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Seven Lean Years—Explaining Persistent Global Economic Weakness

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Bank of Canada and European Central Bank Conference

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The global economy remains weak and divergent

- Global growth rates below previous trend, with series of downside surprises
- Major groups of economies are on divergent paths
- Inflation persistently low in many economies
- Rival—or complementary--explanations
  - Prolonged fallout from the crisis
  - Procyclical policy responses and other events
  - Structural decline in potential growth rates
- These explanations have very different policy implications

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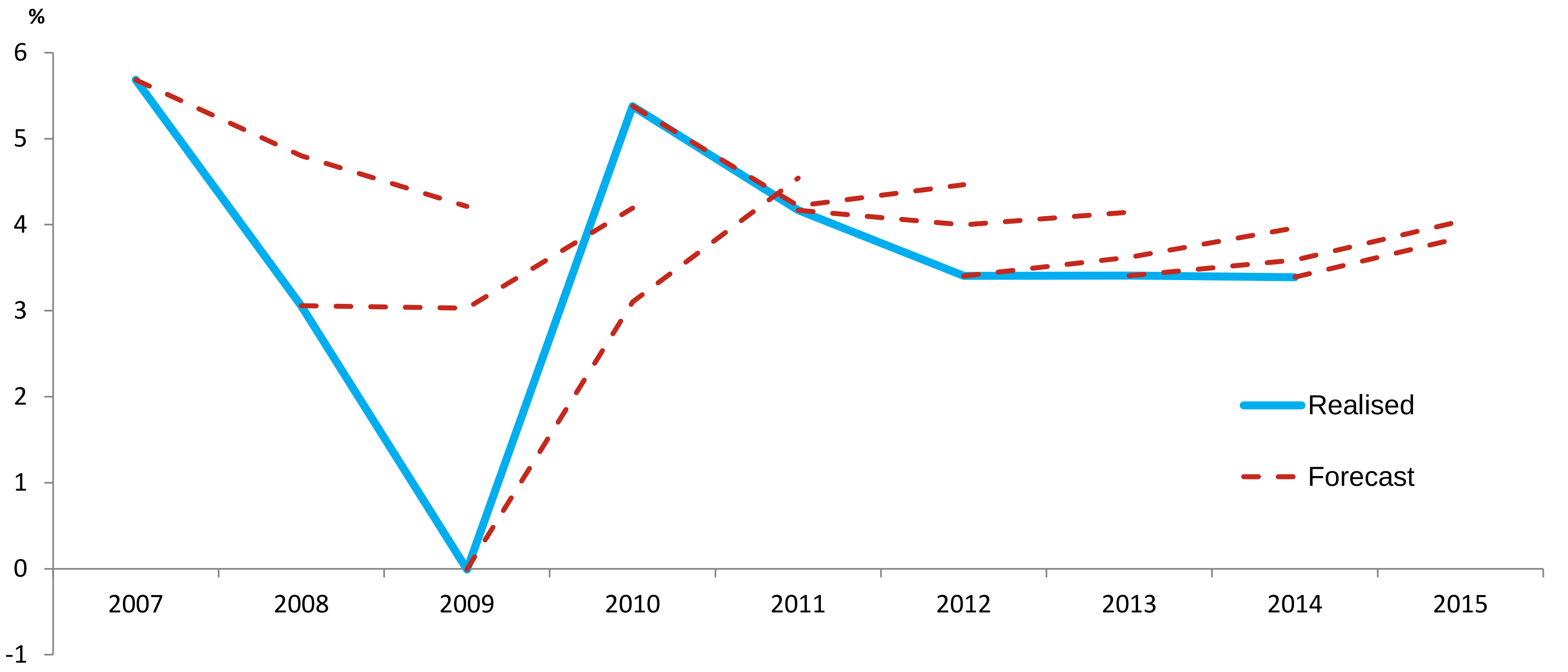
Serial disappointment

World GDP growth - Realised vs IMF forecasts

(%, Annual world GDP growth)

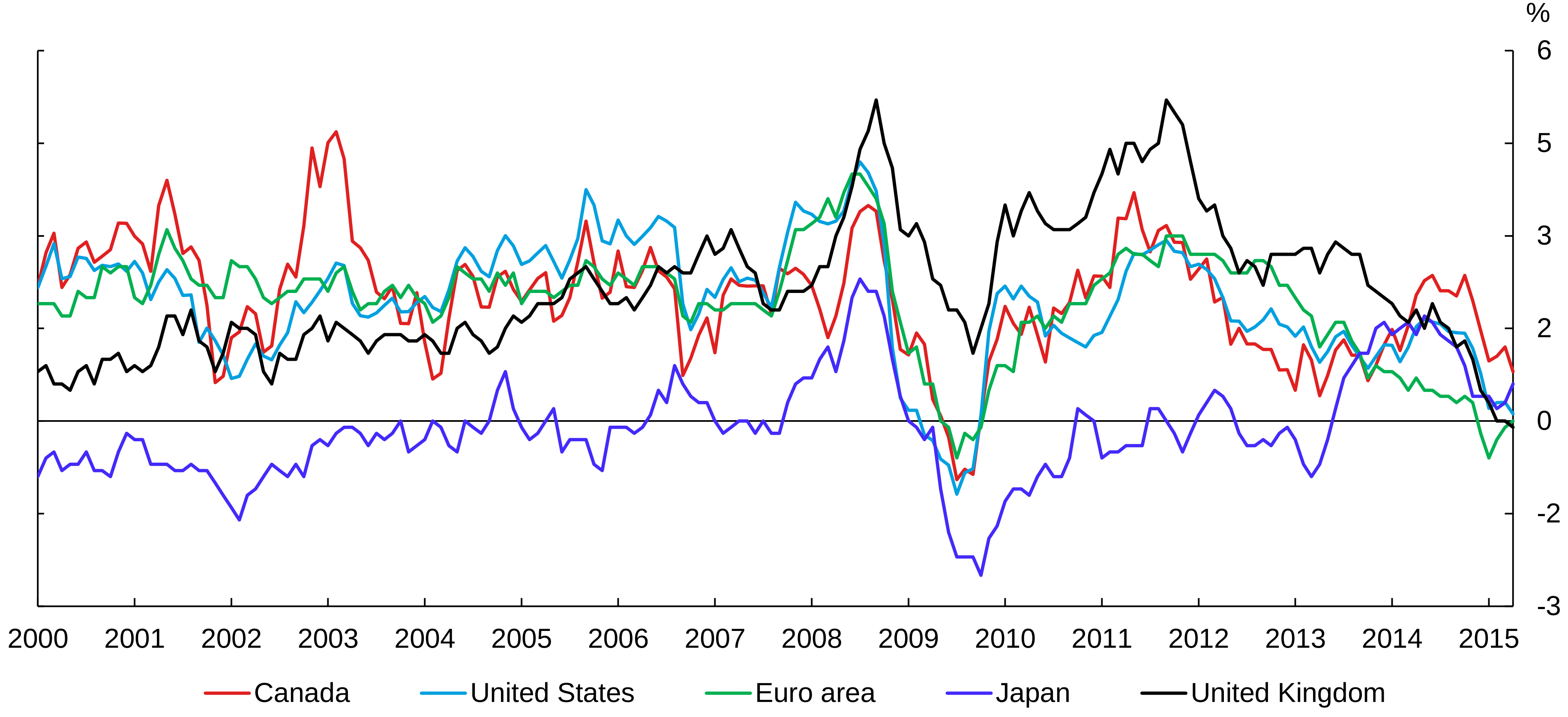


Source : IMF WEO

Last observation: October 2014

Inflation has been persistently slow in many advanced economies

CPI inflation, Year-over-year percentage change



Note: Starting in April 2014 and ending in March 2015, Japanese inflation has been adjusted downward by 2 percentage points, based on Bank of Japan estimates of the effect of the increase in the value-added tax

Sources: Statistics Canada, U.S. Bureau of Economic Analysis, Eurostat, Japan Ministry of Internal Affairs and Communications, Bank of Japan, U.K. Office for National Statistics

