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Charting a path to recovery

Economic outlook | October 2021

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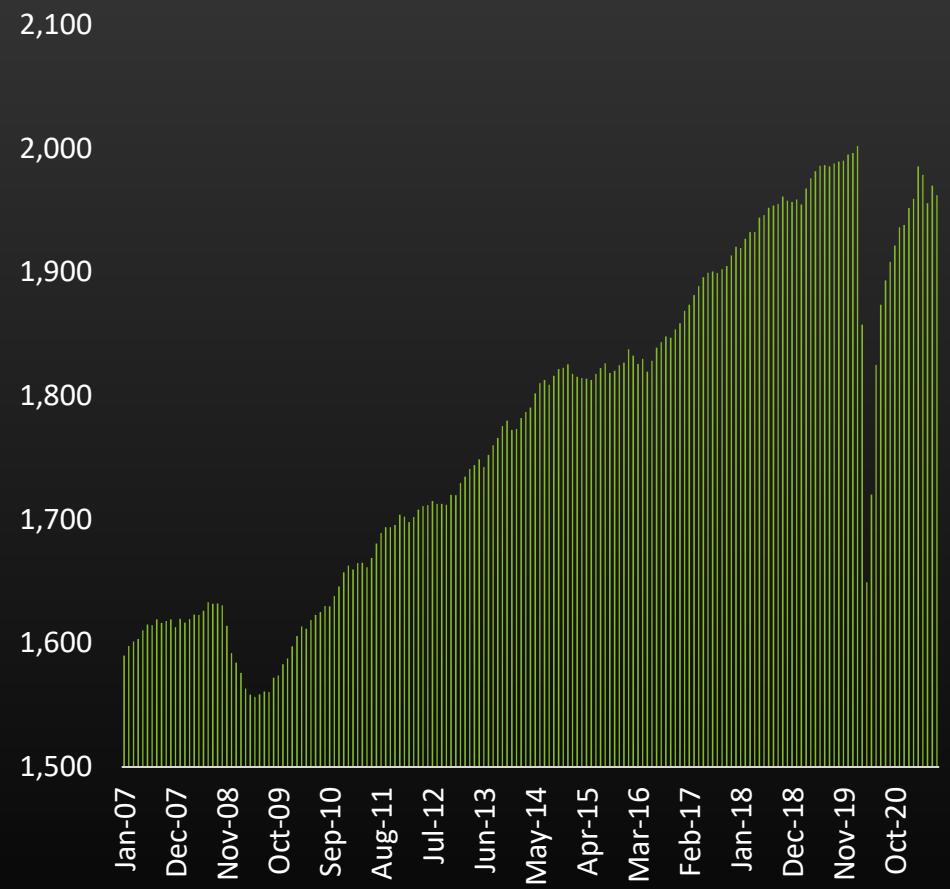
Summary by Chief Economist Craig Alexander

As Canada navigates the fourth wave of the COVID-19 pandemic, it has become apparent that securing enough doses to inoculate the entire population will not be enough to end the pandemic's influence on our economy or society more broadly. From an economic lens, the implication is that near-term growth prospects will continue to depend on health conditions: the number of active cases in Canada and abroad will influence consumer confidence and disrupting trade while public health measure will determine which activities are permissible in any given province or territory. This is evident in the most recent economic growth data, which shows activity falling in April and May before rebounding in June as the third wave surged and receded. Statistics Canada's preliminary estimate is for another dip in July.

The economic impacts of the pandemic go beyond monthly fluctuations in GDP—they're set to influence our outlook for years to come. The federal government's response to the pandemic helped avert a deeper crisis but it's ushered in an era of bigger government. Not only did public spending increase dramatically during the crisis, but a number of post-crisis stimulus and investment programs are set to keep government spending outpacing its revenues for years to come. On the home front, we saw consumers react to the pandemic by shifting their spending to housing and retail goods. As a result, housing prices have skyrocketed across the country along with the amount of mortgage debt held by households. Meanwhile, spending on services, especially in the leisure and hospitality sectors, has plummeted.

On the businesses front, many sectors have experienced a sharp drop in profitability. They have also experienced productivity losses as pandemic compliance measures were introduced and firms have, accordingly, slashed their investment spending accordingly. Now, as economic and health conditions are improving, a new challenge has emerged: labour shortages. While a large portion of our labour force remains underutilized, there is growing evidence of labour-market frictions. In June, Canada had 815,000 job vacancies, up 22% from the month before; a recent survey of Canadian hiring intentions shows that businesses are looking to significantly boost staff levels in the fourth quarter of this year. One major contributing factor is the sharp drop in immigration during the pandemic. Immigration was responsible for the bulk of Canada's labour force growth for the five years before the pandemic. While restoring immigration levels will help, the rapid shift to digital and other responses to the crisis looks to have altered the demand for particularly skills. This has created a skills mismatch, which means that reskilling is a priority but will take time.

