Deloitte.

There's light at the end of the tunnel

Economic outlook

January 2021

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Outlook summary

As 2020 draws to a close, we can finally see some light at the end of the tunnel. Campaigns for COVID-19 vaccination are beginning across Canada and other parts of the globe, signalling a beginning of the end of this tragic pandemic. However, it will take many more months before the vaccines reach enough of the population that our society and economy can begin to truly recover. Until we get there, the country remains in the grips of a deadly second wave of infection. Dealing with the public health crisis has necessitated renewed regional shutdowns and slowed economic growth dramatically from the rebound we witnessed in the third quarter. This is a trend that is, unfortunately, expected to continue in early 2021.

The impact COVID-19 has had on our economy is like nothing in recent memory. Real GDP fell by an annualized 7.3 percent in the first quarter of 2020 and by a jaw-dropping 38.1 percent in the second quarter. The speed of the rebound has also been unprecedented, with growth surging by 40.5 percent in the third quarter. While the breadth of the impact is unparalleled, what is familiar is the composition of the growth emerging from the recession the pandemic created. As was the case after the 2008-09 global financial crisis, this recovery has been led by household spending, investments in residential real estate, and government stimulus, but this is risky given the high levels of public-sector and household debt. Ultimately, Canada needs to orient *growth toward investment and exports.*

Nevertheless, our baseline forecast is built on the expectation that household spending will remain key to growth. We expect sharp differences in performance within spending categories. With many personal services and entertainment venues shuttered or operating at reduced capacity, consumer spending on services remains 12.4 percent below its pre-pandemic level. At the same time, household outlays on durable goods and investments in residential properties have soared well above their levels before the crisis.

Another sector that is punching above its weight when it comes to economic growth is the public sector, with federal and provincial government spending continuing to grow and the federal government transferring billions to households and businesses. Areas of the economy that continue to struggle are business investment and trade, an all-too-familiar narrative. Spending on machinery and equipment has begun to recover but remains depressed, while investments in structures that are dominated by the mining and energy sector have yet to see any resurgence. With global demand still soft, exporters are experiencing a slow recovery

Outlook summary

With lockdowns being renewed across the country in response to rising infection rates, our forecast calls for economic growth to slow to just 2.7 percent in the fourth quarter, leaving the economy down 5.7 percent, or $119 billion, to end the year. The economy is expected to contract in the first quarter before growth resumes in the second quarter of the new year when the weather improves, and more people are vaccinated. Getting enough of the population inoculated to substantially curb the spread of COVID-19 is, however, key to our economic recovery. That means growth next year will be back-end-loaded, given the timing of the national vaccination campaign. As momentum once again begins to build in the second half of the year, we see the economy growing by 4.2 percent in 2021 and 4.9 percent in 2022.

In the meantime, growth will be uneven over the coming quarters. Supported by high levels of savings, households will increase their consumption, but by the second half of next year we'll see spending on goods slow as services spending takes off. Residential investment is expected to decline in the near term after demand that accrued in the spring was unleashed throughout the summer months. After that temporary cooling, residential real estate growth will resume as low interest rates continue to provide stimulus.

Our forecast calls for business investment to grow at a modest pace since the pandemic has decimated corporate balance sheets; it will take years for non-residential investment to return to pre-pandemic levels. Commercial real estate is expected to remain soft until well into the recovery. With economies around the world contending with the second wave of COVID-19, demand for Canadian exports will remain subdued over the coming months. However, growth in exports of goods and services will begin to pick up again over the course of the second half of 2021.

On the policy front, the Bank of Canada has been explicit with its forward guidance. It will continue with its quantitative easing program for as long as it's necessary to support the recovery. While the Bank is likely to start winding down its bond-buying program in 2021, we don't expect it to increase interest rates until 2023. This is smart, as prematurely reigning in monetary stimulus could cause a setback the economy cannot afford. The substantial excess capacity the economy needs to absorb will keep inflation pressures soft, giving little reason to begin raising rates before 2023.

Outlook summary

It's also likely we'll see a change to the Bank's inflation targeting mandate to make it more symmetrical (allowing for periods of below-average inflation to be offset by periods of above-average inflation) next year. This is likely to result in lower short-term rates for a longer period of time.

In November 2020, the federal government presented its fall economic statement which projected a deficit of nearly $400 billion for the current year. Despite the large deficit, and with the details yet to come, the statement contained a promise of $70 to $100 billion in stimulus to support the recovery over the next three years. We expect this will result in stronger government spending in the second half of 2021. We expect less generous spending by provincial governments, which were in a worse fiscal position heading into the crisis.

Overall, our forecast calls for the COVID-19 economic recovery to mirror the one seen after the 2008-09 recession, minus the resurgence in energy investment we saw a decade ago. After the financial crisis, economists often pointed to the need to shift the composition of growth away from households and toward businesses through higher investments and better export performance. We now find ourselves once again in a recovery that is being fuelled by households and supported by even more generous government outlays than we saw during the financial crisis. However, this time the required rotation to business investment and export-oriented growth is even more important than it was 10 years ago. At the beginning of 2007, Canadian households owed $1.40 for every $1 in disposable income; heading into the pandemic, that had jumped to $1.81.

In a final comparison with the global recession of 2008-09, the federal government was in decent fiscal shape heading into the financial crisis, with a debt-to-GDP hovering around 25 percent. Its latest estimate is that pandemic spending will push that ratio north of 50 percent. Simply put, households and governments cannot afford to fully drive the economic recovery this time given their high debt levels. While this might sound like a dire assessment, there is an opportunity for policymakers and business leaders to finally address the productivity and competitiveness underperformance that has held us back for years.

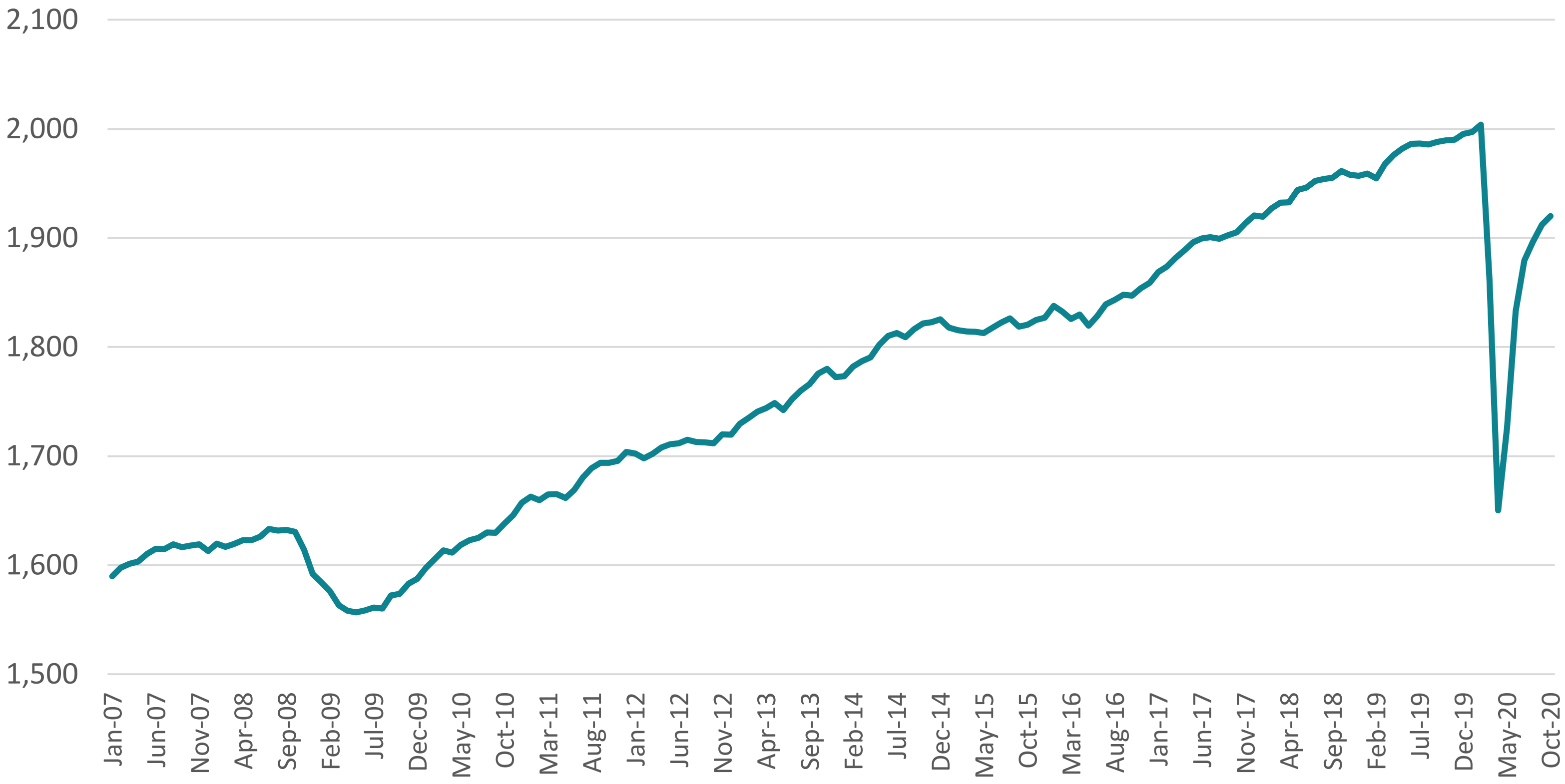
Impacts and recovery to date

In October, the Canadian economy had rebounded to 4.2 percent below pre-pandemic levels of output

At the peak of the decline in April, Canada’s economy had shrunk by a stunning 17.7 percent relative to February. Growth rebounded strongly over the summer months but has since cooled.

- The Canadian economy is slowly recovering from the damage caused by measures taken to address the pandemic.
- The rapid growth associated with the reopening in the summer is now behind us, with growth having slowed significantly in recent months and public health restrictions likely to lead to further cooling during the winter months.
- Despite the strong economic growth earlier in the year, the Canadian economy in October was $83.9 billion below its February level in inflation-adjusted terms.
- To put the size of the current economic decline in context, the total peak-to-trough GDP decline in the 2008-09 recession was $76.5 billion, equivalent to a 4.7 percent drop.

Real GDP: January 2007 to October 2020
Billions, chained $

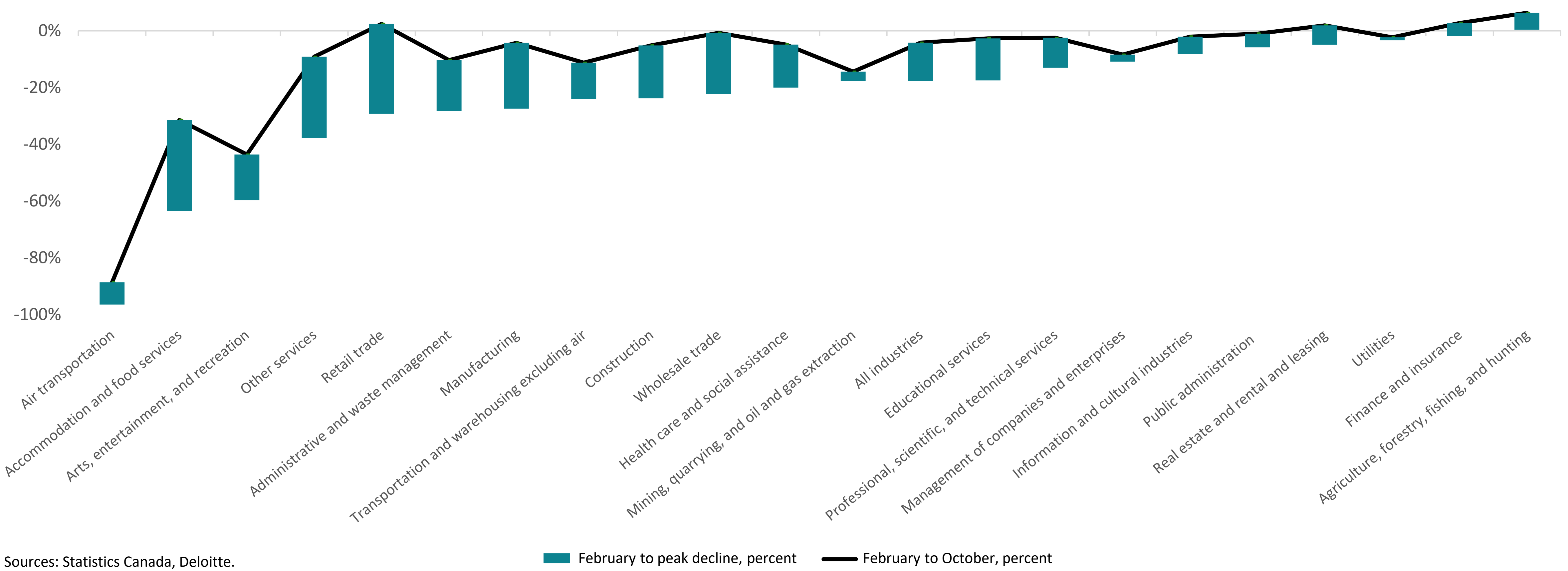


Sources: Deloitte, Statistics Canada

GDP impacts have varied significantly across industries

The economic recovery has been uneven. By October, a few industries had exceeded their February 2020 output levels, while activity remained depressed among those reliant on the hospitality sector. Output in air transportation remains hardest hit, down nearly 90 percent from February.

Real GDP: peak decline in output (bottom point) and change from February to October 2020 (top point)



Sources: Statistics Canada, Deloitte.

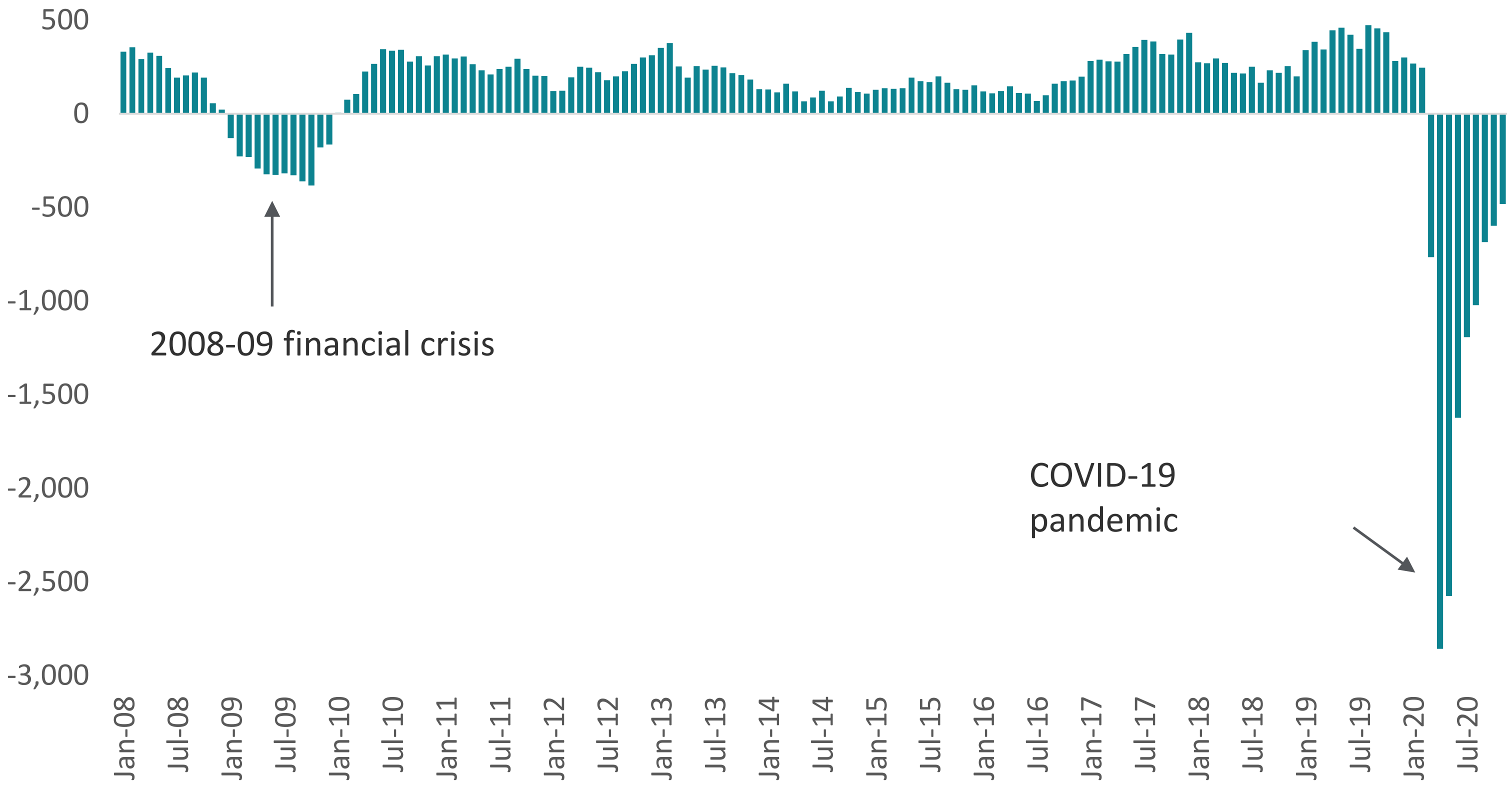
Job market is recovering, but still has a way to go

In April, 2.9 million fewer Canadians were employed compared to the year before. By November, that number had shrunk to 482,000. That's still 100,000 more than the peak job loss during the financial crisis of 2008-09.