Last observation: April 2015

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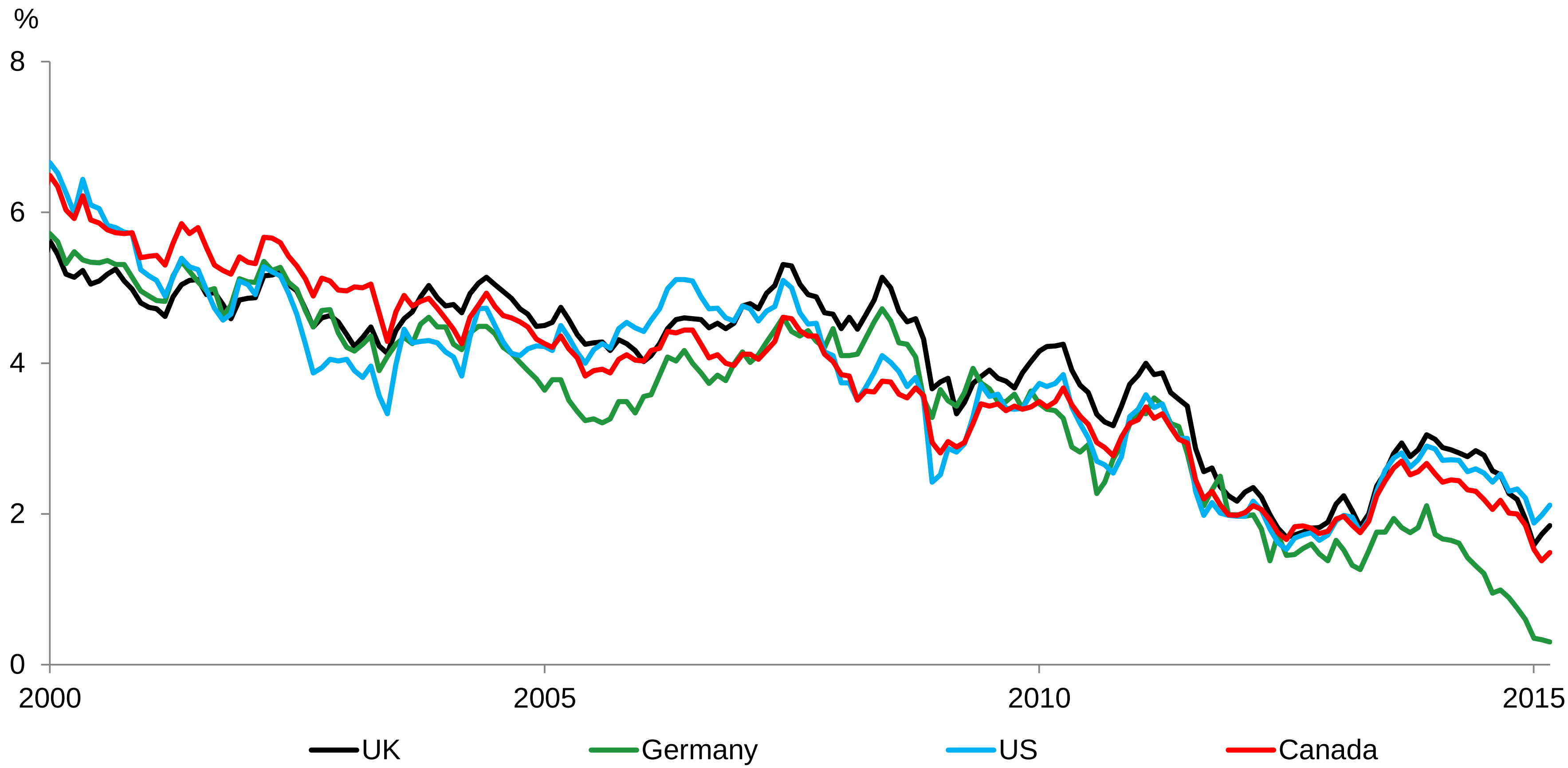
Nominal long-term interest rates

10-year government yields, monthly averages, %



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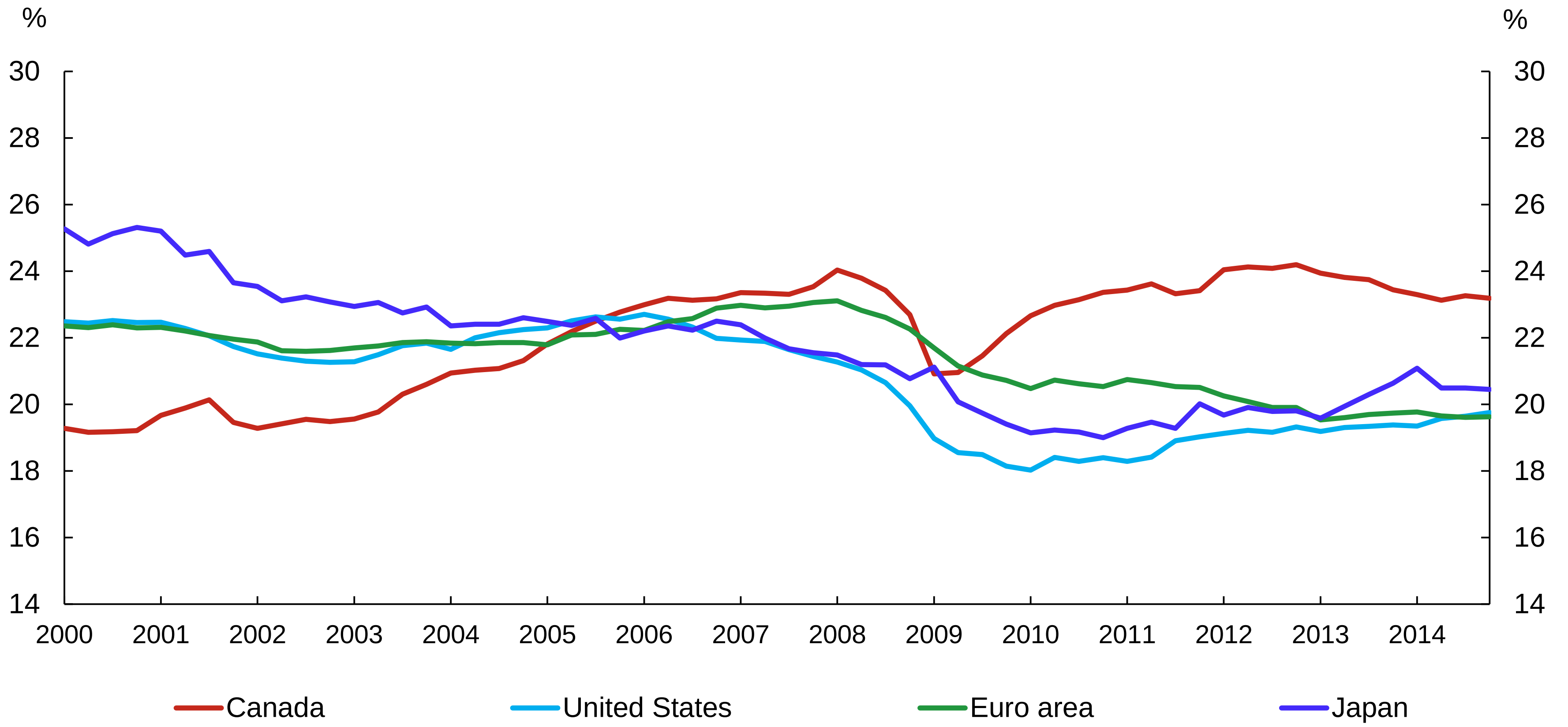
Investment has been on a lower track

Investment as a share of GDP

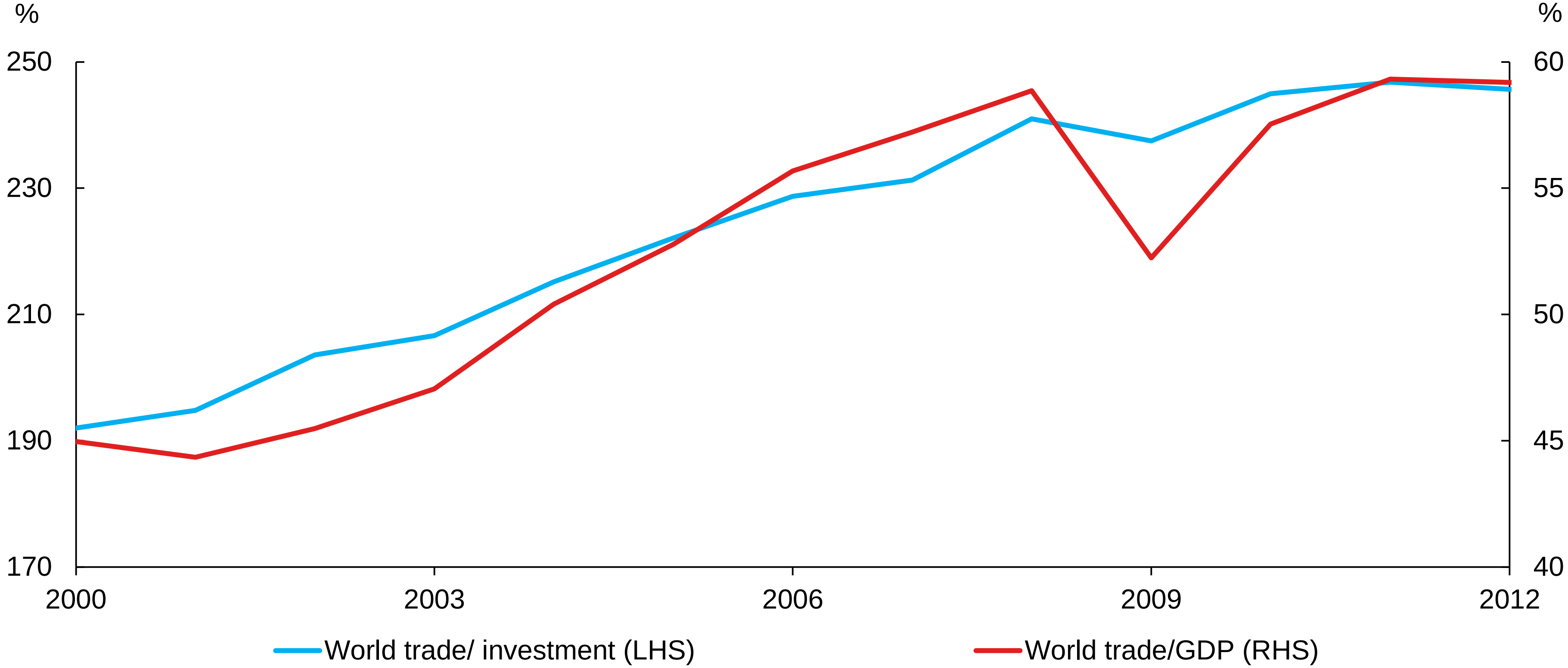


Note: Investment calculated as gross fixed capital formation
Source : StatCan, BEA, EUROSTAT, CAO