Real Canadian monthly GDP, billions



Source: Statistics Canada

Summary

These trends will continue to influence our economic outlook over the next few years. Consumers, who amassed billions in savings, will be a key driver of the recovery. However, our forecast calls for a shift in the prospects of consumer-focused industries. Those that sell goods primarily related to non-travel related leisure and housing have fared very well since the pandemic began, but they're set to experience more modest prospects as households begin to direct their savings toward services. This trend is also expected to impact the housing market. With the economy reopening, households no longer seem to feel the same urgency to invest in bigger homes to make pandemic living more comfortable, as demonstrated by recent months of falling home sales, if admittedly from record-breaking levels. In the longer run, household spending is expected to be constrained by high debt levels.

As consumer-spending growth eases, our economic prospects will increasingly depend on our ability to improve business investment and export growth. However, oil and gas investment has been on a downward trend since 2014. In the early days of the pandemic, companies further slashed their investment in a bid to preserve cash. Despite recent increases in oil prices, investment in the oil sector is projected to make only a sluggish recovery. This will contribute to energy exports flattening out in the coming years.

The story is little better outside of the energy sector. After years of disappointing performance, non-energy investment declined significantly during the pandemic. Recent surveys suggest a modest recovery. Non-energy exports have been relatively flat for a decade, despite solid US demand that grew imports from other countries and leaving Canada with a declining market share. Without stronger business investment, we're unlikely to improve on our recent performance and capture any of the benefits from the strong US recovery.

The longer-term outlook for government spending also faces challenges. Government debt has soared during the pandemic. While deficits are expected to trend down over the forecast now that the peak of the crisis is past, both the federal and provincial governments face a long road back to fiscal sustainability. That's not expected to deter near-term spending intentions, but as we look further out, the economic contribution from public spending is expected to diminish. This will be especially the case as interest rates begin to rise, which will add pressure to debt-servicing costs and begin to crowd out other spending.

Summary

Indeed, the Bank of Canada has already started to withdraw some of its aggressive stimulus, cutting back the pace of its bond-buying over recent months as the economy rebounded and price pressures began to build. While the Bank of Canada maintains that higher inflation was expected and will be transitory, the fact that inflation reached 4.1% in August is sure to catch the central bank's attention. Furthermore, we're starting to see preliminary evidence of firms boosting wages to attract talent. The current high levels of inflation are in part owing to base year effects (comparing now to a year ago when the pandemic impacts were more severe) but wage-push inflation, should it emerge, is completely different and it is the type of pressure that could lead to more widespread price increases.

Taking all these factors into account, our forecast calls for another weak quarter of growth with real GDP advancing by only 3.5% annualized in the third quarter of 2021, a rather subdued rebound after the surprise 1.1% decline in the second quarter. As summer draws to a close, it's now clear that the hoped-for surge in activity led by the vaccination campaign and reopening is not in the cards. The pandemic's impacts continue to linger. Growth prospects are set to improve toward the end of the year based on the assumption that more widespread adoption of vaccine passports will boost consumer confidence and activity. However, there's risk this won't materialize if such passport mandates don't boost vaccination uptake, as that would leave a portion of the population unable to access some non-essential services.

Nevertheless, our expectation is that the recovery will continue, albeit at a slower pace than previously expected, with real GDP increasing by 4.9% this year and 4.3% in 2022. Growth will soften to 2.5% in 2023 as government stimulus begins to diminish.

While the recovery is going to be more prolonged than expected, Canada still finds itself in a relatively enviable position to many other countries given the widespread availability of vaccines and higher inoculation uptake than many of our international peers. As such, we're bullish on the near-term prospects for the Canadian dollar, which is expected to rise to US$0.83 in the first half of 2022. As growth prospects improve in other parts of the world, however, some of those gains will be clawed back, returning the dollar to around the US$0.80 to US$0.81 range.

International outlook

Despite the emergence of the Delta variant, the global economy is on the mend

After a devasting 2020, the economic outlook for this year is much better thanks to increasing vaccination rates.

- The global economy shrank by 3.5% last year, marking only the second time worldwide GDP dropped during the last 40 years of comparable data.
- The outlook for the global recovery has been revised down given the emergence of the highly contagious Delta variant, and surging COVID-19 cases in many parts of the world. The world economy is now expected to grow by 5.8% in 2021, instead of the 6.3% forecast three months ago. Global growth has mainly been dragged down by weaker-than-expected growth in advanced economies, where growth has been revised from 5.8% to 5.0%.
- Despite the downgrade in advanced economies, growth will be fairly broad-based this year. However, many tourist-dependent economies will have to wait until 2022 before their recovery becomes deeply entrenched.
- Meanwhile, growth in emerging markets is being affected by low vaccination rates and the spread of the Delta variant. Through supply chain pressures, a further escalation in cases could put their export recovery at risk. Despite these concerns, emerging markets are still expected to grow by 6.8% this year.
- In 2022, the pace of the world economic growth is projected to decelerate to 4.7%.

