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Pent-up demand drives rebound

Economic outlook | June 2021

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Summary by Chief Economist Craig Alexander

The last few months have demonstrated that the Canadian and global economies remain susceptible to the progression of the pandemic. In our last outlook in March, we anticipated that public health measures would continue throughout the spring, but we did not foresee the impact the COVID-19 variants of concern would have on some parts of the world. Here in Canada, the third wave hit hard, necessitating the reintroduction of strict public health measures and resulting in the economy contracting in April. The short-term dip in economic activity is not unexpected given the business closures across the country, and there is reason for optimism as we look ahead.

Canada's vaccination campaign has gained incredible momentum over the past few weeks. Every single province has started easing public health restrictions, allowing for a gradual resumption of activities. As a result, we expect growth to accelerate sharply during the summer and continue to expand at a fast pace over the remainder of this year and into early 2022 as Canadians partake in social activities that have been limited since the start of the pandemic. Real GDP is expected to expand by 6.7% this year, and another strong gain of 4.1% is anticipated next year.

While the health crisis has resulted in a shift of economic growth out of the first half of this year, what hasn't changed is the expected composition of growth. Some consumer spending has been sidelined due to closures, but other areas, such as residential investment, continued to soar in the first few months of 2021. Household spending will be a stalwart of the economic recovery, although we do anticipate a cooling in the residential real estate sector and a shift from growth in purchases of goods toward services. Government spending has also remained strong and will continue to support the recovery over the next few years as Ottawa rolls out the $100 billion stimulus plan announced in its most recent budget.

Undoubtedly, Canada is in for a year of spectacular economic growth.

Summary

On the business front, we have seen strong demand for some Canadian commodity exports, such as metals and wood products, as the global economy gains steam. With the US economy expected to grow by close to 8% this year, we can anticipate a solid year for Canadian exporters. However, our ability to respond to the rise in demand will be held back by prior years of subpar investment, a situation that's unfortunately not likely to change in the near term.

In addition, several risks are top of mind. In the short term, there's the risk of a variant strain of COVID-19 that is more resistant to the vaccines that are currently available. There's also the risk of higher inflation, due to central banks and governments having dramatically increased money supply to counter the effects of massive job loss early in the pandemic. There might be cases of fiscal crisis in the post-pandemic world, too. After the financial crisis and recession in 2008-09, a fiscal crisis started in Greece and spread to other European nations. It's possible that much of the economic damage created by the pandemic is not being seen because of the massive government stimulus, but it may become more apparent with time.

Another factor worth considering is the long-term sustainability of this recovery. Before the pandemic, it was widely observed that the business cycle was getting long in the tooth and that we were overdue for a correction. The recession we experienced in 2020 was unforgettable in size and speed, but it did not result in the rebalancing that we typically see during downturns. Indeed, we instead witnessed a further building of vulnerabilities because households and governments piled on debt as interest rates fell. The same issues that plagued Canada before the recession—high household and government debt, weak productivity growth, and low levels of business investment—continue to challenge our prospects.

With the economic recovery now fully entrenched, now is the time to begin thinking about how to overcome these challenges.

Canada’s current recovery

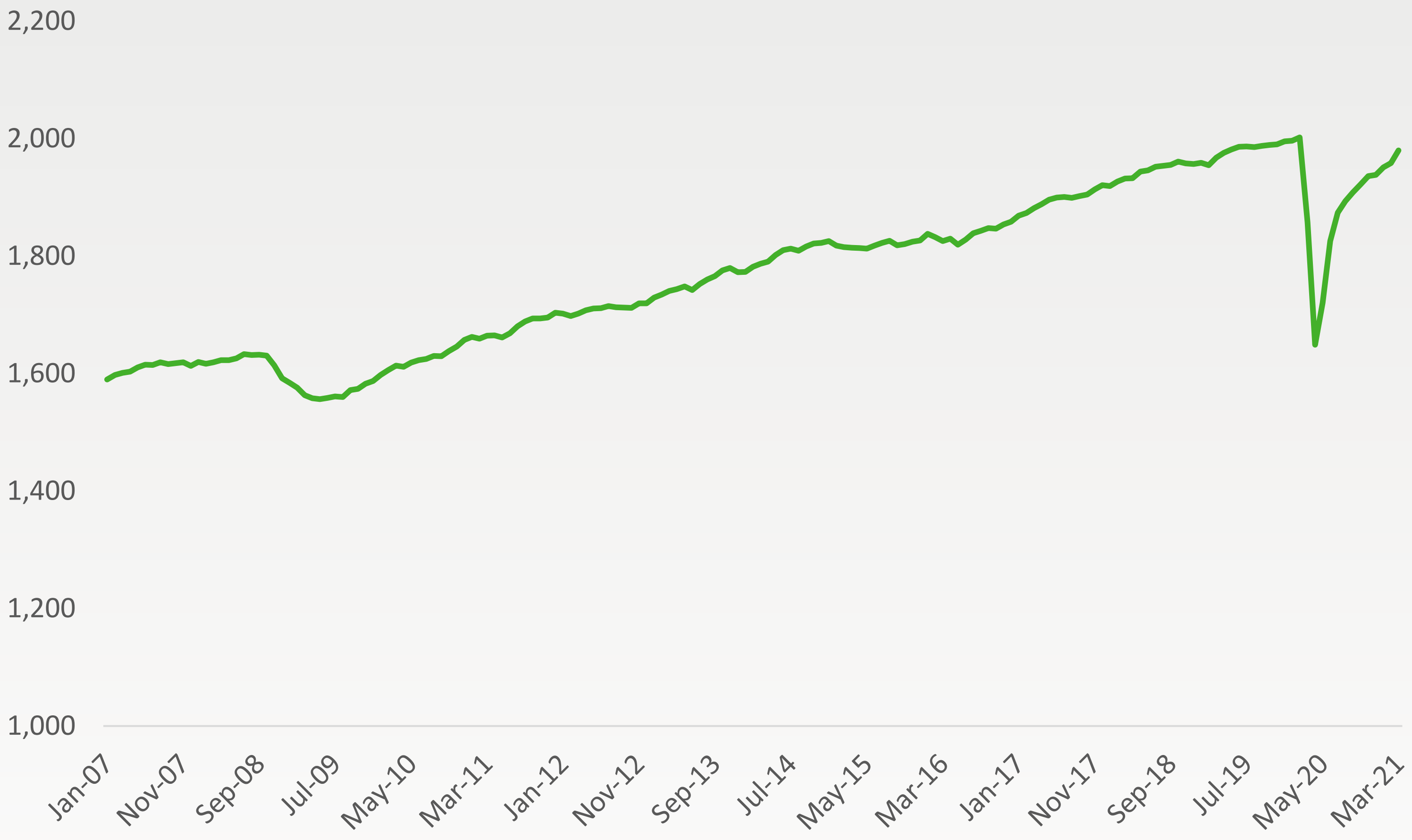
Canada's economy was 1.1% below pre-pandemic levels in March 2021

After experiencing its steepest decline in decades, the economy is getting close to returning to its pre-pandemic level of output.

- When the pandemic reached Canada in March 2020, the economy crashed. It registered a sizeable drop in real GDP in both March and April.
- Since then, it has been on a steady upward trend despite significant second and third waves of new COVID-19 cases.
- That upward trend is expected to have come to an end in April, with preliminary estimates showing that GDP declined that month in response to renewed public health measures, such as the prolonged stay-at-home order in Ontario.
- The decline in output is expected to be short-lived, though, as public health measures eased in many parts of the country in May and June.
- Further, Canada's vaccine rollout has accelerated rapidly over the past few weeks, suggesting better days ahead.

Real GDP: January 2007 to March 2021

Billions, chained $



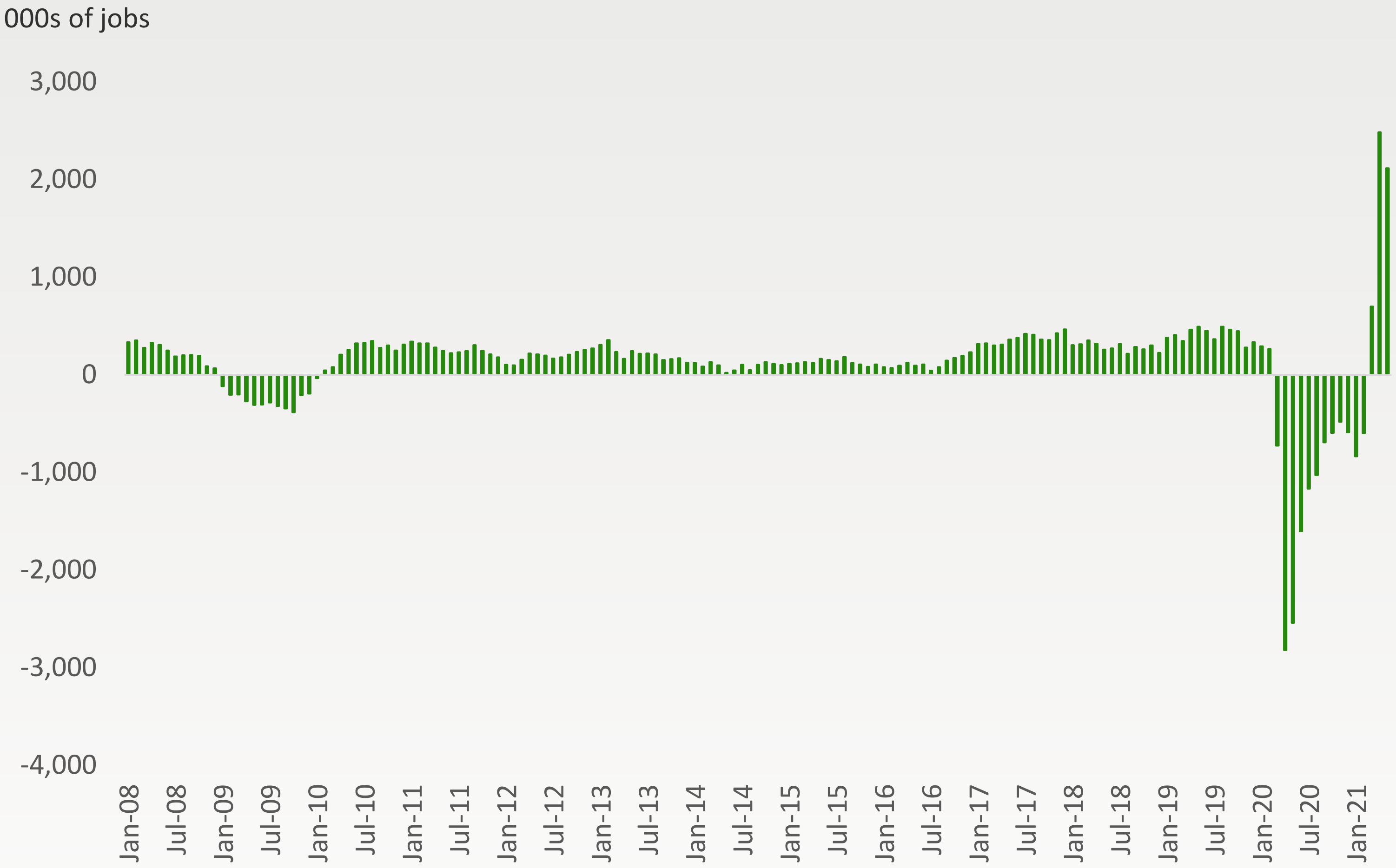
Source: Statistics Canada

Employment struggles to return to pre-pandemic levels

Employment fell for a second consecutive month in May 2021, with 517,100 fewer Canadians employed compared to February 2020. Despite the drop, 2.1 million more were employed this May compared to the same month last year.

