Navigating Economic Uncertainty: Canada's Strategies and Risks

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Issue Statement

How should the Federal Government respond to the increasingly unstable financial market under the influence of global inflation and fragmentation?

Objectives

Maintain low and stable inflation	Mitigate effects of global fragmentation	Address economic concerns

Background + Current Status

Canada's Economic Landscape and Policy Framework

- The government's Inflation-Targeting Framework supports a strong labor market and targets **2% inflation** return over medium term.
- The inflation rate is currently at **2.9%**, down from its peak of **8.1%** in 2022.
- **Mortgage interest costs** and the **high cost of rent** remain two of the largest contributors to the inflation rate, rising **29.8**% and **7.4%** from a year ago.

Global Economic Trends and Concerns

- Global fragmentation **is on the rise.** Global flows of goods and capital have plateaued since the 2008-2009 financial crisis, with a surge in trade restrictions in subsequent years.
- **IMF:** Canadian economy slowing, inflation declining, highlighting need for Bank of Canada's **cautious stance.**

Key Consideration #1: Canadians Economic Concerns

Canadians are struggling with the fact that wages and earnings have not kept pace with price pressures, especially those related to food and shelter:

April 2022:

- Nearly **3 in 4** Canadians reported that rising prices were affecting their ability to meet day-to-day expenses
- **3 in 10** Canadians were very concerned about whether they could afford housing or rent.

Fall 2022:

- **44%** very concerned about their household's ability to afford housing or rent;
- **25%** unable to cover an unexpected expense of $500.

Key Consideration #2: Decreased Economic Gains

- According to the IMF, severe global economic fragmentation may cut global output by up to **7%,** potentially reaching **8-12%** in some countries.

- Reduced capital flows impacts direct foreign investment into Canada, **discouraging** economic development and innovation.

- Global economic fragmentation could lead to **higher macroeconomic volatility**, severe crises, and greater pressures on national buffers.

Key Consideration #3: Deteriorating International Relations Due to Increased Conflicts

- Canada's historical policy of integrating China into global networks faces challenges, with relations reaching a **low point.**
  - **Tensions** between Canada and China have lead to reduced trade volume or increased barriers to entry for Canadian businesses in the Chinese market.
- The Russia and Ukraine **conflict** has caused disruptions in global geopolitics, impacting economies and supply chains.
  - Supply chains have **faced delays, shortages, or increased costs,** affecting industries worldwide, including those in Canada.
- Sharpened **rivalry** with strategic and economic decoupling between US and China.
  - Impacting not only economic relations but also political dynamics and security considerations **globally.**

Policy Option #1: Cross-Border Collaboration with the USA

- Lifting ownership restrictions in key sectors like telecommunications, energy, and transportation boosts Canada's foreign investment and global value chain participation.
  - Easing foreign investment limits attracts more NAFTA investment, expanding trade networks and increasing capital inflows.
- Bilateral cooperation enhances specialization, potentially lowering production costs and prices, easing inflationary pressures.

Risks:

- **Dependence on one country, loss of sovereignty in decision-making, opposition from Canadian firms**

Policy Option #2: Strengthen existing policies/investments

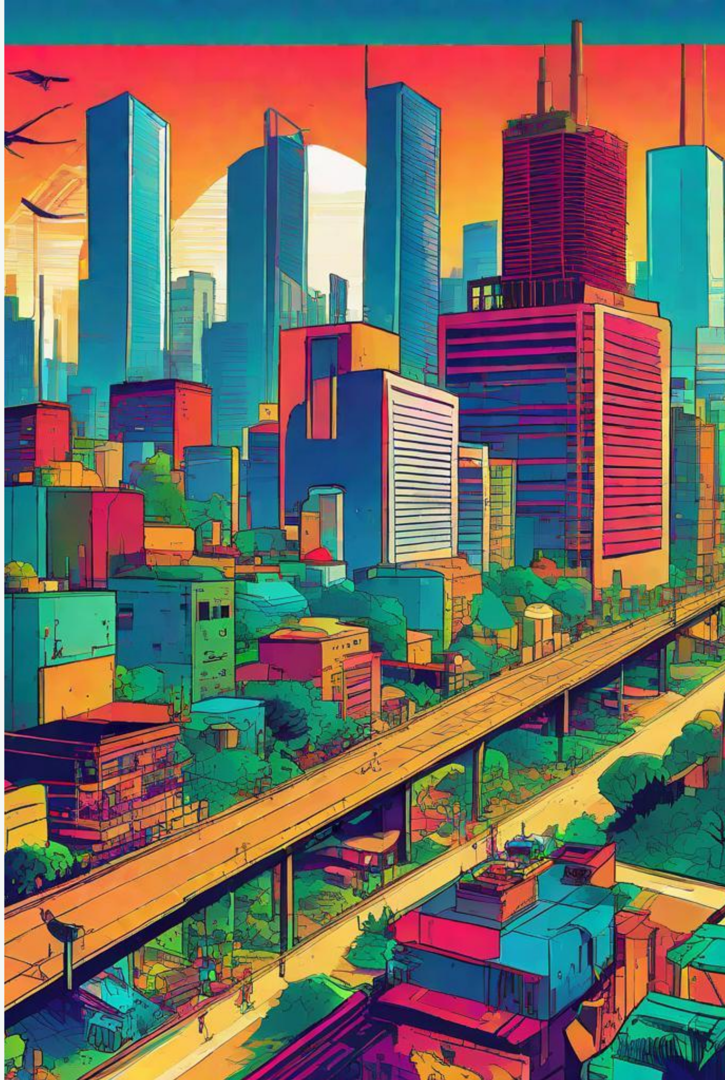
- Leverage $80 billion budget for clean tech tax credits over 10 years.
- Benefit from U.S. Inflation Reduction Act (IRA) to attract investments.
- Global production shift boosts Canada's competitiveness, attracting investments and creating jobs.

Risks:

- Potential regional growth desynchronization.
- Risk of over-subsidizing technologies.
- Canadian programs are less generous and more complex for investors compared to the U.S.

Recommended Option: Selective Investment to enhance Canada’s role in Global Value Chain

- Investing in key sectors (manufacturing, IT, clean energy) can enhance Canada's supply chain resilience and competitiveness.
  - Utilize targeted subsidies to boost employment, rural development, and energy security.
- Leveraging the North American economy, can foster transparency, diversification, and sustainability, aiding global economic resilience.



Risks & Mitigation

RISKS	MITIGATION
Possible reduction in windfall profits and fiscal pressure	Governments can share risk with private sector partners through market-driven mechanisms like tax incentives, PPPs, and revenue-sharing agreements, reducing the burden on public resources
Difficulty in attracting private capital compared to the U.S.	Canada can boost investment attractiveness by easing FDI restrictions, streamlining regulatory barriers, and simplifying approval processes for foreign investors.

Thank you. Please feel free to ask any questions.
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