PERSPECTIVE

Quebec: What's Left after the Post-recession Recovery?

By Joëlle Noreau, Senior Economist

Quebec is gradually emerging from the pandemic and has exited the recession caused by the public health measures imposed to curb the spread of COVID-19. The provincial economy returned to its 2019 real GDP level in 2021, but this conceals many sector-level disparities. A quick comparison with the recession in the late 2000s shows that the causes of the two economic downturns were quite different, as were the impacts suffered and the subsequent economic environments. Quebec's economy held up well, growing despite labour shortages, supply chain disruptions and rampant inflation in late 2021 and early 2022. With very low unemployment and a record number of employed workers, demand for goods and services is expected to remain robust for most of this year. The impact of higher interest rates is likely to be more acute in 2023. The economy still has fuel in the tank—for now.

Analysis and Method

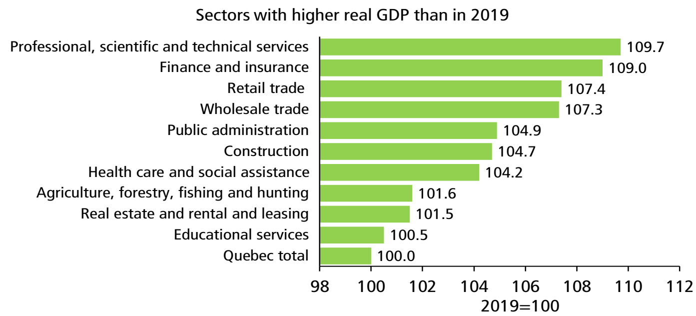
In this *Perspective*, we'll look at real GDP trends in Quebec. First, we'll compare average real GDP in 2021 and 2019 before taking a deep dive into several sectors. We'll then look at 2021's results compared to the situation in the wake of the previous recession in 2008–2010. We'll try to identify similarities in the economic recovery in each of these two episodes. Finally, we'll analyze how recent and future progress is being influenced by today's challenges, including labour shortages, supply issues (supply chain disruptions and input prices), uncertainty over the war in Ukraine, inflation and rising interest rates.

The Extent of the Damage in 2021

Like a tsunami, the COVID-19 pandemic hit hard and with little warning. Graphs 1 and 2 show how quickly the major sectors of Quebec's economy rebounded. Graph 1 shows the sectors with a higher level of real GDP in 2021 than 2019. The province made a complete recovery, with real GDP reaching its pre-pandemic level. The best performing sectors were professional, scientific and technical services (109.7) and finance and insurance (109.0). A significant portion of employees in these sectors were likely able to work remotely and ensure business continuity. As such, these businesses benefited from not having to restart operations after shutting down in 2020.

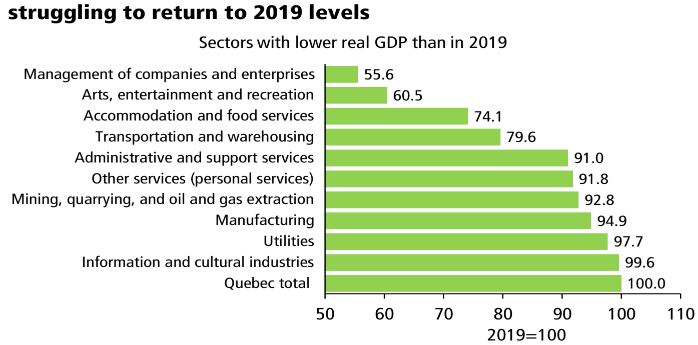
Trade sectors also saw a sharp rise in real GDP, with both retail (107.4) and wholesale (107.3) rebounding strongly. This should come as no surprise. Many service businesses such as restaurants, gyms, and personal care and hair salons experienced sporadic closures, and opportunities for international travel were limited.

GRAPH 1
2021: Some sectors expanded thanks to the pandemic, others despite it



Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 2
2021: Sectors hardest hit by public health restrictions are struggling to return to 2019 levels



Sources: Statistics Canada and Desjardins Economic Studies

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By spending less on work, travel and entertainment, Quebecers had more to spend on goods. Additionally, some people received money from the Canada Emergency Response Benefit, the Canada Worker Lockdown Benefit, the Canada Recovery Caregiving Benefit and other programs.

