Study: The effect of the recent decline in commodity prices on the Canadian economy

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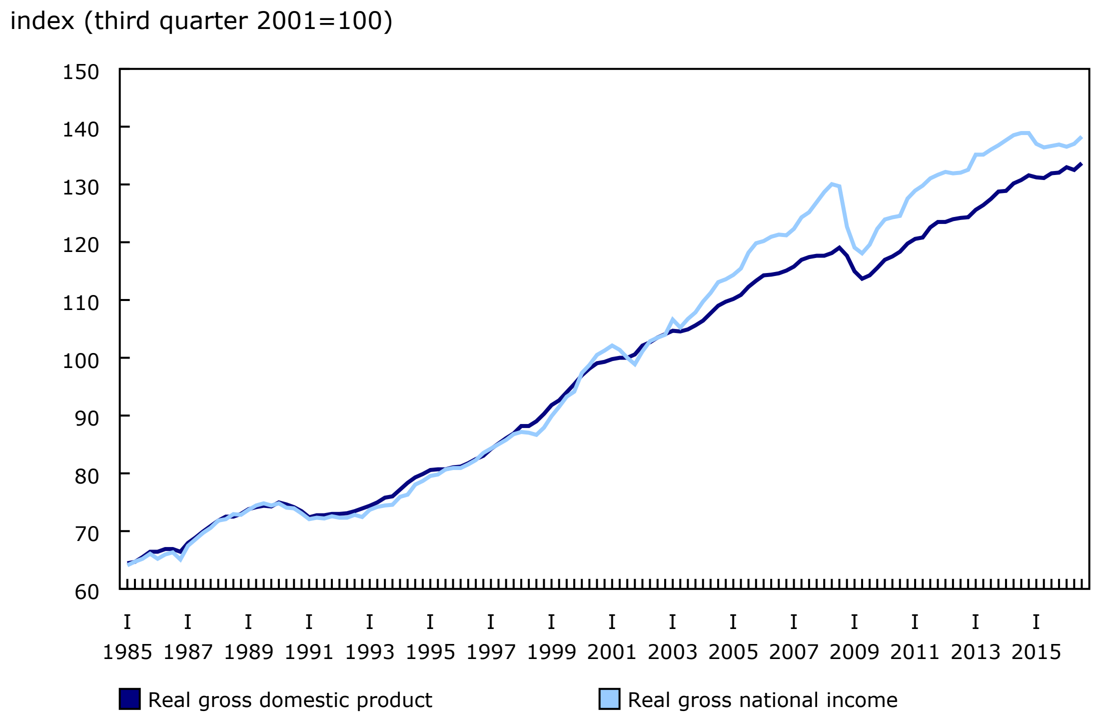
The significant decline in commodity prices between the second quarter of 2014 and the first quarter of 2016 generated a real income shock roughly five times larger than the effect on real gross domestic product (GDP). The impact of the commodity price collapse is examined in two new studies.

The first, "How Big Was the Effect of Falling Commodity Prices on Canadian Real Incomes between Mid-2014 and Mid-2016?," shows that the decline in commodity prices lowered Canada's terms of trade, leading to declines in real gross national income (GNI) in the first (-5.3%) and second (-1.8%) quarters of 2015. The reductions in real income were significantly larger than the declines in real GDP in the first (-1.1%) and second (-0.4%) quarters of 2015. Real GNI combines changes in production (real GDP) with changes in the terms of trade and international income flows to provide a measure of the purchasing power of the income accrued by Canadians.

The study shows that the components of GDP, such as real gross fixed capital formation and real imports, track more closely with changes in real GNI than with changes in real GDP. It also illustrates that non-production influences, such as the terms of trade and international income flows, were not purely cyclical. Rather, they led to a long-run increase in Canada's real income.

Chart 1
Cumulative growth of real gross domestic product versus real gross national income



Source(s): CANSIM table 380-0065.

The second study, "A Historical Perspective in Recent Movements in Canada's Purchasing Power Parity," examines the effect of the recent decline in commodity prices on Canada's purchasing power parity (PPP) with the United States. As commodity prices declined between the second quarter of 2014 and the first quarter of 2016, the value of the US dollar/Canadian dollar exchange rate depreciated from $0.92 to $0.73. However, the PPP remained relatively stable, declining from 0.85 to 0.84 over this period.

Note to readers

Real gross national income (GNI) is a measure of aggregate income. Real GNI incorporates real GDP (real production), as well as real income flows for foreign production activity (foreign investment or working abroad). It also incorporates a trading gain that accounts for relative price changes related to trade. The trading gain is comprised of a real exchange rate effect and a terms of trade effect, the latter being the more important for Canada. Real GNI, therefore, focuses on what Canadians can purchase with their income rather than on how much production occurs.

A purchasing power parity is a statistical measure of the relative price between two economies that provides an estimate of the relative purchasing power of a nation's currency. For example, a Canada-US purchasing power parity of 0.80 would mean that for every $1 a Canadian spends to purchase a particular bundle of goods and services, an American would only need to spend $0.80.

The research articles "How big was the Effect of Falling Commodity Prices on Canadian Real Incomes between mid-2014 and mid-2016" and "A Historical Perspective on Recent Movements in Canada's Purchasing Power Parity," which are part of *Economic Insights* (**11-626-X**), are now available.

For more information contact us (toll-free 1-800-263-1136; 514-283-8300; **STATCAN.infostats-infostats.STATCAN@canada.ca**).

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