Could the Collapse in Oil Prices Push Canada into a Recession?

Description

The oil rout has hit Canada's economy hard, having a far broader impact than many analysts initially predicted. This is because the energy sector makes up roughly one-tenth of Canada's GDP, which is much more than in many other developed economies. As long energy companies are forced to cut investments, slash expenses, and lay off employees because of sharply low crude prices, the impact on Canada's economy will worsen. This has caused a number of agencies to slash their economic forecasts for Canada because of the uncertain outlook for crude.

Now what?

The **Royal Bank of Canada**, the OECD, and **Canadian Imperial Bank of Commerce** have all recently dialed down their forecast economic growth for 2015. RBC now expects that Canada's GDP will expand by 1.8%, whereas the OECD is predicting 1.5%, and CIBC has the most bearish outlook, forecasting a mere 1.4%.

While the oil rout is the biggest contributor, weaker commodity prices across the board are having a deep impact on Canada's resource-dependent economy. This weakness is expected to continue into 2016, with commodities prices expected to remain soft because of a weaker global economy.

However, despite the doom and gloom, I don't expect to see a full blown recession in Canada, although the greatest impact will be felt in the energy patch; many communities in Alberta are preparing themselves for the worst. Once frothy housing markets in the energy patch are cooling fast, with Alberta's average house price continuing to fall as housing inventories, unemployment, bankruptcies, and foreclosures rise. In fact, personal insolvencies in Alberta have risen for the first time since the 2009 recession.

This is even more apparent in the oil hotspots of Fort McMurray and Calgary, which have both seen their average house price for April 2015 drop by about 8% year over year.

The eastern provinces are proving to be far more resilient, and while any decrease in economic activity will also affect them, the impact won't be as severe. Their economies are far more reliant upon service industries and manufacturing, with only a far smaller component of their GDP generated by commodities. Even housing markets in the east remain resilient; the average house price in Toronto for April rose sharply by 10% year over year.

So what?

Clearly, while the threat of a nationwide recession appears unlikely, soft commodity prices are having a significant impact on those regions most dependent on oil and mining. This impact is not solely constrained to those companies operating in the oil and mining industries; many companies operating in and around the energy patch have significant indirect exposure.

While **Canadian Western Bank** (TSX:CWB) only has about 3% of its loan portfolio directly exposed to the oil industry, 39% of its residential mortgages are located in Alberta, with only about 20% of the value of those mortgages being insured. A slowing Canadian economy also doesn't bode well for the growth prospects of Canada's top six banks that rely primarily on Canada for earnings growth, such as the **National Bank of Canada** (TSX:NA).

Nonetheless, investors should not panic. Times like these typically throw up some bargain investment opportunities that investors with the right guidance can readily identify.

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1. TSX:CWB (Canadian Western Bank)
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