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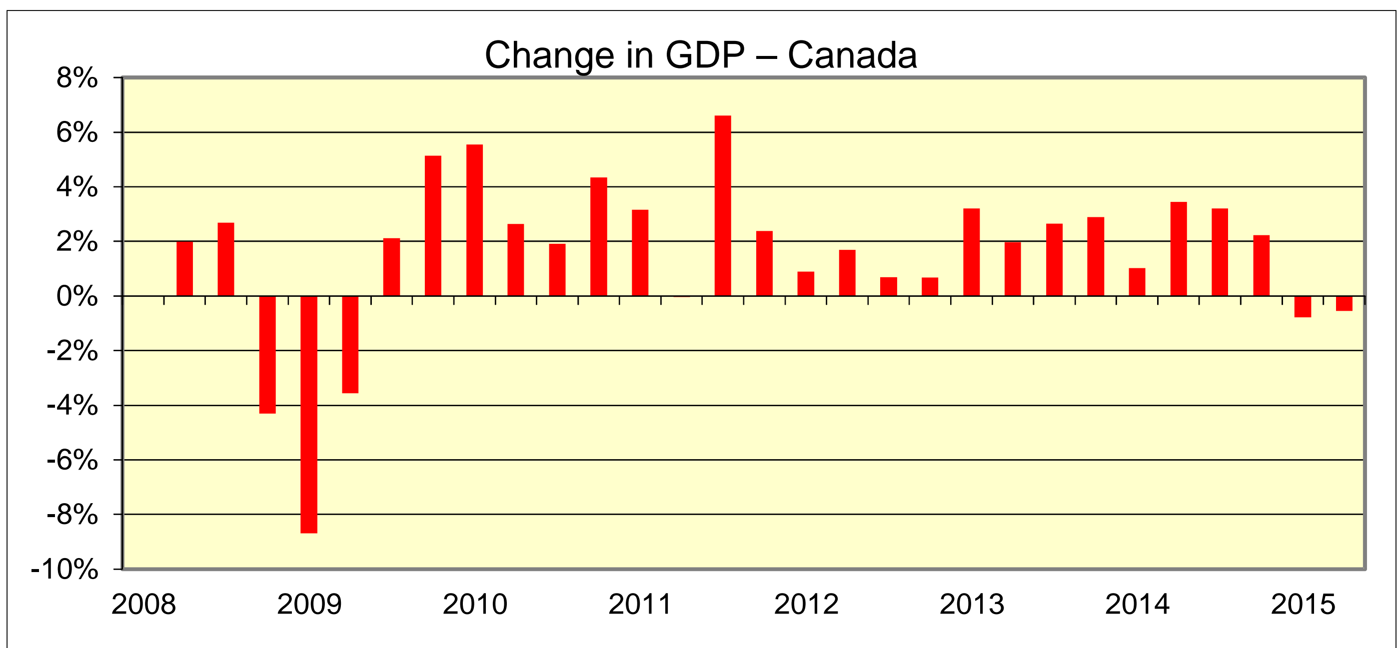
Recession, what recession?

By Richard J. Wylie, CFA
Vice-President, Investment Strategy, Assante Wealth Management

