BDC
Entrepreneurs first

economic
# LETTER
MAY 2015

## THE OIL PRICE SLUMP HAS CHANGED REGIONAL OUTLOOKS

Crude oil prices have unexpectedly dropped since the middle of 2014 due to an overabundance of global supply combined with weaker-than-expected demand outlooks. The larger supply is mainly the result of increased production of shale oil in the United States—oil extracted from rock, rather than from an underground reservoir. New developments in the technology used for this type of extraction have enabled the United States to expand its oil production considerably in recent years.[1]

Canada produces and exports large quantities of oil. In 2014, the value of exports by the oil and gas sector and by refineries reached $134 billion, i.e. one quarter of the total value of Canada's merchandise exports. The negative effects of lower oil prices on the Canadian economy have already started to make themselves felt. The unemployment rate has risen in the oil-producing provinces, and a slowdown in operations has been observed in sectors that are related to the oil industry. Some oil investment projects have been maintained, but many others have been put on hold. The Bank of Canada estimates that investment by the oil and gas extraction sector will be 30% lower in 2015 than it was the year before.[2]

The oil price slump has led forecasters to revise their growth outlooks for Canada downwards. Real GDP, which grew by 2.5% in 2014, is forecast to rise by just 2.0% in 2015. However, the outlooks differ considerably from one region to another. Indeed, only Alberta and Saskatchewan, provinces whose economies are largely based on oil extraction, are expected to suffer an economic slowdown in 2015 (graph 1). Alberta will be the most severely affected: its real GDP growth is forecast to tumble from 4.4% in 2014 (the highest of any province) to 0.1% in 2015, its worst showing since the recession.[3] ▼

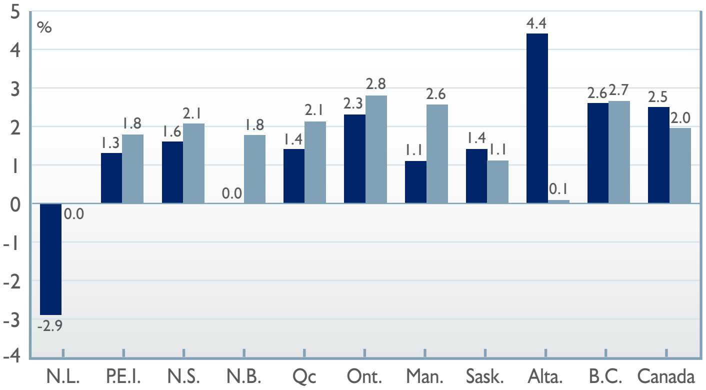
1 Total U.S. oil production rose from 5,077 barrels per day in 2007 to 8,663 barrels per day in 2014, an average increase of 8% per year (Source: U.S. Energy Information Administration).
2 Bank of Canada, Monetary Policy Report, April 2015, page 27.
3 The forecasts of real GDP growth in the provinces are the averages of the most recent forecasts of the seven Canadian chartered banks and of the Conference Board.




BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to May 9. Reliance on and use of this information is the reader's responsibility.

In Newfoundland and Labrador, where oil production is also very important, GDP fell considerably in 2014 due to the drop in mining output and the downturn in oil production caused by the gradual depletion of the Hibernia oil field. Consequently, even though the province is bringing up the rear for the second time in a row, with expected real GDP growth of 0% in 2015, this is actually an improvement compared with the 2.9% pullback that was recorded last year.

