

Canada in a Post-Consumer World: Uncomfortably Numb

Douglas Porter, CFA, Deputy Chief Economist

The March drop in U.S. retail sales sends an ice-cold reminder that consumers won't spring out of the sick bay anytime soon. Sales are down more than 9% from a year ago, and households face a long workout period ahead. The broader picture is that the world economy has effectively lost its sugar daddy. For all the scolding from thrifter nations about loose spending, the simple fact is that the U.S. consumer remained the main driver for global growth right up until last fall—a fact that has become all too painfully obvious in the past six months. While fiscal policy is being scrambled around the world to fill the void, that's not a permanent solution to a diminished U.S. consumer. The hard reality is that there are no obvious full-fledged substitutes for the U.S. consumer. This means that even when recovery eventually takes hold, not only will U.S. growth be subdued, but the risk is that so will medium-term global growth—and specifically Canada.

In the decade up to 2007, U.S. real consumer spending rose at a 3.5% annualized pace, compared with a meagre 1.3% clip for all other sectors of U.S. GDP (Chart 1). Drilling down further, durable goods (autos, furniture, appliances) rose at a hefty 6.7% pace in that period, while non-durable goods (clothes, food, gasoline) chugged along at a 3.3% rate. These unsustainable growth rates are not coming back anytime soon (see Focus February 20, "Thrifty Future"). Meantime, the U.S. government must eventually come to terms with its massive budget deficits, suggesting that the public sector will not be a big contributor to growth beyond the next few years, and consumer spending will eventually face yet another hurdle from a rising tax burden. Against this backdrop, U.S. domestic demand will be challenged to post real growth of much better than 2% over the medium term, following a steady diet of plus-3% gains in recent decades.

Looking beyond the deep valley of the current Great Recession, this much more subdued medium-term outlook is a challenge for all nations, especially Canada. While China has overtaken Canada as the single biggest supplier to the U.S. economy (Chart 2), this country has nevertheless thrived by essentially selling lots of stuff to the U.S. market

CHART 1
THE ONCE-ALMIGHTY U.S. CONSUMER

United States (10-yr % chng : a.r.)

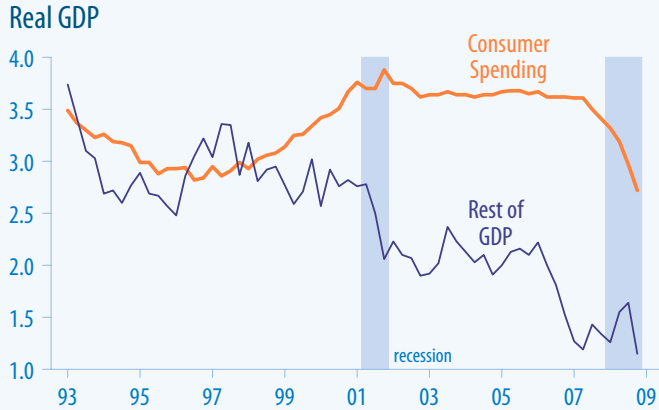


CHART 2
CHANGING OF THE GUARDS

United States (% of total imports)

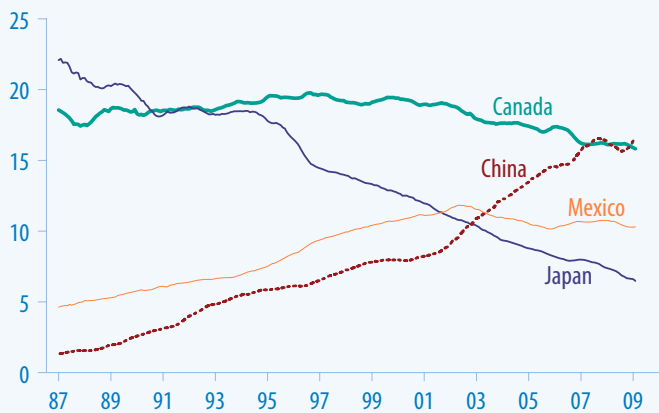


CHART 3
THE TIE THAT BINDS

(2-yr % chng : a.r.)

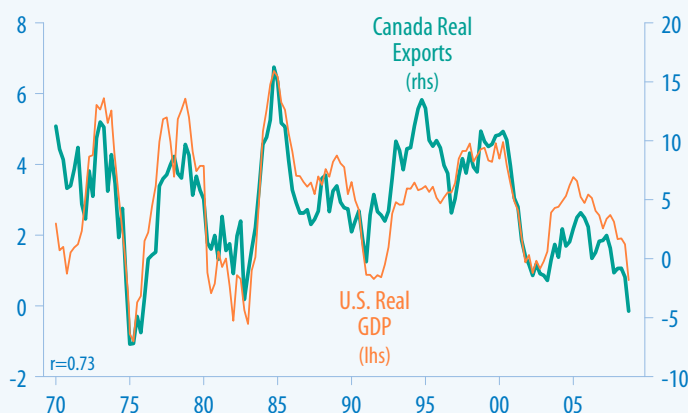


CHART 4
HEADED LOWER
(% of GDP : 4-qtr m.a.)