In wholesale trade, miscellaneous products (129.4), agricultural products (114.1) and machinery (112.2) increased the most. On the retail side, online shopping skyrocketed in 2020 and kept pace in 2021, so much so that 2021 real GDP came in at 160.1 for non-store retailers. Building materials and gardening equipment also performed strongly (118.8), as did sporting goods and hobby equipment (117.3) and furniture and household items (111.9). Many people who were stuck at home used their leisure time to renovate and upgrade their home's interior with new paint or furniture.

Other sectors that more than made up for their 2020 decline include public administration (104.9), construction (104.7) and health care and social assistance (104.2). Information technology, including hardware (94.6) and services (110.6) rose to 109.9 in 2021. Naturally, demand for internet services spiked due to remote work, online shows, entertainment subscriptions—such as music streaming, TV series, movies, classes and workshops—and online shopping.

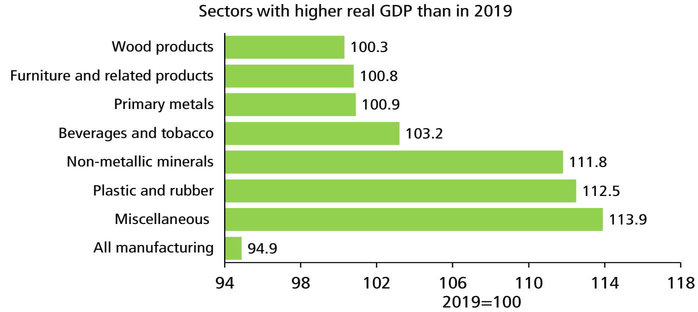
Graph 2 on page 1 shows the sectors that aren't back to 2019 levels. The hardest hit sector was management of companies and enterprises (55.6). The arts, entertainment and recreation sector (60.5) is still lagging, especially performing arts and sports events (53.5), which were hit particularly hard by lockdowns and public health restrictions. Similarly, accommodation and food services are collectively at only 74.1% of their 2019 level. Accommodation (67.7) was hit harder than food services (76.1), with the latter at least able to adapt and offer takeout and delivery.

Goods transportation requirements were high in 2020 and 2021 as consumers demanded quick deliveries and the health care system was under extreme pressure. At the same time, passenger transportation plummeted due to remote work and travel restrictions. As such, transportation and warehousing real GDP came in just below 80% (79.6) of its 2019 level. Administrative and support, waste management and remediation services (91.0), other services such as mechanics and personal care and hair salons (91.8), mining extraction and quarrying, which slowed (92.8), and manufacturing (94.9) all reached at least 90% of their 2019 levels.

Manufacturing in 2021: Uneven Growth

Graph 3 shows the manufacturing sectors that held up well in 2021. Miscellaneous activities, which includes medical supplies and equipment manufacturing, led the way at 113.9. Naturally, the pandemic was positive for this sector. This category also includes sporting goods, which have been highly sought after in the last two years. Plastic and rubber products surpassed

GRAPH 3
2021: Only a few manufacturing sectors are back to or above 2019 levels

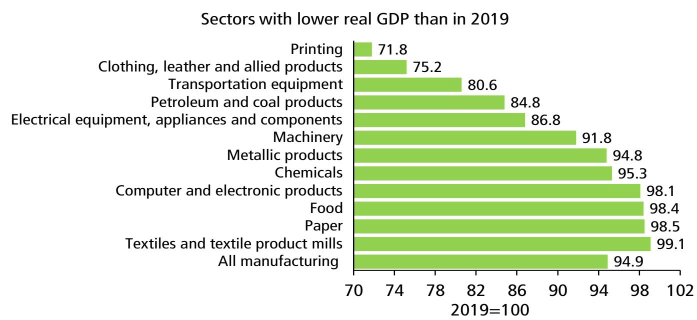


Sources: Statistics Canada and Desjardins Economic Studies

their 2019 level with a score of 112.5 thanks to the booming construction sector, which needs these products. The packaging sector was also in search of resources at a time when health care and public health and safety were working hand in hand. Non-metallic minerals (111.8) were also sought after during this busy period of infrastructure construction. The other categories that exceeded their 2019 real GDP levels didn't generate stellar growth.