### Graph I: In 2015, real GDP growth will be more sluggish in the oil-producing provinces



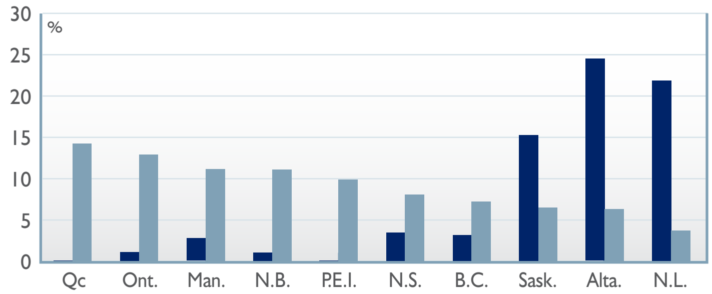

Real GDP annual growth rate (2014)
Real GDP annual growth rate (forecast for 2015)

Sources: Statistics Canada (2014) and average forecast of the seven chartered banks and the Conference Board (forecast for 2015)

The other provinces will also suffer from the oil price slump, but to a lesser extent. The effects will mainly make themselves felt through interprovincial exports. British Columbia and Manitoba, which have close trade ties with Alberta and Saskatchewan, will be the most severely affected.

On the other hand, the recent depreciation of the Canadian dollar—stemming from the oil price slump—and the pickup in the U.S. economy will have beneficial effects on the manufacturing sector, which will counterbalance the negative repercussions of the oil price slump in provinces that produce little or no oil. As graph 2 shows, the manufacturing sector carries the least weight in the economies of the oil producing provinces.

### Graph 2: The manufacturing sector carries less weight in the GDPs of the oil-producing provinces




Oil and gas extraction (as a % of GDP in 2014)
Manufacturing (as a % of GDP in 2014)

Source: Statistics Canada

Due to these two factors, Canadian manufacturing output and exports rebounded in 2014. That trend should continue in 2015, despite a difficult start to the year. The U.S. economy sputtered in the first quarter due to the extremely cold weather, which curbed activity in many sectors. This had repercussions on Canadian manufacturing production and exports, which lost ground. However, these effects should be temporary: the U.S. economy is expected to rally in the second quarter.[4]

The expected acceleration in growth in the United States and a Canadian dollar that promotes exports should also play to the advantage of many service industries, especially tourism, which is particularly important in the Maritimes and in British Columbia. Lastly, the U.S. housing sector should keep regaining momentum, which will support activity in Canada's forestry sector, which is active mainly in New Brunswick, British Columbia and Quebec.

In short, outlooks have darkened in the oil-producing provinces this year due to the oil price slump. On the other hand, outlooks have brightened in other provinces thanks to the expected benefits of a weaker Canadian dollar and accelerating economic growth in the United States. Manufacturing, forestry and some service sectors, such as tourism, should be impacted favourably.

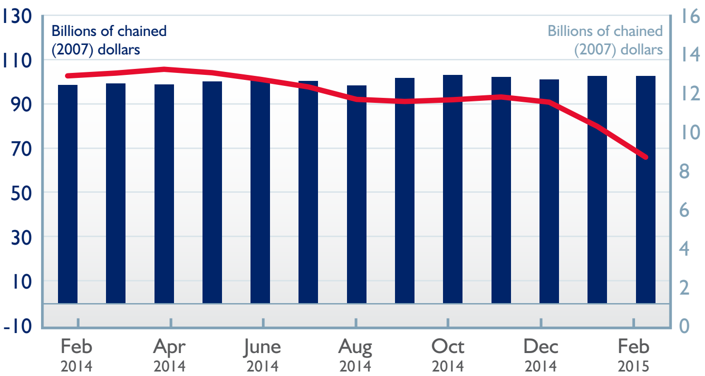
**4** See the section on economic conditions in the United States.

The negative effects of the oil price slump on the Canadian economy were quick to make themselves felt. Besides that, the slowdown in economic activity in the United States also put a damper on growth. Consequently, Canadian GDP growth will likely be sluggish—and perhaps even slightly negative—in the first quarter.

## GDP stalls

Real GDP was flat in February after pulling back 0.2% in January. Production was up in retail trade, agriculture, forestry, hunting and fishing, and in the finance and insurance industry. Meanwhile, it declined in many sectors, in particular transportation and warehousing and mining and oil and gas extraction. In the latter sector, support activities were to blame for the pullback, since oil and gas production has remained fairly stable in recent months despite the oil price slump (graph). Production also flagged in the manufacturing sector in February, the second straight monthly drop. Demand for manufactured goods appears to have suffered from the slowdown in the U.S. economy caused by the exceptionally cold weather observed at the beginning of the year. It should rebound in the months ahead.

