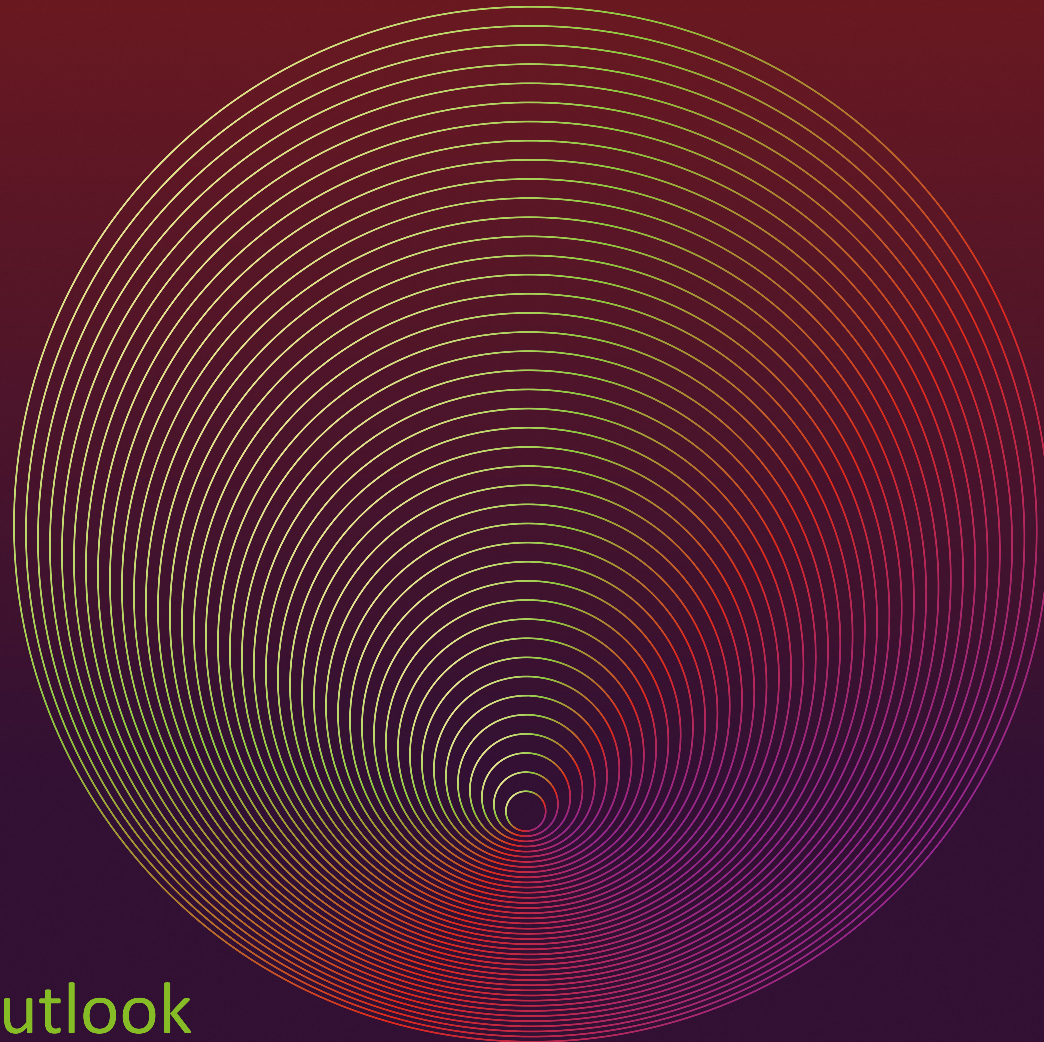
Deloitte.



Omicron clouds the outlook

Economic outlook | January 2022

Table of contents

- Summary
- International outlook
- Canadian outlook: National perspective
- Canadian outlook: Household sector
- Canadian outlook: Business sector
- Canadian outlook: Monetary and fiscal policy
- Conclusion
- Appendix

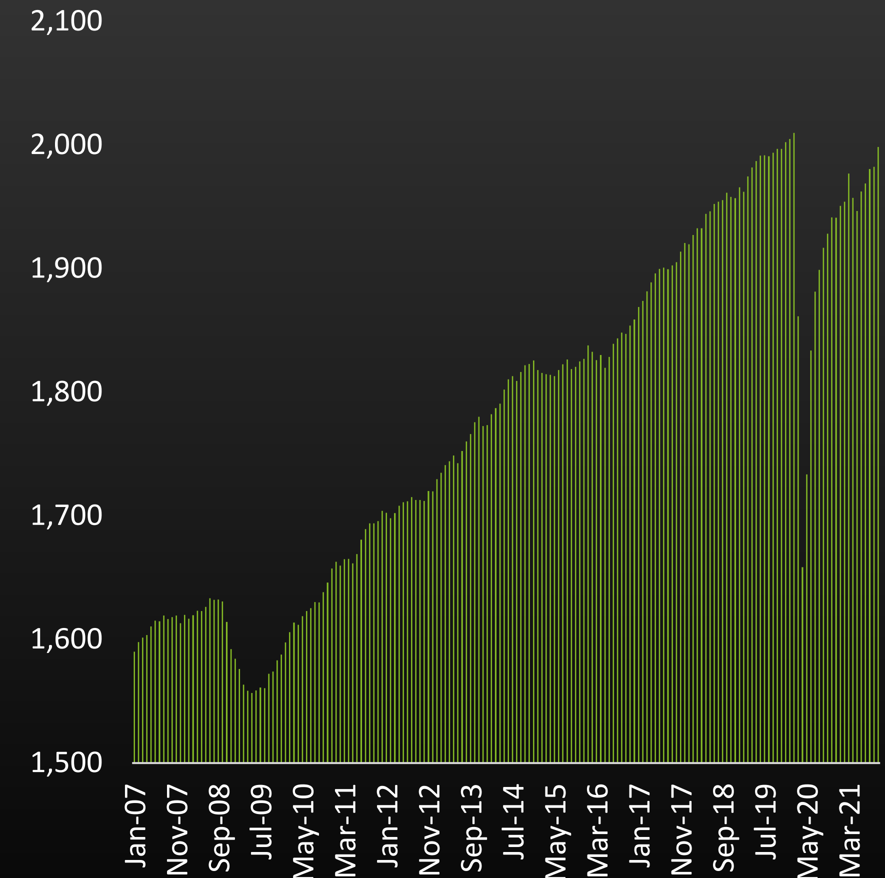
Summary by Chief Economist Craig Alexander

High vaccination rates and warm weather last summer and fall ushered in a period of relative normalcy that allowed the economy to bounce back in the third quarter after contracting in the second. However, the pandemic is once again in the forefront as the latest COVID-19 variant of concern, Omicron, rapidly spreads across the world. The emergence of this highly contagious strain of the virus means that the economy will not grow as quickly in the near term as previously expected. As we've seen in previous waves, economic growth will be affected not only by public health measures to limit the spread but also by consumer and business sentiment. Concerns about crowds are likely to keep more households at home and businesses will naturally respond to the uncertainty in demand by rethinking hiring and investment plans.

While COVID-19 will once again dominate the economic headlines in the weeks to come, there are several factors shaping the outlook, including labour shortages, inflation, supply chain issues, and longer-term structural challenges. Overall, considering these factors, we've downgraded our near-term economic outlook. After expanding by 4.6% in 2021, the economy is now projected to grow by 4% this year; the rapid spread of Omicron has, however, introduced downside risk to this forecast. Growth will remain strong in 2023 at 2.7% as the economy absorbs the large amount of slack remaining in some sectors.

Households are expected to continue to be the main driver of near-term growth. Even though around three million Canadians lost their jobs at the height of the first wave, real disposable income grew at its fastest pace on record in 2020 thanks to generous government relief programs. With reduced options to spend their incomes, savings soared and provided consumers with a stockpile of money that will support the recovery. We're already seeing that in the data, with real consumer spending up 17.9% in the third quarter of 2021. Households are also benefitting from the robust labour market recovery, with employment rising above its pre-pandemic levels in recent months. While the surge in employment is beginning to create labour supply challenges, we have yet to see those labour shortages spur widespread wage growth. Our expectation is that average weekly wages will grow by only 2.2% this year as a pickup in immigration levels boosts labour supply and stronger employment growth in lower-wage industries, such as food services and accommodation, bring down the average wage. The lacklustre wage growth will not temper spending thanks to the stockpile of savings households have, with real consumer expenditures set to increase by 5.9% in 2022.

Real Canadian monthly GDP, billions



Sources: Statistics Canada

Summary

Households have not only been supporting the recovery with their spending on consumer goods and services, but also through the residential real estate market. Residential investment was one of the only major economic sectors to post growth in 2020, and at 4.3% in real terms, it was a strong year by historical standards. A frenzied pace of activity continued into the first part of 2021, with both the resale and new home market doing very well. Activity has since slowed from unsustainably high levels, but the market was so hot last year that it still grew by an estimated 14.1%. Where we will really see last year's slowdown show up is in the outlook for this year. Activity has picked up in recent months but it's coming off lows from last summer and won't be enough to keep the annual average above where it was in 2021. As such, a decline in residential investment of 6.9% is expected in this new year.

One of the hardest hit areas of the economy due to the pandemic was business investment. Significant levels of uncertainty in both foreign and domestic demand coupled with cratering commodity prices resulted in organizations slashing their investment spending by 12.1% in 2020. And while 2021 started on a strong footing, successive waves of the pandemic and lingering supply chain challenges have tempered investment plans, with real spending now estimated to have fallen by another 0.6% last year. Despite the emergence of the Omicron variant and the persistence of jammed supply chains, this year is set to be much better for business investment.

Prices for many commodities have risen well above pre-pandemic levels and global demand is expected to remain strong as the recovery continues. This will provide incentive for firms to execute on their delayed investment plans. While the short-term rebound in business spending is welcome, it does little to change the longer-term challenges facing the sector. For years, Canadian investment was fuelled by the energy sector, but prospects for a repeat performance are bleak given the regulatory uncertainty in the sector and the lack of clear plan for achieving Canada's greenhouse gas (GHG) emission targets. Although energy exports have done better than other export categories and have largely recovered, growth will remain softer than recent trends due to weak energy investment and the hard cap on GHG emissions. Even outside the energy sector, investment has been soft. Unfortunately, there are no compelling reasons for that to change in the outer years of our forecast.

Craig Alexander
Chief Economist and Executive Advisor
Deloitte Canada

Summary

Weak business investment will weigh on the ongoing recovery in the trade sector. Merchandise exports remain about 5% below pre-pandemic levels. Strong global demand will continue to fuel the recovery through 2022. However, beyond that, growth prospects are diminished. The stock of machinery and equipment held by Canadian companies has declined by over 9% over the last seven years, which will restrict our ability to meet rising global demand. Meanwhile, services exports have been one of the hardest hit areas, as exports in this area are closely related to the ability to travel. That said, we expect them to post solid growth this year, though full recovery will be delayed until 2023 when public health risks subside.

On the economic policy front, the final month of 2021 was a busy one, with a renewed mandate for the Bank of Canada and a fiscal update from the Government of Canada. Every five years, these two bodies renew the framework for monetary policy.
For decades, the Bank's mandate has been to provide Canadians with price stability in the form of low, stable, and predictable inflation. It achieved that by using the tools at its disposal (interest rates, quantitative easing (QE), and forward guidance) to target 2% inflation within a 1% to 3% band. In its renewed mandate, the Bank kept its 2% inflation target and the one-percentage-point range around it, but its objective now includes a nod to reaching and maintaining full employment. This is not a dual mandate, like the US Federal Reserve has adopted, but rather provides the Bank with flexibility within its 1% to 3% range to help the economy hit full employment. When we look at the current inflation and labour market situation in the context of the Bank's renewed mandate, there are clear signs that stimulus will continue to be unwound. The Bank has already stopped growing its balance sheet through QE and is poised to raise its overnight rate three times in 2022. Interest rates will continue to rise next year with another two rate hikes in the cards.

Just days after the Bank's new mandate was published, attention turned to the outlook for fiscal policy as the federal government released its fall fiscal update. This update included just over $71 billion in new spending over seven years. Among the new measures are another $8.1 billion for the COVID-19 response and $5 billion for the British Columbia flood recovery efforts. Additional funding is earmarked to accelerate the processing of immigration applications and $40 billion for First Nations childcare stemming from an order from the Canadian Human Rights Tribunal. Along with all the measures announced in the 2021 federal budget, this spending means that in the near term, fiscal policy will remain stimulative, and work in the opposite direction of monetary policy. This year, total government spending and investment will contract mildly and both fiscal and monetary policy will be working in sync to cool the recovery and return growth to a more sustainable pace.

While there is no doubt that Omicron has thrown another wrinkle at our pandemic-weary economy, at this point we've learned to adapt to changing circumstances. While the recent reinstatement of public health measures designed to reduce the virus from spreading has introduced some downside risk to the outlook for the first quarter of this year, the economy will continue on its path to recovery.

International outlook

A more protracted recovery is a global theme

The global economy continues to rebuild from a devastating decline in 2020, but the recovery remains choppy and will take longer than previously anticipated.

