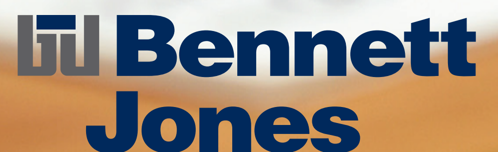
Bennett Jones Spring 2015 Economic Outlook



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David A. Dodge O.C., Richard Dion, John M. Weekes and Michael Horgan

This spring Outlook is structured in three sections. The first section sets out our view of the economic outlook commencing with a very short summary of recent world economy dynamics, followed by a review of the outlook for global growth and Canadian growth for 2015 to 2017. The second section contains an analysis of the factors which undoubtedly will lead to a slower growth of Canadian incomes over the medium term, 2015 to 2024. The third section analyses likely global trade developments and their implications for Canada. Section four contains a summary and conclusions.

Section I: Global Short-Term Outlook: 2015-2017

Recent World Economy Dynamics

Data releases since the publication of our Winter 2015 Economic Outlook last February indicate that in the first quarter of 2015 there was a significant decline in U.S. GDP, a slowdown in China to the lowest growth rate since 2009, and a marked pick-up of growth in the Euro area. The amplitude of the movements, in particular the extent of the weakness in the U.S., clearly took all the analysts by surprise. In the U.S., the second estimate of GDP for the first quarter shows a contraction at an annualized rate of 0.75 percent, following annualized growth of 4.1 percent in the second half of 2014. The stagnation of activity stemmed in good part from temporary factors such as adverse winter weather in the Northeast, port strikes on the west coast, and a front-end loaded drop in drilling activity in the oil sector. It also began to reflect the negative impact of a stronger U.S. dollar on net exports. In China, slower growth was due to relatively durable factors such as an ongoing correction of excess supply in the property market and weaker investment growth. In the Euro area, the acceleration stemmed from the positive effects of lower oil prices on consumption and of a weaker euro on net exports, and the confidence-building effect of a shift to unconventional monetary policy by the ECB.

WTI oil prices have been very volatile in recent months, but appear to have bottomed out in March and have risen to about US$60 per barrel at the end of May, somewhat above the range we expected for the first half of 2015 in our Winter 2015 Outlook. Current futures prices point to gradually rising oil prices over the next several years in anticipation of firming demand and slowing growth of supply.

The fall in oil prices has depressed headline CPI inflation in market economies around the world. In addition, it has led to weaker aggregate output growth in oil-producing countries, especially in North America. The resulting lower inflation rates (even the threat of deflation in some countries) and larger current and prospective output gaps have allowed many central banks, in both advanced and emerging economies (including the Bank of Canada), to ease monetary policy since last December. Combined with expectations of comparatively strong growth and the incipient rise in policy interest rates in the U.S. this year, this has led to a generalized appreciation of the U.S. dollar against most major currencies with the exception of the Chinese renminbi (which has been fairly stable relative to the U.S. dollar).

Global Growth Outlook: 2015-2017

We expect only a very slight strengthening of global growth over the next few years relative to 2014. Global growth should actually edge down to 3.2 percent in 2015 as a faster expansion in advanced economies is offset by a slowdown in the emerging economies. This slowdown not only reflects a continued reduction and a change in composition of Chinese growth, but also cyclical and structural difficulties in a number of emerging economies. Global growth should strengthen a little to 3.5 percent in 2016 as the expansion gains some momentum in both advanced and emerging economies. Difficulties in a number of emerging countries, including Brazil and Russia, are expected to diminish. In 2017, global growth should remain at about this level as further strengthening in emerging economies offsets some deceleration in advanced economies, notably in the U.S. The change of composition and

the slowing of growth in China continue in 2016 and 2017, constraining overall growth in resource-producing countries mainly through lower Chinese imports of and continued sluggishness in prices for metals and minerals.

This projection of global GDP growth suggests that global trade should expand at a relatively modest pace over the next three years. It used to be that international trade grew much faster than global demand. This trade intensity has noticeably diminished in the last decade or so, with global imports growing at the same rate as global real GDP in the last few years. This lower trade intensity is attributed to cyclical and structural factors, including *inter alia*:[1] the relative weakness of investment, a demand component which is import-intensive; a reduction in the pace at which global supply chains are developed; and a slower pace of trade liberalization. Section III of this Outlook, which deals with trade developments and negotiations, describes current challenges to further trade liberalization.