### Oil and gas production have held steady despite the oil price slump, but support activities have dipped lately




Source: Statistics Canada

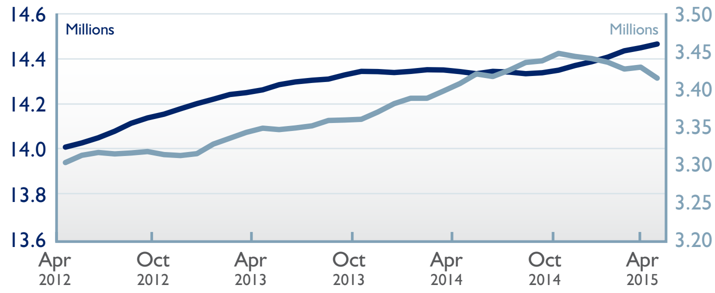
Oil and gas extraction (left)
Support activities for mining and oil and gas extraction (right)

## Employment contracts

After a gain of 28,700 jobs in March, employment fell by 19,700 in April. The trade and construction sectors recorded the largest pullbacks. April's decline in employment comes entirely from part-time jobs, which shrank by 66,500. As for full-time jobs, they increased by 46,900. In recent months, full- and part-time employment have been following opposite trends (graph). Fortunately, full-time employment is showing the upwards trend. Meanwhile, the unemployment rate held steady in April, at 6.8%.

### In recent months, the trend has been up in full-time jobs and down in part-time jobs

(6-month moving average of employment, April 2012 to April 2015)




Full-time employment (6-month moving average)
Part-time employment (6-month moving average)

Source: Statistics Canada

## The trade deficit widens

Exports rose far less than imports did in March compared with the previous month (0.5% versus 2.2%). Consequently, the trade deficit expanded, from $2.2 billion in February to $3.0 billion in March. In the first quarter of 2015, the value of exports fell by 3.0% compared with the previous quarter: exports of energy products tumbled by 20.9% while those of non-energy products edged up by 1.8%. The value of energy product exports has collapsed in recent quarters while those of non-energy products have kept growing, although moderately (graph). In terms of volume, exports were down by 0.1% in the first quarter, but imports fell further, by 0.2%. This tells us that net exports should make a positive, albeit weak, contribution to real GDP growth in the first quarter.

**The value of energy product exports has collapsed in recent quarters**

(Quarterly growth in exports in current dollars)


Source: Statistics Canada

## Housing starts lose ground

Housing starts were down, from 198,546 units in March to 181,814 units in April. The multiple dwellings sector bears full responsibility for these results: in that sector, starts fell by 14.2%, while they rose by 11.4% in the single-family dwellings sector. After accelerating up until September 2014, starts of multiple-dwelling projects have declined. According to the Canada Mortgage and Housing Corporation, which considers that the April numbers are in line with its expectations, builders of multiple-unit buildings are scaling back in order to manage their inventories.

# UNITED STATES

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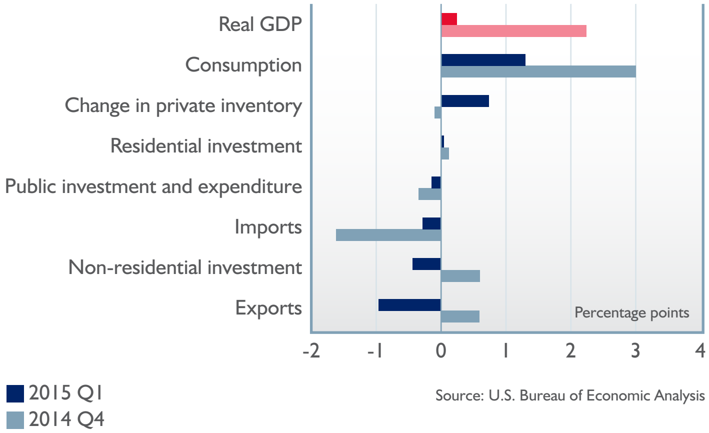
Economic activity took a break in the first quarter; all things considered, this is not surprising, given the weakness that indicators have shown since the beginning of the year. Since it is cold weather that appears to be largely responsible for this slowdown, it is reasonable to believe that the economy will rebound in the next quarter.