- The global economy bounced back strongly last year despite the emergence of the Delta variant. Now facing the Omicron variant, the economy will continue to grow, although we're likely to see a choppy performance across countries based on their specific public health situations.
- Overall global real GDP is expected to increase by 4.3% this year as the recovery slows across the board.
- The largest slowdown in 2022 will be in emerging markets, with Latin American growth decelerating sharply. Brazil fell back into recession last year, and across the area, high inflation and persistent supply chain issues are expected to take some steam out of growth. Emerging market prospects will also feel the pinch of Omicron, with tourism-dependent countries negatively affected by renewed travel advisories and increased consumer hesitation toward leisure travel.
- Growth in the Asia Pacific region will be impacted by slowing growth in China due to a downturn in its property market and worries about the impact of Omicron on consumption.
- The pace of world economic growth will continue to slow into this year toward a more sustainable rate, with real GDP expected to increase by 3.5%.

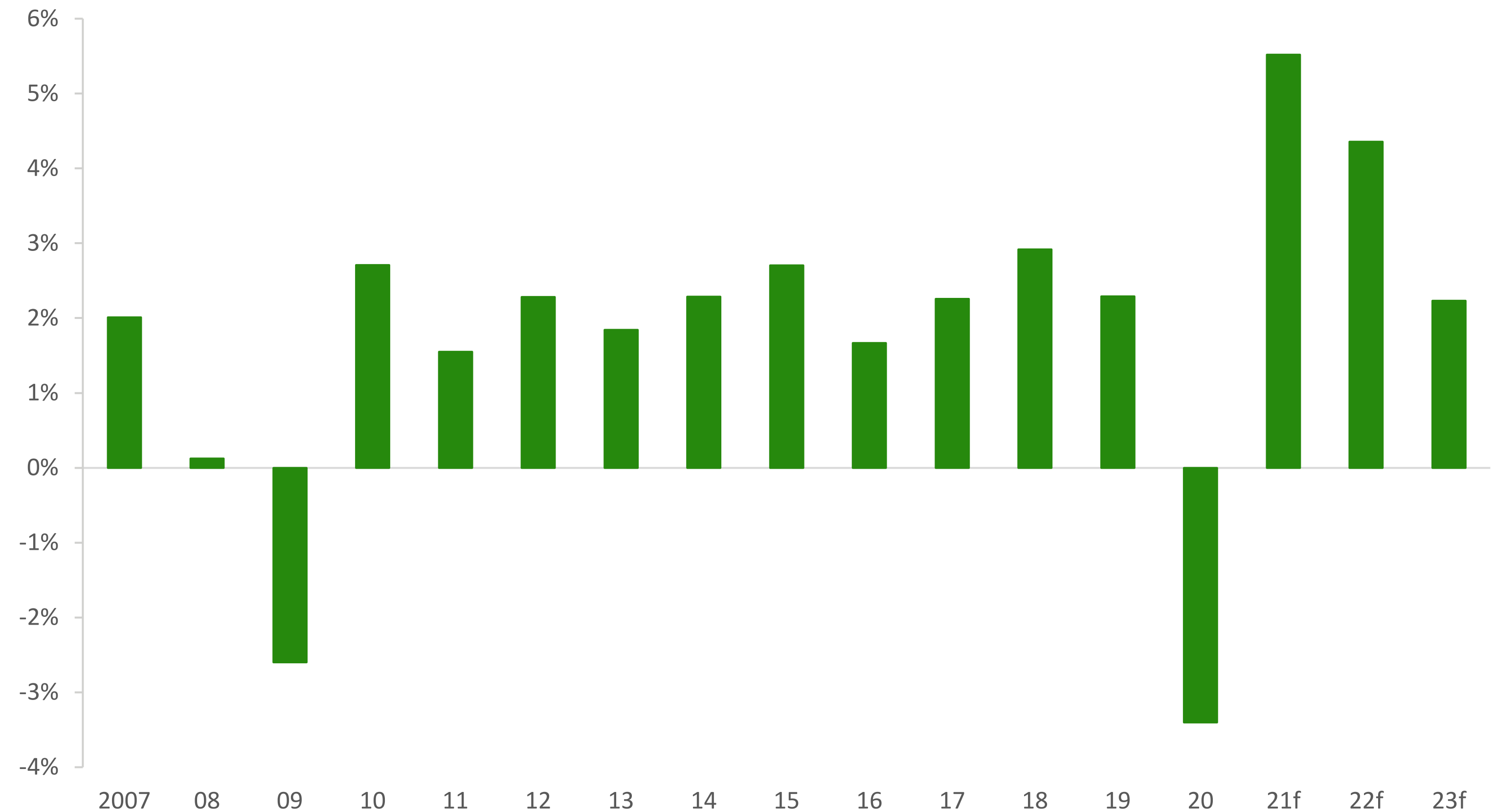
Sources: Oxford Economics, Deloitte

© Deloitte LLP and affiliated entities.

The US economy is gradually returning to trend growth

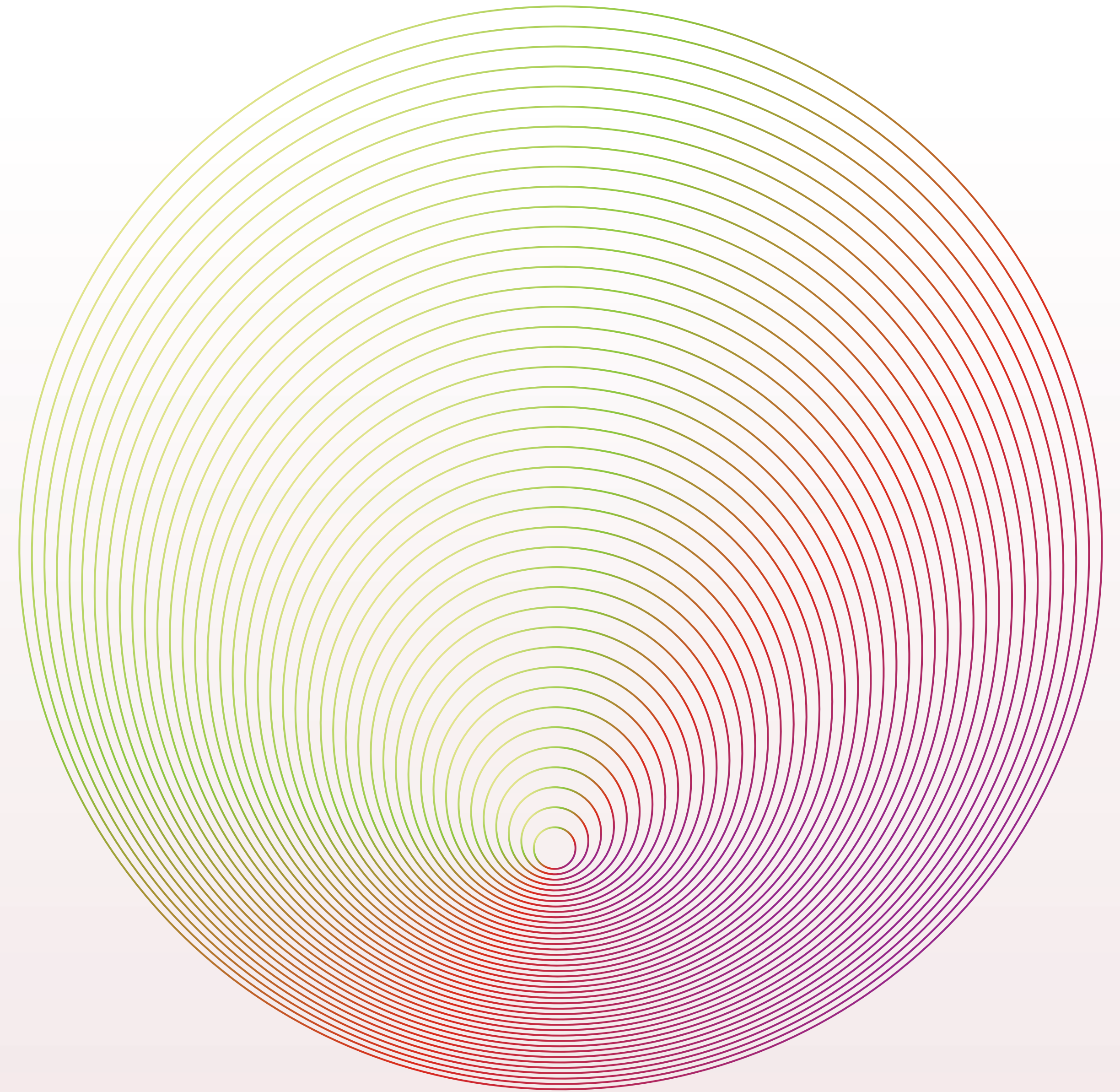
This year will be another one marked by strong economic growth in the United States, where it is expected to slow to a more sustainable pace.

- The US economy recovered strongly last year, with real GDP up 5.5%. Growth was fuelled by many factors, including stimulative fiscal and monetary policy, early and widespread vaccine availability, and a reopening that occurred faster than in other developed countries.
- While growth last year was strong, it wasn't without its challenges, many of which are lingering and will impact the outlook for this year. Supply chain issues, high commodity prices, and labour shortages helped push inflation to 6.8% in November, the highest level in 39 years.
- With inflation running hot, the US Federal Reserve is expected to withdraw its monetary stimulus at a faster pace than previously anticipated, with two rate hikes later this year and another three increases in store for 2023.
- As global demand continues to shift from goods to services, price pressures should ease. Nevertheless, high inflation heading into this year will take some of the steam out of the recovery as the purchasing power of companies and households is eroded by the strong price growth. The interest rate hikes required to tame inflation will also weigh on growth.
- Overall, real GDP growth in the United States is forecast to increase by 4.4% this year and 2.2% in 2023. Steady, strong growth in our largest trading partner is good news for Canadian exporters.



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

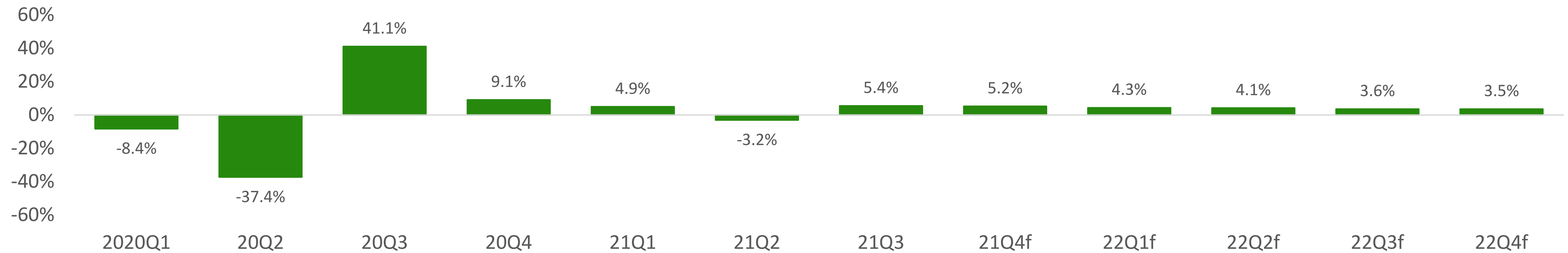
Canadian outlook
National perspective



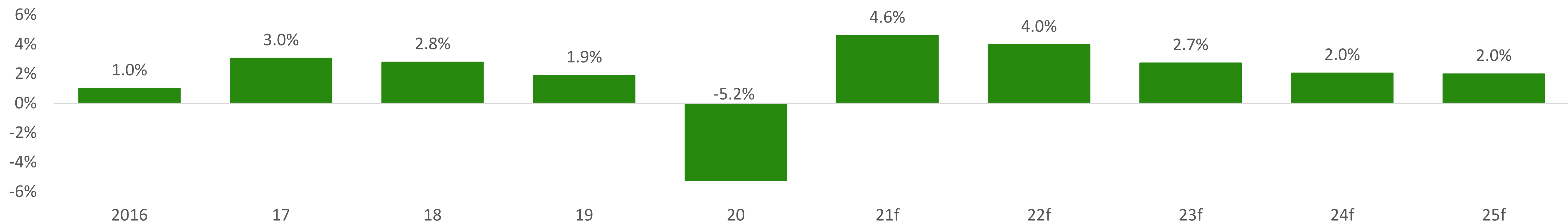
Omicron to slow but not derail the economic expansion

After bouncing back in the third quarter of 2021, the Canadian economy is now bracing for the impact of Omicron. Growth will slow as public health measures limit capacity in some venues. However, this is just a speed bump—growth will continue this year and into 2023.

