

Slow Growth Ahead?

Economic Policy in the Wake of the Financial Crisis

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ECONOMIC
**THRILL
RIDE!**

2008!

THE
THRILL
IS
GONE.



2013

2012

2011

2010

2009

T.S.

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SHOULD HAVE TAKEN
YOUR CORPORATE JET.

9-3-13

13
148

Outline

1. The Components of Growth
2. Standard Macro Policies Are At Their Limits
3. A Timely Rebound of Private Demand?
4. The Burden of a Slow-Growth Recovery
5. A Hint of A Policy Agenda

Growth Components

$$Y = C + I + G + (X - IM)$$



2.9%



3.5



5.7



2.1



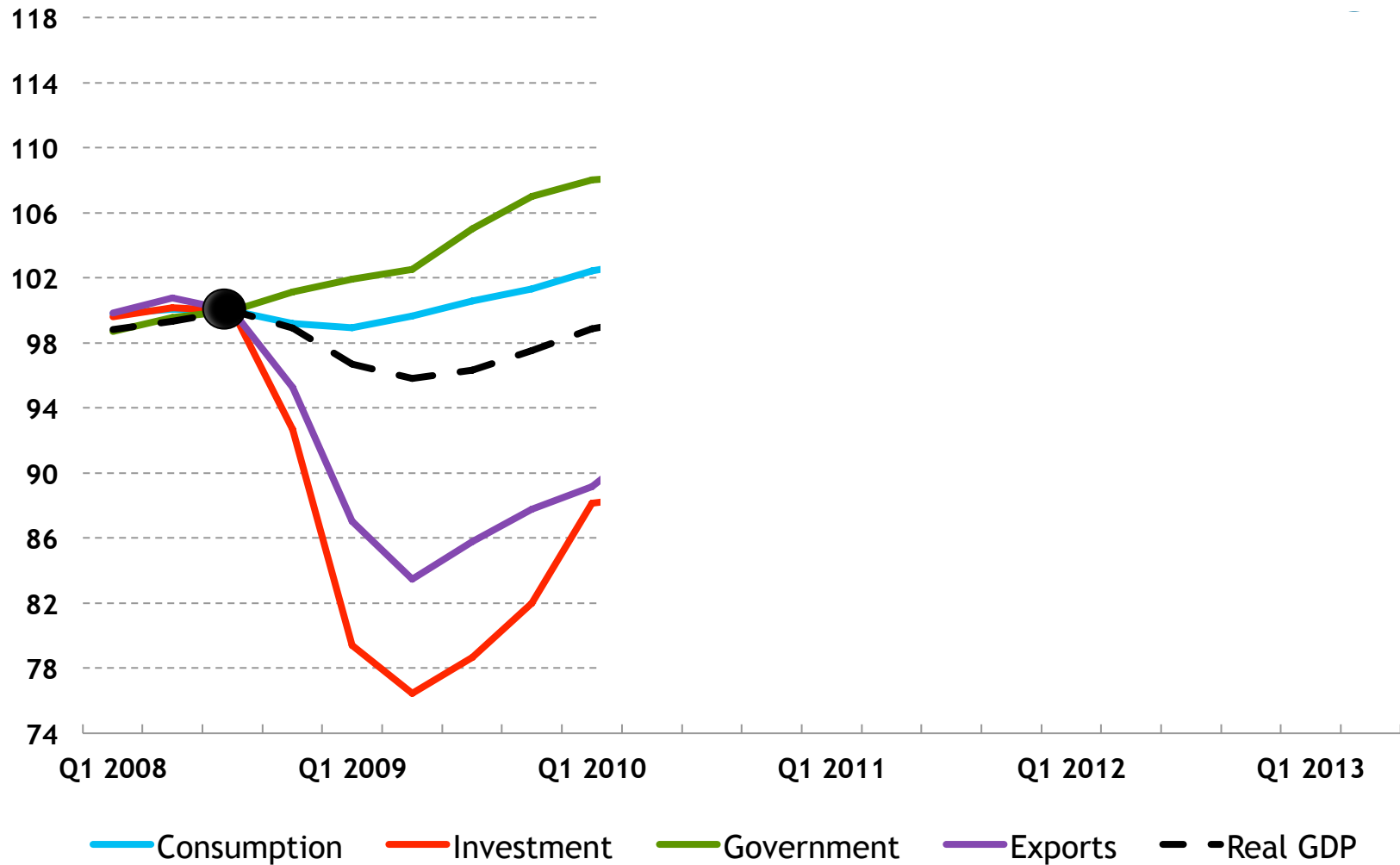
3.5



5.5

(Based on data from 1995:Q1 - 2007:Q4)

Canada's Recession and Recovery



More Fiscal Stimulus?

Jim Flaherty's challenges:

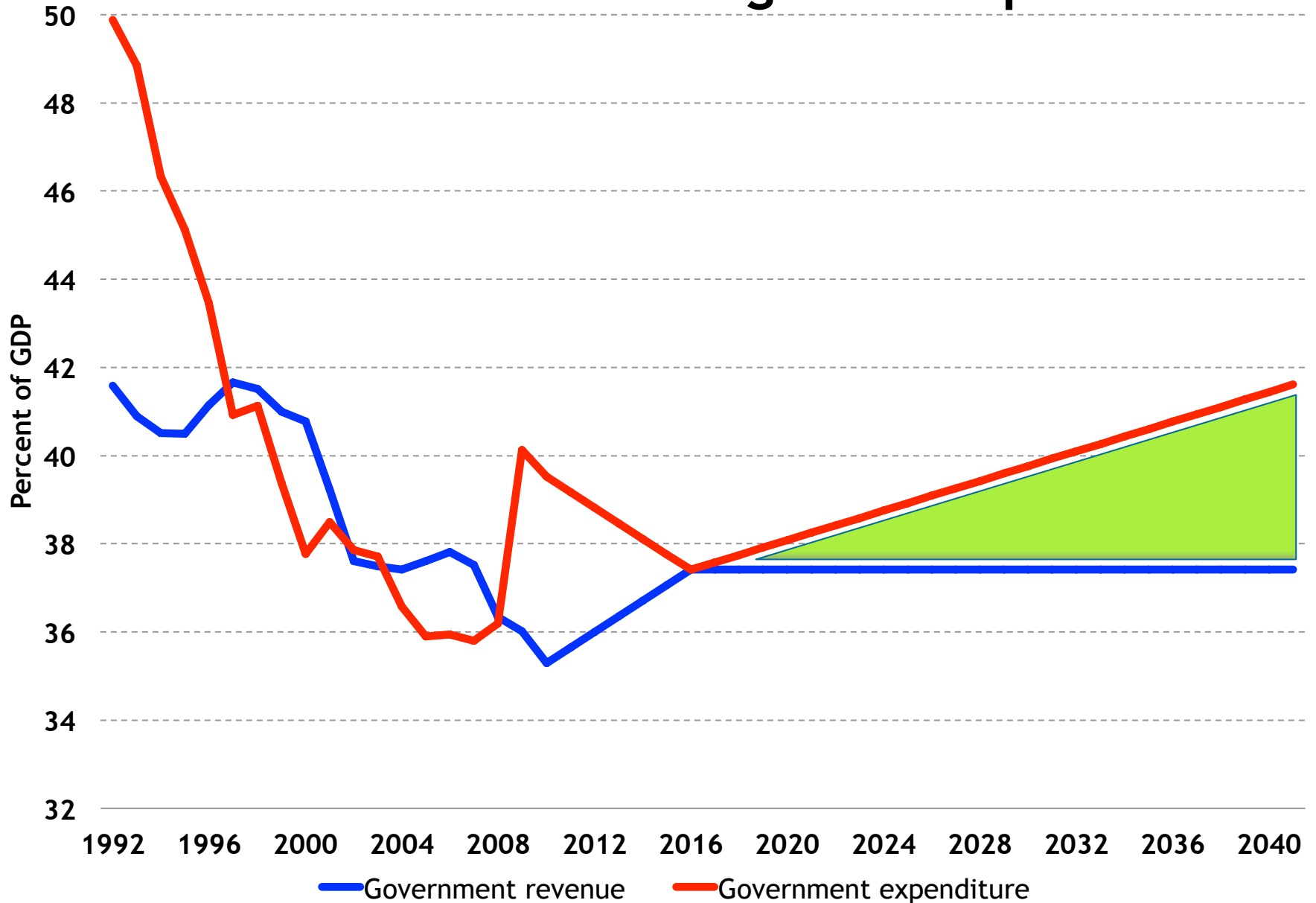
- Until October 2015
- 2016 and beyond



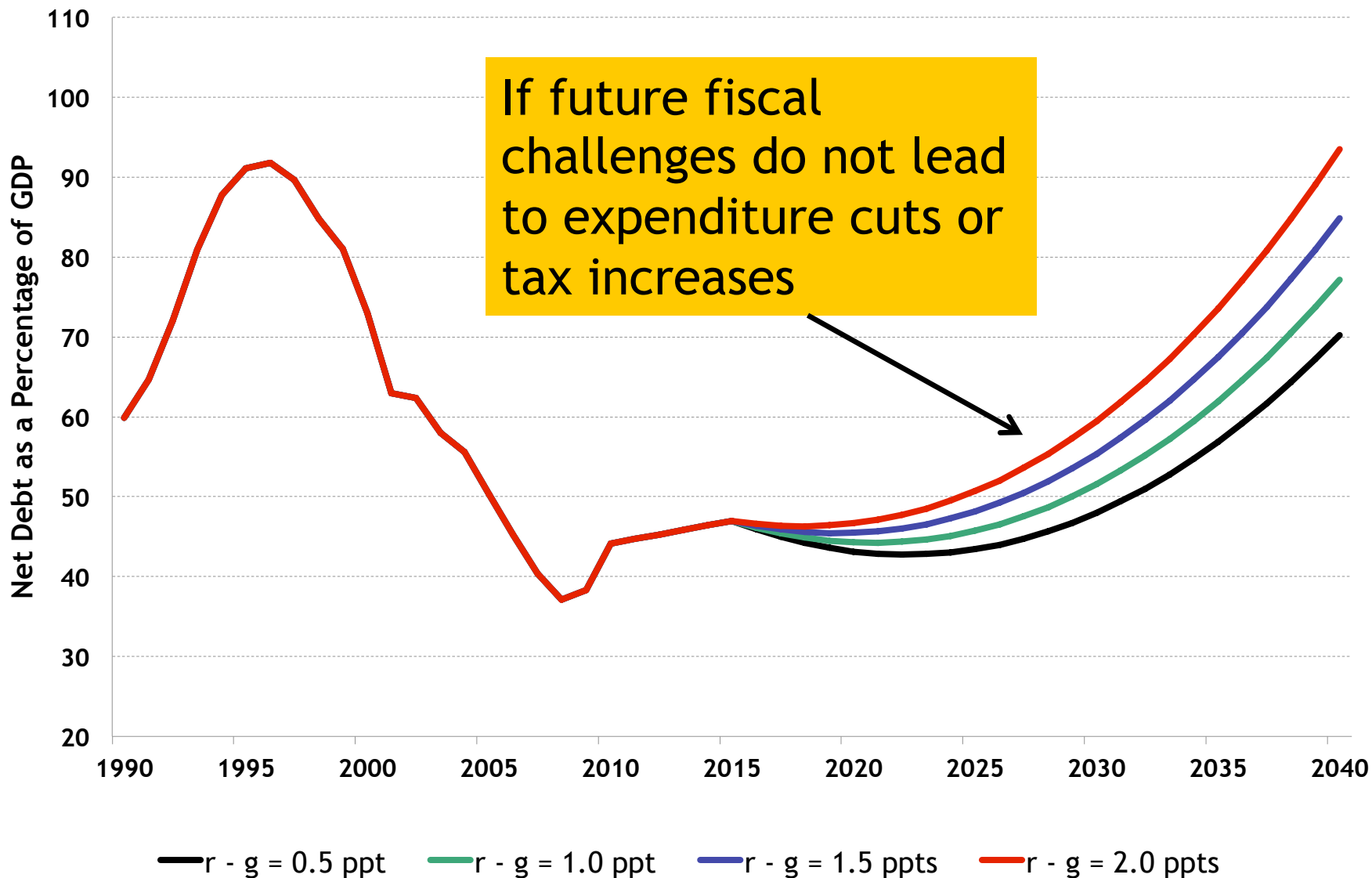
Not Much Room for More Fiscal Policy

1. Political imperative of returning to a balanced budget
 - even at ~ 50%, Canada's debt ratio will be far better than most countries!
 - so why not do more?
2. Difficulties of discretionary fiscal policy
 - better to focus on LR issues

3. Canada's Looming Fiscal Squeeze



Total Government Net Debt-to-GDP Ratio (1990-2040)



More Monetary Stimulus?



How much more can Steve Poloz really do?

→ “stability and patience”

Monetary Policy is At Its Limit

Two reasons to expect nothing more:

i) MP now like pushing on a string?

- “uncertainty” vs. “access to capital”

ii) problems with “ultra-low” interest rates

- financial stability

- household debt, housing prices?