- The labour market recovery remains highly uneven across industries, regions, and population groups. Employment in industries most affected by the pandemic closures continues to lag as Ontario's stay-at-home order curtailed activity in that province, Nova Scotia entered a lockdown at the end of April, and both Alberta and Manitoba introduced tighter measures in early May.
- March 2021 saw an increase in the year-over-year change in employment for the first time since the start of the pandemic. Close to 2.5 million more Canadians were employed in April 2021 than in April 2020, and 2.1 million more in May 2021 compared to May last year.
- The unemployment rate was little changed in May 2021, rising to 8.2% from 8.1% in April.
- Most of the employment decline in May was due to decreases in part-time employment. Furthermore, 22.7% of people employed part-time in May desired full-time positions.
- Total hours worked dropped by 2.7% in April and was little changed in May. Declines in industries most affected by tighter health measures were offset by improvements in educational services, and health care and social assistance. However, hours worked remained 3.8% below February 2020 levels.

Year-over-year change in employment, January 2008 to May 2021



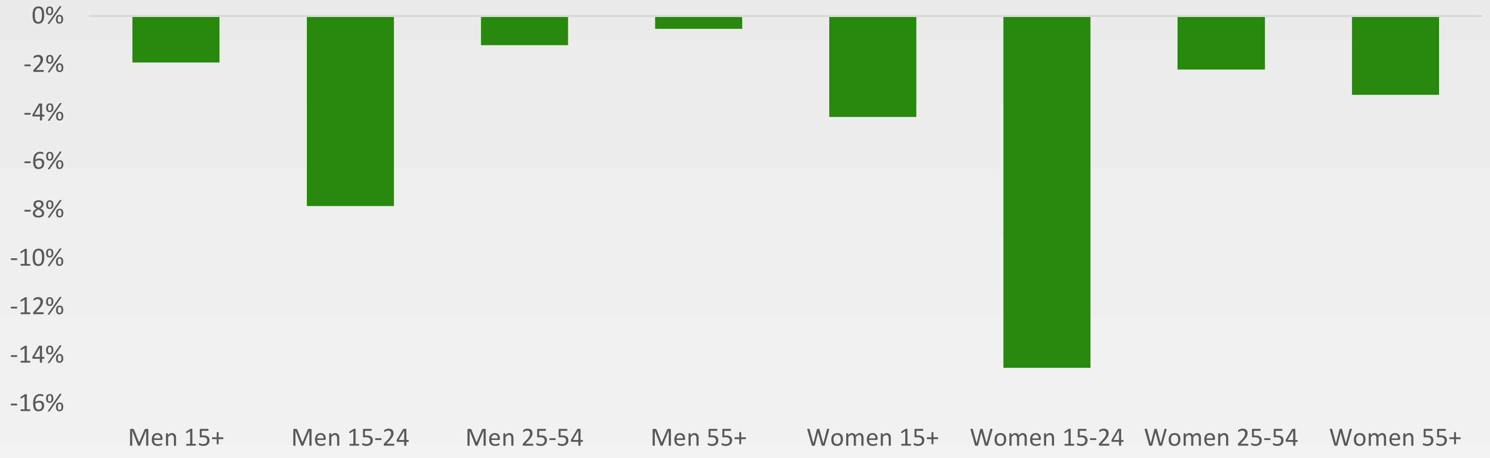
Sources: Deloitte, Statistics Canada

Employment changes have not been equitable across population groups

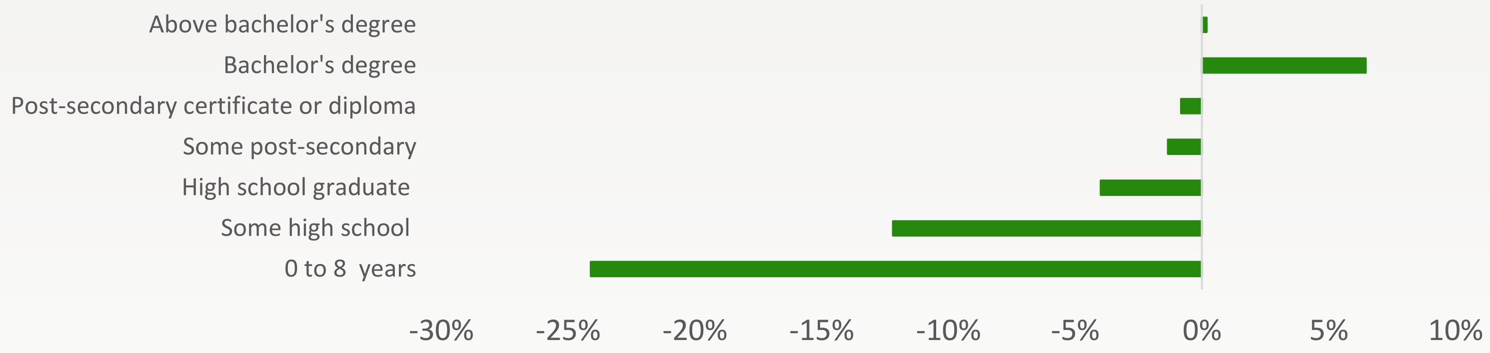
The pandemic has resulted in large increases in long-term unemployment, indicating a mismatch between supply and demand in labour.

- In May 2021, nearly half a million people had been unemployed for at least 27 weeks. Many who lost their jobs in the first wave of the pandemic have since remained unemployed, leading to a surge in long-term unemployment since the fall of 2020. Chronic unemployment can lead to skills atrophy and have lasting impacts on a person’s earning ability.
- Labour force participation dropped in May 2021, with youth and women aged 25 to 54 representing most of the decline. The number of individuals aged 15 to 24 participating in the labour force fell 1.3%, while the decrease among women aged 25 to 54 was by 0.6%. Unfavourable business conditions have caused many women in this age group to stop searching for work. School closures in many parts of the country are also likely to be a factor.
- The employment recovery remains highly uneven across age and gender. Youth employment is the furthest from recovering, and the decline in female employment is higher than males across all age categories.
- By education level, job losses are concentrated among those with lower levels. For those with a university degree (38% of the labour market), employment is 4.3% above February levels.

Employment by age and gender, February 2020 to May 2021



Employment by education, February 2020 to May 2021

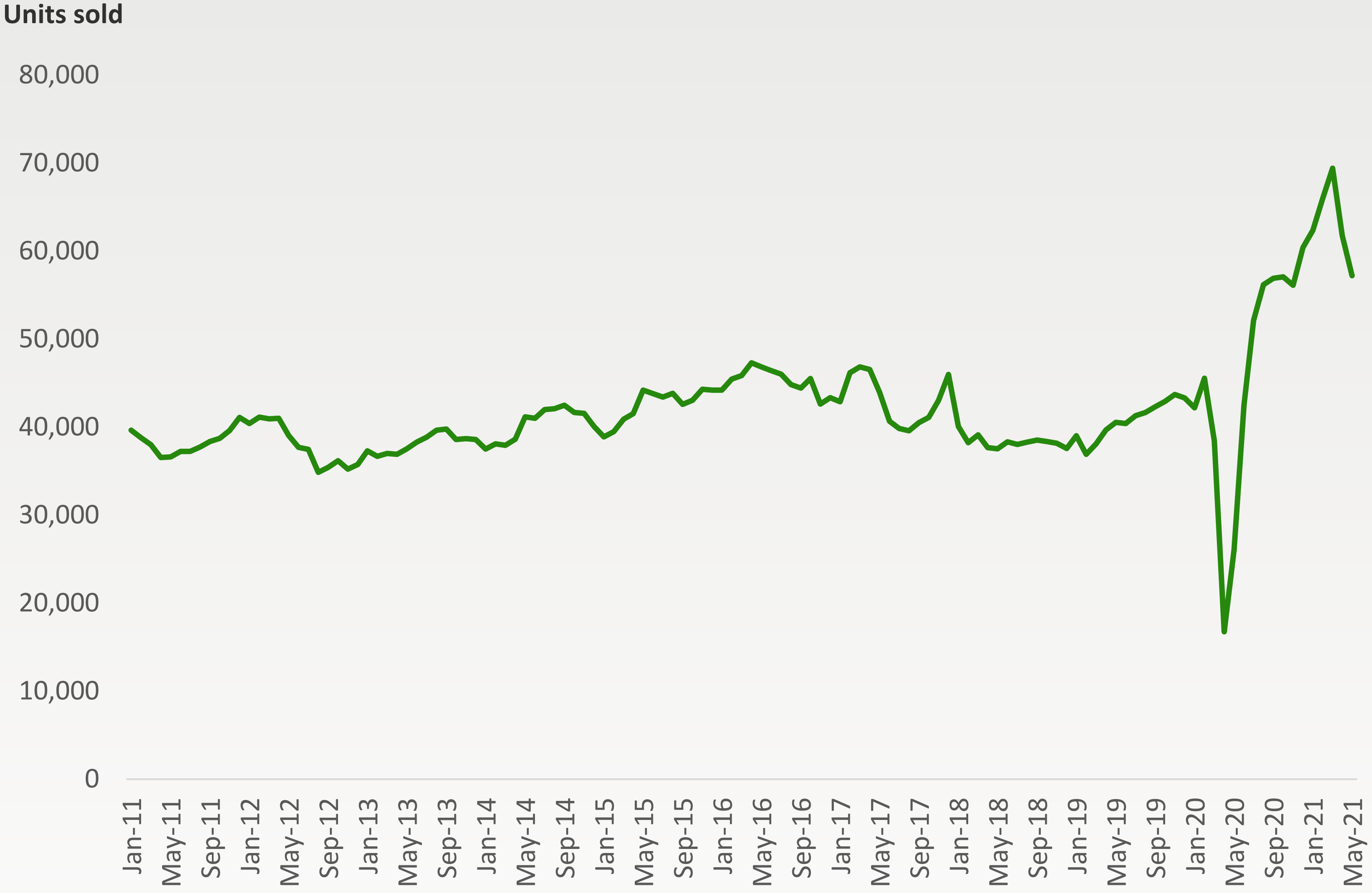


Sources: Deloitte, Statistics Canada

Resale markets are cooling after a flurry of activity

Residential real estate has been a key driver of economic activity as we emerge from recession. After months of record-breaking movement, we're finally seeing some cooling in the resale market.

- The number of homes sold in the resale market fell in both April and May, although activity still remains at a historically high level.
- New listings also fell in May, adding to the supply crunch facing the market. The number of months of inventory on the market sat at 2.1 in May, compared to a long-run average of over five.
- With sales falling more than new listings, the sales-to-new-listings ratio nudged down to 75.4%. This is down substantially from the 91% in January but still over 20 percentage points higher than its long-term average. It remains firmly in sellers' territory.
- With demand remaining strong, price growth has remained firm. The average sale price was up 38.4% from May 2020 to reach $688,000, while the composite home-price index posted a 24.4% year-over-year gain.



