Fundamental Changes Are Needed to Reinvigorate Canada’s Economy

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Bank of Canada governor Tiff Macklem speaks at a press conference in Ottawa on Dec. 11, 2024. The Canadian Press/Adrian Wyld

By Tom Czitron
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Commentary

The Bank of Canada lowered its key interest rate by 0.5 percentage points to 3.25 percent on Dec. 11. This was the second meeting in a row that saw the central bank make a 0.5 percentage point cut.

There was some debate until recently about whether the bank would cut a quarter or half of a percentage point. The key rate has declined from 5 percent in June of this year. The consensus quickly shifted to a larger cut after release of the most recent employment report.

The unemployment rate rose to 6.8 percent in November, up 0.3 percentage points from the previous month. The labour force participation rate—the proportion of the population aged 15 and older who were employed or looking for work—rose slightly, by 0.3 percentage points. But the rate was down by 0.5 percentage points year over year.

The Canadian economy is supporting job growth. However, the population growth of adults in the labour force has been growing by a higher rate. The economy has been unable to absorb the high numbers of immigrants entering the country over the last few years, something policymakers should have considered.

Jobs simply cannot be created quickly enough to absorb Canada's explosive population growth. If this task was not impossible enough, current policies have created a climate openly hostile to investment, with onerous taxes and over-regulation. "Buying" investment by subsidizing industries involved in the environment, film, and other industries is counterproductive.

Unfortunately, cutting interest rates is only a short-term fix. Canada has been in a GDP per capita recession for almost three years, as any breadwinner paying dramatically more for basic foods than only a couple of years ago can tell you. Cutting rates, at this point, is like pushing on a string.

The economic situation may go from bad to worse if incoming U.S. President Donald Trump ends up signing an executive order to impose steep 25 percent tariffs on Canadian exports to the United States. And Canada is in no position to argue.

I have been somewhat familiar, through mutual acquaintances back in the late 1980s, with Trump's ability as a master negotiator. Master negotiators know that when you have all the power and the other side is weak, you can mostly set your own terms.

The U.S. economy is some 14 times the size of Canada's. More importantly, the export to the United States to Canadian GDP ratio is about 20 percent. The ratio in the opposite direction is only about 1.5 percent. Clearly Canada is in no position to throw its weight around.

Interest rate cuts can only do so much. Ten-year Government of Canada bond yields are about 1.25 percentage points below the yields of similar-term U.S. Treasury bonds, putting the Canadian dollar at risk.

The two nations have similar inflation rates, although Canada, due to its stifled economy, may have slightly less price pressures. However, despite a debt issue, the United States is more creditworthy. Also, with the Trump administration's resolve to cut spending, balance the budget, and deregulate, the economic outlook gap between the two countries will probably widen.

The Canadian economy is in a trap. It will take more than lower interest rates to get out of this mess, and there are no quick fixes. The good news is that things can get better if we accept economic reality and pursue good policies.

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Tom Czitron

Author

Tom Czitron is a former portfolio manager with more than four decades of investment experience, particularly in fixed income and asset mix strategy. He is a former lead manager of Royal Bank's main bond fund.

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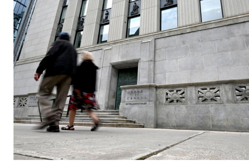

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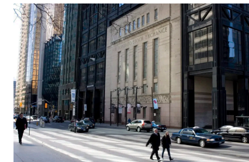

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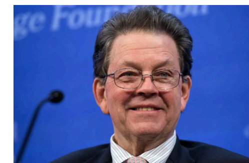

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