- The labour market recovery remains highly uneven across industries and population groups.
- Full-time employment is close to returning to pre-pandemic levels, which is good news. However, there's still a long way to go—more than 20 percent of people working part-time in November wanted full-time work but couldn't find it.
- A total of 446,000 unemployed Canadians are now classified as being long-term unemployed. This is a growing risk, as long-term unemployment can have lasting impacts on one's earning ability.
- Employment for core working-aged women, after being hit hard early in the pandemic, is now only 1.5 percent below pre-pandemic levels. This is the best performance among demographic groups.
- Hours worked remains 5.2 percent below February levels, with 27 percent of the drop stemming from the accommodation and food services industry as public health restrictions continue to limit activity in that sector.

Year-over-year change in employment: January 2008 to November 2020

Thousands of jobs



Sources: Deloitte, Statistics Canada

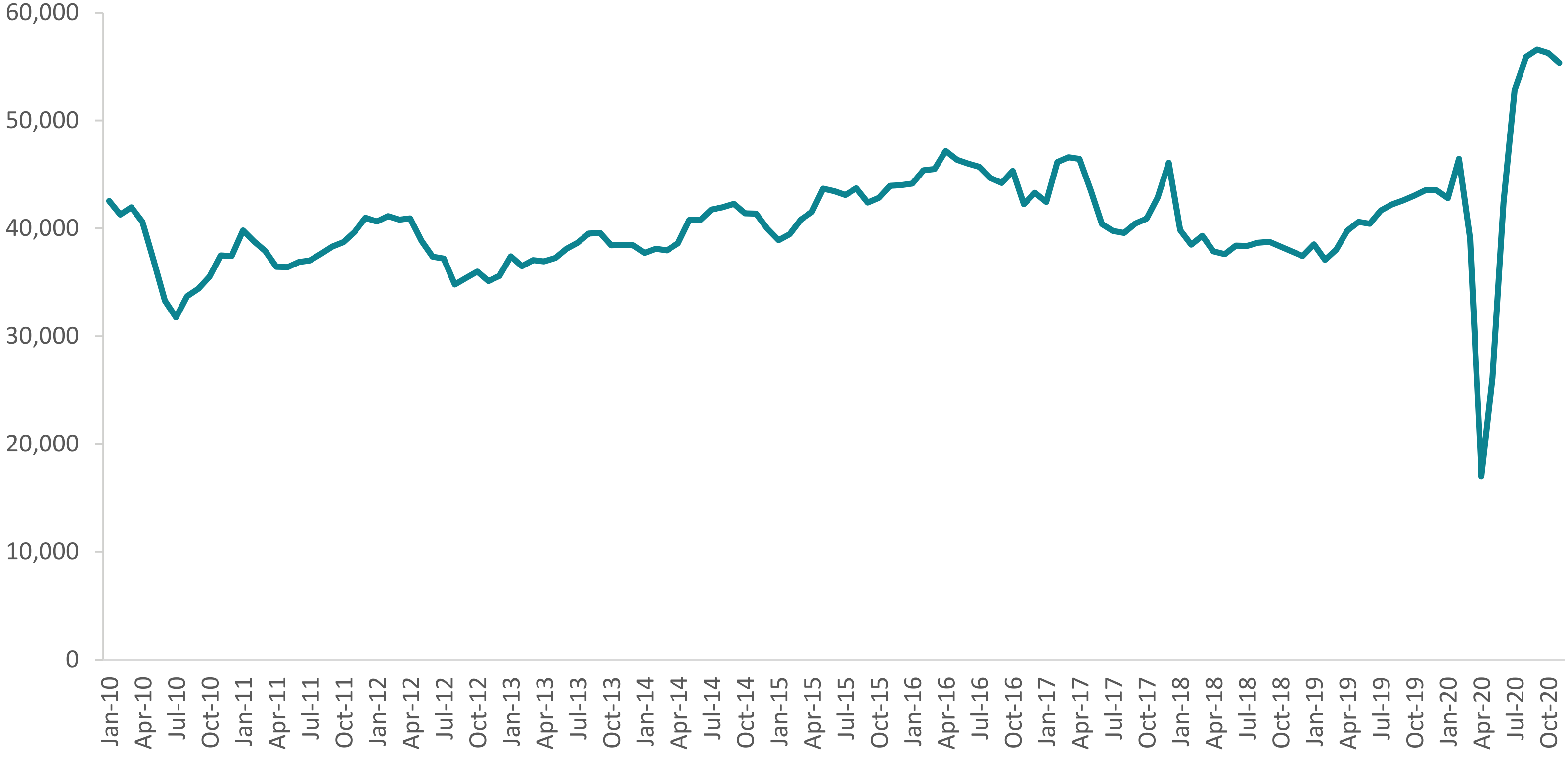
It was a record-smashing summer and fall in the resale home market

After forced shutdowns in the spring, the resale housing market came roaring back over the summer and fall months, breaking records on several fronts.

- After hitting a low in April, the number of homes being sold in the resale market soared in the summer and fall. With data up to November, it looks like resale sales in 2020 will be above last year's, despite the sharp spring decline.
- By July, transactions were up 27 percent from a year ago; from August through November, they were up over 30 percent.
- With demand surging much faster than supply, we have seen market conditions tighten and price growth accelerate.
- That said, November figures indicated the first signs of a potential cooling in the market; transactions fell on a month-over-month basis.

Resale home sales

Number of units sold



Source: The Canadian Real Estate Association.

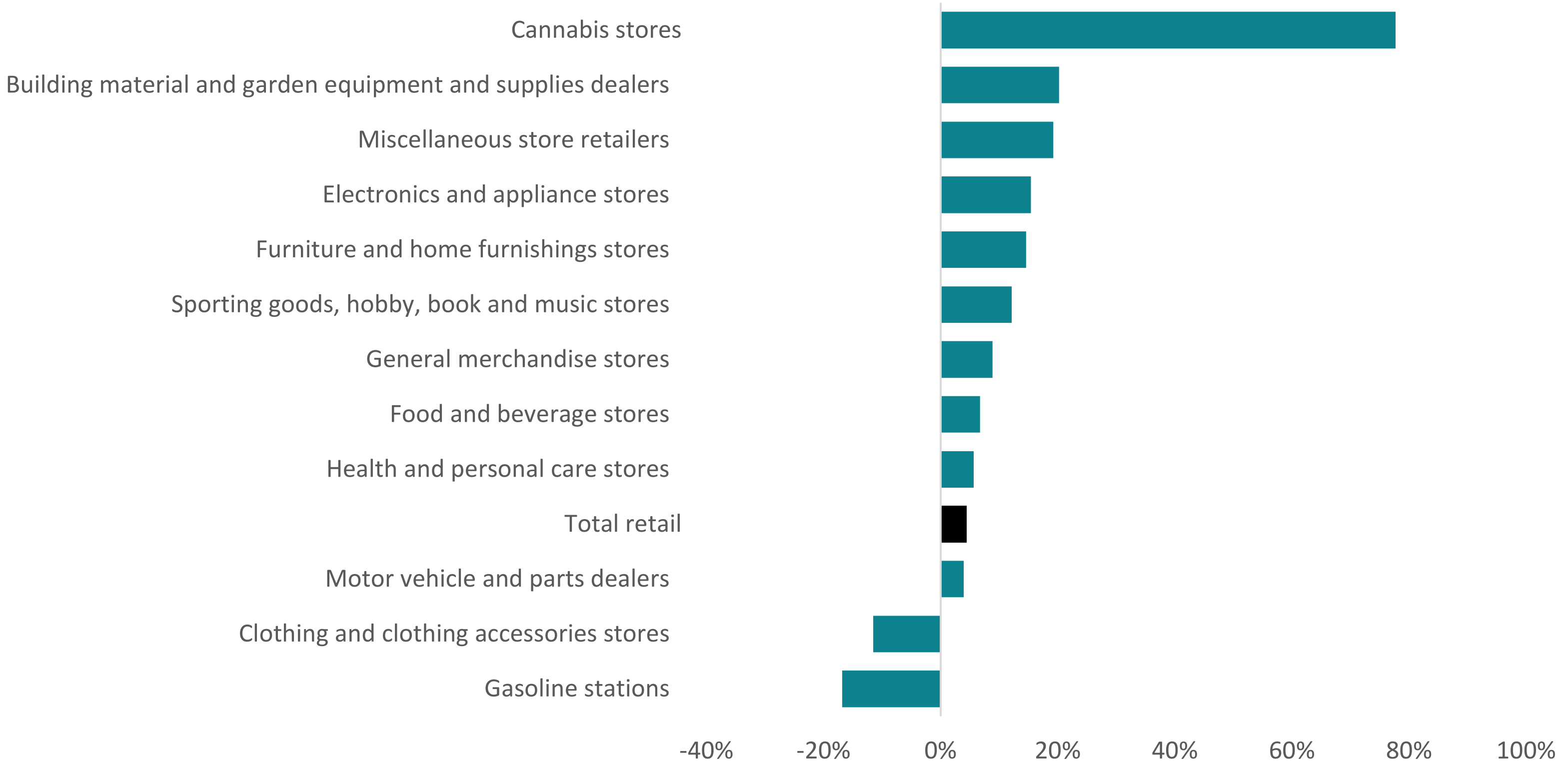
Retail sales have risen above their pre-pandemic level

After posting one of the largest declines early in the pandemic, the retail sector has fully recovered as consumers who were unable to purchase services redirected their spending toward goods.

- As of October, retail sales were 4.5 percent above their pre-pandemic level.
- While most categories have rebounded above their February levels, the work-from-home guidance is suppressing sales of clothing and gasoline. Of those Canadians who were working at least half their usual hours, 4.6 million were doing so from their homes in November.
- With Canadians spending more time at home, we have seen a significant increase in purchases of building and gardening equipment, electronics and appliances, and cannabis.

Retail sales by category

Percent change from February 2020 to October 2020



Sources: Deloitte LLP; Statistics Canada

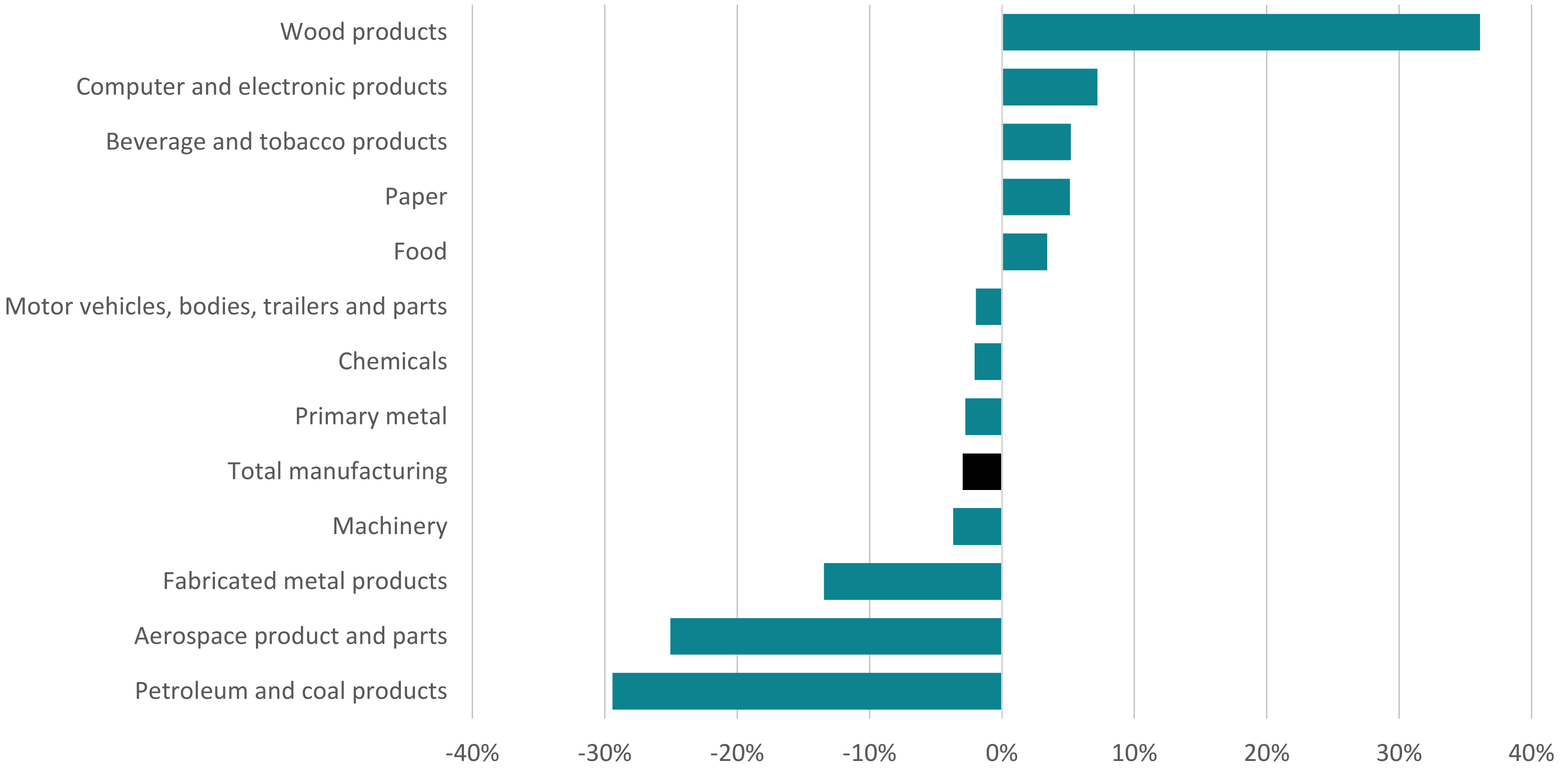
Manufacturing sales are still trailing their February levels

One of the more uneven recoveries is taking place in the manufacturing sector, reflecting shifting household consumption preferences both here and abroad.

- In October, manufacturing sales were 3.0 percent below their February 2020 level, although that number masks some significant disparity across subsector performance.
- The largest growth between February and October has been in wood products manufacturing sales. Driven by strong demand for housing construction in the United States and Canada, these are up 36 percent.
- Computer and electronic sales are also doing well, supported by work-from-home trends, and food manufacturing is up as more as consumers eat at home due to restrictions on in-person dining.
- On the other end of the spectrum, we have petroleum and coal products as well as aerospace, which are both still more than 20 percent off their pre-pandemic sales levels. Non-essential air travel has all but disappeared, reducing the profitability of airlines and, therefore, their demand for aircraft and aircraft parts. Reduced industrial activity and the sharp drop in retail gasoline sales are weighing on demand for manufactured petroleum products.

