

Canadians can be forgiven for being skeptical of Poloz's export optimism

By Barrie McKenna

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Stephen Poloz has taken a lot of heat for being overly optimistic about the export recovery.

There has been a lot less focus on the Bank of Canada Governor's chronic forecasting misses on business investment.

These two vital components of the economy are, of course, linked. In a trade-dependent country such as Canada, exports help drive investment. As companies grow their foreign sales, they gain confidence and eventually expand their operations to meet growing demand.

When Mr. Poloz took over the bank in mid-2013, business investment was flatlining. He confidently predicted that things would get better in 2014. And every year since he's made similar predictions – in 2015, 2016, 2017. Now the bank's forecast shows the investment rebound will come in 2018.

Instead, there has been serial disappointment. Declining business investment knocked 0.1 per cent off gross domestic product in 2014, 1.5 per cent in 2015, 0.9 per cent in 2016 and a projected 0.1 per cent in 2017, according to the Bank of Canada's Monetary Policy Reports, the latest of which was released in January.

Business investment has sagged, even as other parts of the economy have improved, including the labour market. Non-residential business investment has tumbled nearly 20 per cent since 2014 – the largest two-year decline since the 1980-82 recession.

The crater in 2015 and 2016 was due mainly to the commodities price collapse, which triggered the cancellation or delay of several massive oil sands projects.

Unfortunately, the problem has spread beyond the oil patch, where investment has stopped falling and appears poised to recover. The manufacturing sector is an obvious area of concern. Investment in machinery and equipment as a share of GDP is now at its lowest level since 1981.

And the signs for this year and beyond are not encouraging. Overall private-sector capital spending plans are down 1.6 per cent from last year, despite the improvement in the oil and gas industry, according to Statistics Canada's annual survey of capital spending intentions, released in late February. Thirteen out of 20 industry sectors expect to spend less this year, manufacturing and mining among them.

The economy is not evolving as Mr. Poloz, and many other forecasters, thought it would. The natural sequence of export success leading to rising business confidence and eventually investment isn't happening, or at least not strongly enough to drive business spending higher.

The business spending slump has become the main drag on the recovery. Consumer spending and the housing boom in pockets of the country are sustaining relatively weak growth. But they can only do so much.

A big part of the spending story is the commodities price crash, whose effects are still reverberating through the economy.

Another reason is the loss of export capacity and market share in key markets, most notably in the United States. Canadian exporters have lost ground there to suppliers from other countries, leading to a permanent loss of capacity.

And there is the Trump factor. Uncertainty over how U.S. President Donald Trump's "America first" agenda will play out is causing companies to push the pause button on major investments.

Mr. Trump has vowed to renegotiate the North American free-trade agreement, which could punish Canadian exporters, while imposing new competitive pressures at home. There are also proposals for a border adjustment tax that would penalize goods shipped to the United States. Mr. Trump is also vowing much tougher Buy American restrictions on U.S. government contracts.

Any of these measures would make Canada a less attractive export platform for selling into the United States, triggering the unwinding of many Canadian supply chains.

Mr. Poloz is once again predicting that 2018 will be the year that business investment resumes its traditional role of driving the Canadian economy. More clarity on his optimism will come when the bank publishes its next quarterly forecast April 12. Canadians might be forgiven for being skeptical. It is, after all, the fifth time he's said: next year.