Last observation: 2014 Q4

Global trade has weakened post-crisis

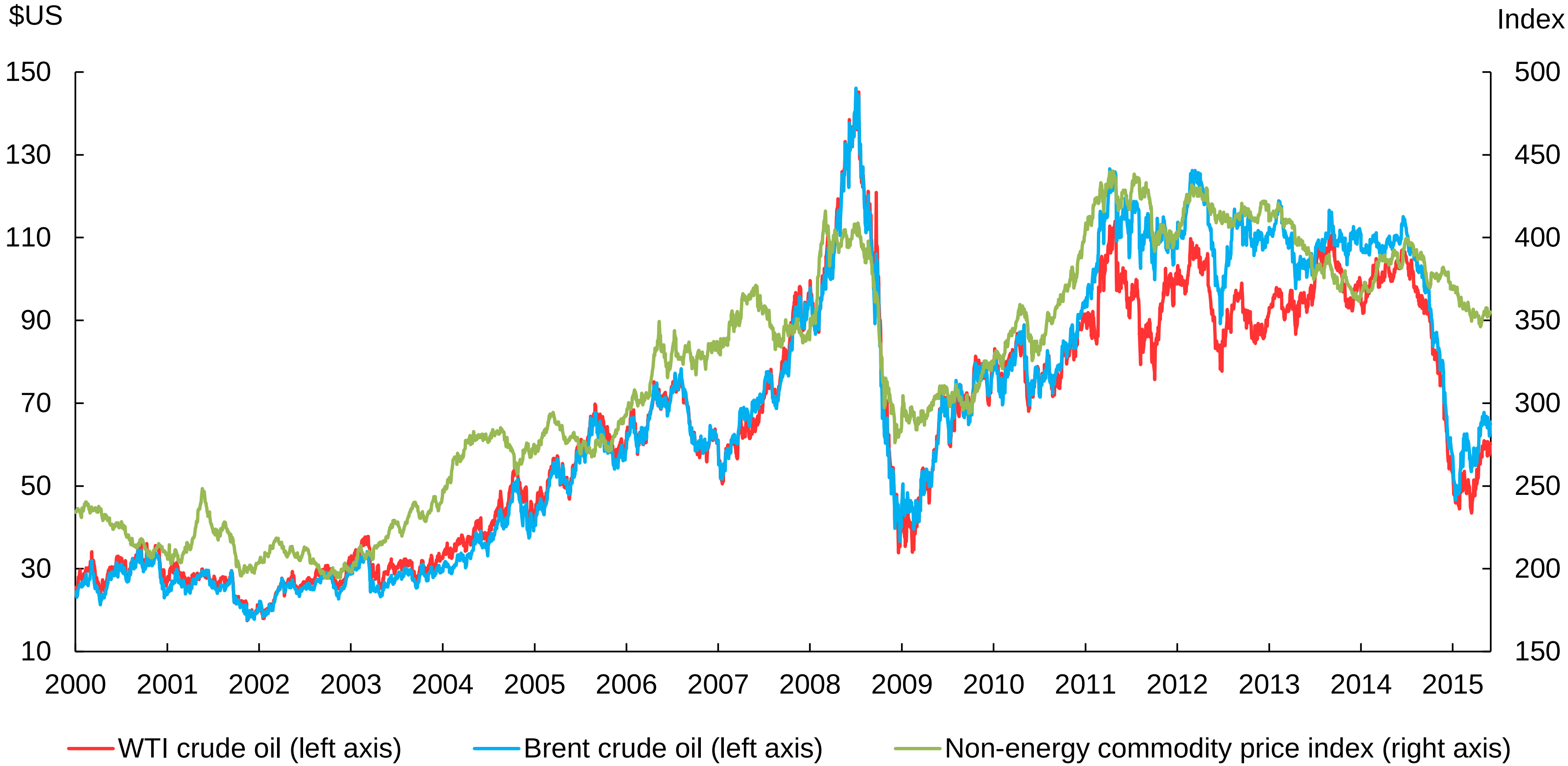
World merchandise trade as a share of GDP and investment
Shares calculated from real values in 2005 USD. Annual data.



Note: World gross capital formation is used to represent investment.
Sources: WDI, IMF IFS, IMF DoT

Last observation: 2013

Commodity prices



Source: Bloomberg and Bank of Canada

Last observation 1/6/2015

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Fallout from the crisis

- It is well-known that recessions following financial crises have persistent effects—Reinhart and Rogoff
  - Balance-sheet repair deleveraging
  - Many initial forecasts did not take this experience to heart
- Deleveraging process has been protracted, with varying results
  - In the US, private sector debt has been brought down while public sector debt continues to mount
  - In the EU, compressed spending did not prevent a further increase in household indebtedness
- Prolonged uncertainty

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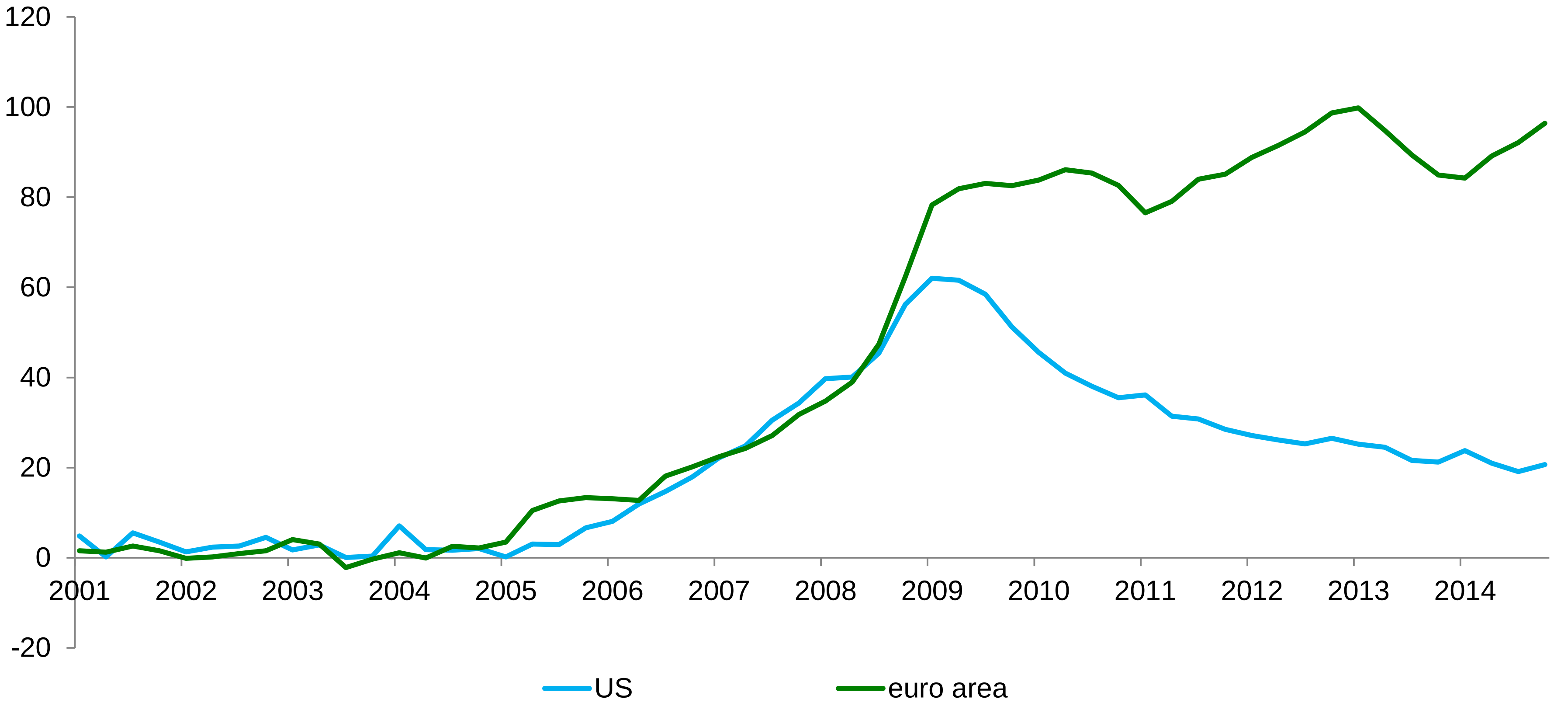
Deleveraging

Domestic debt remains elevated in the euro area
(Cumulative debt increase since 2001, as a share of GDP)

