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# Growth persists amid uncertainty

Economic outlook: October 2019

# Contents

# Overview

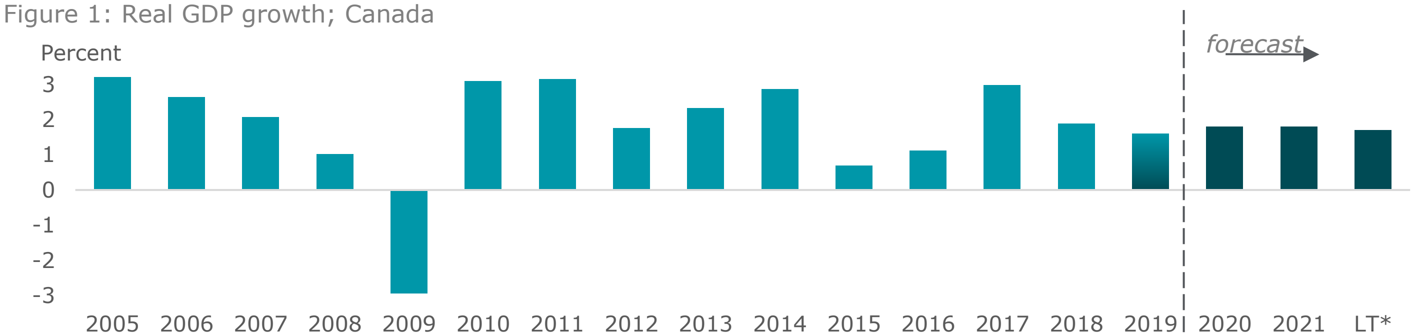
Global financial markets have been on a roller-coaster ride in the three months since our July economic outlook, with recurrent recession chatter accompanied by the escalation of geopolitical uncertainty. Previously existing risks, such as the trade dispute between the United States and China and a chaotic Brexit, were joined by political unrest in Hong Kong and mounting tensions in the Middle East. Economic data has been less volatile, and the main theme remains intact. The global economy is continuing to gradually slow, but the weakness remains limited to the manufacturing sector. The softness did not spread to other sectors but it did broaden geographically, with more regions experiencing a manufacturing contraction.

Amid the rocky global environment, the Canadian economy managed to post a stellar quarter of growth, expanding by 3.7 percent in the second quarter. However, most of the strength is related to a rebound from two prior quarters of virtually no growth. Abstracting from the quarterly volatility reveals a more subdued picture, with the underlying pace just one-third of the second-quarter performance.

Looking ahead, we expect the Canadian economy to grow by around 1.5 percent in the second half of this year, yielding an annual figure of 1.6 percent for 2019. Growth is expected to improve slightly over the subsequent two years, fluctuating around our estimated long-term potential pace of 1.7 percent in 2020 and 2021 (see Figure 1). Despite low unemployment, inflation has remained in abeyance, leaving the door open for the Bank of Canada to join the club currently easing monetary policy. This fast growing group of two dozen institutions, including the Federal Reserve, has in just several months flipped the global monetary policy stance from gradual tightening to broad-based easing. This is a scale of reversal not seen since the Great Recession (see Figure 2).

A cut in the policy rate is far from assured, and would at this juncture be largely symbolic. Easing policy would, at the margin, send the Canadian dollar lower and help support stock valuations, but the associated moves are likely to be overshadowed by economic developments and commodity prices. Overall, we expect the loonie to average around 75 US cents through the end of next year, helping support Canadian export competitiveness.

Figure 1: 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 September 2019.

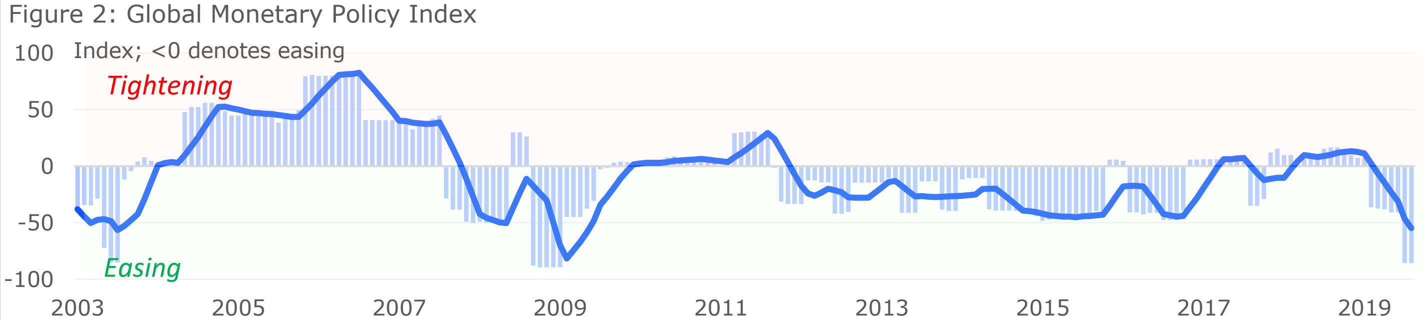
Having said that, the benefit for net trade and investment will be partly offset by softening in overseas demand and moderation in US economic growth. Business investment will also face headwinds from escalating uncertainty and diminished confidence. And, while the stabilization in Canadian housing will be supportive for economic growth, any upside for residential investment and consumption will be limited by elevated levels of household debt.

