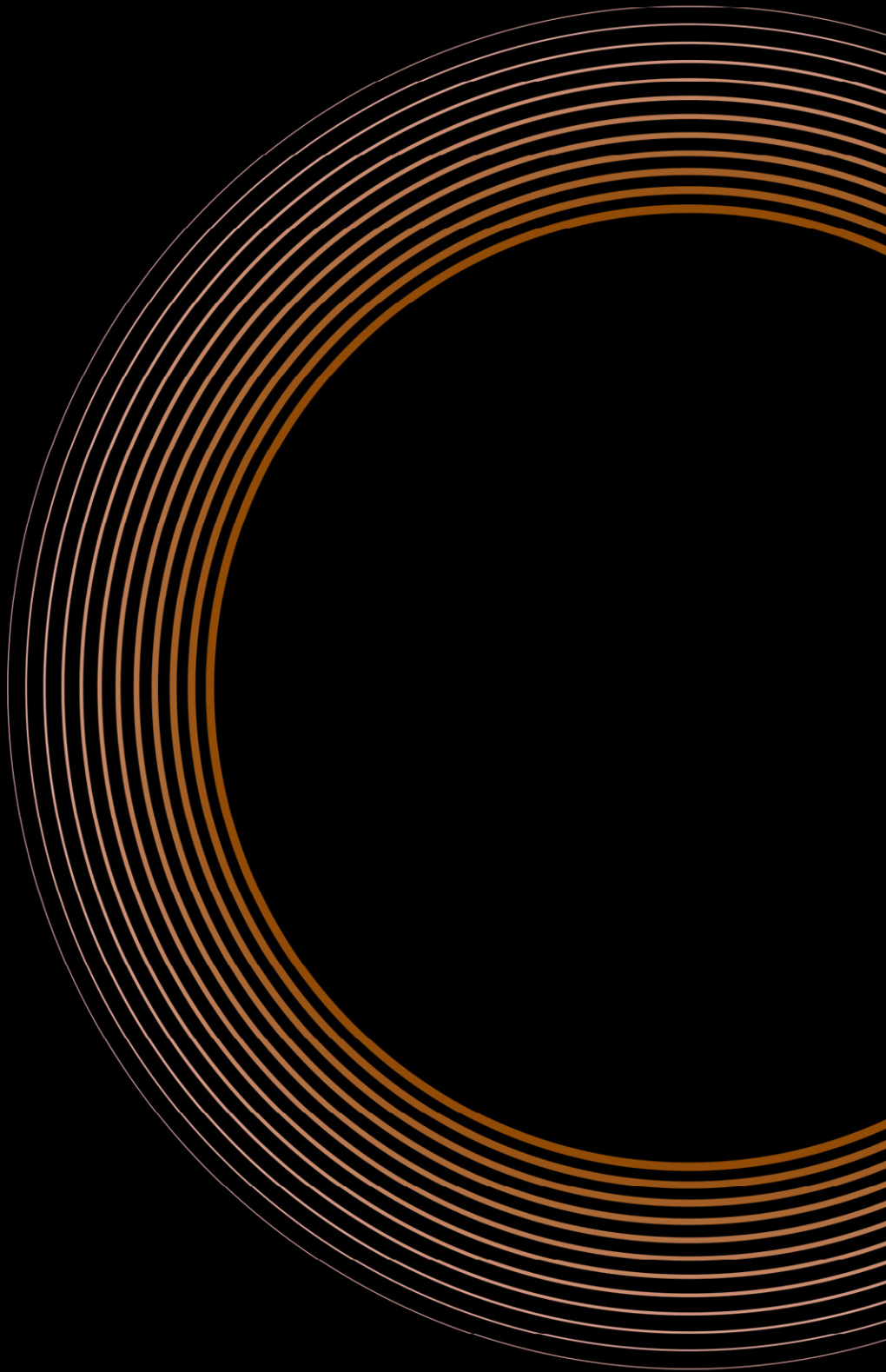
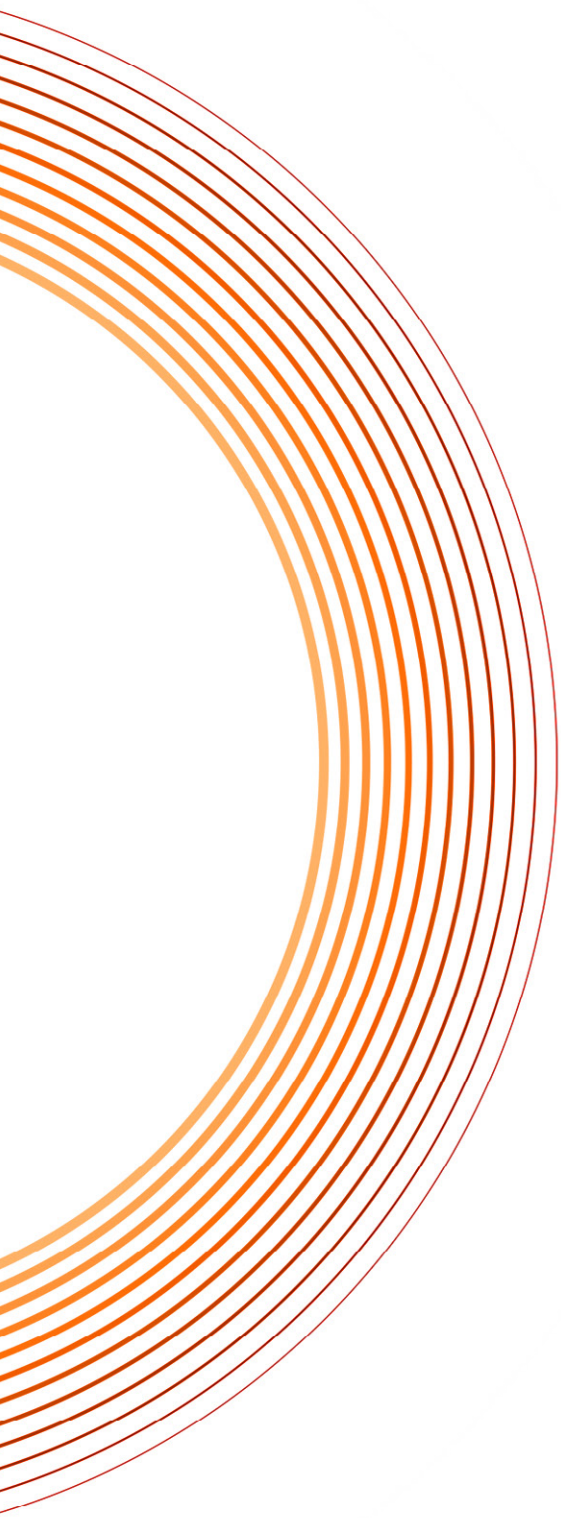