Real GDP, quarter-over-quarter annualized growth



Real GDP, annual growth



Sources: Deloitte, Statistics Canada

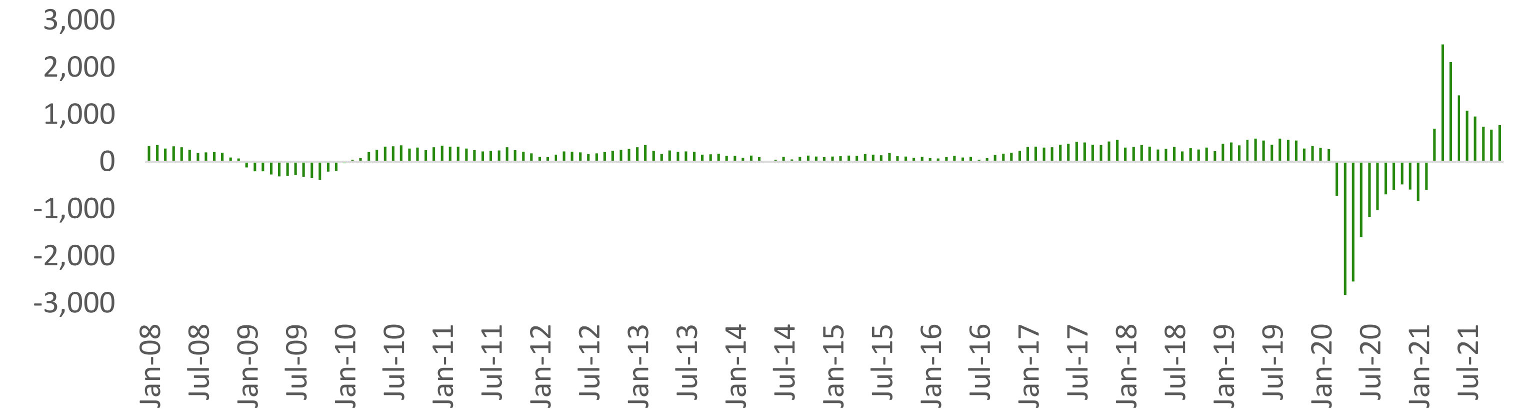
Canadian outlook
Household sector

Total employment continues to improve, and has returned to pre-pandemic levels

Employment increased in November 2021 for the sixth consecutive month, with 186,000 more Canadians employed compared to February 2020. Although the overall picture is positive, employment in sectors most affected by the pandemic continues to lag.

- Overall, the labour market continues to strengthen. By September 2021, total employment had returned to pre-pandemic levels and has continued to grow. The Canadian economy created 153,700 new jobs in November, bringing the total increase over a six-month period to 756,900. The unemployment rate fell 0.7 percentage points to 6% in November, which is only slightly above the 5.7% recorded in February 2020.
- Labour shortages continue to be a concern. The overall job vacancy rate rose to 6% in September 2021, which is considerably above pre-pandemic levels. Job vacancy rates are particularly high and rising in accommodation and food services, reaching 14.4% in September 2021, and other services, rising to 7.2% that same month. This may be a signal of specific skill shortages or a geographic mismatch between vacant positions and workers with the required skills willing and available to fill them.
- The labour market underutilization rate—which captures discouraged workers and those who worked less than half their usual hours, likely for reasons relating to COVID-19—fell in November 2021 to 12.4%. The falling rate and rising job vacancies signals a tightening labour market.
- Total hours worked increased by 0.7% in November, returning to pre-pandemic levels for the first time.

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



Canadian job vacancy rate

Sources: Deloitte, Statistics Canada

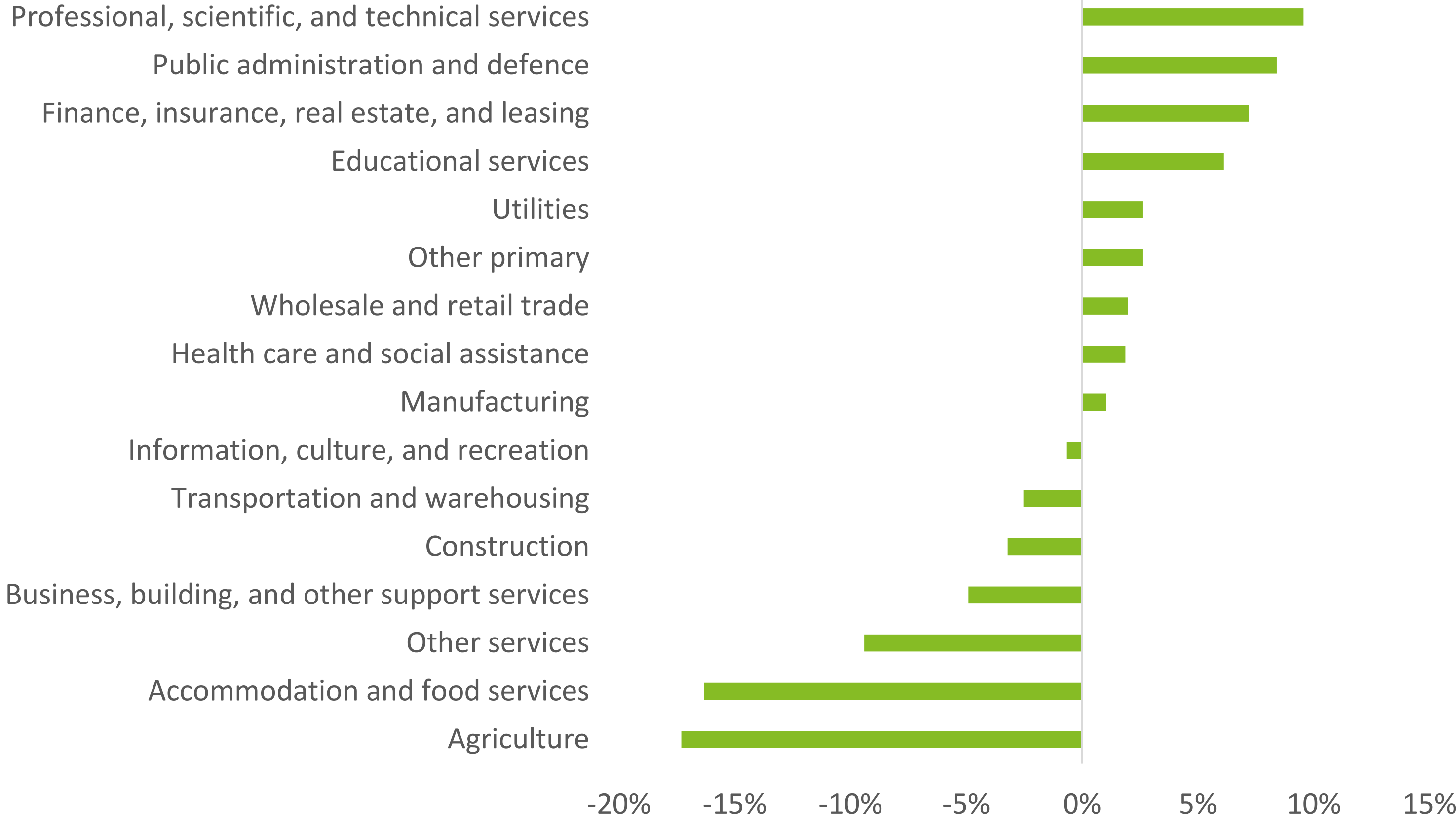
Industries affected by pandemic-related public health measures are experiencing greater impacts

In the fall many pandemic-related restrictions were lifted, allowing restaurants, personal care services, retail stores, and entertainment venues to welcome clients indoors, if with capacity restrictions in some provinces, but a large divergence across industries remained.

- Employment in industries most affected by the pandemic continues to lag. Despite strong growth in the third quarter of last year, 202,100 fewer Canadians were employed in accommodation and food services in November 2021 compared with February 2020. Conversely, employment in industries where people can work from home has risen since the start of the pandemic. This includes: professional, scientific, and technical services; public administration and defence, finance, insurance, real estate, and leasing; and educational services.
- Employment in accommodation and food services is expected to remain below pre-pandemic levels through 2022, and will not fully recover for another few years.
- Although employment in services overall has returned to pre-pandemic levels, employment in commercial services is only predicted to return to February 2020 levels halfway through 2022. This is mainly due to the slow growth expected in accommodation and food services, other services (which includes personal services and maintenance services), and business, building, and other support services.
- Mounting concerns surrounding COVID-19 variants may stall employment growth in jobs involving close contact with others. The unemployment rate is expected to drop below 6% only by the end of 2023 as the participation rate inches higher.

Employment by industry, 2019Q4 to 2021Q4

(Percent change)



Sources: Deloitte, Statistics Canada

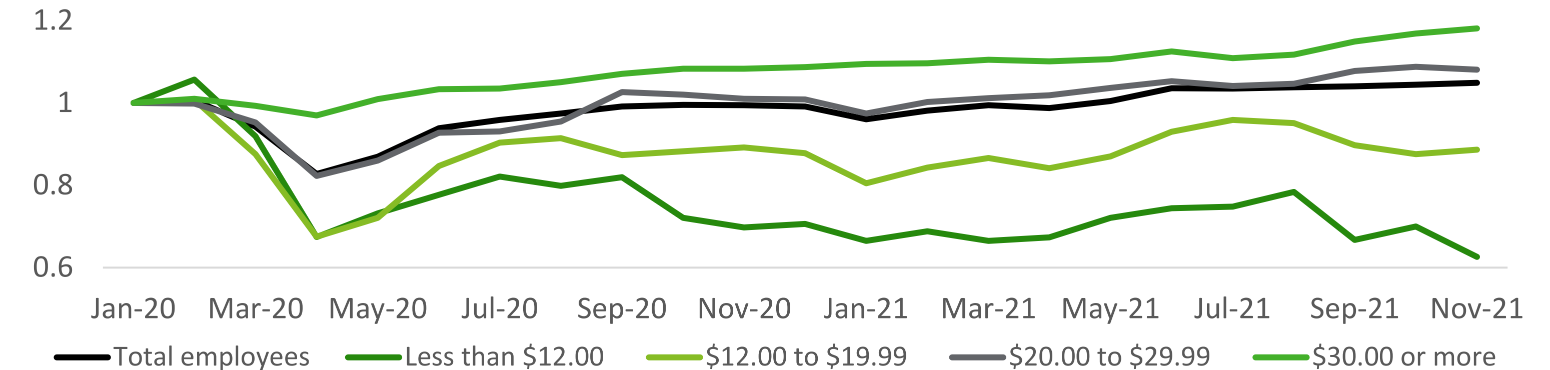
A tale of two labour markets

The employment recovery has been uneven across income and education levels. The negative impact continue to be felt disproportionately by lower-income Canadians and those with less education.

- Industries that continue to face the greatest negative impacts from the pandemic tend to pay the lowest wages. Employment levels for individuals making less than $20 per hour is below January 2020 levels, whereas employment levels for individuals with an hourly salary greater than $20 are above pre-pandemic levels. That is especially the case for employees making more than $30 per hour.
- This discrepancy also shows up in employment by level of education. Employment for those with a post-secondary certificate/diploma or a university degree is up 5.5% while it's down 5.6% for those without.
- More and more jobs (often higher-paying ones) require a university degree, which is why more individuals are opting to pursue a university education.
- However, the unemployment rate among individuals with a high school diploma or less dropped below pre-COVID-19 levels in November, which suggests the number of people potentially wanting to fill the job vacancies in accommodation and food services or other services (which typically don't require university education) is decreasing. As such, the labour shortage issue might be one that persists.

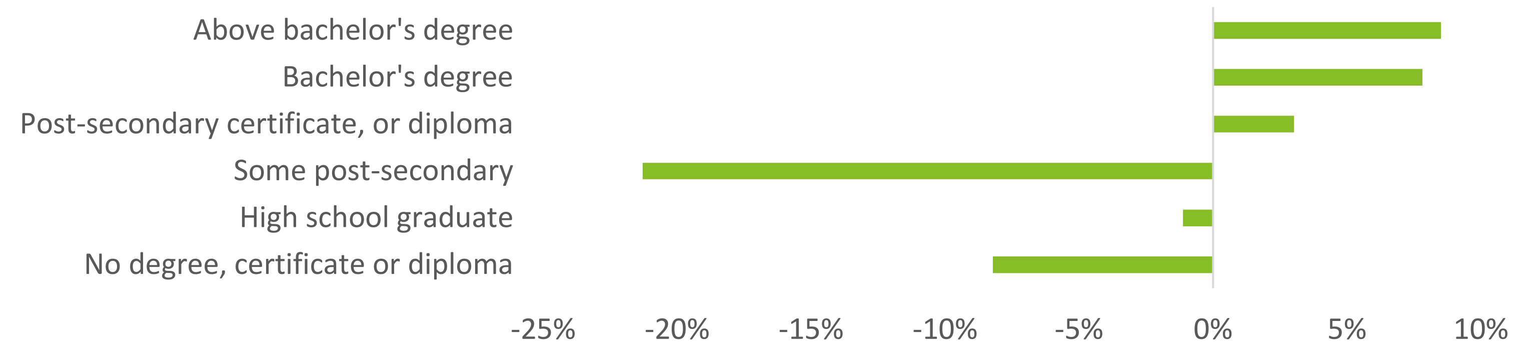
Employment by average hourly wages, January 2020 to October 2021

(Index January 2020=1)



Employment by education (people aged 25+), February 2020 to November 2021

(Percent change)



Sources: Deloitte, Statistics Canada

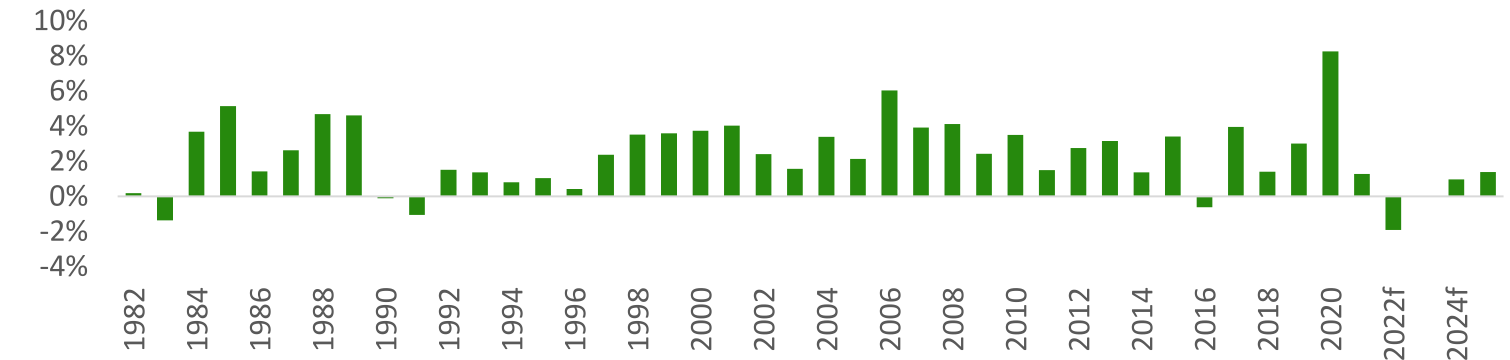
Steady government support and solid wage growth boosted household savings

Strong growth in disposable income and an inability to purchase many services or travel have resulted in a record buildup in household savings that will continue to fuel spending.

