

Economists tell Ottawa to bring fiscal house in order, but plan for worst

Keep deficits under control: economists

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OTTAWA - Canada's top economists are telling Ottawa to continue along on its deficit elimination path, but also to be prepared to reverse course if the economy collapses.

Chief economists at five of Canada's biggest banks briefed the Conservative caucus in Ottawa on Tuesday and later fielded questions on a wide array of economic and financial issues facing the country.

The well-attended meeting was private, but sources say the economists gave the caucus a similar message of concern about the possible fallout from European debt issues that they delivered later to a public event.

"We are dealing with an uneven, uncertain and underwhelming recovery," is how the Royal Bank's Craig Wright summed up the situation.

The message to the government is "stay the course," but also to be ready to return to appropriate stimulus spending if the global economy dives into a second recession.

Finance Minister Jim Flaherty has said he would be "flexible" in the event of a second crisis, but has not been specific about what policies he would pursue. Last month, he halved planned employment insurance premium increases for Jan. 1, citing weaker economic conditions and persistent high unemployment.

But opposition parties said the government is still taking \$600 million out of the economy with a payroll tax hike at the wrong time.

While the economists did not utter the word recession in their public event, which was organized by the **Canadian Bankers Association**, the concern was ever present in their commentary.

TD Bank's Craig Alexander said major bank failures in Europe could touch off a similar credit crisis that followed the Lehman Brother's collapse in the fall of 2008. That plunged the world into the deepest recession since the Great Depression of the 1930s.

Although Canada's direct exposure to Europe is limited, the indirect exposure through U.S. banks and so-called credit default swaps - insurance policies taken out against bank and sovereign defaults - could be considerable.

"We don't know who has got them and if it (a default) is triggered whose loss it will be," he said. "You just don't know and that's why this financial crisis is so scary."

Given the risks, and the overhang of both public and household debt, Canada can at best expect modest growth for some time, they said.

The economists agreed with the consensus that a key reason Canada's economy fared relatively well in the 2008-09 recession is that government finances were relatively solid. Most governments had balanced budgets and debt, relative to the size of the economy, was modest and falling.

That allowed Ottawa to pump billions of dollars into the economy during the slump and run up big deficits, while not breaking the bank.

Other governments were not so lucky. The U.S. also hiked stimulus, but now faces a ballooning national debt that will tax the country for years to come.

But the economists cautioned that the government should not get too complacent. Ottawa's deficit, currently estimated at \$31 billion, is scheduled to be eliminated in four years, but the aging population, along with Canada's poor productivity record, will put pressure on finances in future years.

For instance, Scotiabank's Warren Jestin said it was a "fantasy" that Ottawa can keep increasing health-care transfers to provinces at the current six per cent for longer than "a few years."

The agreement with the provinces expires in 2014, but the Harper government promised during the election to keep the funding increases in place for at least two years after that.

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