Movements in oil prices and exchange rates over the last 12 months should support and help rebalance global growth in the short run. The IMF estimated that lower oil prices might boost global growth by 0.5-0.75 percent in 2015 and by an additional 0-0.2 percent in 2016.[2] Such an impact, which is already factored in our projections, will vary greatly across countries depending *inter alia* on the relative importance of domestic oil production and investment, on the oil intensity of domestic demand and production, and on the degree to which lower oil prices in U.S. dollars feed into lower final domestic-currency prices for oil products to consumers. One would expect the positive impact on growth to be larger in the Euro area, Japan and China than in the U.S.

For a country like the U.S., where oil production and investment in the oil and gas sector are very significant, the time profile of the effect of the oil price shock on growth will depend on the relative speed of adjustment of investment in the oil sector. Inasmuch as this adjustment is more front-end loaded than the increase in real consumer spending arising from the gains in real income associated with lower consumer prices for oil, growth is depressed at first before rebounding as real consumer spending picks up steam. This is what seems to be happening in the U.S.: the reduction of investment in the oil and gas sector was quite substantial in the first quarter of 2015, while U.S. households are only expected to respond more forcefully to real income gains later in the year.

The multilateral appreciation of the U.S. dollar and the Chinese renminbi has the potential to reduce growth disparities between appreciating and depreciating countries by stimulating net exports in the slower growth countries, notably the Euro area and Japan. It can also provide a mild stimulus to global growth inasmuch as these exchange rate adjustments allow for easier monetary policy than otherwise in the U.S. and China without any corresponding tightening of monetary policy in the depreciating countries.

Much as in our Winter 2015 Outlook, we project the **WTI oil price** to remain volatile but to trend up from an end-May level of almost US$60/bbl to US$60-70 in 2016 and US$70-90 in 2017-2020. We expect both supply and demand for oil to gradually adjust to the current price shock, including a slowdown in the growth of production as low oil prices reduce incentives for oil investment and drilling. While generally strengthening global growth should support a firming of oil demand going forward, we expect that supply adjustment, including cost reduction arising from improving technology, will keep oil prices significantly below their 2013 peak until the end of this decade. Our projection does not take into account the possibility of further oil supply disturbance, either positive (*e.g.*, a large influx of Iranian oil) or negative (*e.g.*, geopolitical turmoil in the Middle East). The profile of WTI for 2015 and 2016 in the futures market is consistent with our projection.

Henry Hub **natural gas prices** have been trending down from their US$6/MMbtu peak in winter 2014 to about US$3.00 in May 2015. The U.S. Energy Information Administration expects a very gradual increase in prices to slightly less than US$4/MMbtu by the end of 2016. Futures markets suggest an even slower increase to US$3.30/MMbtu by the end of 2016. In the short run base **metals prices** are buffeted by supply and demand developments, some being common to all base metals and others specific to particular metals. In aggregate, metals prices have been falling since mid-2014, consistent with expectations of both a marked slowdown in demand growth and the coming on stream of new mine supply (iron ore and copper being cases in point). Going forward, demand growth is expected to be

depressed by slower growth in China and, more importantly, by a shift to less metal-intensive production in China. In the first instance, this shift would primarily arise from the slowdown in metal-intensive construction associated with the ongoing correction of excess supply in the property market. In the longer run, it would stem from a relative increase in demand and production of services as the economy rebalances away from investment and toward more consumption. On the supply side, one would expect metals supply and mining capacity to adjust downwards to the lower prices experienced in the last year. Thus, in the short run, metals prices may be facing downward pressures as supply adjusts only gradually and with a lag; but eventually they will stabilize and start to firm up as excess capacity dissipates. Lumber prices, on the other hand, are expected to firm up considerably in the second half of 2015 and 2016 along with an expected pick-up in U.S. single-family housing starts.

Table 1:

Short-term Prospects for Output Growth (%*)

	2014	2015	2016	2017
Canada	2.5 (2.4)	1.7 (2.1)	2.5 (2.4)	2
United States	2.4 (2.4)	2.5 (3.6)	3.1 (2.8)	2.6
Euro area	0.9 (0.8)	1.4 (0.9)	1.5 (1.2)	1.5
Japan	-0.1 (0.1)	0.4 (0.6)	1.5 (1.6)	1.3
China	7.4 (7.4)	6.7 (7.1)	6.3 (6.7)	6.1
World	3.3 (3.1)	3.2 (3.4)	3.5 (3.5)	3.5

*Figures in brackets are from the *Bennett Jones Winter 2015 Economic Outlook*.