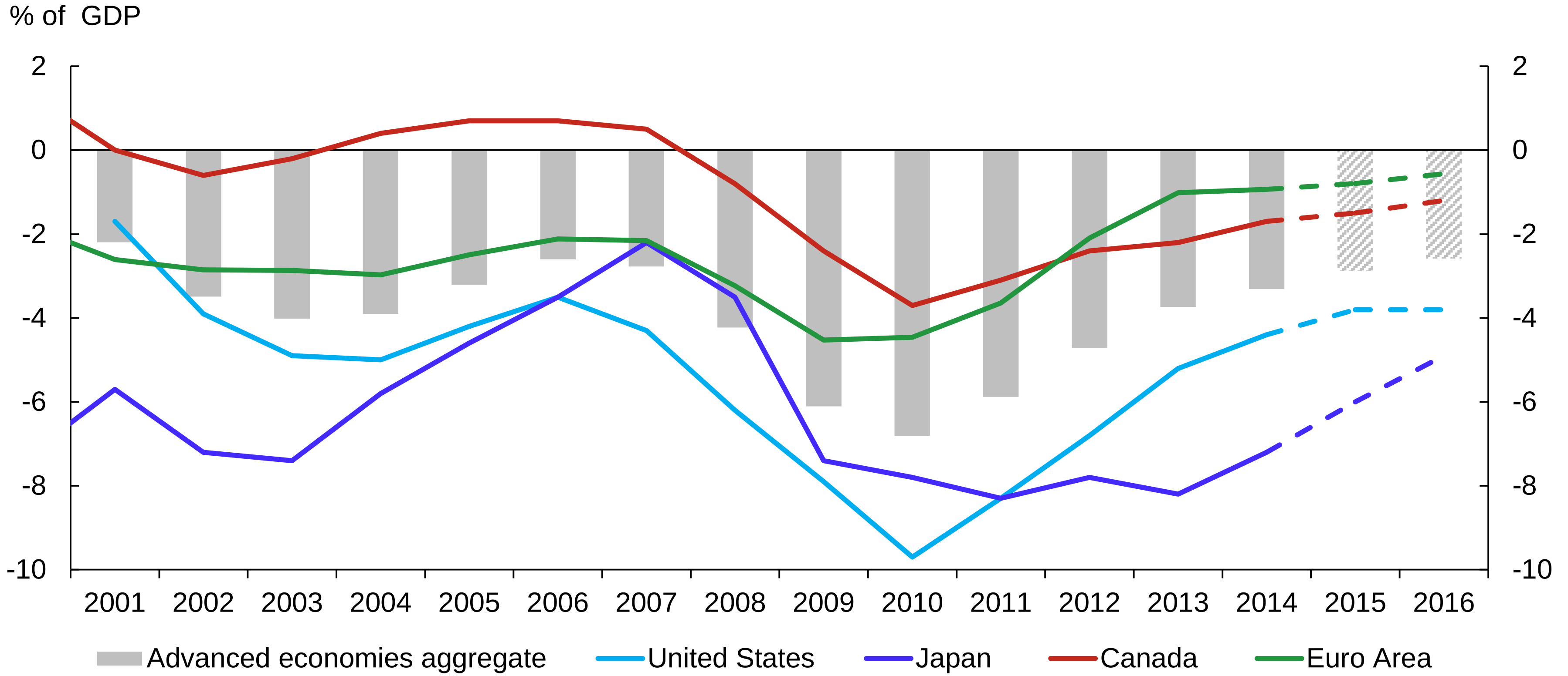


Procyclical policy

- During the crisis, coordinated fiscal expansion—key to preventing another Great Depression
- Starting in 2010, fiscal authorities in many countries started return to balance—in some cases by choice
  - Left monetary policy as "only game in town"
- Another perspective: asymmetric global rebalancing
  - The deficit countries do most of the adjustment
- Financial reforms reinforced financial institutions' ongoing post-crisis balance sheet adjustment

Fiscal consolidation

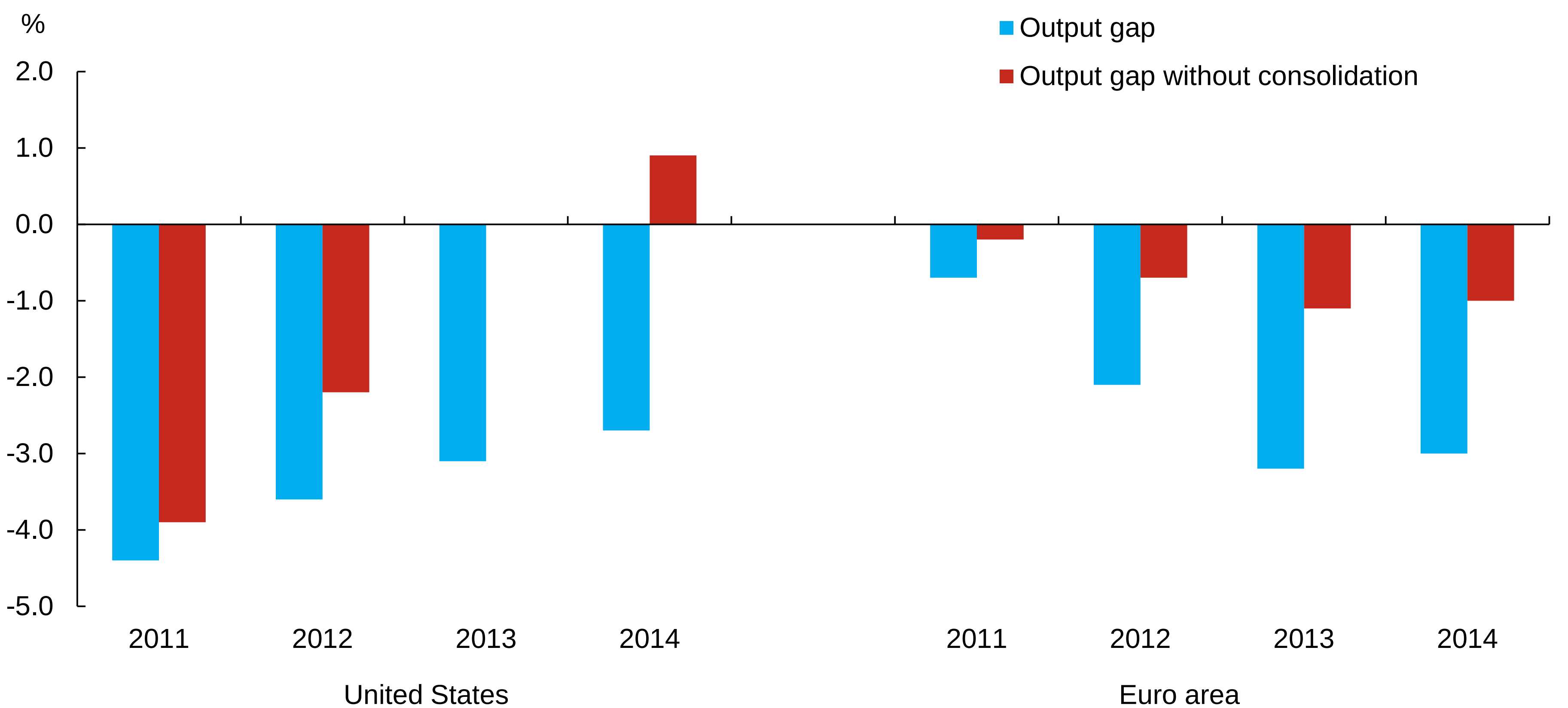
Structural balance as a per cent of GDP in advanced economies



Source: IMF WEO
Notes: 2015 and 2016 are projected values by the IMF.
The chart uses an aggregate series weighted by the IMF PPP weights. The advanced economies in the aggregate include: US, Japan, Germany, France, Italy, Spain, Australia, Canada, Denmark, Ireland, Korea, Netherlands, New Zealand, Norway, Portugal, Sweden, Switzerland, United Kingdom

Fiscal consolidation has delayed the recovery

Estimated effects of fiscal consolidation on the output gap



Source : Staff calculation

Last observation: 2014

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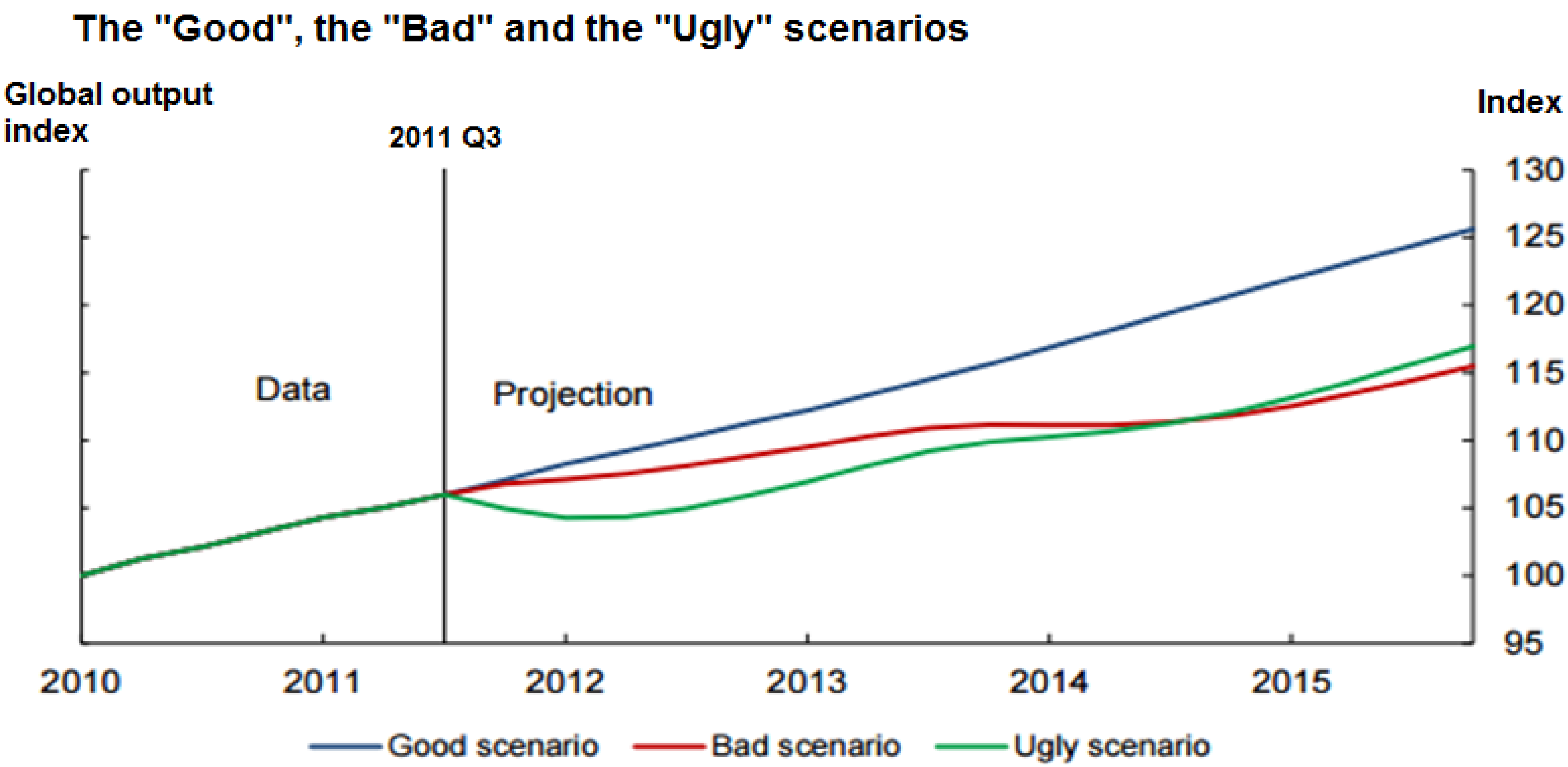
Consequences of asymmetric adjustment



