Some ‘uncomfortable facts’ around Canadian government debt

By Michael Babad
September 19, 2016 – *The Globe and Mail*

There are some “uncomfortable facts” around government debt that BMO Nesbitt Burns wants us to know about as the focus shifts from monetary to fiscal policy.

Government stimulus is a worthy initiative, notably in an embattled Canada and particularly after the ugly results of austerity measures around the world.

BMO doesn’t disagree with that. Indeed, chief economist Douglas Porter says there’s “little debate that those economies with some fiscal space should use it, especially with even long-term interest rates at almost zero (See Germany).”

He points, too, to the praise for Canada’s fiscal initiatives from International Monetary Fund chief Christine Lagarde during her visit last week.

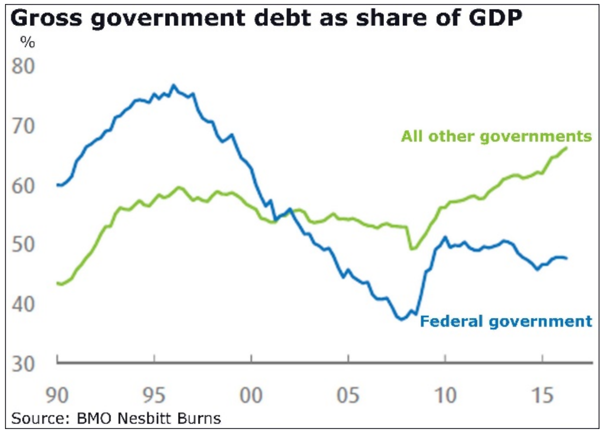
“But we would point to a few uncomfortable facts before we give governments a full green light to spend, spend, spend amid frustratingly sluggish growth,” Mr. Porter said in a recent report.

Among them is the fact that added spending is “no lasting cure – unless stimulus does something to strengthen incentives or the supply side, it will simply provide a one-time lift to activity.”

There’s also the fact that there may not always be an equal bump per government dollar because “so much can leak outside the country and/or be saved,” Mr. Porter said.

“Note that in Canada, job growth is now actually slower than a year ago even with the big fiscal push.”

Mr. Porter wasn’t just referring to the federal government as he suggested that “Canada’s ballyhooed fiscal space may be a little overrated.”



He cited last week’s Statistics Canada report that showed general government gross debt now tops 117 per cent of gross domestic product.

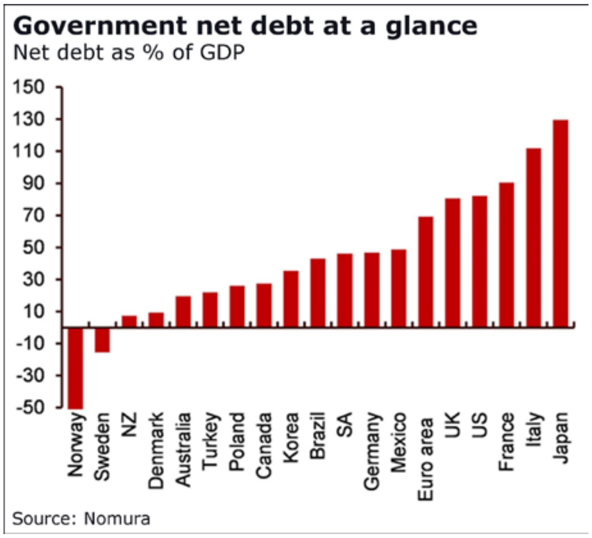
“Given the coming demographic pressures (i.e. health care costs) that provincial governments will face, the country can scarcely be complacent about its fiscal position.”

Support for government stimulus is justifiably spreading around the world. No surprise there, given that so many economies need a jolt, unemployment is high and austerity measures have been crippling.

While Canada’s former Conservative government obviously didn’t cause the oil-induced slump, it arguably added to the trouble in its quest to balance the budget.

Interestingly, the Tories left the issue to the Bank of Canada, which, unlike the government of the day, chose to act and cut interest rates.

Now, the Bank of Canada is leaving it to the Liberals, whose fiscal policy is forecast to help the economy along.



There's more to this story on a global scale, of course.

"With monetary policy losing its effectiveness, and with signs that hysteresis is affecting some countries, many have started to argue that fiscal policy should play a greater role in stimulating growth," said Charles St-Arnaud and Kevin Gaynor of the Nomura economics group, referring to the stand-pat nature of some central banks.

"Fiscal policy is likely to be more effective now, because monetary policy is operating at the lower bound and inflationary pressures are low," they added.

Government stimulus generally comes in two forms, or a combination, of tax measures and spending.

And given low interest rates, financing a fiscal program is cheap, Mr. St-Anaud and Mr. Gaynor said, agreeing with Mr. Porter on a key point.

"Fiscal policy suffers from declining marginal contributions to growth, which means that its effectiveness diminishes over time," they added.

"On that point, it is important to note that both monetary stimulus and fiscal stimulus are suboptimal tools to address structural issues. This means that other policies also need to be considered to boost productivity and potential growth."