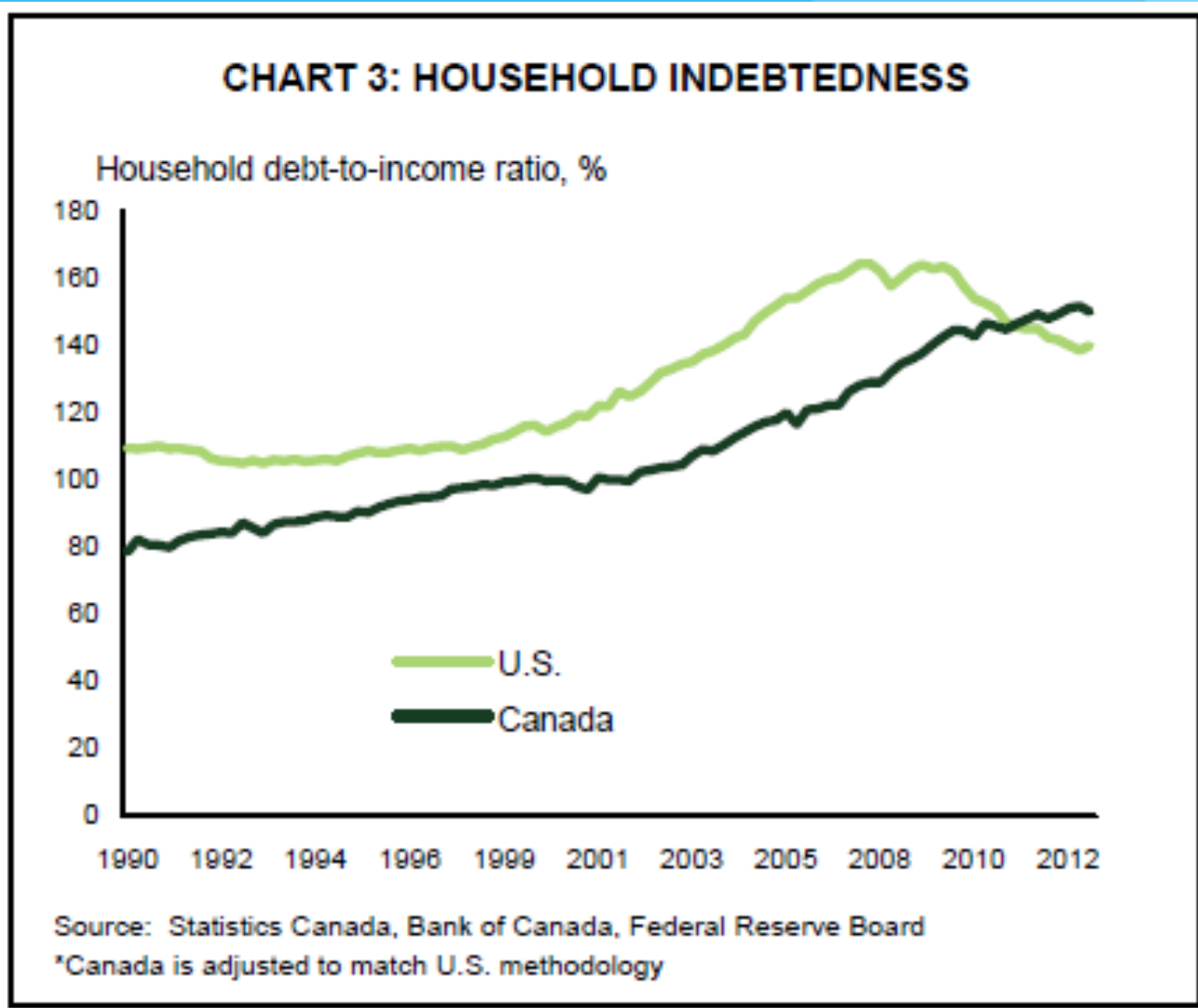
A Timely Rebound of Private Demand?

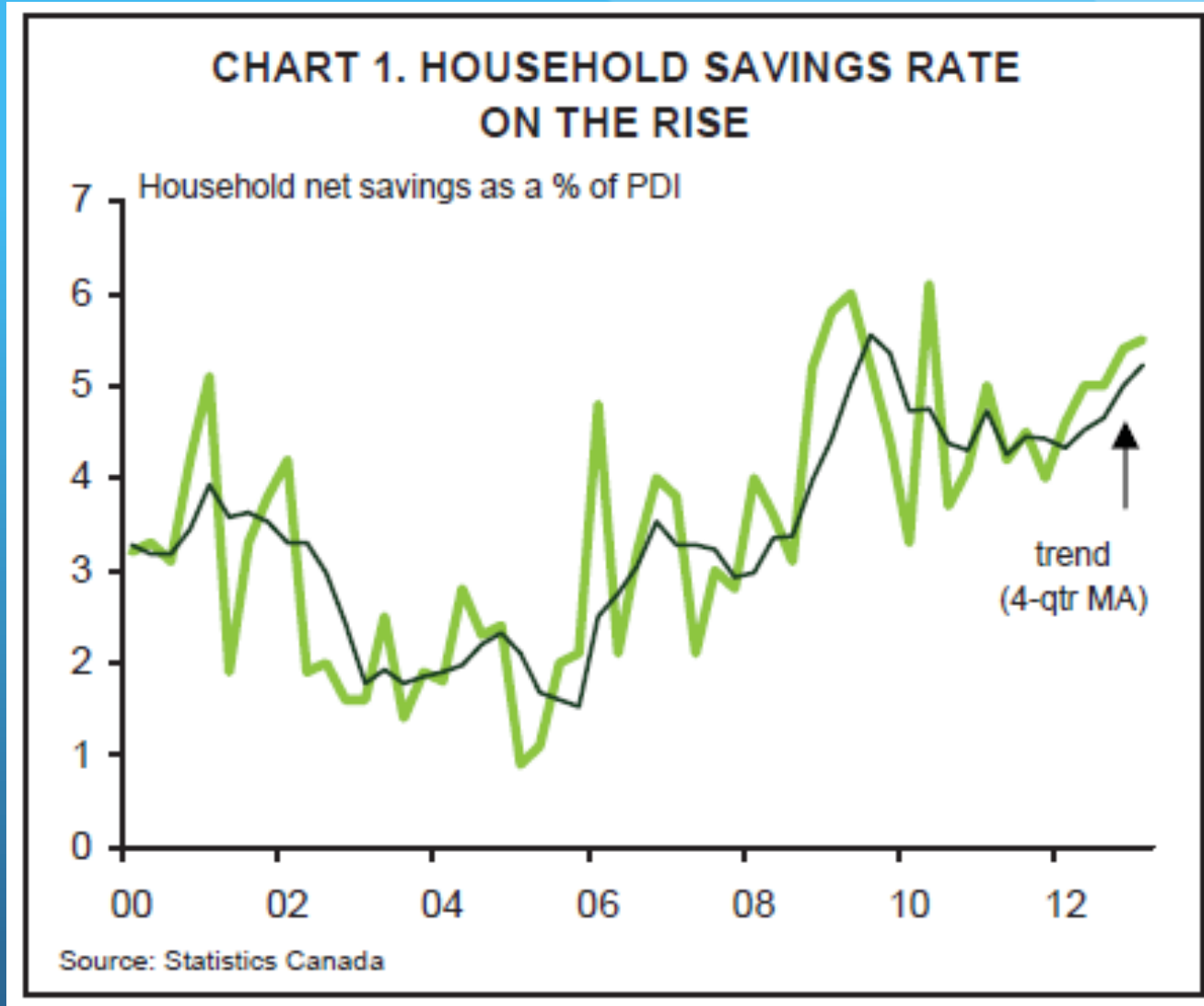
Table 1: Actual and Forecast Annual Growth Rates of Real GDP

Region	2011	2012	2013 (forecast)	2014 (forecast)
United States	1.8	2.2	1.7	2.7
Euro Zone	1.5	-0.6	-0.6	0.9
United Kingdom	1.0	0.3	0.9	1.5
Japan	-0.6	1.9	2.0	1.2
Developing Asia	7.8	6.5	6.9	7.0
Canada	2.5	1.7	1.7	2.2

Source: IMF, *World Economic Outlook Update*, July 2013.

What to Expect from C?





→ C won't be a "driver" of faster growth

A “Rotation” Toward I and X?

