<u>Canada's Limited Solutions to its Slow-Growth Recovery</u>

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Canada is mired in a slow-growth recovery because the United States and Europe are still repairing their economies in the wake of enormous financial crises. As I argue in a recently released paper from the C.D. Howe Institute, as long as the global economy remains fragile, Canada will not return to growth rates anywhere near our pre-crisis standard of 3 per cent.

Much research shows that financial crises are special economic events. The periods before crises are characterized by widespread optimism and the accumulation of debt incurred to purchase financial and other assets whose prices are expected to continue rising. After the crisis begins with a vicious circle of panic and collapsing asset prices, what typically follows is a drawn-out period in which firms, households and especially banks hunker down, repair their balance sheets, and search in vain for reasons to be confident about the future.

Given this context, what can be done to stimulate growth in Canada?

At this point, the Bank of Canada has little ability to help. Given the large amount of uncertainty now faced by Canadian firms, further reductions in the Bank's policy interest rate are unlikely to be effective in stimulating aggregate demand. Most firms aren't suffering from a lack of access to credit; their main problem is insufficient demand for their products.

Not only is further monetary stimulus unlikely to be useful, the ongoing problems associated with "low-for-long" interest rates cannot be dismissed. There is a real danger that ultra-low interest rates are now fuelling the same precarious asset buildup that culminated in the 2008 collapse. Before long, the Bank might even feel the need to increase its policy interest rate. But even if it doesn't, monetary policy is unlikely to be a source of near-term growth.

Canadian governments certainly have more fiscal room than their counterparts in other developed countries, but the case for significant fiscal stimulus is weak, for two reasons. One is that discretionary fiscal policy is most effective when trying to offset a large and sudden collapse of aggregate demand; it is less effective in nudging along an economy that is no longer in freefall. A second is the longer-term budgetary challenges our governments will face over the next few decades as a result of population aging. Add these reasons to the existing political commitments and we have no reason to expect fiscal policy to be adding to growth in the next few years.

Any pickup in the Canadian recovery must therefore rely on private demand. But things don't look so promising here, either. Given the high levels of household debt, consumption is an improbable source of near-term growth. An investment revival will require a significant return of corporate confidence, and a revival of Canadian exports will depend on a strong and sustained foreign recovery – neither of which appears clearly on the horizon.

My first conclusion is therefore that Canadian policy makers should accept the continuation of Canada's slow-growth recovery for the next few years. But accepting this reality does not mean they should do nothing.

Some people don't see a serious problem with an economy growing at 2.1 per cent annually (the average rate for the past four years). But there is a genuine dark side to this kind of slow growth, not visible in the overall unemployment rate. More than 20 per cent of part-time workers are looking in vain for a full-time job. The average length of an unemployment spell is now 21 weeks. One in five unemployed workers has been jobless for 27 weeks or more, and 7 per cent have been unemployed for over a year. The youth unemployment rate is now 14 per cent. Perhaps most disturbing is that not one of these indicators is declining back toward its pre-crisis level. And they probably won't until the growth rate increases and the labour market tightens.

My second conclusion is that our policy makers should think carefully about the kinds of labour market policies that could be used to help these unfortunate Canadians. Changes in income assistance to the unemployed, policies to improve the mobility of labour between sectors and regions, and greater incentives for labour market training are all possibilities. There are probably others. But Canadian governments should be mindful of the reasons for our slow-growth recovery – as well as the associated burdens.

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