As mentioned earlier, the magnitude of the drop in **U.S. growth** in the first quarter has been a big surprise. In our Winter Outlook, we substantially underestimated the negative effects of temporary factors and other headwinds to growth in the first quarter. However, we continue to expect a marked rebound in growth in the rest of the year as adverse weather and port strikes no longer depress activity, and as drilling and investment in the oil and gas sector fall much less rapidly than early in the year and perhaps eventually start reviving. Several elements are expected to support robust growth over the remainder of this year and next: lower oil and natural gas prices, which boost household real income; less drag from fiscal policy; and an improved labour market. The stimulus this would provide to domestic spending, including consumption, residential investment and non-energy business investment, would more than offset the negative impact of the marked appreciation of the U.S. dollar on growth (as much as 0.5 percent per year over the next two years). Overall, we expect U.S. growth to reach 2.5 percent in 2015, peak at about 3 percent in 2016, and then slow to 2.6 percent in 2017. By 2017, the output and labour market gaps would be closed and an aging population would have begun to slow potential output growth to 2.5 percent (or less), over the remainder of the decade.

The expected rise in policy interest rates in 2015 may be delayed to the fall or even early 2016 and proceed at a more gradual pace than otherwise if slack in the labour market and lack of wage pressure prove more persistent than now anticipated by the Fed. Projected appreciation of the U.S. dollar when policy interest rates are raised appears to be prompting the Fed to proceed very cautiously with further rate increases.

In the **Euro area**, the recent stronger momentum in aggregate demand is expected to carry on over the next three years, generating growth in the order of 1.5 percent annually. The stimuli from weaker oil prices, the ECB's unconventional monetary policy, the depreciation of the euro and less drag from fiscal policy is expected to overcome the negative effect of lingering deleveraging in the economy, and this in a context of a diminishing but still considerable output gap and tame inflation. There is considerable uncertainty about whether Greece will stay in the euro area; the downside risk to European growth is "Grexit".

In **Japan**, despite a disappointing start to the year, growth is expected to pick up in response to the weaker yen, easier unconventional monetary policy, lower oil prices, and increased real wages.

Growth in **China** has slowed as a result of an ongoing correction of excess supply in the property market and weaker investment. It should continue to decelerate over the next three years as previous excesses in real estate, credit and investment continue to unwind. Lower prices for oil and expected further progress in implementing structural reforms, including a financial reform, should stimulate household consumption and hence buffer aggregate demand while the economy rebalances away from investment. Thus a gradual rather than an abrupt slowing in growth is expected. In addition, Chinese authorities have considerable policy room to respond to an unwarrantedly rapid moderation of activity. This being said, rebalancing the economy toward more household consumption and less investment, while keeping overall growth above 6 percent, will be a difficult task. Raising the household share of national income and increasing the consumption share of household income should be very gradual processes because they would depend on the implementation of several structural reforms, which so far has been only partial and gradual. Meanwhile, export growth is set to be constrained by lower trend growth in the world economy, the already large Chinese shares of markets for many goods, and the marked renminbi appreciation relative to the yen and the euro. Moreover, excessive leverage in the Chinese corporate sector entails significant risks in the traditional and shadow banking sectors. Overall there is a downside risk to our growth projections for China.

Growth in **Mexico** was only 2.1 percent in 2014 as a result of the tepid domestic demand. The economy is expected to expand at somewhat less than 3 percent in 2015 and 2016. Stronger U.S. growth would boost Mexico's non-energy exports and investment in energy infrastructure would accelerate. However, lingering sluggishness in other components of domestic demand and a tighter fiscal stance would continue to constrain growth. The rest of Latin America as a whole should experience much weaker growth than Mexico over the next two years, reflecting distressing performances by Brazil, Argentina and Venezuela. In contrast, Peru, Columbia, Bolivia and Paraguay are projected by the IMF to register robust growth in the next two years.

As always, there are considerable **risks** to global growth over the short term. There are downside risks related to several potential developments: a sharper-than-expected deceleration of growth in China, with adverse consequences for commodity prices; a weaker momentum of activity in the U.S.; and adverse geopolitical developments, notably a worsening of tensions in Ukraine and the Middle East. There are both upside and downside risks related to the future path of oil prices and the responsiveness of demand to lower oil prices.

Short-Term Outlook for Canada: 2015-2017

As the Bank of Canada noted in its April 2015 *Monetary Policy Report*,[3] the negative effects of the decline in oil prices on household income and wealth have been affecting household spending, and indeed household consumption was nearly flat in the first quarter. Moreover, cuts in investment plans in the oil and gas sector in **Canada** appear to have been more front-loaded than previously expected, contributing to a substantial decline in business fixed non-residential investment. At the same time, the fall in U.S. aggregate demand in the first quarter depressed Canadian exports, which fell modestly. As a result, real GDP declined in the first quarter, by 0.6 percent at an annualized rate. Nevertheless, with the expected resumption of robust growth in U.S. activity in the remainder of the year and the continuing stimulus of a weaker Canadian dollar, growth in real net exports and business investment (in sectors other than oil and gas and ancillary industries) is expected to pick up steam and increasingly dominate the negative effects of the oil price shock on investment. Thus, real GDP growth is projected to improve during the remainder of 2015 to average 1.7 percent for the year as a whole and 2.5 percent in 2016 before slowing to 2 percent in 2017. This slowing after 2016 reflects our expectations that there will be less room for non-inflationary growth as the output gap should be closed by then and adverse demographic developments, including population aging, would yield potential output growth of about 2 percent (See Section II below).