Real GDP growth

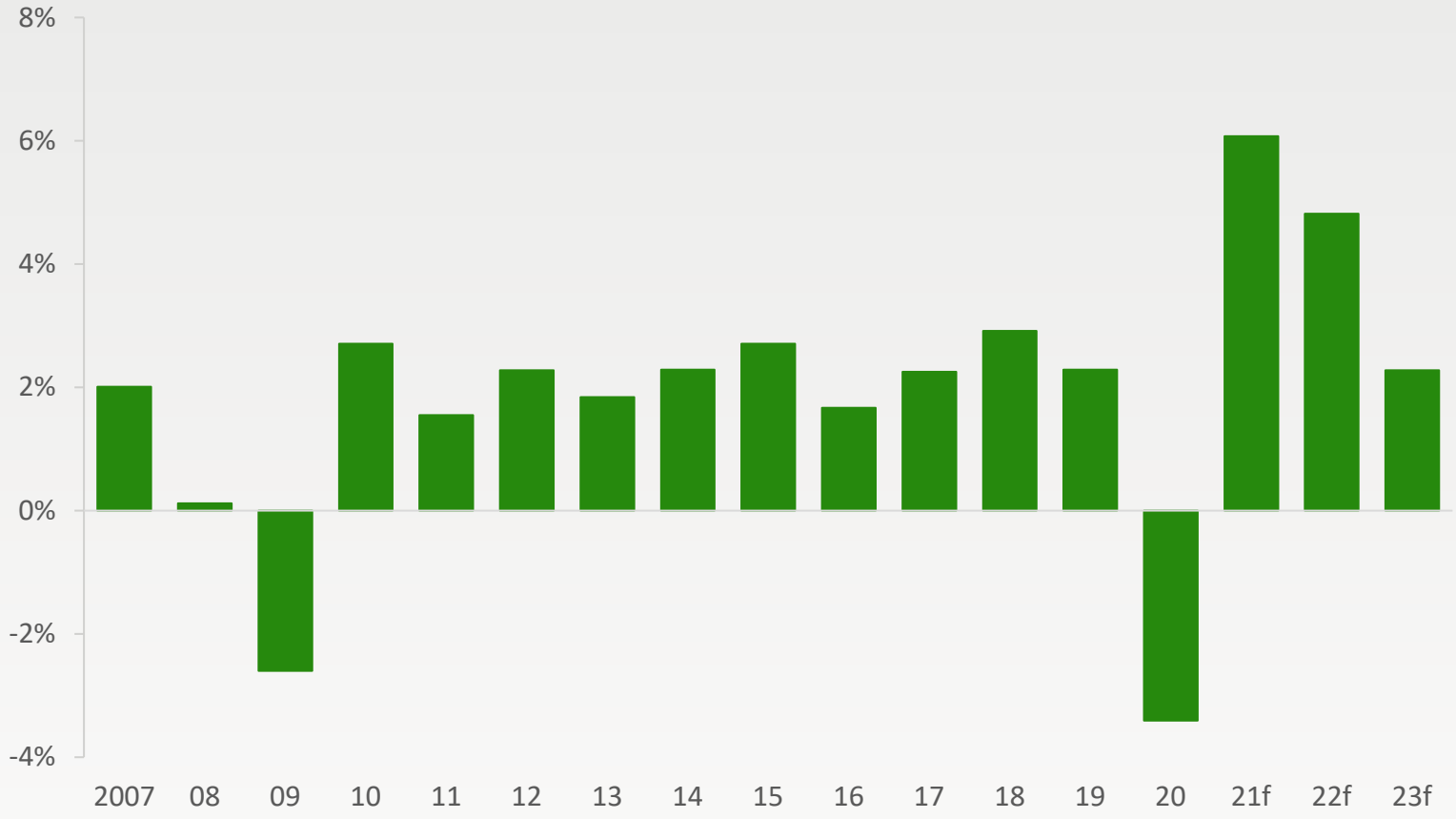
Sources: Oxford Economics, Deloitte

Economic growth in the United States is losing momentum

We had previously projected the US economy would experience a record rebound thanks to its significant monetary and fiscal stimulus. However, rising cases of COVID-19 and supply-side constraints have taken some of the steam out of its recovery.