Meet the obstacles:



Carmen Reinhart

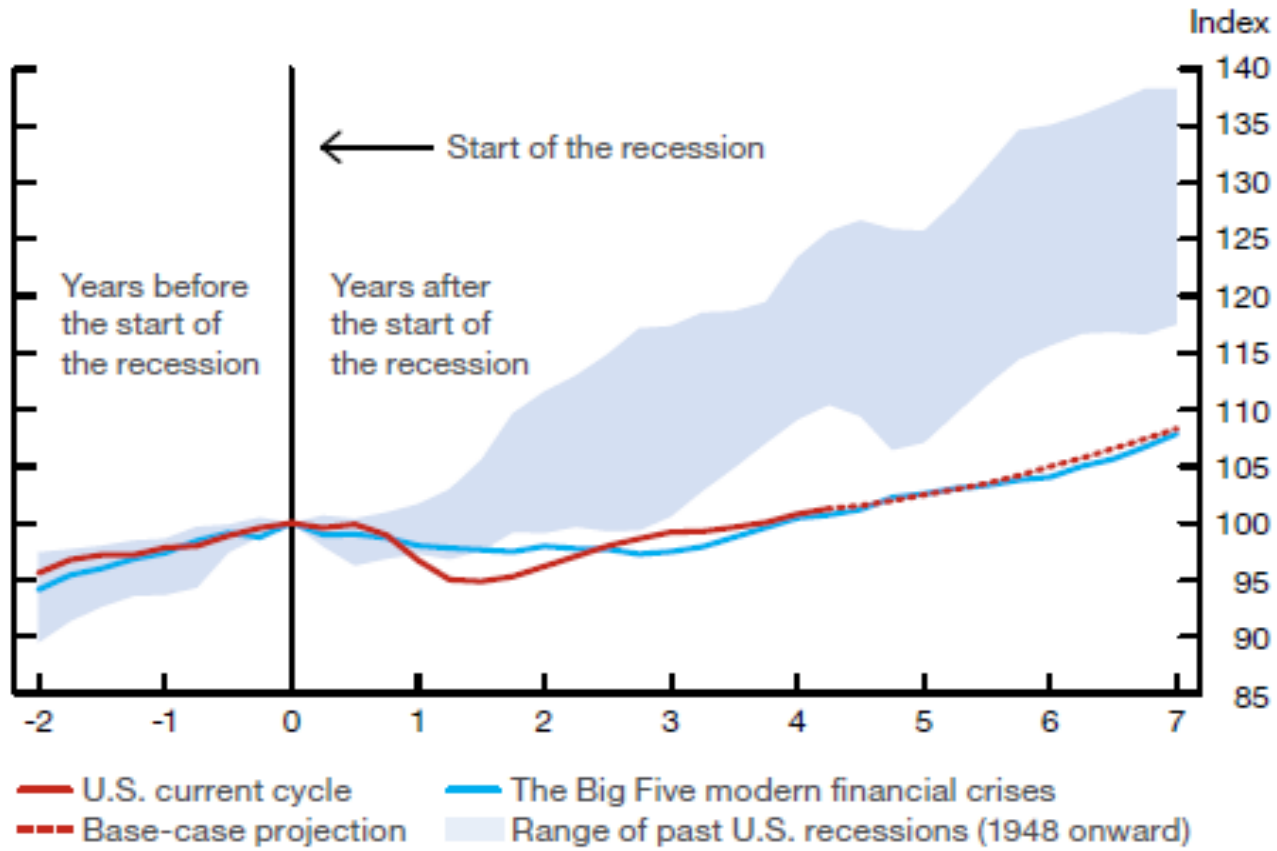
Kenneth Rogoff



1. Panic ... then uncertainty
2. Deleveraging

Chart 7: U.S. real GDP growth is projected to remain relatively modest compared with previous U.S. recoveries

U.S. real GDP across economic cycles; start of recession = 100, quarterly data

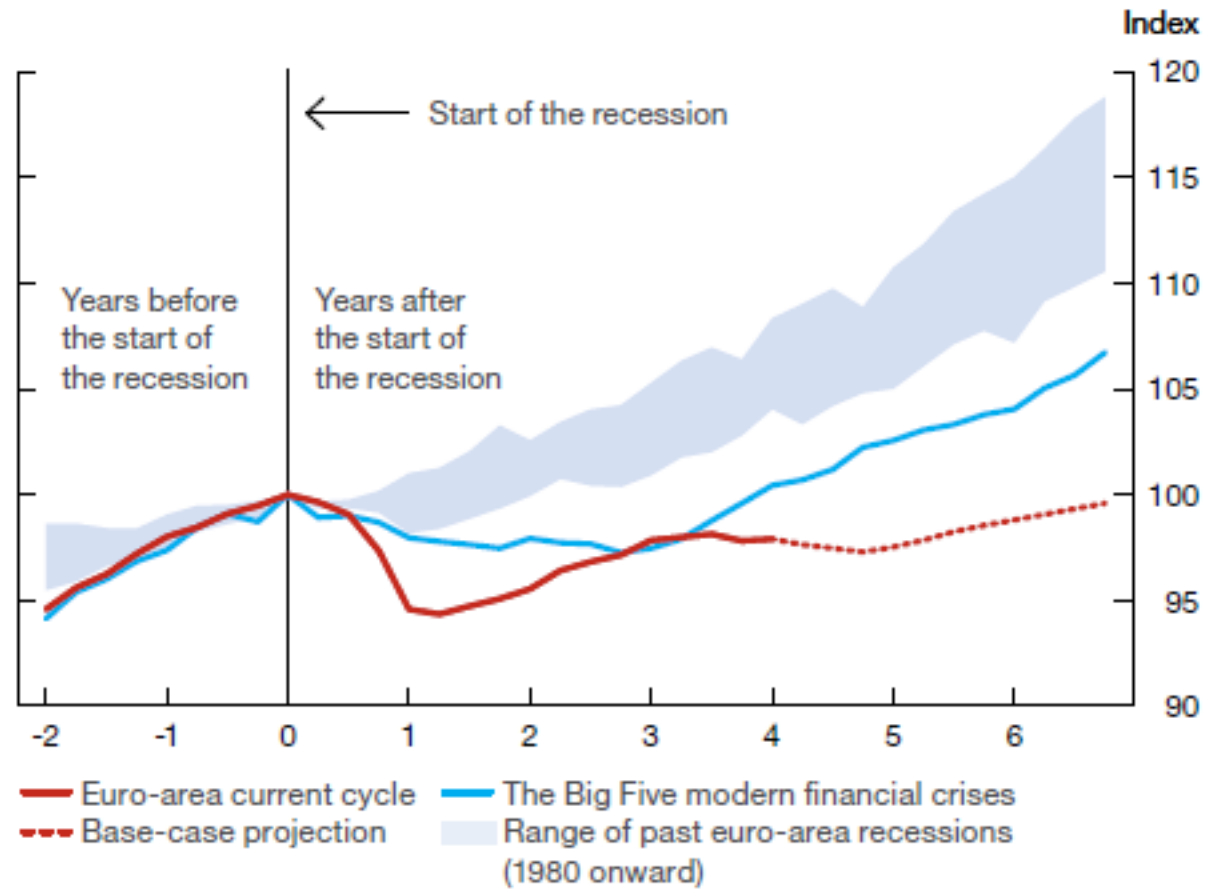


Note: The Big Five modern financial crises, as described in Reinhart and Rogoff (2008), are Spain (1977), Norway (1987), Finland (1991), Sweden (1991) and Japan (1992). See C.M. Reinhart and K.S. Rogoff, "Is the 2007 U.S. Sub-Prime Financial Crisis So Different? An International Historical Comparison," *American Economic Review: Papers and Proceedings* 98, no. 2 (2008): 339-44.

