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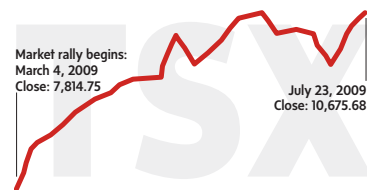
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THE ECONOMY

The recession is over ...

Carney predicts growth this quarter, capping the downturn at a short 9 months – and providing the clearest signal yet that the worst is behind us



BY KEVIN CARMICHAEL OTTAWA

The recession is over, but not the pain.

Canada's central bank predicted yesterday that the economy would expand this quarter, suggesting the economic contraction lasted for about nine months, considerably shorter than the previous two recessions in the early 1990s and the early 1980s.

The Bank of Canada's reassessment of the state of the economy is perhaps the clearest signal yet that the worst of the recession is over.

Buoyed by the prospect of better days ahead, investors rushed to buy Canadian stocks, adding new life to a near five-month rally that economists said has played a big role in reversing Canada's fortunes. The Standard & Poor's/TSX Composite Index rose 243.33 points to 10,675.68, the highest in six weeks. Canada's dollar jumped about 1 per cent to 92.04 U.S. cents, the strongest in almost two months. Yet Bank of Canada Governor Mark Carney stopped short of celebration, saying it will take more than a year to replace the wealth destroyed by the financial crisis.

A graphic example of the hole out of which Canada's economy has to climb is the "output gap," which measures the difference

between current economic activity and the level of production policy makers reckon the economy can sustain without causing rapid inflation.

The Bank of Canada's conventional measure of output gap was -4.3 per cent in the second quarter, the widest deficit on record dating back to 1985.

"We are on track for the recovery both in Canada and globally," Mr. Carney said at a news conference. "But it's early days. It's a long road."

Canadian policy makers attributed their brighter outlook to improved confidence around the globe, reflected in the Dow Jones Industrial Average's 2-per-cent jump yesterday, sending the New York-based index above 9,000 for the first time since January.

The Bank of Canada, which employs more than 300 economists and runs 21 models, predicted in April that gross domestic product would contract 1 per cent in the current quarter and that growth wouldn't return until the final three months of 2009.

As it turns out, policy makers underestimated Canadian consumers' ability to weather the deepest global recession since the Second World War and the central bank's own ability to erect a bulwark against the storm.

Mr. Carney and his senior deputies remain surprised that household credit continued to expand through the recession, providing a measure of support for domestic spending that kept the collapse in exports and rising unemployment rates from taking a greater toll.

The fact that family borrowing continued to increase at its historic pace of about 8 per cent a quarter reflects an increase in home buying – purchases that were encouraged by mortgage rates that fell to record lows as the Bank of Canada dropped its benchmark lending rate to an unprecedented 0.25 per cent and set up emergency cash auctions to ensure banks had access to enough money to continue lending.

"We've seen some remarkable policy response to the economic issues, not just on a regional basis, but on a global basis," said Daniel Bain, president and chief investment officer at Toronto-based Thornmark Asset Management Inc., which oversees investments worth about \$460-million. "It's almost unimaginable where we would be if there had not been some intervention."

It will be months before Statistics Canada officially dates the latest economic downturn.

Canada's GDP declined at annual rates of 3.7 per cent in the final three months of 2008 and 5.4 per cent in the first quarter, satisfying many economists' rule-of-thumb definition of a recession. The Bank of Canada said yesterday that GDP likely contracted at a rate of 3.5 per cent in the second quarter.

StatsCan, however, says the two-consecutive-quarters rule is too crude to truly capture a recession. The agency uses a more qualitative approach that involves an analysis of indicators other than GDP.

The previous two recessions

lasted from April, 1990, to April, 1992, and July, 1981, to October, 1982. Excluding the current contraction, Canada has endured 11 recessions since 1947, ranging in duration from three months to two years, according to StatsCan.

But Mr. Carney is more concerned about depth than he is about duration.

Canada's economy has shrunk so much that the country's "potential output," the rate of growth the economy can grow without stoking inflation, is now 1.1-per-cent – less than half what the speed limit was before the crisis.

That's why the recovery from this recession will be slower than usual.

The Bank of Canada also assumes that much of the spending that has occurred this year is the result of households advancing purchases to take advantage of low borrowing costs and discounts. For this reason, the central bank actually cut its forecast for growth in 2011 to 3.5 per cent from 4.7 per cent in April.

Mr. Carney also stressed that the rebound is fragile, sustained by low interest rates and massive government spending. Business investment is weak, and Canada's exporters are dependent on global demand rebounding as the Bank of Canada assumes it will.

"There are still risks to the recovery," Mr. Carney said. "The point we really want to underscore is that this recovery is the product of policy and where policy is."