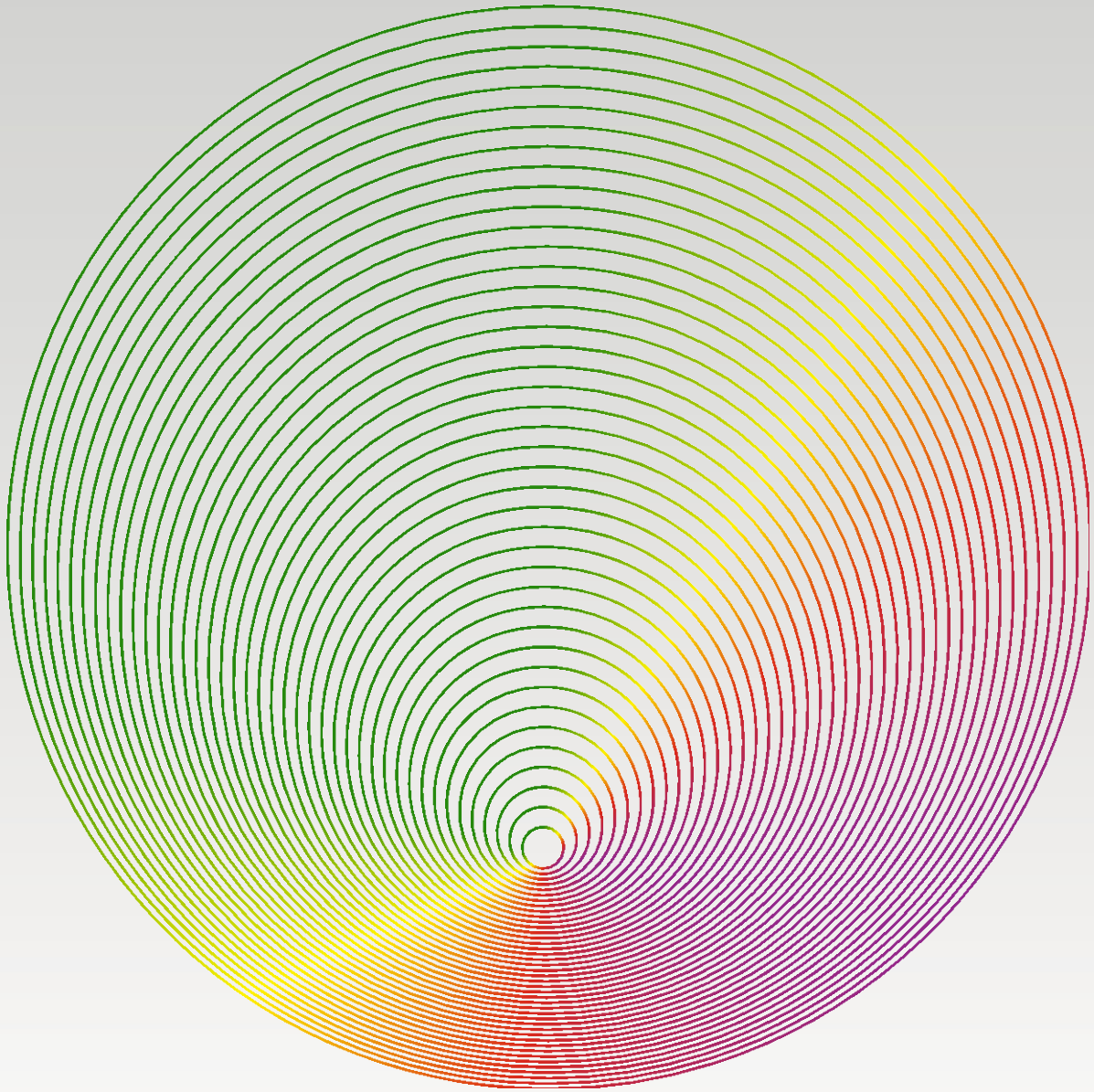
- Given the size of fiscal and monetary stimulus being maintained, policymakers in the United States appear keen to avoid the prolonged economic recovery that the country experienced after the financial crisis a decade ago. However, the pace of recovery has been materially slowed in the second half of this year by higher COVID cases and supply constraints. Nevertheless, we expect US economic growth to accelerate later this year.
- The US Federal Reserve has shrugged off the recent spike in inflation. The central bank continues to use forward guidance to convey to the market its expectations for sustained low interest rates.
- Since the beginning of the pandemic, total fiscal stimulus in the United States has amounted to nearly US$6 trillion, boosted by President Joe Biden's US$1.9 trillion stimulus package. As a point of comparison, the entire US economy produced $21.4 trillion in output in 2019, before the pandemic hit.
- The US economy is now expected to grow by 6.1% this year, and another 4.8% in 2022. Although this is significantly less than the 7.7% projected for 2021 three months ago, the continued strong recovery of the United States will still be an important factor driving the global recovery, and bodes well for demand for Canadian exports.