- Despite three million jobs lost, sizable government transfers resulted in the largest increase in real disposable income on record in 2020—a whopping 8.3%. However, growth in disposable income slowed in 2021 and with transfers winding down, we expect real disposable income to fall this year.
- Income growth was driven by higher-income and higher-skilled individuals who benefitted from increased labour market demand while lower-income individuals benefitted from a large amount of government support, the largest of which was the Canada Emergency Response Benefit (CERB). CERB compensated workers unable to work because of the pandemic.
- On top of strong income growth, an inability to spend on services resulted in a massive buildup of household savings: they reached new highs in 2020—going above $206 billion—and stayed above $170 billion through 2021. For comparison, household savings averaged just $26 billion in the five years preceding the pandemic.
- Household savings are expected to decline sharply in 2022 to just under $79 billion and return to normal in 2023 as they flow instead toward strong consumer spending, especially on services. In 2019, prior to the start of the pandemic, the savings rate was hovering around 2%; it is not expected to return to 2% until the second half of 2023.

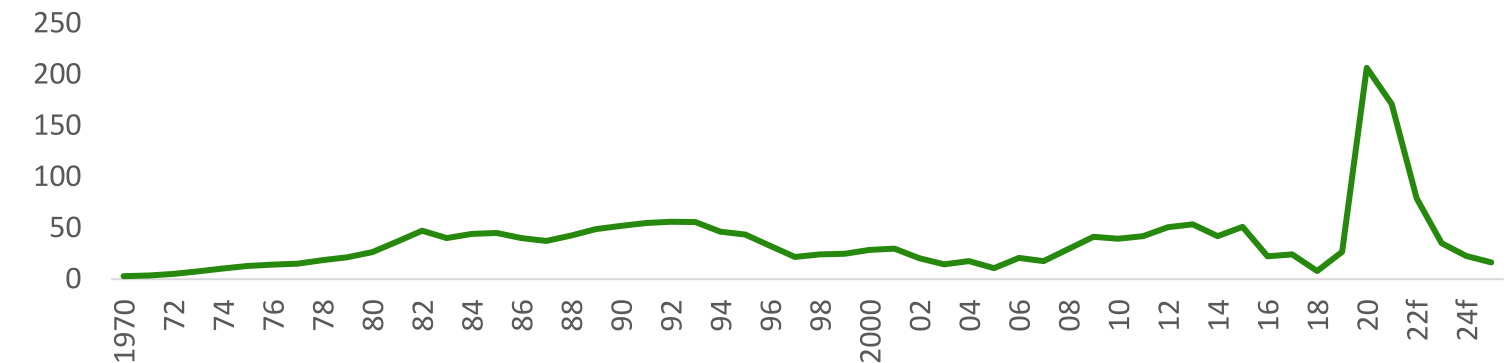
Real disposable income growth

(Percent change)



Household savings

(C$ billions)



Sources: Deloitte, Statistics Canada

© Deloitte LLP and affiliated entities.

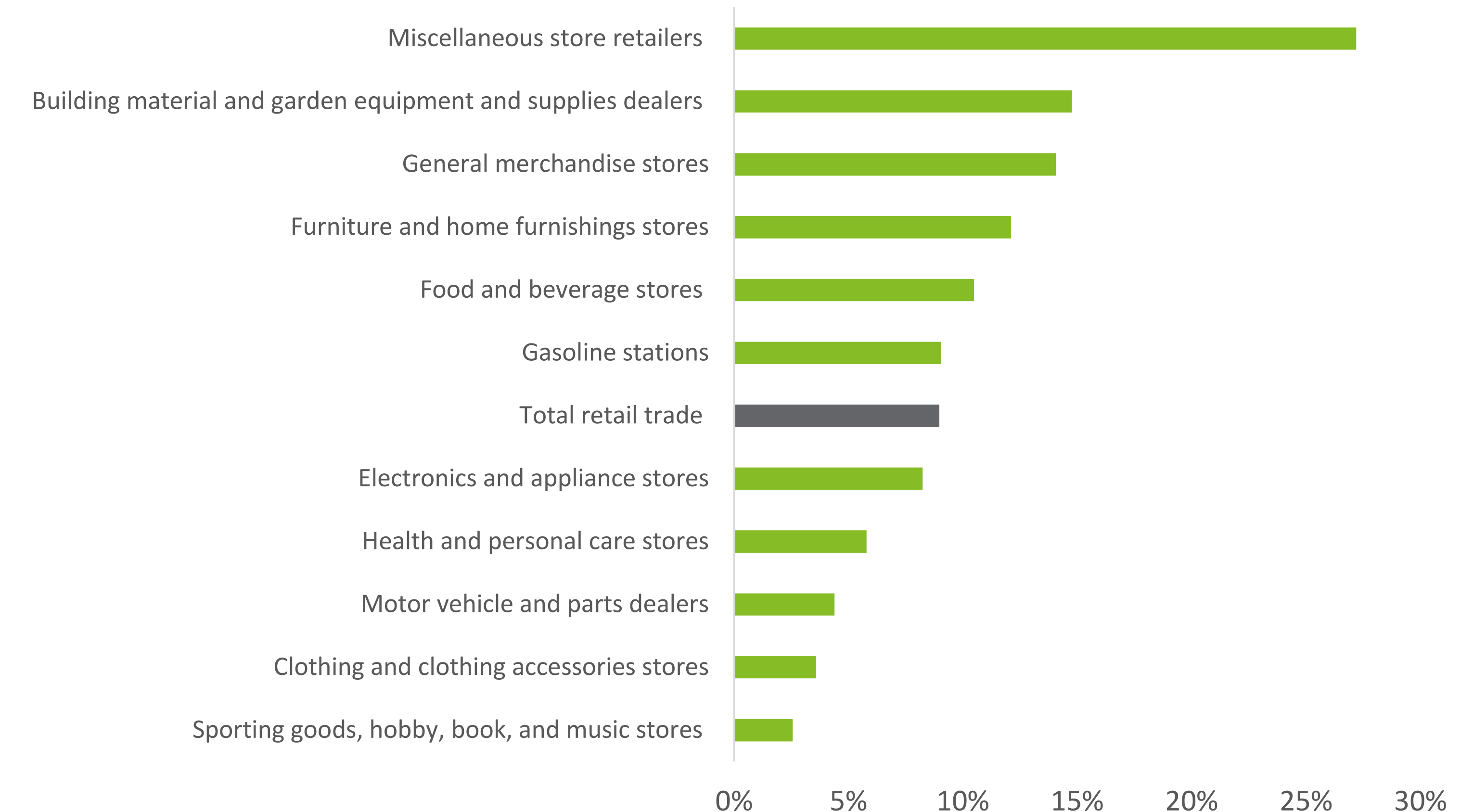
As household income continues to increase, retail spending has been a bright spot

Despite fluctuating store openings and closures throughout the pandemic, retail spending has fared very well. As of September 2021, retail sales are up almost 9% from February 2020.

- During the various waves of the COVID-19 pandemic here in Canada, the retail sector has been affected by public health-mandated closures of non-essential retailers, limits on purchases to only essential goods, and capacity reductions.
- Nevertheless, retail has managed to outperform other sectors impacted by restrictions on food services, accommodation, and entertainment.
- As of September 2021, retail sales were 9% above their pre-pandemic level, with most of the gains coming from miscellaneous retailers, reflecting the over-130% increase in cannabis retail sales since February 2020.
- With consumers spending more time at home, we've also seen a surge in spending on housing-related goods, including building materials, garden equipment and supplies, furniture, and home furnishing.
- Retail sales in all categories have increased above pre-pandemic levels. When retailers are open again following the Omicron wave, spending on services will continue to rise, and retail spending is likely to cool.

Change in retail sales, February 2020 to September 2021

(Percent change)



Sources: Deloitte, Statistics Canada

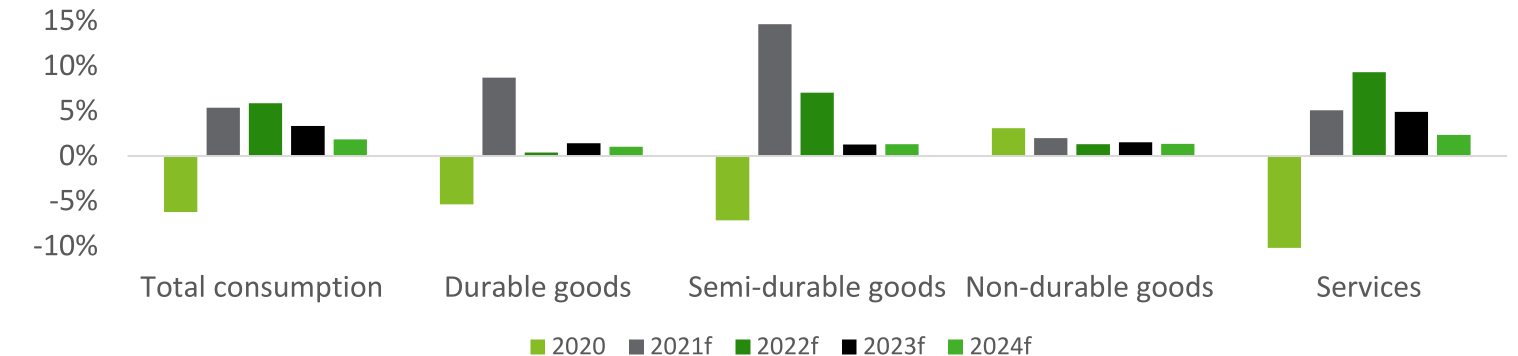
Consumer spending set to shift from goods to services

After falling by more than 6% in 2020, real consumer spending is set to increase over 5% per year in 2021 and 2022. This will mainly be driven by the large increase in real consumer spending in durable and semi-durable goods in 2021 and services in 2022.

- Consumer spending fell by more than 6% in 2020, driven by a 10.2% decline in spending in the service sector and a 1.0% decline in spending on goods.
- In 2021, consumer spending on goods continued to outpace spending on services as public health measures continued to limit spending on services. However, this trend will reverse in 2022 as household spending on services becomes the main driver of growth.
- With increased travel and the reopening of most services, consumer spending in this sector is expected to rise by over 9% in 2022.
- The categories that are expected to benefit the most are: transportation, accommodation, and food; and communication, recreation, and culture services.
- With households still sitting on a large amount of cash, spending on goods is projected to rise another 1.9% in 2022.

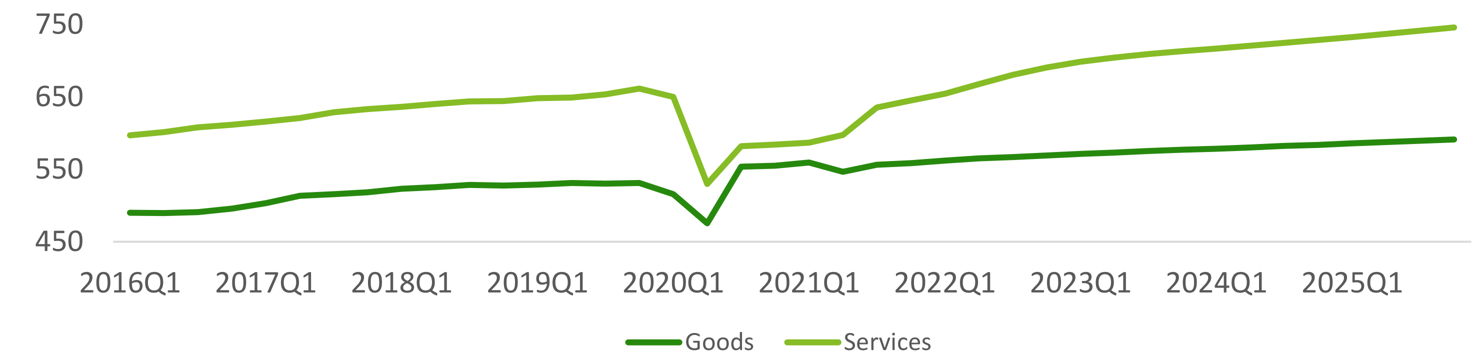
Growth in real consumer spending

(Percent change)



Consumer spending on goods and services

(C$ billions; 2012 prices)

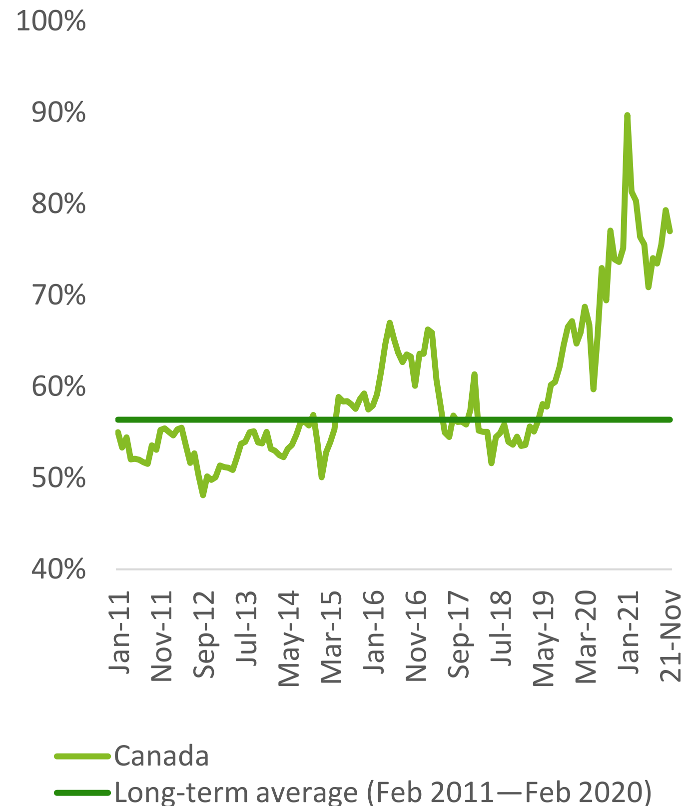


Sources: Deloitte, Statistics Canada

Low housing supply keeps the market tight

After a four-month slowdown over last summer, resale housing activity picked up again. Home prices, not surprisingly, continue to soar.