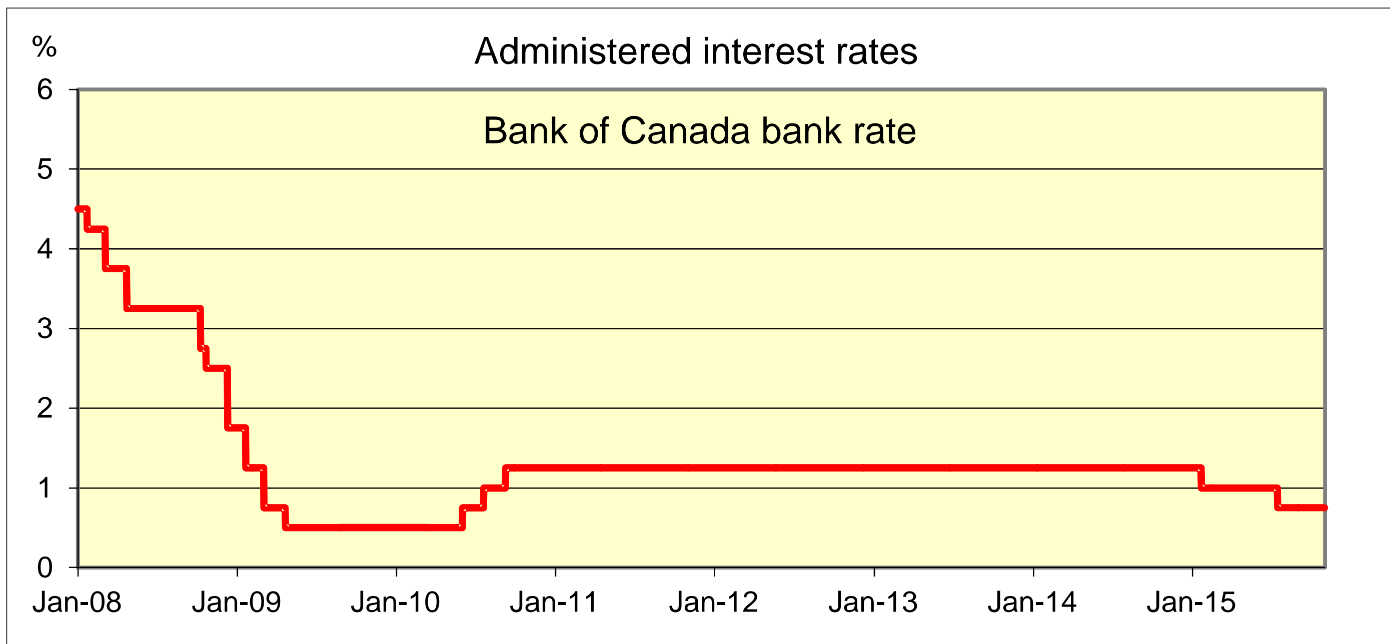
Even though the "Great Recession" of 2008-09 officially ended in mid-2009, investor memories of that chapter of economic history remain surprisingly fresh. The deep recession, coupled with a historic decline in financial markets, continues to draw comparisons to the Great Depression era of the 1930s. Since the end of the downturn in 2009, global economic activity has moved in fits and starts. During this time, policymakers around the world have gone to unprecedented lengths to ensure that their respective nations and economic unions have kept their collective heads above water. Unfortunately, Statistics Canada recently confirmed fears that the country had, in fact, slipped back into recession during the first and second quarters of 2015. While any period of recession is clearly unwelcome, the downturn is expected to have ended in the third quarter. For investors, focusing on the longer term and taking advantage of the calming influence of professional advice can help avoid mistakes associated with panicking when the economy weakens and markets decline.