Manufacturing sales by industry

Percent change from February 2020 to October 2020



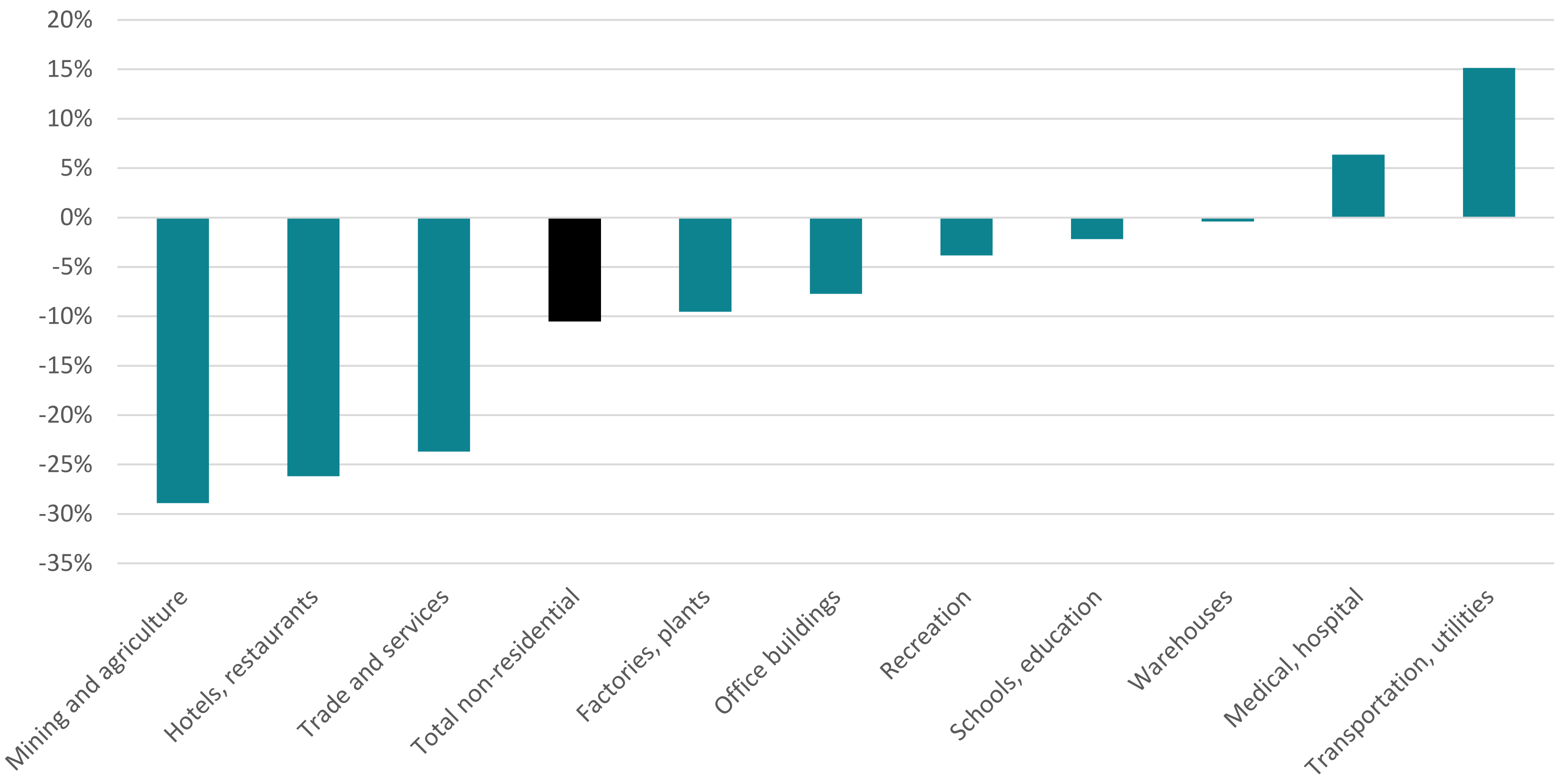
Sources: Deloitte, Statistics Canada

After showing signs of recovery in the summer, non-residential building construction remains down

Investments in non-residential building construction fell sharply during the pandemic. They remain below their levels a year ago despite increased activity during the summer.

- In April, non-residential building investment fell 37 percent below its level at the same time last year as some work was deemed non-essential and had to cease.
- Spending recovered rapidly though, and from May through August was above 2019 levels. However, growth has since softened, declining on a year-over-year basis by 6.6 percent in September and 10.5 percent in October.
- In what is by now becoming a familiar narrative, growth has been uneven across industries. The hardest hit have generally been those with the most challenging economic circumstances, with mining and agriculture and hotels and restaurants experiencing the sharpest declines.
- Medical and hospital investments have risen, which is unsurprising given our current circumstances. Transportation and utilities investments have also increased as work continues on large-value projects such as the Trans Mountain Expansion, Keystone XL, Coastal GasLink, and the Site C hydro dam.

Year-over-year change in non-residential building investment, October 2020



Sources: Deloitte, Statistics Canada

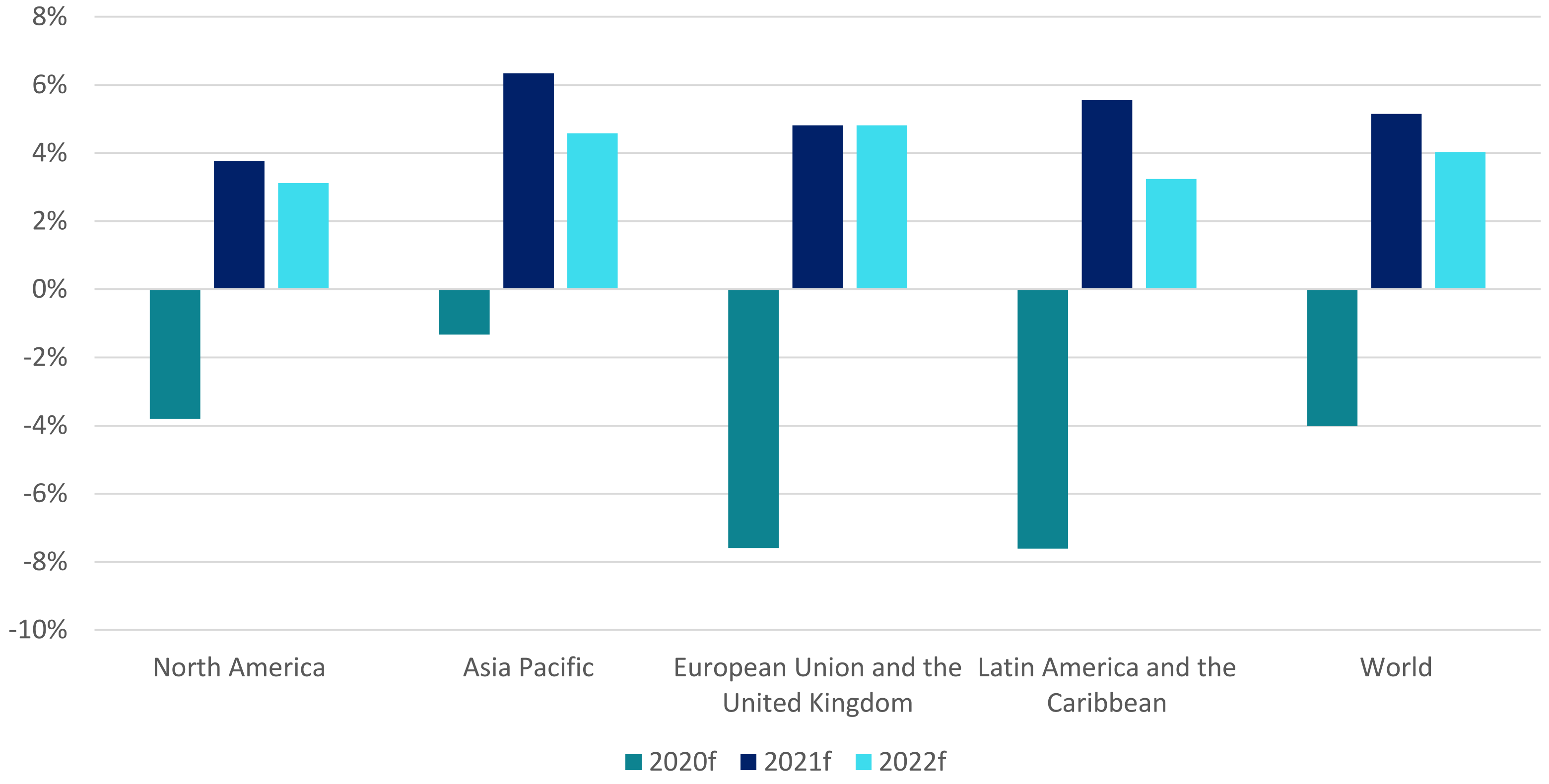
International outlook

Global economy experienced deep, uneven recession in 2020, but recovery to come in 2021

The pandemic has affected every region of the world. North America has performed better than many, particularly Europe. Most countries are projected to experience a large rebound in 2021, but—outside of Asia—the recovery will take several years for most regions.

- We estimate the global economy shrank by a stunning 4 percent in 2020. This marks only the second time world GDP has declined in 40 years of comparable data. During the 2008-09 global financial crisis (the only other decline in recent history), real GDP fell by just 1.4 percent.
- The global economy is projected to rebound by 5.1 percent in 2021 as vaccines become more widely available.
- Asia Pacific is projected to experience a large rebound in 2021, after a relatively small decline in 2020. Much of this strength will occur in China, where the economy is forecasted to grow by 8 percent after a 2.1 percent increase in 2020. Japan, meanwhile, is projected to grow by just 2.7 percent, after a 5.4 percent decline in 2020.
- The European Union is also expecting only a small rebound this year, as a second wave of the pandemic has prompted new lockdowns.

Real GDP growth



Sources: Oxford Economics, Deloitte

The United States will have a smaller economic contraction than many other developed countries

Less restrictive public-health measures in the United States will cap its decline in real GDP to 3.6 percent in 2020, smaller than the 4.0 percent decline expected in global GDP growth.

- The US economy is now just 2.9 percent below levels a year ago, as less restrictive public-health measures have buffered the impact of the pandemic on its economic growth.
- While growth is doing relatively well, the near-term outlook remains fraught with risk as the same less restrictive measures have allowed the virus to spread rapidly. As of December 14, 2020, the United States was reporting 825.2 new cases per 100,000 population over the previous 14 days, 3.7 times higher than the Canadian rate of 220.8 per 100,000 people over the same period.
- The rapid spread of the virus led to tightened restrictions in some states, which will likely soften economic growth in the near term. However, with a new $900 billion stimulus package just passed and vaccination campaigns that will allow most Americans who want a vaccine to have access to one by the summer, economic growth is projected to accelerate in the second half of 2021.
- Overall US real GDP growth is expected to increase by 3.6 percent in 2021 and 3.0 percent in 2022.

US real GDP growth

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

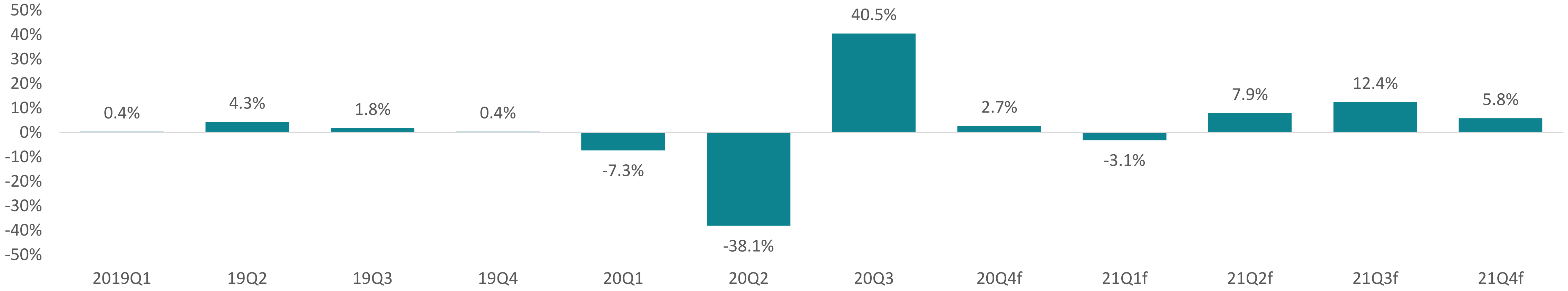
Canadian outlook

Overall

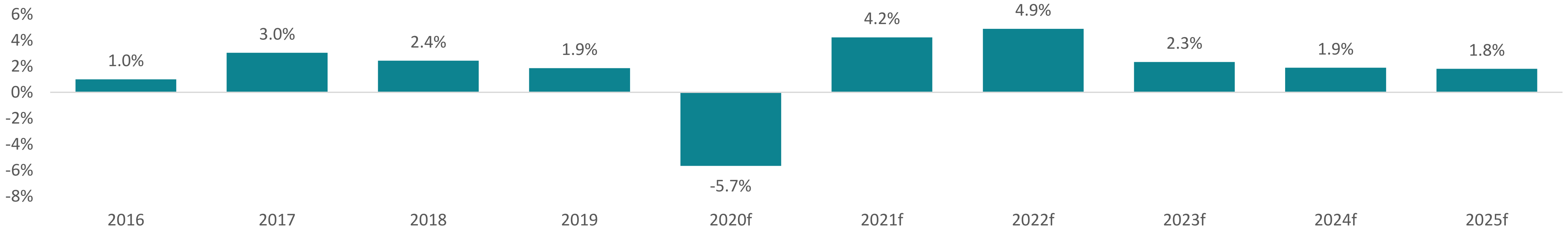
Canada’s economic recovery set to slow in the near term

With many regions of the country facing restrictive measures to protect public health this winter, the Canadian economy is expected to contract in the first quarter of the year. Despite a recovery over the rest of the year, this will cap annual real GDP growth at 4.2 percent this year.

Real GDP, quarter-over-quarter annualized growth



Real GDP, annual growth



Sources: Deloitte, Statistics Canada

Canadian outlook

Household sector

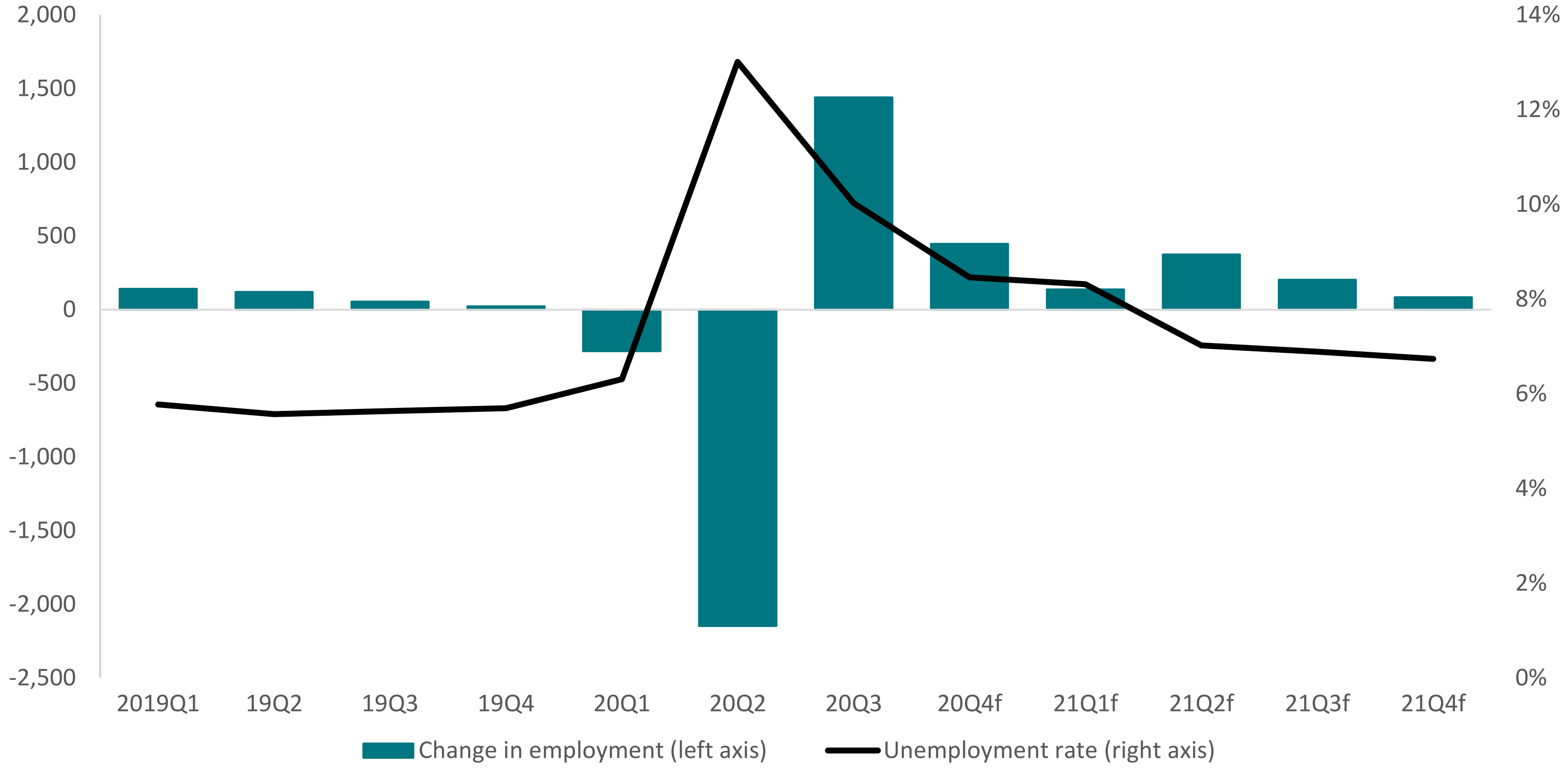
The Canadian labour market continues to slow after resurgence of the virus

Employment growth slowed significantly when the second wave of COVID-19 infections prompted new lockdowns. With cases expected to rise following the holidays, this trend is likely to continue until the economy can safely and fully reopen.

