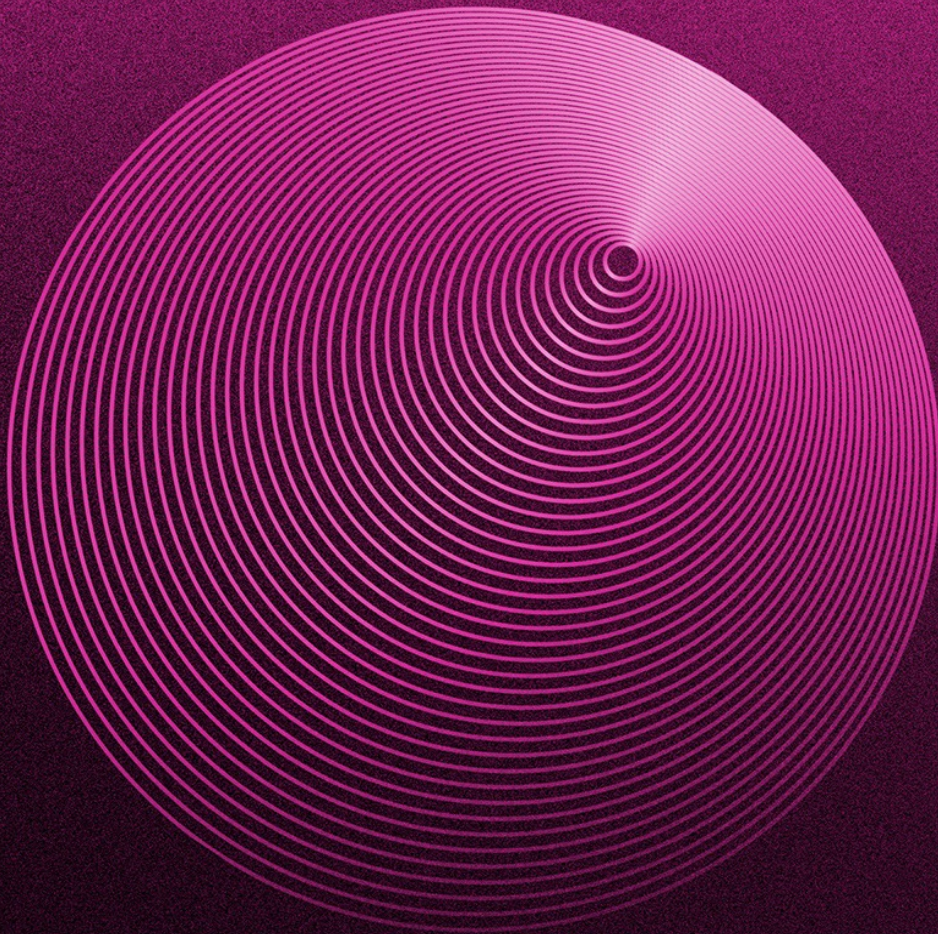


Deloitte.



**The rocky road
to recovery**

Economic outlook | Fall 2024

Introduction

The global backdrop continues to be challenging with no clear line of sight on when the wars in the Ukraine and Middle East will end. Growing trade frictions and the uncertain impact of the US election on policy are weighing on confidence. The August jump in financial market volatility only added to the list of worries on the minds of consumers and companies.

Since our last update, inflation has continued to ease and the central bank in Canada and some of its largest trading partners have started to reduce the amount of policy restraint by cutting policy rates. The global growth picture varies with the US economy's momentum slowing, Europe experiencing a weak recovery and the UK shifting from recession to recovery. China's economy is struggling as the weak real estate market, low consumer confidence and excess industrial capacity sap activity.

Canada's economy posted solid gains in the first half of 2024, but the headline numbers belie a softer performance with consumer spending slowing dramatically in the second quarter and the labour market showing signs of cooling. On a per capita basis, the economy contracted for the seventh of

the past eight quarters. Fortunately, the progress on inflation allowed the Bank of Canada to lower the policy rate by 75 basis points over three consecutive meetings. Our expectation that the inflation rate will continue to decline and reach the 2% target in mid-2025 opens the door for the Bank to continue along this path and we expect an additional 50 basis points in rate cuts bringing the Bank's policy rate to 3.75% by the end of this year. The Bank will continue to ease in 2025 with the overnight rate expected to reach 2.75% mid-year.