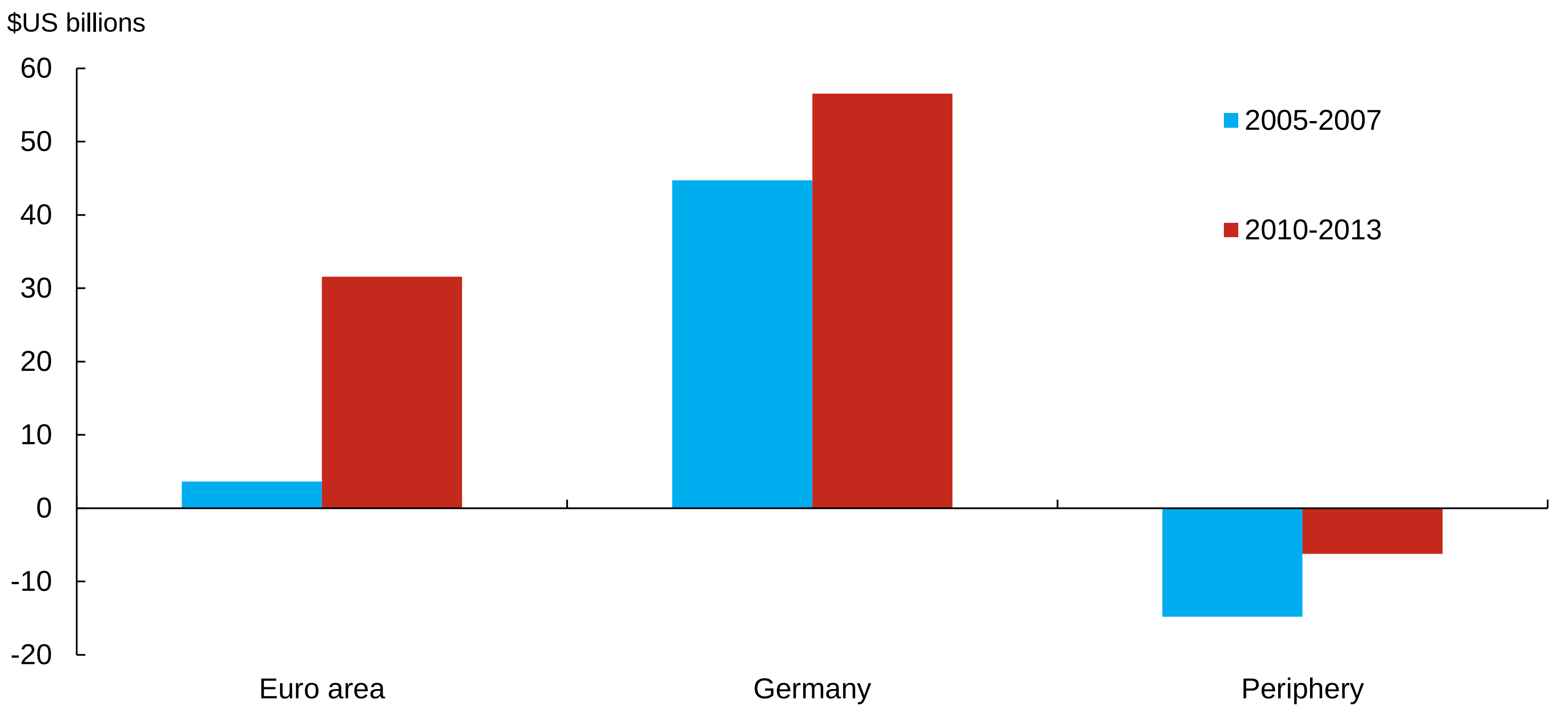
Note: All series refer to world GDP.
Sources: GMUSE and BoC-GEM-Fin simulations

Euro area crisis and adjustment

- Three dimensions to crisis
  - Asymmetric balance-of-payments adjustment
  - Fiscal crisis
  - Financial crisis
- Fragile confidence—limited room to maneuver