- As the number of new housing listings has retreated from its March high and has been trending below the long-term average, home sales have been limited by low supply. As a result, capital spending on ownership transfer costs—including fees for real estate agents and lawyers—has been hit hard, dropping from a record 48% over its pre-pandemic level in the first quarter to just 11% in the third quarter.
- Households' appetite for houses, however, remains elevated, thanks to the extra savings accumulated during the pandemic and a low mortgage rate environment. Home resale activities heated up again toward the end of last year with the sales-to-listing ratio jumping to nearly 80% in October, far above the past-decade average of 56%.
- Only 1.8 months of housing inventory was available in November, the lowest level since the data started being recorded in 2003. That means we're still deeply in a seller's market, which will likely push prices even higher.
- While supply might take years to catch up, demand will ease following the expected interest rate hikes starting in 2022 and waning demand for a larger living space post-pandemic. As such, the growth of home prices will slow to an average annual growth of 1.8% between 2022 and 2023, down from the 20.6% gain seen last year.



Sources: Deloitte, The Canadian Real Estate Association

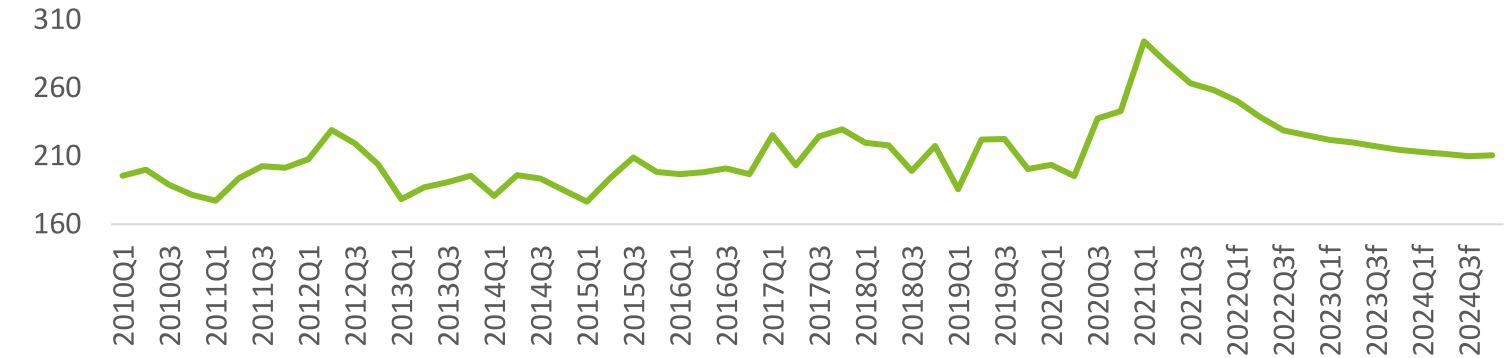
Expected interest rate hikes to weigh on residential investment

Increasing mortgage rates starting this year will reduce Canadians' borrowing capacity and thus constrain home building and renovation spending.

- After peaking at a record 294,000 units in the first quarter of last year, housing starts have been falling. Nevertheless, they were still sitting at more than 30% above the past 10-year average in the third quarter. Given the rate of population growth in Canada, the level of housing we're seeing today isn't sustainable. We expect starts will fall to 235,800 in 2022 and 218,400 in 2023.
- The shortage of construction workers and materials has posed extra challenges for many home building and renovation projects. Construction costs, as a result, soared 16.8% in the first three quarters of 2021. The issue will persist well into 2022 and weigh on the outlook of capital spending on the housing market.
- The rising mortgage rates expected by mid-year will worsen the financial condition of many Canadian households. Not only will homeowners pay higher mortgage interest each month, but a smaller borrowing capacity will also constrain the amount of investment they put in home renovation. For first-time homebuyers, it means that it will be even tougher to enter the market, exacerbating the housing affordability issue across Canada.
- We expect that real residential investment will drop over the next two years before resuming growth in 2024.

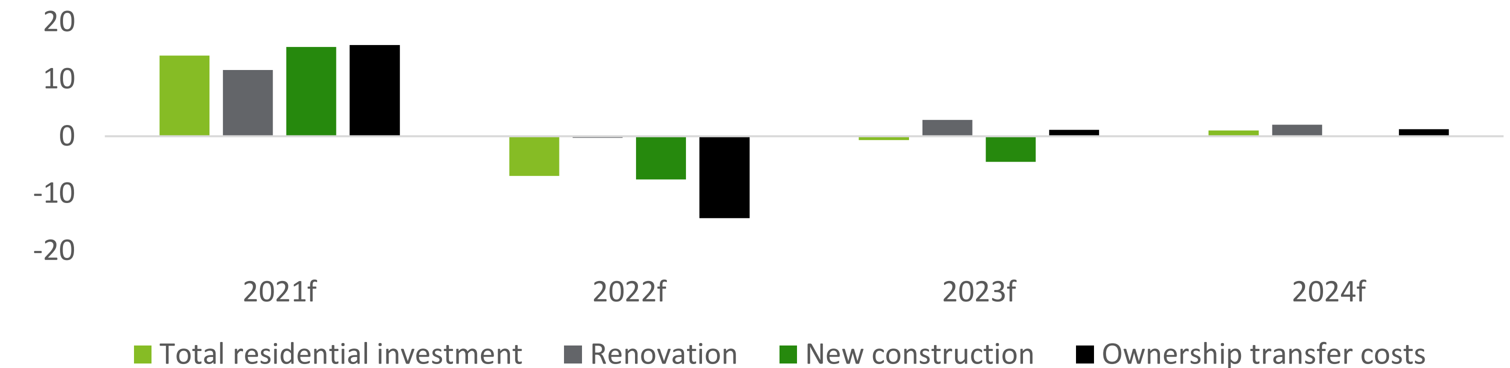
Housing starts

(000s)



Residential investment

(Percent change)



Sources: Deloitte, Statistics Canada

Canadian outlook
Business sector

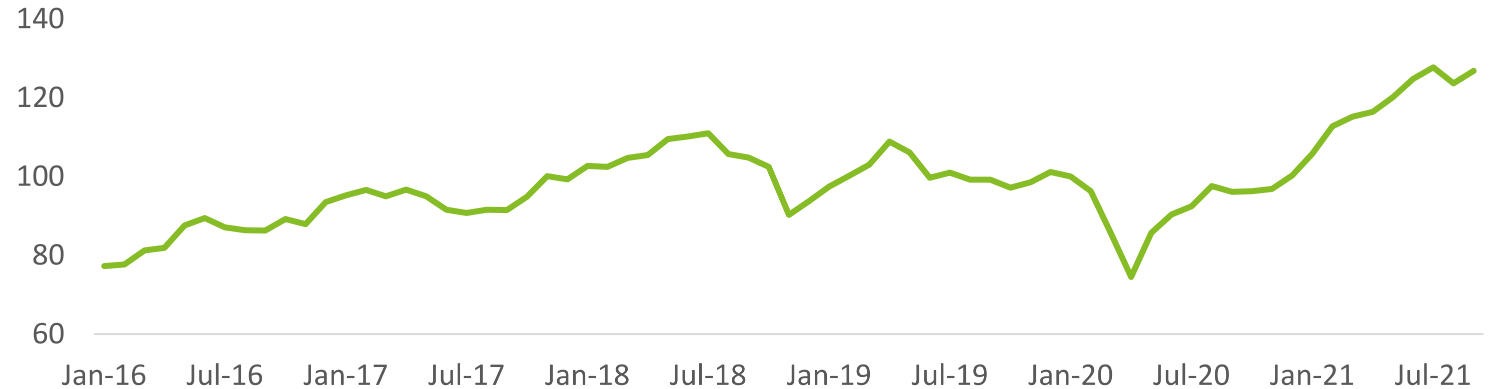
Persistent disruptions in the supply chain catapult costs for cargo and key commodities

Global supply chain challenges coupled with strong demand have boosted the price of raw materials, while rising shipping costs have made it difficult to source key inputs.

- As the global economy moved to the recovery phase in 2021 and demand for goods surprised on the upside, commodity prices rose significantly. Indeed, the Canadian raw material price index has jumped over 25% since January 2020.
- Rising commodity prices is good news for Canadian exporters. As a large producer of commodities, Canada's export revenues for gold, iron, and wood products as well as plastic resins saw significant gains in 2021.
- The rise in commodity prices is a boon for many companies, but supply chain issues are causing headaches for most. While some industries are being hard hit by specific shortages—such as the lack of semiconductor chips in the automotive industry—almost all are being affected by skyrocketing shipping costs, which have increased by over 300% since January 2020.
- These higher shipping costs in turn mean higher costs to businesses and consumers, as evident by the recent global surge in inflation.
- While we expect the challenges to persist into 2022, we did see a pullback in shipping and raw material costs toward the end of last year, suggesting that peak price growth in these areas may be behind us.