## GDP treads water in the first quarter

Real GDP was practically unchanged in the first quarter of 2015, edging up at an annualized rate of just 0.2% after 2.2% growth in the previous quarter. It was consumer spending and changes in inventory that made the largest contributions to growth in the first quarter (graph). On the other hand, non-residential investment and exports were the main sectors holding it back. Economic activity was no doubt disrupted by the exceptionally cold weather that prevailed at the beginning of the year. Consequently, real GDP growth should rebound in the second quarter.

**Most components contributed to the slowdown in GDP growth in the first quarter**

(Contributions to real GDP growth in Q4 2014 and Q1 2015)



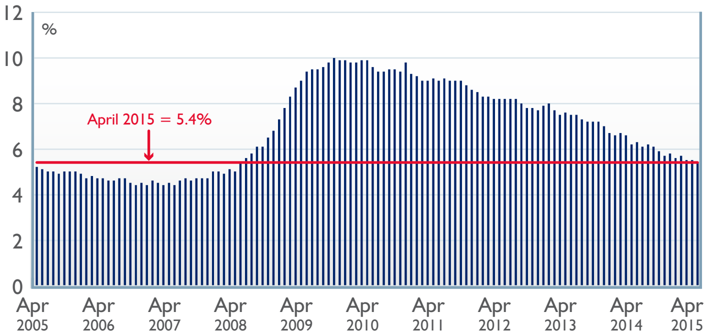

Source: U.S. Bureau of Economic Analysis

## Job growth picks up steam

After an increase of just 85,000 jobs in March (the original number of 126,000 was revised downwards), employment expanded by 226,000 jobs in April. This brings the average monthly increase in employment since the beginning of the year to 194,000, which represents a slowdown compared with the monthly average of 260,00 that was recorded in 2014. The lethargic economic activity in the first quarter no doubt kept job creation in check. The unemployment rate dipped by 0.1 percent in April, reaching 5.4%. It is returning, slowly but surely, to where it stood before the recession (graph).

**The unemployment rate is nearly back to where it was before the recession**

(Unemployment rate, April 2005 to April 2015)




Source: U.S. Bureau of economic analysis

## Housing starts edge up

Starts of single-family homes were up by 4.4% in March compared with the previous month, while those of multiple-unit dwellings fell by 7.1%. In net terms, housing starts recorded a 2.0% increase in March. That was not enough to win back the ground that had been lost in the first two months of the year, so for the first quarter of 2015 overall, housing starts fell by 8.8% compared with the previous quarter. This is no doubt partly attributable to the weather conditions which were extremely harsh at the beginning of the year. ■

# INTEREST RATES

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## The overnight rate should remain stable for the next 12 months

On April 15, the Bank of Canada decided to leave the overnight rate unchanged at 0.75%. The central bank expects real GDP growth to come in at close to zero in the first quarter. The impact of the oil price slump on economic activity was swifter than the Bank had anticipated in January, but it is not expected to be bigger overall. According to the Bank, economic growth will get back on track in the second quarter. Exports of non-energy products and business investment should benefit from greater U.S. demand, the easing of credit conditions and the depreciation of the Canadian dollar. According to the most recent Consensus Forecast survey, the key interest rate should remain stable for the next 12 months. ■