Euro area rebalancing

Current account balances pre and post crisis average

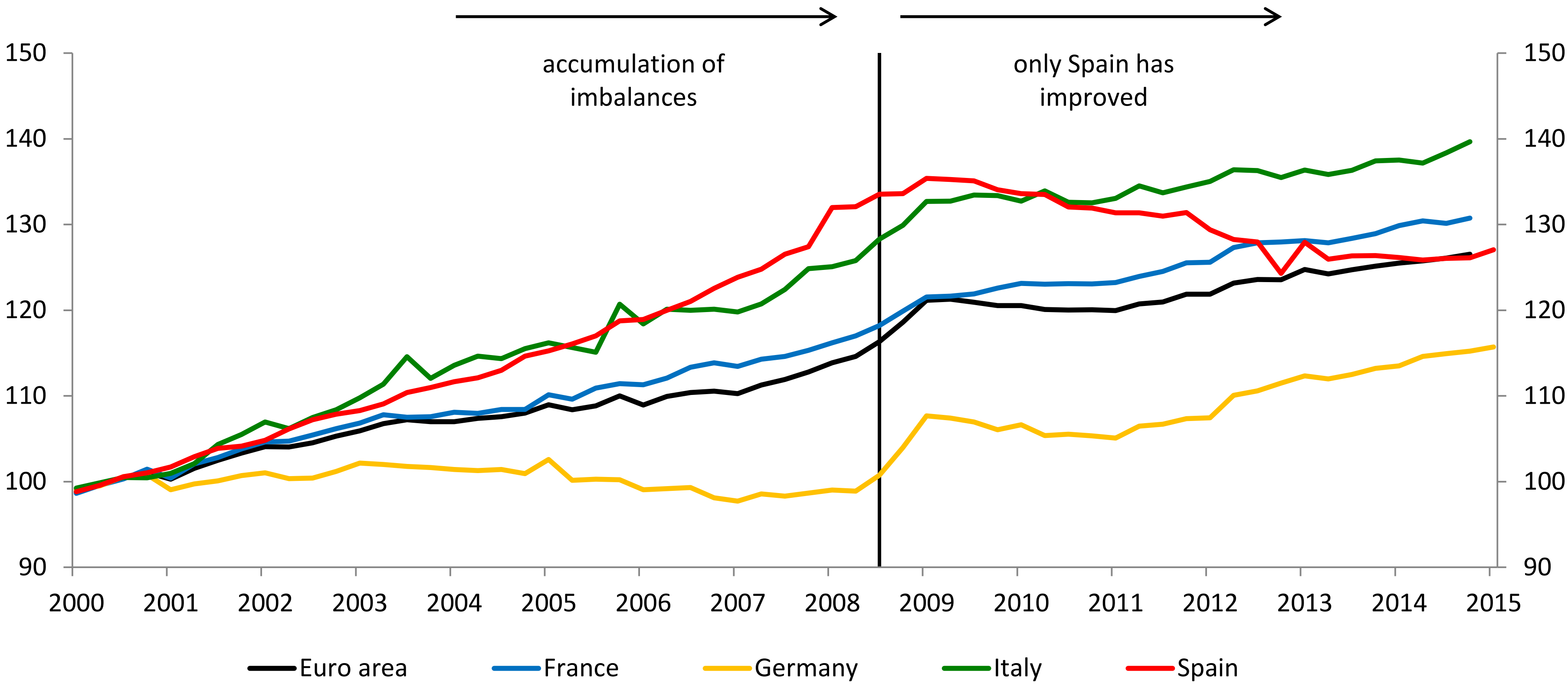


Source: IMF

Labour costs

Nominal Unit Labor Costs

Index: 2000=100



Source : Eurostat

Last observation: 20014Q4

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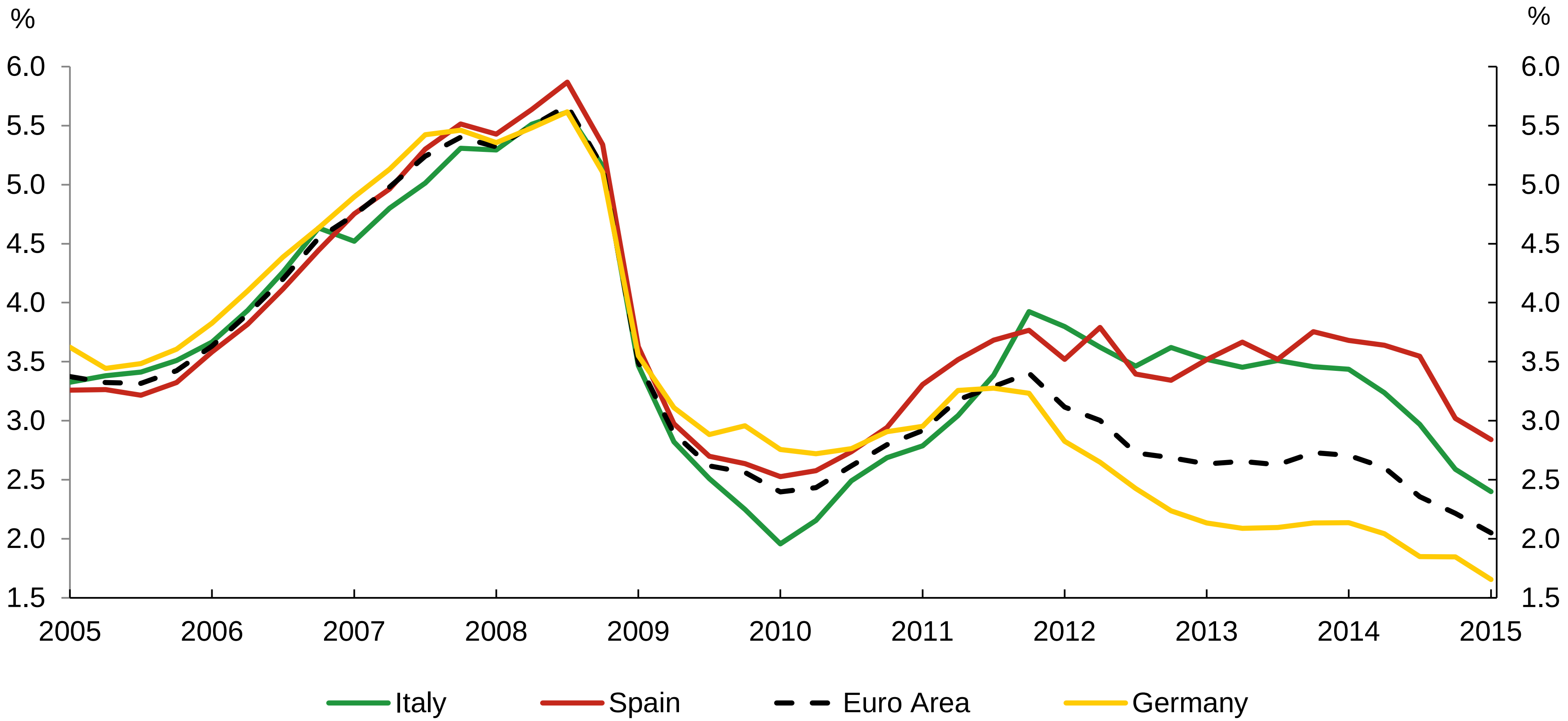
Financial fragmentation in euro area

Interest rates have diverged in the euro area

New loans, quarterly, %

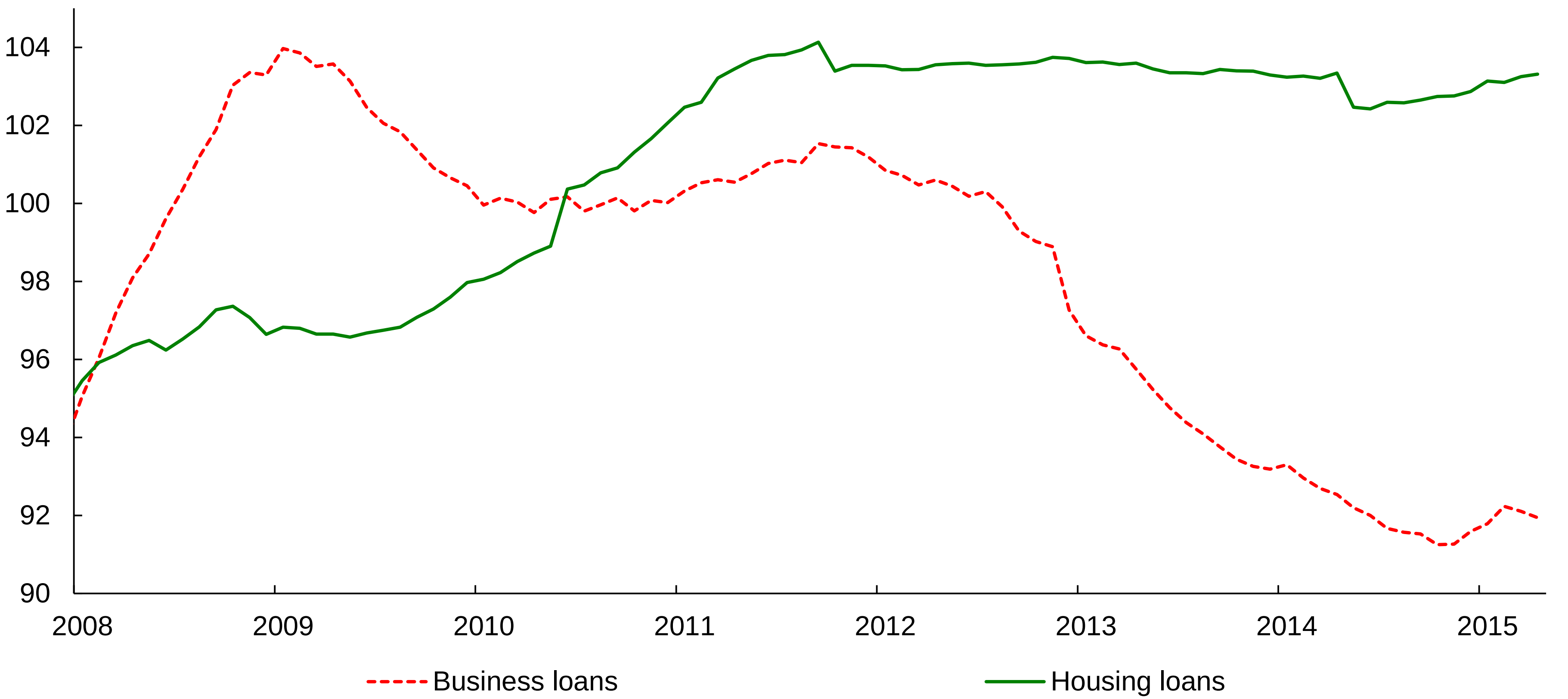


Source: ECB

Last observation: 2015 Q1

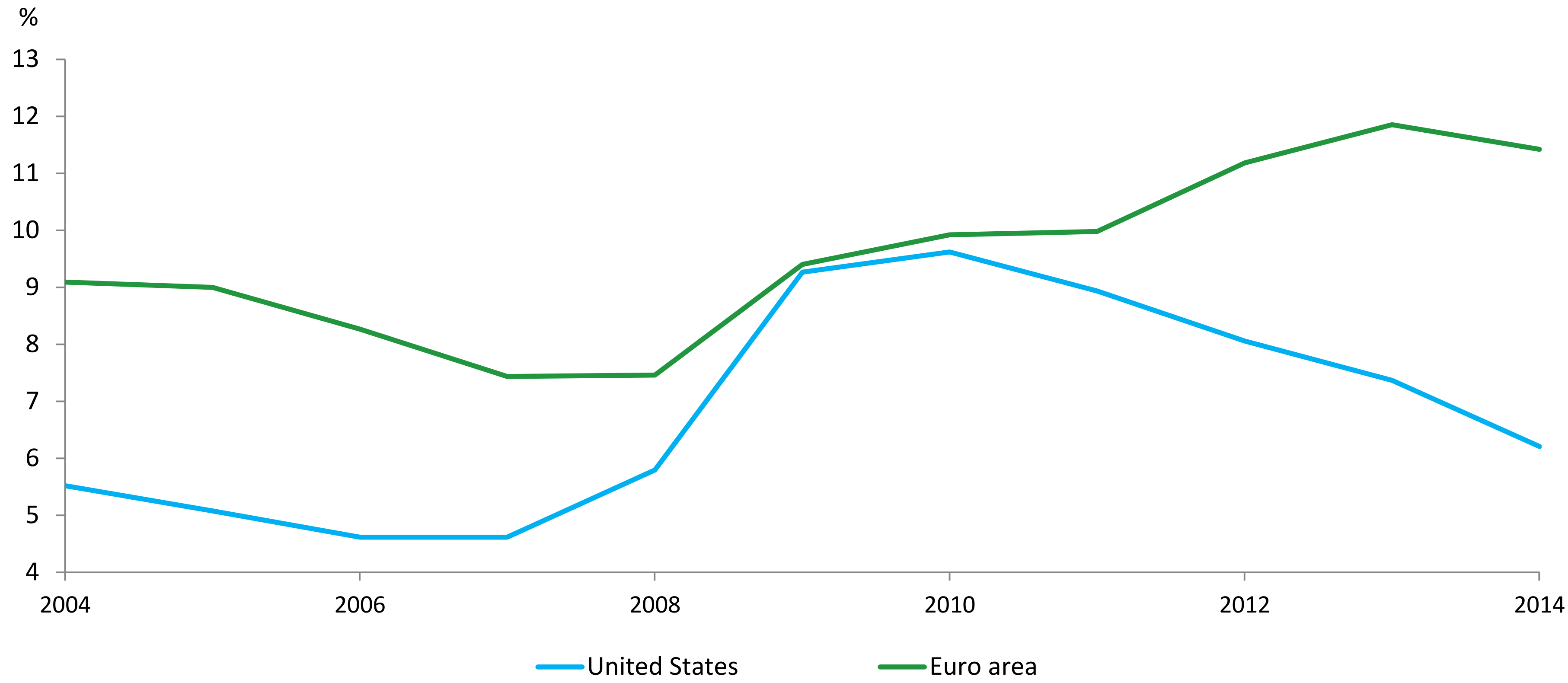
Loan growth in the euro area has been anemic since the financial crisis