- More than 570,000 jobs remain lost since February 2020. With renewed restrictions across the country, employment is expected to decline in December and January. However, there will still be positive employment growth in the first quarter of 2021 as restrictions ease.
- With warmer weather and potential widespread vaccine deployment allowing businesses to safely reopen, we expect employment to reach its pre-COVID-19 levels by the second half of 2021.
- The unemployment rate will trend down to 6.7 percent by the end of 2021. Further improvements will take longer.
- There has been a large increase in long-term unemployment, which can have lasting impacts on the labour market. The unemployment rate is expected stay above 6 percent for years to come.
- The recovery in employment by industry has been uneven. The boost last quarter pushed a handful of sectors above their pre-pandemic levels, though employment growth in sectors hard hit by the pandemic—such as accommodation and food services—will remain subdued in the near term.

Employment growth and unemployment rate

000s



Sources: Statistics Canada, forecasts by Deloitte.

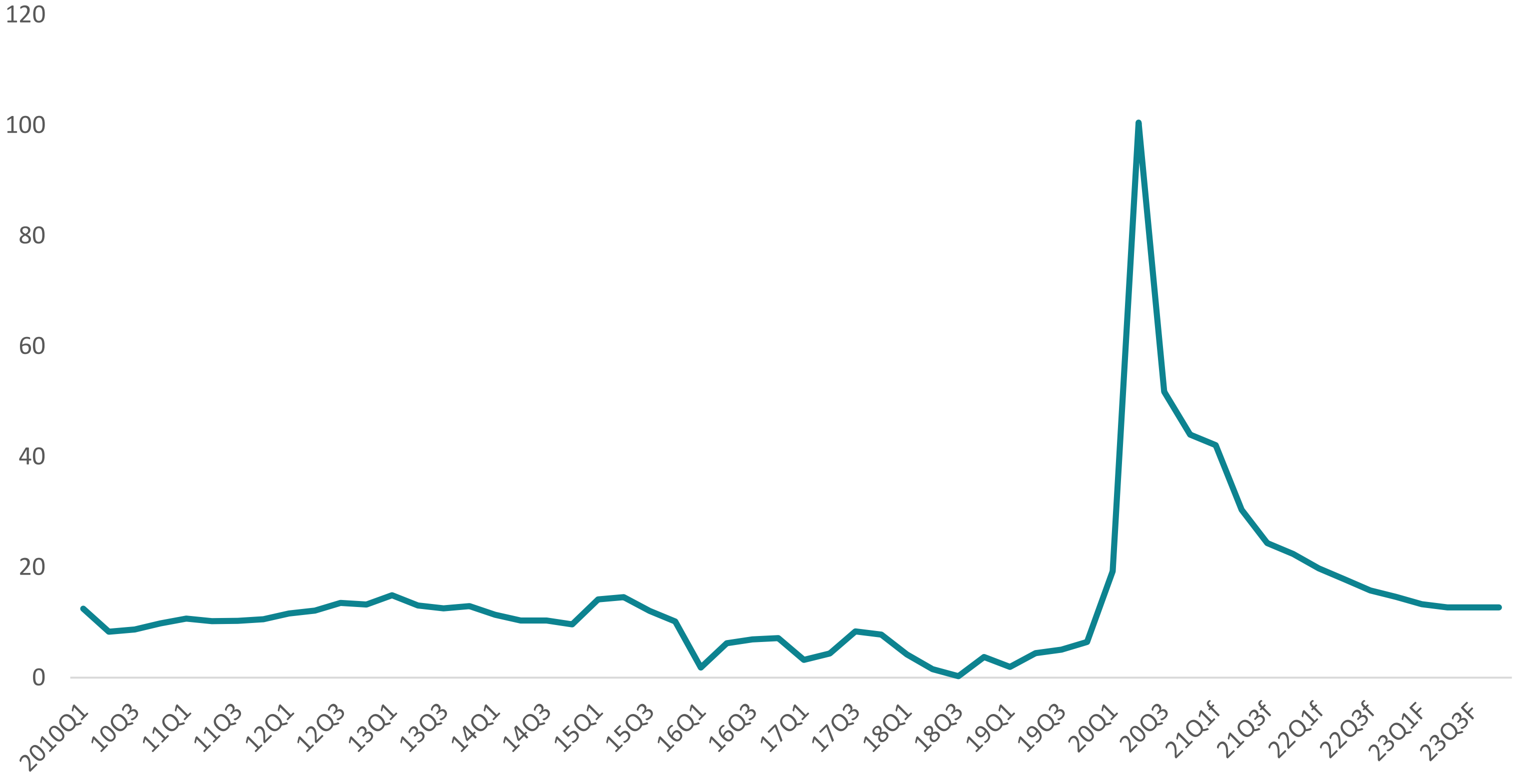
Large increase in savings could support increase in consumer spending if confidence improves

Households have built up $160 billion in additional savings in the first three-quarters of 2020.

- Canadian households built up an impressive amount of savings over the first three-quarters of 2020. Although down from the 28.2 percent high reached in the second quarter, the household savings rate remained at 14.6 percent in the third quarter.
- Savings have increased despite the drop in employment and strength in retail sales because of the large increase in government support and the decline in spending on services.
- We expect household savings to stay elevated until 2023. Yet there is some upside risk if some of these savings are redirected to purchases, particularly if confidence significantly improves following a successful deployment of the COVID-19 vaccine.
- On the negative side, one risk is the possibility of a significant clawback in Canada Emergency Response Benefit payments. The federal government recently announced that people who made less than $5,000 in 2019 or within the previous year before applying would have to pay back their benefits. This is a particular concern for many small business owners, since there was some confusion about whether the threshold related to income before or after expenses.

Household savings

$C billions at quarterly rates



Sources: Statistics Canada, forecasts by Deloitte.

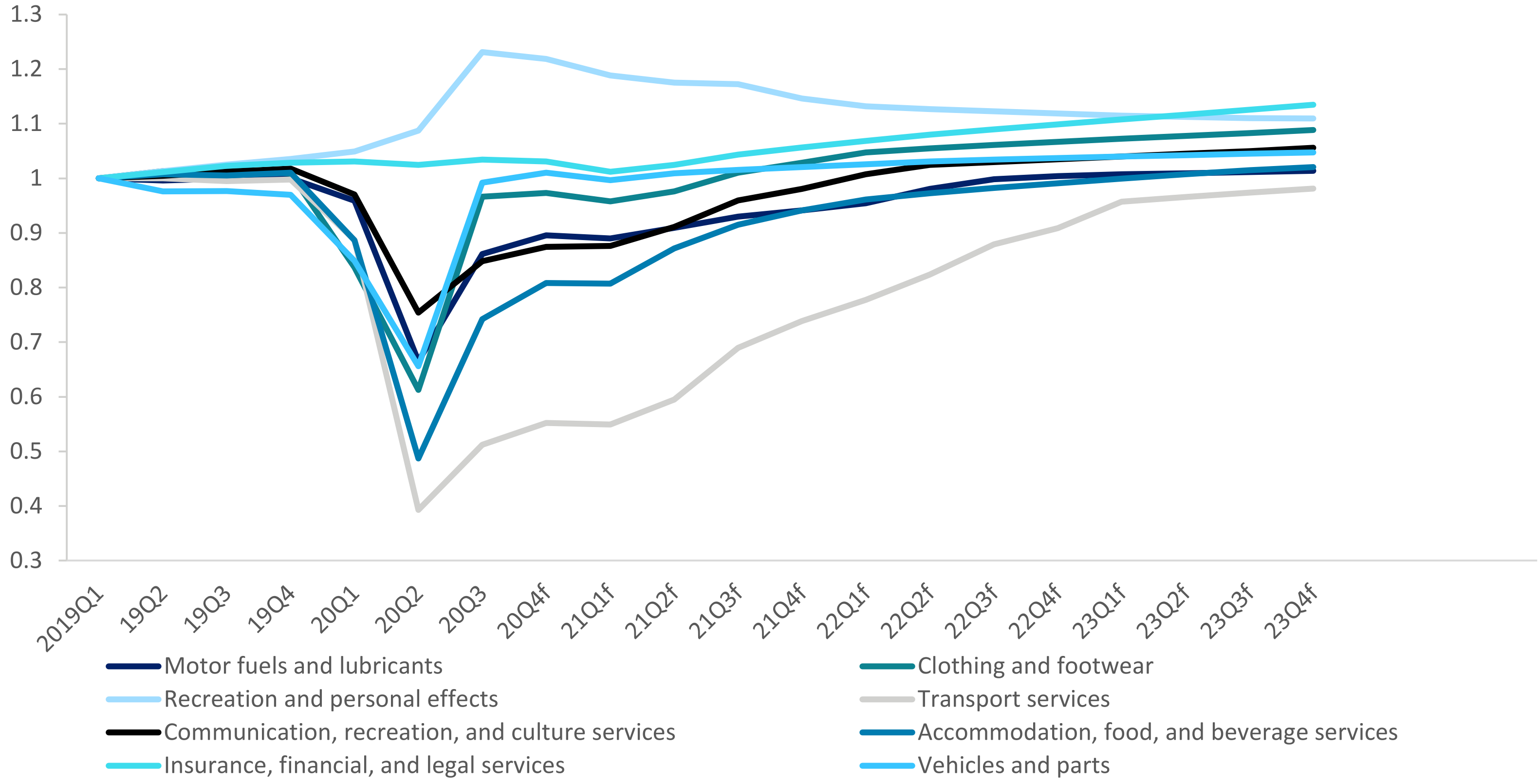
Consumer spending supported by high savings

Consumer spending bounced back in the third quarter of 2020. But with new restrictions, expenditures will slow in the coming months.

- Consumer confidence rebounded in the third quarter as public health restrictions eased. This, together with a partial reopening in the summer, allowed goods spending to increase in the third quarter. However, ongoing restrictions curtailed the rebound for many service categories.
- Spending on recreational goods thrived in the third quarter as Canadians looked for new ways to occupy their time at home. Vehicles and parts, and clothing and footwear also benefited from the excess of household savings.
- We expect growth in the coming months will be more muted as parts of the country entered lockdowns in late December which will restrict activities and the ability to spend.
- The recovery will remain uneven through most of 2021, with services spending unlikely to pick up until the second half of the year. Travel-related categories will face the slowest recovery due to ongoing COVID-19 restrictions.

Real consumer spending by select category

index 2019Q1 = 1



Sources: Statistics Canada, forecasts by Deloitte.

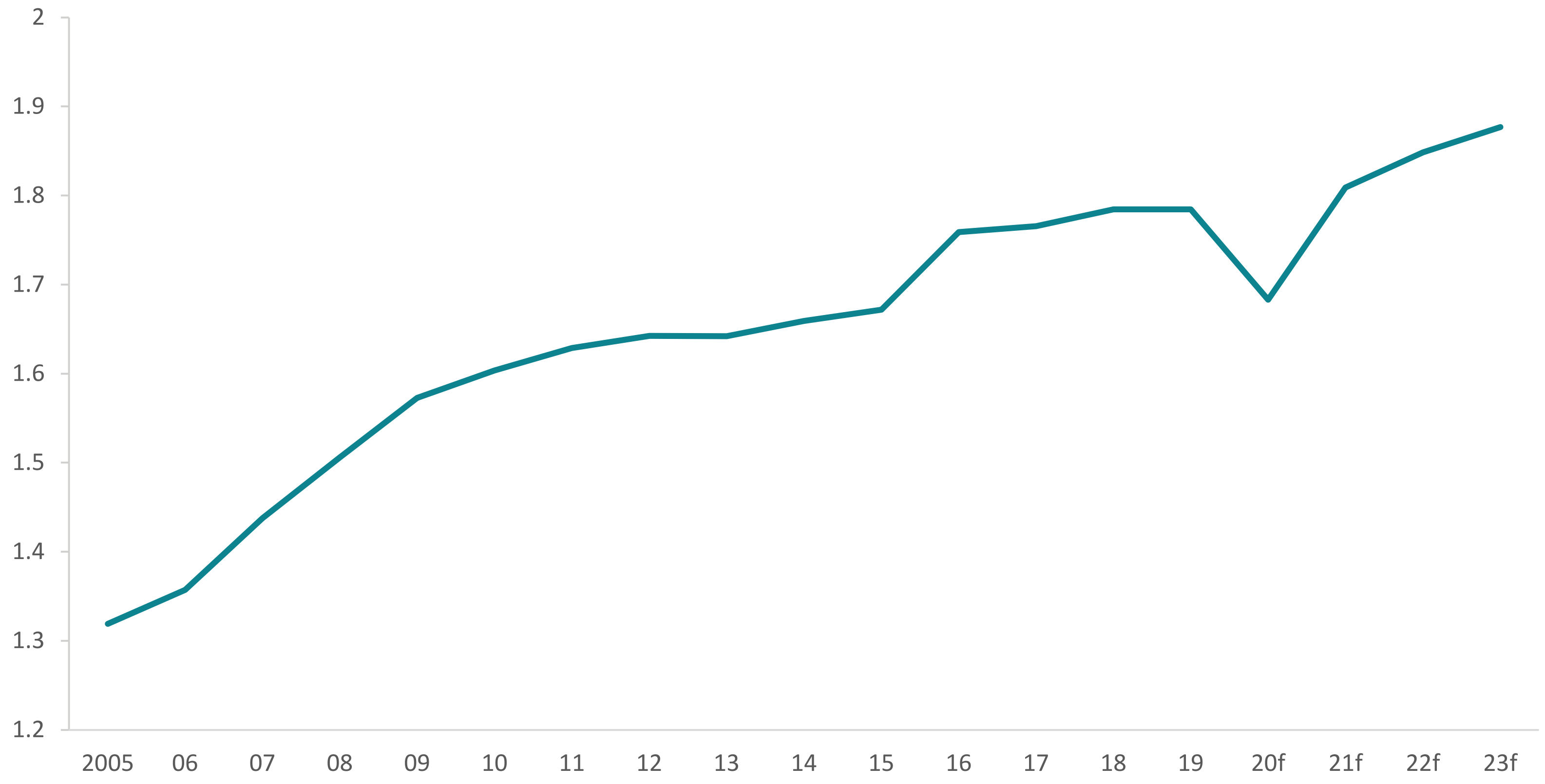
Household debt set to grow to highest levels on record

Record government support programs allowed the ratio of household debt to disposable income to fall in 2020. However, the current pandemic is unlikely to have shifted households' preferences for borrowing. As the economy recovers, household debt is projected to reach new heights, fuelled by very low interest rates and strong mortgage growth.

- Canadian household debt-to-disposable income has been growing for years. The government income-support programs implemented early in 2020 pushed up household disposable income by 10 percent last year, allowing households to reduce their debt-to-income ratio.
- Household interest payments on mortgage debt are estimated to have dropped 0.04 percent in 2020 after rising over 13 percent for the past two years. Interest payments on non-mortgage debt are estimated to have declined by 3.1 percent– the first decline since 2014.
- However, this is likely to be a temporary phenomenon. The easing of income support programs and reopening of the economy will induce households to spend their savings. While interest rates are expected to stay low for the foreseeable future, rising debt will push up interest payments beginning in 2021.
- Our forecasted increase in debt-to-disposable income will exacerbate the financial vulnerability risks the economy was already contending with prior to the onset of the pandemic.