Source: The Canadian Real Estate Association

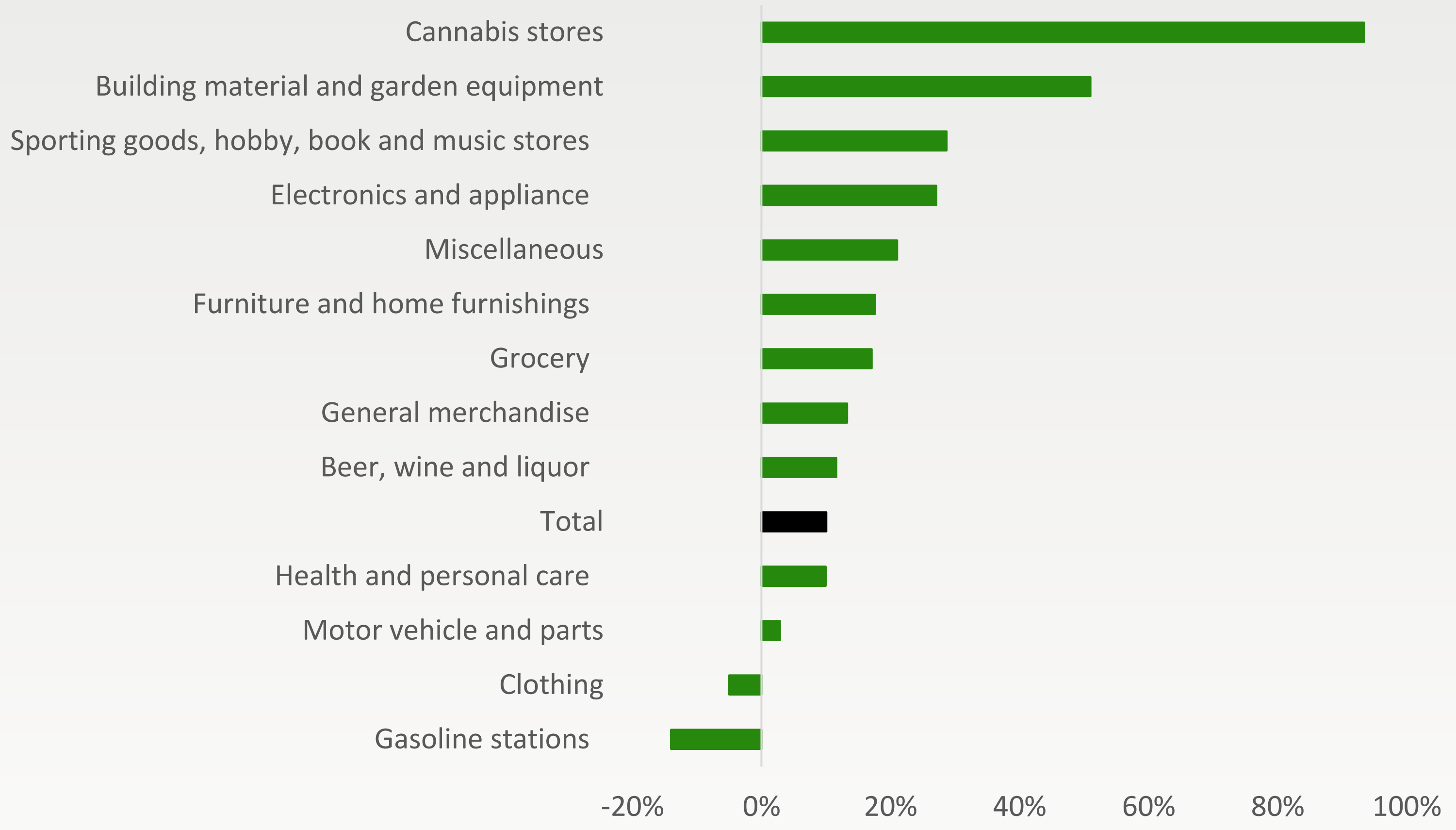
Strong income growth continues to fuel retail spending

Retail sales bounced back quickly last year and continue to trend above pre-pandemic levels. That's thanks to strong income growth and limits on available services.

- Retail is one of the economic sectors that is heavily influenced by public health measures. At times, the sector has been negatively affected by such measures in provinces that limit in-person sales to only essential items. At other times, stores benefited from restrictions as consumers pivoted their spending away from activities like travel and dining out toward goods to enjoy at home.
- This trend is evident in the sales growth by sector, with electronics, sporting goods and hobbies, building material and gardening, and cannabis stores all posting sales more than 20% above their pre-pandemic levels.
- In March, we saw strong growth in retail sales as restrictions were eased between the second and third wave of the pandemic.
- The preliminary estimate for retail spending in April shows a sharp drop in sales. This corresponds to health measures implemented to counteract rising case counts.
- The decline should be short-lived as retailers have begun reopening across the country. However, they will face more competition for consumer dollars as other activities resume and service availability expands.

Retail sales by category

% change from February 2020 to March 2021



Sources: Deloitte, Statistics Canada

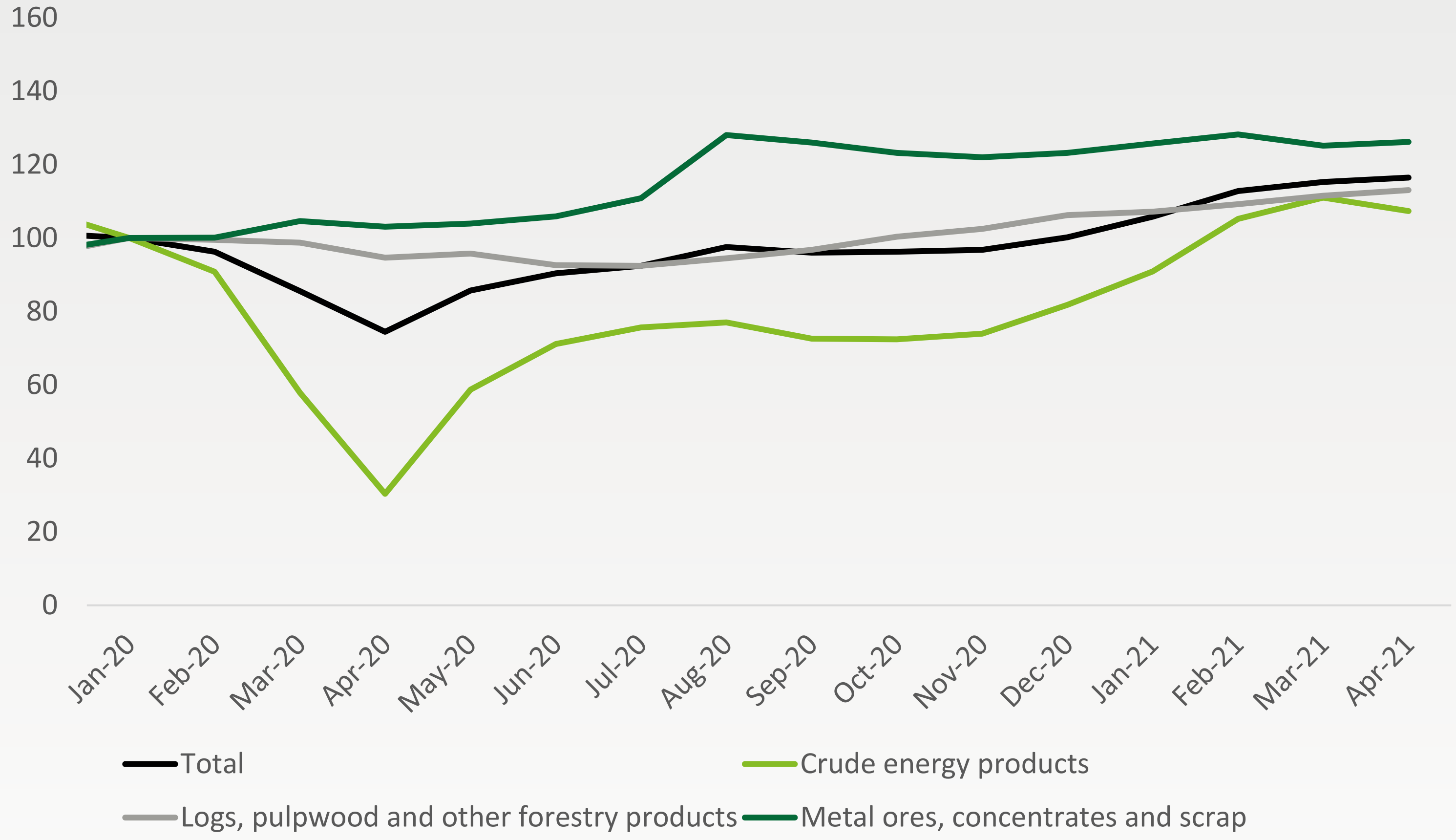
Global recovery is boosting the demand for raw materials

We've seen a broad-based increase in commodity prices, benefitting many Canadian producers.

- Prices for many of Canada's key commodities have been increasing rapidly, coinciding with robust international demand as the global recovery picks up steam.
- Oil prices plunged during the height of the first wave but have recovered strongly and are above their pre-pandemic levels.
- We have also seen strong increases in metal and forestry prices—lumber in particular—as the housing market booms here in Canada and south of the border.
- The commodity price rally pushed up Canada's terms of trade, a key measure of our purchasing power, by 6.1% in the first quarter of the year and by 12.4% relative to the first quarter of 2020. Rising commodity prices have contributed significantly to the appreciation of the Canadian dollar.

Raw materials price index by category

Index: January 2020 = 100



Sources: Deloitte, Statistics Canada

International outlook

Despite the emergence of coronavirus variants of concern, the global economy is on the mend

After a devasting 2020, the economic outlook for this year is much better as vaccination rates move higher and case counts decline.

- The global economy shrank by 3.6% last year, marking only the second time worldwide GDP shrank during the last 40 years of comparable data.
- The outlook for the global recovery continues to be revised up despite an April surge in COVID-19 cases in many parts of the world. Six months ago, the global economy was expected to grow by 5.1% in 2021—it is now expected to reach 6.3%.
- Growth will be fairly broad-based this year although many tourist-dependent economies will have to wait until into 2022 before their recovery becomes deeply entrenched.
- Emerging markets generally face greater health risks and vaccination is going more slowly. Rising commodity prices and strong world demand for emerging market exports, however, are leading to upward revisions to developing country growth forecasts, which currently stand at 6.9% for emerging markets as an aggregate. This is above the 5.8% expected in the advanced world.
- Growth in the global economy will decelerate next year but remain strong, with a gain of 4.6%.

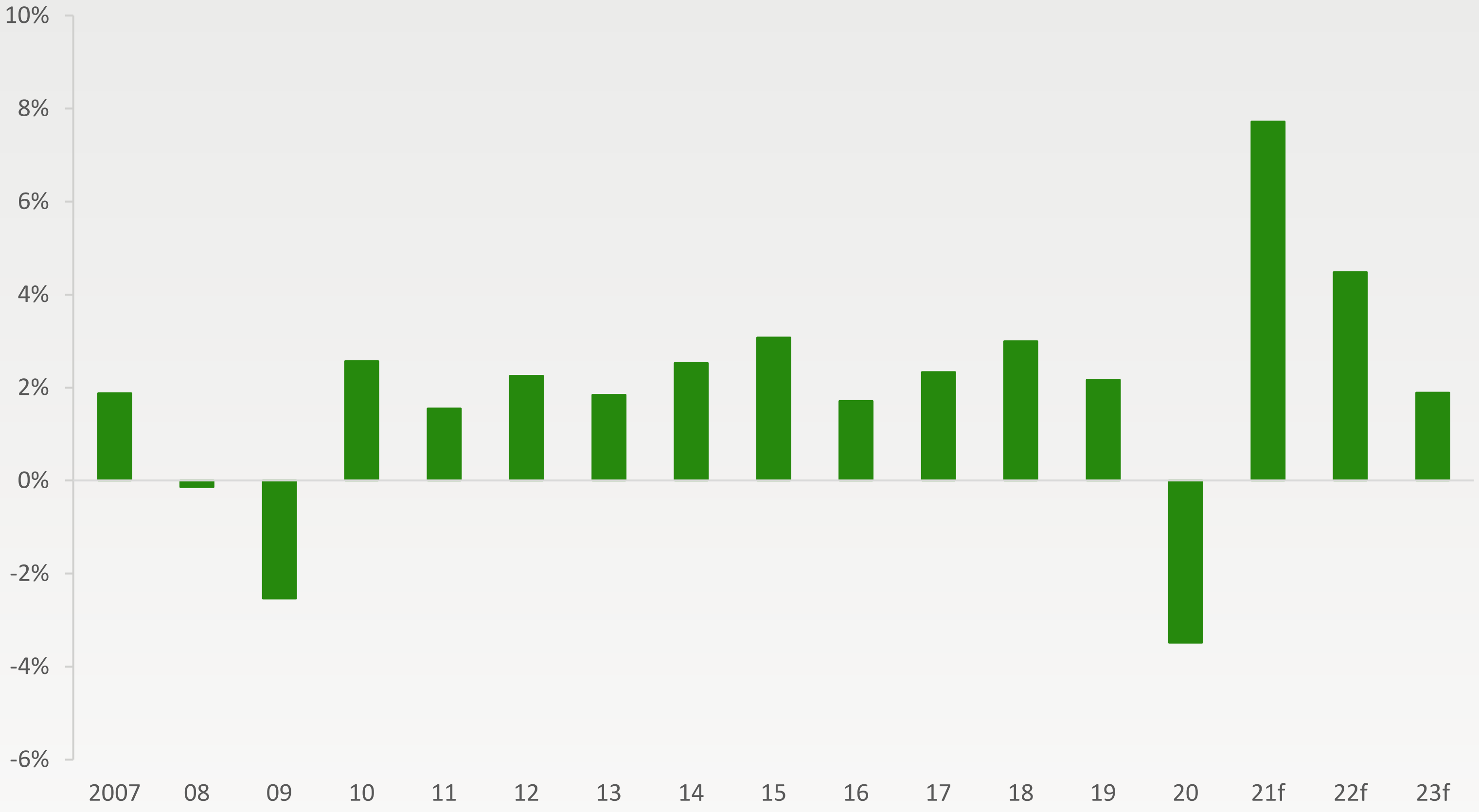
Sources: Oxford Economics, Deloitte

US economic growth set to soar

While the contraction in the United States was not as severe as in many countries, the country is set for one of the strongest rebounds thanks to significant monetary and fiscal stimulus.