Sources: U.S. Bureau of Economic Analysis, Organisation for Economic Co-operation and Development, and Bank of Canada projections

Chart 6: Europe is stagnating

Euro-area real GDP across economic cycles; start of recession = 100, quarterly data



Note: The Big Five modern financial crises, as described in Reinhart and Rogoff (2008), are Spain (1977), Norway (1987), Finland (1991), Sweden (1991) and Japan (1992). See C.M. Reinhart and K.S. Rogoff, "Is the 2007 U.S. Sub-Prime Financial Crisis So Different? An International Historical Comparison," *American Economic Review: Papers and Proceedings* 98, no. 2 (2008): 339-44.

Sources: Eurostat, Organisation for Economic Co-operation and Development, and Bank of Canada projections

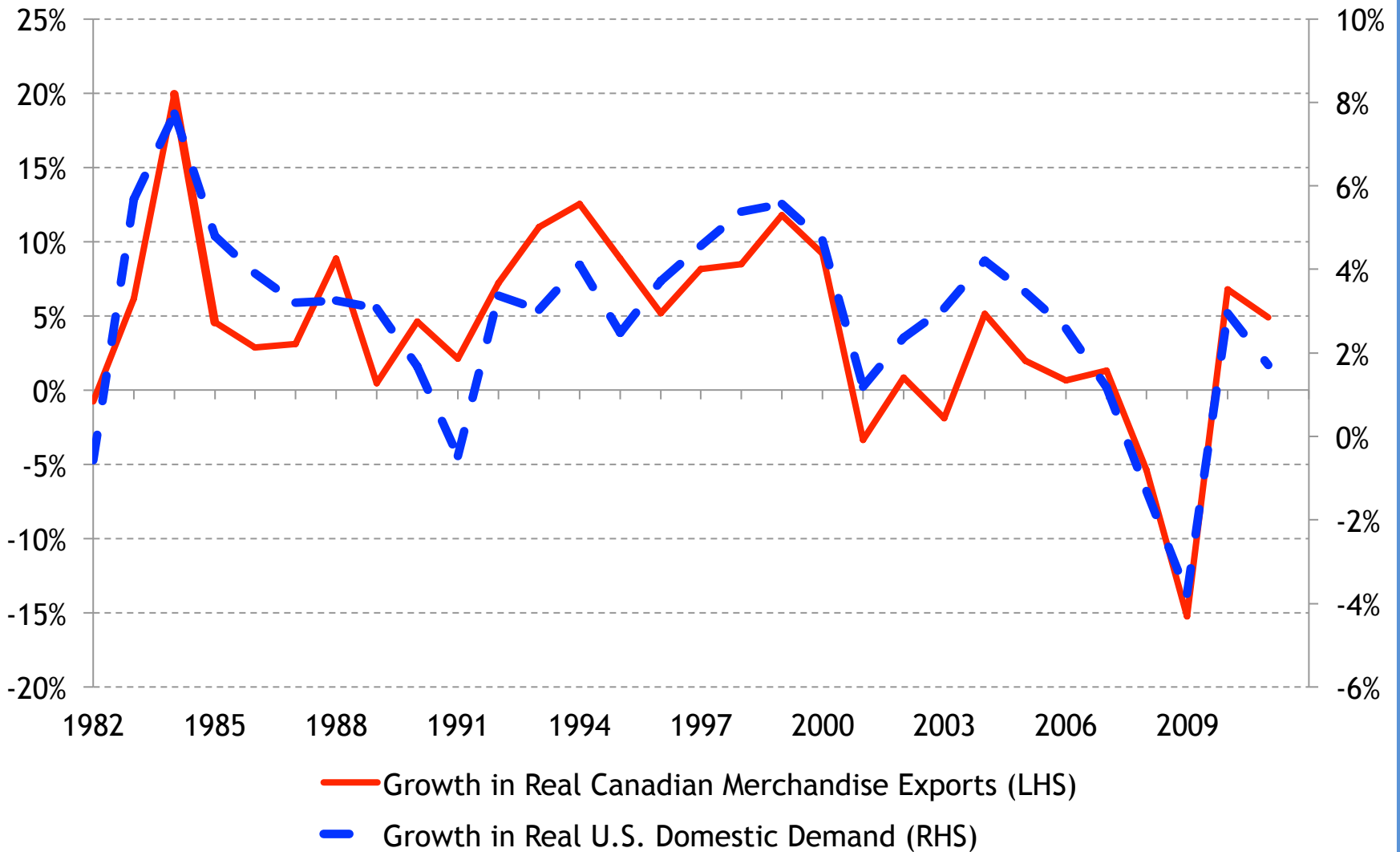
Investment?

- real interest rate vs. “animal spirits”
- B.O.S. July 2013
 - 35% of firms predict higher I
 - 26% predict lower I
- but “balance of opinion” of 9% is actually pessimistic

Exports?

- foreign economic activity is crucial
- real exchange rate?
 - yes, but no simple relationship
- exports-activity relationship may be weakening (Bank of Canada)

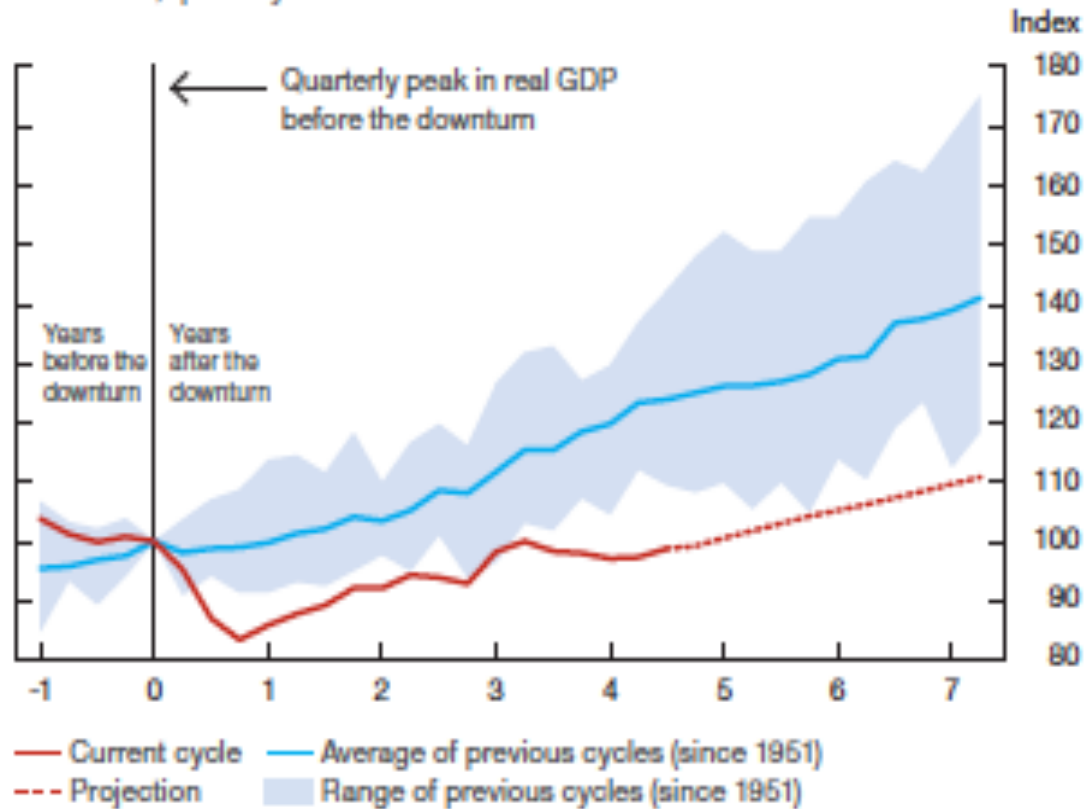
Growth in Canadian Exports and U.S. Domestic Demand



Our exports are very weak!