Household debt to disposable income

ratio



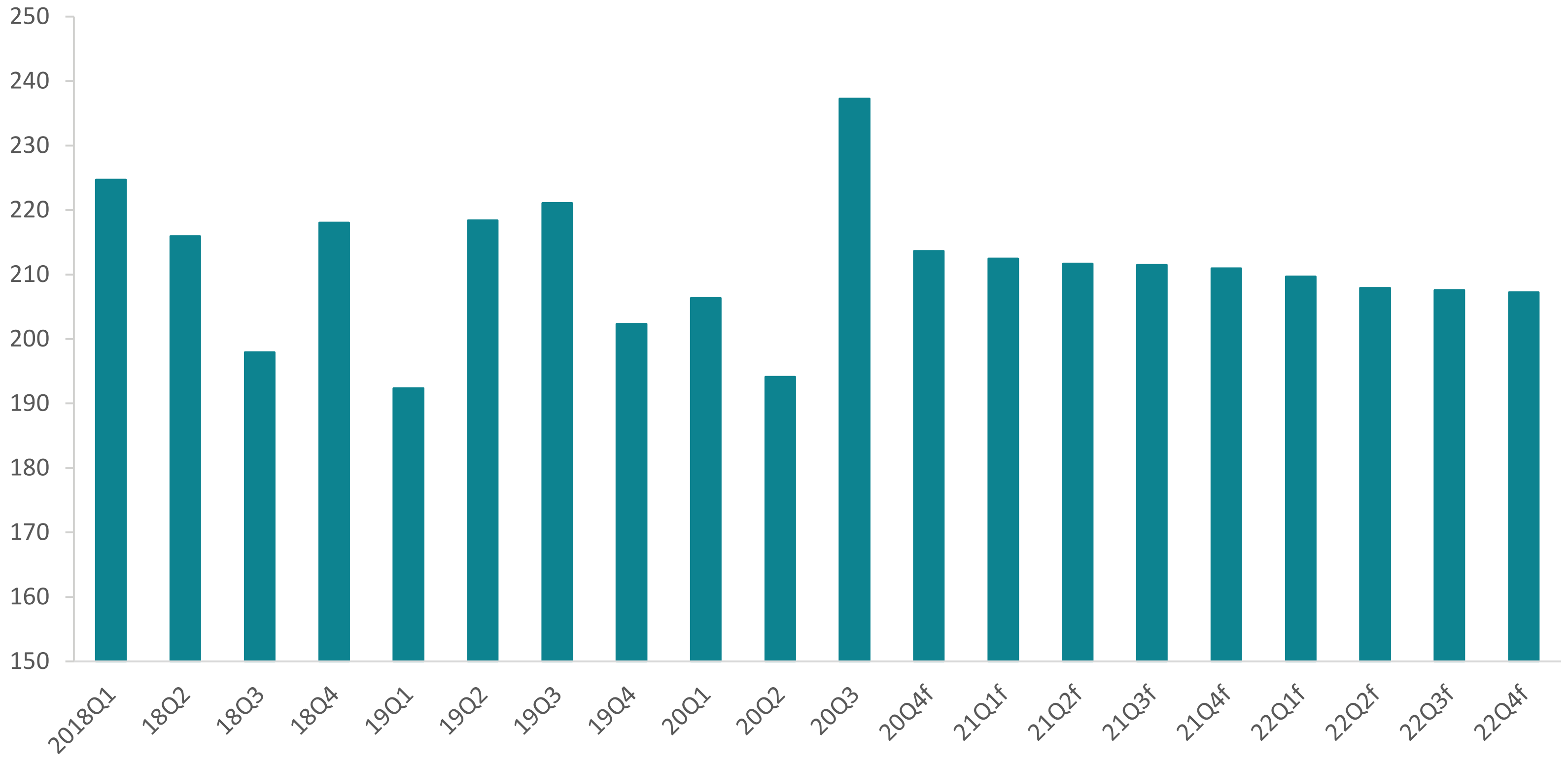
Sources: Statistics Canada, forecasts by Deloitte.

New home construction easing after summer surge

After slumping in the spring, new housing construction accelerated sharply in the summer. Activity has cooled since the reopening bump, but it remains at a healthy level.

- After falling to just 165,000 units in April, housing starts rebounded strongly in the summer, reaching 261,000 in August. Starts have cooled in recent months to a pace closer to underlying demand.
- Despite the recent cooling, new home construction has remained resilient throughout the downturn and is one of the few areas of the economy where activity was higher in 2020 than it was the year before.
- New construction is expected to remain above 200,000 units over the next few years but slowly trend downwards, given our expected slowdown in population growth.
- Real investment in new housing will grow at a modest pace, increasing by an average of 1.9 percent per year over 2021 and 2022 despite the slight deceleration in total housing starts. This is because new single detached homes (which are more costly to build) will increase over the next few years, given strong demand in this segment.

Housing starts
Number of units, 000s



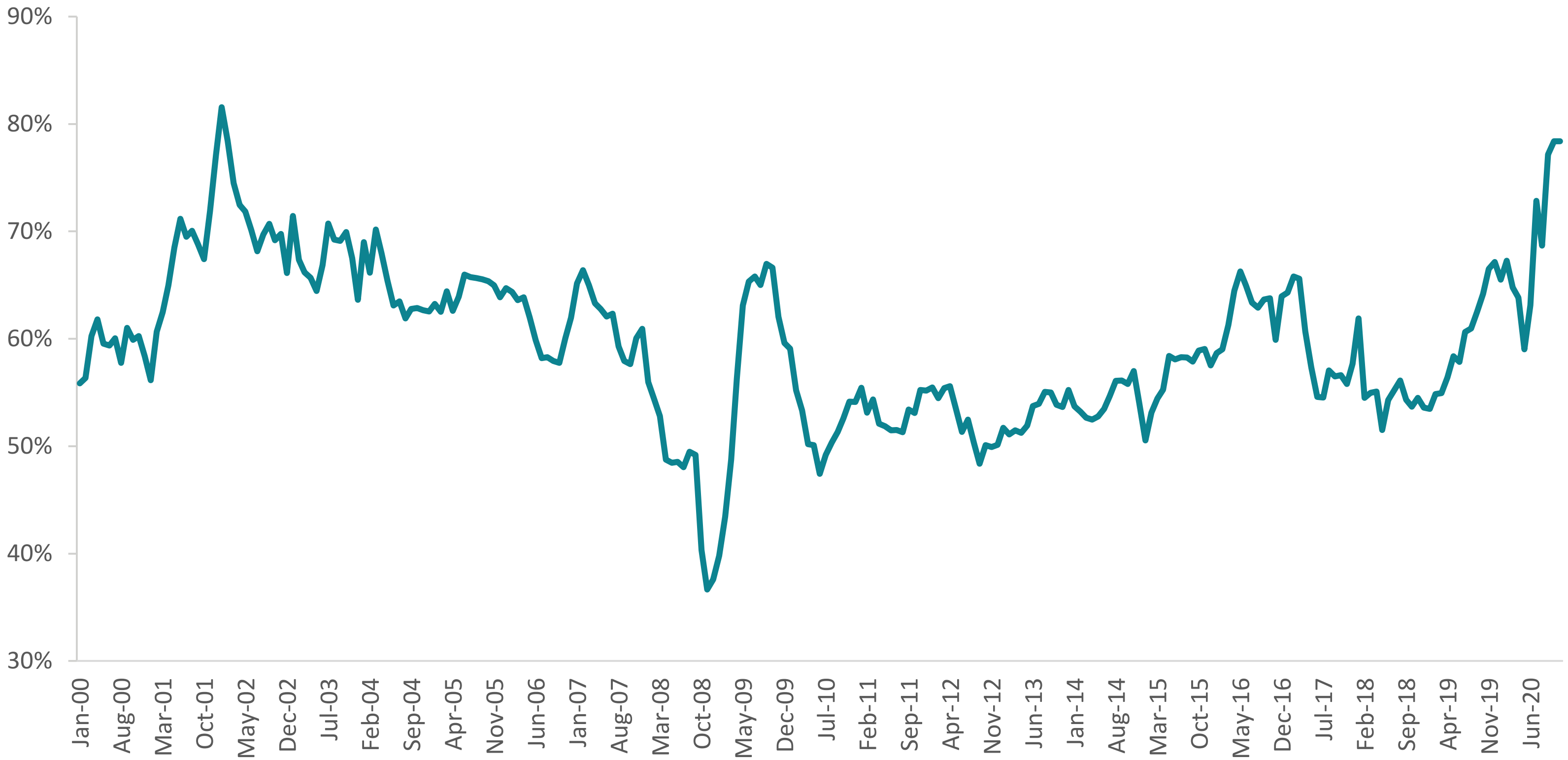
Sources: Deloitte, Canada Mortgage and Housing Corporation

The resale home market is sizzling, but signs of a slowdown are emerging

After posting record-breaking gains for months in a row, the number of homes sold is showing early signs that conditions may be beginning to normalize. However, excess demand will keep home price-growth strong.

- The real estate market rose in the summer and fall as public health measures eased.
- The GDP component that measures real estate transactions, ownership transfer costs, increased by 1,826 percent at annual rates in the third quarter. This was a record-breaking pace of growth, by a wide margin.
- Resale market activity is expected to pull back slightly after this extraordinary gain, but growth in new housing construction and renovations will keep residential investment growing. Overall, after increasing by 2.8 percent in 2020, it will average 2.2 percent per year in 2021 and 2022.
- Even with activity slowing a bit in the near term, strong demand, low financing costs, and tight supply (measured by the sales-to-new listings ratio) will keep home prices pushing upward. Our forecast calls for resale home prices to increase by 11.4 percent this year to an average of $620,107.

Sales-to-new listings ratio



Source: The Canadian Real Estate Association.

Canadian outlook

Business sector

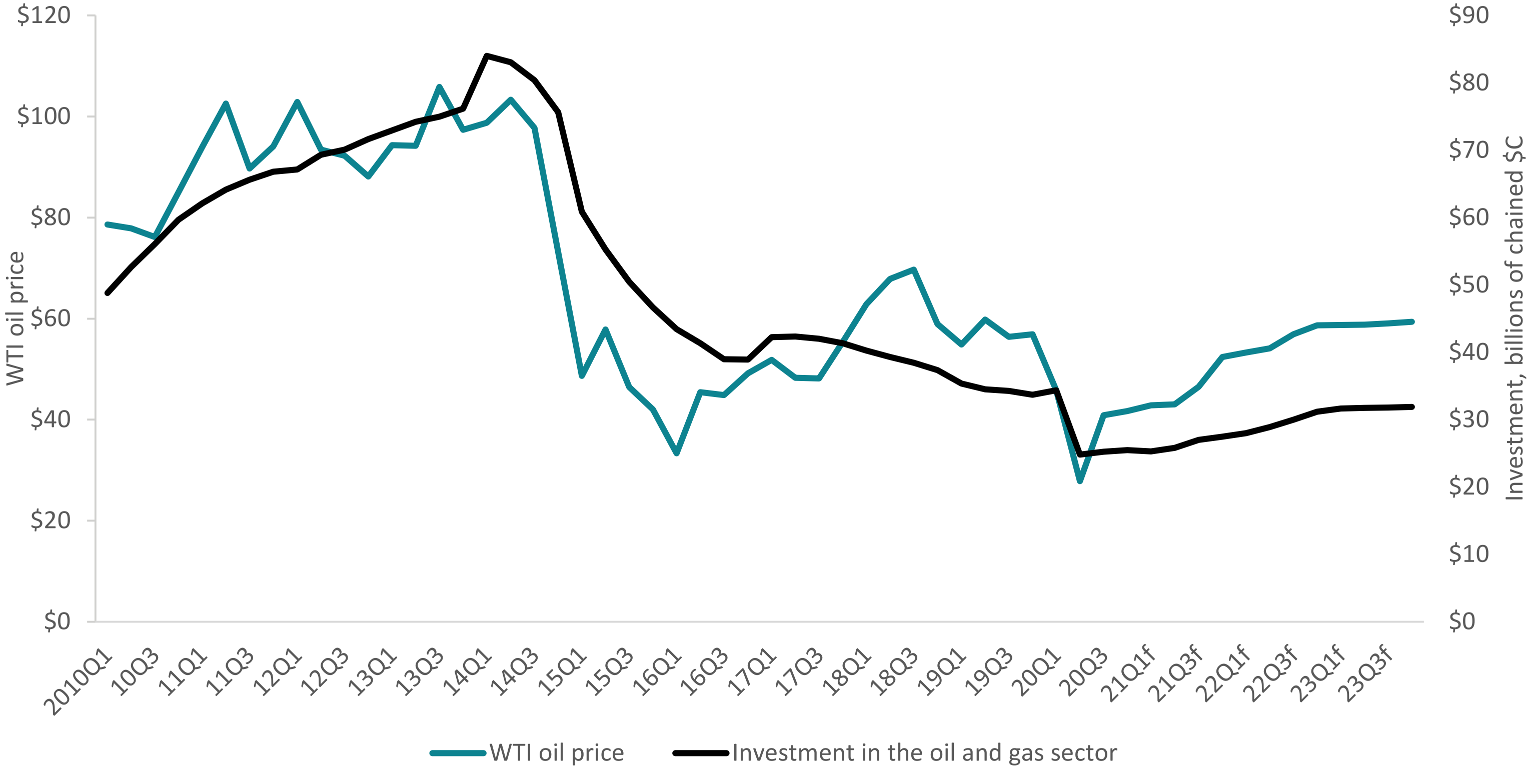
Energy market: Weak oil prices will restrain investment

The subdued outlook for oil prices will limit any recovery in oil and gas investment.

- Global oil demand plunged by a record amount in the first half of 2020, falling to levels not seen since 1995. Demand is projected to stay muted well into 2021 as air transportation remains suppressed and many countries continue lockdown measures.
- Even as demand recovers, price gains will be limited due to high inventories and surplus production.
- As the global economy picks up in the second half of 2021, we expect the price of WTI crude oil to rise. However, gains will be limited. We project prices to increase to $52 a barrel by the end of 2021, well below levels seen through 2018 and 2019.
- With gains expected to remain modest, the energy sector will suffer long-term challenges. On top of the 20 percent drop expected in 2020, oil and gas investment will face another 3.9 percent decline in 2021, leaving it at depressed levels not seen in over 20 years.
- In the long term, this sector will also have to contend with substantially higher carbon taxes, as recently announced by the federal government, which will act to limit investment.