US real GDP growth



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

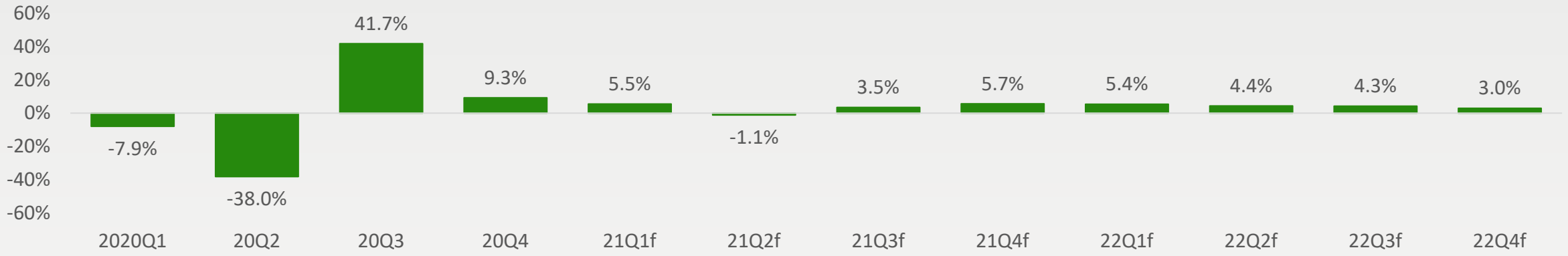
Canadian outlook
National perspective



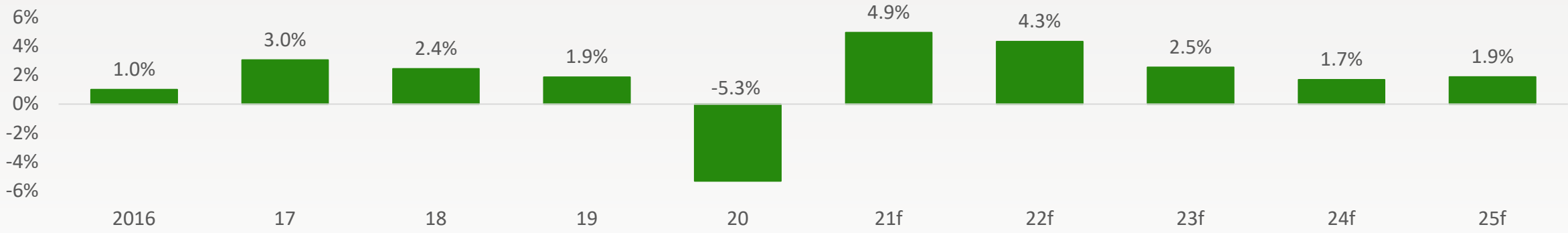
In Canada, the Delta variant has negatively affected both reopening plans and growth

Contrary to previous expectations, reopening plans have proceeded more cautiously or even been rolled back due to the pandemic's fourth wave. As for GDP, the second quarter of 2021 was worse than expected. However, growth is set to pick up in the third as phased reopening plans continue.

Real GDP, quarter-over-quarter annualized growth



Real GDP, annual growth



Sources: Deloitte, Statistics Canada

Canadian outlook
Household sector

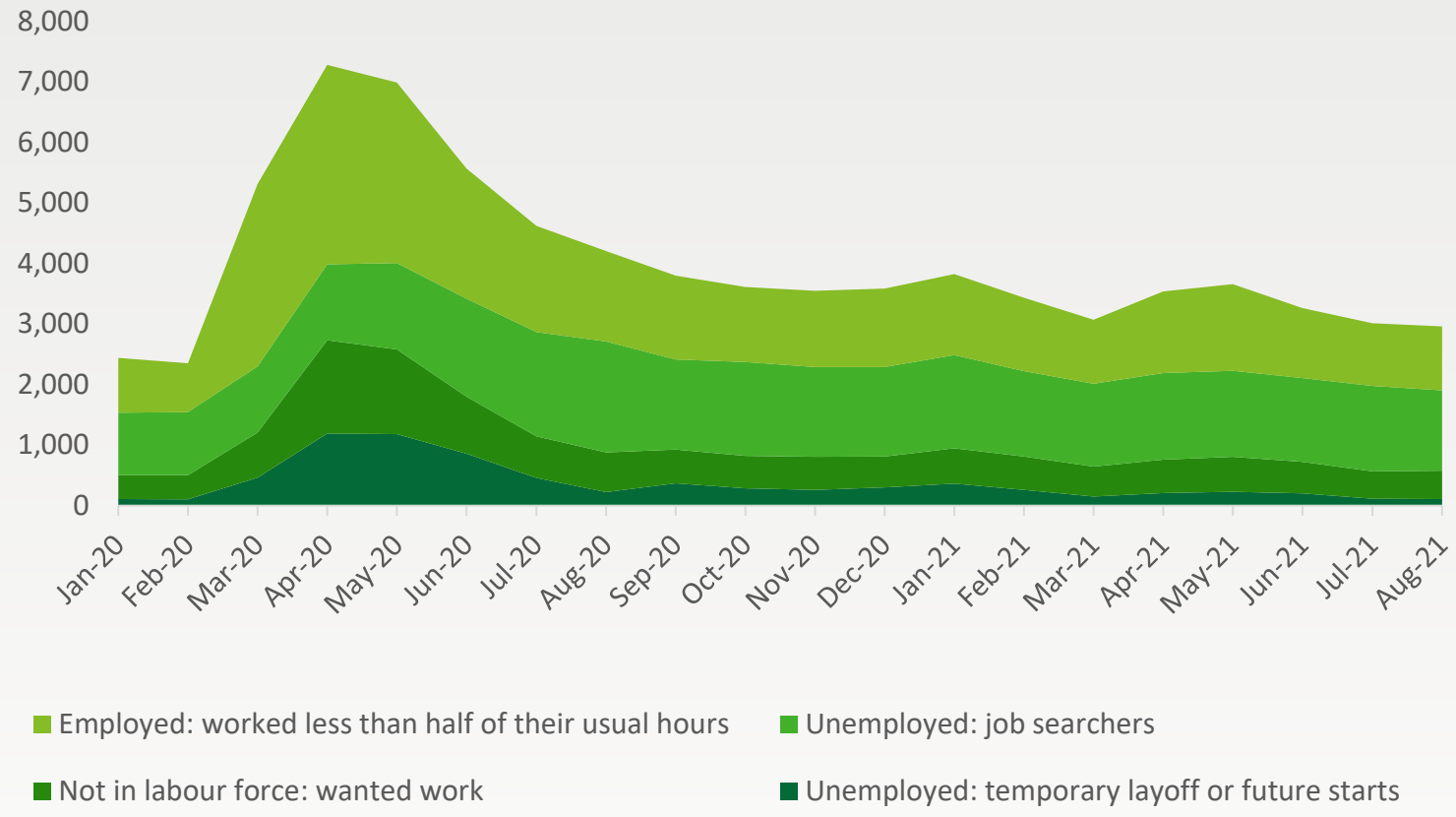
Employment is improving but it remains below pre-pandemic levels