Business loans in the euro area remain at a depressed level
(Index: 2010=100)



The unemployment rate remains elevated

Unemployment rates
(%, annual data)



Source: OECD

Last observation: 2014

"Events, dear boy, events…"

- Fiscal cliff
- Russia/Ukraine
- Arab Spring, Libya, Egypt, ISIS, Gaza
- South China Sea
- Japanese tsunami, floods in Thailand
- North Korea
- The Occupy movement
- Polar Vortex
- etc., etc.

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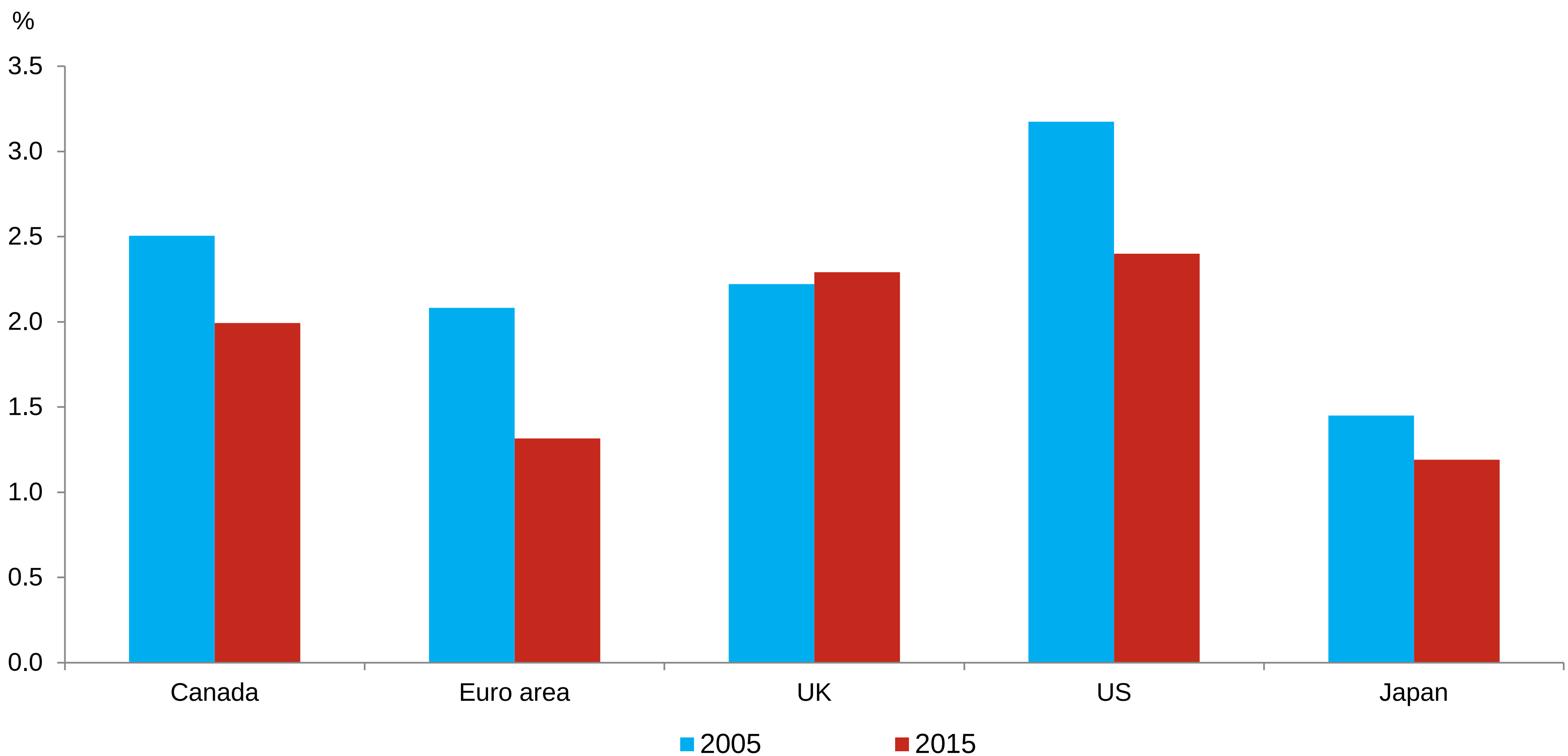
Structural factors

- Meanwhile, potential growth also slowing—for reasons largely independent of) the post-crisis adjustment
  - Demographics
  - Income inequality
  - Increasing share of world GCP in EMEs with high savings rates
  - Maturation of Chinese economy
- “Secular stagnation” arguments take these factors to an extreme

Long-run growth prospects have been revised down across advanced economies

Average of GDP growth forecast 6-10 years out



Source: Concensus Economics

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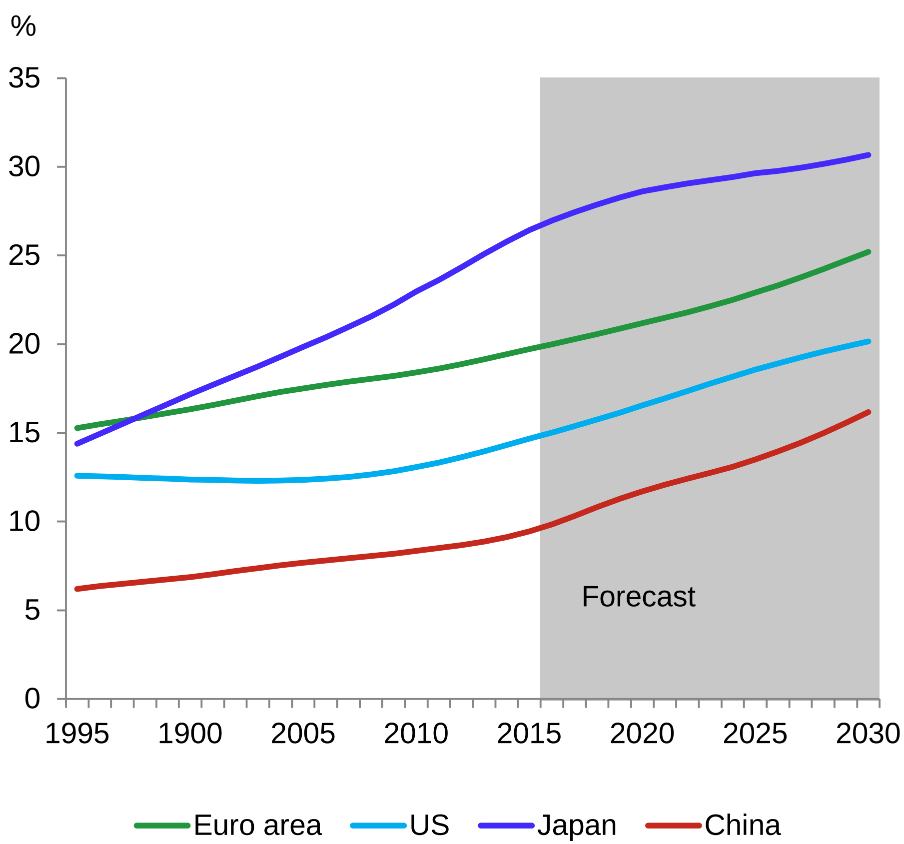
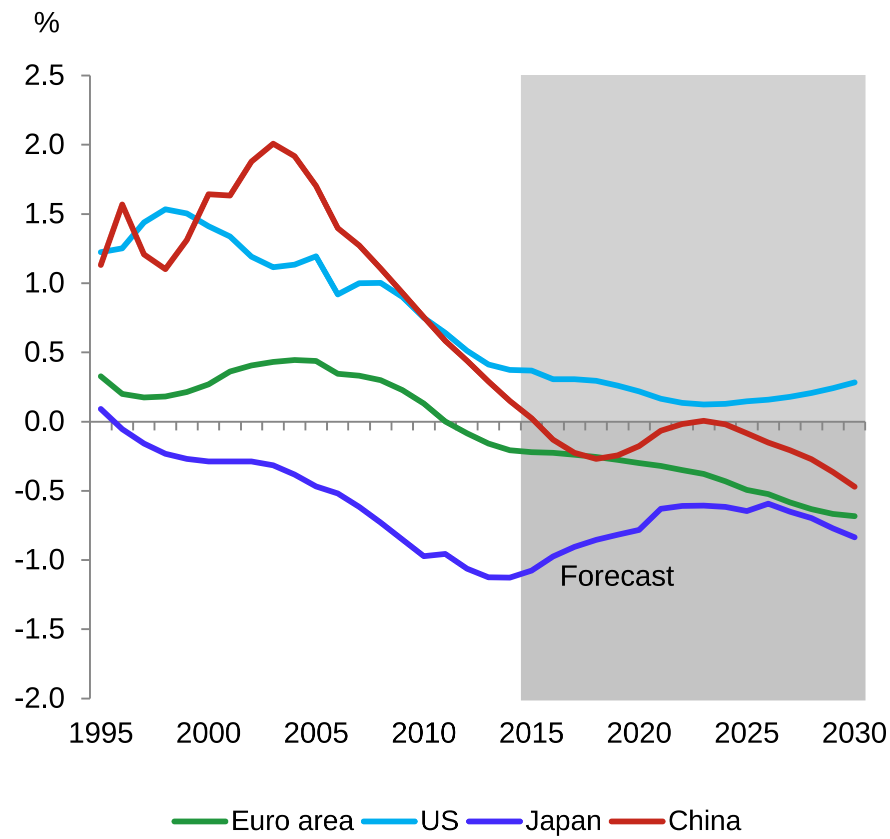
Demographics: aging populations

