The Canadian “Improvement” Factor

Canada—Similar to the U.S.—Has Licked its Inflation Problem and Boosted Output, But Deficits, Interest Rates and Unemployment Still Nag

By Mark L. Ward, Sr.

The United States and Canada share more than the world’s longest border. In many respects, the recent economic performance of both countries is strikingly similar, as both recovered strongly last year from deep recession.

Both the United States and Canada are experiencing low inflation, increased output—and deep concern about government deficits and volatile interest rates. However, unlike the United States, Canada is troubled by persistent high unemployment and weak investment growth.

What does this mean for the Canadian construction industry? As recovery has slowed down, lagging investment clouds commercial construction, while residential builders face mortgage rate instability. Yet other factors, notably a good labor market and the Canadian economic improvement over-all, point to opportunity.

Where She’s Been

To understand the Canadian economic outlook, consider its recent past performance. The Economic Council of Canada’s annual review summarized the situation this way:

“The Canadian economy has completed its recovery from the worst recession in the postwar period, and it is continuing to expand. Events in the rest of the world have clearly influenced this recovery. Economic per-
“Canada’s economic recovery has outpaced the average for Western countries and the Canadian dollar has appreciated against many European currencies, but Canadian leaders complain that it has not been as broad-based or as balanced as anticipated—and high unemployment and volatile interest rates have weakened consumer and investor confidence.”

By international standards, the Council points out, Canada’s “robust” recovery has outpaced the average for Western countries. Moreover, the Canadian dollar has appreciated against many European currencies—though it has fallen against the American dollar.

Industrial production has grown more rapidly than the European average, the Council notes, while “employment growth has been healthy, business profits now exceed pre-recession levels (and) Canada posted a balance-of-trade surplus in the first half of 1984.”

Rising personal consumption and business inventories, together with “vigorous” homebuilding activity encouraged by government incentives, all helped fuel recovery. “By the spring of 1984,” the Council concludes, “the performance of the Canadian economy was above the peak reached in 1981 before the recession came into full force, (with) the rate of inflation headed below 5 percent.”

On the cautionary side, the Council warned about mounting government deficits and noted “the performance of investment, and the persistence of high unemployment rates (makes) the Canadian experience very different from that of the United States.”

The Council further admitted,
“Canada is somewhat constrained in dealing with deficit and unemployment problems by the international economy, the current policy mix in the United States, and particularly the stance of the U.S. Federal Reserve System.”

In strict numbers, the Bank of Canada in its 1984 report to the Minister of Finance, pointed out these indicators of national economic performance:

• Real gross national product, which has declined by more than 5 percent during early 1982, rose more than 7 percent by late 1983 — before moderating to the 4 percent gain posted by late last year. The United States’ GNP performed similarly, though its decline was somewhat less and its rise slightly more.

• The Consumer Price Index peaked with a 13 percent gain in 1981, but dropped steadily to stand at 4.5 percent by the end of 1984. The U.S. inflation rate peaked a year earlier at 15 percent, as prices fell more rapidly before edging up last year to just under 5 percent.

• The rate of spending in the Canadian economy topped 10 percent in 1983, before dropping to 7 percent late last year — still better from the precipitous decline of 1981-82, when the rate from 15 percent to less than 5 percent.

• Business inventories fell 4 percent between 1981 and 1982, before rising 2 percent in 1983 and remaining even last year.

• Labor costs (spending on wages and benefits as compared to GNP growth) have remained steady since early 1982, at about 10 percent above their 1979 level. Meanwhile, since early 1983, new wage settlements have held workers’ annual pay hikes to 5 percent.

• The total number of jobs fell 6 percent in 1982, before rising 3 percent the following year and in 1984. However, the rate of unemployment remains today at 11 percent, after peaking at nearly 13 percent in 1982.

• Corporate profits dipped from $38 billion to less than $20 billion between 1981 and 1982, but have since risen above $40 billion. In 1982, these profits accounted for less than 8 percent of national income, but today stand at the 13 percent mark.

• The prime business loan rate held steady at 11 percent through 1983, hit 13 percent in March 1984, and has fallen back to 11 percent this year. Mortgage rates hit nearly 20 percent in 1982, and have fluctuated between 13 and 15 percent since then.

The Bank of Canada views 1984 in the context of “further recovery from the inflationary turmoil of the 1970’s and the sharp recession of 1981-82. The satisfaction that Canadians can take from lower inflation and expanding output and employment is tempered by... unemployment (that) is still distressingly high.”

Yet given the “genuine progress that has begun to be made,” the Bank believes, “Canada has indeed shown itself capable of turning the momentum of inflation around and of build-
ing the foundation of good performance that is essential for sustained economic advances.”

