Consumer debt spending appears to have insulated Canada from the worst of the credit crisis, but now the alarming magnitude of consumer debt ($1.92-trillion) could exacerbate a day of reckoning.

The backstory behind the economic predicament we face can be traced to statements made by former Canadian Minister of Finance, Jim Flaherty (1949-2014); a "fiscal conservative" that believed in balanced budgets. He and his cohort, Mark Carney, the present governor of the Bank of England (BoE) and past Bank of Canada (BoC) governor, "warned Canadian households about the dangers of elevated indebtedness." (Kawa, 2015) Yet, despite their rhetoric, proceeded to fuel debt spending via ad-hoc fiscal policy that drove Canadians' household debt to the highest level in the G7.

The charts below show the effect of fiscal policies on loan and lease growth. Charts 1 and 2 show the results of the "Harper Government's" ad-hoc fiscal policies led to year-on-year growth on bank balance sheets, backstopped by the Canada Mortgage and Housing Corporation (CMHC): risk-free profits.

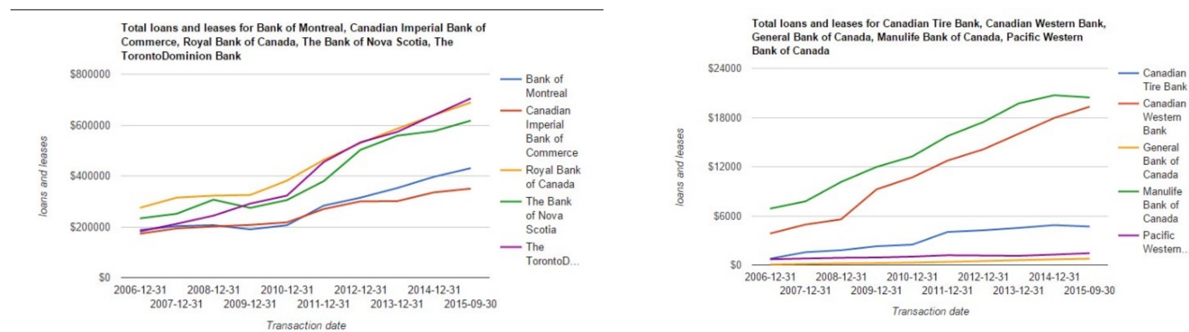

Chart 1, 2, showing loan growth Canadian banks 2006-2015. Source BankNews.TV

Given the current debt to income ratio of 171 per cent, Flaherty was justifiably concerned. The irony being that Canada's banks and economy were the envy of the world, despite the fact that they were predicated on risky policies. A detailed summary of issues he faced are evaluated in a financial scorecard I wrote April 8, 2014, just after he resigned from his post. This scorecard revealed:

1. Canada had jumped its economic ranking from 11th place to 5th.
2. Corporate Canada was sitting on $250 billion in cash, a figure which has jumped in recent years, despite near negative interest rates.
3. 2014 Consumer debt to income ratios that had jumped to 156% from 78% in 1999.

The point to take from this is that the current recession took root well before cheap oil reared its ugly head. In fact, a more accurate assessment might be that it was expensive oil that caused our current problems. This realization is eluded to by Stephen Poloz, the current governor of the BoC who said in 2014 that "oil pushed up the loonie and only now (with a cheaper loonie - 91 cents at the time) are exports slowly starting to rebound."

Stephen Poloz skating on cheap oil

The manufacturing sector lost 278,000 jobs (1 in 6) from 2000 to 2007, a reality that reduced the sector's share of total employment from 16% to 12%. This job disaster

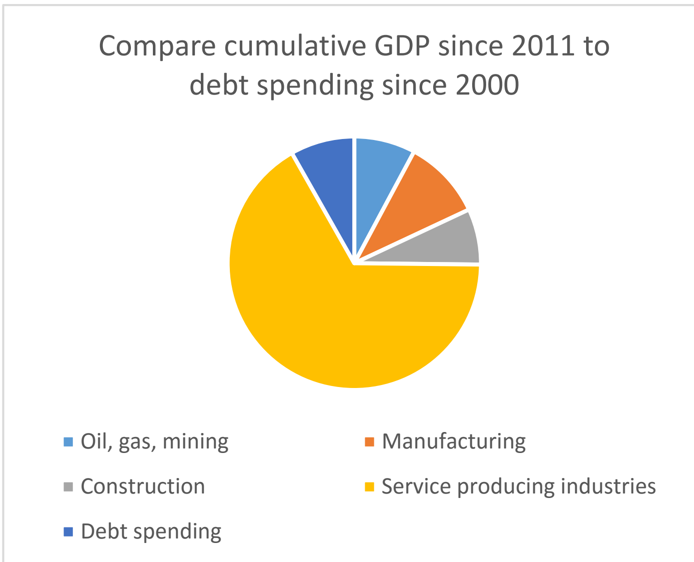

Chart 4, showing cumulative GDP since 2011 and comparing this to the value of consumer debt spending since 2000. Data from Statscan & FP[1]