**Canadian economy battered by
global pandemic and oil price slump**
Economic outlook: March 2020





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Overview

The fallout of the COVID-19 pandemic and all of its associated economic and financial disruptions are expected to cause the Canadian economy to falter.

The fallout of the COVID-19 pandemic and all of its associated economic and financial disruptions are expected to cause the Canadian economy to falter. The economy is tracking a small decline in the first quarter. We expect a significant contraction in the second quarter, with the weakness fading in the third quarter.

However, it is critical to understand that COVID-19 will eventually pass. The virus will eventually burn itself out, just as outbreaks in the past have done so, setting the stage for a rebound in economic activity later in 2020 and into 2021.

In the near term, the decline in economic activity will be a function of weaker global demand, lower commodity prices, and restrictions on the movement of goods and people. But, psychology is playing a big role. At the time of writing this, fear is dominating the behavior of investors and people—and this only makes things worse.

That is not to suggest being complacent. It is important to contain the pandemic and it is critical to protect the wellbeing of people. The best advice is to heed the guidance of medical officials—they know best. However, do not overreact. There is a lot of false or misguided information floating about.

Our base case forecast is for the Canadian economy to experience a 0.2 percent decline in real GDP this year, concentrated in the second quarter.

The degree of economic weakness is tempered by the coordinated effort across many governments and central banks to provide fiscal and monetary stimulus. The Bank of Canada is expected to cut a further 50 basis points, lowering the overnight rate to 0.25 percent. The federal government has announced funding to address the direct impact of COVID-19 and measures to help support funding for businesses.

The upcoming Federal Fiscal Update will also have economic stimulus. Provincial governments will also respond, but will be constrained by fiscal pressures. The policy measures cannot fully offset all of the economic weakness, but they can help mitigate some of the downside risk and they can have a positive psychological impact.

As COVID-19 is contained, with the number of active cases diminishing, and as the impact of stimulus is felt, we look for a rebound of economic growth later this year and through 2021.