Employment rose in August 2021 for a third consecutive month, leaving employment only 156,100 positions below its pre-pandemic level.

- Despite the recent setback in economic growth, the labour market continues to strengthen. The Canadian economy created 90,000 new jobs in August, bringing the total increase over the last three months to just over 400,000. The unemployment rate fell to 7.1%. Although this is still above the 5.7% recorded in February 2020, labour market conditions are quickly improving.
- Labour shortages are becoming an increasing concern, with many organizations reporting difficulty hiring staff. While job vacancies are rising, this is not yet reflected in the labour market underutilization rate, which remains high.
- In addition to the amount of unemployed people, the labour market underutilization rate captures discouraged workers and those who worked less than half their usual hours for reasons related to COVID-19. When comparing August 2021 with February 2020, 27.7% more people are searching for a job, 29.9% more are working less than half their usual hours, and 17.2% more people wanted a job but had given up looking for one.
- With total hours worked still 2.6% below their pre-pandemic levels, recent discussions of labour shortages may reflect a skills mismatch between available labour and the industries experiencing substantial growth.

Labour underutilization

(000s of people)



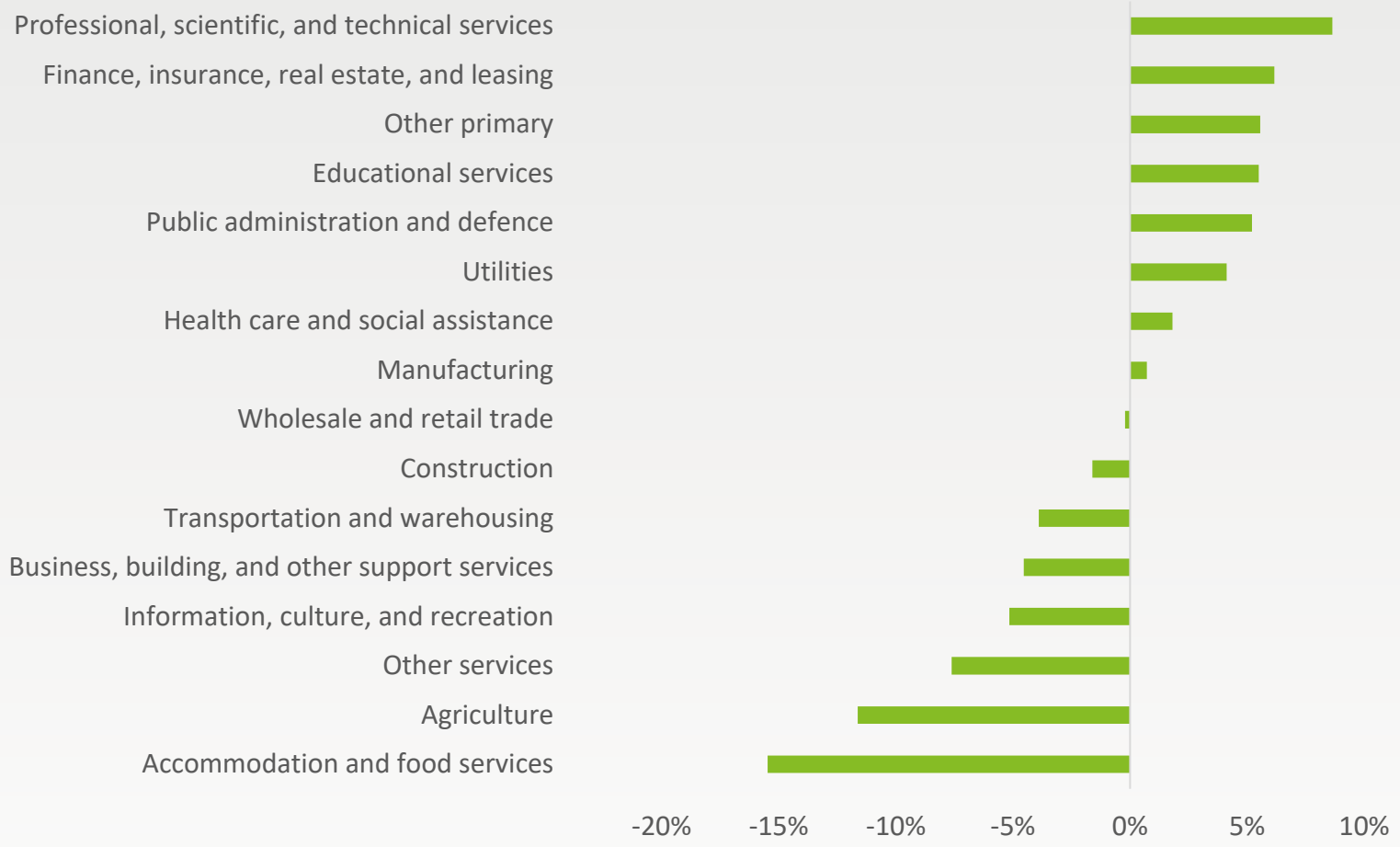
Sources: Deloitte , Statistics Canada

A tale of two labour markets

Although the sectors most affected by pandemic restrictions continue to have reduced levels of employment, restaurants, personal care services, retail stores, and entertainment venues are now able to welcome clients indoors, if still with capacity restrictions.

- Sectors that were able to shift their employees fairly easily to work from home—such as professional, scientific, and technical services as well as finance, insurance, real estate, and leasing—have seen substantial job growth through the pandemic and are now struggling to attract labour.
- On the other hand, hard-hit sectors like accommodation and food services, transportation, and recreation and tourism still have a way to go before employment will be fully recovered from the pandemic.