The manufacturing industries that didn't reach their 2019 levels (graph 4) include printing (71.8), which suffered from the broad-based slowdown across the economy, but more so from the rise in remote work (and subsequent drop in business printing), declining tourism (menus, placemats, promotional items, etc.) and reduced opportunities in the arts, entertainment and recreational sector (posters, programs, etc.).

GRAPH 4
2021: Many manufacturing sectors have not returned to 2019 levels



Sources: Statistics Canada and Desjardins Economic Studies

Remote work shifted workers' wardrobe requirements and dragged down the clothing manufacturing sector (75.2) as a result. Border closures and travel advisories whittled down aircraft manufacturers' order books so much that transportation equipment was only at 80.6% of its 2019 level in 2021. Lower travel volumes also impacted consumption and, consequently, production of petroleum products (84.8).

We also saw substantial declines in electrical equipment and components (86.8), machinery (91.8), metallic products (94.8) and chemicals (95.3).

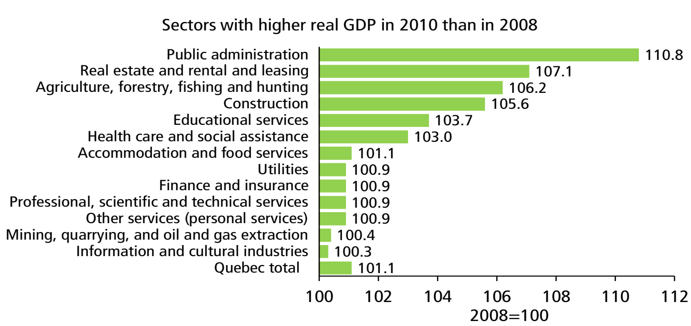
Did We See the Same Trends in the Late 2000s Recession?

It's clear that the two recessions weren't alike. In 2009, Quebec's real GDP dropped 1.1%, although the recession had already begun in the final months of 2008. In 2020, the decline was estimated at 5.4%. The extent and causes of the shocks were also very different.

In the case of the 2020 recession, the pandemic and public health restrictions to curb its spread hampered the economy. Despite colossal financial efforts from governments and central banks to ease the burden on individuals and businesses, real GDP dropped sharply. In 2009, the real estate bubble burst and the subsequent US financial crisis had a knock-on effect across global markets. Although Quebec was less impacted than many countries, it still suffered from a generally weaker economy.

Graph 5 shows how much certain sectors had rebounded from their 2008 levels by 2010. Public administration recovered the most to 110.8% of its 2008 level. The next best performers were real estate and rental and leasing (107.1), agriculture, forestry, fishing and hunting (106.2) and construction (105.6). Then came education (103.7), health care and social assistance (103.0), accommodation and food services (101.1) and a few other sectors at between 100 and 101.

GRAPH 5
2010: The post-recession recovery was unlike 2021



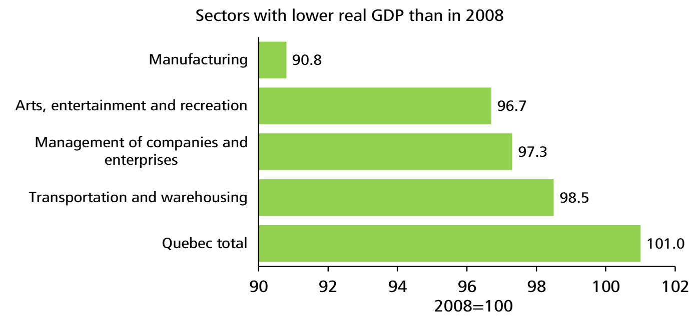
Sources: Statistics Canada and Desjardins Economic Studies

Accommodation and food services was one of the sectors that rebounded past their 2008 level. However, this was certainly not the case in 2021, when circumstances were very different.

