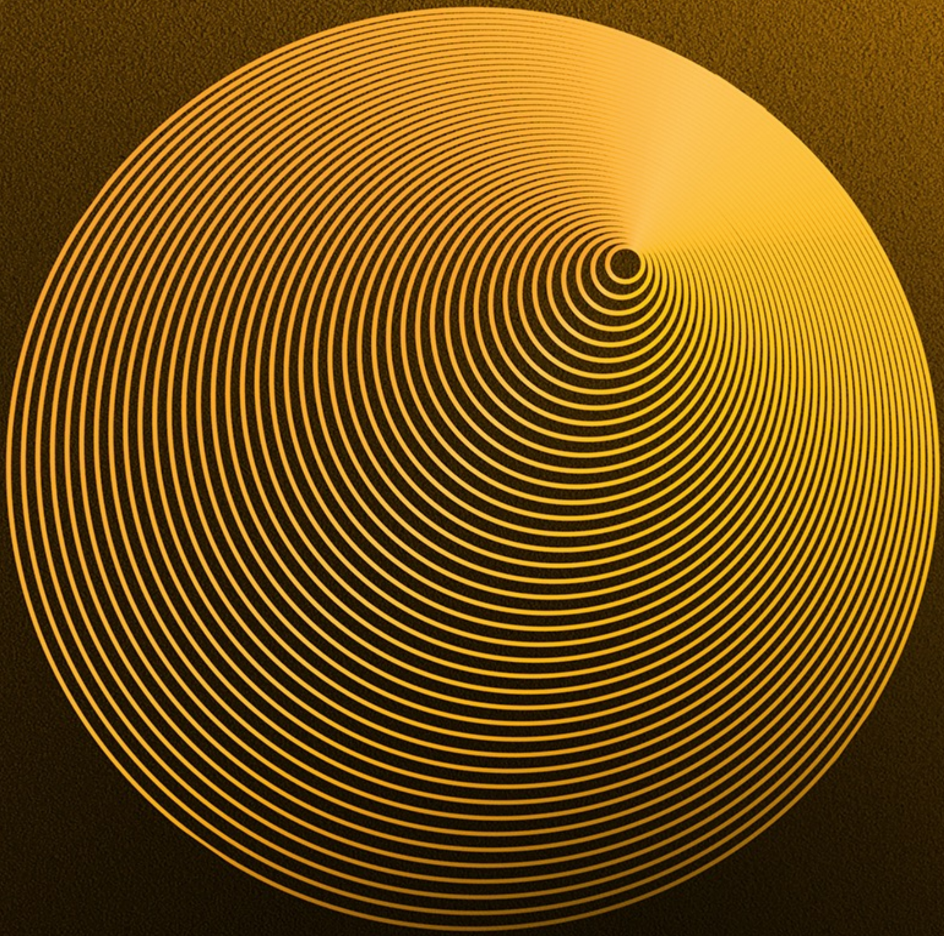
Deloitte.



Hurdles remain amid signs of recovery

Economic outlook | Summer 2024

After three years of economic upheaval, the Canadian economy is beginning to settle down. With inflation on a steady downward trend since peaking in June 2022, the Bank of Canada has now begun to ease its policy stance, paving the way for stronger economic growth. However, the pace of monetary easing is far from certain, and weak investment and productivity performance continue to pose a risk to Canada's long-term economic outlook.

While interest rates were hiked at a rapid clip from March 2022 to July 2023, our forecast assumes the pace of cuts will be much more gradual. After a rate cut in June, we see the Bank holding off until September for a second cut and then moving again in December. Rate cuts are expected to continue throughout 2025 before the overnight rate settles at a neutral level of 2.75% by the end of next year. This forecast assumes that inflation will continue to gradually decrease over the next few quarters and then return to the 2% target by the second quarter of next year.

Recent data suggests that business sentiment in Canada is beginning to recover despite an uptick in insolvencies. According to the Bank's latest *Business Outlook Survey*, business confidence improved in the first quarter of 2024 after nearly two years of steady decline. Evident across regions and sectors, this improved optimism is a hopeful sign that businesses will start to invest more in their operations. Business investment has been very weak in Canada, which directly impacts our productivity—and by extension our living standards.

Since the 2014 commodity price crash, which caused a steep drop in business investment, labour productivity in Canada has remained essentially flat while unit labour costs (the labour costs associated with producing a fixed amount of output) have increased by more than 30%. This situation is unsustainable—unlocking more business investments will be key to boosting labour productivity.