- Policymakers in the United States appear keen to avoid the prolonged economic recovery the country experienced after the financial crisis a decade ago.
- On the monetary policy front, the US Federal Reserve has shrugged off the recent spike in inflation and is keeping its federal funds rate between 0 and 0.25%, sticking with its quantitative easing program and continuing to use forward guidance to convey to the market its expectations for sustained low interest rates.
- Since the beginning of the pandemic, total fiscal stimulus in the United States has amounted to nearly US$6 trillion, boosted by President Joe Biden's US$1.9 trillion stimulus package. As a point of comparison, the entire US economy produced $21.4 trillion in output in 2019, before the pandemic hit.
- Overall, the US economy is expected to grow by 7.7% this year and another 4.5% in 2022. The strong performance is important for the global recovery and bodes well for demand for Canadian exports.

US real GDP growth



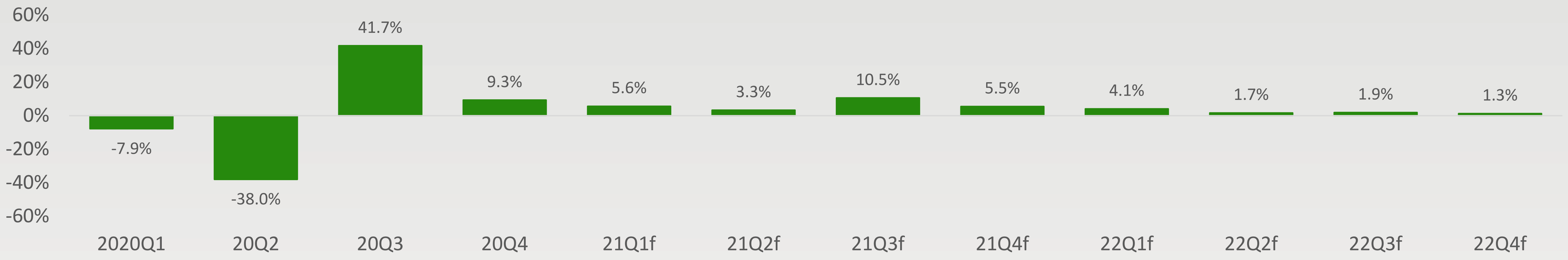
Sources: Oxford Economics, Deloitte, United States Bureau of Economic Analysis

Canadian outlook
National perspective

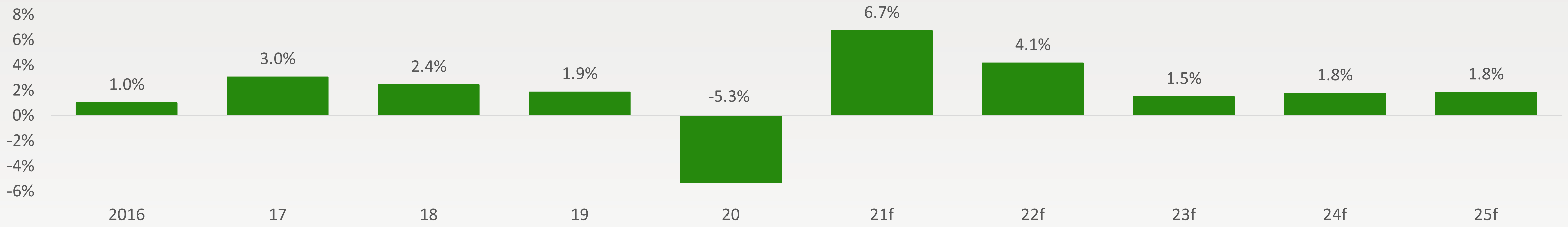
Reopening plans indicate an acceleration in growth

Public health measures taken to fight the third wave of the pandemic will limit growth in the second quarter of this year. However, with provincial and territorial economies reopening and more government stimulus spending on the way, growth is set to take off in the third quarter and remain strong for the rest of this year and into the new one.

Real GDP, quarter-over-quarter annualized growth



Real GDP, annual growth



Sources: Deloitte, Statistics Canada

Canadian outlook
Household sector

The labour market is expected to recover throughout the second half of 2021

With economic growth accelerating in the summer, so too will labour-market gains. Employment growth will peak in the third quarter.

- With slow employment growth in the first quarter of 2021 and with pandemic restrictions only recently beginning to ease in Ontario and still in place in Manitoba, we expect employment growth to be anemic in the second quarter before bouncing back in the third.
- As more and more Canadians become vaccinated, and with summer weather allowing for patios to open across most provinces, we forecast employment will reach its pre-pandemic levels in August. Overall, employment is projected to increase by 4.8% this year and 3.0% in 2022.
- The unemployment rate will trend down to 6.6% by early 2022, but is expected to stay above 6% for years to come.
- Long-term unemployment–the number of people unemployed for more than 27 weeks–remains elevated. This often leads to skill atrophy among those who struggle to regain employment and typically has lasting impacts on the labour market, a contributing factor to the unemployment rate remaining above its pre-pandemic level of 5.7%.

Employment (000s) and unemployment rate

Sources: Statistics Canada, forecasts by Deloitte

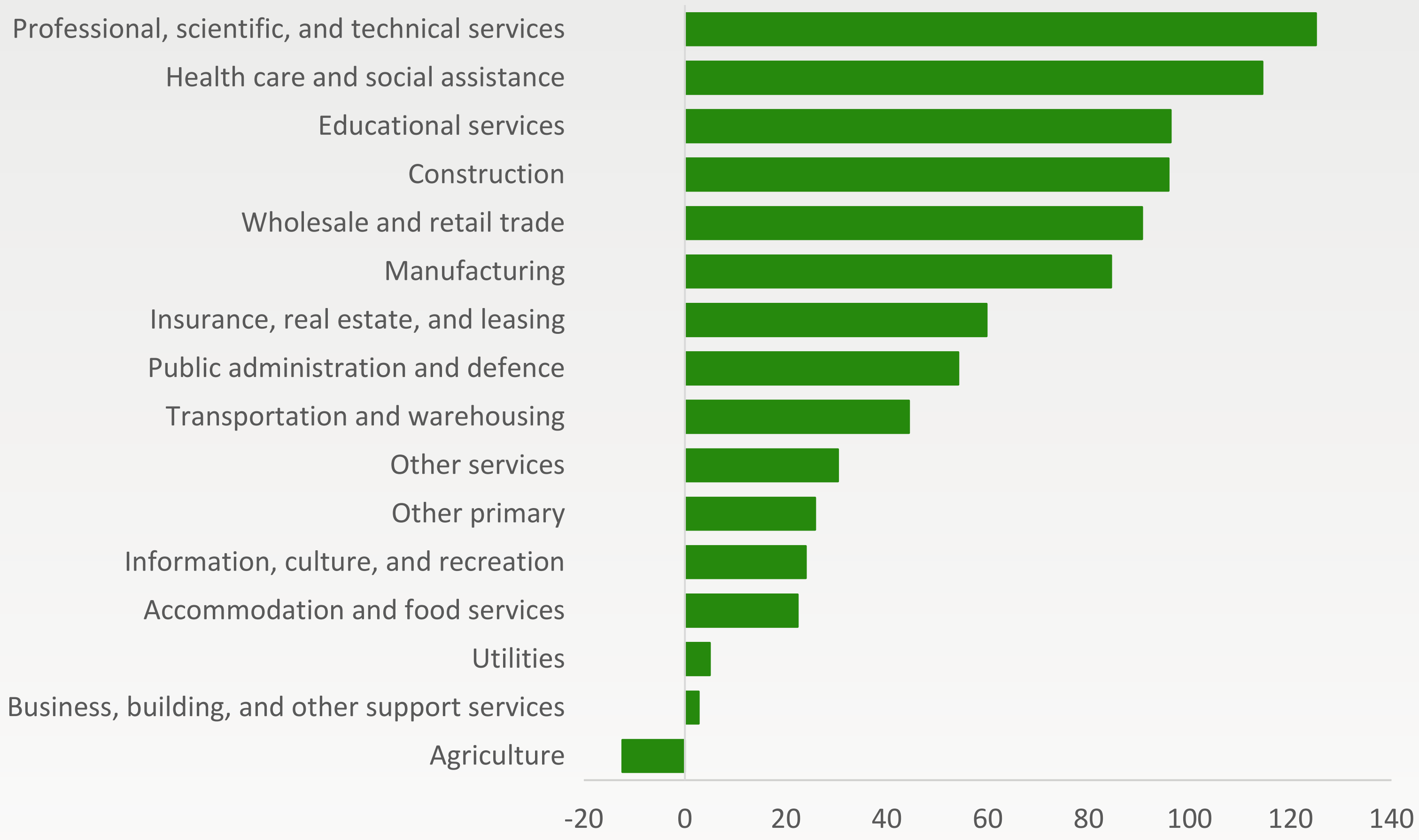
Sectors hit hardest by tighter pandemic restrictions will see a delayed recovery

Employment gains are predicted to be uneven this year. Some sectors are expecting to surpass their pre-COVID-19 levels by the end of 2021, while others are struggling to recoup their labour market losses.

- Due to extended pandemic-related closures through the first quarter and most of the second quarter of 2021, industries most dependent on reopening schedules–such as accommodation and food services, and information, culture, and recreation–will struggle to reach pre-pandemic levels by the end of this year.
- Sectors that have been able to easily adapt to working from home will continue to see growth throughout 2021. Employment in professional, scientific, and technical services is predicted to increase by 8.2% throughout the year.
- With hopes that most Canadians will be fully vaccinated by the end of the summer, and with pent-up demand present as non-essential health-care services resume, employment in health care and social services is predicted to rise by 4.7%.
- With Quebec announcing its plans for children to return to school “as normal” in the fall and other provinces expected to follow suit, we predict a strong increase in employment—7.2%—in educational services in 2021.
- And because of the booming housing market, employment in construction is expected to grow by 7%, surpassing pre-pandemic levels by the fourth quarter.