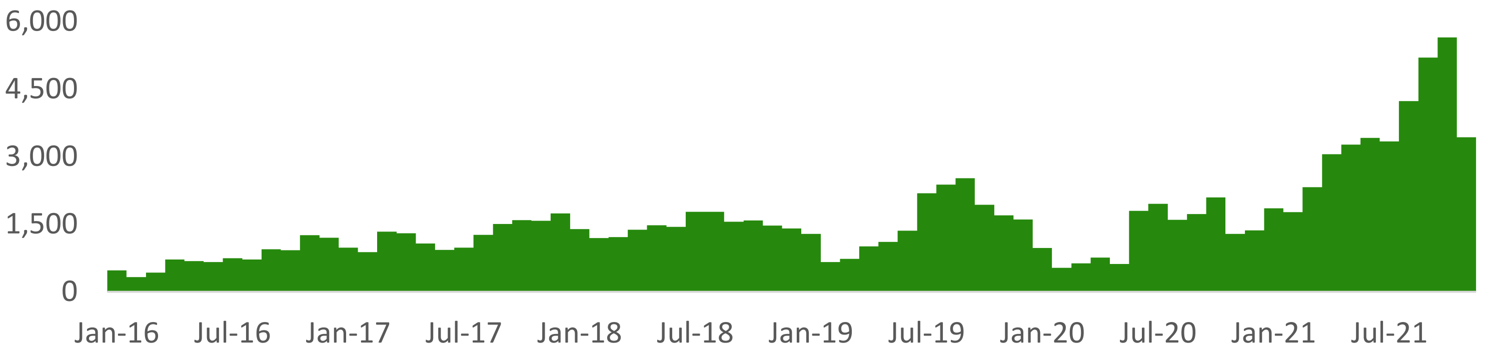
Canadian raw material price index

January 2020 = 100



Sources: Deloitte, Statistics Canada

Baltic exchange dry index, weekly



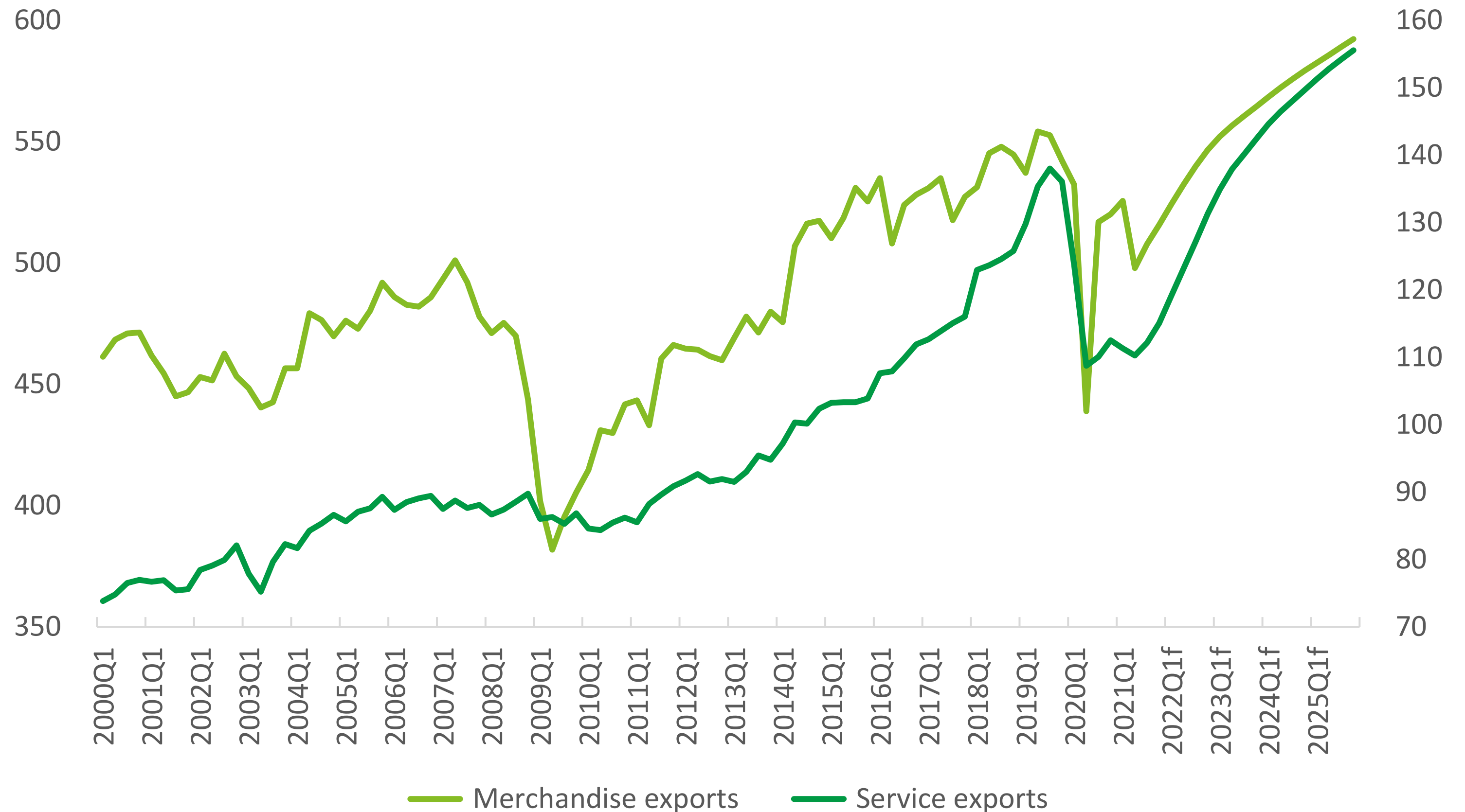
Sources: The Baltic Exchange/Haver Analytics

Exports still have a way to go before they recover to pre-pandemic levels

Merchandise exports are lagging the overall economic recovery. Meanwhile, exports of services remain near recent lows as the sector remains daunted by new variants.

- Surging commodity prices, strong economic growth in the United States, and the easing of pandemic restrictions were boosting Canada's trade balance, but the volume of exports remains far below pre-pandemic levels before the new year.
- Merchandise exports will continue to recover this year, with 5% growth projected.
- Energy products and motor vehicles will lead the way. Energy exports are projected to increase by 6% in 2022, but then cool in the second half of 2023 as reduced investment drags down growth. Motor vehicle exports are projected to increase by 9% this year after being hit by supply chain challenges in 2021. However, weak investment will also take a toll on long-term prospects, while US trade policy remains a key risk.
- With supply chain issues persisting and capacity constraints becoming an issue for Canadian exporters, we expect the pace of growth in merchandise trade will not ease until 2023.
- Export of services continued to decline in 2021 as the ability and willingness to travel remained restricted. We expect them to post solid growth in 2022, although the emergence of Omicron may dampen this outlook. The Canadian government has renewed travel warnings, which is likely to slow the pace of recovery.

Exports of goods and services
(C$ billions; 2021 dollars)



Sources: Deloitte, Statistics Canada

© Deloitte LLP and affiliated entities.

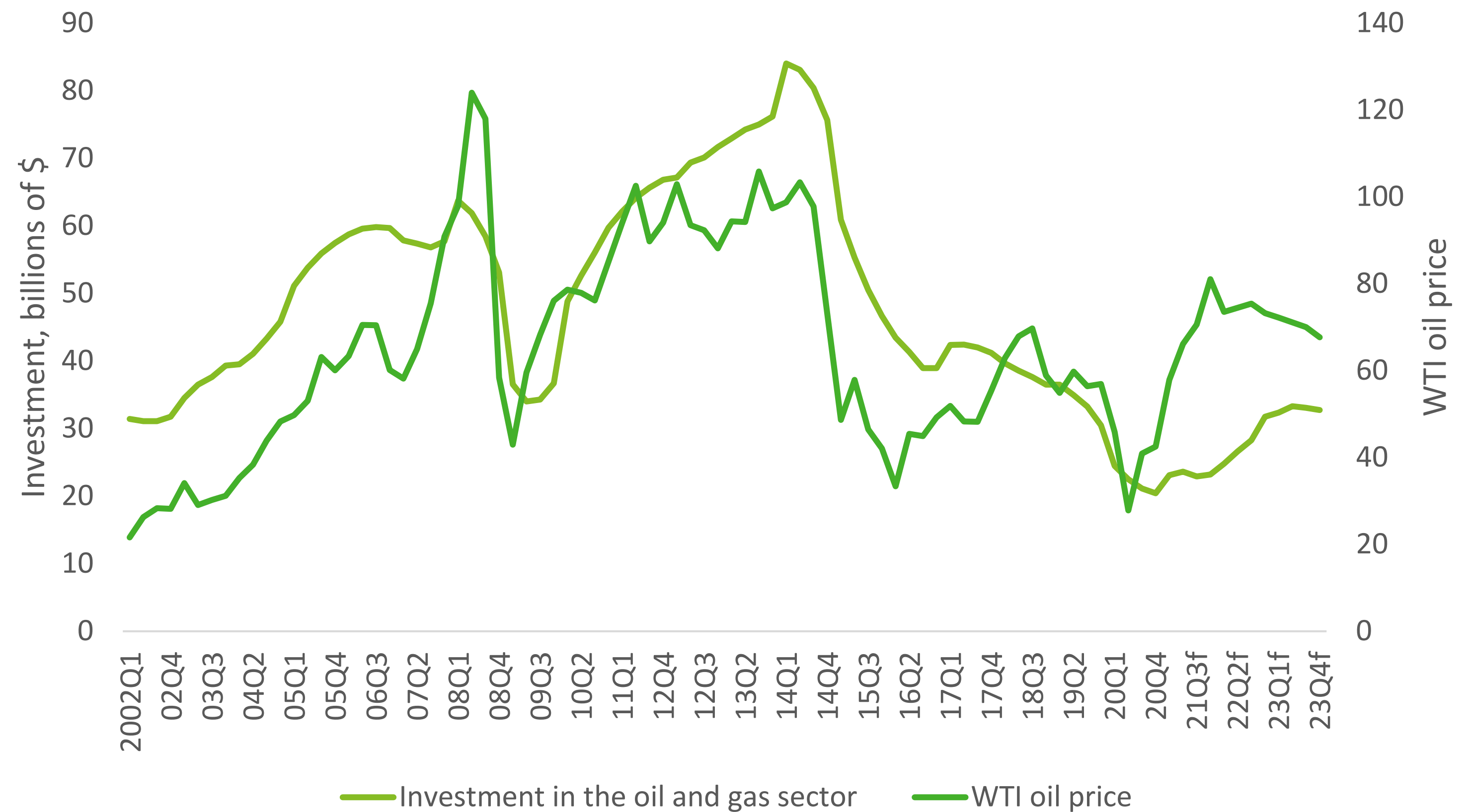
The oil and gas sector is expected to see a limited recovery despite strong oil prices

Investment in the oil and gas sector is expected to see strong growth this year driven by healthy oil prices. However, the levels of investment will remain well below recent highs as uncertainty over the sector's future temper investment decisions.

- Oil prices have recovered to healthy levels over the last year, although the spread of Omicron has taken some of the steam out of the recent recovery.
- Despite its recent retreat, the WTI oil price remains just under US$72/bbl. This is well above recent lows and its pre-pandemic level of about US$63/bbl. We expect prices to remain near current levels through 2022, averaging US$74/bbl, and then ease to US$70/bbl in 2023 as supply increases due to OPEC unwinding cuts made during the pandemic.
- Despite our projection for healthy oil prices, Canadian producers are expected to make only modest increases in investment. Investment in the oil and gas sector is expected to increase by just $6 billion in 2022, about half of the decline seen in the pandemic and a small fraction of the almost $60 billion in annual investment lost since 2014.
- With investment levels remaining soft, growth in output and exports is expected to be much more muted than in recent years. In the decade leading up to the pandemic, oil exports grew by an average of 6.8% per year. We expect oil and gas exports will see average growth of just 3.2% per year over the next five years, which includes some strong pandemic recovery in 2022.
- This slowdown will increase the pressure to improve our non-energy export performance to pick up the slack.

Oil prices and energy investment

(WTI oil price in US$/barrel, investments in billions of chained dollars)



Sources: Statistics Canada, forecasts by Deloitte

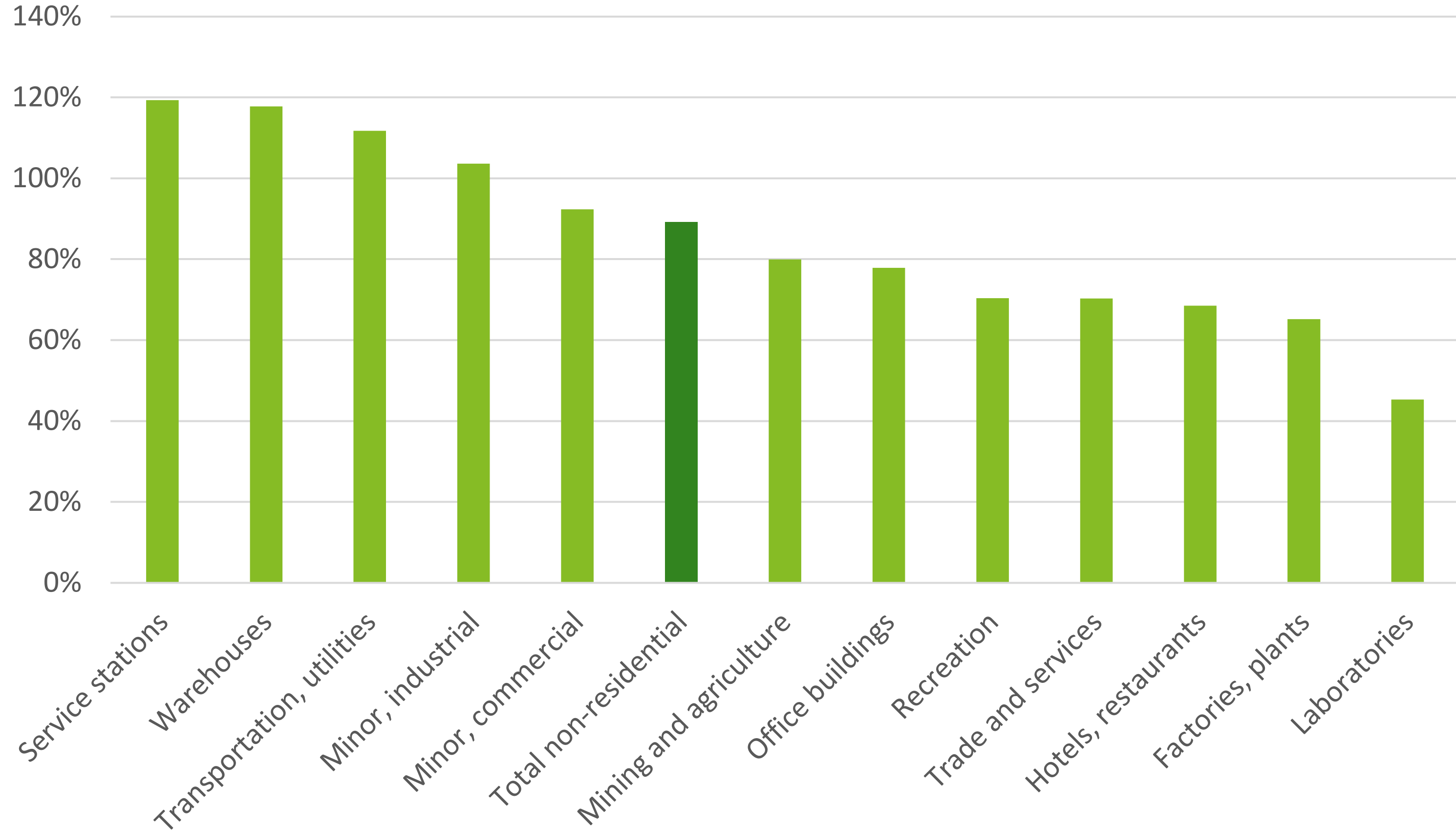
Building construction continues to lag with reduced demand for office space

Business investors are rethinking their constructions plans, as fewer people are expected to return to the office after the pandemic.

