positions over the last decade.

Monetary policy – rates have been brought down. But the one thing that is a little different here than in the United States, and in a way it is exactly the same issue we see here with Mexico, is that as the exchange rate depreciates, of course, all of the fall in oil and gas prices, the fall in food prices, and so on, is not reflected back to the consumer, so that the pressures from the exchange rate movement are to prevent, if you will, deflation on the consumer price side.

Monetary policy will ease. The Governor has indicated in his speech in London earlier this week that probably there will be further easing. Nevertheless, the extreme easing that one might think of elsewhere is probably not possible if indeed what you are trying to do is just to stabilize the consumer price inflation at two percent.

Finally, for us what is so extraordinarily important is that we have appropriate international cooperation to work our way through this. This is not just fiscal stimulus on the part of those nations or groups of nations that have room to move and should have moved to correct some of the imbalances that Paul talked about in his opening statement, but it is incredibly important that we have international cooperation on the trade side. If indeed everybody becomes defensive on the trade side to protect domestic employment, then we have a real global disaster on our hands. What I think is just extraordinarily important for our government, indeed for every government, is that they push very hard on the trade negotiators to get out of the nits and nats and get on with getting an agreement so that we don't have the problems we had after 1930 with a total breakdown of world trade.

Let me just talk about one more issue, and that is discretionary fiscal policy. There is room for discretionary increases in spending, but it is really very important that that spending be effective. We have, in this country, both at the provincial and federal level, quite a large need for infrastructure replacement. We have been rather neglectful, now over the past 15 years or so, on the infrastructure side, so there really is an opportunity here. The problem is that certainly our construction markets are still really quite heated, and we have got to get costs down in that area, so we need some pressure to come off construction. Once that comes off, then the real difficulty with infrastructure investment is that it is spread out over four or five years, and it could well be that the maximum impact is coming just at the time that the economy is in recovery.

This is a very nice, in the dictionary sense of the word “nice,” problem for governments here as to whether in fact they do some needed and necessary spending on infrastructure, recognizing that there are lags that would take hold and that, indeed, the potential is that the maximum impact will be coming just at the wrong time. That is a very tricky decision, and one which federal and provincial governments are going to have to make over the next little while.
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