- In recent months, the relaxation of public health measures have allowed these sectors to increase their employment substantially. Further gains could be limited by the unavailability of labour. Job vacancies in accommodation and food services, and other services have experienced substantial increases in recent months. The job vacancy rate in the accommodation and food services is now at a whopping 12.7%. This might reflect workers being concerned that future government restrictions could adversely affect employment, or it could reflect government income support programs being a disincentive to work.
- Employment in hard-hit sectors should experience substantial growth in 2022 but it will take considerable time to fully recover.

Employment by industry, 2019Q4 to 2021Q4



Sources: Statistics Canada, forecasts by Deloitte

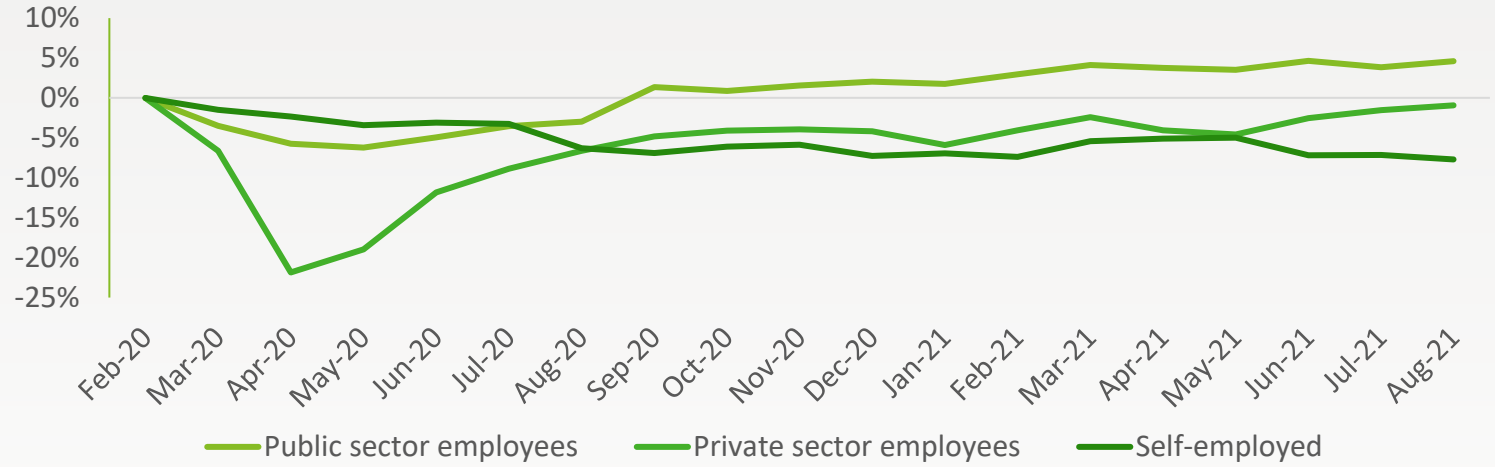
The employment recovery is uneven across age, gender, and education

The negative impact continues to be felt disproportionately by women, younger Canadians, and those with less education.

- The industries that continue to feel the biggest negative impact from the pandemic also tend to employ younger Canadians. Consequently, the number of people aged 15 to 24 participating in the labour force is still well below what it was before the pandemic, especially young men.
- Beyond youth, women continue to face a greater labour recovery hurdle. In August, employment among women stood about 1% below its pre-pandemic level, compared to 0.4% for men.
- The industry discrepancies also show up in employment by level of education. Employment for those with a university degree is up 5.2%, while it's down 3.7% for those without.
- Perhaps not surprising given the amount of government stimulus, employment in the public sector has seen the quickest rebound—it's now 4.6% above pre-pandemic levels. Private sector jobs have also largely recovered, particularly in recent months; sector employment is now just 0.9% below pre-COVID-19 levels.
- In contrast, self-employment remains 7.7% below pre-pandemic levels. August was the fifth consecutive month with no growth in self-employed workers.