Chart 26: ...although the level of exports remains weak relative to previous cycles

Comparison of real exports across economic cycles; quarter before the downturn in real GDP = 100, quarterly data



Sources: Statistics Canada and Bank of Canada calculations and projections

Where does this leave us?

- Macro policy won't (likely) add to growth
- Private demand won't (likely) "rebound"
 - "accept" a slow-growth recovery

What does this mean for Canadians?

The Burden of a Slow-Growth Recovery

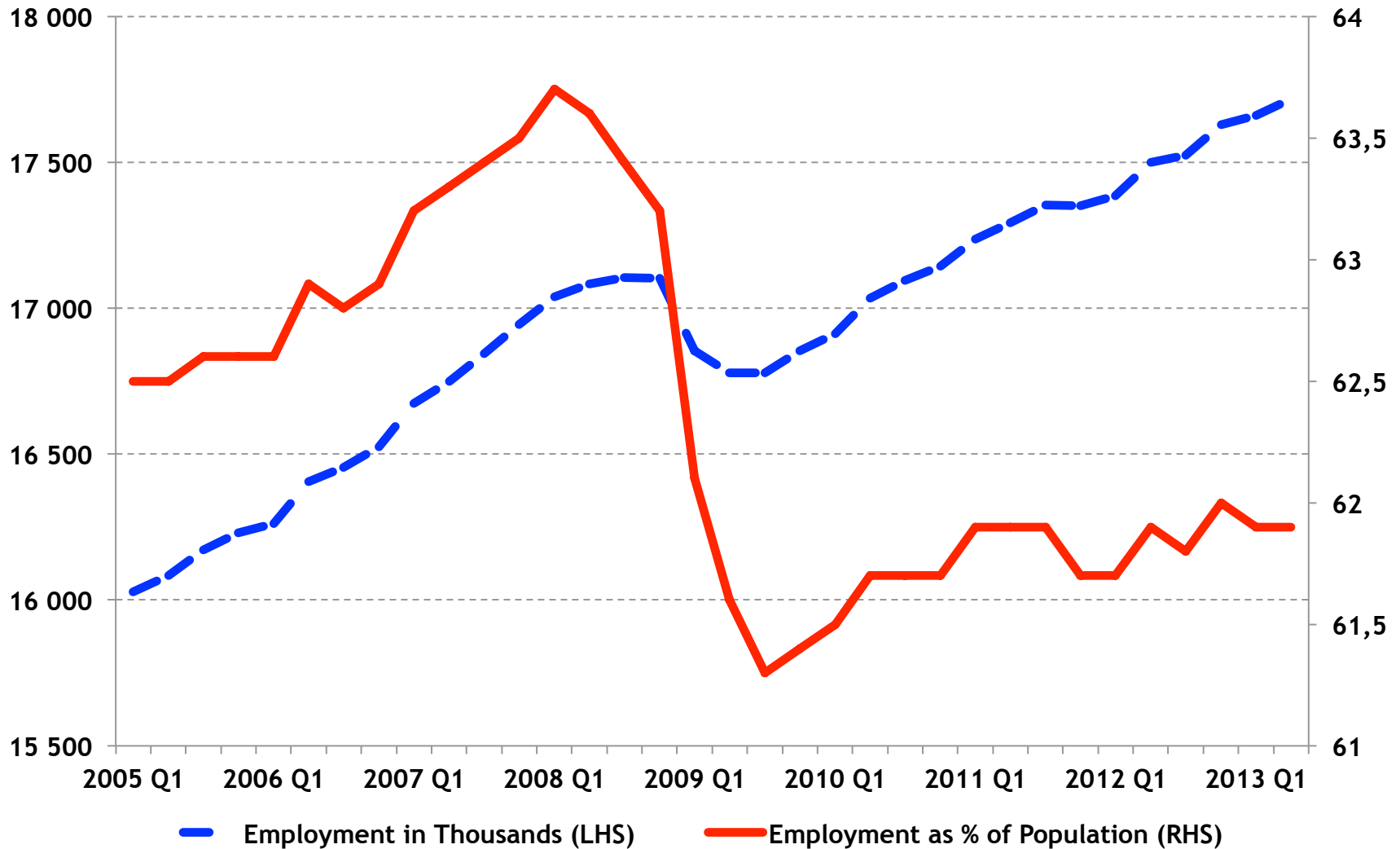
Ben Bernanke often emphasizes:

- poor state of the U.S. labour market
- slow growth doesn't absorb rising LF

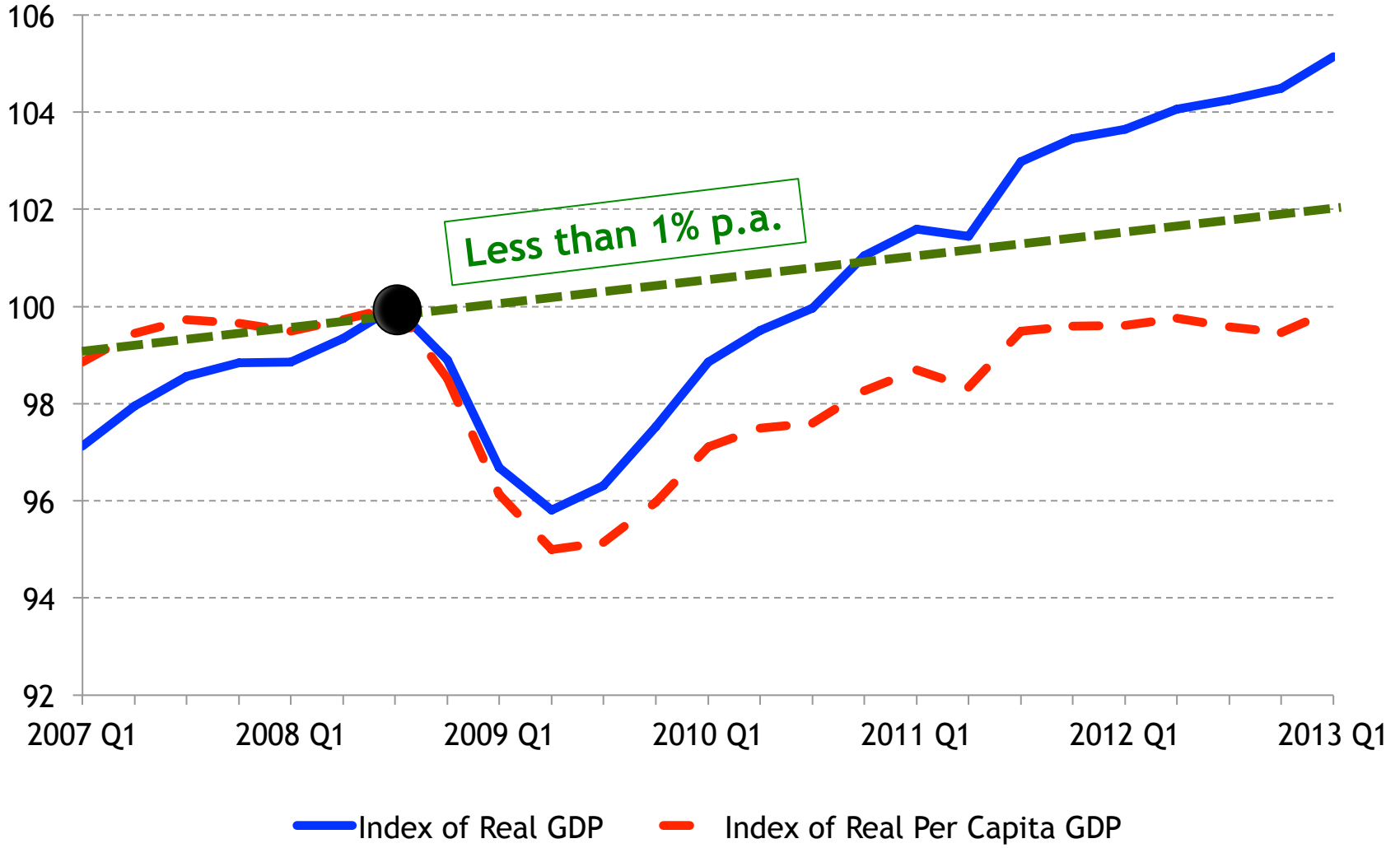
Same basic principle applies in Canada

- recent statements by Bank of Canada

Some “Duelling Data”?