Although chart 4 makes the value of debt funded consumer spending appear similar to manufacturing and construction, it is a mistake to view its economic impact in the same way, after all, this is spending and 100% dedicated to buying things. To quantify the impact on the economy, take debt to income ratios in 2007 as an example. At the time the ratio was 128 per cent. Compared to 164 per cent in the US it appeared that Canada had some maneuverability. So between 2007 and 2012, when the US took money out of the money supply by reducing its consumer debt to income ratio to 140 per cent, Canada harnessed the power of consumers instead. Hundreds of billions were pumped into the economy thanks to consumers, meanwhile the Harper Government was able to boast a balanced budget despite a global meltdown.

In some ways Canada's haphazard fiscal policy was providential. As demonstrated in the US and Europe QE has not produced the desired results. This has prompted economists, such as Adair Turner, the former Financial

declined to 10% by 2009, after the 2008–2009 recession when manufacturers faced weaker demand and cuts to industrial capacity, resulting in the loss of 188,000 additional jobs.[1] [2]

Compared to the recent 40,000 job losses in the oil sector, as estimated in a CBC report December 30th, it becomes clear that oil's economic impact is often overstated. Important yes, but the fact is that oil sector job losses equals only 8 per cent of those lost in manufacturing. A moot point because, based on GDP value, services producing industries, as chart 4 demonstrates, dwarf both manufacturing and resources, followed at a distance by manufacturing (not oil), despite perceptions created by former Prime Minister Stephen Harper's ballyhoo.

QE impact snapshot:

- The US printed $4.5 trillion QE dollars and GDP growth stands at only 2.2%;
- Low unemployment figures at 5.5% and possibly trending down;
- Distorts markets via inflated asset prices;
- Low interest hurts safe industries like insurance;
- Fuel growing income gap between rich and poor;
- May be possible to remove QE from money supply;
- Companies have hoarded cash not invested;
- Companies that should have been shuttered have transformed into zombie companies.

[1] Statscan

[2] Nortel in 2001 dropped more than 45,000 employees and currently Bombardier threatens to cut 7,000 in the near future.

Services Authority chairman, to suggest that the Bank of England should engage in helicopter drops in 2012. In 1999, long before he was made Federal Reserve chairman, Ben Bernanke argued that they could get Japan out its deflationary predicament. Last year, Mark Blyth and Eric Lonergan proposed the Fed should print money to give to households in the US. The University of Oxford's Simon Wren-Lewis joined Blyth and Lonergan in advocating central bank cash transfers for households in the UK." (Sandbu, 2015)

Parker, Souleles, Johnson and McClelland demonstrates the logic behind putting money directly into consumer's hands. The key points they argue is that, "that analogous policies – such as tax rebates in the US – suggests that transfers to the household sector would have a far greater impact on demand at a fraction of the size of QE. Consumers appear to quickly spend between a third and a half of any cash windfalls. So to increase consumption by 1% of GDP, you would need a transfer of 3% of GDP. UK QE currently stands at about 20% of annual GDP. The Bank of England estimates this raised GDP by 3%. Further QE would likely have less effect. So cash transfers to consumers are a far more effective stimulus than that provided by more QE for a lower spend." (Mark Blyth, 2015)

171 per cent debt to income ratio has prompted policy change as evidenced in the recent CMHC restrictions on mortgages, CMHC are also evaluating ways to push risk onto bank balance sheets. The problem is these regulations will kill the goose that has kept blood flowing through the economy. A suitable stand-in must be put in place and clearly QE is not the answer. Neither can we rely on rebuilding manufacturing, this will take time. Infrastructure project will likely help, but even these take time to ramp up. This leaves helicopter money.

The added benefit of helicopter money is that the groups most affected by poor economic policies, the 40,000 jobless oil workers and consumers duped into buying too much house, can be made whole. Simply reduce individual taxes for low and mid income Canadians, and offer victims of Canada's contango oil strategy re-training and re-location money.

Bibliography

Kawa, L. (2015, 2 24). The market is suddenly betting against a rate cut next week. *G&M*.

Mark Blyth, E. L.-L. (2015, 5 21). Now the Bank of England needs to deliver QE for the people. *The Guardian*.

Sandbu, M. (2015, 8 10). Free Lunch: Monetary helicopters hover back into view. *FT*.