



## Canada will remain top G7 performer through 2003

Solid, steady, but not stellar, economic growth is forecast by Scotiabank's Chief Economist

**Warren Jestin,**  
Scotiabank Senior  
Vice-President and  
Chief Economist

**W**ith the volatile financial markets and widespread decline in stock prices over the past 12 months, many people might assume the economic recovery that was originally forecast for 2002 didn't happen at all.

Not so, says Warren Jestin, Scotiabank Senior Vice-President and Chief Economist. "With inventory excesses now under control and stronger global industrial production, there has been a modest recovery in international trade and commodity markets," says Jestin. "However, people need to accept that we are not about to relive the boom days of the late '90s."

An issue of the Global Outlook published by Scotia Economics, articulates the point further: "As the hangover from the bubble of the late 1990s drags on, expectations about economic and financial market prospects have been resized to incorporate slower growth, lower interest rates, leaner profits and a longer recovery. For Canada and the United States, a repeat of the frenzied 5% pace evident at the turn of the millennium is highly unlikely anytime soon."

The good news on the economic front is that Canada's economy is doing well. Canada is well on its way to being the top performer of all G7 nations in 2002 with 3.3% growth over the previous year — roughly a percentage point ahead of the United States. Canada is expected to remain in the top spot through 2003 with a slightly lower growth rate of 2.8%.

As Jestin explains, "Canada's performance edge is underpinned by a competitive exchange rate and solid domestic demand. Consumer spending on 'big-ticket' items and housing activity remain the drivers of growth."

Jestin points out that Canadians are playing catch-up with their American cousins, abetted by low interest rates and a competitive Canadian dollar. "In Canada, income gains are being boosted by more than 400,000 new jobs that have been created over the past year along with prior tax-cutting initiatives. Relative to south of the border there is still considerable pent-up demand to be tapped in Canada."

### Revival in business investment expected by mid-2003

The problem we're facing is that consumers alone don't have the stamina to shift the economy back into high gear. "The restoration of more balanced, sustainable growth requires a revival in business investment, which is unlikely to get underway in earnest before the second half of 2003," Jestin says.

"Investors continue to lean towards safe, liquid investments that favour government-backed, fixed income instruments over equities. For producers, the absence of pricing power has forced renewed rounds of cost cutting to bolster profitability. Even for consumers, widespread discounting and exceptionally low interest rates are needed to keep them in a shopping mood."



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Jestin says the prospect for the Canadian currency isn't outstanding, either, and predicts the Loonie will not go above 66 cents versus the American dollar anytime soon.

"The Canadian dollar has rebounded from record lows against the American currency, bolstered by Canada-U.S. interest rate differentials and our relatively stronger economic fundamentals," Jestin comments. "However, as a secondary currency tied to U.S. developments, further erosion of the U.S. dollar may benefit our currency less than offshore alternatives."

In view of the circumstances, federal and provincial governments are likely to scale back their expectations as well. While Canada is still the only G7 nation enjoying a trade and fiscal surplus, "government balances have been significantly eroded by slower growth, multi-year tax cuts and, at the federal level, renewed spending largesse."

To hold the line in fiscal 2003, Jestin says the provinces "are relying upon higher tobacco taxes and fees, increased contributions from enterprises, and revenues/reserves from prior years. The stakes are high as the federal and provincial governments negotiate health care, a new five-year Equalization agreement for April 2004, urban growth management and the Kyoto Protocol."

"With interest rates anchored at historically low levels by the virtual absence of inflation, the global expansion is expected to broaden and deepen over the next year. In the meantime," Jestin concludes, "many businesses on both sides of the border will continue to focus on cost control and consolidation, not capital expansion, to bolster their bottom-line performance."



44 King Street West  
Toronto, Ontario M5H 1H1

e-mail: [cashmanagement@scotiabank.com](mailto:cashmanagement@scotiabank.com)  
[www.scotiabank.com](http://www.scotiabank.com)