# SPECIAL REPORT
## TD Economics

July 18, 2016

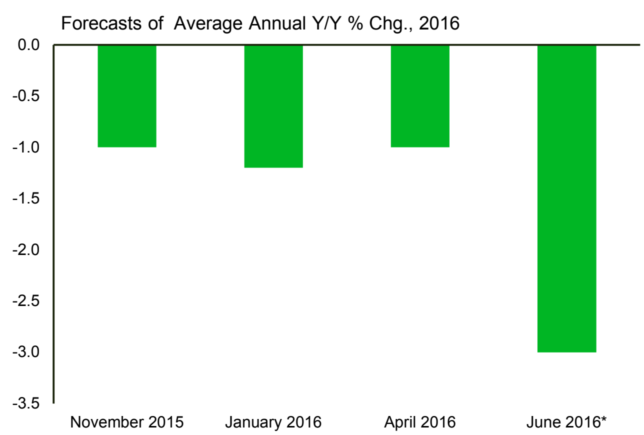
# ALBERTA'S RECESSION NOT QUITE LIKE THE OTHERS

### Highlights

- In our revised quarterly provincial forecast released last week, we downgraded Alberta's economic outlook substantially. We now anticipate a sizeable real GDP contraction of 3 percentage points in 2016, bringing the cumulative drop posted since 2014 to a hefty 6.5 percentage points.
- Many have drawn comparisons between the current recession and those recorded in the past, notably the painful downturns in the early-to-mid-1980s.
- Based on our revised forecasts, the 2015-16 recession is likely to go down in history as one of the most severe using the GDP benchmark. Compared to the average of the past four recessions, declines in both real and nominal are expected to be double the magnitude.
- However, labour market indicators point to an average recession (i.e., percent reduction in employment) or below average (i.e., percentage increase in the unemployment rate).
- The current recession would likely be even deeper had it not been for a number of mitigating factors, including low interest rates, a drop in the Canadian dollar and moderately growing U.S. economy. That said, to the extent that these factors have been blunting the downside, the recovery anticipated in Alberta starting next year is likely to lack the typical punch that has characterized those in the past. TD Economics is expecting average real GDP gains of about 3.2% annually in the 2017-18 period.

Alberta's economy can't catch a break. The economic fallout from last year's oil price plunge has continued to reverberate through the province so far this year. And just as the global oil market has provided a decent whiff of recovery, the northern part of the province was hit by the outbreak of wildfires in May. More recently, the unprecedented vote in the United Kingdom to leave the EU has further raised global uncertainty, with likely some knock on effects to trade and investment across North America. Notwithstanding this year's difficulties, the seeds appear to be sowed for renewed expansion in Alberta in 2017, partly fuelled by rebuilding efforts related to the devastation in Fort McMurray. At the same time, however, we do not foresee output in the province returning to its pre-recession level until 2018, which would effectively stretch out this period of weakness to four years.

**CHART 1: FORECASTS FOR ALBERTA REAL GDP GROWTH**




Source: Consensus Forecast, *June 2016 Forecast from TD Economics

Periods of boom followed by bust are no strangers to an economy that is tied to the vagaries of the global oil market. Including the current downturn, the Alberta economy has suffered five recessions since the early 1980s. While that is not a particularly outsized number given the traditional business cycle lasts about 7 years,

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no other province in Canada has matched Alberta for the severity of its average recession. Indeed, four of the down-cycles have either featured – or in the case of the current one, projected to feature – cumulative peak-to-trough real GDP and employment declines surpassing 2.5% (table 1).

As the table reveals, the 2015-16 recession is expected to go down in history as a well-above-average recession based on a number of key benchmarks, notably GDP. The contraction in nominal GDP in the current downturn is forcast to be particularly out-sized, consistent with the larger-than-average declines in both oil prices and shock to business and personal incomes. Labour market indicators, however, either point to an average recession in 2015-16 (i.e., peak-to-trough drop in employment) or below average (rise in unemployment rate). Regardless, the stretch from 1982-86 is still likely to be regarded as the most challenging period in the post-war period in Alberta. During that period, two painful recessions were recorded within a mere three years, which kept the jobless rate above 10% for a full half decade.

