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Analysts brace for recession confirmation

By Jeff Buckstein

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Domestic and in particular international pressures have taken their toll on the Canadian economy, leading to a widespread expectation that 2015 second-quarter data due later this summer will show the country in a technical recession after two quarters of GDP contraction.

Canada's two biggest business provinces have been particularly hard hit. Ontario recently endured a credit downgrade. A precipitous drop in oil prices over the past year has slammed Alberta, forcing many in the oil patch to cancel or ditch plans to proceed with capital projects, and has also contributed to rising unemployment and provincial debt.

"I think that we have already had some material impact on trade and investment that has caused, in part, the recession. In other words, the recession reflects to some extent the trade and investment impact of the past two quarters," said Vern Krishna, counsel with TaxChambers LLP in Toronto.

"Whether it will have further impact remains to be seen, and depends upon several other variables that have to play out — one of which is the price of oil, which has had an impact on our investment and GDP. And the other is commodity prices in general. How long will these continue to affect us?

"There is a relationship between trade and investment. But we have to be careful to determine which is the cause and which is the effect," Krishna added.

In addition to the drop in the price of oil, China has been experiencing a market slump. Canada's resources have helped to fuel the explosive growth of China but if Chinese businesses and the government have less money to spend, that could affect Canadians, said Cyndee Todgham Cherniak of LexSage Professional Corporation, a Toronto-based international law and sales tax firm.

The world's second-largest economy experienced a 17.6 per cent decline in its imports in the first quarter of 2015 on a year-over-year basis, according to The World Bank.

"We're not isolated or insulated from a global downturn. The good news is that Canada is strong in its own right, and has goods and services that other countries need. So hopefully the fact that Canada has entered into free trade agreements and diversified will put Canada in a better position to weather any downturn globally. And it highlights why the Canada-CETA [Comprehensive Economic and Trade Agreement] and the TPP [Trans-Pacific Partnership] are so important as trade agreements," Cherniak said.

The sharp drop in oil prices over the last half of 2014, from more than U.S. $100 a barrel to roughly $50 a barrel by year's end, was a major factor in the Bank of Canada's decision last January to drop its overnight rate from one per cent to 75 basis points. The bank followed that with an announcement July 15 of a further 25 basis point cut to 50 basis points, or one-half per cent.

"Additional monetary stimulus is required at this time to help return the economy to full capacity and inflation sustainably to target," the Bank of Canada said in a press release.

Jesse Goldman, an international trade and investment lawyer at Bennett Jones, said the Bank of Canada has employed a stimulative monetary policy in hopes that a lower dollar would make Canadian exports more competitive, and to help businesses with the cost of borrowing to increase productivity, thus stimulating exports and domestic demand.

"But that hasn't happened, I think, because of the situation in the petroleum industry worldwide. It's affected Canada pretty significantly. It's quite a concern because the expectation that stimulative monetary policy would, in turn, stimulate an export revival in Canada hasn't happened yet," said Goldman.

"The manufacturing sector in Ontario continues to be moribund. I think one can legitimately question whether it's ever going to bounce back. There's been a fundamental structural change in the manufacturing sector in Canada. And I'm not sure at this point that it's capable of being responsive to stimulative monetary policy," he added.

In Ontario, the traditional heart of manufacturing in Canada, the recent downgrade by credit rating agency Standard & Poor's from A+ to AA- will have an impact on the province's coffers because it will increase its cost of borrowing over the long term, said Krishna.

"We have already a substantial amount of carrying costs, and our debt as it is, I think, is in the vicinity of about $12 billion a year and, of course, any downgrade has an adverse effect on your carrying costs," Krishna said.

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