Change in employment by industry, 2021

000s



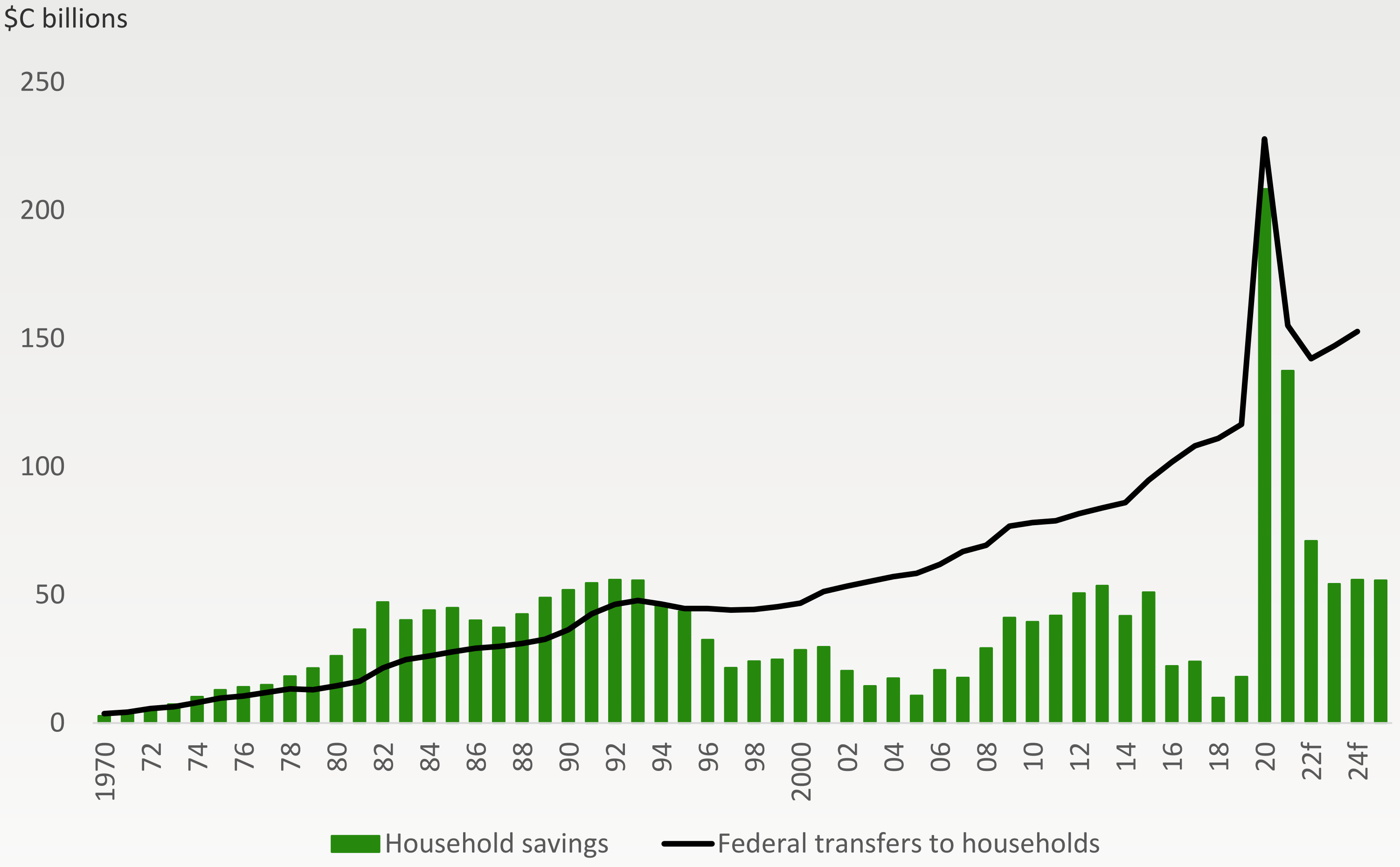
Sources: Statistics Canada, forecasts by Deloitte

Despite choppy labour market performance, household savings remain dramatic

With restrictions on activities and stores, and helped by a surge in government transfers, households saved an unprecedented $208 billion last year.

- The federal government routinely transfers a large amount of money to the household sector, the largest payments being child benefits, Employment Insurance, and Old Age Security. When the pandemic hit, it introduced a new temporary transfer, the Canada Emergency Response Benefit (CERB).
- CERB payments were generous enough that household disposable income increased by 10.4% in 2020 despite a 1.5% decline in labour income.
- This year, federal transfers will remain elevated while the labour market recovery accelerates, putting more money into Canadians' pockets. But public health restrictions over the first half of the year in many parts of the country dampened the ability of consumers to spend. Adding those factors together and this year will be another one of significant household savings.
- This savings stockpile will serve as one of the key drivers of economic growth in the second half of the year and into the next one as consumers tap their accounts to fulfill more than a year of pent-up desire for social activities.
- As Canadians spend, we expect to see the savings rate dip, from 14.5% in 2020 to an average of 4.9% in 2022.

Household savings and federal transfers



Sources: Statistics Canada, forecasts by Deloitte

Consumer spending set to surge thanks to pent-up demand and high savings

As Canadians treat themselves after more than a year of restricted life, consumer spending is expected to reach pre-pandemic levels in the third quarter.

- Consumer spending fell across all major categories last year except for non-durable goods, which benefited from a surge in food and alcohol consumption as restaurants remained closed for a large part of the year.
- Spending on durable goods will grow by 13.4% this year. This is already in the books, as the gains in the first half of 2021 have been very strong. The annual growth is tempered by an expected pullback in the second half of this year.
- Among the major spending categories, services such as personal care, accommodation, and food services suffered the largest decline in 2020. The rebound this year has been constrained by public health restrictions, but will accelerate sharply in the second half of this year and into 2022. We are expecting service-sector spending to increase by over 10% next year given that is where the pent-up demand has been building.
- The overall outlook for household spending is optimistic thanks to the significant accumulation of savings over the past year, the prospects for job growth, and the high level of consumer confidence. We expect to see a rotation in spending away from growth in housing and goods and into more service-sector activities.

Growth in real consumer spending

Sources: Statistics Canada, forecasts by Deloitte

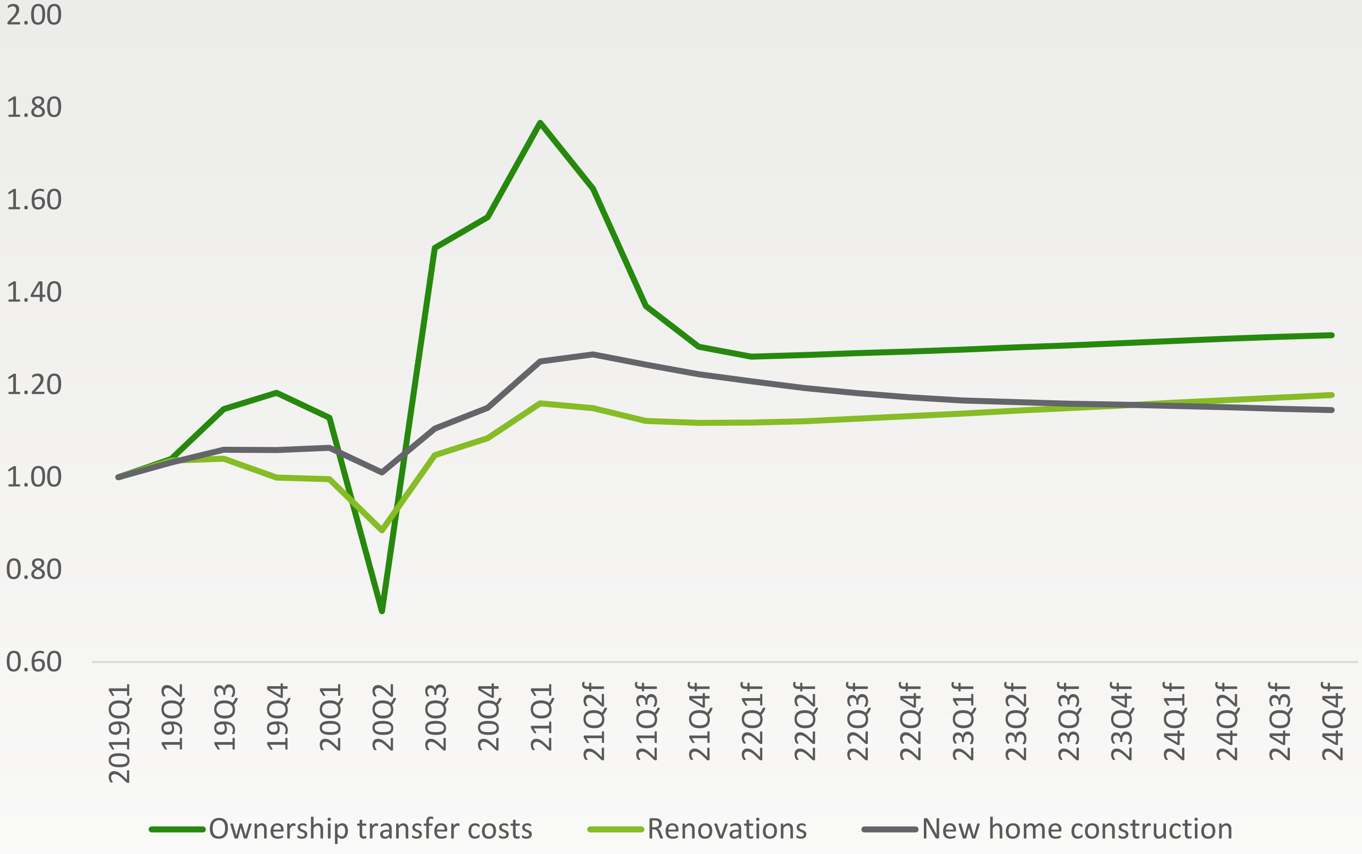
Housing market showing signs of cooling after exceptional growth

We've seen significant growth in all components of residential investment since the end of the first wave of the pandemic, led by housing ownership transfer costs.

- During the initial pandemic wave, there was a sharp decline in ownership transfer costs, which depend on resale market conditions and include real estate commissions, land transfer taxes, and legal and file review costs. However, the resale market was exceptionally hot in the fall and winter, driving a surge in this investment category.
- The number of homes being sold each month has fallen since peaking in March and, as such, we expect investment in ownership transfer costs to cool over the rest of the year.
- Strength in the resale market has had repercussions on other residential investment spending. Soaring home prices coupled with the need to create work-from-home spaces have enticed households to spend more on renovations. This spending is also expected to soften as the resale home market stabilizes.
- Strong housing demand has also encouraged new home construction. Housing starts increased last year despite the pandemic and are on track to increase by another 13.4% this year, to an average of 249,300 units across the country.

Residential investment by component

Index 2019Q1 = 1.0



Sources: Canadian Real Estate Association, forecasts by Deloitte

Canadian outlook
Business sector

Small increase in business investment expected as firms grapple with excess capacity

Companies slashed investment in 2020 and are only expected to increase their spending by a modest amount this year.

- After cutting investment by 11.4% last year, business investment is set to increase by only 4% in 2021 before rebounding by another 5.7% in 2022.
- Despite strong demand, many Canadian companies are operating at historically low levels of capacity, and this will serve to limit investment in the near term. The only sectors where capacity utilization is above its historical average is in forestry, non-energy mining, construction, and a handful of manufacturing sectors.
- Looking forward, energy investment will continue to be a source of weakness, especially when the Trans Mountain expansion pipeline, Coastal Gas pipeline, and LNG Canada finish construction.
- However, we should see better growth in non-energy investment due to strong demand from the United States and China. Business investment has been a chronic underperformer in Canada in recent years. We'll be closely watching its performance over the coming months for evidence that we are beginning to shift away from a consumer- and government-led recovery and more toward a business- and export-driven growth path.