How should businesses respond? First and foremost, businesses need to address the risks, putting their people first. Second, management actions will be needed to navigate through the difficult economic times and create business continuity. This can include managing the disruption to supply chains, cash flows, and liquidity. Then there is the opportunity to learn from the crisis and implement decisions that will make the business stronger, such as improved work flexibility or key investments. Finally, business leaders need to prepare for the eventual economic rebound that could be months or a few quarters away. Again, the economic weakness is a valley and the key focus is to support people and manage business through to the other side of that valley.

Real GDP Growth; Canada



Note: LT denotes the long-term or equilibrium rate of growth of the economy, currently estimated to be approximately 1.7%.
Source: Statistics Canada. Forecast by Deloitte Economic Advisory, as of March 2020.

Context

Canadian economic growth slowed in late 2019, with the economy posting a very modest 0.3 percent annualized gain in the final three months of last year. However, things were looking up. The US and China had reached a trade agreement that would halt the escalation of the tariff war that was jeopardizing global economic activity. The UK negotiated and successfully legislated the terms of an exit from the EU, avoiding the hard BREXIT that would have been very damaging to the European economy. Indeed, the Deloitte forecast was that global and Canadian economic growth would improve in 2020.

That all changed with news in January of the outbreak of COVID-19 in China. The dramatic efforts at containment were bound to have significant global economic and financial effects. A weaker Chinese economy lowered demand and depressed prices of commodities. Trade flows with China were disrupted, but this then had knock-on effects through global supply chains. In mid-February, the number of net new cases in China were falling. As a result, we expected the bulk of the blow to global economic growth to be felt in the first quarter of 2020, but a rebound was anticipated in the second quarter. In Canada, rail blockages would also take an economic toll in early-2020.

Then, matters deteriorated greatly. Although containment was working in China, the number of cases outside of China jumped higher—particularly in countries like Italy, South Korea, and Iran. With the economic disruption likely to last longer, financial markets increasingly priced in the possibility of a global recession. Equity prices plunged precipitously and money fled to bonds, lowering bond yields to record lows. As the

financial distress persisted, there has been a move to the safety of cash, the US dollar, and to a lesser extent gold.

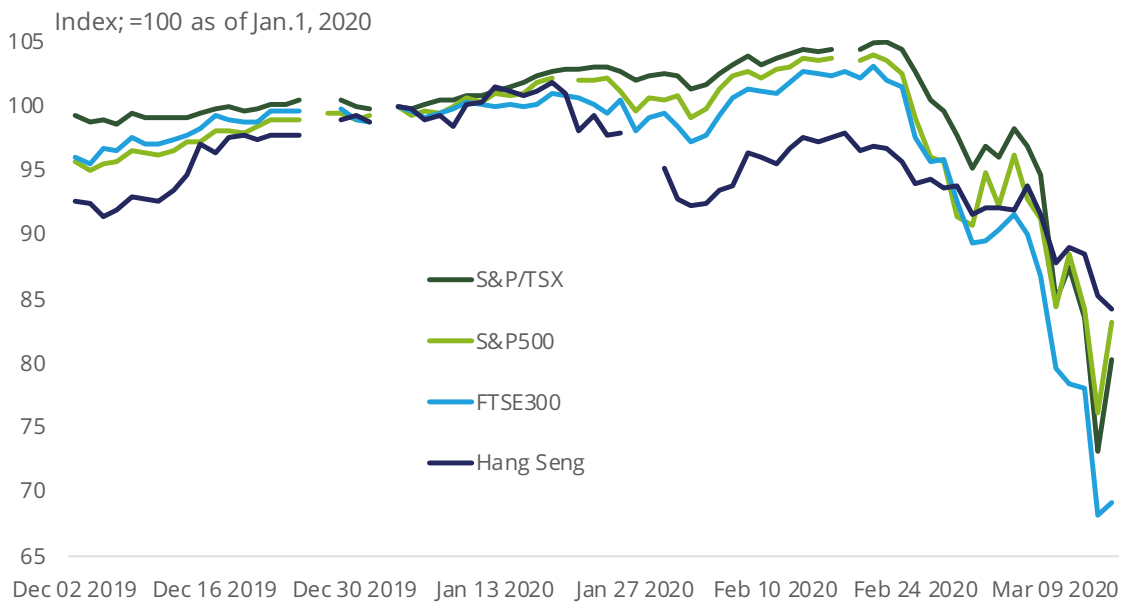
Financial markets were further roiled by a disagreement during the recent OPEC meeting. Saudi Arabia had wanted an agreement to reduce supply to support oil prices, which had fallen from US\$60 a barrel on the West Texas Intermediate (WT) benchmark at the start of the year to around US\$45 prior to the meeting. Over the past three years, Russia—which is not an OPEC member—had attended the meetings and committed to coordinate supply with the oil cartel. At this meeting, however, Russia refused to agree to an oil production reduction. This was viewed as an effort to protect its share of the global oil market, which has been reduced in recent years by the rise of US shale oil supply. Due to the disagreement, Saudi Arabia announced that it would increase oil supply causing a plunge in oil prices.