- Thanks to elevated demand for consumer goods during the pandemic, investment in warehousing and transportation facilities have spurred significant increases in construction. In fact, by October, investment in these categories had surpassed its pre-COVID-19 level by almost 20%. We expect capital spending on these projects will continue to rise over the next two years, as companies respond to increased online purchases and expand their supply capacity.
- However, this won't be enough to turn the tide on the construction sector's prospects. In fact, building construction is projected to be one of the weakest areas in non-energy investment as construction of office buildings, recreation facilities, hotels, and restaurants continues to slump and workers increasingly indicate their preference to continue working from home at least part-time. According to October's construction data, investment in these buildings was still more than 20% lower than its pre-pandemic levels. With the office vacancies rate in Canada surging to its highest level in decades, we're unlikely to see much improvement any time soon.
- As many people have relocated away from downtown and wish to continue to work from home, demand for office space and the surrounding commercial stores will remain subdued.

Investment in construction projects, October 2021

(Index, February 2020=100)



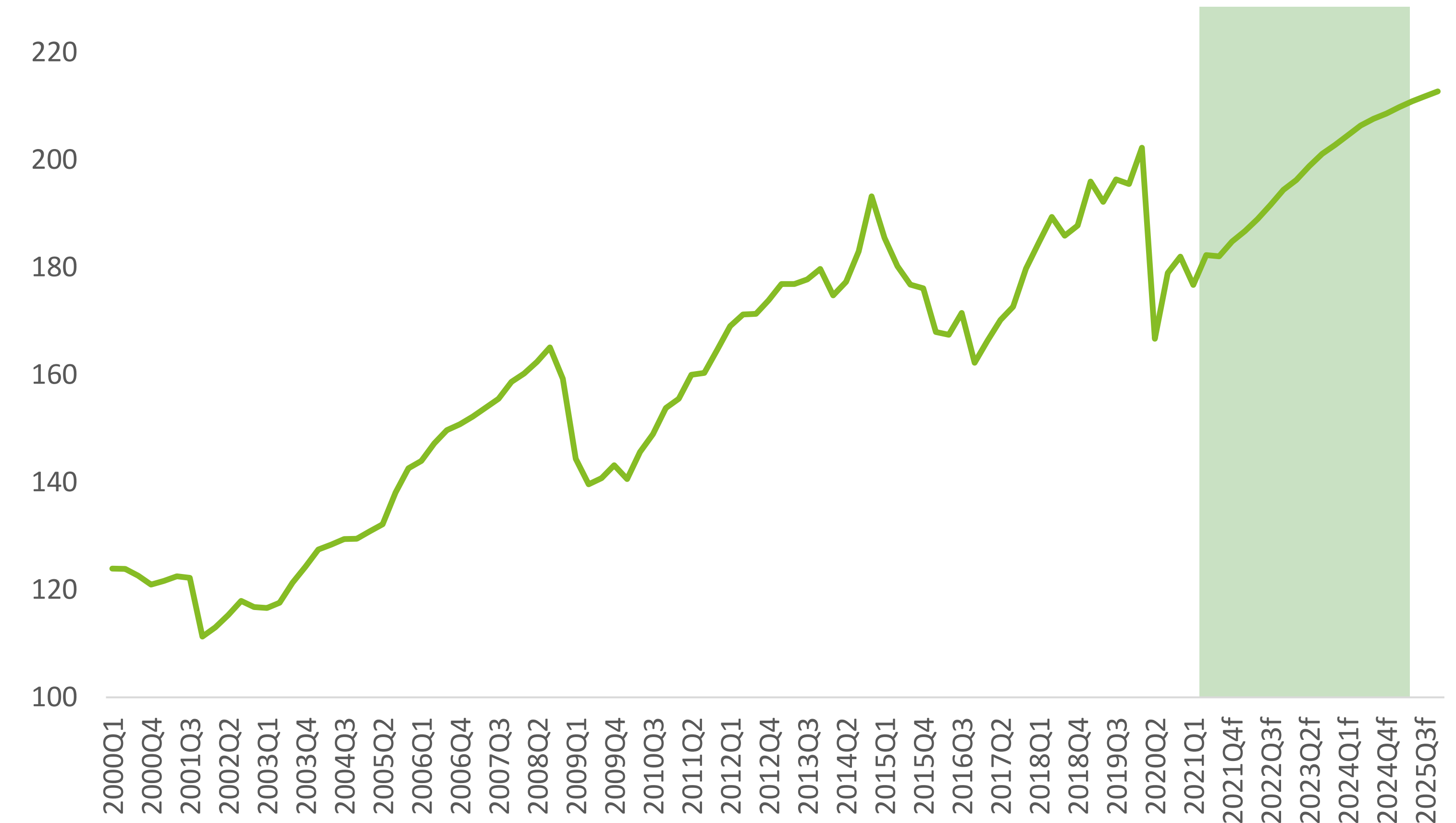
Sources: Deloitte, Statistics Canada

© Deloitte LLP and affiliated entities.

Non-energy investment to see solid growth after the pandemic

Following two consecutive years of decline, non-energy business investment is poised to grow this year, if at a modest level. However, similar to energy investment, the level of investment will remain modest. The Omicron variant also poses challenges to the recovery.

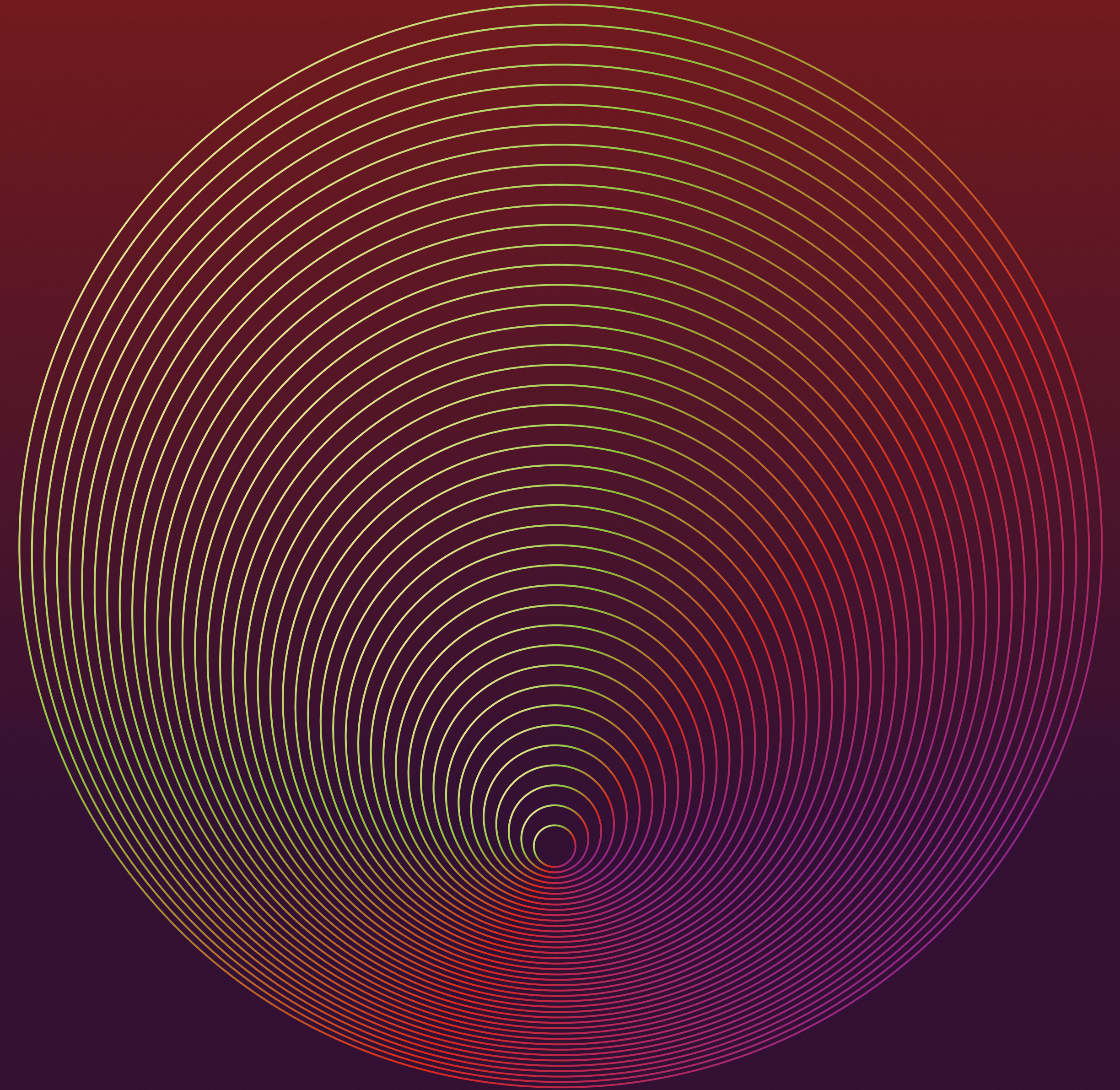
- On the positive side, Canadian businesses are increasingly optimistic about the future, as indicated by the Business Outlook Survey indicator from the Bank of Canada. The indicator reached a record high in the third quarter of 2021.
- As a result, many businesses are planning to increase their capital spending over the next year, especially on machinery and equipment, to satisfy increasing demand and to ease capacity constraints caused by supply chain bottlenecks and labour shortages.
- Investment is particularly strong in the utilities sector, which rose 18.4% in 2021, thanks to large hydroelectric projects. This is continuing to drive growth in 2022.
- Many investment projects that were postponed earlier in the pandemic will also resume this year as economic conditions improve. Investment in the other mining sector and the transportation and warehousing sector is expected to post strong growth over the next two years.
- Despite these increases, the level of investment is projected to remain soft, remaining below pre-pandemic levels until 2023. The stock of machinery and equipment held by Canadian companies has declined by more than 9% over the last seven years and is expected to decline again in 2022.
- Additionally, the recent surge of COVID-19 cases has increased uncertainty. This could further weigh on business confidence and investment intentions in the near term.



Sources: Deloitte, Statistics Canada

© Deloitte LLP and affiliated entities.

Canadian outlook
Monetary and fiscal policy



© Deloitte LLP and affiliated entities.

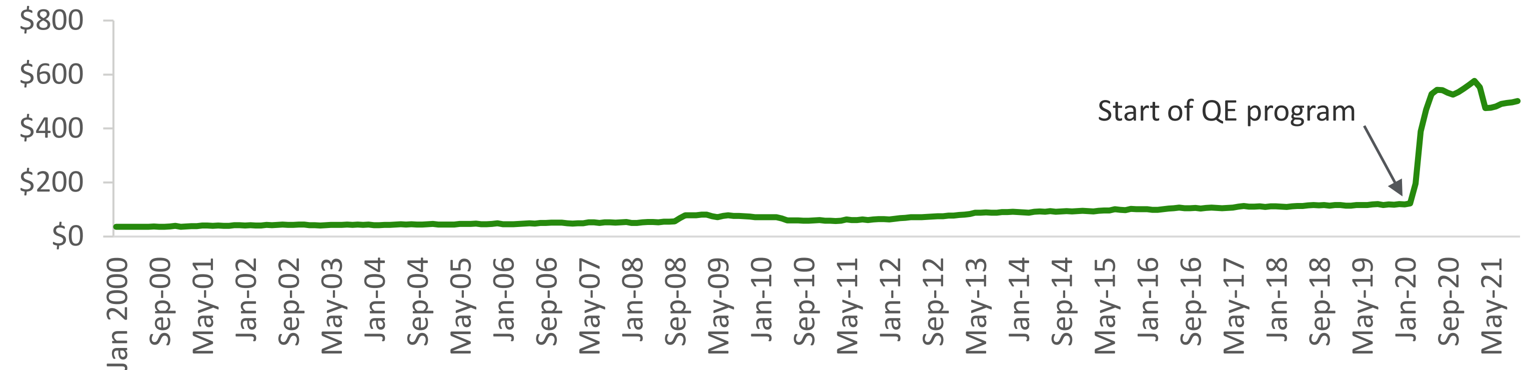
Tighter monetary policy is coming sooner than expected

The Bank of Canada ended quantitative easing (QE) in October 2021. It has maintained its forward guidance on the path for the overnight rate, which is pointing to a rate hike in the second quarter of this year.

- With inflation at its highest level since 2003, rate hike expectations have been moved forward not only in Canada, but also in other large economies like the United States, Australia, and England. We're now expecting the Bank of Canada to raise the overnight rate during the second quarter of this year.
- What seemed to be a transitory increase in inflation in the third quarter of 2021 has now persisted for almost a year, and we believe that price growth will remain hot into 2022 and only return to its 2% target at the beginning of 2024. The supply chain constraints, labour shortages, high demand for specific goods, and increase in commodity and energy prices are all contributing to keeping inflation at a high level. The newest coronavirus variant is keeping workers from going back to work, which is likely to cause even more supply chain disruption and push up inflation.
- The Bank of Canada recently renewed its monetary policy framework for 2022 to 2026. It will keep its inflation target of 2% but will also consider the maximum level of employment in its future monetary policy.
- In the United States, meanwhile, the Federal Reserve had not as of December 2021 concluded its QE program, but we expect it to do so in the coming months. American inflation is now increasing at its fastest pace since 1982, posting a 6.8% year-over-year increase in November 2021. The Fed is now moving toward tighter monetary policy, and a first hike of its federal funds rate is expected during the second quarter of 2022. This should help to cool down price pressures.

