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Canada's 'atrocious' growth figures show potential risk of recession

OECD's latest economic outlook shows the global economy is suffering from a lack of investment

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Last week brought us the latest edition of the OECD's twice-yearly analysis of the global economy, so this is a good time to take a step back and assess the economic landscape. At the same time, we will reassess our view of the Canadian economy, in particular, following the publication of what Bank of Canada Governor Stephen Poloz deemed the country's "atrocious" growth figures in the first quarter.

First, the overarching theme from the Organization for Economic Co-operation and Development's latest economic outlook is that the global economy is suffering from a lack of investment, which is weighing on the world's ability to generate wealth, increase consumption, create jobs and push wages higher. This means we will have to deal with a lower potential growth rate, which is also reflected in the OECD's forecast.

The forecast for global economic growth in 2015 has been lowered from 3.6 per cent to 3.1 per cent, and from 3.9 per cent to 3.8 per cent for 2016, mainly because of a disappointing first quarter in the United States.

Speaking of which, the forecast for growth south of the border has been cut to 2 per cent from 3.1 per cent for 2015. We find this a bit low as there is strong doubt among experts about the regular seasonal adjustment for first-quarter GDP data by the U.S. Bureau of Economic Analysis.

In fact, some studies have found that although the average growth rate of employment has been similar for quarters one to four in the past decades, GDP figures have been diverging more and more between quarter one and quarters two through four. The bureau is expected to offer a full review of its seasonality adjustment framework by July and we could then see these figures revised upward by a significant margin.

If the first-quarter downer is confirmed, then we agree that 2015 growth expectations should be ratcheted down, but at this point, we are prone to believe that the current figures won't hold.

Elsewhere, the euro zone is expected to grow by 1.4 per cent this year, faster than previously anticipated, as its recovery is gaining important breadth, and China has been revised downward, to 6.8 per cent from 7.1 per cent for 2015 and to 6.7 per cent from 6.9 per cent for 2016, which is a significant slowdown compared with the past few years.

All in all, the OECD gives the global economy a B-minus and believes that for it to deserve an A, it needs more investment and faster jobs creation. These must come on the back of structural reforms aiming at increasing productivity and competition through concerted monetary and fiscal policy.

Canada

Our view on Canada is slightly more bearish than the OECD's, which expects growth to slow to about 1.5 per cent in 2015. We fully expect this year's quarterly growth to average zero per cent with significant risks for back-to-back negative quarters to start the year, which would mean a technical recession.

Using annual averages, this would mean 1.2 per cent growth year over year, below the OECD's forecast. The OECD also expects the Bank of Canada to raise its leading rate in the first half of 2016, which we see as only an outside chance. The bank is more likely to wait for the U.S. Federal Reserve Board to be some way into its tightening cycle before following suit.

Just like the Bank of Canada, the OECD says that it sees some movement toward non-energy exports under way and, on that front, we must say that we feel it remains too early to make such a statement. The devaluation of the Canadian dollar does help our energy exports, but we sadly do not yet see convincing signs of a rebound in non-energy exports (See chart below).

We still believe that this will eventually happen, but Canada's manufacturing sector has lost some of its capacity in the past decade with the loonie flying high, so we must now give it time to return to form before we can enjoy any benefit. The fact that last week's trade report for April showed weakness in machinery imports leads us to believe that more patience will be needed.

Bottom line: We agree with the OECD that the global economy is living with the consequences of significant underinvestment during the recovery from the recession and that slower growth lies ahead. In the short term, we expect some positive surprises and stronger growth from the U.S. economy than the OECD.

In Canada, while we believe the OECD has identified the most important issues in the economy, we do not entirely agree with their conclusions. As long as the U.S. economy is doing well, the Canadian economy will hold its footing, but expect underperformance as long as commodities remain under pressure. And with China slowing down and keeping a lid on commodities, that might be the norm for a while.

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