	Capacity utilization 2021 Q1	Average capacity utilization 2000-2019
Forestry and logging	**89.0**	**84.8**
Oil and gas extraction	77.5	79.8
Mining excluding oil and gas and support services	**83.4**	**79.9**
Electric power generation, transmission and distribution	81.6	84.6
Construction	**92.4**	**87.9**
Food manufacturing	78.6	79.9
Wood product manufacturing	**85.1**	**82.1**
Paper manufacturing	86.3	88.4
Petroleum and coal products manufacturing	81.1	85.8
Chemical manufacturing	**79.9**	**79.2**
Plastics and rubber products manufacturing	72.5	79.9
Non-metallic mineral product manufacturing	67.1	77.3
Primary metal manufacturing	77.7	84.2
Fabricated metal product manufacturing	69.2	77.8
Machinery manufacturing	76.1	79.3
Computer and electronic product manufacturing	80.9	82.3
Electrical equipment, appliance and component manufacturing	**78.2**	**77.4**
Transportation equipment manufacturing	75.5	84.1

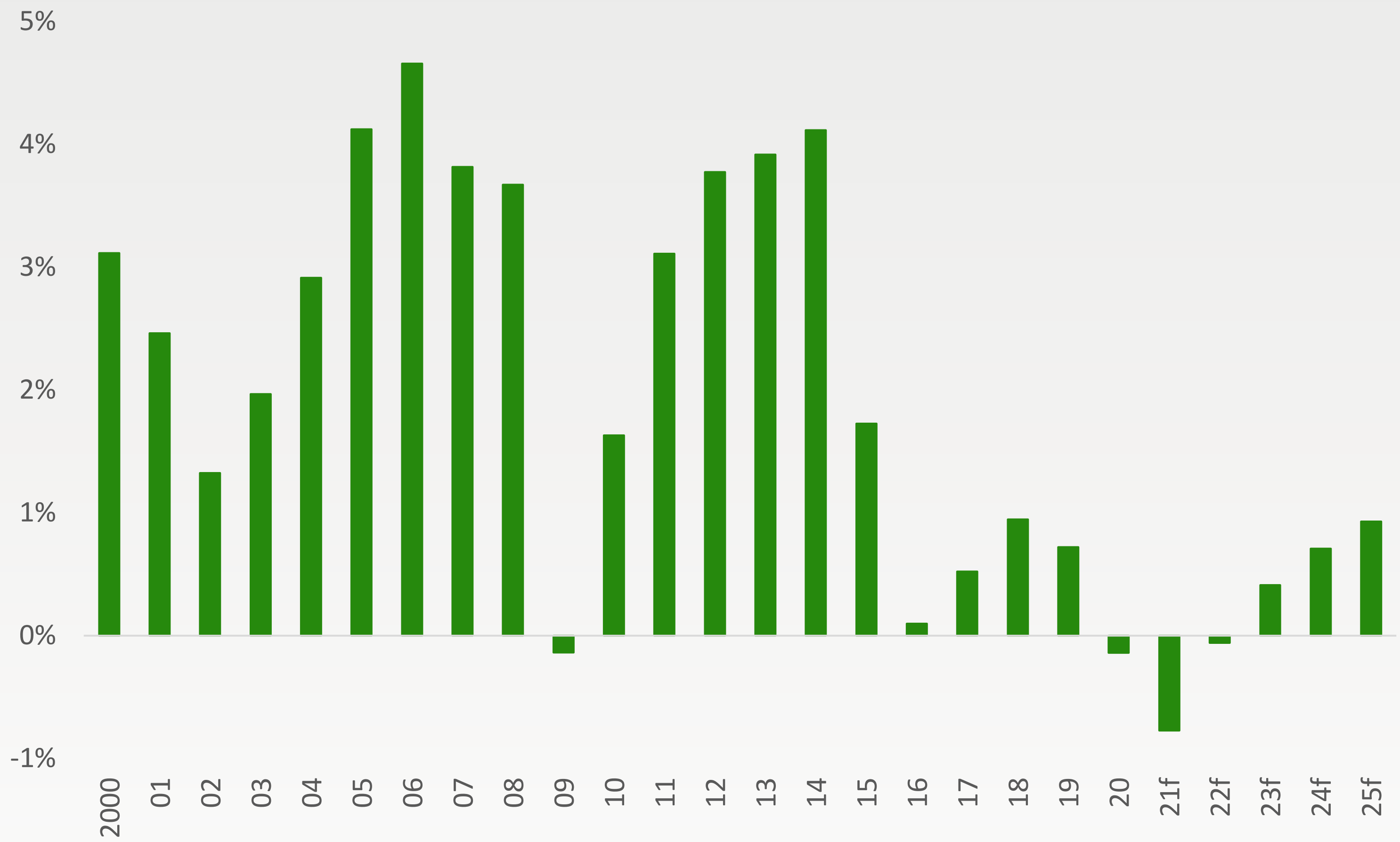
Source: Statistics Canada

Weak investment is leading to a decline in the amount of fixed capital in Canada

The value of fixed assets in Canada fell in 2020, and will continue to decline throughout the next two years.

- Before the commodity price crash in 2014, Canada's capital stock grew at a strong rate, thanks primarily to significant investment in the oil and gas industry.
- Since that time, investment levels have languished, which has limited gains in the capital stock. More recently, the large decline in investment during the pandemic is weighing on capital formation, a trend that will continue into next year.
- The amount of capital in an economy is one of three key factors that determines an economy's ability to grow in the long term. With growth in the capital stock expected to be negative or below 1% over the next few years, Canada's potential output growth will be limited to about 1.5% per year between now and 2025.

Fixed assets in the business sector, constant dollars



Sources: Statistics Canada, forecasts by Deloitte

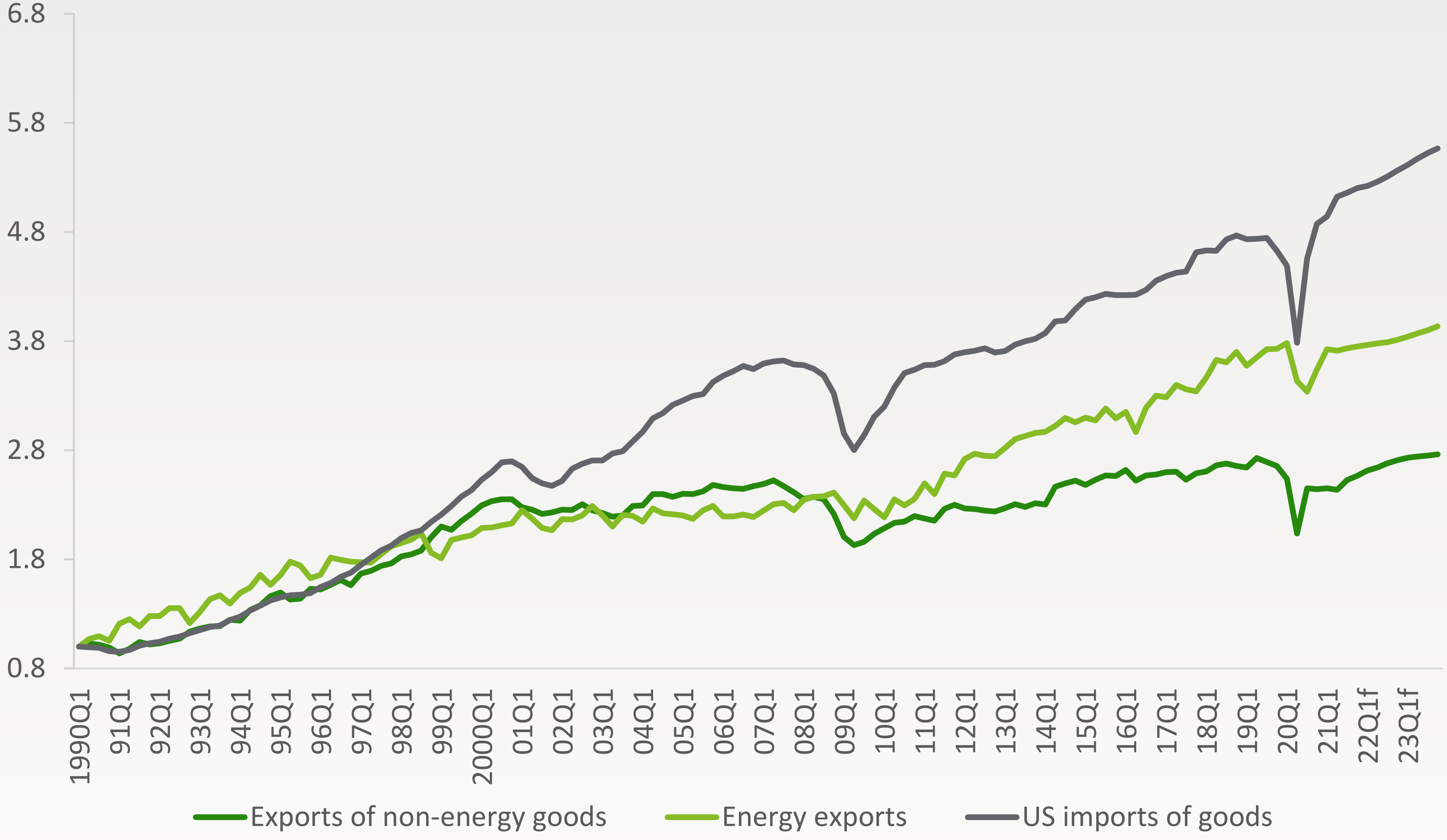
Soaring commodity prices rally Canada's trade surplus, but declining market share is a concern

Commodity exports are expected to continue to fuel merchandise trade this year. However, a lack of investment in the energy sector and a decline in US market share will restrain long-term growth.

- Canada recorded a $1.2 billion trade surplus in the first quarter of 2021 and started off the second quarter on solid footing, posting a $594 million trade surplus in April.
- The strong recovery in the United States and in many advanced economies is underpinning a strengthening in commodity prices, particularly for energy and forestry products.
- Fuelled by the global economic reopening, merchandise exports are expected to remain strong and grow by a further 13.5% in the third quarter.
- Both exports and imports of motor vehicles and parts will be constrained in the short term as the sectors contend with the semiconductor chip shortage that forced automakers to stop or reduce production in April.
- The longer-term outlook for the export sector is challenging. While the United States is seeing significant growth, it’s unclear how much market share Canada can retain in the long run since, beyond the energy sector, it has not seen much increase in exports despite rising US demand.
- With business investment remaining subdued, Canada’s export sector is facing slow growth prospects after its expected post-pandemic bump.

Exports of goods, US imports of goods

Index 1990Q1 = 1



Sources: Statistics Canada, forecasts by Deloitte

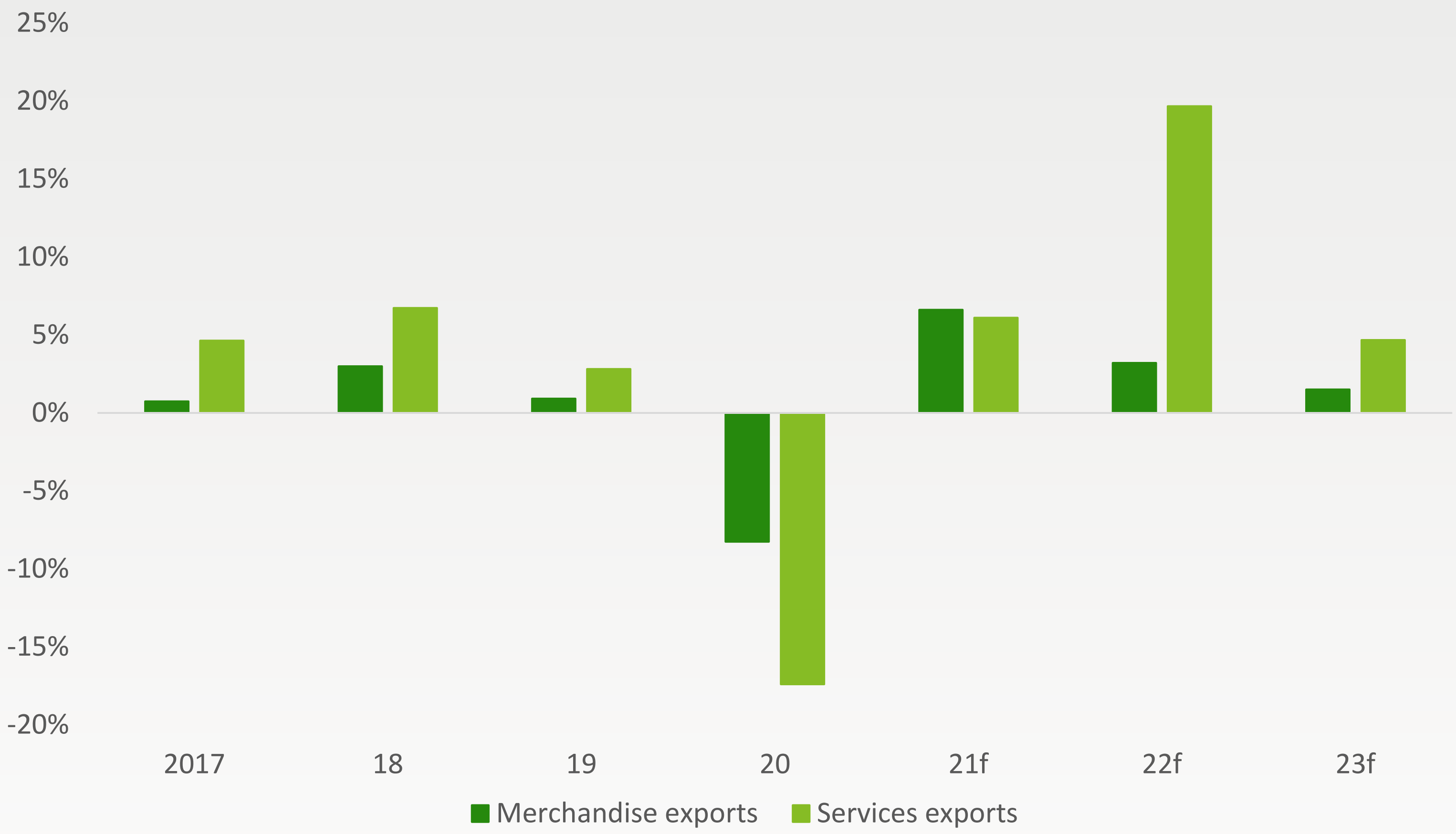
Services exports are still stalled, but set to grow as Canada reopens

More stringent health-related guidelines following the third wave of the pandemic have further devastated Canadian service exports.