Source: Statistics Canada

Interest rates

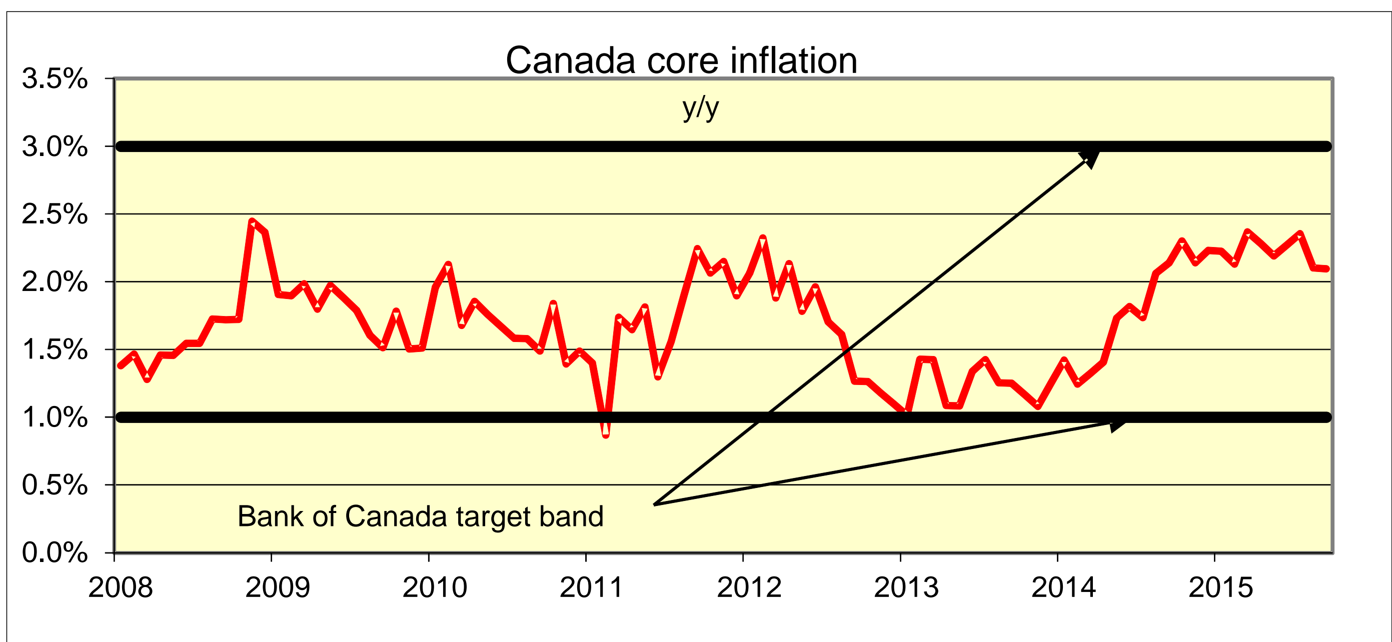
As can be seen in the preceding graph, the domestic economy was technically in recession (two consecutive quarters of negative growth) during the first and second quarters this year, but this was a very modest decline when compared to 2008-09. Data revisions can be anticipated, but at this juncture the figures point to a modest 0.3% decline in total output during the first half of 2015. This is a far cry from the 4.2% output loss experienced in 2008-09. By the same token, the Bank of Canada was unwilling to take any unnecessary risks. As can be seen in the graph below, at both its January 15 and July 15 meetings, the central bank lowered its benchmark bank interest rate by 25 basis points (a basis point is 1/100th of one percent) amid declining forecasts and Bank of Canada Governor Stephen Poloz's comment describing first quarter economic activity as "atrocious." These rate cuts represented a removal of two of the three tightening moves made by the bank on June 1, July 20 and September 8, 2010. At that time, Canada had weathered the economic storm better than other nations. The interest rate hikes undertaken in 2010 gave the bank the "dry powder" it needed to combat the more recent reversal. Subsequently, the bank apparently adopted a "wait and see" stance at its monetary policy announcement on September 9, 2015.



