Can infrastructure replace the export-led recovery that never came?

By Barrie McKenna
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Exports have been at the heart of Stephen Poloz's narrative for the Canadian economy since he took the helm of the Bank of Canada.

Everything good starts with exports, Mr. Poloz explained in his first speech as governor of the central bank in June, 2013. The former head of Export Development Canada confidently predicted that a growing foreign appetite for everything Canada produces – particularly from its No. 1 customer, the United States – would put the country on a solid path to recovery.

"The sequence we can anticipate is the following: Foreign demand will build; our exports will strengthen further; confidence will improve; existing companies will expand; companies will invest to increase capacity; and new ones will be created," he told members of the Chamber of Commerce in Oakville, Ont. "This sequence may already be under way."

The subsequent sharp drop in the Canadian dollar – to roughly 75 cents (U.S.) from above parity – made the narrative even more convincing.

More than three years later, it hasn't happened – at least, not in the steady sequential trajectory envisioned by Mr. Poloz.

This week, the Governor acknowledged he was wrong, his confidence in the narrative badly shaken.

"The level of exports is well below where we thought it would be by now," he told reporters in Ottawa after the bank's rate decision on Wednesday.

It's not just that exports haven't recovered. A chunk of them may never come back because Canada's competitive position in the world has been permanently impaired by lower-cost economies, leaving the economy desperately searching for a new growth driver.

The Bank of Canada has run a simulation showing that if exports are one percentage point weaker than expected over the next two years, it would knock 0.5 per cent off overall GDP. As it is, the central bank expects the economy to grow just 1.1 per cent this year and 2 per cent, respectively, in 2017 and 2018.

So what's the new thing that will save Canada's economy? It's not the private sector, it's government stimulus, including federal government infrastructure spending and tax breaks.

"The Bank of Canada is essentially depending on a fiscal lift to get the economy back to its full potential," said Craig Alexander, chief economist at the Conference Board of Canada.

In addition to its lowered expectations for exports, the central bank has slashed its forecast for economic growth this year and next.

The result is that if you take government spending out of the equation, the economy would be essentially "stagnant," according to Mr. Alexander.

Government stimulus will add 0.7 of a percentage point to GDP in 2017, and a full percentage-point by the end of 2018, according to the bank's latest monetary policy report.

But that boost could prove too optimistic, if Canadians choose to save rather than spend the estimated $23-billion being doled out under the new Canada Child Benefit in 2016-17, pointed out Ben Homsy, a fixed-income analyst at Vancouver-based Leith Wheeler Investment Counsel Ltd.

"The Bank of Canada may be overreliant on the benefit they're going to get from stimulus," he said.

Already, there's evidence that consumer spending, which had been propping up the economy, is faltering. Retail sales declined for a fourth consecutive month in August, dropping 0.1 per cent, according to figures released Friday.

It's no coincidence then that Finance Minister Bill Morneau's Advisory Council on Economic Growth, a blue-chip panel of advisers, this week recommended the creation of a national infrastructure bank. The council predicts the bank could leverage $40-billion in federal seed money to raise additional private capital and deliver more than $200-billion in infrastructure over the coming decade.

The council has in mind large-scale projects that would boost the economy's competitiveness, over and above the money spent on construction. These might include toll highways and bridges, high-speed rail, port and airport expansions, city infrastructure, national broadband infrastructure, power transmission and natural resource infrastructure.

Instead of scanning the trade data for clues about where the economy is headed, Mr. Poloz may now be logging onto Infrastructure Canada's Project Tracker website.