In the near-term, the economy is expected to grow at a more moderate pace with softer labour market conditions preventing an improvement in consumer confidence especially heading into 2025 when many mortgage holders will have to refinance their loans at much higher rates.¹ Similarly, the recovery in the housing market is expected to remain modest given poor

1. About half of all outstanding mortgages are held by borrowers who have yet to face higher rates because their payments were fixed for five years (with either a fixed or variable mortgage rate). Households that hold these mortgages will generally see a larger payment increase than those that have already renewed. The impact of the rise in debt-servicing costs will be partially offset for households whose income has grown over the intervening period. Source: Bank of Canada, [Financial Stability Report](#), May 9, 2024

Introduction

affordability conditions across most markets. Additional rate cuts in 2025 and increased supply should stimulate activity next year.

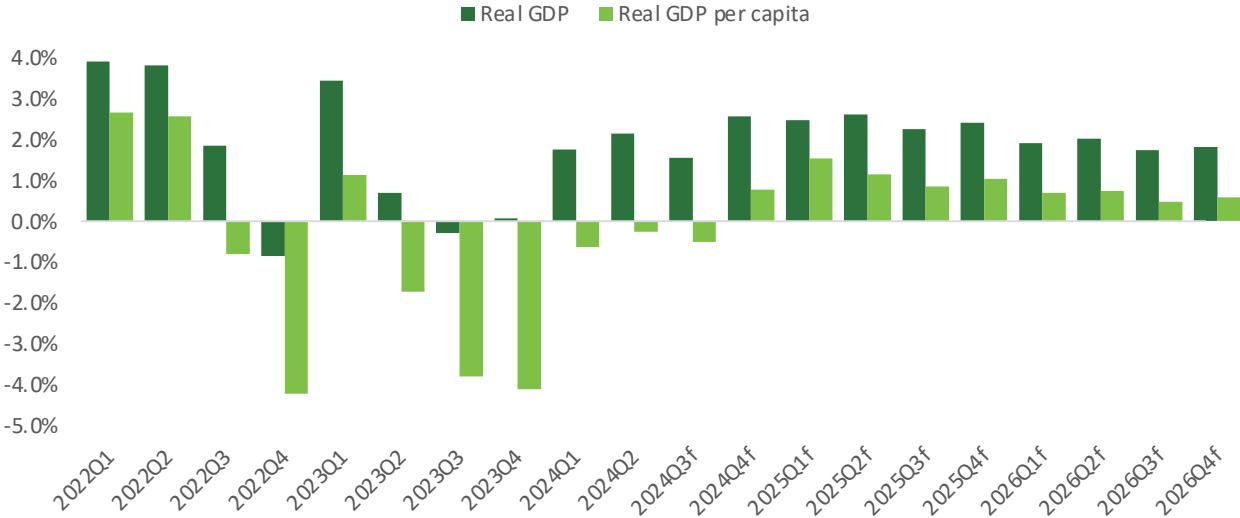
Canadian companies are also likely to remain cautious in the latter part of 2024. Deloitte's Q3 CFO survey showed an overwhelming 93% of Canadian CFO's said now is not a good time to take on greater risks with two-thirds worried about consumer demand. On a more positive note, 53% of CFO's surveyed were more optimistic about their companies' financial prospects compared to three months earlier. Like the housing market, we expect business investment to recover slowly with the

gradual easing in financial conditions and pickup in demand in 2025 spurring stronger investment next year.

Despite the myriad of uncertainties, we remain optimistic about Canada's economy in 2025. With the US election in the rearview mirror, Canadian companies will have a clearer understanding of the challenges and opportunities in their largest external market. Lower rates will ease the burden on the highly indebted household sector sufficiently to support a pickup in spending and a housing market recovery. After two years of subpar growth, we look for the economy to hit its stride in 2025.

Introduction

Real GDP growth will accelerate next year and remain strong in 2026 (per cent change)



f = forecast
Source: Statistics Canada; forecast by Deloitte

Monetary and fiscal policy



Monetary and fiscal policy

High interest rates over the past two and a half years have worked to suppress demand throughout the economy creating a situation where demand now lags supply. When there is excess supply in an economy, price pressures ease and this is exactly what we've seen in Canada over the last few months. After soaring past 8% in 2022, inflation increased just 2.5% this past July. While the progress on the inflation front has allowed the Bank of Canada to begin lowering its policy interest rate, there are still elements working to keep inflation levels elevated. Shelter prices, and in particular rent prices, remain too high for comfort. Despite the deceleration we've experienced, shelter prices continue to be the biggest stronghold on inflation. This continues to weigh on households, especially for those who are renewing their mortgages at higher rates or seeking to dip their toes in the housing market. Despite elevated growth in shelter prices, we expect that soft economic conditions will continue to exert downward pressure on inflation over the rest of this year and 2025, landing at the 2% target by mid-year next year.