# OIL PRICE

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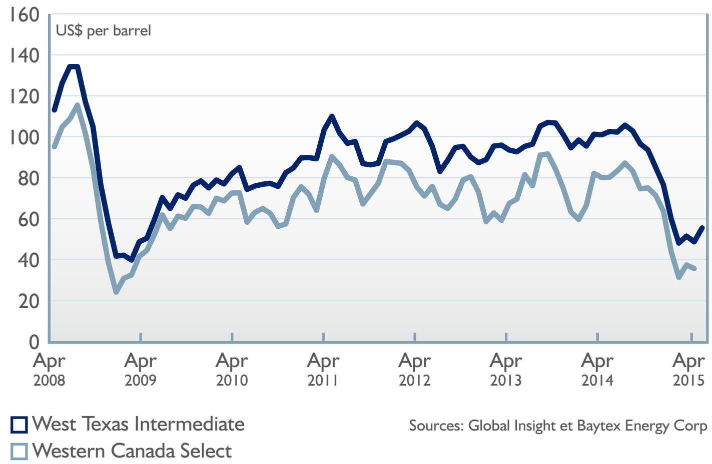
## Crude oil prices creep back up

Crude oil prices have crept up a bit, rising from an average of US$47.90 per barrel in March to an average of US$54.70 in April (for West Texas Intermediate). During the month of April, U.S. output recorded pullbacks which, even though they were modest, encouraged expectations of supply returning to a more balanced level relative to demand; this gave a boost to prices, especially since U.S. oil inventories were showing weaker-than-expected growth. But this upwards movement was held in check by the fact that Saudi Arabia declared that it had expanded its production considerably to meet demand. At the same time, persistent tensions in Yemen, which could disrupt the supply chain, continued to exert upwards pressure on crude prices. ■

### Crude oil prices have crept back up

(Price of crude oil, April 2008 to April 2015)




Sources: Global Insight et Baytex Energy Corp

# CANADIAN DOLLAR

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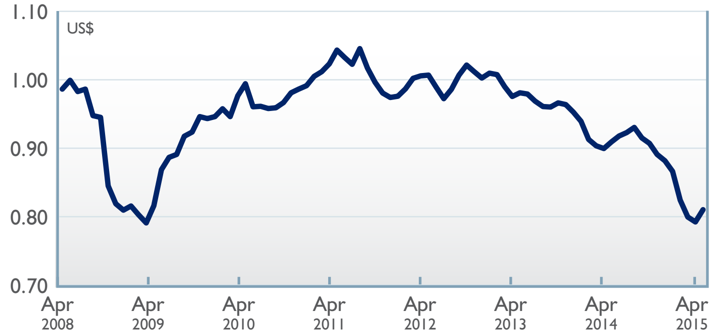
## The Canadian dollar appreciates

After eight consecutive months of depreciation, the Canadian dollar turned the corner in April. Its value rose by 2.3% against the U.S. dollar. The upturn in crude oil prices no doubt contributed to the loonie's appreciation. Also, Canada's real GDP growth in the first two months of the year proved to be sluggish, but less so than expected, and this must have been another contributing factor. ■

**The Canadian dollar appreciated in April**

(Canada / United States exchange rate, April 2008 to April 2015)




Source: Bank of Canada

# SME CONFIDENCE

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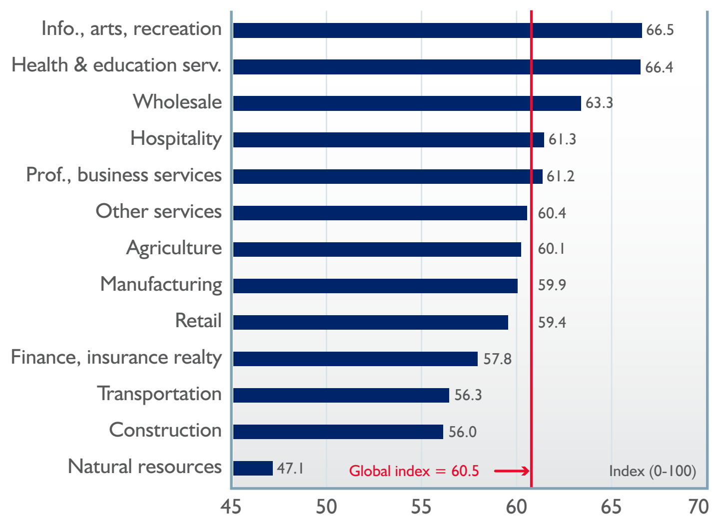
## SME owners' confidence dips slightly