Index of Real GDP and Real Per Capita GDP

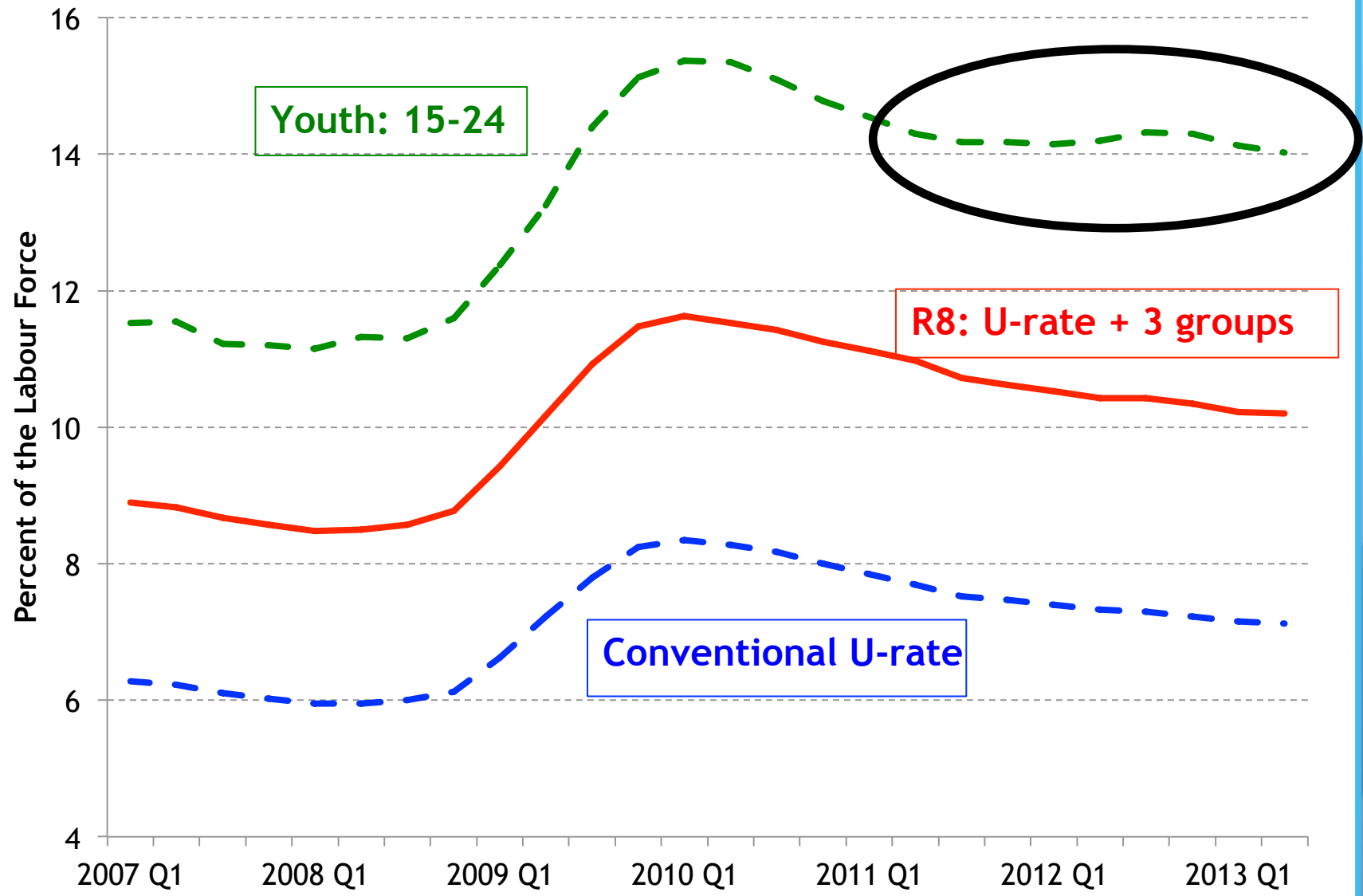


Shouldering the Burden

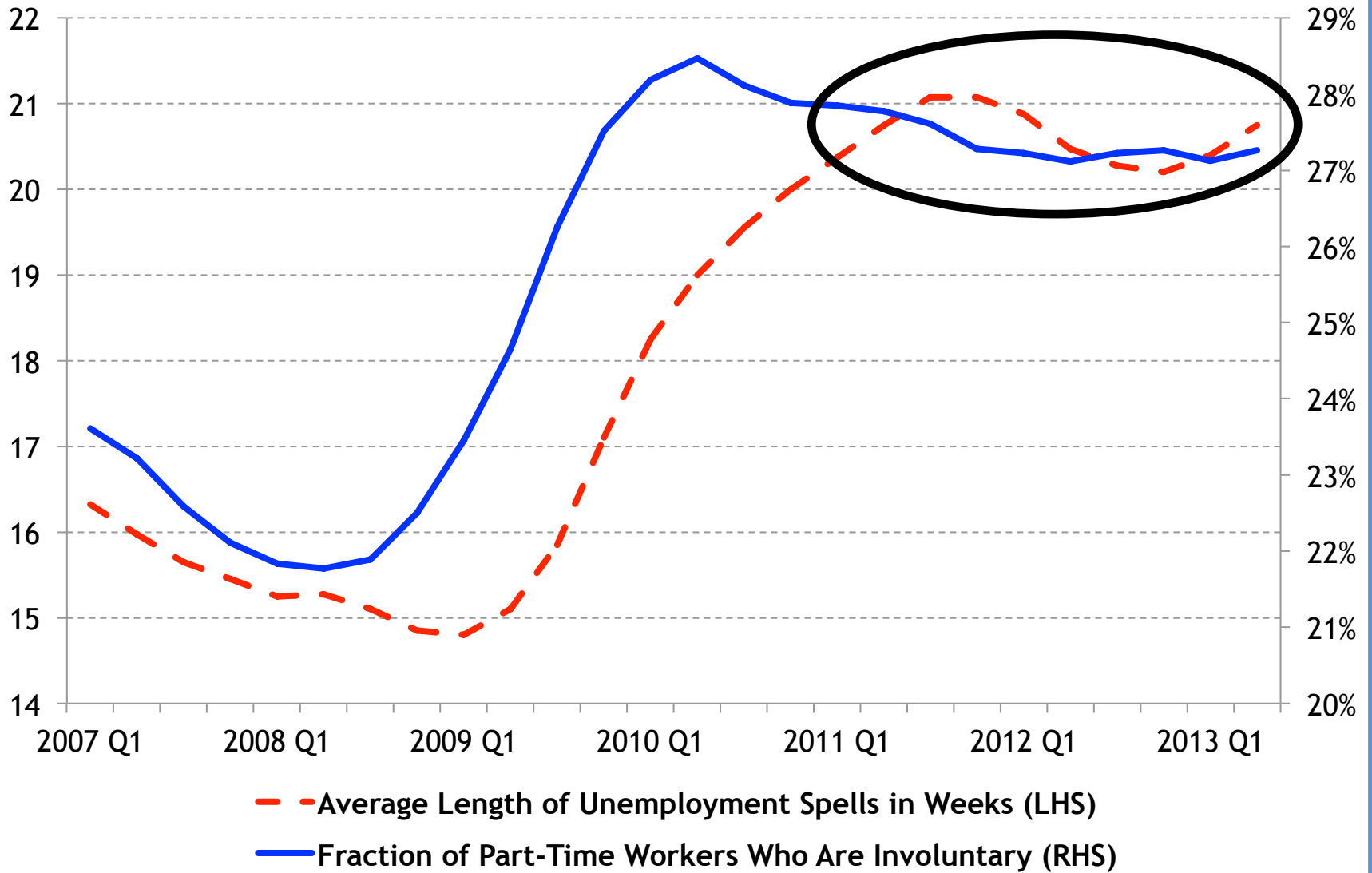
The groups most hurt by the recession:

- unemployed (rising average duration)
- youth unemployed, and discouraged
- involuntary part-time workers
- long-term unemployed

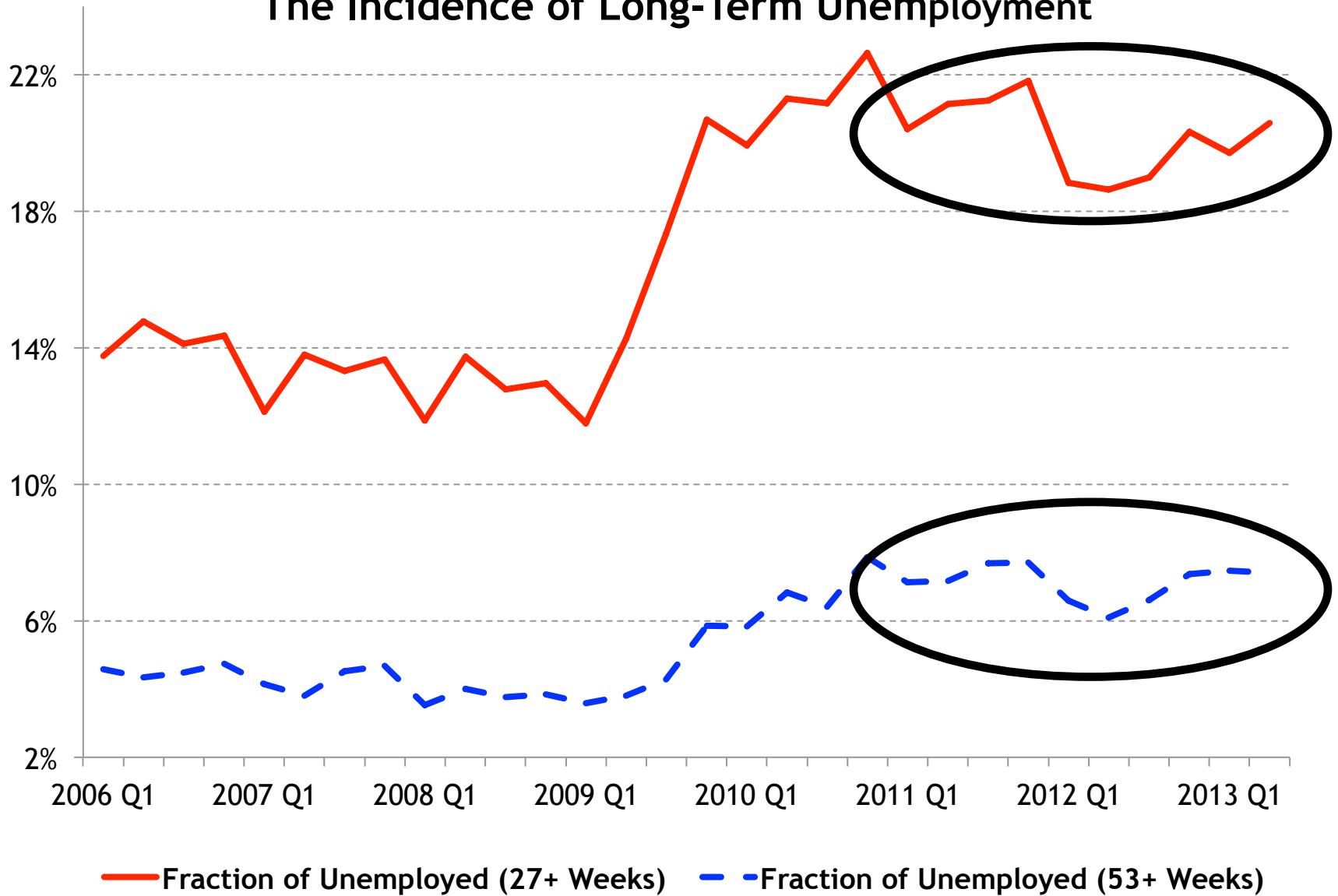
Three Canadian Unemployment Rates



Involuntary Part-Time and Unemployment Duration



The Incidence of Long-Term Unemployment



A Hint of A Policy Agenda

OECD (2013): policies for “targeted assistance”
→ improving LM functioning

Three-part package?

1. improve \$\$ support to unemployed
2. encourage more LM mobility
3. improve LM training

(different time spans for the various policy payoffs)

Summary

1. Standard macro policies are tapped out.
2. Few reasons to expect a quick rebound of private demand.
3. We need to accept the likelihood of a continued slow-growth recovery.
4. Policy focus should be on alleviating the burden of slow growth → LM policies.

Thank you for listening.