With inflation on a downward trend, the Bank of Canada has begun making cuts to its policy rate with three consecutive 25 basis point cuts at its June, July and September meetings bringing the overnight rate to 4.25%. The Bank of Canada has noted that inflationary pressures are easing and that component prices of inflation are nearing historical averages. Core measures of inflation have continued to work their way down as well, solidifying the Bank's view that inflation is cooling as expected. Despite the headwinds to inflation, we forecast the Bank will make two additional cuts to their policy rate this year before delivering a more gradual pace of cuts over 2025. Overall, we forecast a total 125 basis point reduction in the Bank's policy rate by the end of this year, and a return to its neutral rate of 2.75% by the middle of 2025.

One of the biggest surprises in the second quarter GDP report was the outsized contribution of government spending. Indeed, when looking at government consumption and investment, the public sector accounted for a whopping 80% of

Monetary and fiscal policy

the gain in real GDP. While higher spending this year was expected given measures outlined in provincial budgets, it is neither sustainable from a deficit perspective nor the key to returning economic growth and inflation back to sustainable levels. As governments look to balance their books, or at a minimum reduce the size of the deficit-to-GDP ratio, a gradual cooldown in spending is expected over 2025 and 2026.

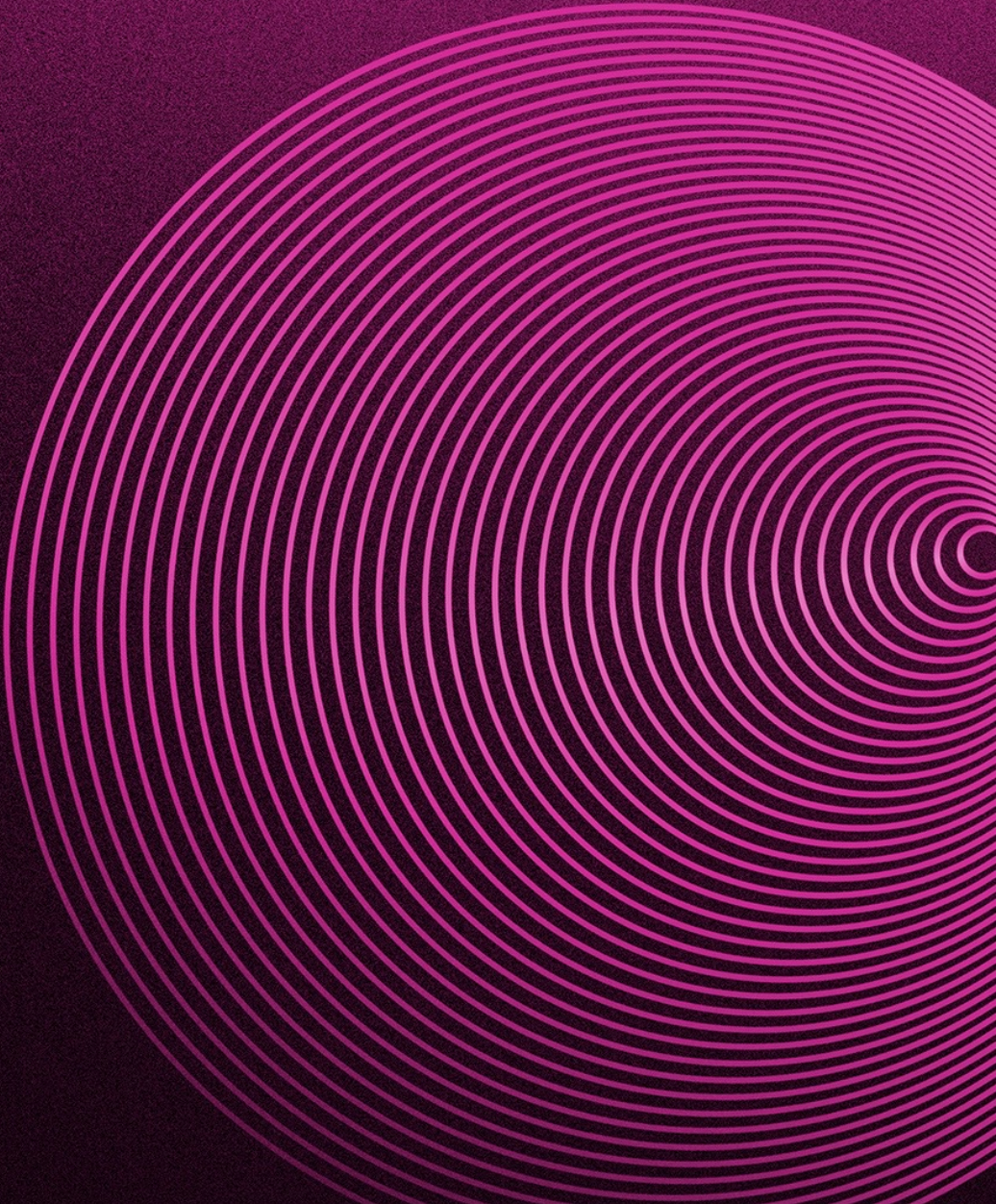
Budget shortfalls are expected to persist in the short term but will gradually reduce over the decade. Despite this relative restraint, neither the collective provincial

nor federal budgets are expected to return to surplus this decade. We expect real government spending growth to slow and fall below GDP growth starting in 2025.