- Exports of services continue to be hammered by the pandemic, with Canada's service trade deficit at $226 million in April 2021.
- Due to ongoing quarantine restrictions and other travel guidelines, exports of travel services are still far below 2019 levels.
- Similarly, exports of transportation services, which are tied to the travel sector, are also lagging.
- However, as the economy reopens and global case counts continue to recede, the recovery in travel service exports will begin to accelerate, with output in 2022 set to more than double the level of activity observed in 2021.
- This recovery will help to push up total service exports by nearly 20% next year.

Exports of goods and services

% change



Sources: Statistics Canada, forecasts by Deloitte

Canadian outlook
Monetary and fiscal policy

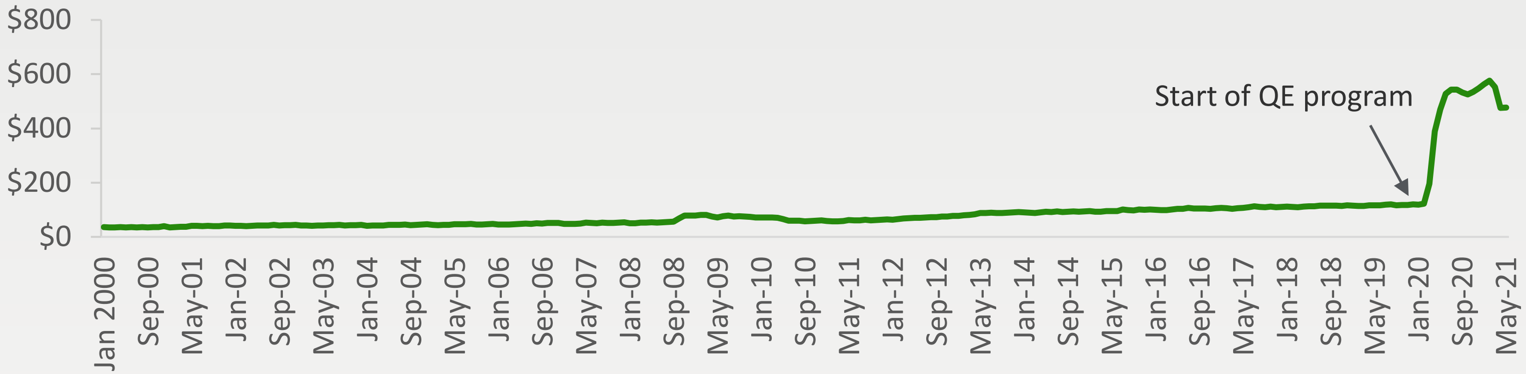
Monetary policy will remain accommodative even with the economic recovery well underway

With its policy interest rate still at the effective lower bound and no plan to raise it this year, the Bank of Canada is maintaining its quantitative easing (QE) program and its forward guidance to markets.

- The Bank of Canada's QE program continues with purchases of $3 billion per week, although we expect the bank to reduce the program as the recovery continues.
- The Bank of Canada's three measures of core inflation all point to rising price pressures. Total CPI inflation is currently above the upper half of the 1-3 % target band but, according to the bank, it is likely to move back toward 2% in the next few months. That's because this level is being influenced by base-year effects, since prices are being compared to April 2020, when the economy was at its lowest pandemic point. The bank is waiting for inflation to be consistently above target before raising its policy interest rate. Our forecast expects the first hike to happen at the beginning of the fourth quarter of 2022.
- Our forecast currently suggests the path of policy interest rates will be similar in the United States and in Canada. However, given that the Federal Reserve changed its inflation target last year to average-inflation targeting, there is a chance it will be slower in raising rates, despite the increase in inflation south of the border. With the revision of its monetary policy framework coming later this year, there is also a possibility that the Bank of Canada may adjust its policy target, such as having a dual mandate of low inflation and low unemployment or average inflation targeting.

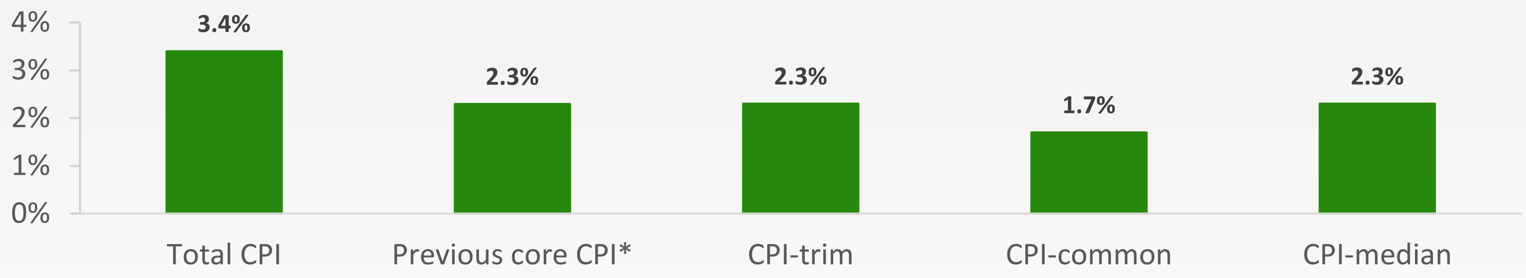
Bank of Canada assets

$C billions



Measures of Canadian inflation

April 2021, year-over-year growth



* CPI less 8 most volatile components and indirect taxes

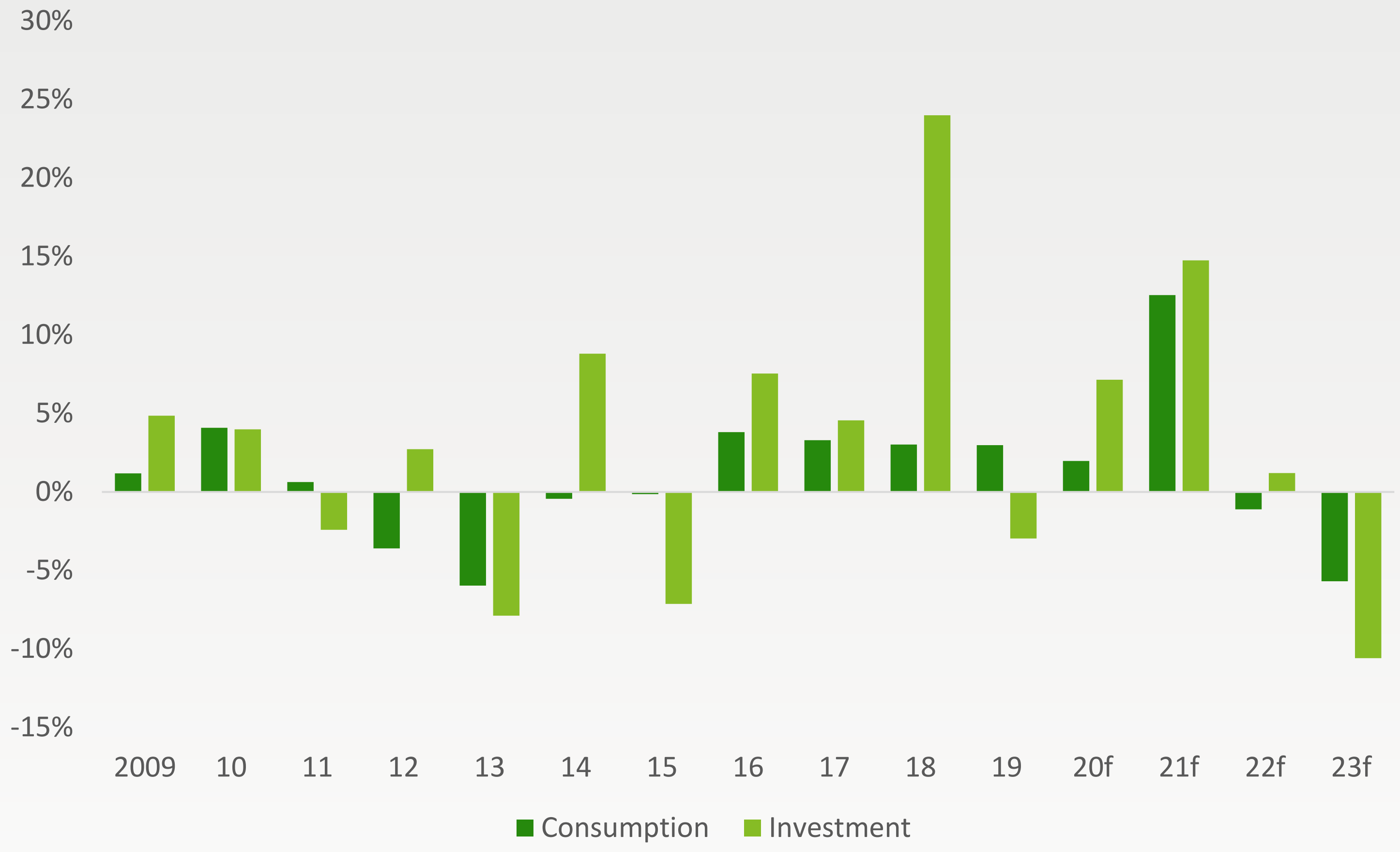
Sources: Statistics Canada, forecasts by Deloitte

The federal government is set to unleash significant stimulus

In addition to the increase in transfers to households noted earlier, the most recent federal budget included a massive stimulus plan to support the economic recovery.

- The 2021 federal budget pledged federal spending growth on investment and goods and services far greater than what was observed after the 2008-09 financial crisis.
- The budget revealed increased spending on a wide range of initiatives, including support for a system of affordable early childhood education, increased funding for post-secondary students, enhancements to Old Age Security and the Canada Workers Benefit, and investments in digital infrastructure and transit, just to name a few.
- Overall, these measures will help boost real federal investment spending by 14.7% this year and its spending on goods and services by 12.5%.
- While spending levels will remain elevated throughout the near term, they are expected to recede from the 2021 high in the near term; the most significant drop will be in 2023.
- This decline in spending in 2023 will soften overall economic gains that year, although other sectors of the economy will be strong enough by that point that the economy will only experience a modest slowdown as the federal stimulus is slowly withdrawn.