The international community responded quickly amid growing economic and financial risks with the G7 agreeing to coordinate efforts to support the global economy. The Federal Reserve slashed the fed funds rate to zero and restarted its crisis-era bond-buying program, aimed at purchasing \$700 billion in longer-dated US Treasury debt. The Bank of Canada, the Bank of England and many other central banks also injected additional stimulus and extended emergency lending facilities aimed at ensuring liquidity in money markets and access to US dollar funding. Governments across the globe have also started to launch measures to combat the outbreak, limit contagion, as well as to stimulate growth.

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Global Stock Markets; Price Indices



Source: TSX, FT, NYT, HSI



Canada

It is especially difficult to forecast economic activity in a pandemic. Economists are not epidemiologists, so we do not know how long the pandemic will last nor how far it will spread. Our base case assumption is also that the COVID-19 will eventually burn itself out. We have assumed that happens in the summer.

The Canadian economy will be negatively impacted by lower commodity prices and lower exports due to the global weakness. Business investment will also be deterred by the weaker demand and lower commodity prices but also by poor business confidence and by the distress in financial markets. Although consumer spending will be boosted by hoarding activity in March, it will ultimately be curtailed by less willingness to go to malls, restaurants, and other public places. Employment and personal income will be affected by reduced hiring and by labour disruptions caused by efforts to contain the spread of the virus. The negative wealth effects from the correction in equity markets could also dampen spending, as will lower consumer confidence. Inventories are a bit of a wild card, as they could be diminished by difficulty importing from abroad or by hoarding, but they could also increase as demand and sales wane. Profits are projected to drop sharply in 2020. The main point is that there will be broad-based economic weakness.

On the plus side, policymakers have responded and will likely do more in the months ahead. The Bank of Canada has cut its policy rate by one percentage point, and we expect another half point easing taking the overnight rate down to 0.25 percent—

an all-time low. While this is supportive to economic growth, the ability of monetary policy to address the economic weakness is limited due to the nature of the current health crisis. The pandemic is creating both a supply and demand shock, and that means fiscal policy may be more impactful in this environment. A sustained weak Canadian dollar will help export competitiveness, but it won't address weak global demand.

We have factored the expected economic weakness and the monetary and fiscal stimulus into the forecast tables at the back of this publication. The profile is for a weak first quarter of 2020, our tracking is for an annualized -0.5 percent decline in the first quarter, followed by a 3.5 percent correction in the second quarter. The weakness will persist into the third quarter but will be diminishing. Then, we expect to see a rebound in economic growth.

Businesses and Canadians are facing at least a couple of tough quarters. The most vulnerable sectors are energy, mining, hospitality, tourism, and transportation. Automotive and real estate are also expected to experience significantly weaker sales. The health care sector will experience an increase in demand for its services, but this can create its own challenges if there are inadequate resources.

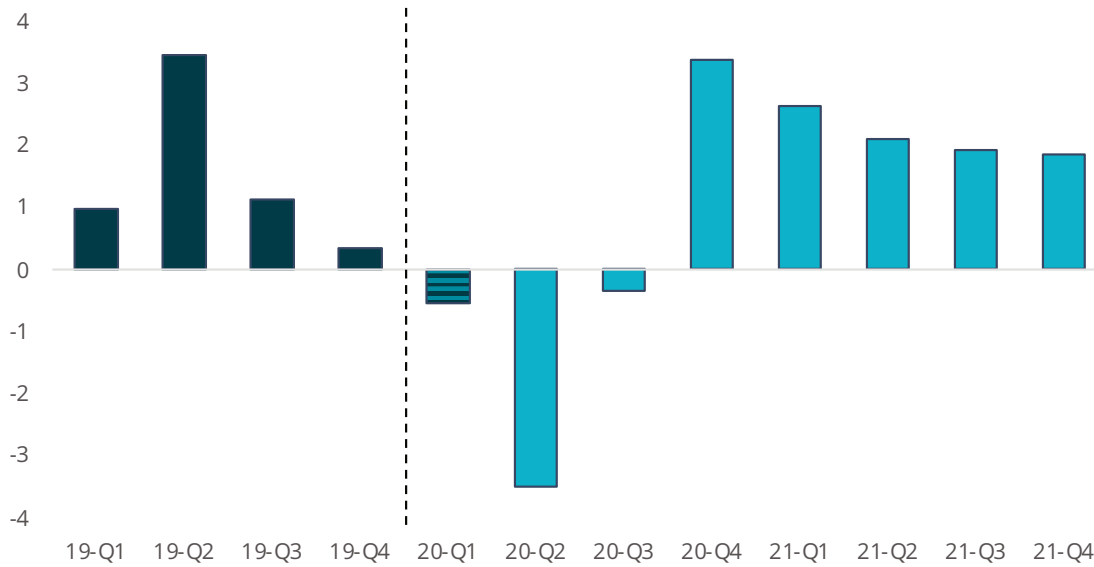
The provinces of Alberta and Newfoundland and Labrador are particularly vulnerable to the drop in oil prices, with the latter also facing a dire fiscal situation. BC is more exposed than other provinces to the economic disruption in Asia. However, all provinces will be impacted by weaker