Share of population aged 65+



Labour force growth

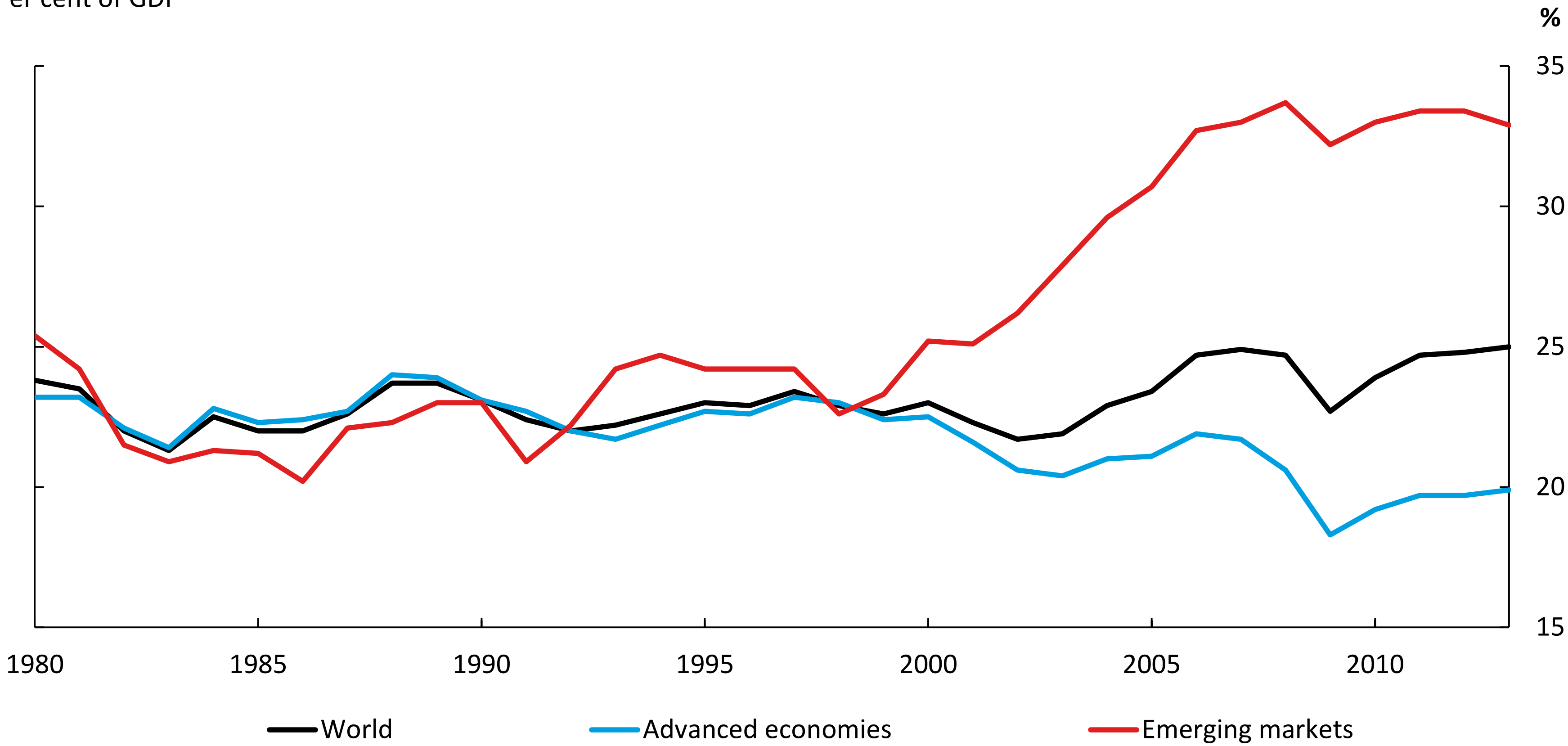


Source: United N population statistics

Savings glut?

Global, Advanced Economies and Emerging Market Savings

Per cent of GDP

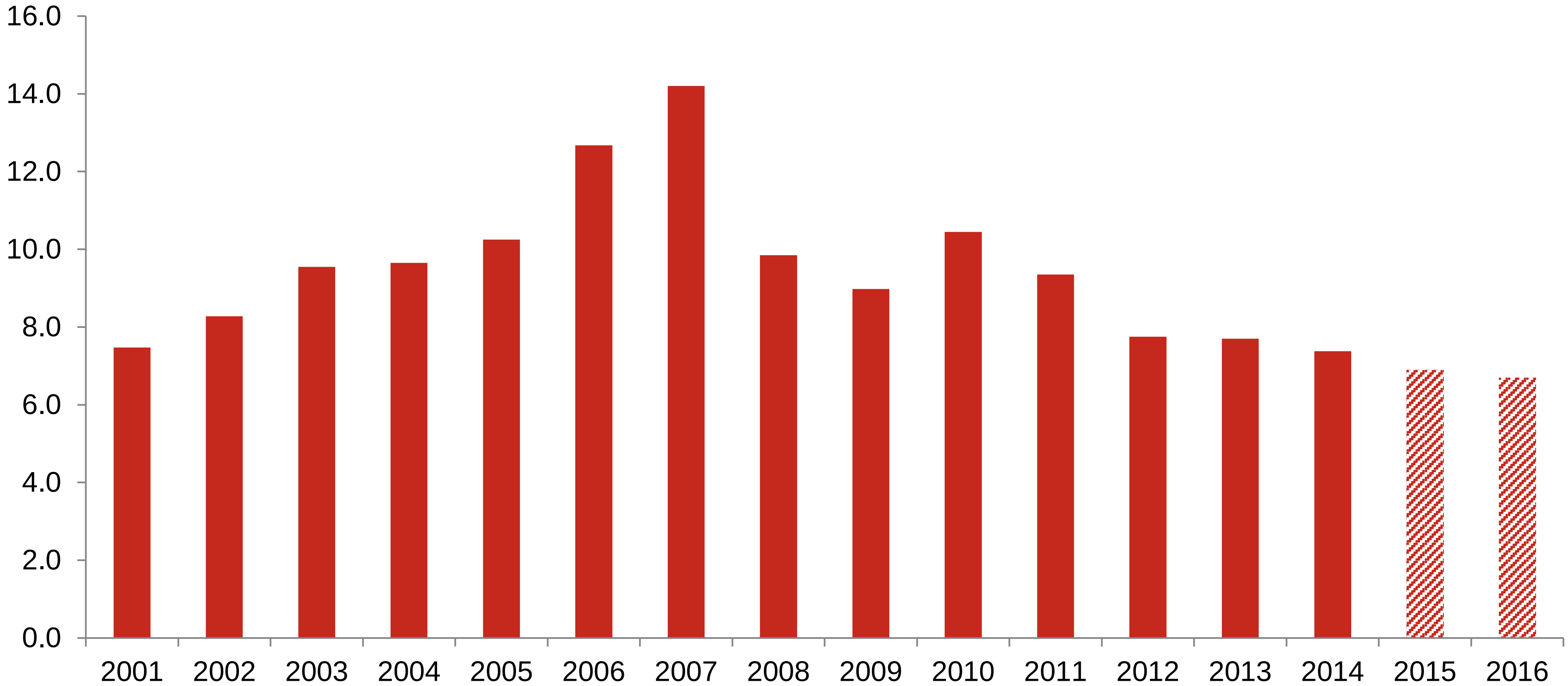


Sources: IMF, *World Economic Outlook*, April 2014

Last observation: 2013

Slowing Chinese growth

Real GDP Growth in China
(Y/Y, % GDP growth)



Sources: Haver and Consensus Forecasts (May 11, 2015)

Conclusion

- Appears to be some truth to all of competing explanations
- Implies that we need policy action across several fronts
  - Structural reforms may help address longer-term growth potential
  - But deficient demand, reflecting post-crisis adjustments, also needs to be addressed