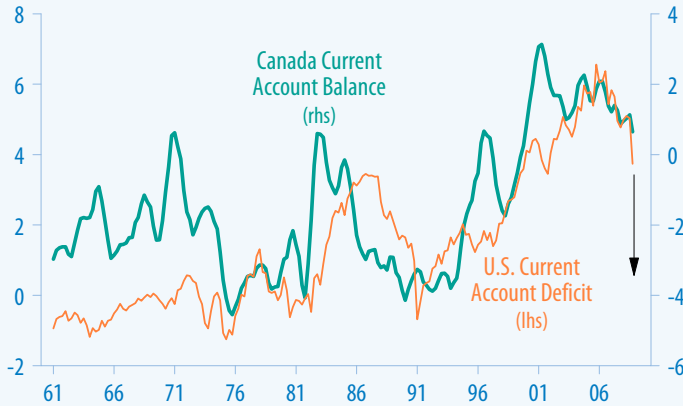


CHART 5
CANADA'S BRIEF NET CREDITOR STATUS
(% of GDP)

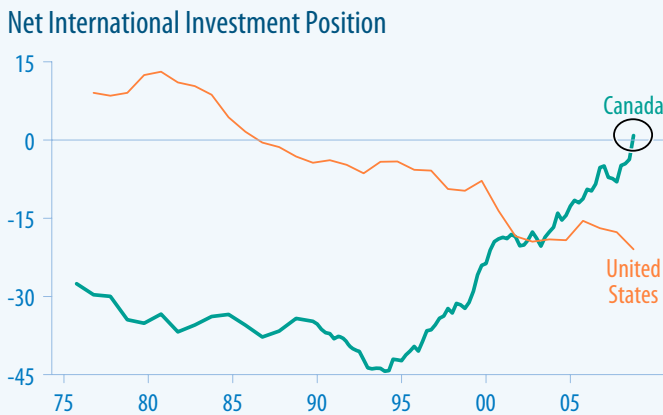
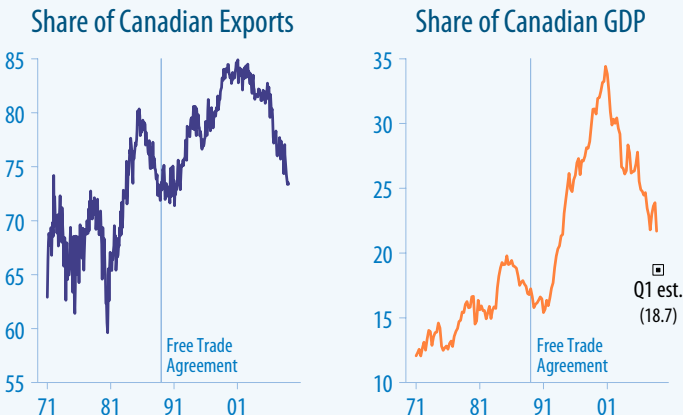


CHART 6
HEADING SOUTH
Exports to United States (percent)



(Chart 3). Brisk U.S. consumer demand was the bedrock beneath the three-decade string of Canadian merchandise trade surpluses, recent sub-6% unemployment rates, and strong government revenues. Gone, gone, gone.

In fact, Canada's foray into the refined world of current account surpluses this decade can simply be viewed as the mirror image of the U.S. descent into unsustainably large current account deficits. Prior to the great lift-off by U.S. consumers in the early 1980s, the U.S. current account had actually been, on average, in a balanced position for the prior two decades. That may well be where the U.S. is ultimately headed again as households deleverage. With the U.S. rapidly heading back to something more manageable on the current account front, Canada's deficit could approach its pre-1980s norm of around 3%-to-4% of GDP, or over \$60 billion per year (Chart 4).

A return to large current account deficits by itself is no disaster, especially if they are merely cyclical in nature. However, this looks to be much more long-lasting, with the U.S. consumer likely embarking on a prolonged period of retrenchment. As Canada begins to run a series of significant current account deficits, the country's new-found status as a net creditor nation (Chart 5) will abruptly end. Again, that's no disaster given that Canada has been a net debtor for most of its history, but it would remove one rather prized feather from the country's cap.

More importantly, the diminished U.S. consumer will weigh on Canada's medium-term growth prospects. True, exports to the U.S. have faded relative to other countries and relative to Canada's GDP in recent years (Chart 6). For instance, merchandise exports to the U.S. now account for less than 20% of Canadian nominal GDP, well down from more than 30% earlier this decade. Even so, there is little doubt that U.S. demand will still have an outsized impact.

The Bottom Line: A post-U.S.-consumer world reinforces the need for Canada to find new sources of growth, whether from domestic demand or non-U.S. markets. Otherwise, with U.S. real spending struggling to reach a 2% trend rate, Canadian GDP may also struggle to grow much faster than 2% on a sustained basis even after the U.S. recovery takes hold.

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