The 2024 federal budget emphasizes the goal of maintaining the debt-to-GDP ratio throughout the decade, so our forecast anticipates that government investment will moderate and align more closely with real GDP growth moving forward. Overall, growth in total government consumption and investment spending is expected to cool to 2.2% next year after posting growth of 2.6% this year.



Households



Households

With Canada's economy slowing, we have seen job gains moderate in recent months. Despite the slowdown there is no sign of an uptick in layoffs with the softness in the labour market thus far concentrated in youth and new immigrants. Weak job creation combined with strong population growth has sent the unemployment rate upwards to reach 6.6% in August, a 1.5 percentage point increase since April 2023. We anticipate that job creation will remain modest over the next few months as the economy regains its momentum. This will keep the unemployment rate elevated in the short term, before falling back below 6% in 2026 as slower population growth allows labour markets to catch up with the number of job seekers.

Hourly wage growth has remained robust, running at 5% year-over-year in August, a pace inconsistent with returning inflation to its 2% target. But the rising unemployment rate has removed the leverage from workers asking for higher wages, and we expect most employers will offer smaller compensation packages going forward. We expect to see the average year-on-year pace of wage growth to fall below the 4% mark by the first quarter of 2025.

Growth in consumer spending came in weaker than expected in the second quarter of this year, as Canada's highly indebted households continued to feel the impacts of elevated interest rates. Although interest rates have started to decline, many homeowners who renewed/acquired their mortgages at low rates during the pandemic have been forced to renew at much higher rates, limiting their ability to spend on discretionary items, especially large and costly durable goods. Data for the second quarter show that households are now spending 15 cents of every dollar servicing their debt.² Results from Deloitte's latest ConsumerSignals report show that Canadian consumers continue to feel the impact of higher interest rates and inflation with 38% noting that their financial situation has worsened over the past year.³ As interest rates come down, consumer confidence should recover, helping drive consumption.

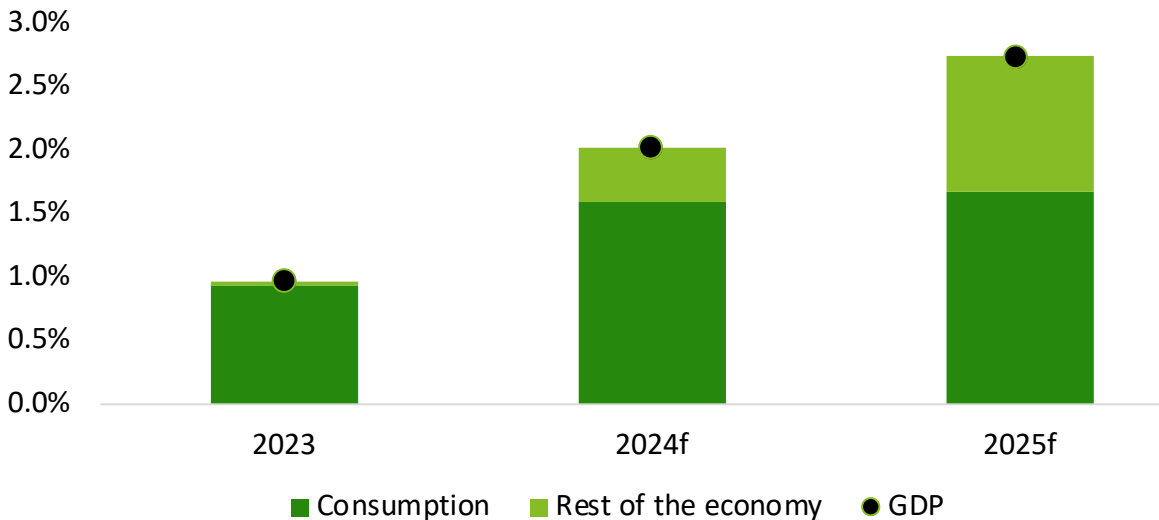
2. Statistics Canada. "[National balance sheet and financial flow accounts, second quarter 2024](#)", September 12, 2024.

