A new impetus to growth will be essential to a gentle deleveraging

When it comes to the financial situation of households, the chorus is getting familiar: a high level of debt that constitutes a vulnerability for the Canadian economy and financial system. The picture is fortunately less alarming for businesses. In a study of 47 countries in 2014, the McKinsey Global Institute \(^1\) ranked Canadian companies in the third quartile of the most indebted. However, in the case of governments, the same study placed Canadian public debt slightly above the median of the group of considered countries.

This is an important factor, at a time where the federal government has engaged into several years of deficits. The goals of this strategy are noble, for the most part, especially in a context of private investment retrenchment. Low borrowing costs make this method of additional economic support relatively inexpensive. However, while it is recognized that the federal government enjoys a good degree of financial latitude, some provinces have relatively high debt levels, which must be taken into account in the comparative analysis of Canadian public debt.

All else equal, higher federal borrowing could lead to Canada to climb in the ranking of countries in terms of total public debt to GDP. Without deleveraging by other economic agents, the rank of Canada in terms of its total debt to GDP would possibly end up at a higher level. In the McKinsey Global Institute’s study, Canada’s total debt relative to its GDP was already above the median in 2014, particularly due to the high level of household debt.

Boosting growth significantly and sustainably will be the key to avoiding a too strong increase in debt ratios. One can expect that this will happen in the coming years, as the impact of the measures announced in the recent budget intensifies. It remains that over the longer term, the Canadian economy will have to walk on its own, and without as generous a contribution from the energy sector as in the past. This underscores the importance of measures to encourage long-term productivity gains.

Implications: Public debt is a solution that is justified in the short term to help boost the Canadian economy. Over the long term, it could however bring its share of problems, for example if interest rates rise or if creditors begin to lose confidence. If the fiscal stimulus measures succeed in fostering sustainable growth, they will kill two birds with one stone: preventing an excessive surge in public debt ratios and reduce household debt ratios through higher incomes. The less desirable alternative would be excessive debt that is unaccompanied by growth gains. The deleveraging that would come to be necessary would then necessitate some painful consolidation of government and household balance sheets.

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