The announced **fiscal stance** of governments in Canada will have a restrictive effect on Canadian growth in the next three years. The recent budget projections by the governments of Canada, Ontario, Alberta and Quebec imply an overall budgetary tightening, as measured by the year-to-year reduction in their aggregate deficit, of nearly 0.2 percent of GDP in 2015 rising to over 0.3 percent of GDP in 2016 and to nearly 0.5 percent of GDP in 2017. More than half of the cumulative tightening originates from announced fiscal consolidation in Ontario. Because this fiscal drag will tend to reduce domestic demand and hence reduce inflationary pressures, the Bank of Canada could raise its policy interest rate more slowly over the next two years and still achieve its inflation target.

Table 2:

Planned Deficit Reductions by Governments as % of Canadian GDP

	2015-16	2016-17	2017-18	Cumulative
Federal	0.169	0.014	0.041	0.224
Ontario	0.120	0.176	0.218	0.513
Quebec	0.134	0.031	0.024	0.188
Alberta	-0.261	0.092	0.170	0.002
Total	0.162	0.313	0.453	0.927

The Canadian dollar hovered around US$0.80 at the end of May. In our Winter 2015 Outlook, we projected the Canadian dollar to be volatile within a US$0.76-0.84 range in 2015, based on a WTI oil price ranging from US$45/bbl to US$55/bbl. With a WTI oil price now looking like it will hover around US$60/bbl over the rest of 2015, we would expect the Canadian dollar to fluctuate mostly in the higher part of this range over the remainder of this year.

Over the medium term, the two most important factors to take into account when assessing the future trend value of the Canadian dollar are: (1) the future evolution of oil prices, and (2) the future evolution of the short-term interest rate differential between Canada and the U.S. Oil prices might impart modest upward pressure on the Canadian dollar over the next several years based on our projection of a gradually rising WTI oil price (but one still remaining below its 2013 peak). Over the next couple of years, as U.S. short-term interest rates rise earlier than Canadian rates, the positive differential currently in favour of Canada will narrow. This would tend to depress the value of the Canadian dollar. Finally we note that the recent trend appreciation of the U.S. dollar against a basket of global currencies is likely to unwind somewhat over the medium term, implying some very modest appreciation of the Canadian dollar. Based on all the above considerations, our view of the trend exchange rate of the Canadian dollar over 2017-2020 is centred on US$0.85.

Section II: Growth in Real Household income in Canada: 1984-2024

Canadians have just entered a decade during which their real disposable income will tend to grow at a much slower pace than in the past. Since 2007, Canadian households have pretty well maintained the same average pace of growth in their real disposable income (per capita) as in the preceding quarter of a century, in spite of a recession and a sluggish recovery. This is set to change in the next decade as adverse demographics will depress real income growth per capita. There is little likelihood that faster productivity growth, increased labour force participation or gains in the terms of trade provide more than a very partial offset to adverse demographics. This means that on average the purchasing power (and saving power) of Canadian households is set to progress much more slowly than in the past. In such a context of slow growth in average household income, issues with respect to income distribution among households are likely to become more acute.

In this section, we summarize the findings and conclusions that emerge from our work on projecting growth in real disposable income per capita in Canada over the next decade. The projections appear in Table 3. A more detailed (and more technical) report that goes over the sources of the growth in real disposable income in Canada over the last 30 years and over the projections for the next 10 years is available online.[4]

At the outset, one must reckon that the next decade in Canada will likely witness four important changes relative to the previous two or three decades: demographics will slow economic growth in Canada instead of boosting it; world growth and the pace of globalization will be slower; real commodity prices and Canadian terms of trade will be relatively flat on average (at fairly high levels) instead of generally rising; and the Canadian dollar should fluctuate in a broad range centred on US$0.85, and avoid persistent bouts of acute weakness, as in the decade to 2003.