With the federal election just weeks away, it's natural to question how the election outcome will factor into the outlook. The simple answer is that it does not. Election platforms are not policies, but rather proposals that may never be legislated even if the party wins. For this reason, they're not factored into the outlook until they're signed into law. Until such time, the status quo of currently legislated policies is assumed.

The bottom line is that economic growth should continue at a modest pace both in Canada and around the world. Importantly, it will be taking place in an environment riddled with risks, such as the US-China trade war and a disorderly Brexit. A scenario whereby politics further damages the world economy, sparking a global downturn and dragging Canada into recession, is plausible. On the other hand, risks could abate, leading to a rebound in economic growth and boosting prices of commodities and stocks. A timely and successful resolution of trade frictions would substantially improve business sentiment and boost trade and investment. An orderly resolution of the Brexit process—or its annulment—would also improve confidence and lead to improved economic growth in Europe and beyond.

While these are merely downside risks that manifested in positive growth by not being realized, it is also important to consider "true" upside risks, such as the potential loosening of purse-strings by fiscally sound governments or meaningful structural reforms in economies where growth is restrained by inefficient policies. In this environment, we encourage clients to think through the potential economic scenarios and consider how each would affect their business. Just as there are hazards, every economic and financial outcome also creates opportunities that can be capitalized on by those better prepared to navigate the rapidly evolving economic environment

Figure 2: Global Monetary Policy Index




Notes: Index defined as an average of major central bank policy stances, weighed by their respective economies' nominal GDP in USD.
Sources: Respective statistical agencies and central banks, Deloitte Canada.

# International

## *Economy appears increasingly fragile*

The global economic expansion continued to lose momentum during the third quarter, with particular weakness in manufacturing. Many Asian and European manufacturing purchasing manager indexes (PMIs), which were already signalling contraction in the second quarter, continued to languish. The US indexes, which were previously more resilient, weakened during the summer. The highly regarded ISM manufacturing index actually dropped below the crucial 50-point level, the threshold for growth.

The key question for the global economy is whether the weakness in manufacturing will spread to services: so far the service sector continues to expand, but contagion remains a distinct possibility, particularly as the frequency of the use of the R-word—whether based in fact or fiction—continues to increase. The resulting fragility of the global economy leaves it highly vulnerable to any further negative shocks.

The continued slowdown has weighed on financial markets. Sentiment improved on signs of forthcoming central bank accommodation, before retreating on an intensification of the US-China trade dispute and political risks surrounding Brexit. There was a positive reaction to suggestions of central bank stimulus, though it was offset by an appreciation that the monetary authorities have limited scope to lower rates.

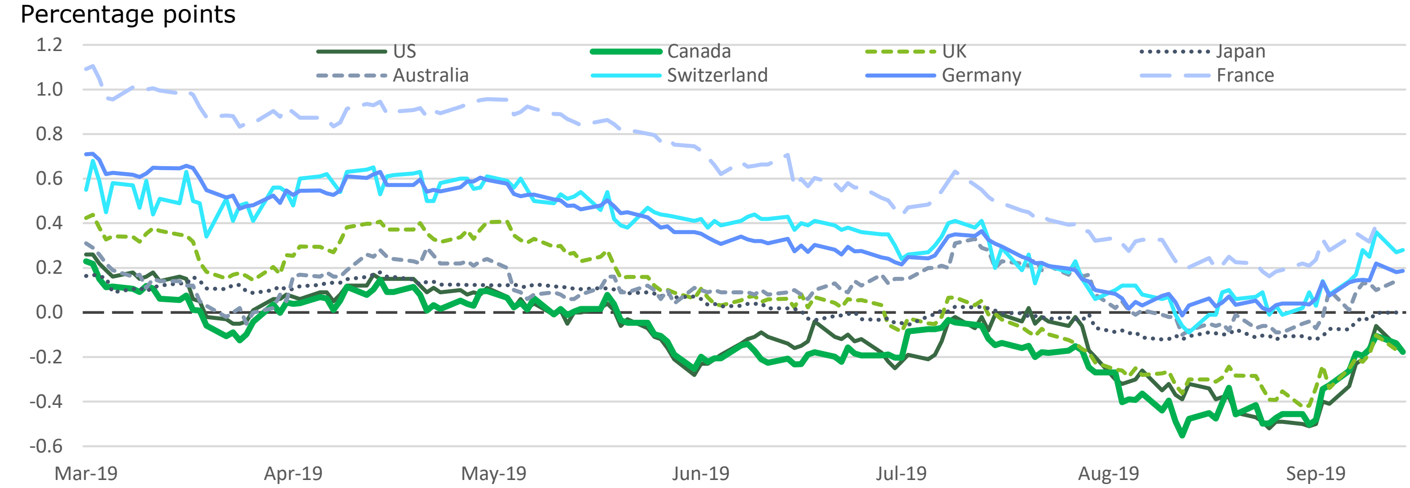
Things are likely to get worse before they get better.

