



Canada's Prime Minister Justin Trudeau arrives for a press conference after the G20 Summit in Hamburg, Germany, July 8, 2017. TOBIAS SCHWARZ  
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## CANADA

# Canada's Economy Is Booming Under Justin Trudeau. But Can It Last?

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Canada's economy is booming, and that's good news for Justin Trudeau. The question is whether it can last until the next election.

Growth in May beat all forecasts, a 4.6 percent expansion on a yearly basis that was the fastest in 17 years. Canada is forecast to lead the Group of Seven in growth this year, data compiled by Bloomberg show.

Fortunately for the prime minister, Canadians are starting to feel it. Recent polls show his popularity stable or improving. His marks on the economy are particularly strong -- half of those who voted for the rival Conservative Party, whose core political message is economic competency, give Trudeau a passing grade on the subject. The Bloomberg Nanos Canadian Confidence Index has reached an 11-month high.

Yet one risk is the economy may be peaking too fast, politically. That might explain why Trudeau and Finance Minister Bill Morneau continue to say they will stick to their spending plan rather than tighten fiscal policy amid the expansion.

The Bank of Canada raised interest rates on July 12, and is expected to hike at least once more this year. As Bloomberg reported last week, some officials within the Trudeau government are nervous the tightening began too soon, as Canadians carry ample debt. A Morneau spokesman said Friday the minister has “full confidence” in the central bank.

Political concern may nonetheless be warranted. Trudeau’s Liberal Party under a former leader swept to power in 1993 and won three subsequent elections -- all of them while interest rates were stable or falling and the economy was relatively strong. “The working assumption of every central bank is more governments would favor more growth and looser policy,” said Doug Porter, chief economist at Bank of Montreal.

Rates are now projected to rise heading into Canada’s 2019 election, while growth is forecast to fall. The last time a Liberal government entered an election in the middle of a monetary policy tightening cycle was in 2006; that year, the Conservatives defeated them.

## **Can It Last?**

Output growth will peak this year at 2.6 percent and slow in each of the next two years to 1.9 percent in 2019, according to a Bloomberg consensus survey. While still respectable -- it’d be behind only the U.S. in the G-7 -- it’s nowhere near the level of growth being seen today. Sustaining the current pace would be a tall order.

“To me, that’s virtually impossible,” said Jean-Francois Perrault, chief economist at Bank of Nova Scotia in Toronto and a former finance department official. It would be “fantastical” to have growth anything close to 3 percent in 2019, he said. “You’re in a world when growth is at least twice potential. That can’t be sustained.”

Trudeau came to power in 2015, a year when growth sagged to 0.9 percent, partly by pledging new deficit spending on infrastructure and family tax cuts to prop up the economy.

The strong growth will likely cut Trudeau’s deficit figures and, as such, borrowing requirement. “They could choose to spend a part of that, and still have a lower deficit than we have in the budget, financed in part through higher revenues,” Perrault said.

## Rate Tension

Trudeau and Morneau have stayed quiet since the report that some of the prime minister's officials are worried Poloz will stunt growth by moving too quickly on rates. Poloz nonetheless has backing from economists for hiking. "I think the Bank of Canada's exactly right in doing what it's doing," said Randall Bartlett, chief economist of the University of Ottawa's Institute of Fiscal Studies and Democracy.

Because of how the Bank of Canada has incorporated federal fiscal projections in its forecasts, there's a risk markets might over-read any tension over rates and interpret the government "as having more influence on the governor than it would past Bank of Canada governors," he said. "The risk is still small and likely won't influence market decisions unless the prime minister or finance minister say something publicly."

Governor Stephen Poloz, meanwhile, may not move all that quickly. "Beyond the near-term, a return to a more cautious communication strategy and pace of interest rate increases is expected in light of the headwinds facing Canada," including slow inflation growth, Toronto-Dominion Bank Senior Economist Brian DePratto said in a research note.

## Week Ahead

MLI leading indicator (Monday, 7 a.m.) Industrial product price index and raw material price index (Monday, 8:30 a.m.) Bloomberg Nanos consumer confidence index (Monday, 10 a.m.) Markit Canada Manufacturing PMI (Tuesday, 8:30 a.m.) Jobs report (Friday, 8:30 a.m.) Trade report (Friday, 8:30 a.m.) Toronto home sales (time unconfirmed) Vancouver home sales (time unconfirmed) Desrosiers auto sales (time unconfirmed)

## Surprising Spread

Canada's currency, trading near the highest in two years, may also be reaching a peak.

The spread between the Canadian and U.S. [Citigroup](#) Economic Surprise Indices -- which track when an indicator beats or misses expectations -- widened to 130 points this week, the most since 2011. The divergence may be a sign the loonie is about to weaken, according to David Doyle, an economist at Macquarie Capital Markets in Toronto.

Similar divergences in 2015 and 2016 presaged periods when the Canadian dollar depreciated 8 percent and 4 percent over the subsequent three months, Doyle said.

## Popular Boost

Canadians' optimism for their own finances and job security has reached a 10-month high, polling for the Nanos confidence index published Monday showed. The share of those who say their finances have worsened in the last year fell to 21.7 percent, the lowest in a year.

The share of those expecting the economy to strengthen over the next six months rose to 28.1 percent, the highest level since November of 2015, the month Trudeau took power.

An Abacus Data poll released this month found 62 percent of Canadians think Trudeau is doing at least "an acceptable job" on the economy, including 49 percent of those who voted in the last election for the Conservatives. The party governed from 2006 to 2015 and is Trudeau's chief rival, particularly on the economy.

The same firm, in its last survey during the election, found 37 percent of respondents said the election was about the economy, more than any other subject, with 55 percent of Conservative voters listing it as their top issue. "The shift in perceptions about the economy is something the government can trumpet," Abacus Chief Executive Officer David Coletto said.

Trudeau will hope they remain as high as rates rise -- and with growth and the dollar poised to cool.