While the province has been through its fair share of difficult recessions, no other Canadian region has matched the extent of boomtimes during the intervening years, leaving Alberta at the top of the charts in terms of annual average economic growth since 1982. It is this historical resiliency that should underpin hopes that the province will re-emerge as a leading growth area over the longer haul. A year ago – amid the slide in oil prices – we issued a 25-year provincial growth outlook that had Alberta positioned atop the Canadian leaderboard. The province faces no shortage of medium-term challenges – a lofty budget deficit, adjustments to a new carbon pricing regime, inadequate pipeline transportation and competition from the U.S. shale industry chief among them. However, based on Alberta's track record and comparative strengths, we remain confident in the province's ability to successfully overcome the barriers erected in its path.

## Current cycle hearkens back to the 80s

For many battle-hardened Albertans that have lived through past cycles, the current times hearken back to the difficult period in the early-to-mid 1980s. At the time, the province experienced two painful recessions (1982-83 and 1986). Today, Alberta finds itself fighting through its second

**Table 1: Alberta Economic Indicators**
**Cumulative Annual % Change, Unless Otherwise Stated**

| | 1982-83 | 1986 | 1991 | 2008-09 | Previous Recession Average | 2015-16 Forecast |
|---|---|---|---|---|---|---|
| **Real (inflation-adjusted)** | | | | | | **TD Econ.** |
| Real GDP (2007, C$) | -3.1 | -2.8 | 0.4 | -5.5 | -2.7 | **-6.5** |
| Per Capita | -2.7 | -3.4 | -1.2 | -4.7 | -3.0 | **-8.8** |
| Real PDI (2002, C$) | -3.9 | -0.8 | -1.8 | -0.9 | -2.1 | **-5.6** |
| Per Capita | -8.1 | -2.0 | -3.5 | -2.4 | -4.0 | **-7.9** |
| Real Home Prices (2002, C$) | -36.6 | 0.2 | -3.1 | -7.2 | -11.7 | **-12.2** |
| **Current Dollar** | | | | | | |
| Nominal GDP | 10.5 | -13.5 | -0.3 | -17.0 | -5.1 | -16.1 |
| Personal Disposable Income (PDI) | 12.4 | 2.6 | 3.9 | -0.2 | 4.7 | -5.4 |
| Corporate Profits | 22.8 | -29.8 | -12.3 | -35.5 | -13.7 | -58.0 |
| West Texas Intermediate U.S. $ Price of Oil* | -24.9 | -52.5 | -48.4 | -65.4 | -47.8 | -67.6 |
| Average Existing Home Price | -21.6 | 3.6 | 2.6 | -4.4 | -5.0 | -3.9 |
| **Labour Market Indicators*** | | | | | | |
| Employment | -5.3 | -2.5 | -0.8 | -2.7 | -2.8 | -3.0 |
| Unemployment Rate Level (Trough-to-Peak Change) | 8.3 | 1.6 | 3.5 | 3.8 | 4.3 | 2.7 |
| Unemployment Rate Peak (Peak Level, %) | 11.7 | 10.5 | 10.0 | 7.1 | 9.8 | 7.9 |

Source: Statistics Canada. Alberta Budget 2016. Forecast by TD Economics as of July 2016. Based on quarterly peak-to-troughs sizeable economic downturn since 2008-09. In each of these eras, the first of the two recessions (1982-83 and 2009) was part of a global economic crisis whereas the second (1986 and 2015-16) was more specifically attributable to weakness in the global oil market that delivered a nasty blow to the Alberta economy. But notwitstanding some of these broad similarities, points of distinction are even more pronounced. Consider, for example, the duration and strength of the expansions between the respective downturns. A strong revival in commodity prices beginning in 2009 not only mitigated the impacts of the 2008-09 recession but set the stage for a renewed five-year period of prosperity. In contrast, economic growth resumed following the 1982-83 recession, but persistent double-digit interest rates left many areas of the economy – especially the housing market – struggling to shake off the weakness during the ensuing recovery in 1984-85. Thus, when Alberta was hit by another substantial leg down in oil prices in 1986, the economy fell victim to its second severe downturn within a mere three years.