3. Deloitte. "[ConsumerSignals: Canada](#)", August 28, 2024.

Households

However, with households facing softer labour markets and rising debt payments, they will be unable to drive economic growth the way they have over the past two years with consumption's contribution to GDP growth expected to soften and other sectors of the economy beginning to pick up the slack.

Slower population growth and increased payments to crimp consumption's role in economic growth next year (per cent)



f = forecast

Source: Statistics Canada; forecast by Deloitte

Households

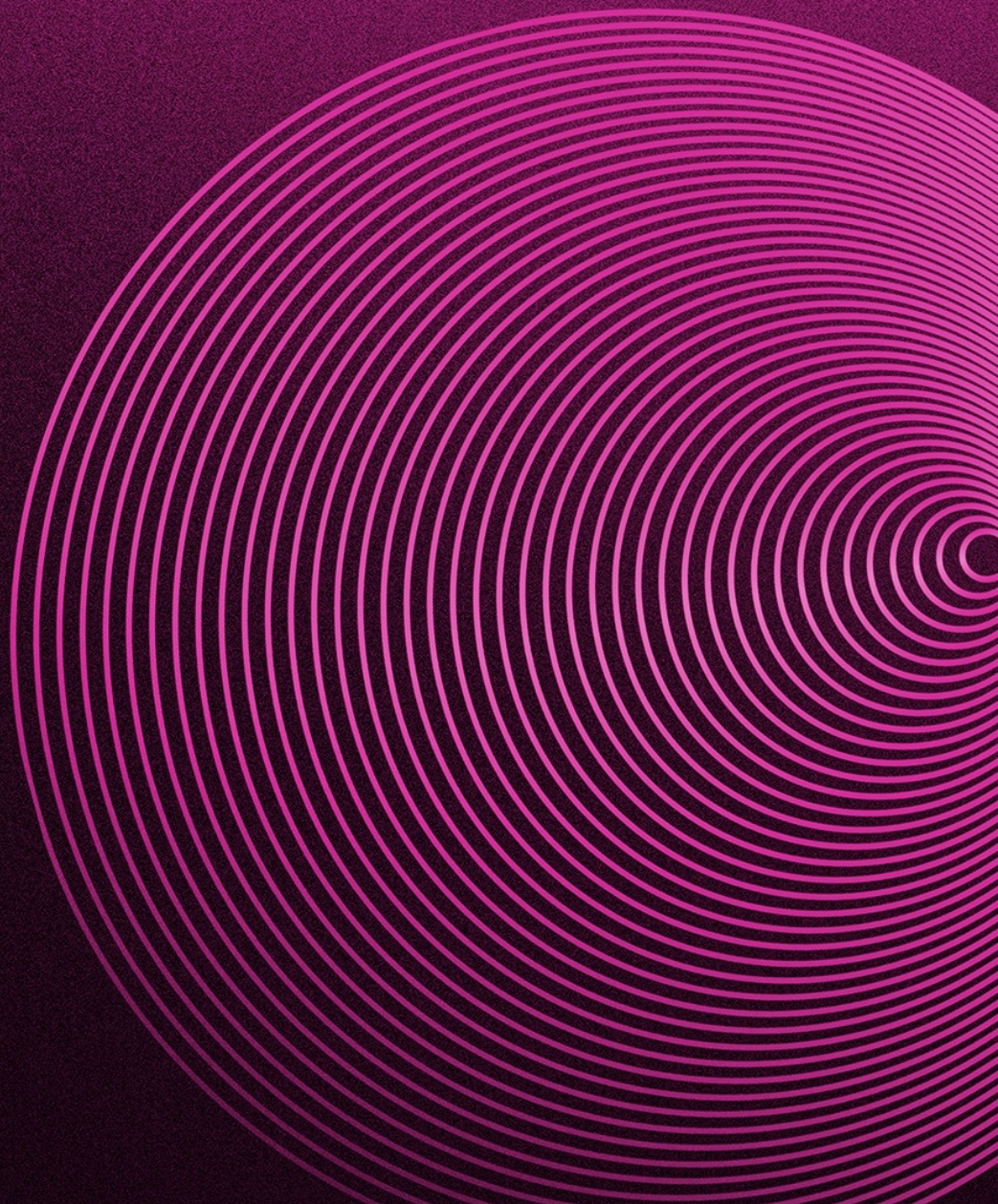
Interest rates continue to dampen activity in the housing market with affordability challenges creating a significant barrier to activity. Despite recent rate cuts, many potential buyers remain excluded from the market, especially in major urban centers where property prices have surged. Elevated property taxes, maintenance costs, and other ownership-related expenses further deter potential buyers. Even with lower interest rates, the overall cost of homeownership remains prohibitive for many.