Source: Bank of Canada

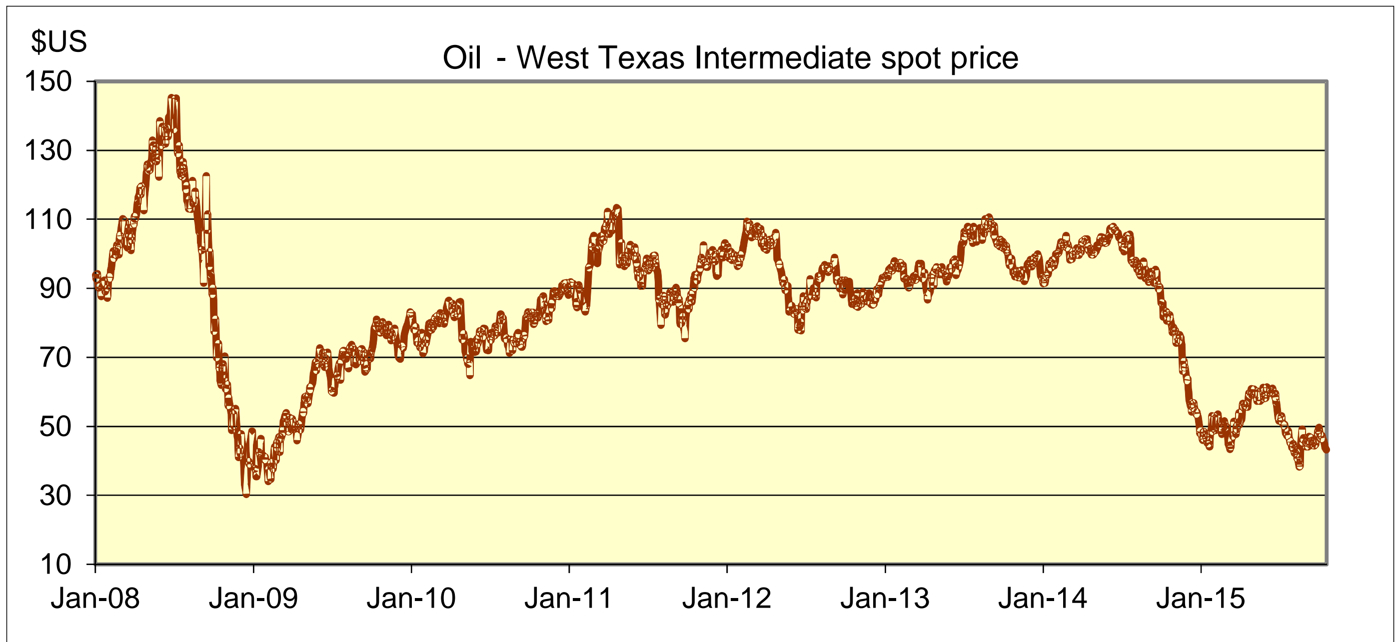
Inflation

The primary focus of the Bank of Canada is inflation and, as can be seen by the graph below, the bank's core inflation rate[1] has remained within the 1.0% to 3.0% target band almost through the entire post-crisis period, even as other regions flirted with periods of deflation (broad-based price declines). However, the source of at least some of the world's concerns with deflation does play a significant role in Canada.



Source: Statistics Canada; Bank of Canada

[1] Core CPI: The Consumer Price Index excluding eight of the most volatile components (fruit, vegetables, gasoline, fuel oil, natural gas, mortgage interest, inter-city transportation and tobacco products), as well as the effect of changes in indirect taxes on the remaining components.

