Business Cycle Council

Communiqué

May 1, 2020

Canada Entered Recession in First Quarter of 2020

Statement from the C.D. Howe Institute's Business Cycle Council

Toronto, May 1 – The C.D. Howe Institute's Business Cycle Council met on April 16, 2020 to review the case for calling the beginning of a recession in the first quarter of 2020 and the dating of the business cycle peak. We then briefly convened on April 30, 2020, following the release of February GDP data.

The C.D. Howe Institute Business Cycle Council, co-chaired by Steve Ambler and Jeremy Kronick, is an arbiter of business cycle dates in Canada. The Council typically meets annually, but also when economic conditions indicate the possibility of entry to, or exit from, a recession. The Council is comprised of Canada's preeminent economists active in the field. Members of the Council participate in their personal capacities, and the views collectively expressed do not represent those of any institution or client.

Given the unprecedented nature of the COVID-19 crisis, and with the ensuing government shutdown putting a stop to much of economic activity, the Council determined a meeting was warranted. The Council addressed two main questions: first, did the Council have sufficient data to determine that the Canadian economy entered into a recession in the first quarter of 2020? and second, if the economy was in a recession, in which month did the peak occur?

Members first reviewed the criteria for determining recessionary periods. The Council defines a recession as a pronounced, persistent, and pervasive decline in aggregate economic activity. This means that the Council looks at three dimensions: by how much did economic activity decline, how long did the decline last, and how broad was this decline across economic sectors? It looks at both GDP and employment as its main measures of economic activity. To measure the breadth of an economic contraction it uses two different diffusion indices.

On the question of how pronounced the drop in economic activity is, the minimum criterion is a decline that lasts at least one quarter. While the Council normally waits for at least one revision of economic data, Statistics Canada's exceptional release on April 15 of a "nowcast" estimate of GDP data showed a 9 percent

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drop in March GDP, resulting in a quarterly drop of 2.6 percent (the largest one quarter drop in GDP on record). The magnitude of the contraction makes it extremely unlikely that any future adjustments will overturn the conclusion of a major drop in economic activity in the first quarter.[1] We also have employment data for the first three months of the year. Labour force survey data indicate a 1.5 percent drop in total employment in the first quarter, with a 5.3 percent drop in March alone.

This leaves the question of the pervasiveness of the decline in economic activity. The Council makes use of two diffusion indices, which allow us to gauge the breadth of economic growth. These measures both use 50 as a natural dividing point, with a score above 50 indicating more expanding than contracting industries and a score below 50 the opposite. We do not yet have the full industry breakdown for March GDP data, though we do have January and February. Having the first two months of the quarter allows us to determine what the index would have to be in March for entry into a recession. In January, the index sat at 59.41, and in February it sat at 49.50. Therefore, the diffusion index in March would have to be above 41.09 for the diffusion index in 2020:Q1 to sit above 50. With government-enforced shutdowns of non-essential industries, and with employment falling in every industry except natural resources, it is highly unlikely the diffusion index will be above 50 for 2020:Q1.

Therefore, members felt that applying the Council's methodology to the preliminary data available suggests that Canada entered a recession in 2020:Q1.

This leaves the question of the month in which the peak in the cycle occurred. GDP growth was positive in January and flat in February, while employment growth was positive in both months. Both indicators turned negative in March. The diffusion index, as mentioned above, was well above 50 in January and essentially at 50 for February. Based on this preliminary data, Council declared February as the cycle peak.

The decision to declare a recession with a February peak is based on preliminary data available as of April 30, 2020. Members of the Council pointed out that further GDP revisions will occur, which might impact the peak month. However, any revisions are extremely unlikely to be significant enough to alter the recession call for 2020:Q1.

1 Based on a study by the Bank of Canada (Tkacz 2010), the 2.6 percent drop is more than 10 times as large as the upper half of the 95 percent confidence band for GDP revisions by Statistics Canada.

Members of the C.D. Howe Institute Business Cycle Council

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Steve Ambler, Co-Chair, Professor, Université du Québec à Montréal.

Jeremy Kronick, Co-Chair, Associate Director of Research, C.D. Howe Institute.

Ted Carmichael, Founding Partner, Ted Carmichael Global Macro.

Philip Cross, Former Chief Economic Analyst, Statistics Canada.

Stephen Gordon, Professor of Economics, Laval University.

Eric Lascelles, Chief Economist, RBC Global Asset Management.

Stefane Marion, Vice President & Chief Economist, National Bank of Canada.

Angelo Melino, Professor of Economics, University of Toronto.