Demographics at play behind Canada's lagging growth

By David Parkinson
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Maybe the problem behind Canada's weak business investment in the current economic recovery isn't one of confidence, or credit access, or capacity. Maybe it's our age.

The Bank of Canada raised this notion in last week's Monetary Policy Report, in which it slashed its 2016 economic growth forecast – citing in part the disappointing dearth of capital spending from businesses outside the distressed energy sector.

The central bank was quick to point out that non-energy exports have risen to near their prerecession peaks, helped in no small part by the slump in the Canadian dollar over the past two years that has made Canada's non-commodity exports highly competitive in foreign markets. Yet, that's doing little to inspire the exporters who are enjoying the ride to open their wallets and expand their operations.

And it's not as if there isn't a need, in many export sectors, to expand. The manufacturing sector's capacity utilization in the first quarter of 2016 was its highest in a decade. Some segments – notably forest products and transportation equipment – are running at very close to their limit.

Yet, despite this increasingly tight capacity, capital spending in manufacturing is expected to go down this year, by nearly 11 per cent, according to Statistics Canada estimates. The Bank of Canada's recent quarterly Business Outlook Survey showed decidedly muted spending plans among exporters over the next year, "even those unaffected by commodity prices."

"Capacity pressures have increased in much of the manufacturing sector, and financing conditions remain favourable," the central bank said in its quarterly Monetary Policy Report. "As both foreign and domestic demand increase, industries outside the resource sector will need to invest to expand production."

In that report, the bank suggested that investment is being held back by "uncertainty over future demand prospects," and that certainly looks to be a factor. But it raised another possible contributor to the lack of an investment recovery in response to the export gains and capacity constraints. The country's aging population could be holding back spending.

"There are a lot of smaller and medium-sized companies that have owners, and people who have developed the company, who are getting older and may be thinking of retiring," Bank of Canada senior deputy governor Carolyn Wilkins said in the press conference after the release of the MPR.

As the huge baby-boomer group moves increasingly into retirement territory, the implication is that a growing number of the country's business owners and entrepreneurs probably are not thinking so much about committing time and money to expanding these businesses – they are looking to cash in and ease out.

Canadian government statistics show that, in 2014, more than 60 per cent of Canada's small and medium-sized companies were owned by people who were over the age of 50. Just a decade earlier, it was less than 50 per cent. The country's entrepreneurial base is aging fast.

It's similar to the demographic impact that many economists have noted in the labour market. It's no coincidence that labour force participation rates have been in decline – to their lowest in 16 years as of June – at the same time as the leading edge of the boomer generation has crossed over the 65 age threshold. The population of Canadians aged 55 and older has increased 17 per cent in the past five years alone. The population aged 25 to 54 – the so-called prime working years – has risen a tiny 1.3 per cent.

One solution to combat the aging of the work force is for people to keep working longer and, indeed, that is already happening: The participation rate among those 65 and over has nearly doubled in the past decade, to about 14 per cent. Similarly, perhaps more business owners will be willing to keep minding the shop for a few more years.

But it’s a very different question to ask them to invest more money, or to take on more debt, to expand their businesses when they have their retirement nest eggs to think about – especially after years of weak investment returns that have stunted savings. That’s why the demographic puzzle for business investment, at the grassroots level, may prove to be a very difficult one to solve.