The souring in sentiment has led many investors to seek shelter in the safest financial assets, locking in money in highly rated government bonds. Increased demand for longer-term bonds bid up their prices and pushed down their yields. In some cases, yields on longer-term notes and bonds fell below those of shorter-term bills, resulting in an inverted yield curve. This dynamic was particularly apparent in the US, Canada, and UK bond markets, with the inversion reaching 50 basis points in late August as tensions related to both trade and Brexit reached a nadir (see Figure 3). The inversion was a strong market signal that monetary policy is too tight in the current economic climate and that a downturn might be in store.

An inverted yield curve is also problematic for the economic engine's lubricant: credit markets. Financial intermediaries are facing an existential crisis. Banks and other credit providers typically borrow short and lend long, but an inversion deems such lending potentially unprofitable. This is particularly problematic in the Eurozone, where long-term yields are negative. In fact, no less than $17 trillion in global debt is currently trading with negative yields—that is nearly a quarter of all global debt.

Summer market capriciousness has recently subsided to relative calm, but bouts of volatility are sure to manifest in light of the fragility of the

Figure 3: Yield curve gradients (3m-10y); Majors




Source: National central banks and statistical agencies.

global economy: things are likely to get worse before they get better. The key sources of uncertainty and pessimism are little changed from our last outlook, with the US-China trade dispute and increasing possibility of a disorderly Brexit remaining top of mind. Additionally, the escalation of tensions between two major oil producers—Iran and Saudi Arabia—risks disrupting oil production and transport. The fragility of the global economy leaves it vulnerable, with a supply shock potentially acting as a catalyst for a downturn.

On the US-China trade front, the United States implemented new tariffs on US$125 billion worth of Chinese imports, including: footwear, diapers, smart watches, dishwashers, flat-panel televisions, and a host of other popular household products. Sixty-nine percent of consumer goods imported from China will now face a tariff. China retaliated with tariffs on US$75 million of US goods including, for the first time, a 5 percent tariff on US crude oil. China also allowed its currency, the renminbi, to depreciate to more than 7 per US dollar, the weakest level since 2008. The impact of the trade dispute on Chinese exports, combined with its slowing economy, warranted a higher exchange rate. Nevertheless, the US Treasury department announced for the first time since 1994 that it was labelling China a currency manipulator. An International Monetary Fund (IMF) report argued the renminbi exchange rate to the US dollar was "broadly in line with medium-term fundamentals."[1]

Overall, global developments were negative but broadly in line with expectations in our last quarterly economic forecast, requiring little change to the Canadian economy outlook. The main risks continue to come from political developments, which are disrupting trade, weakening business confidence, and curtailing business investment. Key upcoming events are an increase in US tariffs on China on October 15, with more kicking in on December 15, as well as Brexit, scheduled for October 31.

Central banks are providing stimulus, but low rates are relatively ineffective in boosting demand in the current environment. The global easing of monetary policy is really about sending a signal to investors, businesses, and consumers that the central banks are prepared to act. One might speculate that given the low level of policy rates, central banks should keep their powder dry and not ease policy so they have the scope to cut if a recession takes hold. However, there is an alternative argument. Since central banks cannot cut rates to the degree they have in the past in reaction to a recession, they might use their limited scope to ease policy in a preemptive way to forestall a turn in the business cycle. Regardless of the exact motivation, further central bank monetary stimulus is likely in the months to come, from the Federal Reserve, the European Central Bank (ECB), and many other central banks. These actions are positive for the Canadian economic outlook because they diminish the risks of a global downturn.

[1] https://www.imf.org/en/News/Articles/2019/08/13/tr08092019-transcript-of-the-press-conference-on-china-article-iv-consultations-report

# United States

## *Resilient to global frailty, but slowing anyhow*

The international economy that matters the most to Canada is that of our major trading partner, the United States. US economic growth slowed to 2.0 percent in the second quarter, as it continues to gradually converge to its long-run potential of near 2 percent. The previous pace of expansion, much of which was above potential, had absorbed most of the available economic slack, as evidenced by the drop in the unemployment rate to a 50-year low. The impact of prior tax cuts is also fading. The US economy is still in good shape and it remains at the top of the advanced-economy growth leaderboard in 2019. As we head into 2020, however, we anticipate a further moderation of economic growth, with US real GDP growth cooling to 1.6 percent next year.

Given the health of the US economy, a couple of natural questions are: why is America not feeling more pain from the US-China trade dispute, and why is the Federal Reserve easing monetary policy? With respect to the former, the fallout of the trade war is hurting the global economy as the impact of tariffs ripples through global supply chains. This will negatively affect US exports, but the impact on the overall economy is diminished by the fact that exports account for only 8 percent of GDP. The domestic market can support a lot of economic activity on its own. However, America is not immune to what happens beyond its borders. As noted earlier, US exports growth will be curtailed and consumer prices will rise as the cost of tariffs are passed along. A more important concern is for US multinational corporations, which operate on a global scale. If global activity weakens and profit growth diminishes, it will have an impact on investment and hiring across corporate divisions, including those in the United States.

The Fed is cutting rates as an insurance against the downside risks to the US economy. It also has an impact on global financial conditions, because the US dollar continues to be the world reserve currency and many financial assets trade as spreads to US bond yields. Consequently, the Fed's easing of monetary policy is helping to shore up business and financial market confidence as well as taking some of the pressure off international financial markets.