**Forecasts still being marked down**

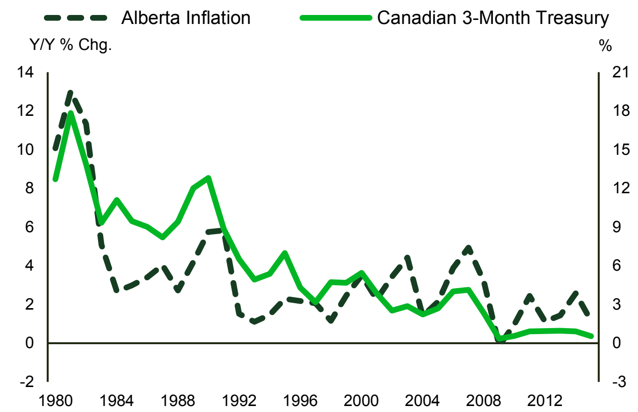
For residents of Alberta – many of whom have lived through the 1980s experience – the question is often raised about how this recession will ultimately compare to those in the past. Of course, until the recession actually ends, we must rely on forecasts and estimates rather than hard actual data. Still, given the time that has elapsed since the oil price rout began, growing confidence that WTI price recovery and historical experience, the picture is becoming clearer.

In recent years, forecasters (including ourselves) have had a tendency to understate the current recession as measured by GDP and overstate the weakness in the labour, and to a lesser extent, housing markets. Recently, Alberta's expected economic contraction has suffered further downgrades as impacts of the recent wildfires, and to a lesser extent, heightened global uncertainty surrounding Brexit are built in. In our June Provincial Economic Forecast, we tripled this year's expected real GDP decline from about 1% to almost 3% on the heels of even larger-than-expected drop in activity in 2015. Looking ahead, the story of moderate economic rebound beginning in 2017 remains in place. And, if anything, the recent rise in oil prices and the prospect for reconstruction work have made us more steadfast in that view.

**How will the 2015-16 downturn stack up?**

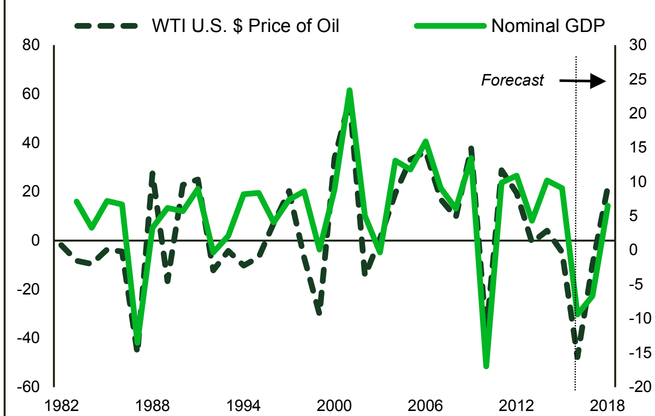
Using these updated expectations, we can glean the following highlights from table 1:

**CHART 2: EARLY 1980'S PLAGUED BY HIGH RATES AND INFLATION**



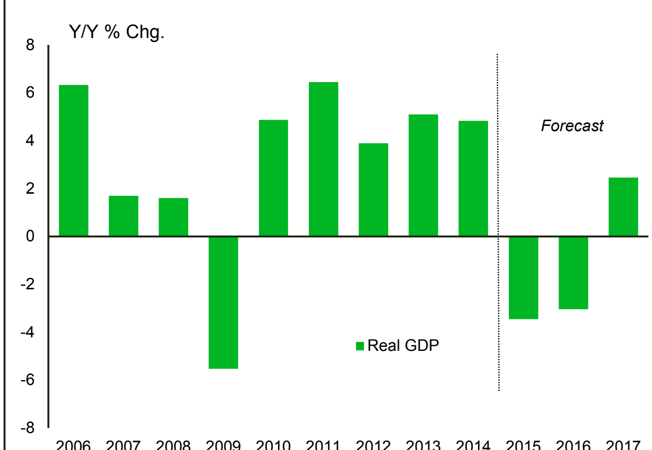

Source: Statistics Canada, Bank of Canada, TD Economics.

