Upcoming Interest Rate Cut Won't Address the Economic Headwinds Facing Canada

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People pass the Bank of Canada in Ottawa on July 24, 2024. The Canadian Press/Justin Tang

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Commentary

The Bank of Canada will announce its decision on its key interest rate on Dec. 11. The general view of market watchers, as recently as a week ago, was that the bank would cut the rate by 25 basis points, to 3.5 percent from 3.75 percent.

The Canadian economy has been mathematically growing overall in terms of GDP, albeit anemically. When looking at GDP per capita, the economy has contracted the last six quarters in a row. Does the 25-basis point forecast still hold? Will lower rates help the economy significantly? Let's look at the current situation.

Inflation has come down to 2 percent, which is effectively the bank's target rate it set when inflation was approaching double digits in 2022. Although this may seem impressive, a 2 percent inflation rate is less a result of outstanding economic stewardship when one realizes that Canada has been in a state of economic sclerosis for years. Our present environment is closer to a depression than a normal period of growth.

One does not have to convince Canadians that we are in severe decline as families and individuals struggle to put food on the table. Food and shelter prices have gone up by significantly more than the official Consumer Price Index rate. In a conversation I had with staff members of a large supermarket I frequently shop at located in an affluent neighbourhood, I was told that many customers are visibly upset about food prices. I was also informed that the store, which stocks high-end products, was bringing in cheaper products and allocating more shelf space to less expensive staples. One cashier quipped that in all her years working there, only recently did she notice the store carrying Hamburger Helper.

Statistics Canada said on Dec. 6 that the unemployment rate had risen to 6.8 percent in November, up 0.3 percent from the previous month. Job growth was comparatively strong but could not keep up with the massive numbers of new residents that have flooded Canada over the last few years. The unemployment rate is 36 percent above its recent floor of 5 percent. Typically, a 50 percent or more rise in unemployment coincides with the latter stages of a traditional recession. However, these are not traditional times. Usually, recessions are severe and end quickly. All lost growth is soon made up. Unfortunately, Canada has effectively been in a low-grade economic downturn for about six years which has been long enough to significantly lower the standard of living.

Considering the continued travails of the economy, the market consensus is that the central bank will now cut rates by 50 basis points to 3.25 percent. Some are even forecasting a larger cut, as some panic seems to be setting in. I am contrarian on this subject. Although I concede that a 50-basis point or more cut is almost certain, it will not benefit the economy over the long run. We should have learned our lesson that we cannot ensure prosperity by artificially low interest rates. Canada bond yields, at 1.25 percent below similar-term U.S. Treasuries, makes no economic sense.

Also, if lowering rates result in an economic boom, Canada would be in far better shape. Interest rates that are artificially set too low relative to inflation incentivize government, corporations, and individuals to take on too much debt. It results in malinvestment in the private sector, a consumer overburdened with credit card debt, and out-of-control government debt. All these factors curtail longer-term economic growth in pursuit of a short-term fix.

Additionally, from an ethical point of view, synthetically low rates relative to inflation robs bondholders. People who save their money

and are cautious should not have to subsidize out-of-control government spending and speculators.

Canada needs to focus on getting its economic house in order. Relying on interest rates cuts is like inflating your tires above the suggested air-pressure range to offset a two-inch gash, while your brake pads have completely worn down. Firstly, the government must stop this unhinged policy of raising overall taxes during what is effectively a depression. Second, it must significantly cut spending—even more than Elon Musk and Vivek Ramaswamy have promised in the United States—since spending in Canada is significantly higher despite spending little on defence.

Canada also needs to cut regulations. Although largely unnoticed, over-regulation, combined with government make-work schemes, is stifling the economy. In essence, Canada needs to abandon its anti-investment obsession. We have made Canada a bad place to invest, so we should not be surprised that companies don't want to invest here without massive corporate welfare handouts.

The cut announced Dec. 11 will be greeted with fanfare and relief. However, it will not address the economic headwinds facing Canada nor will it return living standards to anywhere close to America's. Tough decisions are needed.

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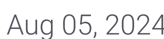

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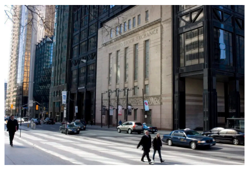

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