Unfortunately, the Fed's last rate cut emboldened the Trump Administration to expand tariffs on Chinese exports. This is an undesirable outcome and a disappointing precedent. Given the signs of global weakness and the downside risks to inflation, the Fed is likely to cut at least one more time in an effort to shore up business and investor sentiment. Normally, this would weaken the dollar, but in the current environment, the US economy still has better prospects than other nations and interest rates are higher in the US. The implication is that the US dollar will likely remain strong.

All told, the recession risks are greater in Asia and Europe than they are in the United States, but the prospects of more moderate US economic growth will have implications for Canadian exports.

# Canada

## *Blockbuster headline masks a soft trend*

As forecasted in our previous outlooks, growth returned to the Canadian economy in the spring. After two quarters of virtually no growth, economic activity increased by a whopping 3.7 percent during the second quarter, blowing past expectations. However, much of this blockbuster gain can be characterized as a mere return to the modest pace of growth that prevailed before stalling for two quarters. Despite the second-quarter surge, real GDP growth—whether defined in a year-over-year or moving-average basis—was around the mid-1 percent mark.

Moreover, details of the second quarter report portray a far less impressive picture of the economy. Apart from the first increase in residential investment in six quarters, suggesting green shoots in previously frozen housing, it is a challenge to find a positive element in the report. Consumption, which accounts for the lion's share of economic activity, grew by its slowest pace in seven years, expanding by just 0.5 percent annualized. This implies consumers sat out the second quarter altogether, perhaps focusing on home-buying instead.

Business capital spending fared worse still. Fixed investment in non-residential assets declined by an annualized 13.3 percent, with intellectual property (IP) the only category exhibiting growth. Spending on non-residential structures declined for the sixth consecutive quarter, for a cumulative decline of 8.3 percent. This was largely a function of lower capex in the mining and oil and gas sector, already one-third below the pre-2015 peak as the sector continues to reel from low prices and lack of pipeline capacity. Worse still, machinery and equipment spending fell 32 percent, giving up more than the entire prior quarter's exorbitant gain and erasing all the progress made since the end of 2017.

The trade figures were too highly affected by abnormal performance in prior quarters. Exports surged over 13 percent (annualized), as crude oil, basic chemicals, and agricultural product shipments rebounded. Somewhat paradoxically, imports decreased 4 percent during the quarter as aircraft and parts imports returned to more typical levels, offsetting half of the first-quarter spike. The combination was favourable for growth, with net trade alone accounting for more than the entire gain in economic activity. This is true even if we strip the drag from inventory destocking, much of which was related to the decline in imports.

Ascertaining the true pace of economic growth amidst the substantial volatility of GDP can also be done by way of final domestic demand (FDD). FDD strips out the impacts of net trade and inventories and is arguably a better measure of underlying economic health than GDP itself. Distressingly, the gauge, which is seldom negative apart for downturns, contracted outright during the second quarter. While the decline was modest, at 0.7 percent, it is the third one in four quarters. As a result, final domestic demand was a mere 0.3 percent higher than a year ago—the slowest pace of growth since the commodity price collapse of 2015/16.

### Growth to return to more normal pace

The recent volatility should give way to some stabilization in the pace of growth, as past imbalances are increasingly cleared. Despite the expected diminished volatility, the pace of growth in the second half of the year is expected to average 1.5 percent. This sub-par performance will be caused by weak global demand and soft commodity prices. A modest acceleration to 1.8 percent is in the cards for next year, as lower interest rates shore up demand internationally and domestically.