**CHART 3: ALBERTA'S OIL DEPENDENCY**
(YEAR-OVER-YEAR % CHANGE)

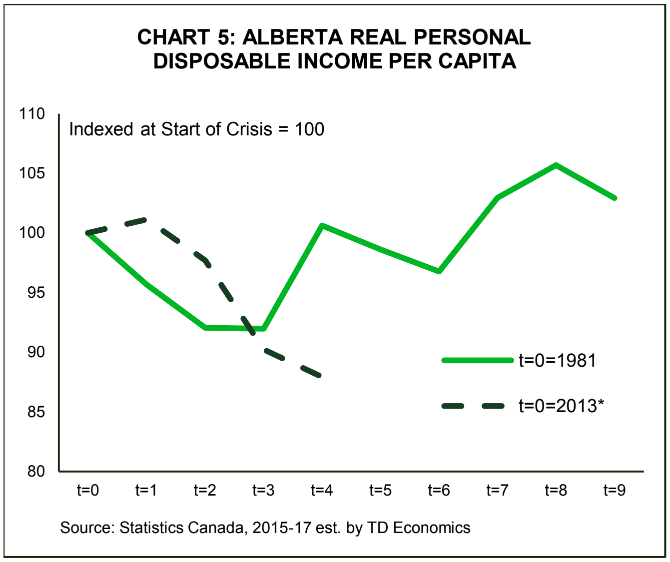



Source: Statistics Canada. Wall Street Journal. F. by TD Economics as of July 2016

**CHART 4: ALBERTA REAL GDP GROWTH**



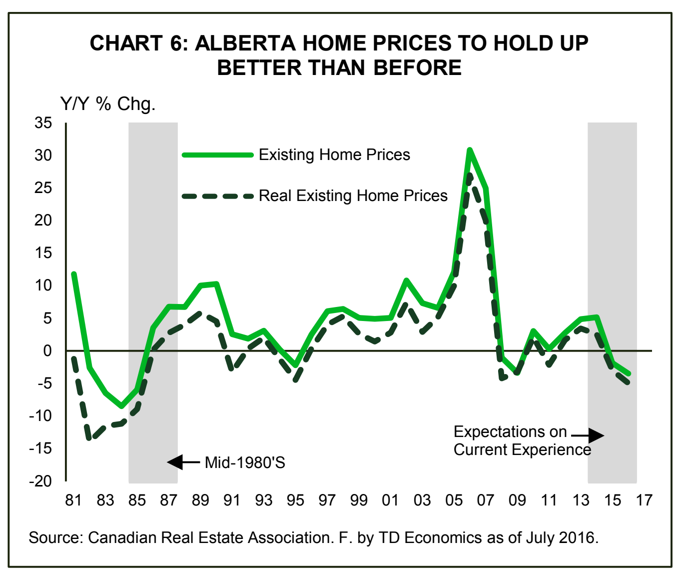

Source: Alberta Budget 2015 and 2016, TD Economics.