demand for their exports, softer consumer spending, lower business investment, and reduced tourism. A key question is how weak the US economy becomes, since Canadian provinces do more north-south trade than east-west. The US had more momentum than its peers, but the number of US cases are climbing and containment will likely lead to an economic slump. So, the Canadian economic weakness will be felt from coast-to-coast.

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Real GDP; Canada

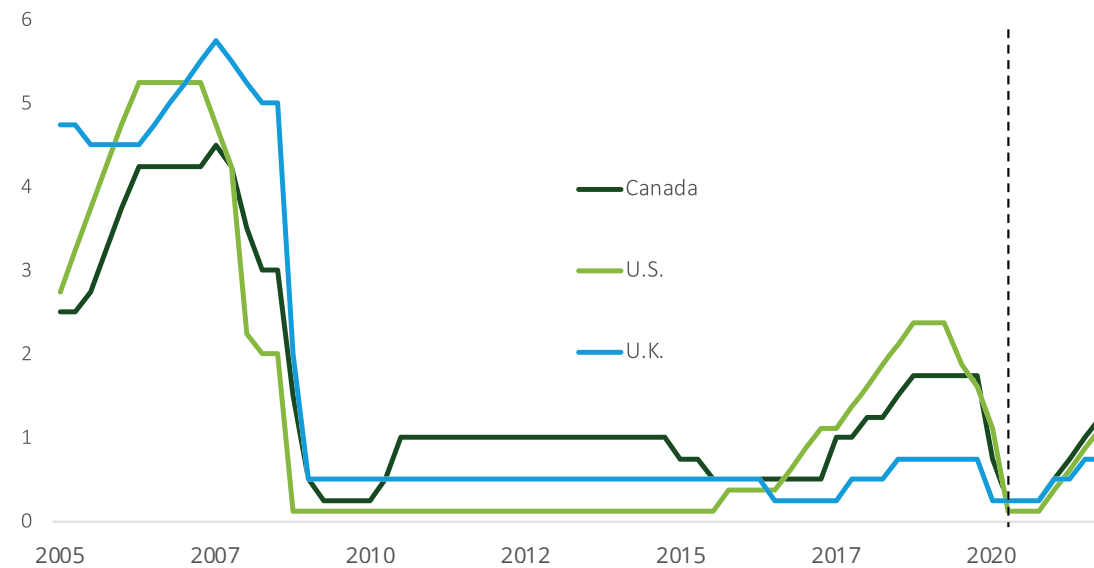
q/q % ann. chng.



Source: Statistics Canada. Forecast by Deloitte Economic Advisory, as of March 2020.

Central Bank Policy Rates

Percent



Source: Bank of Canada, Federal Reserve Board, Bank of England. Forecast by Deloitte Economic Advisory, as of March 2020.