The high interest rate environment is expected to continue suppressing new home construction in the immediate future. Elevated rates increase borrowing costs for both developers and prospective homebuyers, leading to a decline in the supply and demand for new housing projects. However, interest rates are now projected to ease more rapidly than expected in our previous forecast and that should stimulate new home construction. This shift to a lower interest rate environment is expected to rejuvenate construction activity, particularly as it coincides with a broader economic recovery and improved consumer confidence.

We anticipate new home construction to rise from 246,000 units in the first quarter of 2025 to 267,000 units by the end of next year. Activity in the resale market is facing a slow recovery with resale home sales activity still below historical averages. However, with home prices well off their 2022 peak and mortgage rates falling, we expect sales activity to begin picking up in the final quarter of this year with strong growth in the cards in both 2025 and 2026 as sales return to their historical average.



Business



Business

Real business investment surged 11.1% in the second quarter, primarily driven by a spike in aircraft and other transportation equipment investment. However, this strong growth is unlikely to be sustained given weak domestic demand and a slowing US economy with gains decelerating to around 4.5% in the second half of the year.

The outlook for commercial office building construction, the largest component of non-residential building construction investment, remains subdued. In fact, capital spending in non-residential building construction has been on a downward trend for more than a year and a recovery does not seem likely soon. Building permits for non-residential construction have been declining for over a year, and we expect this weakness to continue to weigh on overall business spending in the near-term.

Another negative factor affecting the business outlook is subdued business confidence. According to the latest Bank of Canada Business Outlook Survey, uncertainty—especially around red tape and regulations that slows business plans—and cost pressures, primarily due to the

carbon pricing, are top concerns for businesses.⁴ Firms linked to discretionary spending have reported deteriorating sales indicators over the past year, and their expectation for sales growth over the next 12 months remain weak. Overall, despite the beginning of interest rate cuts, muted business confidence is expected to constrain investment growth in the near term.

On a positive note, the ramp-up of several major transportation equipment manufacturing projects is poised to provide support to Canada's business investment in the short to medium term. This is driven by the establishment of large-scale EV battery equipment manufacturing facilities. For instance, Honda recently announced a \$15 billion investment to build four new manufacturing plants in Ontario. Other notable investments include the \$7-billion Volkswagen EV battery plant in Ontario and the \$7 billion Northvolt battery plant in

4. Bank of Canada, "[Business Outlook Survey—Second Quarter of 2024](#)", July 15, 2024.

Business

Quebec. These investments are expected to offset a substantial drop in pipeline investments as work concludes on Coastal GasLink and the Transmountain expansion this year. Overall, these major projects, together with an expected improvement in business sentiment, are expected to drive a rebound in real non-residential business investment which is projected to grow by 2.9% in 2025 before slowing to 1.4% in 2026.