If we compare the two recessions, six sectors—finance and insurance; public administration; construction; real estate and rental and leasing; agriculture, forestry, fishing and hunting; and education—rebounded past their "initial levels" both times. Meanwhile, in 2010, 13 sectors had higher real GDP than in 2008, while in 2021, only 10 sectors exceeded their 2019 level.

Graph 6 shows the sectors that failed to return to their 2008 level. These included manufacturing (90.8), arts, entertainment and recreation (96.7), management of companies and enterprises (97.3) and transportation and warehousing (98.5).

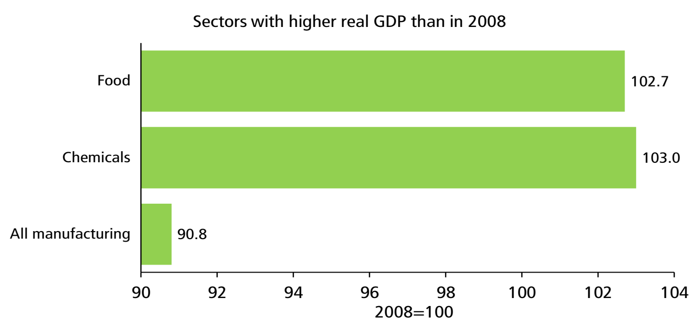
GRAPH 6
2010: Many fewer sectors failed to recover than in 2021



Sources: Statistics Canada and Desjardins Economic Studies

Manufacturing was at a lower level in 2010 (90.8) than in 2021 (94.9). Graph 7 and graph 8 on page 4 show that only the food (102.7) and chemicals (103.0) sectors managed to exceed their pre-recession levels in the year following the economic downturn.

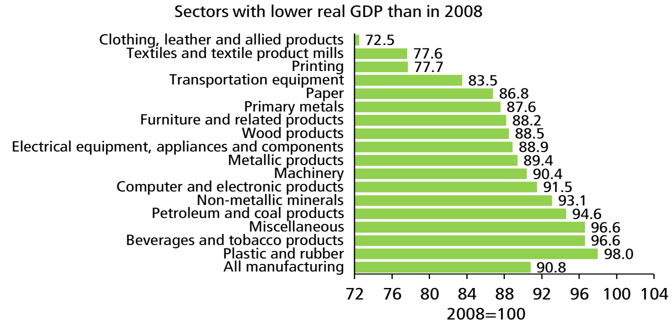
GRAPH 7
2010: Only two manufacturing sectors had recovered to pre-recession levels



Sources: Statistics Canada and Desjardins Economic Studies

Printing, clothing, leather and allied products and transportation equipment were among the sectors that suffered the heaviest losses in both 2010 and 2021. This is one thing the two recessions have in common.

GRAPH 8
2010: Most manufacturing sectors were below pre-recession levels



Sources: Statistics Canada and Desjardins Economic Studies

The decline in transportation equipment was fairly comparable in 2010 (83.5) and 2021 (80.6). However, in terms of aerospace products, the drop in real GDP was more pronounced in 2021 at 76.9 vs. 84.8 in 2010. The vehicle production sector was hit hard by the semiconductor shortage in 2020 and 2021, and in 2021 was at just 61.9% of its 2019 level. Like many vehicle manufacturers around the world, truck manufacturer Paccar reduced working hours and laid off many employees at its Sainte-Thérèse plant last fall.

What Does the Future Hold?

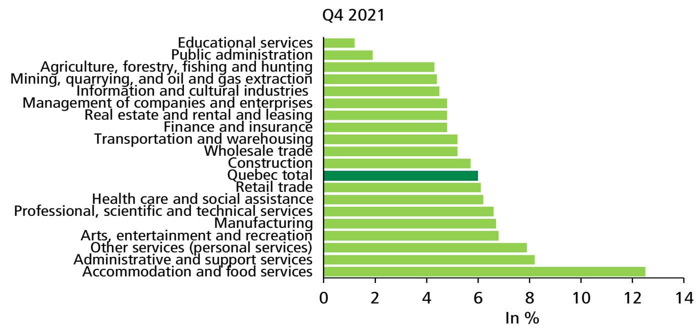
What is the prognosis given that the labour shortage is worsening, supply chains are still snarled, the war in Ukraine is dragging on, inflation is a growing threat and interest rates are rising?

