Could Canada’s High Inflation Turn Into Stagflation? Here’s Why Canadians Shouldn’t Be Concerned

Description

Stagflation: even the term sounds nasty, like some kind of curse word or Spiderman villain or disaster film on par with *Sharknado.* Sometimes, the term sounds dated, spoken only in history or economic classes or old films that take place in the 70s. But every now and then, when the economy is doing poorly, when inflation is high, and we see signs of negative economic growth, the word creeps back into our vernacular, showing up with the same urgency as an apocalypse, scaring people into buying gold or stocking up on water or selling their stocks.

Lately, “stagflation” has reared its ugly head in the discourse of certain economists and analysts, who claim the high inflation we’re facing could turn to stagflation. Perhaps the loudest voice in this arena is American billionaire Ray Dalio, who warns that the U.S. economy today is very similar to that of the economy in the 70s, which was mired by stagflation.

Could Canada be facing the same threat? Are we on the brink of a particularly *stagflationary* era? Let’s take a look.

Stagflation: A recap

Stagflation is a portmanteau that squeezes “stagnation” and “inflation” together. Three key components make up stagflationary times: high inflation, high unemployment, and negative economic growth (that is, a decline in a country’s GDP). This triple threat mires an economy, bringing prices up while also leaving people unable to make enough income to keep up.

In recent years, we’ve seen only one or two periods of *real* stagflation, and they occurred during the 70s and early 80s. During this time, stagflation was caused primarily by a supply shock (sound familiar?) of oil. OPEC was boycotting allies of Israel during the Yom Kippur war by refusing to sell them crude oil. This caused oil prices to quadruple, and the worldwide economies began to slow down. At the same time, unemployment rose to a whopping 11% in Canada, hovering above 7% until 1983.

In addition to these three, many experts believe poor monetary policy can also be a major catalyst of stagflation. That is, when the central bank and government pass “easy” monetary policies that either lets inflation carry or worsens it, a period of stagflation becomes possible.

Is Canada facing stagflation?

Short answer: it’s possible.

For one, inflation is high, with no signs of stopping. But remember this: inflation in the 70s was *much* higher. Back then, Canadians were experiencing inflation in double digits. At that time, inflation rose from 2.70% in 1971 to 7.49% in 1973 to a whopping 11% in 1974 and 10.67% in 1975. In fact, for 10 years (from 1973 to 1983) inflation stayed above 7%.

At the same time, unemployment was alarmingly high during the late 70s and early 80s, reaching 13.1% in 1982. Considering that the unemployment rate in Canada has fallen to 5.5% in February 2022 (which is lower than the 5.7% unemployment rate in February 2020), that’s a good sign we’re steering clear of stagflation.

Perhaps one cause for concern is the Bank of Canada’s relatively ineffective monetary policy. So far, the BoC has raised interest rates by a mere 25 basis points, which has done very little in terms of easing inflation. But the BoC has numerous scheduled meetings this year, and, if worse comes to worst, they could raise the benchmark rate to 3.50%, which would be more than double pre-pandemic rates.

Bottom line

Again, I wouldn’t lose sleep over stagflation. Of all its major signs — high inflation, high unemployment rates, negative economic growth — only the first is plaguing Canada. Though, true, we may see some negative economic growth — a drop from 4.6% GDP growth last year to a projected 3.5% this year — it hasn’t reached stagflationary levels just yet.

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