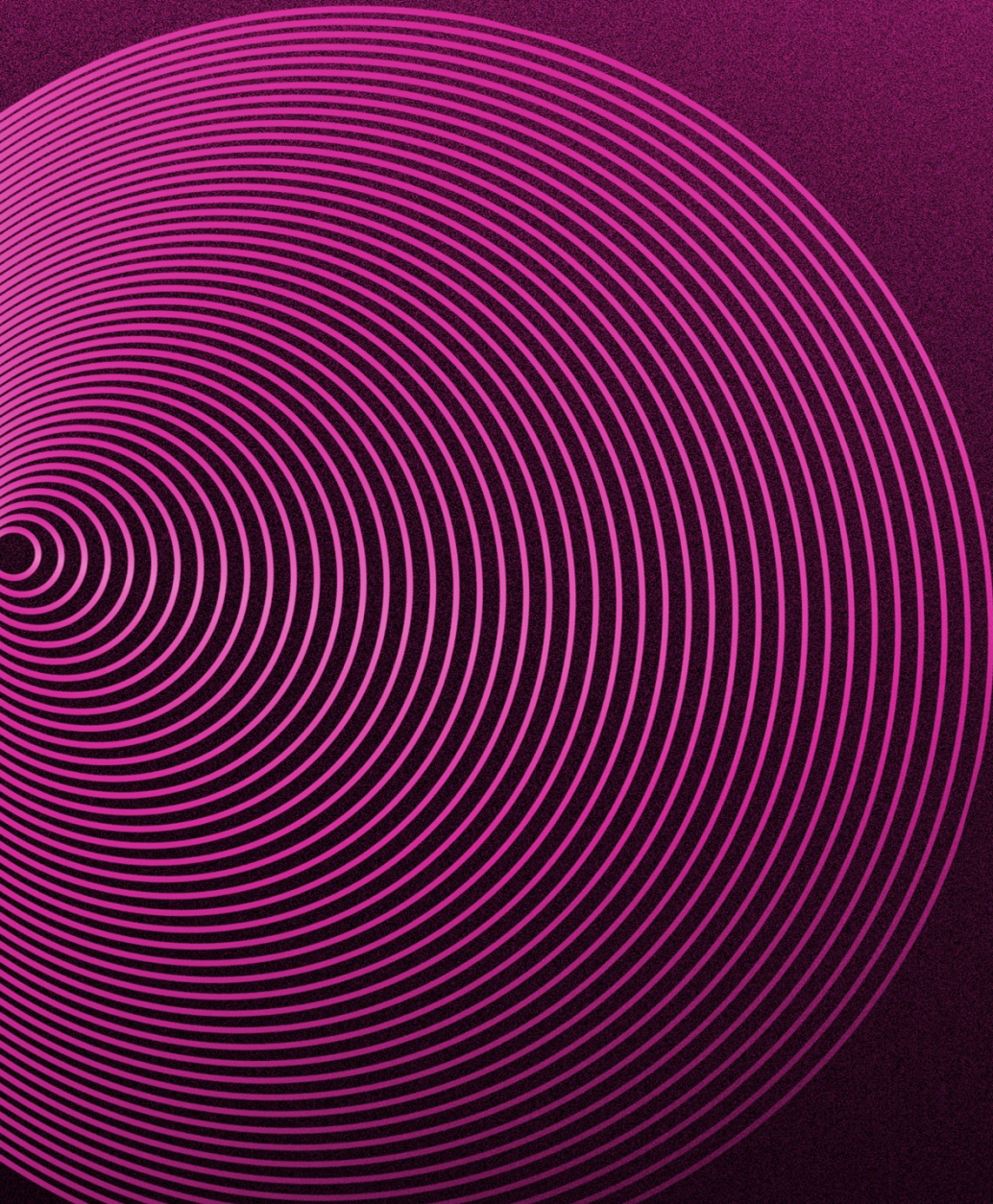
After a bumper 2023 where Canada's exports finally surpassed levels seen prior to the pandemic, we expect things to normalize considerably this year with export growth relatively muted at 0.6%. While the opening of the Transmountain Pipeline Expansion continues to augur well for Canada's oil exports in the near-term, the economic slowdown unfolding in the US is projected to pose some headwinds for Canada's exports, almost 80% of which flowed south of the border in 2023. Next year though, Canada's export capacity is set to get a significant boost from the commencement of operations at LNG Canada which expects to begin exporting in the summer of 2025.⁵ This coupled with an anticipated upswing in U.S. economic

activity towards the end of next year is projected to give a boost to exports which are forecasted to grow by 2.7%.

Where imports are concerned, the profile this year is relatively similar to last year, with import growth penciled in at 0.5%. The weakness observed in the second quarter of this year is expected to carry through to the third quarter as consumers and businesses cautiously navigate an economic environment that has seen the unemployment rate move over a full percentage point higher in just a year. Nevertheless, with another 50 basis points in interest rate cuts forecasted through December, we think that this combined with the 75 basis points in cuts so far, will help the import outlook to turn the corner by the end of this year as household and business confidence return.

5. The U.S. Energy Information Administration, "[North America's LNG export capacity is on track to more than double by 2028](#)", September 6, 2024

Risks to the outlook



Risks to the outlook

The economy continues to face risks on the upside and downside. Notably, consumers have been stockpiling savings with the savings rate pushing above 7% last quarter, its highest rate outside of the pandemic since the early 1990's. With mortgage rates declining alongside interest rates, households renewing their mortgages over the next two years will face a smaller shock than previously expected. As a result, the stockpile of savings may prove excessive to meet higher mortgage payments and an unleashing of this savings on the economy represents an upside risk to the forecast.

The biggest downside risk to the forecast lies in the trade sector. The global economy is facing elevated geopolitical tensions and the risk of broad-based tariffs by the world's largest consumer market should former President Trump be reelected, all of which bodes poorly for trade prospects. Further, we are closely watching rising trade tensions between Canada and China. Citing unfair trade practices, the Canadian government has recently announced their intention to follow the lead of their US counterparts and levy a surtax of 100% on Chinese-made electric vehicles and 25% on steel and aluminum products from China effective

October 1st and October 15th respectively.⁶ At this stage, given that the tariffs only target 0.6% of Canadian merchandise imports, we don't see any immediate and major threat to the import outlook. However, we note that the impact could be felt in prices as costs rise for downstream users of imported aluminum and steel, and consumers face higher prices for electric vehicles in Canada.