Canada: Economic forecast

	2019				2020			
	Q1A	Q2A	Q3A	Q4E	Q1F	Q2F	Q3F	Q4F
Real economic activity								
Gross domestic product	1.0	3.4	1.1	0.3	-0.5	-3.5	-0.3	3.4
Consumption expenditure	2.4	0.4	2.0	1.9	1.1	0.0	0.5	2.4
• Durable goods	4.8	-2.6	1.4	-0.2	1.1	-0.8	0.7	2.1
• Services	2.4	1.0	2.3	3.4	0.7	-0.5	0.4	2.8
Residential investment	-3.1	6.4	13.0	1.1	-2.9	-4.1	2.1	4.2
Non-residential fixed investment	5.5	-1.4	8.3	-3.1	-1.8	-6.5	-3.7	3.2
• Non-residential structures	4.4	4.3	11.2	-1.7	-2.1	-9.6	-8.7	1.8
• Machinery & equipment	42.7	-23.2	-2.6	-13.5	-0.2	-7.5	-6.8	3.5
Government consumption & investment	2.8	0.7	2.1	0.5	2.4	2.7	2.2	2.0
Exports of goods & services	-4.0	10.6	-0.6	-5.1	-3.7	-6.4	-0.7	2.6
Imports of goods & services	8.3	-4.1	-0.2	-2.5	-1.3	-0.2	1.5	2.3
Prices								
Consumer price index (y/y)	1.7	2.2	1.9	2.1	2.0	1.3	1.4	1.5
Implicit GDP price index	4.5	4.5	0.4	4.1	1.1	-2.1	2.1	2.2
Nominal income								
Gross domestic income	5.7	8.2	1.3	4.5	0.6	-5.6	1.8	5.6
Personal income (y/y)	3.5	4.7	4.5	4.4	3.1	0.2	-0.1	-0.2
Corporate profits; pre-tax (y/y)	-13.9	-9.0	-17.9	2.4	4.3	-18.6	-7.5	3.9
Labour market								
Employment	3.0	2.6	1.1	0.5	1.1	-0.8	0.4	0.9
Unemployment rate (%)	5.8	5.6	5.6	5.7	5.6	6.2	6.3	6.1

	2021				19E	20F	21F
	Q1F	Q2F	Q3F	Q4F			
Real economic activity							
Gross domestic product	2.6	2.1	1.9	1.8	1.6	-0.2	1.8
Consumption expenditure	2.2	2.0	1.9	1.8	1.6	1.1	1.8
• Durable goods	1.9	1.7	1.6	1.5	0.6	0.3	1.5
• Services	2.4	2.2	2.1	2.0	2.1	1.3	1.9
Residential investment	3.7	2.9	1.7	1.7	-0.6	1.1	2.6
Non-residential fixed investment	3.1	2.9	2.4	2.4	-0.7	-1.7	1.4
• Non-residential structures	2.4	2.6	2.7	2.9	0.9	-2.1	0.1
• Machinery & equipment	2.4	2.8	2.7	2.5	-1.4	-6.7	0.9
Government consumption & investment	1.7	1.7	1.6	1.6	1.6	1.9	1.9
Exports of goods & services	2.3	1.8	2.0	2.2	1.2	-2.5	1.3
Imports of goods & services	1.9	1.8	2.0	2.2	0.3	-0.8	1.8
Prices							
Consumer price index (y/y)	1.7	2.0	2.0	2.0	2.0	1.6	1.9
Implicit GDP price index	2.1	2.0	1.9	1.8	1.9	1.3	1.8
Nominal income							
Gross domestic income	4.7	4.1	3.8	3.6	3.6	1.1	3.5
Personal income (y/y)	0.8	3.0	3.8	3.7	4.3	0.7	2.8
Corporate profits; pre-tax (y/y)	7.7	29.1	28.5	19.6	-10.2	-4.8	20.8
Labour market							
Employment	0.7	0.6	0.6	0.6	2.1	0.6	0.6
Unemployment rate (%)	6.0	6.0	6.0	6.0	5.7	6.1	6.0

Canada: Financial forecast

	2019				2020			
	Q1A	Q2A	Q3A	Q4A	Q1E	Q2F	Q3F	Q4F
Interest rates (%)								
Overnight rate target	1.75	1.75	1.75	1.75	0.75	0.25	0.25	0.25
3-month GoC bill	1.67	1.66	1.65	1.66	0.60	0.20	0.20	0.20
2-year GoC note	1.55	1.47	1.58	1.69	0.60	0.75	0.80	0.90
5-year GoC note	1.52	1.39	1.40	1.68	0.70	0.80	0.90	1.00
10-year GoC bond	1.62	1.46	1.37	1.70	0.75	0.85	0.95	1.05
Yield curve spread (pp)								
3-month vs. 10-year	-0.05	-0.20	-0.28	0.04	0.15	0.65	0.75	0.85
2-year vs. 10-year	0.07	-0.01	-0.21	0.01	0.15	0.10	0.15	0.15
Foreign exchange								
USD/CAD (\$C)	1.33	1.34	1.32	1.32	1.38	1.36	1.35	1.34
CAD/USD (US cents)	75.24	74.77	75.72	75.76	72.46	73.53	74.07	74.63