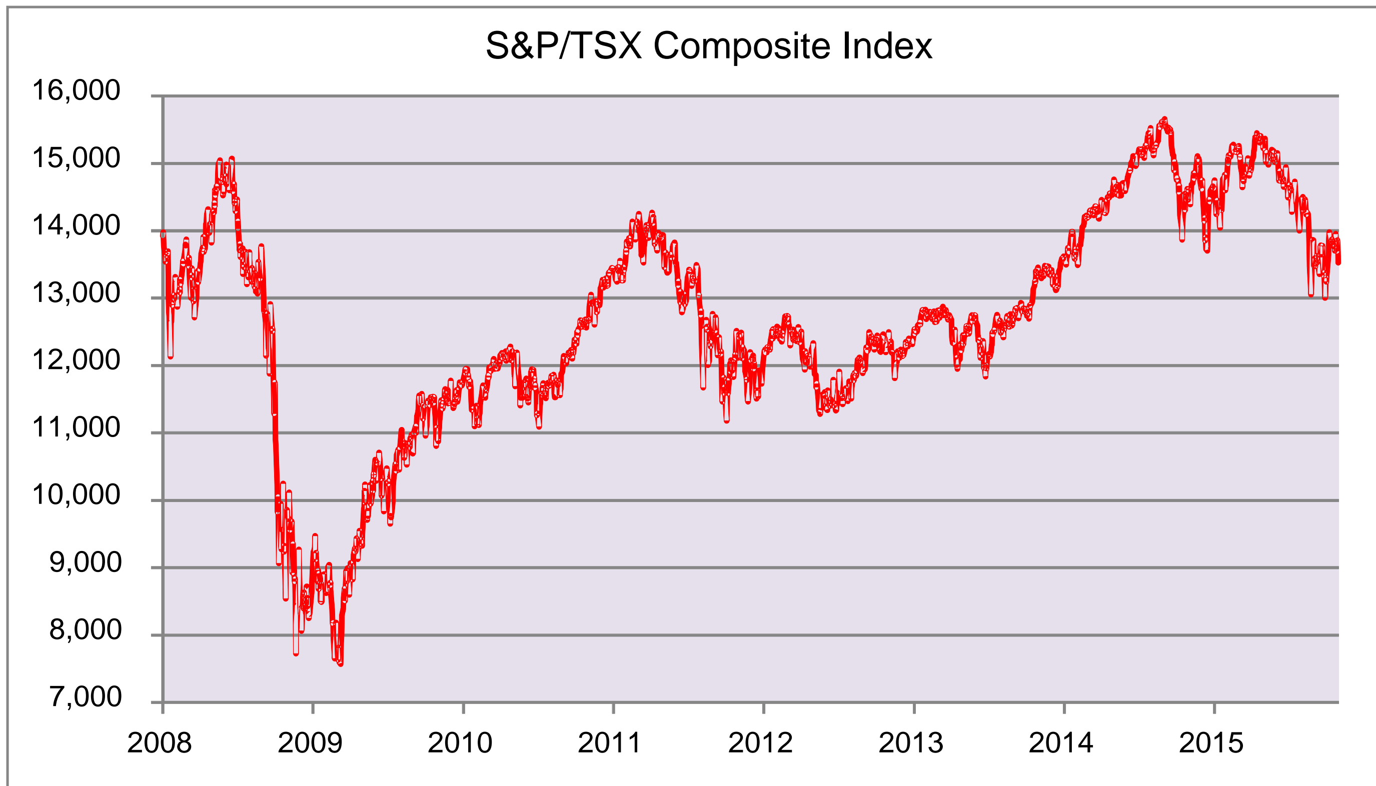


Source: U.S. Energy Information Administration

The recent slowdown in China's economy has dampened commodity prices, and crude oil in particular has been hard hit. As a resource-rich nation, Canada's trade balance and the value of the currency can be heavily influenced by commodity prices. In mid-2014, output from Canada's energy sector stood at 10% of overall GDP. Less than a year later, it represented only 9.2%. The shift has mirrored the move in crude oil prices. As can be seen in the above chart, after dipping into the US$90 range in 2013, West Texas Intermediate (WTI) rebounded to US$107.95 on June 20, 2014. However, it subsequently plunged 64.6% to US$38.22 on August 24, 2015, its lowest point since February 23, 2009, at the height of the financial crisis.

Markets

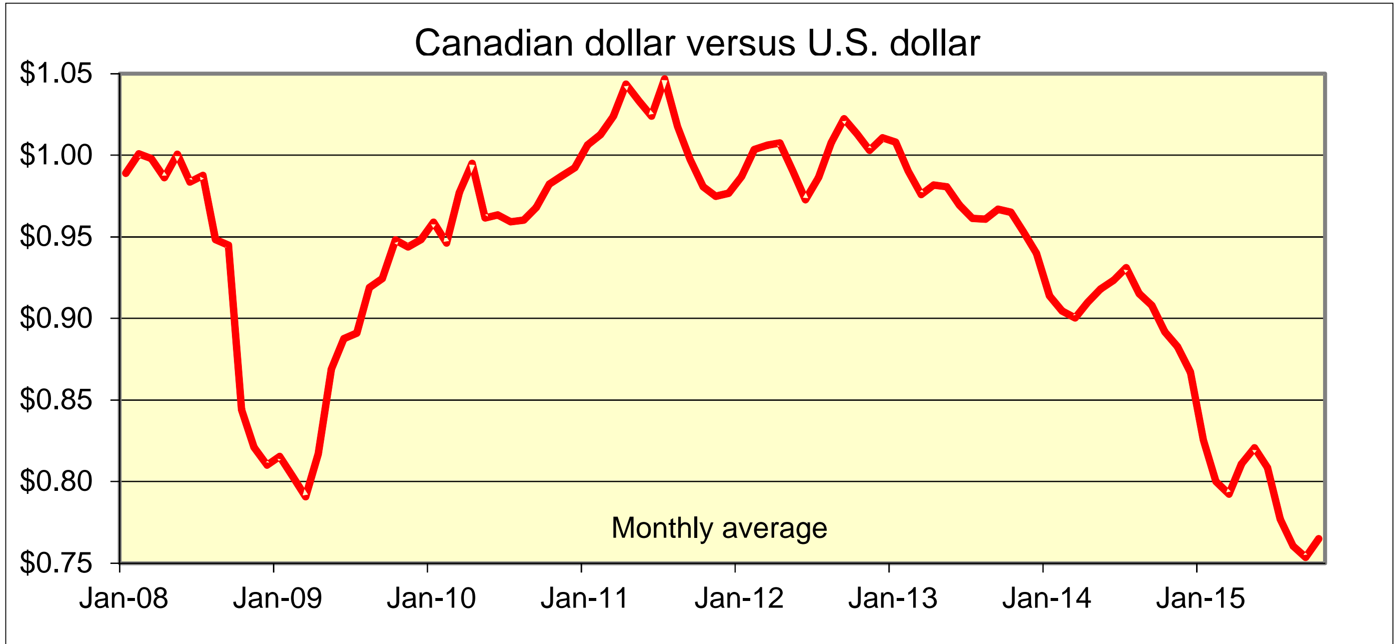
Not surprisingly, the domestic equity market has reflected both slumping energy prices and the general economic malaise. Unlike the U.S., where new market highs were established as recently as May 2015, the S&P/TSX Composite Index peaked on September 3, 2014. As can be seen in the accompanying graph, a number of alternating reversals and attempts at recovery left the index with a 16.9% cumulative decline at the market close on September 28, 2015. At the 13,000 level, the index was virtually unchanged from the closing level posted on December 14, 2006. Even though the 16.9% decline from September 2014 to September 2015 is not considered an outright bear market (a bear market is traditionally signalled by a 20% drop from a market high), the prevailing weakness and accompanying spike in volatility left many investors with deep concerns.