Boosting labour productivity is key to maintaining wage growth
(indexed to 2015Q1=1)

Source: Statistics Canada

Unfortunately, while we expect business investment will grow each quarter throughout 2024, substantial declines in the second half of last year will be tough to overcome, leaving annual growth negative for the year. Next year is looking better, thanks in part to the start of construction on several electric vehicle (EV) battery plants.

While these investments are good news, more urgency is needed nationwide for addressing weak business investment and productivity performance.

Instead of the labour shortages we saw last year, the economy's current challenge is generating enough jobs to keep up with Canada's rapidly growing population.

Despite a strong pace of growth—including one of the best months of job creation ever recorded in April 2024—employment (+2.0%) has not kept up with population growth (+3.4%) over the past 12 months. That has meant the unemployment rate has risen nearly a full percentage point to 6.2%. We expect it will remain elevated for the rest of this year before beginning to fall again in 2025.

After averaging 5.3% in 2023, wage growth slowed dramatically to just 3.9% (annualized) in the first quarter of 2024. As inflationary pressures ease, slower wage growth will be the norm this year and next.

While there was a collective sigh of relief when news broke that the Bank of Canada had cut its policy interest rate, Canadian households are the most indebted in the G7. The increases in interest rates since 2022 have hit Canadians' pocketbooks and, as households set aside more of their income to pay interest on mortgages and loans, real consumer spending per person has fallen in five of the last seven quarters.

The effect on home-building has been even more dramatic. In the first quarter of 2024, real residential investment per person was down 22.8% from the same period two years ago.

Looking ahead, both consumer spending and residential investment are expected to pick up as interest rate decreases work to restore demand. However, consumer confidence is low, there is reluctance to make major purchases, housing affordability remains a challenge, and savings rates are well above normal. While these factors will restrain the pace of recovery in the second half of 2024, we will see stronger gains in both consumption and residential investment next year as confidence returns.

Overall, Canada's economy grew stronger in the first half of this year than previously forecast. Our updated forecast projects this will be balanced by a more limited pick-up in real GDP growth in the second half of 2024, given the slower pace of household spending we now expect to see. We are projecting real GDP growth of 1.2% for 2024 followed by 2.6% growth in 2025. In per-capita terms, growth will continue to decline this year, with real GDP per person falling by 1.6% in 2024 before clawing back to gain 1.1% growth in 2025.

Provincial forecast

Provincial forecast

The outlook in Atlantic Canada is relatively positive. While Newfoundland and Labrador was the only province to experience a recession in 2023, better growth prospects are ahead—driven by higher oil production. The floating production, storage, and offloading (FPSO) vessel Terra Nova will be completing its first year of operations since finishing maintenance and repair work and SeaRose will resume production in the second half of this year. Overall, the province's real GDP is expected to rise 1% in 2024 and a further 1.7% in 2025.

Prince Edward Island is expected to continue being an economic growth leader throughout the forecast, thanks to strong population growth, relatively low debt levels, and easing inflation pressures, which will support household spending. Overall, real GDP in the province is expected to grow at over three times the Canadian average this year and ease only slightly to a pace of 3.7% next year.

Nova Scotia's short-term outlook is also optimistic as interest rate cuts throughout 2024 and 2025 will encourage household discretionary spending. In addition, increases in public sector spending and a significant rebound in exports are expected, boosting real GDP growth to 1.7% this year and 1.9% in 2025.

In New Brunswick, relatively low consumer debt levels have allowed consumption and residential investment to hold up comparatively well, a trend that is expected to continue in the near term. On the downside, New Brunswick's export sector relies on the United States and with growth expected to gradually slow south of the border this year, the province is expected to feel the pinch. Overall, we forecast that New Brunswick's economy will grow by 1.5% this year and 2.2% in 2025.

Provincial forecast

Central Canada is a weak spot in our economic outlook. We expect GDP growth in Quebec will be particularly muted this year, and the province is forecast to have the weakest growth in the country as relatively soft population growth limits gains in domestic demand. The economic malaise should be short-lived, however, thanks to strong non-residential investments, including Northvolt's $7-billion EV battery plant and Rio Tinto's plans to invest $1.1 billion to expand its Complexe Jonquière aluminum smelter. Overall, Quebec's real GDP is expected to increase 0.7% in 2024 before rising 2.6% in 2025.