- *The 2015-16 recession is likely to go down as well-above-average in terms of output/GDP contractions* – the current recession is expected to yield a cumulative annual decline in real GDP of around 6.5%, which is more than twice that of the average of past downturns.
- *... and relatively long in terms of duration* – the recessions suffered in 1986, 1991 and 2009 amounted to roughly one year of contraction in both output and employment. The two years of contraction expected in the current cycle would match the 1982-83 recession as the longest in the post war period.
- *Nonetheless, labour markets are likely to be far less affected than in the 1980s* – despite the large hit to output, employment is expected to decline by just under 3% from its quarterly peak in 2015 until its expected trough later this year. The jobless rate is likely to continue to hold in the 7-8% range. In sharp contrast, recorded net job reductions in 1982-83 were roughly double the magnitude. And after staging a brief recovery, employment proceeded to fall by another 4% peak-to-trough in 1986, which left the unemployment rate hovering at close to 10% until the late 1980s.
- *Real household living standards are likely to suffer a bigger blow than average but not quite as bad as the early 80s* – undoubtedly, the 2008-09 and 2015-16 recessions have featured (or are featuring) much deeper-than-average hits to nominal personal disposable incomes (PDI) than in the past, consistent with the magnitude of the nominal oil price shock. The expected 5% cumulative drop in nominal PDI estimated for 2015-16 would be the deepest on record. Compared with the 1982-83 recession, when current-dollar PDI actually continued to grow at a rapid clip. But that growth was owing to the distortionary effect of higher inflation and to a lesser extent ongoing brisk population gains. Adjusting for these influences, real PDI per capita (i.e., which are proxies for changes in household living standards) are likely to fall by less than it did in 1982-83.
- *Real home price declines more moderate in the 2015-16 recession* – home prices in the major Alberta markets have shifted into reverse in recent quarters, but the expected drop is likely to pale in comparison to that suffered in 1982-83. This likelihood reflects two developments. First, the steep downturn in home prices in 2010 addressed part of the imbalance that had formed in the market. And, second, average resale home price gains recorded since then have been reasonably contained. In contrast, the mix of a wildly overheated housing market and spike in interest rates in the late 1970s and early 1980s resulted in a particularly painful housing market correction that persisted from 1981 to 1985, with real after-inflation existing home prices recording a drop of some 20% over that 4-year period. By the time of the 1986 oil-induced recession, much of the froth had already been wrung out, so home prices remained quite steady during the second recession.

### Some factors are helping to cushion the blow ...

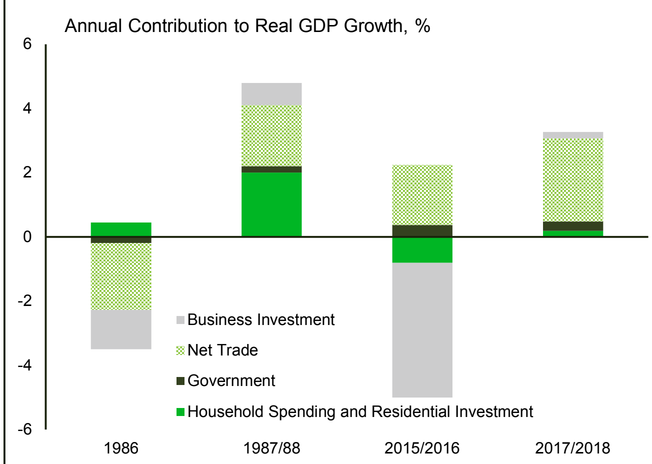
In sum, while offering cold comfort to the many residents that are struggling this year, several of the key measures (notably within the job market) are pointing to a relatively less



severe outcome than that suffered through the back-to-back recessionary period in the 1980s. Clearly, looking at the unprecedented slide in oil prices alone suggest that the hit to the economy in the current cycle could have been significantly worse. Growing confidence that oil prices have hit firmer ground at US$45-50 per barrel and likely to grind higher over time should prevent an even deeper downturn (in stark contrast to the 1980s, when WTI prices fell continuously from 1980-85). But there are a number of counterbalancing influences that have helped to cushion the economic blow, most of which were either not in place in the 1980s or were less relevant:

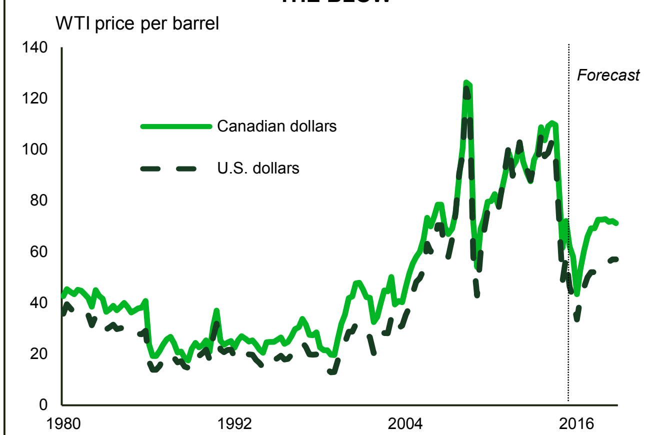
- The Canadian dollar's descent from near parity in 2014 to a low of 68 US cents in January has provided an important counterbalance to the decline in U.S.-dollar oil prices, both by mitigating some of the financial hit on oil producers but also increasing the export competitiveness of the province's non-energy export sector. Some of these benefits have since dissipated, with the loonie bouncing back to the mid-to-high 70s but that move has come hand in hand with higher oil prices. Looking back, the currency also declined during the 1982-83 recession, but actually strengthened during the period of plunging oil prices in 1986.
- Since the 1980s, the Alberta oil industry has shifted from a focus on conventional production, which has shorter investment cycles, towards longer-term oil sands projects. Investment in the province's oil sector is expected to fall to about two fifths of its peak 2014 levels this year, which will become a major output constraint over the medium term. However, in the short run, output related to past oil sands investments is likely to continue growing, providing some economic offset to weaker investment. During the 1982 scenario, crude oil production declined sharply before rebounding moderately in 1983 while in 1986, output was held relatively steady.
- Alongside the benefits of a weaker currency, a moderately growing U.S. economy is providing a good source of underlying demand for export-oriented industries. This knock-on benefit extends to the province's tourism and professional services industries. Although a rebound in American growth in the mid-1980s played a role in softening the 1986 downturn, recessions stateside in 1982-83 and 2009 exacerbated Alberta's difficulties during those periods.
- Supportive monetary policy during the current cycle is

**CHART 7: NET TRADE TO LEAD RECOVERY**



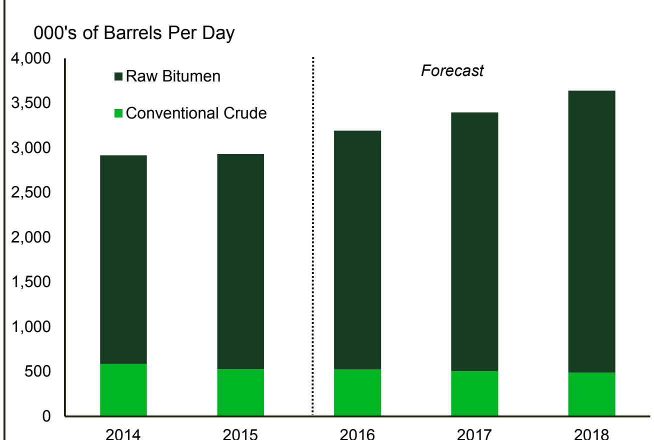

Source: Statistics Canada. F. by TD Economics as of July 2016.

**CHART 8: CANADIAN DOLLAR HELPS CUSHION THE BLOW**




Source: Wallstreet Journal, Bank of Canada. F. by TD Economics as of July 2016

**CHART 9: ALBERTA OIL PRODUCTION**



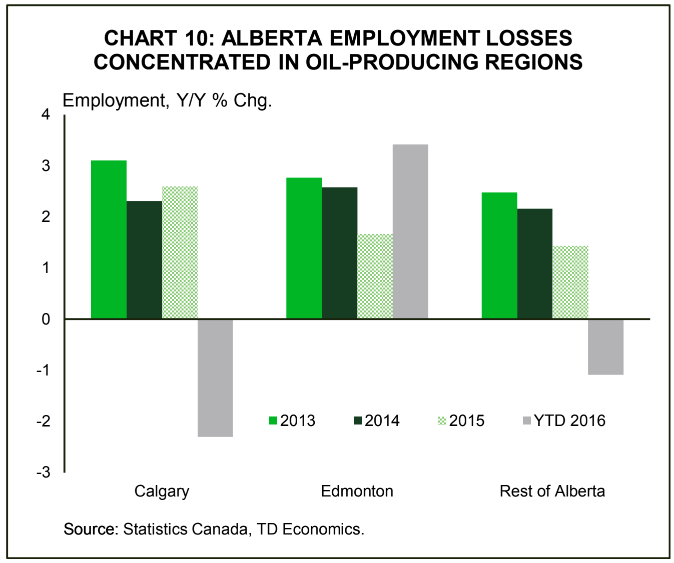

Source: Government of Alberta Budget 2016, TD Economics.