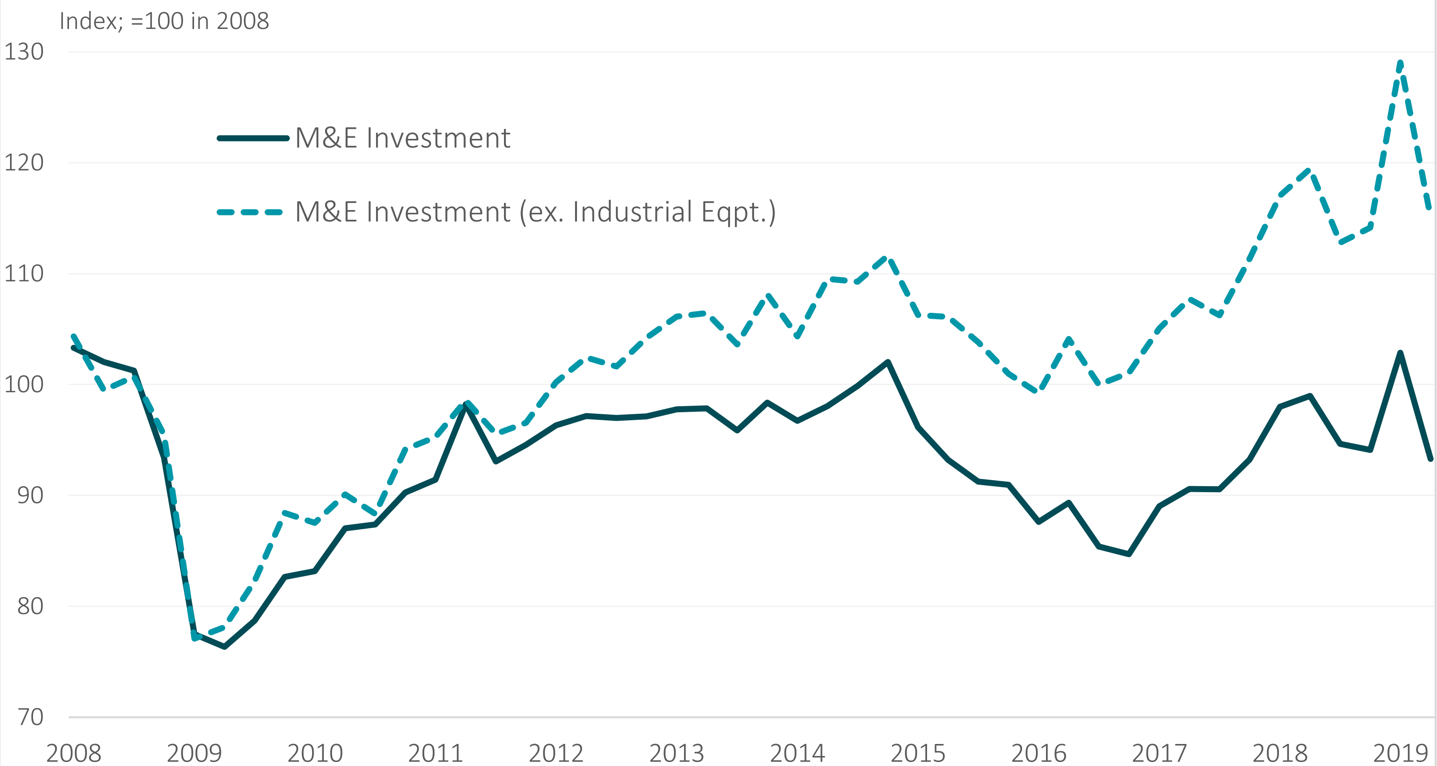
Durable goods consumption should particularly benefit from the lower-rate environment. However, given the high levels of household leverage, any increase in durables spending would be limited and would take away from less rate-sensitive spending categories. Overall, despite low unemployment and moderate income growth, spending growth will remain modest as many households limit their accumulation of debt.

Lower interest rates should also help shore up residential investment. The housing market appears to have already turned the corner, removing a key domestic headwind to growth. Lower mortgage rates in an increasingly balanced real estate market will act together to support the continued recovery in housing. Spending on furniture and appliances is likely to benefit.

Export growth will remain subdued, held back by weak demand abroad. While Canada is somewhat shielded from the weakness through its reliance on a resilient US economy, growth in the United States will nonetheless slow next year as it converges to its long-term potential.

Weak global demand will also keep a lid on commodity prices that, alongside elevated uncertainty, hurt business investment. Investment has been a source of serial disappointment for years, with history repeating itself this year with the encouraging surge in the first quarter completely unwound the following quarter. The story is more nuanced than it would appear. Nearly all of the decline in machinery and equipment (M&E) investment last quarter was related to the highly volatile aircraft category, which also accounted for much of the first-quarter surge. The remainder of the weakness stemmed from industrial equipment, a category tightly linked to the energy sector. In fact, stripping out energy-sector investment portrays a brighter picture of business investment in Canada overall (see Figure 4). Ultimately, the path will depend heavily on the commodity-price environment and business confidence.

Figure 4: Real machinery & equipment (M&E) investment; Canada




Source: Statistics Canada. Calculations by Deloitte Economic Advisory.

**To cut, or not to cut?**

The Bank of Canada will face a not-so-trivial dilemma in the coming weeks, and will have to carefully weigh all relevant factors before coming to a decision. While we can only speculate as to the Bank's updated outlook, assessing the arguments for and against a rate cut may shed some light on the quandary.

All things considered, the table (see Figure 5*)* suggests that a compelling case can be made in both instances. This leaves the door open for the Bank to ease monetary policy, should the Governing Council deem it needed. It also provides scope to keep the status quo, should a wait-and-see approach be deemed more appropriate for the economy. Choosing patience does not rule out future cuts should they become warranted. Ultimately, the path of policy will remain highly data-dependent, with developments judged on how, if at all, they are likely to alter the path of Canadian inflation. We have included a quarter-point cut in the forecast to reflect the increased downside risks since our July forecast.

Figure 5: Factors potentially impacting the Bank of Canada's monetary policy decision

| **Standing pat** | **Token cut** |
|---|---|
| Growth returned with a bang in Q2 | Q2 growth boosted by transitory factors |
| Expansion to continue, albeit at a modest pace | Trend pace of growth closer to mid-1% |
| Economy continues to pump out jobs | FDD declined for third time in four quarters |
| Unemployment at a 45-year low | Downside risks intensifying |
| Inflation metrics above 2% midpoint | Signalling united front against potential downturn |
| Robust wage growth | Not cutting would push up loonie |
| Fed/ECB cuts already felt on longer GoC rates | Not cutting risks further inverting yield curve |
| Economic impact of a cut likely to be minimal | Neutral rate estimates have been declining |
| Keeping powder dry with policy rate already low | Pre-emptive cut may reduce need for later cuts |

# Provinces

## *West is no longer the best*

The recent soft patch encountered by the Canadian economy has not been uniformly distributed across the provinces (see Figure 6). Despite the global slowdown being limited to manufacturing, Canada's industrial heartland fared comparatively well. In fact, growth in Quebec has accelerated to 2.9 percent since late 2018—double the national pace.