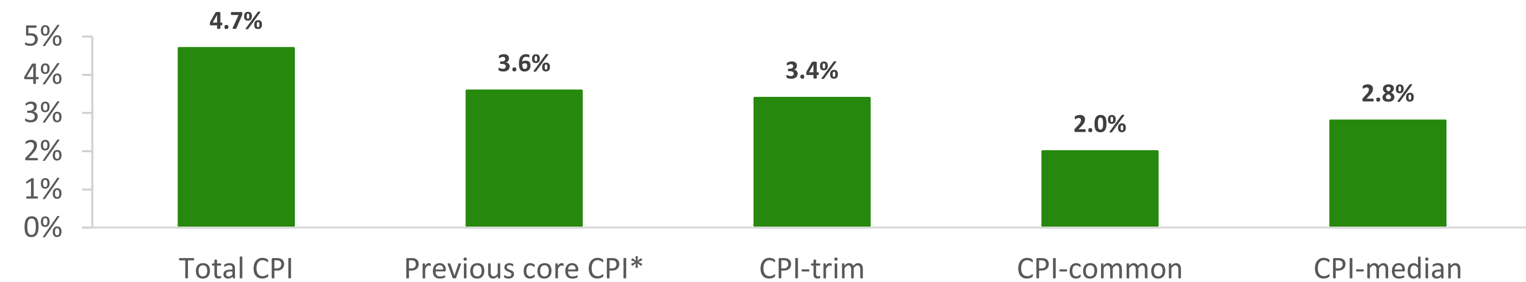
Bank of Canada assets

($C billions)



Measures of Canadian inflation

(November 2021, year-over-year growth)



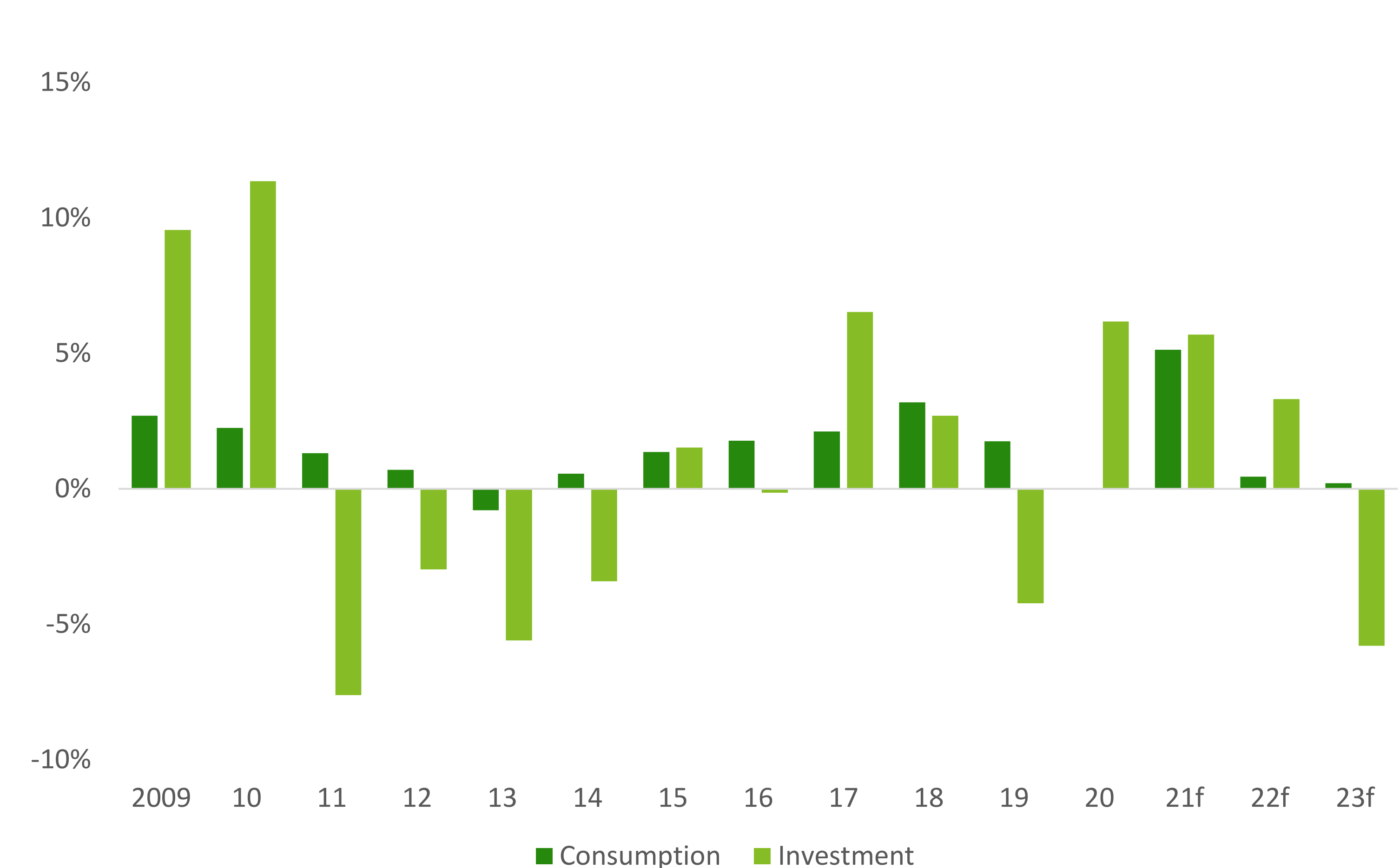
* CPI less 8 most volatile components and indirect taxes

Sources: Statistics Canada, forecasts by Deloitte

Fiscal policy continues to support the ongoing recovery

Federal and provincial governments have stepped in with large fiscal stimulus. However, record debt levels will force governments to reduce spending, particularly as interest rates began to rise.

- We expect federal spending growth over the next few years to follow the budget estimates in the economic and fiscal update released in December 2021. That means elevated levels of spending will continue into 2022, with targeted federal support measures for those who were particularly hard hit by the pandemic.
- However, overall spending on goods and services and investment is expected to fall in 2023 as stimulus spending declines and provincial and territorial governments focus on balancing their books.
- The withdrawal of fiscal stimulus is projected to be slow, and deficits at the federal and provincial/territorial levels are expected to persist over our forecast period, which runs until 2030.
- Federal and provincial/territorial debt increased substantially during the pandemic-caused recession. Federal debt is expected to peak at 48% of GDP in 2021-22 and many of the provinces and territories have similarly high debt ratios. According to the government's calculations, even if the recovery is slower than expected, the federal debt-to-GDP ratio should remain on a downward trend. This will help us deal with another crisis or rising rates in the future.



Sources: Statistics Canada, forecasts by Deloitte

Concluding remarks

Don’t let the latest near-term threat derail focus on our longer-term challenges

One consistent facet of the COVID-19 crisis is that it continues to last longer than expected. Late last spring it was the emergence of the Delta variant that set back the economic recovery of many countries, including our own. This winter it’s Omicron. Despite the rightful concern about this latest variant and the need for renewed public health measures to curb its spread, it’s important to remember that we’re in a much better position to deal with COVID-19 now. We have vaccines that are effective at preventing the worst health outcomes, a large share of our population is inoculated, and we’re fortunate enough to have sufficient supply to offer people booster shots to help slow the spread of this highly transmissible variant. We also have therapeutics that could help in the fight against the virus.

Despite the tools at our disposal, this latest variant will slow the economic recovery. It’s important to remember, however, that it’s expected to be a short-term setback and that the conditions for economic recovery remain. We’re still seeing a lot of monetary and fiscal stimulus, and consumers are still sitting on a stockpile of cash to power the recovery. Further, high commodity prices are boosting our export prospects. The key takeaway is that the recovery will continue, just a bit slower and with more downside risk than previously expected.

Arguably the greater challenge facing Canada’s economy is its long-term prospects. The population is aging and that means we need to do a better job of helping under-represented members of our society into the labour market, including Indigenous peoples, and women, immigrants and refugees. Our ability to compete internationally has been challenged for years due to chronic underinvestment and weak productivity growth—we need new strategies and innovative approaches to change these circumstances. Finally, we need to find a way to address climate change by making meaningful reductions in our emissions—a very difficult task given our large geography and industry composition. However, if there’s a silver lining in the pandemic, it’s that the crisis has shown that we are in fact capable of tackling the toughest issues. That means we can change our rather lacklustre longer-term economic prospects; we just have to devote the time and resources necessary to do so.

© Deloitte LLP and affiliated entities.

Appendix

Key economic indicators

	2020	2021				2022				20A	21F	22F
	Q4A	Q1A	Q2A	Q3A	Q4F	Q1F	Q2F	Q3F	Q4F			
Real economic activity												
Gross domestic product	9.1	4.9	-3.2	5.4	5.2	4.3	4.1	3.6	3.5	-5.2	4.6	4.0
Consumption expenditure	3.0	3.4	0.5	12.1	3.9	3.3	3.6	3.3	2.7	-4.5	5.2	4.3
• Durable goods	-0.7	1.8	-12.6	-5.4	-0.4	4.5	3.7	1.2	1.4	-5.4	8.7	0.4
• Services	1.6	1.9	7.5	27.8	6.2	6.0	8.3	7.9	6.2	-10.2	5.1	9.3
Residential investment	16.0	43.2	-11.3	-31.3	-6.0	-1.5	2.8	-3.1	-2.2	4.3	14.1	-6.9
Non-residential fixed investment	4.8	-8.4	15.3	-0.9	6.5	7.5	8.6	8.4	12.6	-12.1	-0.6	7.3
• Non-residential structures	-8.2	4.1	3.4	-1.1	7.9	9.1	10.4	9.0	14.9	-10.0	-4.9	7.8
• Machinery & equipment	27.9	-24.9	38.1	-0.7	4.4	5.1	5.8	7.4	9.0	-15.4	6.7	6.7
Government consumption & investment	7.3	6.2	0.8	0.7	7.0	0.4	-1.6	-1.5	-1.9	0.9	5.2	0.9
Exports of goods & services	3.7	2.7	-17.0	8.0	7.2	8.1	7.8	7.2	6.7	-9.7	1.2	5.9
Imports of goods & services	11.3	4.6	2.1	-2.3	7.5	6.9	8.6	6.5	4.9	-10.8	6.7	5.7
Prices												
Consumer price index (y/y)	0.8	1.5	3.3	4.0	4.6	4.5	4.1	3.4	2.7	0.8	4.6	2.7
Implicit GDP price index (y/y)	1.7	6.0	9.3	7.8	7.0	4.6	3.1	3.1	3.3	1.7	7.0	3.3
Labour market												
Employment	9.9	1.0	2.5	7.4	3.4	2.0	1.2	1.1	1.2	-5.1	4.6	2.6
Unemployment rate (%)	8.8	8.4	8.0	7.1	6.3	6.2	6.1	6.1	6.1	9.6	7.5	6.1

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

Financial market indicators

	2020	2021				2022				20A	21F	22F
	Q4A	Q1A	Q2A	Q3A	Q4F	Q1F	Q2F	Q3F	Q4F			
Interest rates (%)												
Overnight rate target	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	0.25	0.25	1.00
3-month T-bill	0.10	0.08	0.12	0.17	0.13	0.27	0.43	0.68	0.93	0.10	0.13	0.93
1-year GoC note	0.17	0.14	0.21	0.28	0.58	0.69	0.81	1.04	1.28	0.17	0.58	1.28
2-year GoC note	0.24	0.20	0.36	0.48	0.90	0.93	0.96	1.10	1.25	0.24	0.90	1.25
5-year GoC note	0.41	0.71	0.92	0.92	1.37	1.38	1.39	1.49	1.61	0.41	1.37	1.61
10-year GoC bond	0.66	1.22	1.46	1.31	1.65	1.66	1.68	1.76	1.87	0.66	1.65	1.87
Yield curve spread (pp)												
3-month vs. 10-year	0.56	1.15	1.34	1.14	1.52	1.39	1.25	1.08	0.93	0.56	1.52	0.93
2-year vs. 10-year	0.43	1.02	1.10	0.83	0.75	0.73	0.72	0.66	0.61	0.43	0.75	0.61
Foreign exchange												
USD/CAD ($C)	1.30	1.27	1.23	1.26	1.25	1.25	1.24	1.24	1.24	1.30	1.25	1.24
CAD/USD (US cents)	0.77	0.79	0.81	0.79	0.80	0.80	0.81	0.81	0.80	0.77	0.80	0.80

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

www.deloitte.ca

About Deloitte
Deloitte provides audit and assurance, consulting, financial advisory, risk advisory, tax, and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries and territories bringing world-class capabilities, insights, and service to address clients' most complex business challenges. Deloitte LLP, an Ontario limited liability partnership, is the Canadian member firm of Deloitte Touche Tohmatsu Limited. Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Our global Purpose is making an impact that matters. At Deloitte Canada, that translates into building a better future by accelerating and expanding access to knowledge. We believe we can achieve this Purpose by living our shared values to lead the way, serve with integrity, take care of each other, foster inclusion, and collaborate for measurable impact.

To learn more about Deloitte's approximately 330,000 professionals, over 11,000 of whom are part of the Canadian firm, please connect with us on LinkedIn, Twitter, Instagram, or Facebook.

© Deloitte LLP and affiliated entities.
Designed and produced by the Agency | Deloitte Canada. 21-4140255