Our **base case** projections of growth in Canadian real disposable income are consistent with these expected changes. Over the next decade real disposable income per capita is likely to grow not much above half the rate experienced over the last 30 years, *i.e.* a meagre 0.9 percent per year. This reflects the likelihood that growth in real national income will slow considerably and that the household net after-tax share of that income will decline. The projected slowdown in real income growth would largely arise from adverse demographics: slower growth in working-age population because of earlier falls in the birth rate and a decline in the labour force participation rate due to population aging. Along with a projected further decrease in average hours worked per worker, this would substantially slow the contribution of total hours worked to growth in production and real income. One likely mitigating factor is that the labour force participation rates of the persons 55 to 70 years of age are likely to be on upward trends over the next decade as a result of economic pressures and/or incentives to enter or stay longer in the labour force. Our base case projection factors in such upward trends. However, that still leaves a substantial shortfall in the growth of total hours worked relative to the past.

One cannot count on future gains in the terms of trade (rising commodity prices) to significantly offset the impact of this slower growth in total hours worked on real national income growth. Terms of trade have boosted growth in real national income over 1984-2007 and depressed it over 2008-2014. Terms of trade, driven by movements in fact that real commodity prices are currently difficult to predict because of the uncertain future evolution of the factors that influence both the demand for resources (*e.g.*, growth in China) and the supply of commodities (*e.g.*, technology). Our judgment is that a scenario of flat terms of trade for the next decade balances the risks, especially in view of the fact that real commodity prices are currently at relatively high levels by historical standards.

Table 3:

Factors Contributing to Growth in Real Gross National Income and Disposable Income (%)					
	Average annual contributions to growth (%)		Growth Projections (%)		
			Low Case	Base Case	Optimistic
	1984-2007	2008-2014	2015-2024	2015-2024	2015-2024
Total Hours Worked	1.60	0.87	0.3	0.5	0.7
Labour productivity	1.35	1.00	1.0	1.4	1.7
Terms of trade	0.27	-0.42	-0.1	0	0.2
Net investment income from abroad	0.00	-0.09	0	0	0
Residual	-0.06	0.06	0	0	0
Equals: Real gross national income	**3.17**	**1.43**	**1.2**	**1.9**	**2.6**
Plus:					
Household share of national income	-0.36	0.16	0	-0.1	-0.2
Relative price of consumption	-0.03	0.36	0	0	0
Tax and transfer system	-0.27	0.37	0.1	0	-0.1
Residual	0.01	0.12	0	0	0
Equals: Real disposable income	**2.52**	**2.44**	**1.3**	**1.8**	**2.3**
Real disposable income per capita	**1.41**	**1.32**	**0.4**	**0.9**	**1.4**
Memo items:					
Real GDP growth	2.90	1.59	1.3	1.9	2.4
Population growth	1.09	1.11	0.95	0.95	0.95
Labour force growth	1.49	0.99	0.4	0.6	0.8

Sources: Calculations based on data from Statistics Canada Cansim matrices 380-0065, 380-0066, 380-0071, 380-0072 and 051-0001. Note that the calculations were made with the data available prior to the release of the Canadian national accounts on May 29, 2015.

At the same time as real national income would slow, the household share of that income should decline, albeit at a much slower pace than in the 1984-2007 period partly because the negative impact of globalization on real wages is likely to diminish and labour should become relatively more scarce in Canada due to demographics. As well, the current tax and transfer system on average is likely to have no effect on growth in real disposable income over the next decade, in contrast with a negative effect over 1984-2007. This is because growth in transfers received by households is expected to match growth in income taxes and contributions to social insurance plans paid by households over the next decade, rather than fall short of it as during 1984-2007. Over the 2015-2024 period, growth in household income and payments will likely slow more than growth in transfer receipts relative to 1984-2007. Transfer receipts for old age are expected to increase relatively rapidly because of population aging.

That leaves growth of labour productivity as the only factor that could materially support real income growth going forward. In our base case we assume productivity growth over the next 10 years to be slightly above its 1984-2007 average (1.4 percent versus 1.2 percent) on the premise that the reduced abundance of labour, especially skilled workers, starts putting upward pressure on real wages and thus incent firms to invest more in labour-saving technologies. This incentive is likely to be reinforced by business expectations that the Canadian dollar should remain in a range around US$0.85 and not fall to the much lower levels seen in most of the 1984-2007 period.

But productivity growth may well not improve over the next decade and indeed may remain at the low average rate experienced since 2007. Moreover, it is quite possible that labour force participation rates for individual age groups will also remain at current levels. This **low case** projection would imply that real income per capita would grow at only 0.4 percent per year compared to the 1984-2014 average of almost 1.4 percent per year (and compared to 0.9 percent in our base case). While we attach a higher probability to the base case outcome, the low case outcome remains a clear possibility.