Looking at the Canadian residential construction industry, the Bank pointed out the overall 1984 trend: “While the volume of consumer expenditures grew quite strongly on average in 1984, there was evidence of some deceleration during the summer in response to the earlier rise in interest rates.” Households, worried about the “possible future course of interest rates,” were encouraged to increase savings and reduce mortgages.

However, while “the purchasers of houses responded the similar forces,” the Bank adds, “the weakness of residential construction also reflected the timing of the effects of previous government programs which seem to have increased housing starts early at the expense of starts more recently (Canadians voted in a new government last September).

The outlook for commercial construction is guardedly optimistic, the Bank suggests, as “the business sector continued to behave cautiously overall, although there were some indications that business investment”—the key to new construction—“was reviving as 1984 went on.”

The best commercial construction markets are likely indicated by “investment gains evident in certain service-producing sectors and in those goods-producing industries that have recently experienced significant increases in . . . capacity utilization.”

A less enthusiastic appraisal of recent Canadian economic performance is offered by Michael Wilson, the new Minister of Finance. In the introduction to his legislative agenda, Wilson writes:

“Today, despite two years of recovery, the legacy of the worst recession since the 1930’s remains. Employment has barely recovered to the pre-recession level, the unemployment rate is extremely high, and Canadian industry is still operating substantially below its capacity.”

Wilson says the recovery “has not been as broad-based or as balanced as anticipated”–while at the same time, “high unemployment and volatile interest rates have weakened consumer and investor confidence.”

The finance minister worries that, because exports to the United States have helped sustain Canadian recovery despite weak domestic spending, the country is tied more closely to American fortunes. “The net effect,” he believes, “has been to increase the risk of a downturn in Canada should U.S. economic growth falter.”

Wilson says, “a further disturbing feature of the recovery is its uneven distribution.” Some provinces have seen rapid growth, while others are more depressed; and “among industrial sectors, manufacturing (ii) experiencing fairly robust recovery while many resource-based industries are still languishing.

“In summary,” Wilson concludes, “although the Canadian economy continued to grow in 1984, the uneven nature of this growth, the weak demand in several major sectors, and continued high unemployment rates have resulted in a growing perception that the recovery has run out of steam.”

Where She’s Going

A detailed projection of future Canadian economic performance is offered by the Economic Council of Canada in its annual review. Here is what the group forecasts for the rest of the decade:

- The estimated 3.1 percent growth rate is insufficient to appreciably lower the unemployment rate—which should remain in double digits until in the 1987-89 period. Despite this high unemployment, the total number of jobs will rise 2 percent annually in 1983-85 and 1987-89.
- Labor productivity will increase 1 percent each year through 1986, and
then jump 2 percent annually through the end of the decade. Real wages will grow accordingly—but less than 6 percent. Meanwhile, moderate wage gains will help keep inflation below 5 percent.

The Council concludes, “Three problem areas emerge from our analysis — the current poor performance of investment, the anticipated large federal deficits, and the persistent high rates of unemployment. Even in the most optimistic case, (projections for) all remain in a range that leaves much room for improvement.”

As in the United States, the Canadian government must reduce spending or increase taxes—or a combination of both—to pare the deficit. Thirty years, federal expenditures accounted for 27 percent of domestic spending and totaled $438 for each Canadian; in 1983, government’s share of spending is 46 percent, or more than $7200 per capita.

Michael Wilson, the government finance minister, believes real growth will average “just under 3.5 percent” for the rest of the decade. Moreover, “investment spending should pick up over the 1986-90 period, in response to the assumed lower levels of real interest rates in Canada.”

However, he expects unemployment to average 9 percent for the next five years, standing at 7 percent in 1990. “This would mean,” Wilson points out, “it would take nine years to bring the unemployment rate down to where it was prior to the recession.”

Back in America

Contractors and manufacturers in the United States interested in establishing Canadian offices will not only find improving economic opportunities, but will discover the national government receptive to investments by American construction firms.

The Canadian Parliament is expected to approve measures making it easier for non-Canadians to establish new businesses in the country or acquire existing Canadian businesses. According to Minister of Industry Sinclair Stevens, “We are going to make it clear the government welcomes investment in Canada, because investment means jobs.”

Under the proposal, foreigners acquiring Canadian businesses with assets of less than $5 million would be exempted from review requirements, and need only file a notification. For larger acquisitions, firm deadlines are established for government decision.

Other legislative changes under consideration by the new government which affect the Canadian business climate include tax simplification, reduced regulation of business, and increased support for small businesses. Unlike in America, the Canadian system of government guarantees the prime minister a parliamentary majority.