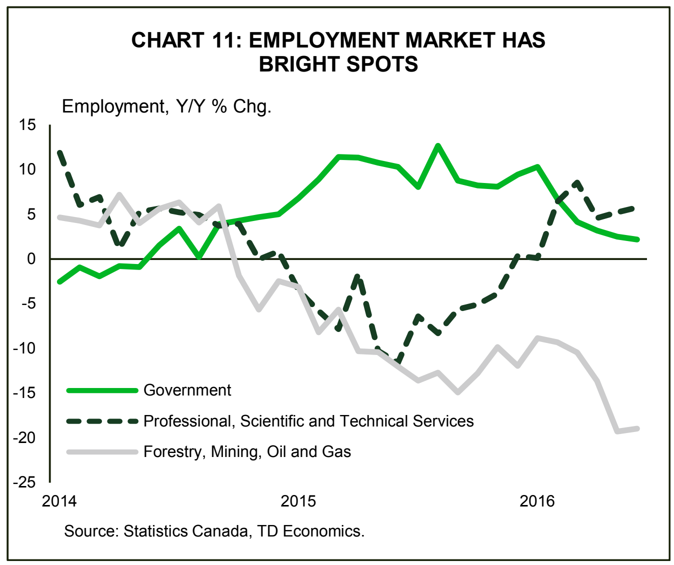
helping to mitigate the sting on household and business balance sheets, in sharp contrast to the high-rate environment of the 1980s. In addition, fiscal stimulus is also being generated by substantial infrastructure investments at both the provincial and federal levels. Based on expected capital spending plans, these measures are on track to significantly outstrip those undertaken during the 1980s. Within the job market, weakness in oil-related and private sector hiring over the past year has been mitigated by rising public sector payrolls, of which the Edmonton CMA has been a major beneficiary (Chart 9). Although more recent data suggest that public hiring has recently tapered off, these gains remain strongly in positive territory year-over-year. In past cycles, public-sector employment has also increased but not to the same extent.

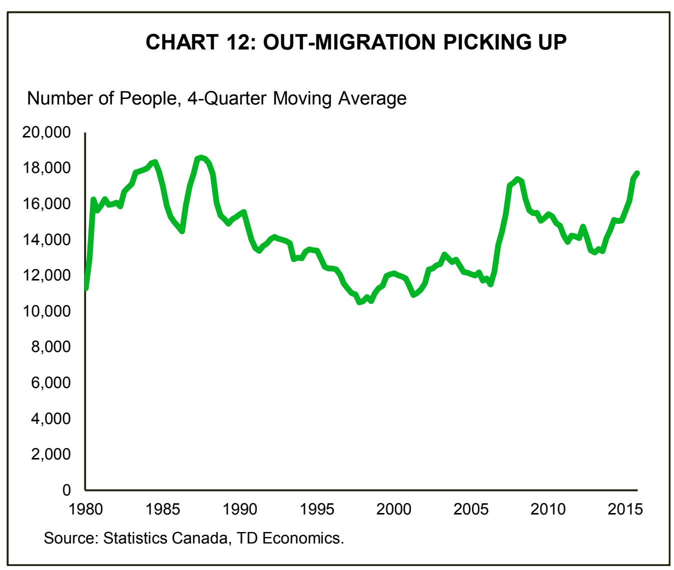
- Not all areas of private-sector job creation are struggling. Case in point is the technology-oriented industry of professional, science and technical services (PSTS), where employment growth is running at a high single-digit rate (Y/Y) so far in 2016. This strength is probably being driven in large part by individuals formally employed in the oil patch who see opportunities to redeploy their skills. In contrast, the number of PSTS workers declined sharply in the 1982-83 recession and were relatively flat in 1986.
- Outmigration rates from Alberta have been accelerating, and are pushing above those recorded in the early-to-mid 1980s (Chart 11). All things equal, an exodus of workers from a region's labour market reduces upward pressure on the unemployment rate. However, a major downside is that spending within that same region is reduced.