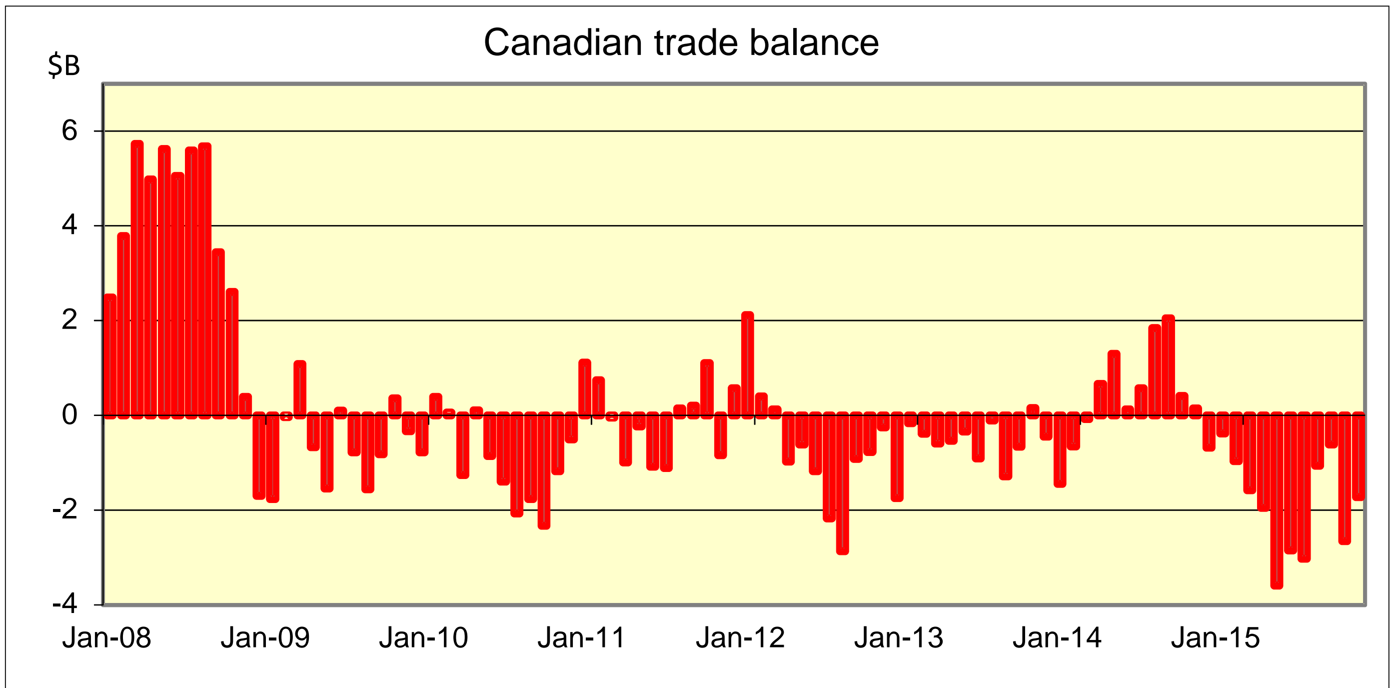
Source: S&P

The currency also came under fire during the same period. As can be seen in the graph below, the Canadian dollar, which traded above par with the U.S. dollar for much of 2012, eased down to an average of US$0.923 by June 2014. However, it dropped far more rapidly following that juncture, hitting a 10-year low of US$0.743 on September 29, 2015.

Even though the currency's volatility in international markets can appear alarming, these movements in the value of the Canadian dollar can act as an economic shock absorber. As most commodities are priced in U.S. dollars, a rising U.S. dollar (relative to the Canadian dollar) drives up the prices received by commodity exporters like Canada. While it will take time, Canada's lower export prices will also help sectors outside of commodities.