All in all, we expect adverse demographics to depress growth in real disposable income per capita to low levels over the next decade. This will severely constrain further progress in the living standard of the average Canadian household. One cannot count on a durable run of gains in the terms of trade to significantly cushion the blow. Even a spurt of labour productivity growth large and persistent enough to make a material difference would be a tall order in view of the disappointing experience of the last 30 years. In fact, even under our **optimistic-case** assumptions about the various sources of growth, real income per capita growth seems destined to fall significantly short of the pace experienced over the last 30 years.

Section III: Trade Developments and Negotiations

Continued Uncertainty

On April 14 WTO economists predicted that growth in the volume of world merchandise trade would pick up only slightly over the next two years, rising from 2.8 percent in 2014 to 3.3 percent in 2015 and eventually 4 percent in 2016. This prediction is consistent with the global growth trajectory set out in the first section of this Outlook. Commenting on this picture WTO Director-General Roberto Azevedo said, "Trade growth has been disappointing in recent years, due largely to prolonged sluggish growth in GDP following the financial crisis." It is noteworthy that early last year WTO economists predicted a 4-percent rise in merchandise trade for 2014, a figure that was revised downward to 3.1 percent in September, before slipping to 2.8 percent.

As noted in the first section of this Outlook the appreciation of the US dollar and the Chinese renminbi have some modest potential to stimulate net exports in countries with depreciating currencies, notably the euro area and Japan, over the next two years. There are encouraging signs that Canadian non-energy exports to the U.S. are growing substantially this year.

Liberalizing Trade and American Political Will

Our Fall 2014 Economic Outlook described at some length how trade negotiations could enhance the future prospects for the growth in world trade and the contribution it could make to global GDP. Negotiated trade liberalization plays a vital role in ensuring conditions of competition that will encourage businesses to look for ways to improve productivity. There has been a credibility gap between the amount of activity in various negotiations and the likelihood that they would be brought to conclusion and then implemented. What is needed is political will, particularly in the U.S., to turn promise into reality. The odds for securing real trade liberalization were improved in late May with the passage of a "trade promotion authority" (TPA) bill by the U.S. Senate. A major battle is now underway in the House of Representatives on the specifics of the bill. Whether the bill eventually passes may depend on exactly what is included. Passage of the law would be good news for the cause of trade liberalization and making the international trade rules more responsive to the complexities of international trade built increasingly through global value chains. Passage would put the U.S. back into the game as a real leader. Failure of Congress to pass the legislation would end any chance of President Obama securing a major trade agreement during his administration and would set back the cause of global trade liberalization.

This proposed legislation would provide the President with wide-ranging authority to conduct trade negotiations and bring trade agreements back to the Congress for approval through a procedure, known as fast track, that would not allow amendments to the implementing legislation nor to the agreements themselves. The bill also provides a series of far reaching trade negotiating objectives for the U.S., together with procedures for consultation with the Congress prior to initiation of a negotiation and during its conduct.

This authority would allow President Obama, and his successor, to initiate and enter into trade agreements prior to July 1, 2018, or (through an extension procedure) prior to July 1, 2021. Importantly this authority would also apply to trade negotiations initiated prior to passage of the act. This includes WTO negotiations, the Trans-Pacific Partnership (TPP), trade negotiations with the European Union, and negotiations on trade in services, and environmental goods.

Such authority is essential for creating an environment in which trading partners of the U.S. are prepared to put meaningful concessions on the table in the knowledge that the Administration has the authority to conclude trade agreements and a clear pathway for bringing them into force.

Prospects for TPP

The 12-nation TPP negotiations are the closest to realization. Negotiators have made considerable progress in recent months and at the late April meeting between Prime Minister Abe and President Obama it became clear that the two largest economies in the TPP negotiation are close to an historic agreement. The political will on both sides is there to

resolve the remaining differences and put the TPP into its final end game. This process will begin as soon as, but only if, Congress passes this legislation.

This final phase of the TPP negotiations brings particular challenges for Canada. Early efforts by Canada to gain entry to the TPP negotiations were resisted by our prospective TPP partners in particular by the U.S. with the support of New Zealand and Australia. These countries were concerned that Canada would not be prepared to make meaningful market access concessions for dairy and poultry products. Eventually Prime Minister Harper convinced our TPP partners that Canada should be admitted to these negotiations as a full participant. It was clear from the outset that Canada would not get a free ride.

Despite knowing that concessions on these products would be a necessary Canadian contribution to a successful TPP conclusion, Canada has not yet put a market access offer for dairy and poultry products on the table. Nor has the government launched a domestic consultation process about the form such an offer might take. This has made it much harder for Canada to be able to play a constructive leadership role in the negotiations in pursuit of Canadian export interests.