### …. but will likely dull the pace of recovery

At the same time, to the extent that these factors may be blunting the recession, they provide less potential to drive a strong recovery beginning next year. Historically, in the two years following the end of a recession, Alberta has recorded an average growth rate of 5.8% per year. In constrast, even with rebuilding activity associated with the wildfires, the province's economy will likely be hard pressed to grow by more than 3.2% annually in 2017-18. Sharp declines in interest rates, a U.S./global boom, strongly rebounding oil prices and rejuvenated household spending as well as housing markets have been at the backbone of past recoveries in the late 1980s and post 2009. This time around, interest rates are close to zero, limiting the upside for interest-



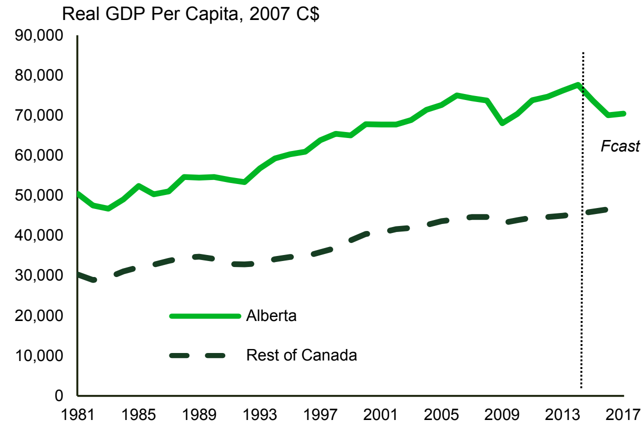
sensitive sectors such as housing. Oil prices are unlikely to reach levels that will stimulate significant new large-scale projects over the next few years. Ditto for natural gas prices that are expected to creep back to only US$3 per MMBtu. Government infrastructure investment will probably begin to wane by 2018. Perhaps most importantly, Alberta is not immune to some of the universal influences – notably an aging population – that have brought down its longer-term growth potential relative to past decades.

We project that by 2018, real GDP in Alberta will have only returned back to its 2014 level. That being said, Alberta's GDP per capita is poised to remain well above that of any other Canadian province, even during the throes of recession. This year, per-capita GDP in Alberta is expected to decline to $77,000, but that compares with $53,000 in the rest of Canada.

### Alberta's still well-positioned for long-term growth

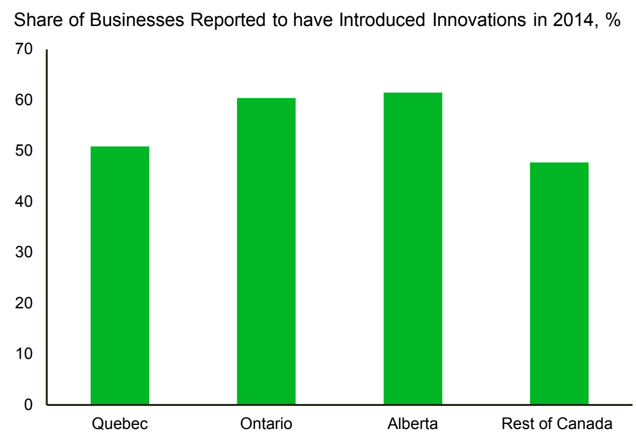
Regarding Alberta's longer-term prospects, much will depend on how the province tackles many of the challenges on its doorstep – sizeable budget deficits, inadequate oil and gas pipeline capacity, competition from the U.S. shale industry for investment, and addressing climate change to name a few. While some of the Alberta Advantage has been eaten away by the pressures of lower oil and gas prices, a large part of the foundation remains in place. The province continues to boast a competitive tax system and a relatively low government debt burden. Immigration rates may ebb and flow, but the province's labour market remains relatively young, highly educated and more oriented towards science and engineering than most economies – ingredients that tend to go hand and hand with innovation and diversification. As such, we remain confident that Alberta can retain its status as a leading growth area not just in Canada, but within North America.

**CHART 13: ALBERTANS STILL ENJOY A HIGHER STANDARD OF LIVING**




Source: Statistics Canada. F. by TD Economics as of July 2016.

**CHART 14: BUSINESSES IN ALBERTA AMONG TOP INNOVATORS**




Source: Statistics Canada, TD Economics.