	2021				19A	20F	21F
	Q1F	Q2F	Q3F	Q4F			
Interest rates (%)							
Overnight rate target	0.50	0.75	1.00	1.25	1.75	0.25	0.50
3-month GoC bill	0.45	0.70	0.90	1.20	1.66	0.20	0.45
2-year GoC note	1.00	1.10	1.20	1.30	1.69	0.90	1.00
5-year GoC note	1.10	1.20	1.30	1.40	1.68	1.00	1.10
10-year GoC bond	1.15	1.25	1.35	1.45	1.70	1.05	1.15
Yield curve spread (pp)							
3-month vs. 10-year	0.70	0.55	0.45	0.25	0.04	0.85	0.25
2-year vs. 10-year	0.15	0.15	0.15	0.15	0.01	0.15	0.15
Foreign exchange							
USD/CAD (\$C)	1.33	1.33	1.33	1.33	1.32	1.34	1.33
CAD/USD (US cents)	75.19	75.19	75.19	75.19	75.76	74.63	75.19

Concluding remarks

Our base case forecast is for the Canadian economy to suffer a temporary contraction in 2020, but with growth returning in 2021. The risks to our quarterly projection are balanced. It is possible that the pandemic will abate more quickly and the stimulus could be more impactful, such that economic growth returns as early as the third quarter. It is equally possible for the pandemic to last longer with greater and longer-lasting economic fallout. In this environment, we highly recommend that businesses use scenarios to assess vulnerabilities. But, our core message is that the tide will eventually turn—we just don't know exactly when.

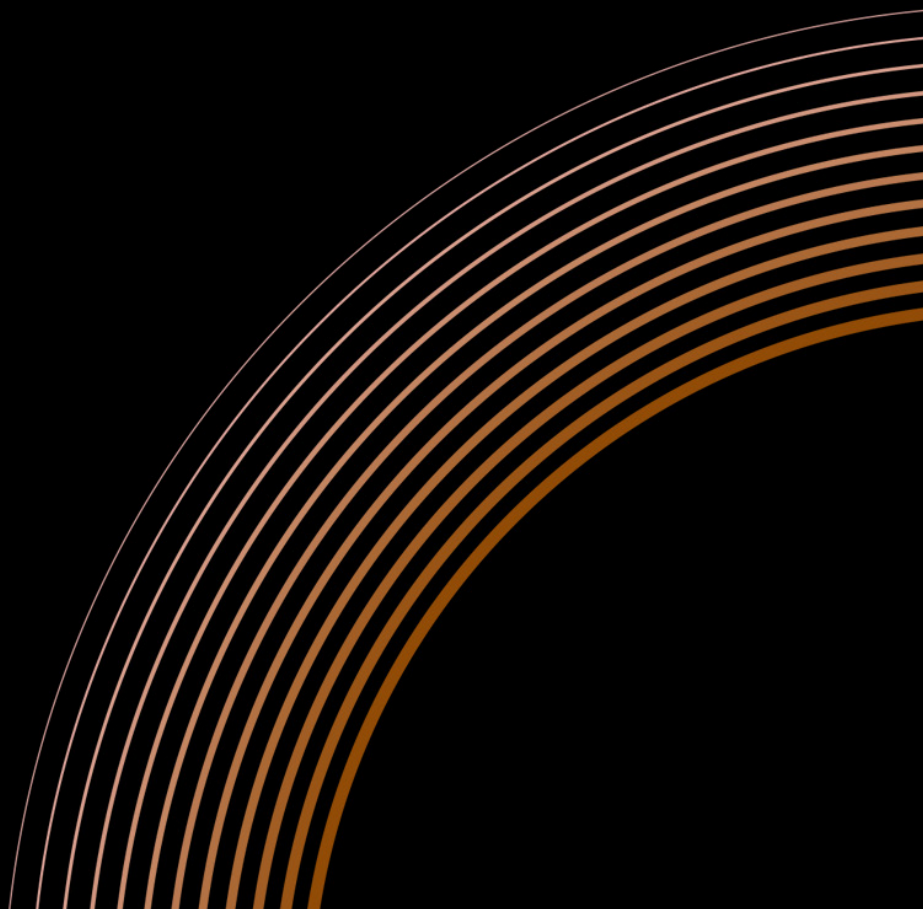
Deloitte Canada has published a number of reports in recent days to help businesses understand the current environment and possible actions, including: [COVID-19: Practical workforce strategies that put your people first](#), [COVID-19: Managing supply chain risk and disruption](#), [COVID-19: Managing cash flow during a period of crisis](#).