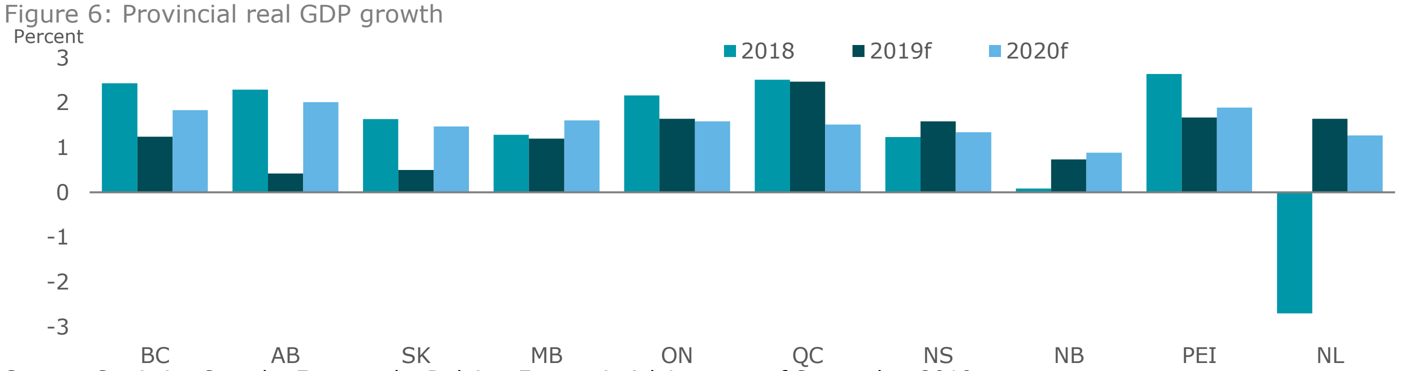
The Quebec economy will for the third year in a row post annual growth near the mid-2 percent mark. It's benefitting from broad-based growth, with particular strength in housing-related industries and manufacturing, but some of the gains are related to the removal of US steel and aluminum tariffs. Ontario's metal manufacturers will also benefit from the removal of tariffs, but provincial growth will trail Quebec due to a cooling real estate market. Housing will subtract nearly 1 percentage point from headline growth in Ontario, with the economy expected to grow by about 1.6 percent this year. Growth across the two economies will converge toward the mid- to high-1 percent range as both approach their potential speed limits next year and beyond.

The rest of Canada, meanwhile, has underperformed. While quarterly GDP figures are not available for these provinces, it is apparent from other higher-frequency indicators that conditions were weakest in the three energy-producing provinces of Alberta, Saskatchewan, and Newfoundland and Labrador. Economic growth in British Columbia, which topped provincial rankings for years, has all but fizzled out as the white-hot housing market has all but collapsed. Declining values of real-estate assets have weighed on household spending, already under pressure from homeowners saddled with mortgage debt. As a result, the BC economic expansion will slow from 2.4 percent last year to just 1.2 percent this year, before a modest rebound expected in 2020 as housing conditions normalize.

Economic conditions are even more dire on the eastern side of the Rockies, where low crude prices and a large discount on global benchmarks weighs on conventional investment and drilling. Oil activity in Alberta was further reduced by mandated production curtailments related to limited outbound pipeline capacity. It's the same story in Saskatchewan, albeit to a lesser extent—although its provincial economy is facing significant challenges of its own, finding itself caught in the middle of the US-China trade spat because of a ban on canola exports to China. Both Prairie provinces will see growth slow to near stall-speed this year before accelerating to the 1- to 2-percent range, with the forecast highly susceptible to commodity prices.

Low crude prices are also hurting investment in Newfoundland and Labrador, with the provincial economy further undermined by fiscal and demographic challenges. Nonetheless, modest growth of 1.6 percent should return to the easternmost province this year, after a 2.7 percent contraction last year. Of the remaining Atlantic provinces, both Nova Scotia and PEI should notch a similar pace of growth, while New Brunswick—hindered by a lack of labour-force growth—looks to manage only half of that pace.

Figure 6: Provincial real GDP growth




Source: Statistics Canada. Forecast by Deloitte Economic Advisory, as of September 2019.

