Intelligence MEMOS

From: Jeremy Kronick and Steve Ambler

To: Bank of Canada Watchers

Date: September 10, 2020

Re: **THE GDP STORY IS NOT AS BLEAK AS REPORTED**

Statistics Canada released its initial estimate of second-quarter GDP last month. Output dropped by 11.5 percent compared with the first quarter and by a little more than 13 percent compared with the second quarter of 2019. This is the largest recorded quarterly decline since Statistics Canada began reporting quarterly GDP numbers in 1961.

The estimate was scary enough, but the way it was reported may have caused either unnecessary panic or unnecessary pessimism. Media reports emphasized the "annualized" change in GDP, which was a drop of 38.7 percent, which is worse than scary. Does this mean Canadian GDP will actually wind up falling almost
40 percent, as it did in the Great Depression of the 1930s? Almost certainly not. In fact, in the current context, using the annualized rate of change is misleading.

Calculating the annualized change in GDP involves assuming the second-quarter contraction will continue at exactly the same pace for four full quarters. After two quarters, a quarterly growth rate of -11.5 percent would translate into a decline of 21.7 percent; after three quarters, 30.7 percent; and after a full year, 38.7 percent.

But the contraction almost certainly won't continue at the same pace for four quarters. The Canadian economy already turned a corner in May. The second-quarter growth number resulted from a very large drop in GDP in April followed by growth in May (4.8 percent) and June (6.5 percent). The Statistics Canada quarterly report suggested growth continued in July, albeit with a more modest monthly increase of approximately 3 percent. As long as we can avoid, or at least handle, a second COVID wave, such that restrictions on economic activity won't return, Canada's recession will actually have ended in May, when growth resumed.

The C.D. Howe Institute Business Cycle Council defines a recession as a pronounced, protracted and pervasive decline in real output, as measured by GDP. If growth does continue, this recession will have been the shortest in Canadian economic history, with the peak of the previous expansion occurring in February and the trough of the business cycle in April. (It will still be a two-quarter recession, however: GDP fell by 2.1 percent in the first quarter, with the steep decline in March swamping feeble growth in January and a basically flatline February.)

To put all this in perspective, the recession that began in June 1981 lasted fully 16 months from peak to trough while the recession of the early 1990s lasted 25 months. In both cases, however, the peak-to-trough contraction of GDP was much milder than we have just experienced, at 5.3 percent and 2.2 percent, respectively. The granddaddy of Canadian recessions was, of course, the Great Depression. Contraction started in October 1929 and continued uninterrupted until February 1933, a total of 39 months, with industrial production down by just over 40 percent from peak to trough. In that case, the 40 percent decline was truly 40 percent.

Since the beginning of the pandemic many Canadians with time on their hands have become recession-watchers. But since the short, sharp downturn was heavily influenced by policy lockdowns meant to be temporary, they should keep in mind that annualized changes in quarterly GDP are not a meaningful indicator of the pandemic's ongoing economic effects. The year-over-year decline of 13 percent from the second quarter of 2019 is a much more helpful indicator of our economic state.

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