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Bank of Canada says third-quarter growth was worst since recession

BY JULIAN BELTRAME

OTTAWA – The Canadian economy likely suffered the worst quarter since the recession over the summer months, but Bank of Canada governor Mark Carney warns against taking too gloomy a view.

"I wouldn't obsess about the third quarter," Carney told reporters Wednesday after Canada's central bank released its latest global economic outlook.

The bank conceded the economy likely continued to brake in the July-September months to 1.6 per cent growth — down from two per cent in the second quarter and the distant memory of the first quarter's 5.8 per cent advance.

But Carney said Canadians should take a longer view and also take comfort that no matter how modest, at least activity is still positive.

"Two years ago, I (would have said) the economic picture we've just seen would have made the bank happy, would have made Canadians happy, given the alternative," he said.

"We've recovered the jobs, we've recovered the lost output, we are doing better than virtually anybody else in the advanced world."

Canada's current rate of growth is about half the pace the bank had expected a few months ago, and even slower than the U.S., but Carney notes that there's no comparison between the Canadian and U.S. economies.

While all and more of the about 400,000 jobs Canada lost during the recession have been recovered, the U.S. has only recouped about 15 per cent of their losses. And Canadian domestic demand is outpacing the U.S. by 20 per cent.

Dangers lurk, however, as the bank's latest quarterly review makes clear.

Both the Canadian and global recoveries, as well as future growth projections, are more modest now than they were three months ago.

To accommodate those diminished expectations and increased risks, the bank on Tuesday suspended the monetary tightening cycle it began in June. Analysts think the bank's key interest rate will stay at one per cent for many months.

The bank says in the balance it still believes the recovery will continue, but it highlights "important" risks, both internal and external, with the potential to upset the apple cart.

Canadian households are steeped in debt and could become a drag to the economy should housing prices collapse. Latest data shows debt-to-disposable income among households has reached a record 147 per cent.

“If there were a sudden weakening in the Canadian housing sector, it could have sizable spillover effects on other areas of the economy, such as consumption, given the high debt loads of some Canadian households,” the bank states.

Carney acknowledged keeping rates low for an extended period only increases the debt load risk, but said he believes consumer spending, including on housing, is tracking lower.

Coincidentally, the TD Bank also warned about household debt in a report Wednesday, saying one-in-10 households could find themselves in financial distress when interest rates rise. Fortunately, that many not be for some time.

Externally, the bank heightened its concerns over the growing friction in the world over currency manipulation, with advanced economies threatening to retaliate against China’s undervalued yuan.

The issue will be central to discussions at this week’s G20 finance ministers in Korea, but Carney suggested a solution will be slow and laborious.

Advanced economies, particularly the U.S., have long complained that China and other fast-growing Asian economies are artificially keeping their currencies below their true value in order to boost exports and discourage imports.

Although China has made some moves to increase the value of the yuan and hike domestic consumption, advanced economies believe those actions have not gone far enough.

Carney said as big a concern is that frustration will grow in advanced economies to such an extent that it will touch off a currency war, although he said China was the key.

“It’s not just China’s position ... but as part of rebalancing the global economy, increased flexibility of the (yuan) is absolutely essential,” the bank governor said.

Despite the challenges, the bank sees the Canadian economy advancing from the slow third quarter to a 2.6 per cent gain in the fourth, and an average 2.3 per cent in 2011, followed by 2.6 in 2012.

One encouraging signal is that businesses have begun to invest in new machinery and equipment, which should boost productivity going forward.

Another, said Carney, is that exports will turn from being a net drag on growth to a tiny positive sometime next year as global demand picks up.

Still, it’s going to be a slow, hard slog back to normalcy.

The economy is not nearly as strong as the bank thought it was in July. It calculates output gap — the slack in the economy — remains at 1.75 per cent, not 1.5 per cent as estimated in the previous review.

The bank’s best guess now is that the economy will eventually right itself, but won’t be firing on all cylinders for another two years.