# Canada: Economic forecast

| | 2018 | | | | 2019 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Q1A** | **Q2A** | **Q3A** | **Q4A** | **Q1A** | **Q2A** | **Q3E** | **Q4F** |
| **Economic activity** | | | | | | | | |
| Real GDP ($2012) | 1.5 | 2.5 | 2.1 | 0.3 | 0.5 | 3.7 | 1.3 | 1.7 |
| Personal expenditure | 1.2 | 1.8 | 1.3 | 0.9 | 2.9 | 0.5 | 1.9 | 1.7 |
| • Durables | -0.1 | -1.8 | -0.6 | -1.9 | 5.3 | -1.3 | 1.9 | 1.5 |
| • Services | 2.3 | 2.9 | 1.3 | 2.0 | 2.2 | 1.3 | 2.1 | 1.9 |
| Residential investment | -8.4 | -0.3 | -3.2 | -10.4 | -3.9 | 5.5 | 3.7 | 3.2 |
| Business investment | 1.7 | -0.6 | -7.7 | -8.1 | 4.7 | -6.4 | 3.0 | 2.9 |
| • Non-residential construction | -1.3 | -4.1 | -8.6 | -14.2 | -3.0 | -1.8 | 1.8 | 2.5 |
| • Machinery and equipment | 22.0 | 4.0 | -16.3 | -2.3 | 42.9 | -32.4 | 3.5 | 2.4 |
| Gov't expenses and investments | 1.6 | 2.5 | 2.5 | -0.3 | 2.6 | 0.9 | 1.9 | 2.0 |
| Exports | 3.6 | 12.0 | 0.8 | 0.3 | -3.3 | 13.4 | 0.8 | 1.5 |
| Imports | 4.2 | 6.2 | -8.9 | -0.7 | 8.7 | -4.0 | 2.2 | 2.1 |
| **Prices** | | | | | | | | |
| CPI | 3.3 | 1.2 | 2.6 | 1.1 | 1.5 | 3.4 | 2.1 | 1.7 |
| GDP deflator | 1.9 | 1.5 | 1.9 | -3.3 | 4.9 | 4.5 | 1.2 | 1.5 |
| **Income** | | | | | | | | |
| GDP at market prices | 3.2 | 3.9 | 4.3 | -3.1 | 5.7 | 8.3 | 2.5 | 3.2 |
| Personal income (year-over-year) | 5.3 | 4.5 | 3.3 | 3.2 | 3.2 | 4.0 | 4.3 | 3.6 |
| Pre-tax corporate profits (year-over-year) | -1.2 | 5.4 | 17.4 | -17.4 | -15.8 | -6.8 | -11.3 | 21.8 |
| **Labour market** | | | | | | | | |
| Employment | 0.3 | 1.0 | 1.3 | 2.2 | 2.9 | 3.0 | 0.6 | 0.5 |
| Unemployment rate (%) | 5.8 | 5.9 | 5.9 | 5.6 | 5.8 | 5.5 | 5.7 | 5.8 |

* Quarterly data is presented in quarter-over-quarter annualized percent change, annual data is year-over-year percent change, unless otherwise noted

Source: Statistics Canada. Forecast by Deloitte Economic Advisory, as of September 2019.

| | 2020 | | | | 2018A | 2019F | 2020F |
|---|---|---|---|---|---|---|---|
| | Q1F | Q2F | Q3F | Q4F | | | |
| **Economic activity** | | | | | | | |
| Real GDP ($2012) | 1.6 | 1.7 | 1.9 | 1.8 | 1.9 | 1.6 | 1.8 |
| Personal expenditure | 1.6 | 1.7 | 1.8 | 1.8 | 2.1 | 1.6 | 1.7 |
| • Durables | 1.0 | 1.2 | 1.5 | 1.5 | 1.0 | 0.8 | 1.2 |
| • Services | 1.8 | 1.9 | 2.1 | 2.0 | 2.6 | 1.9 | 1.9 |
| Residential investment | 2.2 | 1.7 | 1.5 | 1.5 | -1.5 | -1.8 | 2.5 |
| Business investment | 2.5 | 2.4 | 2.5 | 2.4 | 0.7 | -2.1 | 2.0 |
| • Non-residential construction | 2.1 | 2.3 | 2.4 | 2.2 | -0.9 | -4.9 | 2.0 |
| • Machinery and equipment | 3.2 | 3.5 | 3.7 | 3.5 | 6.1 | -0.2 | 0.5 |
| Gov't expenses and investments | 1.8 | 1.9 | 1.9 | 1.8 | 3.0 | 1.6 | 1.8 |
| Exports | 1.4 | 1.6 | 1.8 | 1.6 | 3.2 | 2.6 | 2.1 |
| Imports | 1.9 | 1.8 | 1.7 | 1.7 | 2.9 | 0.8 | 1.5 |
| **Prices** | | | | | | | |
| CPI | 1.8 | 1.9 | 2.0 | 2.0 | 2.2 | 2.0 | 2.0 |
| GDP deflator | 1.9 | 2.1 | 2.0 | 2.0 | 1.7 | 2.0 | 1.9 |
| **Income** | | | | | | | |
| GDP at market prices | 3.5 | 3.8 | 3.9 | 3.8 | 3.6 | 3.6 | 3.7 |
| Personal income (year-over-year) | 3.5 | 2.9 | 3.1 | 3.2 | 4.1 | 3.8 | 3.2 |
| Pre-tax corporate profits (year-over-year) | 20.9 | 8.2 | 9.4 | 9.4 | 0.8 | -4.4 | 11.6 |
| **Labour market** | | | | | | | |
| Employment | 0.7 | 0.6 | 0.6 | 0.6 | 1.3 | 2.0 | 0.8 |
| Unemployment rate (%) | 5.8 | 5.9 | 5.9 | 6.0 | 5.8 | 5.7 | 5.9 |