Oil prices and business investment

WTI oil price in US$/barrel; investment billions of chained $C



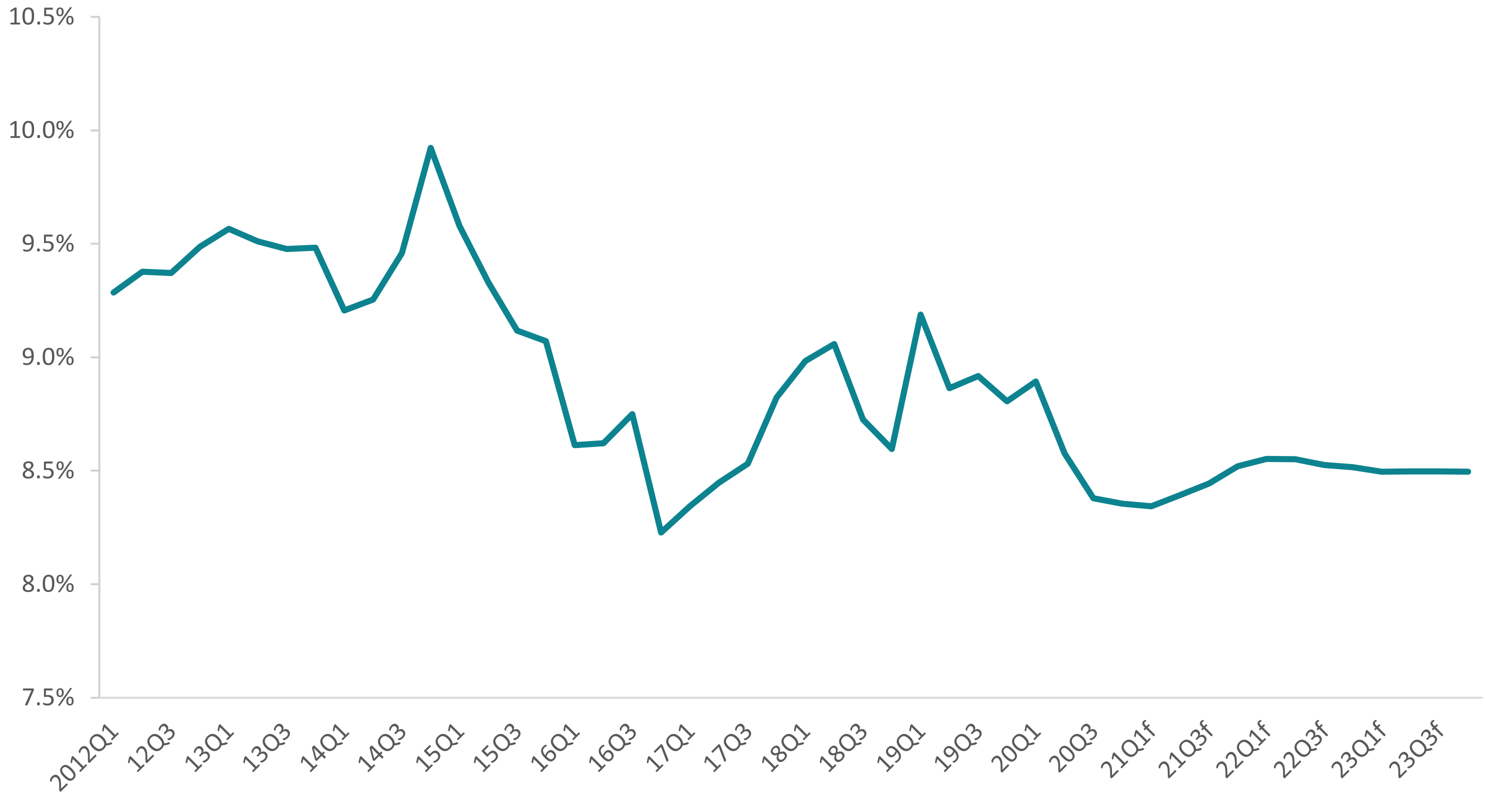
Sources: Statistics Canada, forecasts by Deloitte.

Non-energy business investment recovery curtailed for years to come

Business investments' share of spending in the economy has been low for years, a trend that is set to continue.

- Business investment has been one of the weakest-performing areas of the Canadian economy over the last four years. Weak global demand, rising bankruptcies, and heightened uncertainty mean this sector is unlikely to be a driver of growth over the next few years. Overall, we expect non-energy business investment to increase by just 1.5 percent in 2021, following an incredible 9.5 percent drop last year.
- By category, the worst performance will be in engineering investment, which is dominated by the energy sector. Purchases of machinery and equipment have fallen substantially as firms slashed spending on new transportation vehicles and other discretionary items. This category is expected to rebound in 2021, fuelled by key investments in digital capabilities, but spending likely won't reach pre-pandemic levels until late 2022. Building construction is expected to outperform other sectors this year, thanks to relatively strong demand for warehouses and still low office vacancy in key markets.
- With investment remaining sluggish, the level of capital stock is projected to decline in both 2021 and 2022. This will extend its poor performance over recent years which saw the capital stock per worker fall from $92,200 per worker in 2015 to $88,900 in 2019.

Non-energy investment as a share of GDP



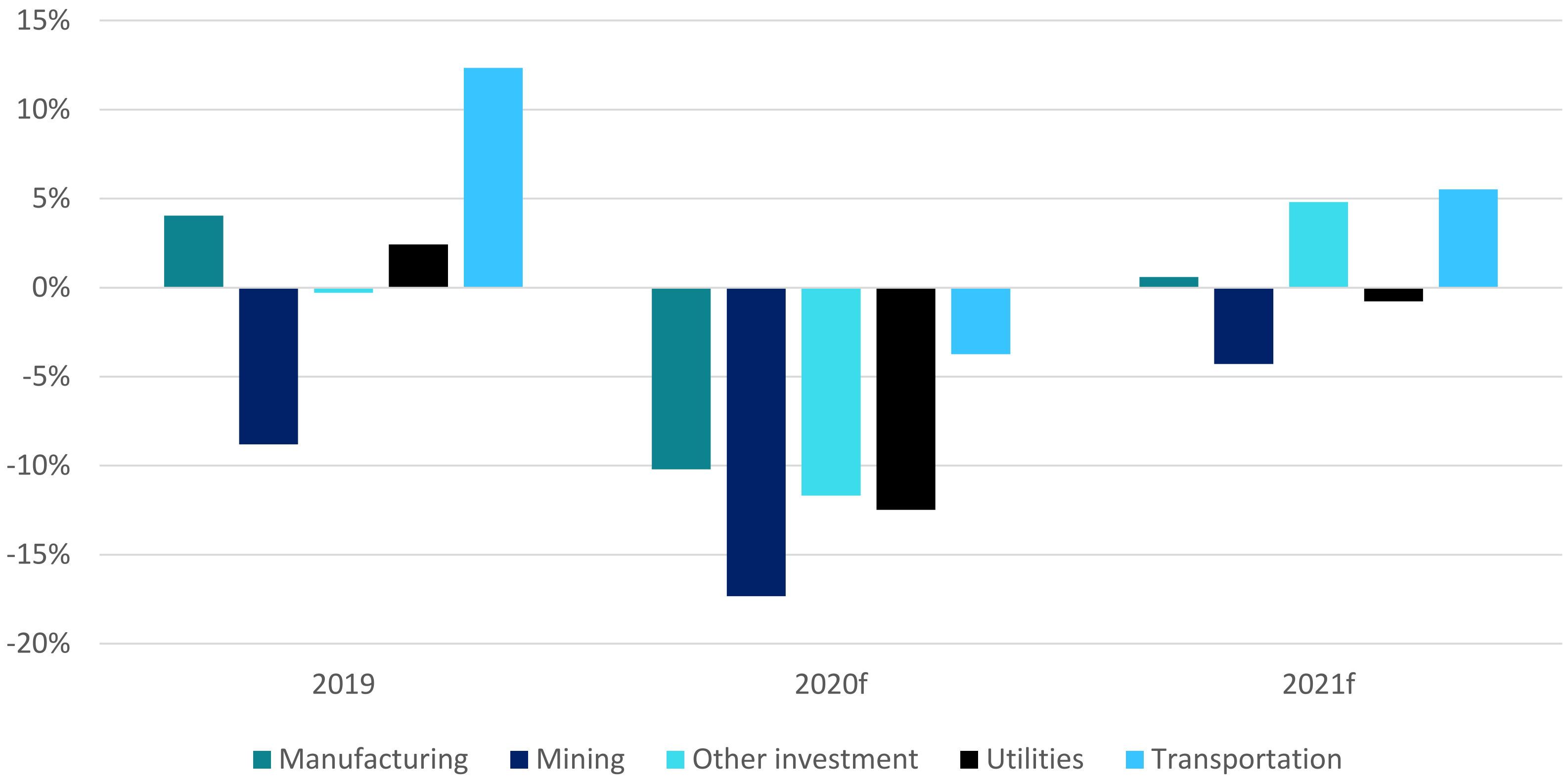
Sources: Statistics Canada, forecasts by Deloitte.

Almost all industries cut back their investment spending in 2020, but 2021 should be better

The decrease in mining investment accounts for one-third of the overall investment decline in 2020. With no recovery in sight for the mining industry, a resurgence in investment will have to come from other industries.

- Non-energy mining investment has been on a downward trend since 2012 as metal and non-metal mining investment collapsed amid weaker demand from China and lower raw-material prices. Adding in the recent collapse in energy investment, total mining investment will decline by another 4.3 percent in 2021 following a 17.3 percent drop in 2020.
- Ideally, we would see a shift to manufacturing and non-energy exports, but that is unlikely. Manufacturing investment is projected to remain weak, connected to sluggish demand for Canadian exports and low rates of capacity utilization.
- Transportation and warehousing investment is projected to see the quickest recovery as pipeline construction ramps up on the Keystone XL pipeline and new warehouses are constructed to support the large increase in online sales.
- Other investment will also see a strong recovery, with finance and professional services investing in digital technologies.

Non-residential business investment growth



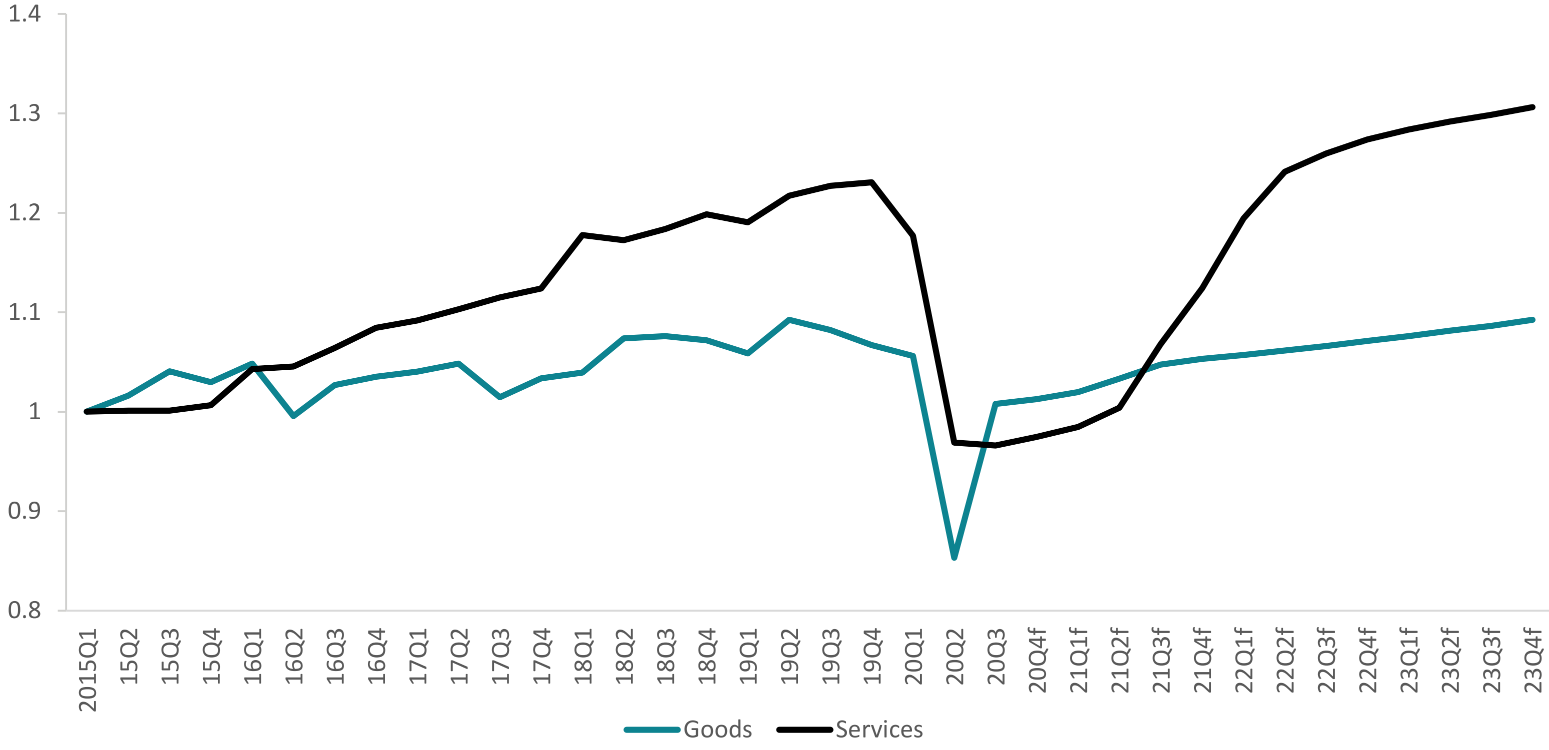
Sources: Statistics Canada, forecasts by Deloitte.

Trade sector recovery tapers off, with a weak long-term outlook

Demand for Canadian exports has been cut short by a global resurgence of the novel coronavirus. Exports of services, which are heavily influenced by the ability to travel, won't rebound until the virus is controlled.

- A second wave of COVID-19 infections around the world impeded a further rebound in goods exports in the third quarter. Although they were just 2.3 percent below where they were at the beginning of the year in October, we don't expect the gap to fully close until late next year.
- Exports of services, which are closely linked to travel, continue to struggle as borders remain closed. After declining slightly in the third quarter, they remain 19 percent below January 2020 levels.
- Looking ahead, services exports will receive a boost in the second half of 2021 as the health crisis subsides. Merchandise exports will also benefit from a global reopening, but on a smaller scale.
- By commodity, aircraft exports have hardly grown since May and face a long road to recovery. Travel services are in a similar position; they currently sit 70 percent below January levels.
- We expect aggregate exports to reach pre-pandemic levels in the first half of 2022. The post-recovery outlook is less favourable. Long-term structural trends of weak business investment and lagging competitiveness will keep growth muted for years to come.

Exports of goods and services
index 2015Q1=1



Sources: Statistics Canada, Forecasts by Deloitte.

Canadian outlook

Monetary and fiscal policy

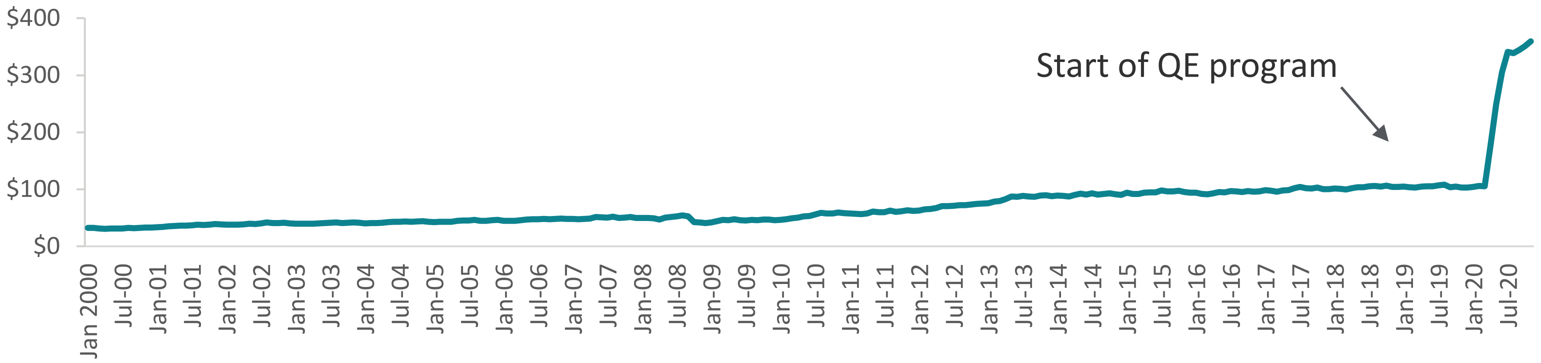
Monetary policy will remain highly accommodative over the next few years

The Bank of Canada acted quickly at the beginning of the pandemic, slashing interest rates, implementing a quantitative easing (QE) program, and providing forward guidance to markets.

- The central bank's QE program has seen the size of its balance sheet increase substantially, from $105 billion in February to $360 billion in November. It has said it will continue to support the recovery by maintaining its QE program as long as required. With growth picking back up starting in the spring, the bank will likely begin scaling back its asset purchases in 2021.
- Today's rock-bottom interest rates are expected to be with us longer than the QE program.
- While the Bank of Canada's three measures of core inflation are showing near-target increases, other measures are pointing to soft price growth. Our forecast calls for tepid inflation to continue for a while given the substantial slack in the economy. With inflation muted, the Bank will not start raising its overnight rate until 2023.
- The central bank is expected to change its inflation target this year to allow for periods of below-target inflation to be offset by periods where it is above. This is not anticipated to alter long-run inflation expectations, but it may keep the Bank of Canada on hold for longer than currently forecasted as such a policy would take the pressure off raising short-term rates to keep inflation from pushing above 2 percent.