In addition, Canada's trade actions likely won't occur in a vacuum, with China, our second largest destination for exports, expected to retaliate in the coming weeks. Indeed, the Chinese government has already begun to make moves to this effect with China launching antidumping investigations into some Canadian agriculture and chemical products.⁷ The outcomes of these investigations are yet to be seen but could cast a gloomy cloud over the export outlook should the ensuing measures prove significant.

6. Government of Canada, "[Canada implementing measures to protect Canadian workers and key economic sectors from unfair Chinese trade practices](#)", August 26, 2024

7. The Wall Street Journal, "[China to Launch Trade Probes Into Some Canadian Agriculture, Chemical Products](#)", September 4, 2024

Key economic indicators

	2024f				2025f				2024f	2025f	2026f
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f			
Real economic activity											
Gross domestic product	1.8	2.1	1.6	2.6	2.5	2.6	2.3	2.4	1.2	2.4	2.1
Household consumption expenditure	3.6	0.6	1.9	2.3	3.0	3.2	3.1	2.9	2.0	2.6	2.8
• Durable goods	2.0	-7.9	0.9	1.2	2.0	2.6	2.5	2.2	1.1	1.2	2.1
• Services	5.0	1.8	2.0	2.5	3.2	3.3	3.1	2.9	2.9	2.8	2.9
Residential investment	-0.1	-7.3	8.6	-0.5	6.1	6.6	5.9	7.2	0.0	4.4	4.9
Non-residential investment (excluding IP)	2.4	11.1	4.8	5.1	1.7	1.1	1.1	1.3	-0.7	3.0	1.2
• Non-residential structures	3.7	2.0	1.7	3.4	0.9	1.0	1.0	1.1	-2.4	1.6	0.9
• Machinery and equipment	0.0	28.8	10.0	7.9	2.9	1.4	1.2	1.6	2.3	5.5	1.5
Government consumption and investment	2.5	6.7	2.0	2.3	1.6	1.6	1.6	1.6	2.5	2.1	1.3
Exports of goods and services	-1.8	-1.6	3.5	3.4	3.9	3.8	4.7	-1.8	0.6	2.7	3.4
Imports of goods and services	-0.5	-1.0	3.0	3.8	3.7	4.1	4.8	-0.5	0.5	2.8	3.7
Prices											
Consumer price index (y/y)	2.9	2.8	2.4	2.2	2.1	2.0	2.0	2.8	2.6	2.0	2.0
Implicit GDP price index (y/y)	3.4	3.9	3.0	2.1	3.1	2.7	2.6	2.5	3.1	2.7	2.3
Labour market											
Employment	1.5	2.4	0.5	1.5	1.5	1.5	1.9	1.8	1.7	1.5	1.6
Unemployment rate (%)	5.9	6.2	6.6	6.7	6.5	6.5	6.3	6.2	6.4	6.4	6.0

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 September 12, 2024.

Financial market indicators

	2024f				2025f				2024f	2025f	2026f
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f			
Interest rates (%)											
Overnight rate target	5.00	4.75	4.25	3.75	3.50	3.25	3.00	2.75	3.75	2.75	2.75
3-month T-bill	4.96	4.79	4.39	3.93	3.54	3.31	3.09	2.86	4.25	3.00	3.00
1-year T-bill	4.78	4.62	4.06	3.83	3.58	3.42	3.23	3.02	3.93	2.86	2.90
2-year GoC bond	4.11	4.21	3.54	3.36	3.19	3.05	2.89	2.90	3.83	3.02	3.21
5-year GoC bond	3.51	3.71	3.18	3.05	2.99	2.96	2.96	2.95	3.36	2.90	3.23
10-year GoC bond	3.44	3.67	3.25	3.00	2.90	2.95	3.00	3.25	3.05	2.95	3.23
Yield curve spread (pp)											
3-month vs. 10-year	-1.53	-1.12	-1.14	-0.93	-0.64	-0.36	-0.09	0.39	-0.93	0.39	0.33
2-year vs. 10-year	-0.67	-0.54	-0.29	-0.36	-0.29	-0.10	0.11	0.35	-0.36	0.35	0.02
Foreign exchange											
USD/CAD (\$C)	1.3488	1.3684	1.3637	1.3710	1.3749	1.3820	1.3850	1.3826	1.3710	1.3826	1.3659
CAD/USD (\$US)	0.7414	0.7308	0.7333	0.7294	0.7273	0.7236	0.7220	0.7233	0.7294	0.7233	0.7321

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 September 12, 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
Partner



Alicia Macdonald
Director



Anna Feng
Manager



Robyn Gibbard
Manager



Mikayla Schoel
Manager



Pablo Alegria
Senior Associate



Zach Gaskin
Senior Associate



Madison MacKinnon
Senior Associate



Momanyi Mokaya
Senior Associate



Dhruv Deshpande
Analyst



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