The different sectors of Quebec's economy will continue to evolve at varying paces. Certain factors will temper the progress of large swaths of the economy, while other factors could have a positive effect.

The labour shortage is nothing new and is the result of a well known and widely documented demographic problem. The aging population and labour pool has been creating imbalances for years. According to projections from the Institut de la statistique du Québec, this will continue until the end of the decade. The strength of Quebec's economy when the first lockdowns ended is also why so many workers are urgently required. It's also exacerbating hiring and retention problems. As a result, goods and services deliveries are being delayed, contracts are being turned down, expansion projects are being postponed and businesses are choosing to set up elsewhere. In some cases, business owners are burning out from lack of staff. Wage pressure is also acute and being compounded by rapidly rising inflation. Efforts to improve productivity are therefore essential to limit the negative impacts of the labour shortage on real GDP growth.

The labour shortage will impact sectors differently. Graph 9 provides an overview of the obstacles facing the major sectors. It breaks down how many unfilled positions there were in the fourth quarter of 2021 and shows which sectors will have the biggest hiring challenges. In some cases, digitalization of operations may reduce demand for workers, but that's not the case for the entire economy. It might help with goods manufacturing, but personal care is another story.

GRAPH 9
The number of job vacancies is particularly high in accommodation and food services



Sources: Statistics Canada and Desjardins Economic Studies

Serious challenges will persist over the coming quarters, especially in the accommodation and food services sector, which lost staff during the pandemic. Some technological solutions will help, such as robot waiters and smartphone ordering, but won't bridge the gap completely. It'll take some time before the sector recovers to its 2019 level.

The administrative and support, waste management and remediation services sectors are struggling to hire, as are neighbourhood businesses such as mechanics and personal care and hair salons. The manufacturing sector is having serious trouble filling vacant positions, and it'll take some time for this to improve. The arrival of new immigrants will be crucial, but it'll be a while before they're able to join the workforce. Another potential solution is in-house retraining, but that requires a time investment too. There's some room for growth in the sector over the coming quarters, but nothing to write home about. Supply chain disruptions will put another wrench in the works unless local suppliers can fill the gap left by their international counterparts. But they'll need additional resources to meet demand too. Even if automation and/or digitalization do come to the rescue, it won't happen overnight.

There are also shortages of certain inputs, such as building materials, semi-conductors and some chemicals, which are hampering operations. In recent months, these supply chain issues have persisted primarily due to China's strict zero-COVID policy and the war in Ukraine. The invasion's effects are on full display in grain and energy prices and fertilizer availability. Russia accounted for 43.3% of Quebec's fertilizer imports in 2021.

However, the province does little other trade with the two countries.

Inflation has unquestionably spread into every corner of the economy and is clouding business and consumption decisions alike. In addition, central banks are attempting to contain rising prices by hiking interest rates. Together these two factors are expected to cool real GDP growth in 2022, but not trigger a downturn.

Still Some Fuel in the Tank

As you can see, the pandemic hit hard and without warning, but Quebec rebounded quickly. We can draw some parallels between the recessions of the late 2000s and 2020, but there aren't many. The shocks that triggered them and the subsequent recoveries weren't on the same scale. The post-recession economic environments aren't comparable either.

Although many of the issues we discussed, including labour shortages, supply chain disruptions and spiralling inflation, were already present in late 2021 and early 2022, Quebec's economy grew. It began the year on a strong note despite public health measures to contain the fifth wave of COVID-19. With very low unemployment and a record number of employed workers, demand for goods and services is expected to remain robust for most of this year. The impact of higher interest rates is likely to be more acute in 2023. The economy still has fuel in the tank—for now.