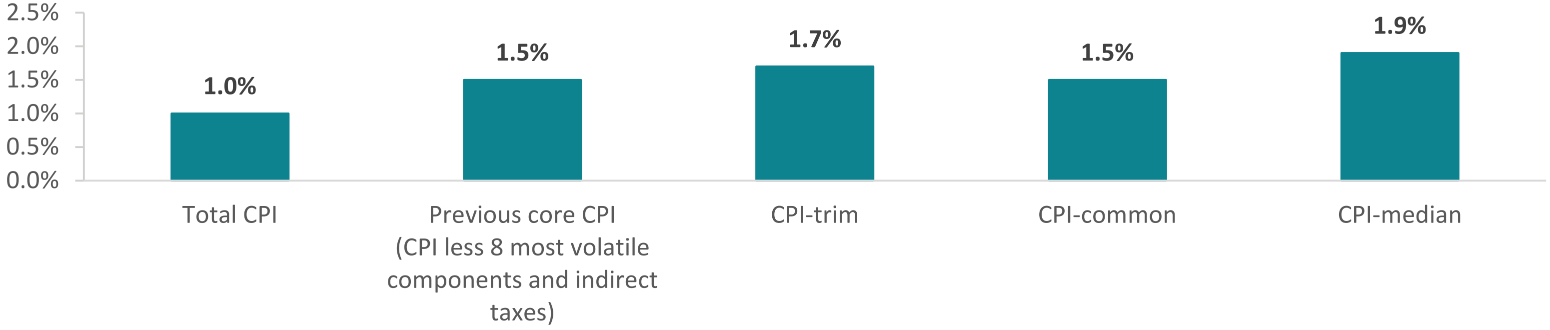
Bank of Canada assets

$C billions



Measures of Canadian inflation

November 2020, year-over-year growth



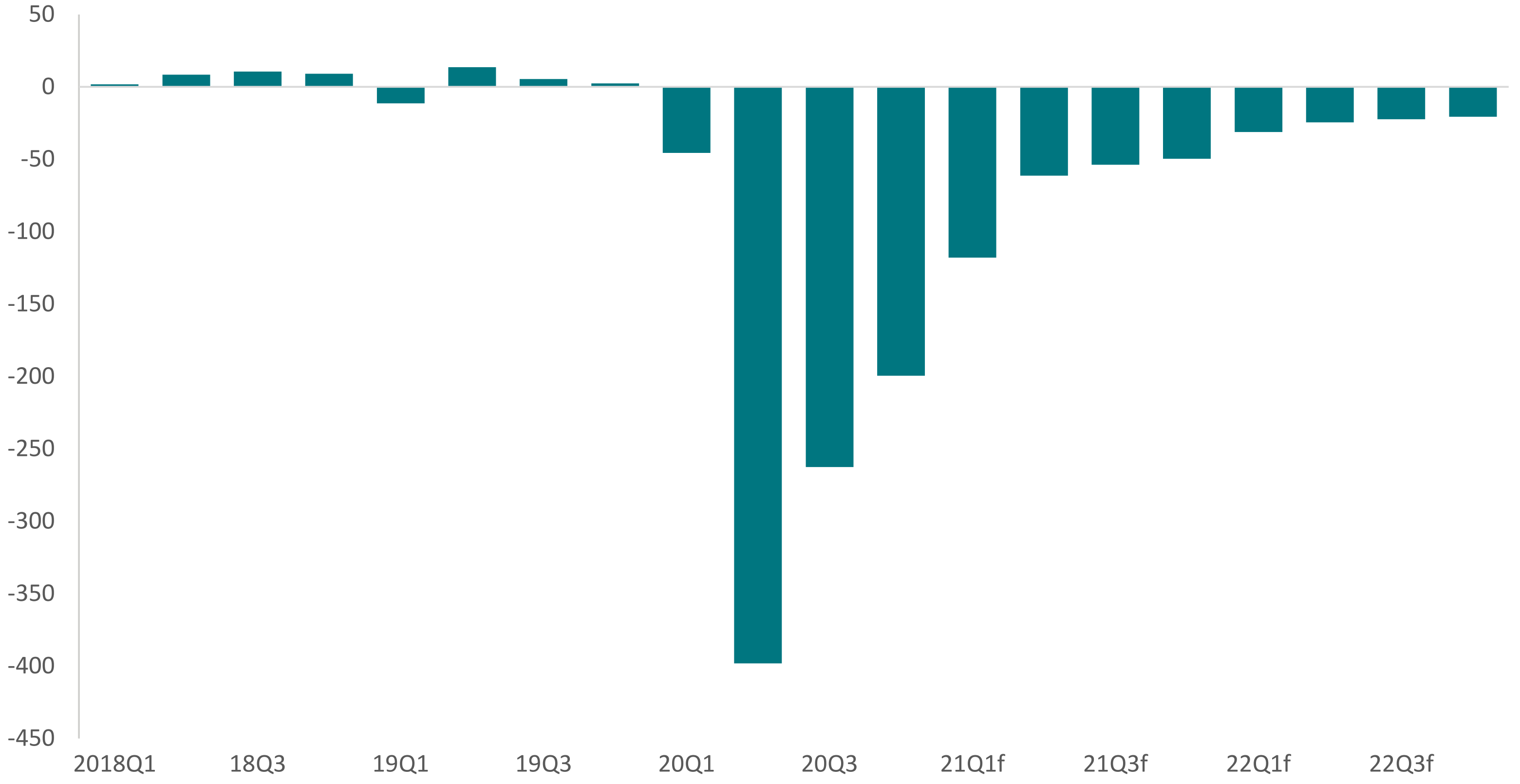
Sources: The Bank of Canada, Statistics Canada

Fiscal policy will need to adjust to deal with large deficits

Federal deficit could reach as high as $400 billion this year before trending down over the next several years.

- The Government of Canada is projecting large deficits over the next few years.
- Depending on the speed of the economic recovery and the timing and size of the government’s forthcoming stimulus plan as roughly outlined in the recent Fall Economic Statement, the final deficit could reach as high as $400 billion this year before going down over the next several years.
- If the federal government spends the upper range of its stimulus estimate ($100 billion), the federal debt-to-GDP ratio could reach 58.5 percent in 2023-24, a level not seen since the late 1990s.
- While extremely low interest rates make borrowing affordable, the plan is not without some risk. Although not our base case forecast, higher interest rates could result in significantly higher debt-service costs, particularly in the event of another or more prolonged economic downturn.

Federal net lending
$C billions



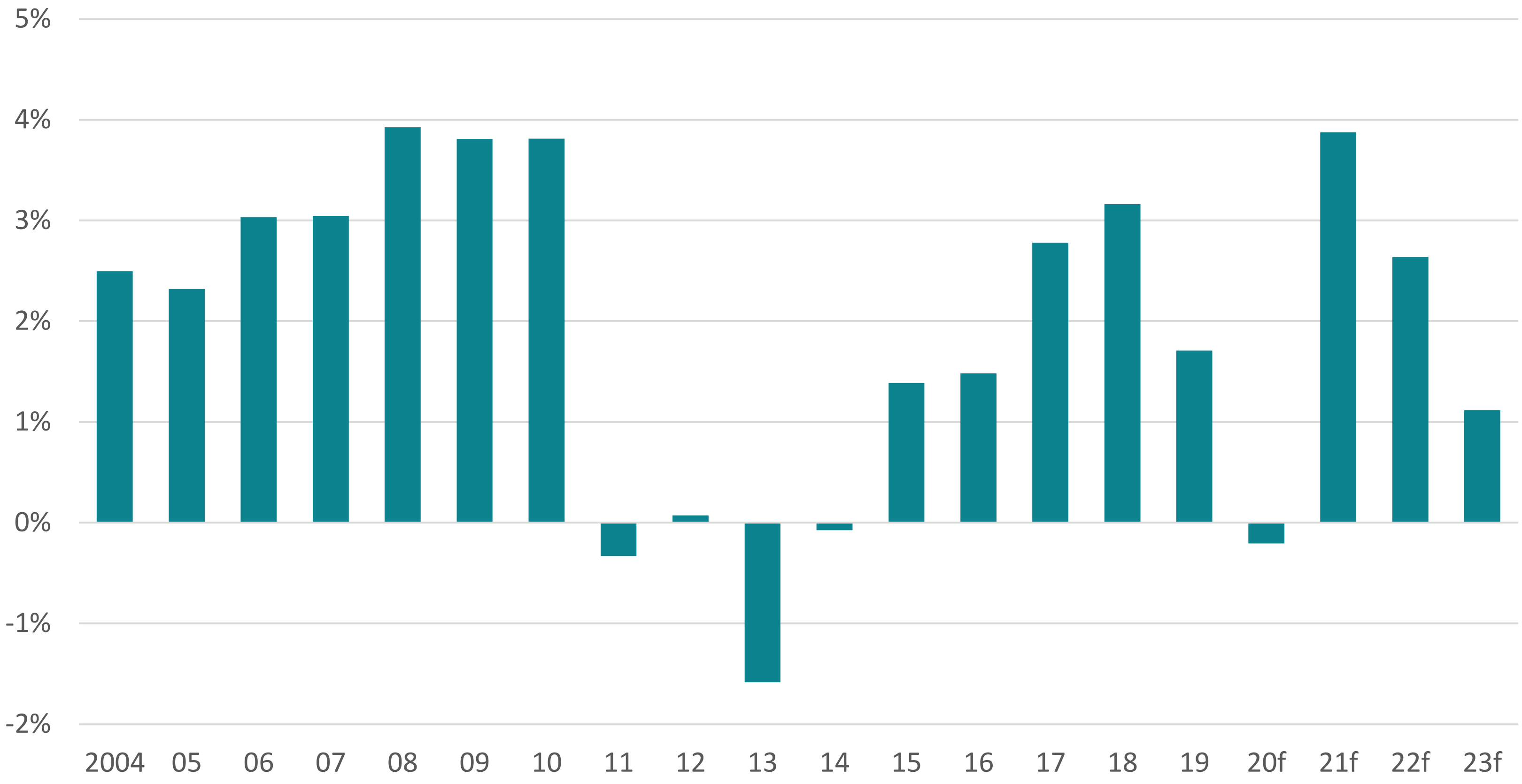
Sources: Statistics Canada, forecasts by Deloitte.

Government spending set to rise with more money for infrastructure and program expenditures

The federal stimulus plan is projected to push spending up by rates not seen since the stimulus plan of 2009-10, which followed the financial crisis. Higher federal and provincial debt this time around will likely limit sustained spending increases.

- The federal government's Fall Economic Statement contained a mix of spending announcements designed to help support the economic recovery. It also stated the government's intent to follow through on a stimulus plan of up to $100 billion, which would be detailed in an upcoming budget.
- This stimulus is projected to boost total government spending by 3.9 percent in 2021, a rate of increase not seen since 2010.
- However, provincial governments are in much worse fiscal shape than they were when the last recession hit a decade ago, and in many cases will be unlikely to match federal funding.
- We expect government spending growth to slow in 2023 as provincial governments restrain spending to address their structural deficits and rein in the growth of their debt.

Government spending growth on goods and services, and investment



Sources: Statistics Canada, forecasts by Deloitte.

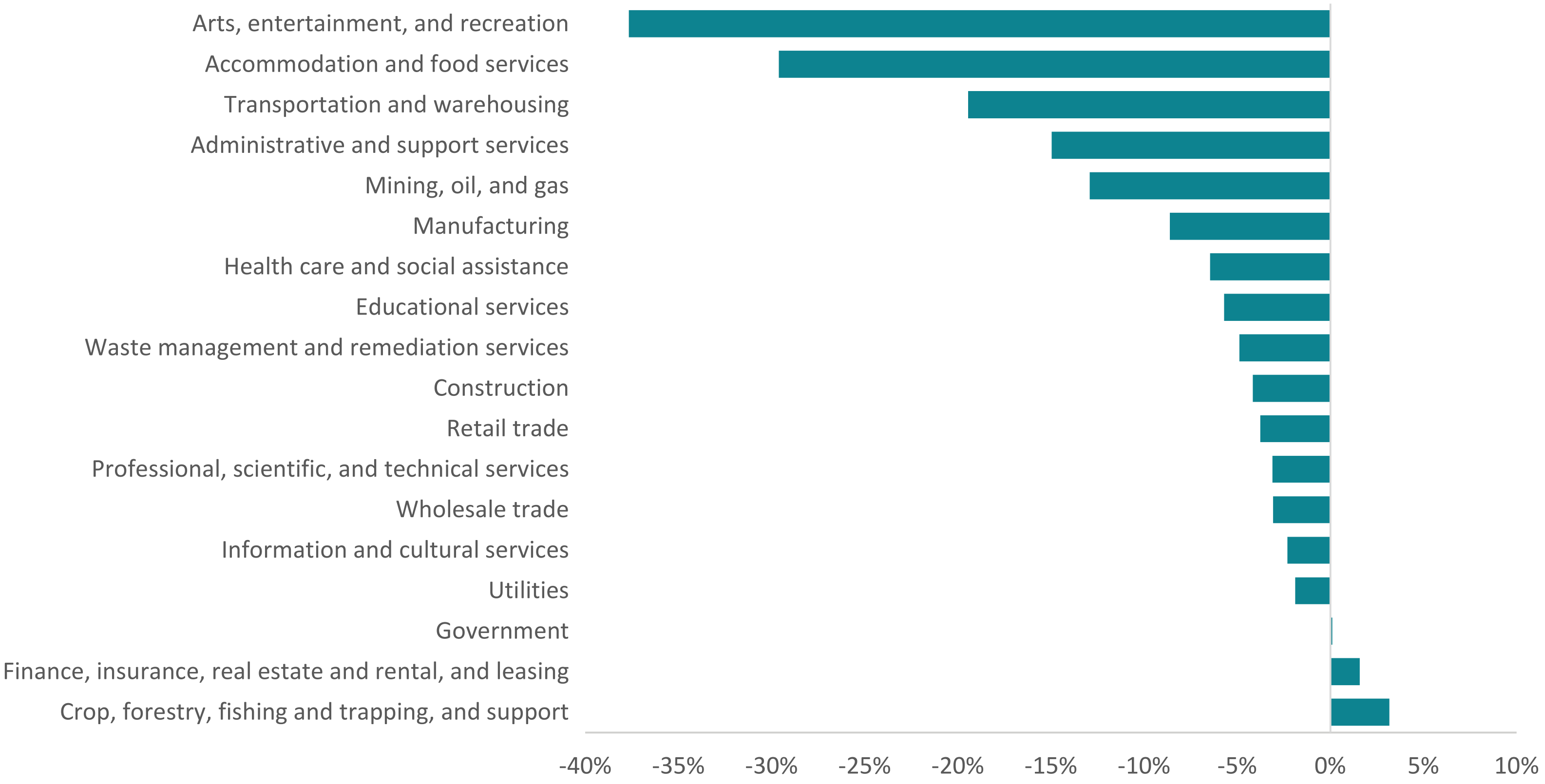
Industry overview

Industry overview: 2020 wrap-up

The recession incurred by the pandemic and oil-price shock affected all industries. The few industries posting growth in 2020 are overshadowed by record-breaking declines in others.

- Most industries experienced a decline in output in 2020 due to business activity restrictions created by the pandemic and exacerbated by the oil price shock.
- The hardest-hit sectors have been in tourism, where travel restrictions, forced business closures, and a second wave of viral infections led to sharp declines in activity. Arts, entertainment, and recreation was hardest hit, dropping by 37.7 percent in 2020. Accommodation and food services experienced a rebound in recent quarters but has a long road to recovery ahead.
- The finance, real estate, and insurance sector is bucking the overall trend thanks to the rapid recovery of the resale home market and stock-market volatility driving demand for investment advice.
- Most sectors began recovery efforts in the third quarter, but the rebound was not enough to bring them back to pre-COVID-19 levels.
- Growth is expected to slow significantly in 2020's fourth quarter and early 2021.