Our key messages include: create a command centre for resilience planning and coordination, implement a talent strategy to support your people, evaluate working capital and liquidity requirements, identify supply chain disruptions and build contingencies, engage with customers to help them and support business continuity, evaluate and enhance digital capabilities.

In our opinion, there are three stages to management in this environment. First, respond to the crisis and take actions to ensure business continuity. Second, learn from the crisis and use the opportunity to take actions to make the organization stronger. Third, position the organization to thrive when the tide turns.

Deloitte Canada has published a number of reports in recent days to help businesses understand the current environment and possible actions.

For over a year we have been warning our readers that the global and Canadian economies were in the late stages of a business cycle and that at some point there would be an event to trigger a turn in the cycle. It looks like the recent global pandemic may be that event. Policymakers are acting to limit the economic weakness and now is the time for business leaders to step up, protect their workers, support their customers and navigate through this temporary economic valley.



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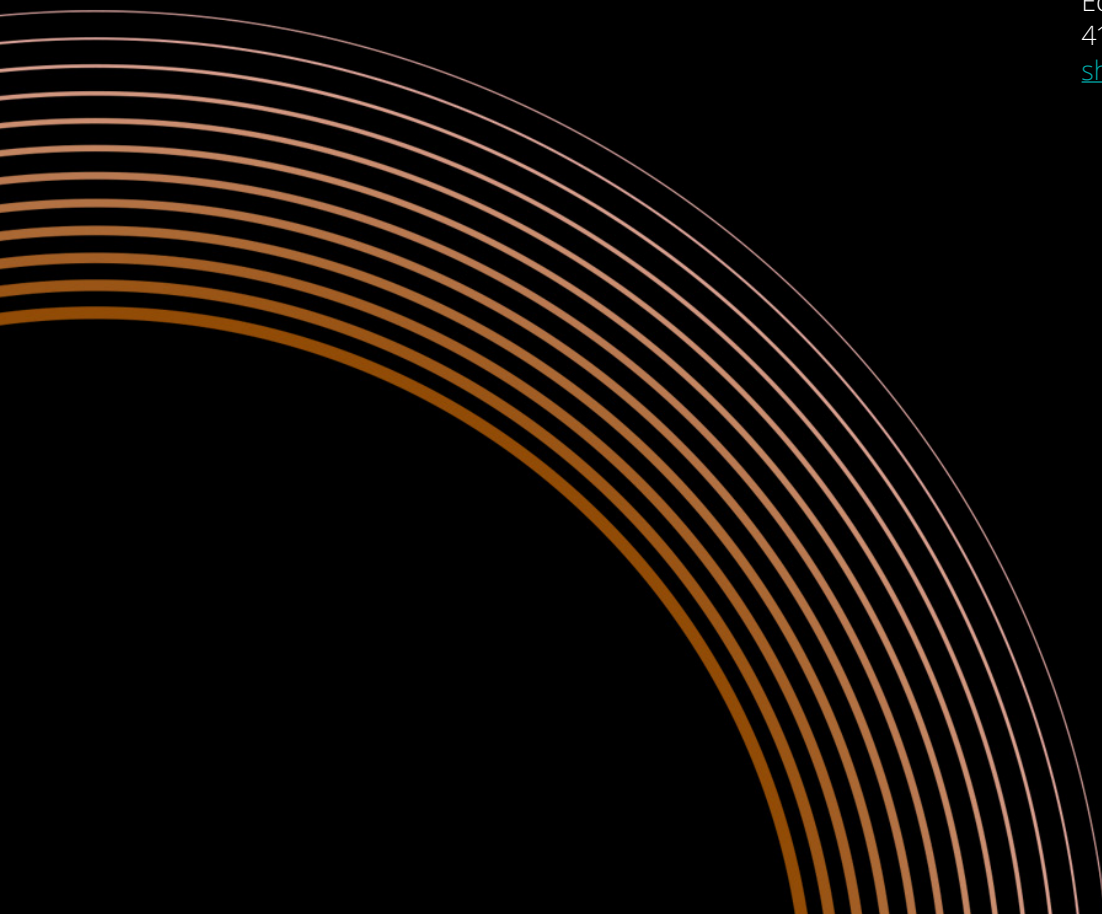
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