Real federal spending growth



Sources: Statistics Canada, forecasts by Deloitte

Forecast risks

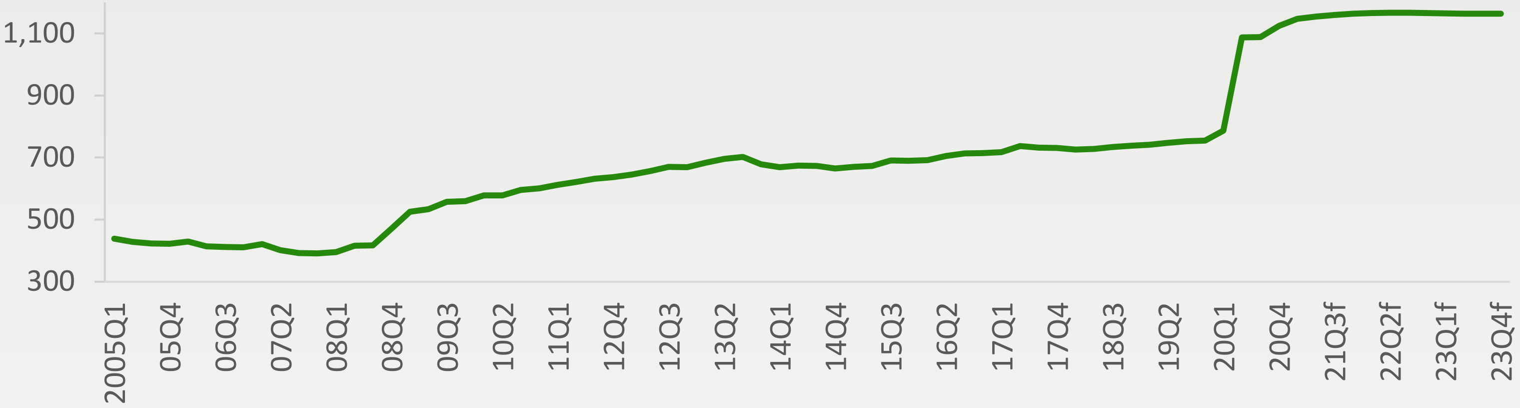
High debt levels leave the economy vulnerable to future shocks

While the pandemic remains the key risk in the near-term outlook, high levels of debt are the most significant risk to our long-term economic fortunes.

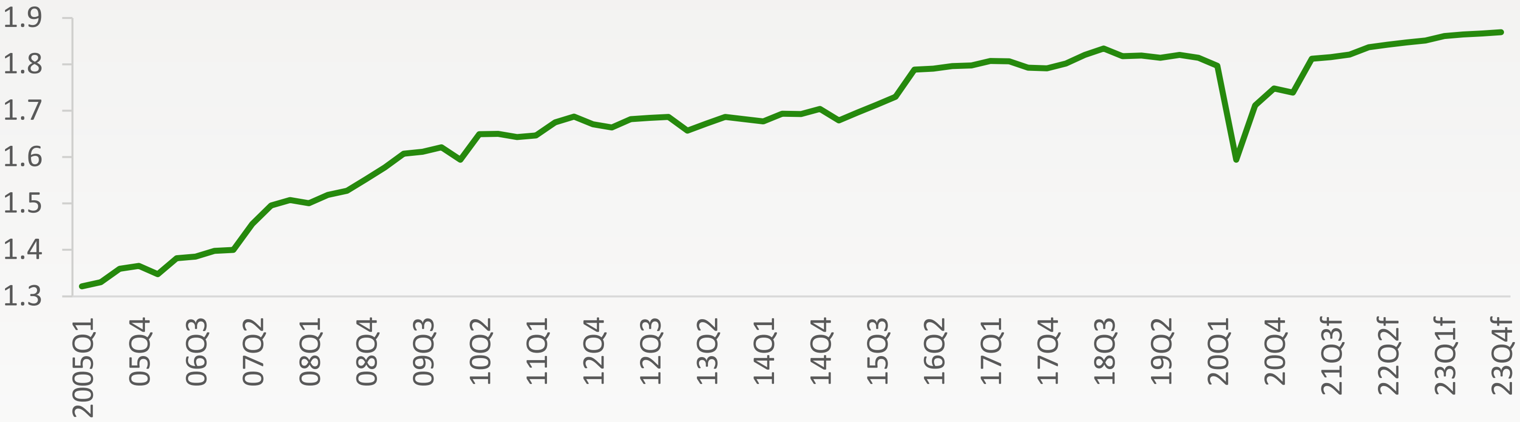
- There is no doubt that the swift action of the federal government to aid households and businesses ensured the economic decline caused by the pandemic was not larger than what we experienced.
- However, that massive support came with a cost: federal debt skyrocketed. Interest rates are currently very low, making that debt affordable, but they will continue to rise from their record lows. As a result, federal debt-servicing costs in 2025 will be nearly double what they were in 2020. By 2030, they are expected to increase 2.3 times relative to 2020.
- The federal transfers that boosted household income growth, combined with restrictions that limited consumers' ability to spend, had a positive impact on the household-debt-to-income ratio last year.
- However, this improvement will be short-lived because households have been racking up mortgage debt, and income growth will slow after being propped up by government transfers.
- With households and governments supporting the recovery, these high levels of debt and what they mean for the sustainability of spending are key risks to our outlook.

Federal net debt

$C billions



Ratio of household debt to disposable income



Sources: Statistics Canada, forecasts by Deloitte

Top 10 risks to monitor

The base-case economic outlook is positive, but there are many potential risks

Health risks: Vaccination against COVID-19 is reducing risk, particularly in advanced economies. However, many emerging market economies are still facing significant health risks and vaccination will take considerable time. This can create headwinds for economic growth, and the risk of vaccine-resistant variants will persist until global levels of vaccination improve.

Inflation: Central banks and governments have massively increased money supply, with monetary authorities arguing that the recent rise in inflation is temporary. However, if the circulation of money (i.e., velocity) accelerates or wage pressures from labour shortages increase, the possibility of an inflation shock cannot be ruled out.

Business debt: Many businesses have been kept afloat by cheap credit and government support programs. This raises the possibility that many zombie businesses--effectively insolvent companies that don't close—have been created. As government support programs end and interest rates rise, the economic scars from the recession may become apparent, with an accompanying increase in insolvency and bankruptcy.

Government debt: In the wake of the 2008-09 financial crisis, a fiscal crisis started in Greece that spread to several other European countries. Given the dramatic deficits governments around the world are running due to their pandemic response efforts, it's likely that financial markets will worry about the capacity of some countries to meet their financial obligations. As the European crisis a decade ago proves, this sort of concern can quickly spread once fiscal risk becomes a financial market focus.

Increased taxation: Related to the fiscal risks, governments will need to find a way to rebalance fiscal policy during the recovery. It's likely that higher personal and business taxes will be part of the governmental rebalancing efforts. The G-7's desire to implement a global minimum corporate tax is just an example of the tax risks.

Increased business concentration: Large companies have gained market share during the pandemic, which hit smaller firms harder. This increased business concentration could lead governments to implement changes to competition policy.

Reshoring and industrial policy: The pandemic disrupted supply chains and led to a dramatic increase in the role of government. As the pandemic wanes, governments appear to be increasingly enamoured with industrial policy and a desire to have essential products manufactured domestically. While deglobalization is unlikely, industrial policy runs the risk of weakening the role of market prices for resource allocation and investment. There may be some economic gains from this, but the history of industrial policy shows it can create a lot of risk as well.

ESG and transition to low-carbon future: There is a strong trend toward factoring environmental, social, and governance issues into business decisions and government policy. The objectives of ESG considerations are clearly desirable, but they can create considerable economic disruption.

Residential real-estate boom and related household debt: Particularly in Canada, the housing boom and rising household borrowing remains a key concern.

Geopolitical tensions: Despite the change in leadership in the United States, friction between that country and China continues to pose global risks.

Concluding remarks

Concluding remarks

Despite some pressing concerns around debt levels and weak business investment, the overall economic outlook for Canada in the near term is unequivocally positive. The vaccination campaign has ramped up significantly in recent weeks: in the week from June 8 to June 14, Canada administered an average of about 424,000 vaccines a day. Progress on inoculation combined with strict public health measures have resulted in a steep drop in new COVID-19 cases and have allowed provinces to move forward with their reopening plans.

Since the start of the pandemic, getting the public health situation under control has been the key to a true recovery. With such significant progress on that front, we can look forward to a summer and autumn of strong economic growth. The reopening also means that sectors of the economy that have largely been left behind—such as those in the hospitality industry—will realize strong gains. A recovery in these sectors should also help to even out the inequality in employment outcomes we've seen thus far, given that these industries employ many women and younger Canadians.

Taken together, we can expect the second half of 2021 to bring stronger and more equal economic growth. This is certainly something to look forward to as we head into summer.

Appendix

Key economic indicators

	2020	2021				2022				20A	21F	22F
	Q4A	Q1A	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F			
Real economic activity												
Gross domestic product	9.3	5.6	3.3	10.5	5.5	4.1	1.7	1.9	1.3	-5.3	6.7	4.1
Consumption expenditure	2.5	3.4	5.9	8.5	6.4	5.0	2.9	2.6	2.3	-4.4	5.9	4.9
• Durable goods	-1.3	5.9	-2.4	-0.7	-0.2	1.1	2.0	1.5	1.6	-3.3	13.4	0.6
• Services	1.3	0.9	9.1	22.3	14.8	10.9	6.7	4.9	4.5	-10.3	4.9	10.8
Residential investment	16.9	43.3	-8.7	-21.7	-9.5	-3.6	-1.4	-0.7	-0.3	4.1	16.3	-6.6
Non-residential fixed investment	5.9	-2.7	10.7	10.5	7.3	3.7	4.3	4.2	4.5	-13.6	1.1	5.8
• Non-residential structures	-6.3	2.5	9.7	11.2	7.5	3.6	4.6	4.3	4.5	-11.3	-2.6	5.9
• Machinery & equipment	28.1	-10.2	12.4	9.3	7.0	3.7	3.9	4.2	4.5	-17.4	7.3	5.7
Government consumption & investment	6.1	5.8	8.4	2.7	3.5	1.6	-1.0	-0.7	-1.9	0.4	6.4	1.5
Exports of goods & services	4.1	6.0	-2.3	12.7	5.0	6.3	3.8	5.1	3.7	-10.0	5.5	5.5
Imports of goods & services	11.6	4.3	4.4	6.6	7.1	7.5	5.7	5.7	5.6	-11.2	8.2	6.4
Prices												
Consumer price index (y/y)	0.8	1.5	3.2	3.0	3.1	2.7	2.0	2.1	2.4	0.8	3.1	2.4
Implicit GDP price index (y/y)	1.9	6.0	7.5	5.8	4.6	2.0	1.7	1.5	1.9	1.9	4.6	1.9
Labour market												
Employment	9.9	1.0	1.7	9.9	3.5	2.4	1.4	0.8	0.8	-5.1	4.8	3.0
Unemployment rate (%)	8.8	8.4	8.2	7.4	6.8	6.6	6.4	6.4	6.4	9.6	7.7	6.4

Note: Unless otherwise noted, all figures are expressed as annualized % changes.
Sources: Statistics Canada, Bank of Canada. Forecast by Deloitte Economic Advisory, as of June 15, 2021.

Financial market indicators

	2020	2021				2022				20A	21F	22F
	Q4A	Q1A	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F			
Interest rates (%)												
Overnight rate target	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.25	0.25	0.50
3-month T-bill	0.10	0.08	0.14	0.15	0.17	0.18	0.19	0.19	0.45	0.10	0.17	0.45
1-year GoC note	0.17	0.14	0.31	0.37	0.43	0.46	0.49	0.50	0.77	0.17	0.43	0.77
2-year GoC note	0.24	0.20	0.27	0.29	0.32	0.33	0.35	0.36	0.56	0.24	0.32	0.56
5-year GoC note	0.41	0.71	0.74	0.75	0.75	0.76	0.76	0.76	0.91	0.41	0.75	0.91
10-year GoC bond	0.66	1.22	1.24	1.22	1.21	1.20	1.19	1.18	1.29	0.66	1.21	1.29
Yield curve spread (pp)												
3-month vs. 10-year	0.56	1.15	1.10	1.07	1.04	1.02	1.00	0.99	0.84	0.56	1.04	0.84
2-year vs. 10-year	0.43	1.02	0.97	0.93	0.89	0.86	0.84	0.81	0.73	0.43	0.89	0.73
Foreign exchange												
USD/CAD ($C)	1.30	1.27	1.24	1.24	1.25	1.25	1.25	1.25	1.24	1.30	1.25	1.24
CAD/USD (US cents)	0.77	0.79	0.81	0.80	0.80	0.80	0.80	0.80	0.81	0.77	0.80	0.81

Sources: Statistics Canada, Bank of Canada. Forecast by Deloitte Economic Advisory, as of June 15, 2021.

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