Estimated real GDP growth by industry in 2020



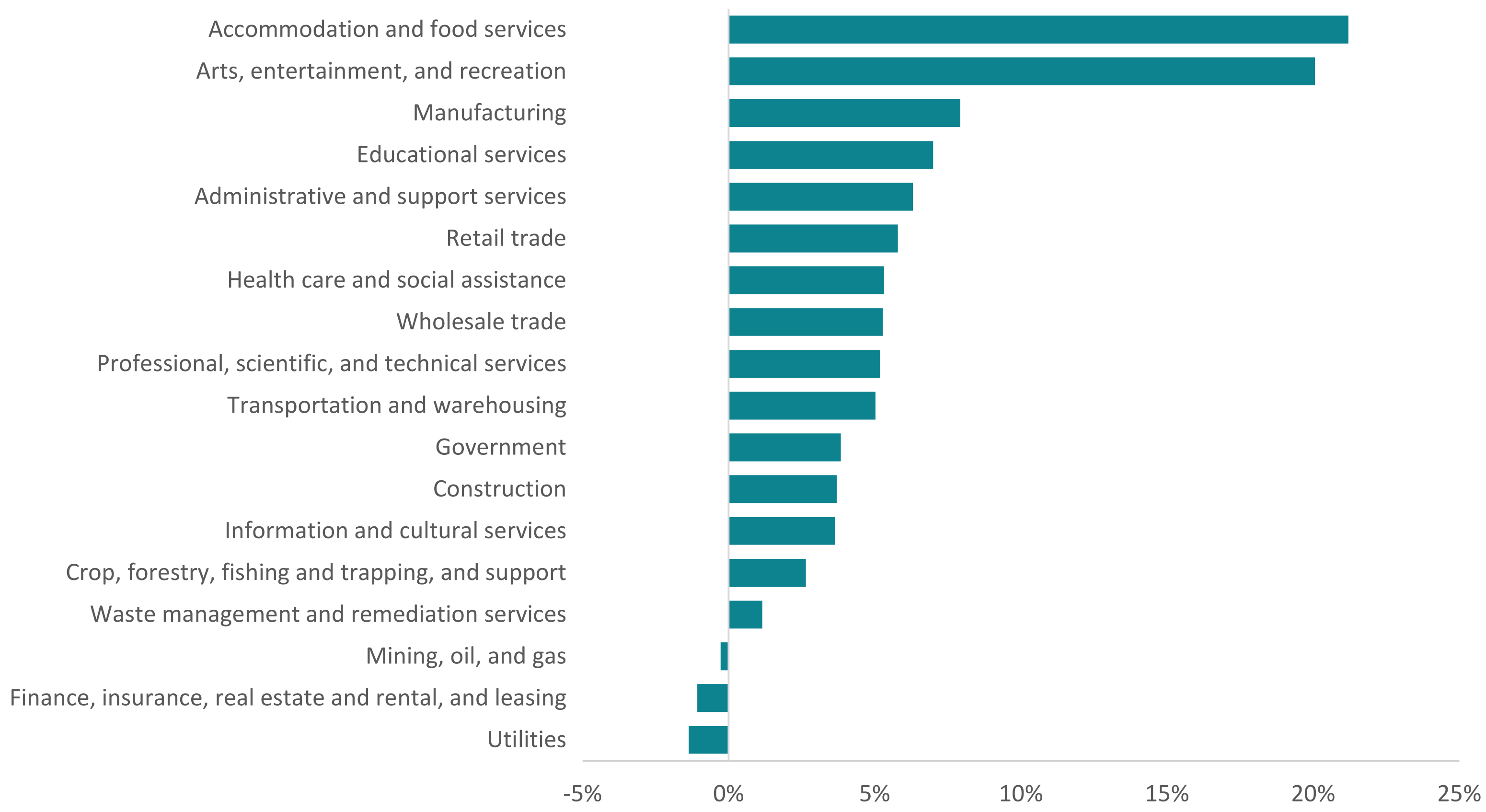
Sources: Statistics Canada, forecasts by Deloitte.

Industry overview: Looking ahead to 2021

With the economy expected to reopen this year, most industries will see a substantial rebound in 2021. However, with the scars left by the pandemic, a full recovery could take years for some.

- The accommodation and food services and the arts and entertainment sectors will post the strongest growth this year as activity has started to increase again after the sharp declines in the first half of 2020. Despite the gain this year, the level of activity will remain well below what occurred in 2019.
- The retail and wholesale trade sectors will build on the quick rebound seen in 2020, although growth is forecasted to slow early in the year as public health measures continue to keep people at home. With households sitting on significant savings, activity should increase as the year progresses and confidence improves with the gradual reopening of businesses.
- The weak outlook for mining investment will be a drag on mining output. The sector is projected to face another small decline.
- Health care and social assistance should see strong growth as the sector continues to battle the ongoing effects of the pandemic while beginning the vaccine rollout and catching up on an unprecedented delay in non-critical procedures, which were postponed during the height of the pandemic.

Outlook for real GDP growth by industry in 2021



Sources: Statistics Canada, forecasts by Deloitte.

Select sector profiles

Manufacturing

- Canada’s manufacturing sector exemplifies the uneven recovery.
- With consumer buying habits shifting to align with restrictions on activities, we have seen sales recover in certain segments, including food, beverages, and tobacco and computer and electronics. Other sectors where demand remains depressed, such as aerospace and refined petroleum products, continue to struggle.
- The number of active businesses in the manufacturing sector fell by 6.5 percent between February and August 2020.
- With corporate balance sheets devastated around much of the world, investment demand will remain soft. This will lead to a subdued rebound in machinery and primary metal manufacturing.
- Motor vehicles and parts will fully rebound in 2021 as consumer preferences shifted away from public transit during the pandemic.

Accommodation and food services

- The accommodation and food services industry has been hit extremely hard by the lack of international travellers and the restricted ability to serve domestic clients during lockdown periods.
- Nearly 10,000 fewer businesses in the industry were actively operating in August 2020 compared to February, a decline of 15 percent.
- The very near-term outlook for this sector is subdued, with renewed lockdowns across many cities constraining the ability to operate. However, growth should pick up again in the second quarter of 2021 as patio season returns and an increasing share of Canadians are vaccinated, encouraging more travel.
- However, it will take many years for the sector to fully recover as international and domestic tourism will be slow to come back. Indeed, we do not foresee output in this industry returning to its pre-pandemic levels until the end of 2024.

Energy

- After the hospitality-focused industries, the energy sector has been on the receiving end of some of the pandemic’s biggest negative impacts.
- Canada’s energy sector was already on shaky ground before COVID-19 swept the globe, with investment falling for years after the 2014 commodity price crash.
- With economic activity dropping, people working from home, and very few people travelling for leisure, demand for fuels has tanked.
- Conventional oil and gas production fell in the first two quarters of 2020 before stabilizing in the third. Non-conventional production was harder hit, with output falling around 30 percent (at annual rates) in both the second and third quarter.
- The combination of low prices and soft demand have hurt balance sheets and will keep investment subdued. Oil production will not return to pre-pandemic levels until early 2026.

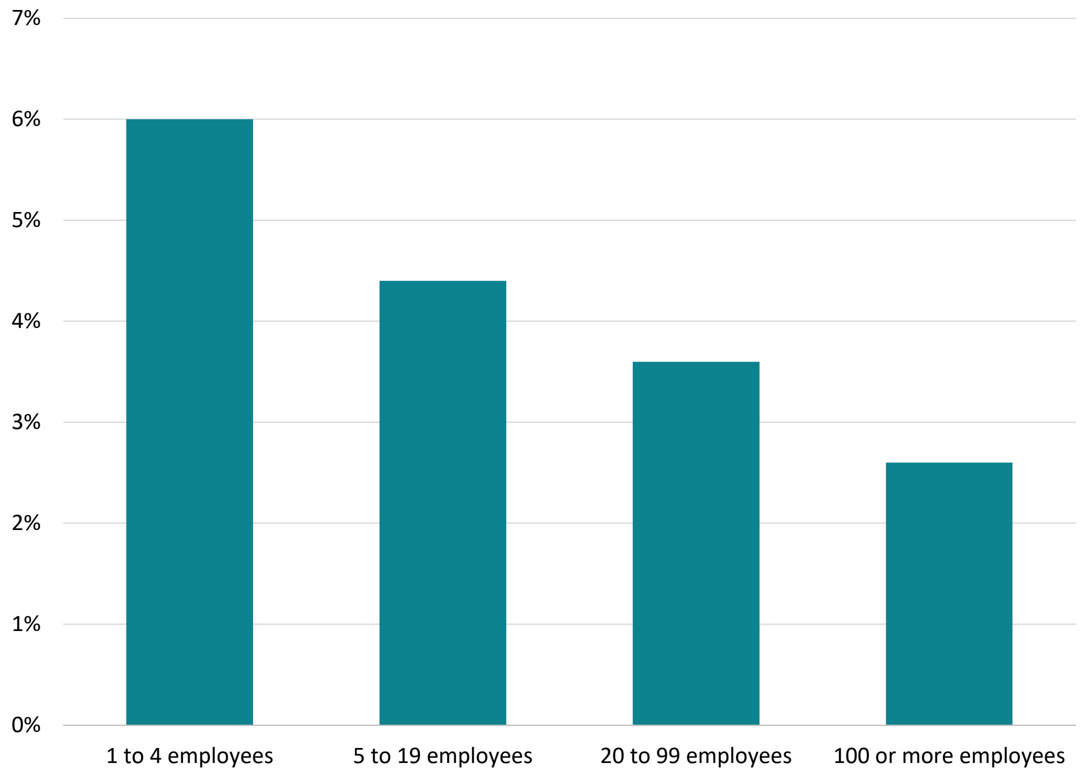
Assumptions and risks

Assumptions and risks

The economic outlook remains fraught with uncertainty, and there are significant risks in both the short and long term. Not all the risks are to the downside, however.

- Surging COVID-19 cases across much of Canada pose a threat to near-term growth projections. If public health measures need to be further tightened or prolonged, our forecasted decline in economic growth in the first quarter of 2021 could turn out to be larger than anticipated.
- Our forecast assumes that by the second quarter of the year, vaccinations will become more widely available. Combined with the ability to resume more outdoor activities as the weather warms, that will lead to stronger growth. It won't be until the third quarter that growth really accelerates when more of the population becomes vaccinated. Given recent announcements of faster-than-expected vaccine deliveries, it is possible that growth could accelerate quicker than expected.
- A longer-term risk stemming from the pandemic is the potential for lasting scars on businesses and labour markets. The number of people who are experiencing long-term unemployment is high and this could reduce future wage and spending growth. On the business front, a large percentage of firms are actively considering bankruptcy and we believe there could be many zombie firms out there hanging on due only to government support. A spike in bankruptcies is possible on both the business and consumer front, which would dampen growth prospects.
- On the upside, households are sitting on billions of extra savings thanks to generous government support programs and an inability to engage in regular activities. When they might release this money back into the economy is highly uncertain. It could occur quicker than expected, creating upside risk to our outlook this year.

By business size, share of businesses actively considering bankruptcy or closure because of COVID-19



Sources: Statistics Canada Survey of Business Conditions.

Concluding remarks

Concluding remarks

While 2020 is now in the rearview mirror, it is a year that will not be soon forgotten. Canada experienced its worse recession since the Great Depression, but the depth of the decline was not as bad as feared during the first wave of infections thanks to extraordinary fiscal policy intervention. Overall, our estimate points to an economic contraction of 5.7 percent for the year.

As we start 2021, we're still dealing with COVID-19 but there are many reasons to believe this year will be much better from an economic viewpoint. We have seen the economy rebound strongly, albeit unevenly, and by the end of September, Canadians who want a COVID-19 vaccine should be inoculated. However, our economic growth will hinge on measures required to contain the spread of the virus and the willingness of consumers to spend during a time of heightened uncertainty.

Despite that uncertainty, our forecast calls for the economy to rebound by 4.2 percent this year. The recovery will continue into next year, with real GDP growth of 4.9 percent in 2022.

When we look beyond the short term, however, many risks remain. Our primary concern is that, once again, we are in an economic recovery fuelled by household spending and government stimulus. While the latter has been essential to minimizing the devastation caused by the pandemic, both governments and households are bearing enormous debt loads. Stronger growth will require that rotation to business investment and export-led growth that was called for but never fully materialized after the 2008-09 financial crisis. Our fear is that, once again, rotation will remain elusive.

Business investment has underperformed overall economic growth for years. It has not just been an energy story—investment spending in other industries is also shrinking as a share of the economy. Investment is not only key to a more sustainable economic recovery but is also for helping boost productivity and our standard of living.

Crafting and implementing new strategies to boost investment and productivity that put us on a more prosperous economic growth path should be a major focus of this new decade.

Appendix

Key economic indicators

	2019	2020				2021				19A	20E	21F
	Q4A	Q1A	Q2A	Q3E	Q4F	Q1F	Q2F	Q3F	Q4F			
Real economic activity												
Gross domestic product	0.4	-7.3	-38.1	40.5	2.7	-3.1	7.9	12.4	5.8	1.9	-5.7	4.2
Consumption expenditure	2.0	-7.7	-36.5	46.0	2.3	-2.1	6.3	9.6	4.2	1.7	-4.7	4.3
• Durable goods	-2.3	-31.2	-46.2	262.7	1.9	-6.7	4.6	3.6	1.7	0.0	-4.4	12.0
• Services	3.7	-11.1	-54.1	44.3	7.6	-3.4	11.0	18.5	7.2	2.1	-10.5	4.7
Residential investment	-2.9	-1.4	-47.7	187.3	-6.9	-24.8	5.3	3.8	2.7	-0.2	2.8	1.8
Non-residential fixed investment	-5.9	-0.6	-55.1	25.8	1.8	-3.4	10.8	16.6	9.9	1.1	-12.6	1.6
• Non-residential structures	1.7	6.9	-49.8	-1.2	1.7	-1.8	12.9	20.2	11.6	1.1	-9.4	0.5
• Machinery & equipment	-17.4	-12.7	-63.6	91.8	1.9	-6.1	7.3	10.6	7.0	1.0	-18.0	3.3
Government consumption & investment	1.4	-0.3	-12.7	15.0	0.3	5.5	3.1	5.8	4.1	1.7	-0.2	3.9
Exports of goods & services	-4.2	-6.6	-56.7	71.8	2.1	3.1	5.8	9.1	5.6	1.3	-10.1	5.0
Imports of goods & services	-2.9	-9.3	-65.0	113.7	10.9	1.8	5.4	8.2	11.4	0.4	-11.8	7.8
Prices												
Consumer price index (y/y)	2.1	1.8	0.1	0.4	0.4	0.7	1.8	1.6	1.7	2.1	0.4	1.7
Implicit GDP price index (y/y)	3.2	0.7	-0.9	1.6	2.4	3.7	5.3	3.7	2.6	3.2	2.4	2.6
Labour market												
Employment	0.1	-1.5	-11.4	8.6	2.5	0.7	2.0	1.1	0.4	2.1	-5.2	5.9
Unemployment rate (%)	5.7	6.3	13.0	10.0	8.5	8.3	7.0	6.9	6.7	5.7	9.4	7.2

Note: Unless otherwise noted, all figures are expressed as annualized percent changes.
Sources: Statistics Canada, Bank of Canada. Forecast by Deloitte Economic Advisory, as of December 23, 2020.

Financial market indicators

	2019	2020				2021				19A	20E	21F
	Q4A	Q1A	Q2A	Q3E	Q4F	Q1F	Q2F	Q3F	Q4F			
Interest rates (%)												
Overnight rate target	1.75	1.41	0.23	0.23	0.25	0.25	0.25	0.25	0.25	1.75	0.25	0.25
3-month T-bill	1.66	1.17	0.25	0.15	0.20	0.20	0.20	0.20	0.20	1.66	0.20	0.20
1-year GoC note	1.73	1.19	0.30	0.22	0.38	0.43	0.47	0.49	0.50	1.73	0.38	0.50
2-year GoC note	1.61	1.14	0.31	0.27	0.37	0.41	0.45	0.48	0.50	1.61	0.37	0.50
5-year GoC note	1.54	1.11	0.40	0.36	0.48	0.55	0.62	0.67	0.71	1.54	0.48	0.71
10-year GoC bond	1.51	1.13	0.55	0.55	0.67	0.74	0.80	0.86	0.91	1.51	0.67	0.91
Yield curve spread (pp)												
3-month vs. 10-year	-0.15	-0.04	0.30	0.40	0.47	0.54	0.60	0.66	0.71	-0.15	0.47	0.71
2-year vs. 10-year	-0.10	-0.00	0.24	0.29	0.29	0.32	0.35	0.38	0.40	-0.10	0.29	0.40
Foreign exchange												
USD/CAD ($C)	1.32	1.34	1.39	1.33	1.29	1.29	1.29	1.29	1.29	1.32	1.29	1.29
CAD/USD (US cents)	0.76	0.74	0.72	0.75	0.77	0.77	0.78	0.78	0.78	0.76	0.77	0.78

Sources: Statistics Canada, Bank of Canada. Forecast by Deloitte Economic Advisory, as of December 23, 2020.

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