The Business Barometer index lost one percentage point in April, coming in at 60.5. From a regional perspective, the downturn is generalized, since the index lost ground in seven of Canada's ten provinces. On the other hand, losses and gains were fairly evenly spread among the sectors (up in six sectors and down in the other seven). The information and arts and entertainment industry and the health services and education sector are where we find the most confident SME owners. Meanwhile, pessimism reigns in the natural resources sector, which has been upset by the oil price slump. In that sector, the index stands below 50, which means that the business owners who expect better outcomes in the next 12 months are outnumbered by those who expect a weaker performance. ■

**Confidence is at its lowest in the natural resources sector**

(Business Barometer, April 2015)




Source: Canadian Federation of Independent Business

# BUSINESS CREDIT CONDITIONS

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## More credit is granted to businesses

The amount of credit granted to businesses by the chartered banks increased by 1.8% in March. Short-term credit rose by 1.9% and long-term credit by 0.4%. The January cut in the overnight interest rate influenced the market rates. The effective interest rate for businesses, i.e. a weighted average of various bank and market interest rates, applicable to new loans granted to non financial businesses, reached its lowest level ever, which no doubt stimulated demand for credit (graph). ■

**The effective interest rate for businesses has never been so low**

(Weekly data, from March 9, 2001 to March 27, 2015)


Source: Bank of Canada

# KEY INDICATORS—CANADA

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**Key indicators—Canada**

| | Historical[1] | | | | 2015[2] | | | | 2015 | | Forecast | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2011 | 2012 | 2013 | 2014 | Q1 | Q2 | Q3 | Q4 | Latest[3] | | 2015 | 2016 |
| Real GDP (% growth) | 3.0 | 1.9 | 2.0 | 2.5 | | | | | Feb | 0.0 | 2.0 | 2.1 |
| Machinery and Equipment Expenditures (% growth) | 8.1 | 1.9 | 0.7 | 0.7 | | | | | | | -0.5 | 2.9 |
| Pre-Tax Corporate Profits (% growth) | 23.3 | -6.7 | 0.7 | 11.2 | | | | | | | -4.2 | 6.2 |
| Industrial Production (% growth) | 4.1 | 1.4 | 1.8 | 4.2 | | | | | Feb | -0.4 | 1.0 | 1.9 |
| Industrial Product Prices (% growth) | 6.9 | 1.1 | 0.4 | 2.5 | -0.6 | | | | Mar | 0.3 | -1.6 | 2.3 |
| Non-Residential Construction (% growth) | 15.9 | 13.5 | 5.0 | -0.1 | | | | | | | | |
| Housing Starts (' 000 units) | 193 | 215 | 188 | 189 | 175 | | | | Apr | 182 | 177 | 178 |
| Personal Expenditures (% growth) | 2.2 | 1.9 | 2.5 | 2.8 | | | | | | | 2.2 | 2.0 |
| Consumer Price (% growth) | 2.9 | 1.5 | 1.0 | 1.9 | -0.1 | | | | Mar | 0.4 | 1.0 | 2.1 |
| Employment (% growth) | 1.5 | 1.3 | 1.4 | 0.6 | 0.7 | | | | Apr | -0.1 | | |
| Unemployment Rate (%) | 7.5 | 7.3 | 7.1 | 6.9 | 6.7 | | | | Apr | 6.8 | 6.8 | 6.6 |
| SMEs Confidence Index (CFIB) | 66.3 | 63.9 | 63.9 | 64.9 | 61.4 | | | | Apr | 60.5 | | |
| Manufacturers Confidence Index (CFIB) | 67.3 | 66.5 | 63.8 | 65.8 | 61.9 | | | | Apr | 59.9 | | |

1. Annual growth rate
2. Quarterly growth, at annual rate
3. Month-over-month growth

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business.