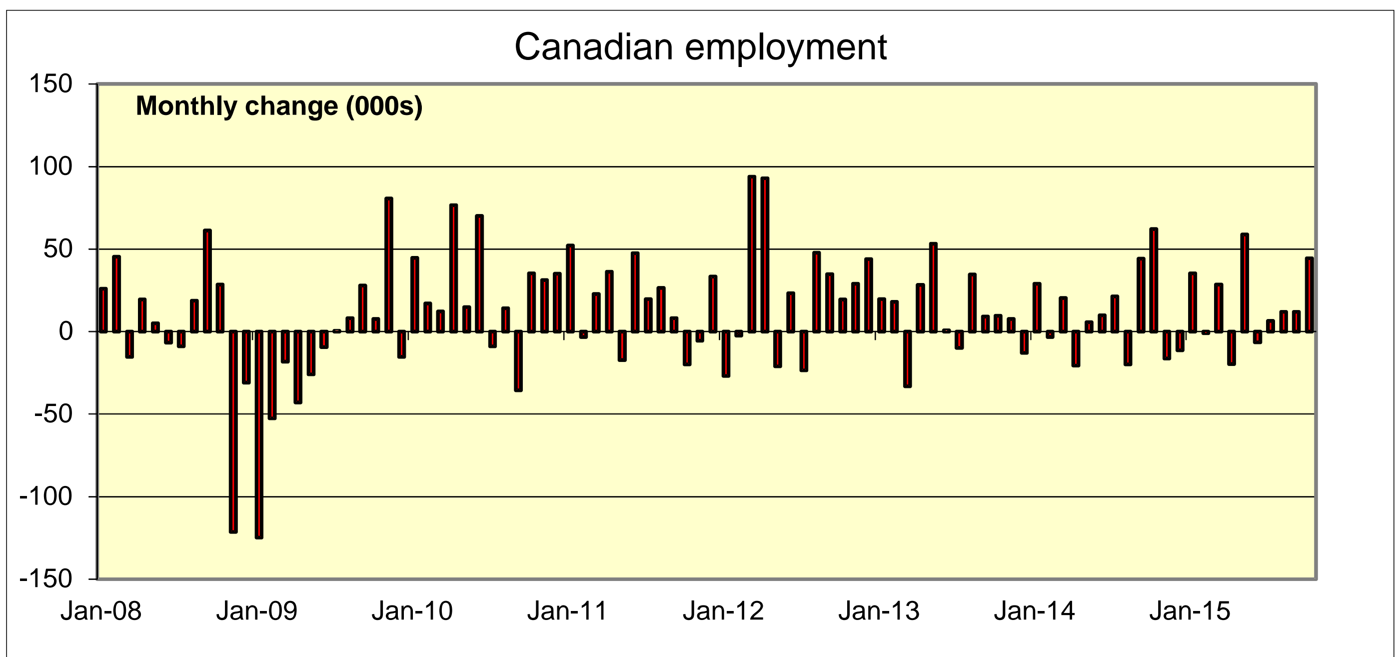
Source: Bank of Canada



Source: Statistics Canada

Employment

One other area of comparison that typically appears in the press is the employment situation. In Canada, job gains have been unimpressive and continue to point to a widening gap between the labour market here and in the U.S. Nevertheless, they remain far better than what would be expected during a material economic downturn. Statistics Canada announced that 44,400 jobs were added to the domestic labour market during October, the second-strongest monthly gain in the last 12 months. As can be seen in the graph below, no steady pattern of job growth has emerged. The mixed results have left job growth on a year-over-year basis at a mere 0.8%. However, it is still growth. Furthermore, the prevailing 7.0% unemployment rate still represents a material improvement from the previous recession's 8.7% peak.



Source: Statistics Canada

While the thought of Canada returning to recession is understandably disconcerting, taking advantage of professional financial advice can help to mitigate some of the emotional impact of this news. Taking a step back and looking at the longer term can help when it is difficult to stick with a financial plan. The discipline required to maintain a plan with regular contributions is rewarded in the long run.

Conclusions

- A return to "recession" in Canada (or elsewhere) is not a welcome event. However, it is very likely that the 2015 recession will prove to be a short-lived, relatively shallow decline.
- Changes in interest rates and the value of the currency will help to cushion the impact of the recession and help set the stage for a recovery.
- Investors who have put cash to work during slower economic periods have traditionally reaped the rewards when the inevitable rebound occurred. Taking advantage of professional advice and a disciplined approach can help dampen the emotional response that can accompany a softening in the economy.

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