The main immediate prize for Canada in the TPP agreement would be improved access for Canadian agricultural, industrial and service products to the Japanese market on the same footing as our competitors from other TPP countries. The U.S. has taken the lead in negotiations with Japan, structuring a deal certain to benefit American interests. Canada has been virtually excluded from shaping the nature of Japanese concessions. Indeed, Canada's failure to meaningfully engage in the TPP discussions has led Japan to stop bilateral trade discussions with Canada.

Now, influential American voices are making clear that Canada will not be allowed to benefit fully from the TPP agreement unless it steps up to the plate for supply management products. Worse still, some senior Americans officials are suggesting that Canada should simply be excluded from the TPP agreement until such time as it makes an adequate contribution.

Exclusion from TPP, or being denied equal benefits in a TPP agreement, would be damaging to Canadian exporters for whom the Japanese market is critically important. To give some sense of the significance of this market to Canadian interests, it is worth noting that in 2013 Canadian agri-food exports to Japan amounted to some $4.1 billion. This compares with agri-food exports to the EU which were $2.8 billion.

Canada Needs to Reinvigorate its Commitment to an Ambitious Trade Negotiations Agenda

If the TPA legislation passes the U.S. Congress in June, in all likelihood the TPP negotiations will be largely concluded before Canadians go to the polls on October 19. Clearly this creates an awkward situation for the government. While it will not be easy to make concessions that improve foreign access for dairy and poultry products to the Canadian market, that is exactly what the government will need to do. Walking away from a generational opportunity to put Canadian exporters on an equal footing in key Pacific markets with their TPP competitors would mean abandoning the ambitious trade negotiations agenda that has purportedly been at the heart of the government's jobs and growth strategy.

It might be tempting for politicians of all stripes to avoid making decisions about potential Canadian concessions until after the election. However, this could well result in a situation in which Canada would subsequently have to negotiate its accession to the agreement. In an accession negotiation Canada would have no say over the content of the TPP agreement but TPP members would be free to set the terms of admission for Canada. The result could well be that Canada would then pay a higher price in terms of concessions on sensitive products. It could also result in access concessions by TPP partners for Canada being phased in more slowly than for the original TPP members.

Importantly, securing the benefits of trade liberalization and making the hard choices to get Canada there is not just the responsibility of the Conservative government. It requires a broad and sustained national commitment including the opposition parties and provincial governments. This national effort is needed not just this year but also in the years ahead as Canada works to secure its prosperity in a world of competitive trade liberalization. As nations that compete with Canada negotiate to open new markets, we must make sure that Canadians are placed on an equal footing. Moreover if we are to achieve domestic productivity increases required for future prosperity (see Section II above), we need both access to and competition pressure from foreign markets.

Furthermore, in light of recent developments, Canada's trade negotiations strategy needs to be strengthened. Canada is falling behind not only in the TPP negotiations but also in other important markets. New Zealand and Australia have both secured significant free trade agreements with China. In Canada's case we have not responded positively to suggestions from the Chinese side that we begin such negotiations. It makes no sense to turn our backs on the Chinese market which, together with the markets of the U.S. and the European Union, is at the top of the heap in terms of importance in international trade.

Nor is China the only market where we are in danger of falling behind. Australia and New Zealand are also well ahead of Canada in the negotiation of trade liberalizing agreements with the ASEAN countries. Additionally, Australian Prime Minister Tony Abbott is committed to early conclusion of a major agreement with India.

It is true that Canada has secured an important agreement with the European Union. But implementation of that agreement is at least a year away and a number of hurdles still need to be overcome as we move along the road to implementation. Canada has implemented a major free trade agreement with South Korea, an important achievement; it should be recalled that this agreement only allowed Canada to catch up with the U.S. which had completed its negotiation with Korea several years earlier.

Canadian political leaders need to make a clear commitment to a reinvigorated, ambitious trade negotiations agenda, one that will not be held hostage by antiquated and growth-destroying marketing board and other protectionist policies. Canada must be in the forefront of shaping agreements with our partners, ensuring benefits for Canadian exporters. The opportunities beyond our borders are enormous and growing and it is imperative we move now to take advantage of them.

New Trade Opportunities for Dairy and Poultry

For some time now Canada's supply management system, which, among other things, controls imports of dairy and poultry products, has impaired the capacity of Canadian governments to negotiate the best possible access to foreign markets for Canadian exporters.

In the NAFTA negotiations two decades ago, Canada's refusal to make concessions on supply managed products led to three separate bilateral agreements on agriculture rather than one overall agreement, as was the case for other parts of the NAFTA. The Canadian government now faces a similar challenge in the TPP negotiations as described above.