High interest rates will continue to weigh on the Ontario economy this year, resulting in a deceleration in consumer spending and employment growth. However, as inflation slows and interest rates fall, we expect stronger growth in the second half of 2024 and into 2025. The province's economy will benefit from a host of investments in the EV battery manufacturing sector, including the Volkswagen EV battery plant, the NextStar Energy battery plant (Stellantis and LG Energy Solution), the Umicore facility, and the Honda EV battery plant. Ontario's economy is set to grow by 1% this year and 2.6% next year.

Farther west, Manitoba's economy will be the weakest in the Prairies, with GDP growing just 1.1% this year as relatively high debt levels limit consumer spending. Inflation has already fallen substantially in the province and has been below 2% for seven straight months. Combined with lower interest rates, this improved affordability will propel economic gains of 3.1% in 2025.

Saskatchewan's economy will be one of the country's leaders in growth over the near term as a recovery in the agriculture sector and very strong business investment propel real GDP growth of 1.6% this year and 4.3% next year.

Provincial forecast

The Alberta economy is benefiting from a population surge as Canadians from other provinces flock to Wild Rose Country in search of a lower cost of living. That and the opening of the Trans Mountain pipeline expansion will keep Alberta growing above the national average, with GDP gaining 1.5% this year and 3.3% next year.

Finally, growth in British Columbia will be weak in 2024 as its highly indebted households pare back their spending in the face of rising debt servicing costs. Further, non-residential investment is in for a tough year, with work being completed on several major infrastructure projects. As interest rates fall over the next 18 months, a boost in consumer spending and housing construction will help lift provincial GDP growth to 2.9% next year after growth of just 0.7% this year.

Provincial real GDP forecast
(percent change)

	2023	2024f	2025f
Newfoundland and Labrador	-2.5	1.0	1.7
Prince Edward Island	2.2	3.9	3.7
Nova Scotia	1.3	1.7	1.9
New Brunswick	1.3	1.5	2.2
Quebec	0.2	0.7	2.6
Ontario	1.6	1.0	2.6
Manitoba	1.3	1.1	3.1
Saskatchewan	1.6	1.6	4.3
Alberta	1.5	1.5	3.3
British Columbia	1.6	0.7	2.9

Note: f = forecast.
Sources: Statistics Canada; forecast by Deloitte Economic Advisory.

Final thoughts

Final thoughts

Economic news has been generally positive since our last outlook, with GDP and employment faring better than expected and the Bank of Canada beginning to cut interest rates in line with our previous forecast.

Lower interest rates should encourage households to spend and businesses to invest. However, there are still risks to the economic outlook in the form of geopolitical tensions and the possibility that inflation and interest rates won't fall as expected. On the geopolitical front, conflicts in Palestine and Ukraine are contributing downside risk to the global economy. Here at home, the progress on inflation will dictate the speed of monetary easing and therefore the timing of the expected acceleration of economic growth.

Canada's chronically weak productivity and significant increases in unit labour costs are creating risk that inflation may stay above the Bank of Canada's target range for longer, as large wage increases without productivity gains are inflationary. Turning around productivity performance is not only key to ensuring a return to 2% inflation on a sustainable basis but also integral to Canada's long-term growth prospects.

Key economic indicators

	2023				2024				2023	2024f	2025f
	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f			
Real economic activity											
Gross domestic product	3.4	0.7	-0.3	0.1	1.7	1.6	2.1	2.7	1.2	1.2	2.6
Household consumption expenditure	2.9	0.5	0.1	3.2	3.0	3.1	2.5	2.4	1.7	2.4	2.8
• Durable goods	2.1	-2.6	4.4	8.7	0.4	1.0	0.8	1.4	2.1	2.4	1.5
• Services	3.6	0.9	1.5	3.5	4.3	3.2	3.0	3.2	2.7	3.1	3.1
Residential investment	-14.2	-4.1	-.8	-2.3	1.3	2.0	3.9	6.0	-10.3	2.1	5.2
Non-residential investment	3.3	10.9	-14.0	-10.4	4.5	4.6	6.4	7.2	-0.7	-0.2	5.2
• Non-residential structures	2.5	11.9	-13.3	-14.7	1.9	5.7	5.1	7.1	2.6	-1.5	3.0
• Machinery and equipment	2.2	22.2	-22.5	-11.3	6.4	11.3	16.8	12.8	-6.4	2.1	5.9
Government consumption and investment	4.3	0.0	4.3	-1.6	2.1	1.2	1.6	1.0	2.1	1.4	1.6
Exports of goods and services	15.6	3.1	-3.2	3.2	1.9	0.5	0.6	5.0	5.4	1.3	3.8
Imports of goods and services	2.3	5.7	-0.2	0.9	1.5	1.6	1.1	2.7	0.9	1.4	3.1
Prices											
Consumer price index (y/y)	5.2	3.5	3.7	3.2	2.9	2.6	2.3	2.2	3.9	2.5	2.0
Implicit GDP price index (y/y)	2.1	-0.4	1.5	3.0	3.4	3.3	1.8	1.1	1.5	2.4	1.8
Labour market											
Employment	3.9	1.8	1.7	1.9	1.5	1.2	1.5	1.9	2.4	1.5	2.0
Unemployment rate (%)	5.1	5.3	5.5	5.8	5.9	6.2	6.3	6.3	5.4	6.2	5.7

