Chapter 2

Current Issues

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Impacts on Canada

Canada's financial system fared relatively well throughout the financial crisis. Credit conditions were strained, but for the most part markets remained open and banks continued to extend credit, albeit on tighter terms. However, the recession that originated in the United States has spread globally through trade, financial and confidence channels.

For Canada, the global downturn and declining demand for our exports have affected economic activity. Over the last several months of 2008, a steady stream of data confirmed that the economy was unravelling. Manufacturing shipments (or sales) started to decline in August, and in September employment in this sector began to fall, a trend that has spilled over into 2009. On the external front, merchandise exports have fallen steadily since August, with the exception of October, while merchandise imports declined in four of the last six months of 2008. The interplay between the ongoing unwinding of commodity prices and the economic contractions in the major economies has played a pivotal role in the collapse in trade. In the fourth quarter, real economic activity contracted 0.8% over the previous quarter, with exports of goods and services retracting by 4.7% and imports by 6.4%. For the year as a whole, GDP expanded by a meagre 0.5%. Overall, trade was a drag on the economy as net exports removed 1.8 percentage points from growth.

Looking forward, the outlook remains fraught with a high degree of uncertainty. Moreover, revisions to the data are becoming more common and more extreme. For example, the initial report on U.S. economic growth in the fourth quarter of 2008 indicated that that economy contracted by only 3.8%; the first revision indicated a much deeper contraction of 6.3%. Consequently, economic projections are constantly being revised and downgraded[1].

With a greater-than-expected contraction in fourth quarter Canadian GDP, the hand-off from 2008 to 2009 was weaker, suggesting diminished performance prospects for the year. This development, taken with more recent monthly employment data, led to heavy downgrading of most Canadian forecasts for real GDP growth in 2009 and 2010. For example, in mid-March, the Toronto-Dominion Bank again revised its forecasts downwards from -1.4% to -2.4% for 2009, and from 2.8% to 1.3% for 2010. In a similarly dated forecast, Bank of Montreal economists projected 2.5% contraction for 2009, but a 1.3% rebound for 2010. However, assessing the depth of the recession has been challenging since many of the downside risks are materializing. The Bank of Nova Scotia is now projecting that government expenditures on infrastructure, and their spinoff into non-residential activities, are expected to be the primary source of economic growth in Canada well into 2010. Stimulus measures announced in Budget 2009 will provide almost $30 billion in support to the Canadian economy this year, an amount equivalent to 1.9% of GDP, and are expected to create or maintain close to 190,000 Canadian jobs. Many of these investments are partnerships with provinces, territories and municipalities. Over the next two years, the total stimulus to the Canadian economy, including stimulus from other levels of government, will surpass $50 billion, an amount equivalent to 3.2% of GDP.