



The Bottom Line

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The Consumer Recession

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The sizable decline in stocks in the past two days reflects the growing awareness that the U.S. economy is going into a deeper and more protracted recession than expected. It is no longer seen as a housing recession, but a full-blown consumer recession. The consumer has represented as much as 72% of the U.S. economy in recent years, so the deceleration in household spending has a profound impact on the overall economy. In the past two days, we have seen larger-than-expected declines in retail sales, industrial production, inflation, oil and gasoline prices and employment. In the past three weeks, official as well as anecdotal evidence of a significant plunge in activity has mounted, including declines in shipping, homebuilding, auto sales, manufacturing, trucking, technology and restaurants. Bank loans and other forms of credit have plummeted as the credit crisis has hit business as well as consumers. Unemployment in the U.S. is headed to at least the 7%-to-8% range.

While very dramatic actions have been taken by financial authorities worldwide, it will take some time before the free flow of credit emerges, and even more time until the economy recovers. It is painfully obvious that 'decoupling' of other economies and financial markets was wishful thinking. The housing and credit bubbles have popped; and now the stock market shock is adding to consumer and business woes. The global credit crisis and economic slowdown has spread around the world. Canada cannot escape the knock-on damage of not only the U.S. recession, but also the wealth destruction arising from the plunge in our stock market and the slowdown in our housing markets. There is a downshift in global commodity demand, which impacts the formerly booming commodity-related sectors of our economy. The boom has turned to bust. Canada, too, is headed for recession and our government will awaken to the need for deficit spending. We are not immune to the global difficulties and the sooner we realize that and take action to mitigate the domestic damage, the better. We have a very sound banking system, and far more prudent households, but we are fully globalized in our financial and economic dealings. Our recession will be milder than in the U.S. and other countries with housing bubbles, but we should expect challenges through much of 2009.

There will be a multi-year adjustment to the new world of reduced leverage. The current crisis will mark the end of an era. No longer will the U.S. be borrowing from China to buy from the Middle East to burn oil at home—the 'borrow-buy-burn' mentality and the leverage that allowed it is painfully vanishing.

The Bottom Line: The financial crisis, while hopefully diminishing, leaves in its wake a dramatic slowdown in the U.S. and elsewhere. The stock market is reflecting that reality.

The problems are viral, as we have seen, and Canada is not immune. Unfortunately, the likelihood of a protracted and deep recession in the U.S. is high, with the rest of the world mirroring the U.S. in varying degrees. Expect recession in Canada.

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