# Canada: Financial forecast

| | 2018 | | | | 2019 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Q1A** | **Q2A** | **Q3A** | **Q4A** | **Q1A** | **Q2A** | **Q3E** | **Q4F** |
| **Interest rates** | | | | | | | | |
| Overnight rate % | 1.20 | 1.25 | 1.47 | 1.69 | 1.75 | 1.75 | 1.75 | 1.50 |
| 3-month T-bill % | 1.10 | 1.26 | 1.59 | 1.64 | 1.67 | 1.66 | 1.60 | 1.45 |
| 2-year government bond % | 1.77 | 1.91 | 2.21 | 1.86 | 1.55 | 1.47 | 1.45 | 1.45 |
| 5-year government bond % | 1.96 | 2.06 | 2.33 | 1.88 | 1.52 | 1.39 | 1.40 | 1.45 |
| 10-year government bond % | 2.09 | 2.17 | 2.42 | 1.96 | 1.62 | 1.46 | 1.45 | 1.50 |
| **Yield curve** | | | | | | | | |
| 10-year-3-month % | 0.99 | 0.91 | 0.83 | 0.32 | -0.05 | -0.20 | -0.15 | 0.05 |
| 10-year-2-year % | 0.32 | 0.26 | 0.21 | 0.10 | 0.07 | -0.01 | 0.00 | 0.05 |
| **Canadian dollar** | | | | | | | | |
| USD/CAD | 1.26 | 1.29 | 1.31 | 1.32 | 1.33 | 1.34 | 1.32 | 1.33 |
| US cents | 79.06 | 77.45 | 76.51 | 75.68 | 75.24 | 74.77 | 75.76 | 75.19 |

*All forecasts are end of period

Source: Statistics Canada. Forecast by Deloitte Economic Advisory, as of September 2019.

| | 2020 | | | | 2018A | 2019F | 2020F |
|---|---|---|---|---|---|---|---|
| | **Q1F** | **Q2F** | **Q3F** | **Q4F** | | | |
| **Interest rates** | | | | | | | |
| Overnight rate % | 1.50 | 1.50 | 1.50 | 1.50 | 1.69 | 1.50 | 1.50 |
| 3-month T-bill % | 1.45 | 1.45 | 1.45 | 1.45 | 1.64 | 1.45 | 1.45 |
| 2-year government bond % | 1.45 | 1.50 | 1.55 | 1.60 | 1.86 | 1.45 | 1.60 |
| 5-year government bond % | 1.50 | 1.55 | 1.60 | 1.65 | 1.88 | 1.45 | 1.65 |
| 10-year government bond % | 1.55 | 1.60 | 1.65 | 1.70 | 1.96 | 1.50 | 1.70 |
| **Yield curve** | | | | | | | |
| 10-year-3-month % | 0.10 | 0.15 | 0.20 | 0.25 | 0.32 | 0.05 | 0.25 |
| 10-year-2-year % | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.05 | 0.10 |
| **Canadian dollar** | | | | | | | |
| USD/CAD | 1.34 | 1.33 | 1.33 | 1.32 | 1.32 | 1.33 | 1.32 |
| US cents | 74.63 | 75.19 | 75.05 | 75.76 | 75.68 | 75.19 | 75.76 |

# Concluding remarks

*Opportunities exist even in a downturn*

The main message is that we are in the midst of a global economic slowdown that threatens to weaken Canada's growth prospects. The modest rate of expansion projected in the Deloitte base case scenario increases the possibility that a negative shock could trigger a turn in the business cycle.

What are the implications of such a scenario for Canadian businesses, and how should they respond to this economic environment?

For starters, it is crucial to understand particular business vulnerabilities to a downturn. No two organizations will be affected exactly the same. Businesses that are better positioned to endure the most challenging environments can benefit from a downturn by capitalizing on opportunities that aren't accessible to less-prepared competitors. It is possible: a recent *Harvard Business Review* article reported that 14 percent of publicly traded companies had accelerated their growth rate and increased profitability during the last downturn.

There are three types of opportunities to consider during downturns.

1. **Financial**: managing expenses better, strengthening balance sheets, and pivoting spending toward strategic objectives.

2. **Market**: changing product offerings and/or pivot to new markets.

3. **Strategic**: positioning for growth by making structural changes such as investing in new technology, establishing alliances, seeking mergers or acquisitions, and hiring and developing human capital.

In all these cases, leaders need to be mindful of their response and consider market and customer perspectives.

Choosing among these opportunities will require careful analysis of the economic, financial, and business environments of the particular company. Among the most popular strategies is the typical belt-tightening. However, according to a survey of businesses conducted by the Bank of Canada, organizations appear to have frequently utilized market and strategic opportunities, even in a downturn as deep as the Great Recession.

Leaders need to think holistically in terms of their operational and strategic response. Planning from an offensive position provides the impetus for a rapidly evolving mindset if, or when, a downturn occurs.

The traditional blueprint for planning looks too static for the kind of economic reality we now face. Dynamic planning, including scenario planning, is necessary to stay ahead of change and position an organization to quickly resolve challenges or capitalize on opportunities.

So, remain calm and approach planning and risk management from a mindset of opportunity. Start thinking now about potential actions to execute if economic conditions deteriorate. Understand that inaction or drastic, non-strategic belt-tightening in anticipation of a downtown will only make things worse.

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