It is important to note that we are talking here about a negotiation. There is no suggestion that Canada would need to accept whatever the Americans say they want us to do. Canada's concessions would be negotiated by Canadian negotiators under instructions from the Canadian government. Furthermore those negotiations would be conditioned significantly by the protection that the Americans are likely to leave in place in any deal for their own dairy producers.

It is time for all political parties to take another look at what is at stake rather than continuing to pledge to support an approach that no longer responds to Canada's emerging new interests.

Not only is the current support of supply management damaging the export interests of other sectors, it is also preventing the dairy and poultry industries from taking advantage of significant growing opportunities for these products in the global marketplace. Global demand for quality agricultural products is increasing faster than agricultural production. Prices for agricultural products are increasing substantially as the growing middle class in emerging economies seeks quality products for their dinner tables. Canada is one of the few places in the world with the capacity to increase significantly its agricultural production in a truly sustainable fashion. The global opportunities for Canadian agriculture are of historic proportions.

Canadian dairy and poultry producers can also benefit from these new export opportunities. But, clearly, the federal government, which established and maintains the current marketing system, needs to take the lead in devising a plan that will allow the supply managed industries to realize their full potential. Such a plan would need to be phased in over time so that producers would have adequate time to prepare to take advantage of the new conditions of competition. While no two situations are identical, in developing a plan it would be instructive to look at how previous Canadian governments approached the removal of the Crow's Nest Pass grain freight subsidies, and the buy-back of licenses in the fisheries industry.

Just as many western grain farmers were frustrated by Canadian Wheat Board constraints, many dairy and poultry producers are frustrated by the constraints the supply management program puts on their capacity to innovate and respond to new opportunities. It is time our political leaders began to encourage the industry to treat global markets as an opportunity rather than a threat. A good plan would allow Canadian producers of these commodities to become globally competitive and reap the substantial opportunities that are available in the world beyond our borders.

Section IV: Summary and Conclusions

After a very disappointing start of 2015, we project that global growth will pick up in the remainder of the year and through 2017 to about 3.5 percent. U.S. growth should average 2.5 percent this year and about 3 percent next year before slowing to a more sustainable 2.6 percent in 2017. Canada will follow a similar pattern of 1.7 percent this year, 2.5 percent next and 2 percent in 2017 as WTI oil prices move up from current levels to US$70+ per barrel by the end of 2017.

Over the decade to 2024, global growth is likely to average no more than 3 percent as China slows and demographic factors weigh on growth in advanced economies, including the U.S, Europe and Canada. Moreover, global productivity growth appears to have slowed since the beginning of this century. In Canada, labour productivity growth (total economy) slowed from an already modest rate of 1.2 percent per year over the period 1984-2007 to only 1 percent per year since 2007. Were this to continue, real disposable income per head could grow at less than 0.5 percent per year in the decade ahead compared to 1.4 percent in the period 1984-2007.

For Canada to maintain the pre-recession growth in disposable income, governments and the private sector will have to make great efforts to increase productivity growth and competitiveness. Government policies to facilitate labour force participation of older workers, to promote competition in our domestic market, and to improve access of Canadian firms to foreign markets are very important. Renewed emphasis on innovation by management of private enterprises is essential.

Securing international trade agreements is an essential component of enhancing productivity growth through increased competition at home and access to foreign markets. Canada has lagged badly behind our competitors in securing trade agreements, in particular those which would open Asian markets to our producers. TPP is a case in point. Governments (federal and provincial), all political parties and the private sector need to get behind efforts to remove the protectionist barriers at home which both block our ability to conclude trade deals and hamper productivity improvement domestically.

Notes

1 IMF, *World Economic Outlook April 2015*, pp. 41-42.

2 IMF, *World Economic Outlook April 2015*, p.7.

3 The report can be accessed online at http://www.bankofcanada.ca/2015/04/mpr-2015-04-15.pdf.

4 See G*rowth in Real Household Income in Canada: 1984-2024* at http://www.bennettjones.com/Publications/Updates/Growth_in_Real_Household_Income_in_Canada.

This paper was prepared by David Dodge, former Governor of the Bank of Canada, Richard Dion, former Senior Economist with the Bank of Canada, John Weekes, Canada's Chief Negotiator for the North American Free Trade Agreement (NAFTA), and Michael Horgan, former Canadian Deputy Minister of Finance. All are Senior Advisors with Bennett Jones and members of the Bennett Jones Government Affairs & Public Policy Group.

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Authors

David A. Dodge O.C.
613.683.2304
dodged@bennettjones.com

Michael Horgan
613.683.2309
horganm@bennettjones.com

Richard Dion
613.683.2312
dionr@bennettjones.com

John M. Weekes
613.683.2313
weekesj@bennettjones.com

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