ALBERTA FINANCE
Office of Budget and Management
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Economic Spotlight

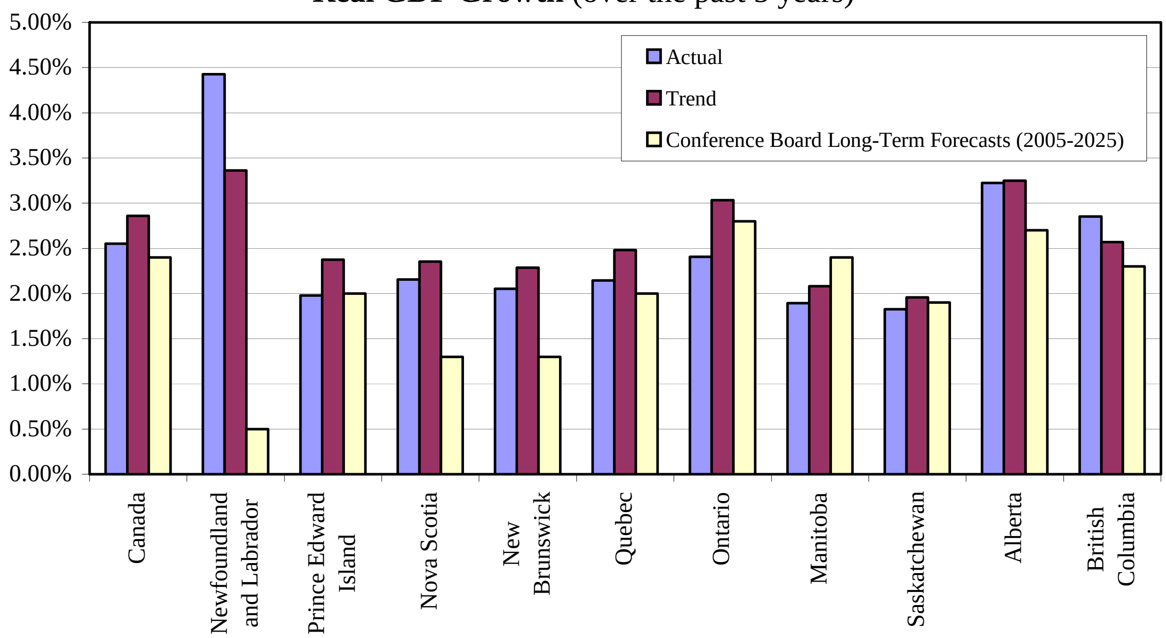
ESTIMATES OF PROVINCIAL TREND REAL GDP GROWTH

Potential Gross Domestic Product (GDP) is the output that would be produced if an economy were operating at full capacity. This measure can help identify whether or not a given actual real GDP growth rate is sustainable in the long term.

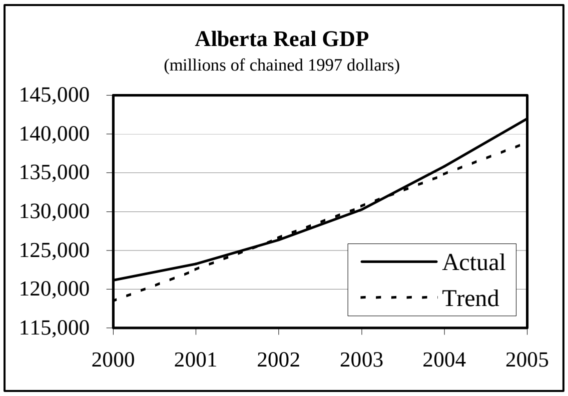
While potential GDP cannot be measured explicitly, numerous techniques, such as Hodrick-Prescott (H-P) filtering, exist to estimate trend GDP, which can serve as a suitable proxy. By averaging the growth in trend real GDP over the past five years, we have produced a benchmark to examine whether actual real GDP is growing faster or slower than trend real GDP.

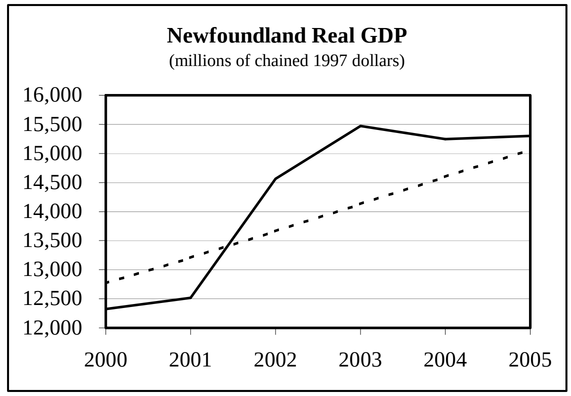
Alberta's five-year average trend growth rate is second highest among the provinces, behind only Newfoundland and Labrador. Saskatchewan, in contrast, has the lowest five-year average trend growth rate among the provinces.[1] In 2005, all but two provinces, Prince Edward Island and New Brunswick, operated above trend output. Somewhat

Real GDP Growth (over the past 5 years)



[1] A five-year average actual real GDP growth rate above the five-year average trend real GDP growth rate does not automatically imply that the province is operating above capacity (ie: is in a boom period). For example, the province could be operating below capacity but be returning to trend real GDP.





surprisingly, Ontario operated 0.7% above trend output in 2005, implying that, to invoke a colloquialism, tales of its economic demise have been greatly exaggerated.

The results suggest that on average the Alberta economy has been growing at approximately the rate of trend real GDP over the past five years, which is sustainable over the long term. Actual real GDP growth in 2005, however, was 4.5%, which is above trend and increased Alberta's positive output gap to 2.2%.

Newfoundland and Labrador's actual real GDP has grown far faster than trend real GDP over the past five years, in part due to Hibernia, which began operating in 1997. This rapid growth at the beginning of the decade could, in light of the recent development and operations of offshore oil and gas platforms, be thought of as a movement to a new steady state, rather than as a permanently sustainable rate of growth.

Growth in Ontario's actual real GDP over the past five years has been slower than growth in trend real GDP. According to the estimates, Ontario has been operating above trend real GDP since approximately 1999, so slower growth over the past five years has merely served to move Ontario closer to trend output.

Finally, for the nation as a whole, average actual real GDP has been growing below the rate of average trend real GDP. This result is even more pronounced using auxiliary estimation techniques. The low average actual growth rate appears to be a return to trend output, rather than deviation away from it. This is similar to the findings for Ontario, which is not surprising given that Ontario constitutes over 40% of the Canadian economy.