Notes: f = forecast. Unless otherwise noted, all figures are expressed as annualized % changes.
Sources: Statistics Canada; Bank of Canada; forecast by Deloitte Economic Advisory as of June 2024.

Financial market indicators

	2023				2024				2023	2024f	2025f
	Q1	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f			
Interest rates (%)											
Overnight rate target	4.50	4.75	5.00	5.00	5.00	4.75	4.50	4.25	5.00	4.25	2.75
3-month T-bill	4.48	4.65	5.11	5.08	4.99	4.88	4.64	4.39	5.08	4.39	2.89
1-year GoC bond	4.44	4.71	5.19	4.83	4.21	4.39	3.81	3.61	4.83	3.61	3.22
2-year GoC bond	3.84	4.12	4.75	4.27	4.11	4.22	3.65	3.45	4.27	3.45	2.90
5-year GoC bond	3.16	3.34	4.03	3.67	3.51	3.40	3.25	3.00	3.51	3.00	2.95
10-year GoC bond	3.03	3.08	3.70	3.56	3.44	3.65	3.30	3.25	3.56	3.25	3.25
Yield curve spread (pp)											
3-month vs. 10-year	-1.45	-1.57	-1.41	-1.52	-1.57	-1.23	-1.34	-1.13	-1.52	-1.13	0.36
2-year vs. 10-year	-0.81	-1.04	-1.05	-0.71	-0.67	-0.57	-0.35	-0.20	-0.71	-0.20	0.35
Foreign exchange											
USD/CAD ($C)	1.35	1.34	1.34	1.36	1.35	1.37	1.36	1.35	1.36	1.35	1.34
CAD/USD ($US)	0.74	0.74	0.75	0.73	0.74	0.73	0.73	0.74	0.73	0.74	0.75

Notes: f = forecast. The overnight rate represents the end of the period. All other indicators' quarterly values are period averages. Annual figures reflect the end of the period as measured by the Q4 quarterly average.
Sources: Statistics Canada; Bank of Canada; forecast by Deloitte Economic Advisory as of June 2024.

Contributors

Economic Advisory

With leaders in macroeconomics, microeconomics, policy and regulatory analysis, economic development, and analytics and modelling, Deloitte's Economic Advisory practitioners have the knowledge and experience to tackle some of the most complex and challenging policy and business issues of today.

Dawn Desjardins
Chief Economist

Matthew Stewart
Director

Alicia Macdonald
Senior Manager

Robyn Gibbard
Manager

Anna Feng
Manager

Madison MacKinnon
Senior Associate

Mikayla Schoel
Senior Associate

Momanyi Mokaya
Senior Associate

Zach Gaskin
Analyst

Pablo Alegria
Analyst

Deloitte.

Legal disclaimer

About Deloitte
At Deloitte, our Purpose is to make an impact that matters. We exist to inspire and help our people, organizations, communities, and countries to thrive by building a better future. Our work underpins a prosperous society where people can find meaning and opportunity. It builds consumer and business confidence, empowers organizations to find imaginative ways of deploying capital, enables fair, trusted, and functioning social and economic institutions, and allows our friends, families, and communities to enjoy the quality of life that comes with a sustainable future.

Deloitte provides industry-leading consulting, tax and legal, financial advisory, audit and assurance, and risk advisory services to nearly 90% of the Fortune Global 500® and thousands of private companies. We bring together world-class capabilities, insights, and services to address clients' most complex business challenges.

Deloitte LLP, an Ontario limited liability partnership, is the Canadian member firm of Deloitte Touche Tohmatsu Limited. Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

To learn more about Deloitte Canada, please connect with us on LinkedIn, X, Instagram, or Facebook.

Designed and produced by the Agency | Deloitte Canada. 24-9374154