Employment by age and gender, February 2020 to August 2021

Employment change (%) compared with February 2020



Sources: Deloitte , Statistics Canada

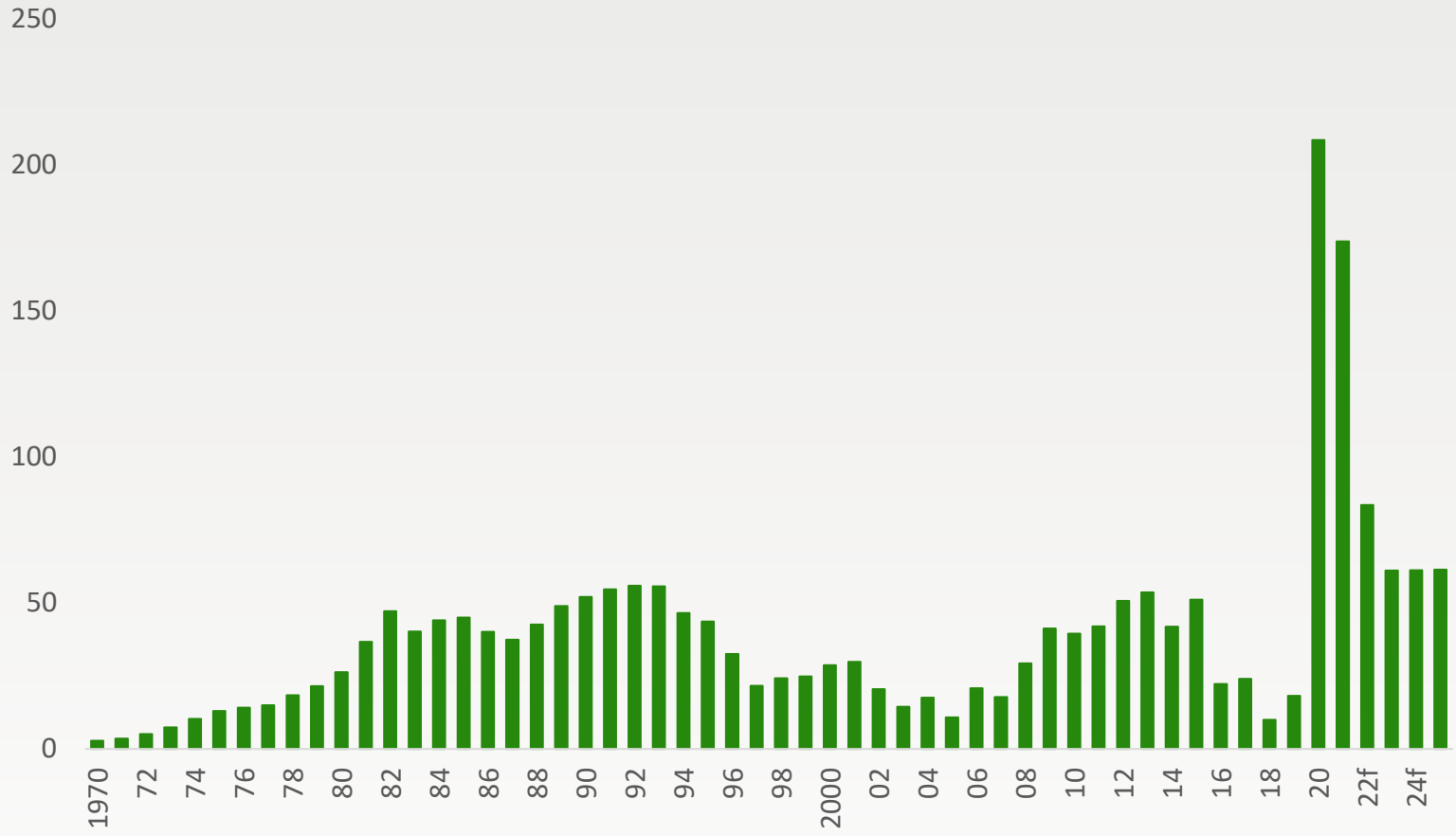
Strong government support and solid wage growth boosted household savings

Strong growth in disposable income couple with an inability to purchase many services or to travel has led to a record buildup in household savings that will fuel spending in the coming year.

- Despite being in the worst recession in Canada's history, the country in 2020 saw the strongest increase in real household disposable income on record: a whopping 9.5%.
- Higher-income and higher-skilled individuals 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 compensated workers unable to work because of the pandemic.
- With the majority of the jobs lost being on the lower-income scale, average hourly private-sector wages soared by 13% in 2020. This year, those wages will fall by 3.1% as some of those lower-income jobs come back. Even still, we expect a modest increase in real disposable income, as some government support programs remain in place.
- On top of strong income growth, an inability to spend on services has resulted in an incredible buildup of household savings. These climbed to a new high in 2020—reaching $208 billion—and they've stayed high through 2021.
- Although household savings are expected to remain elevated over the next few years, their return to more normal levels in 2022 will fuel large increases in consumer spending.

Household savings

(C$ billions)



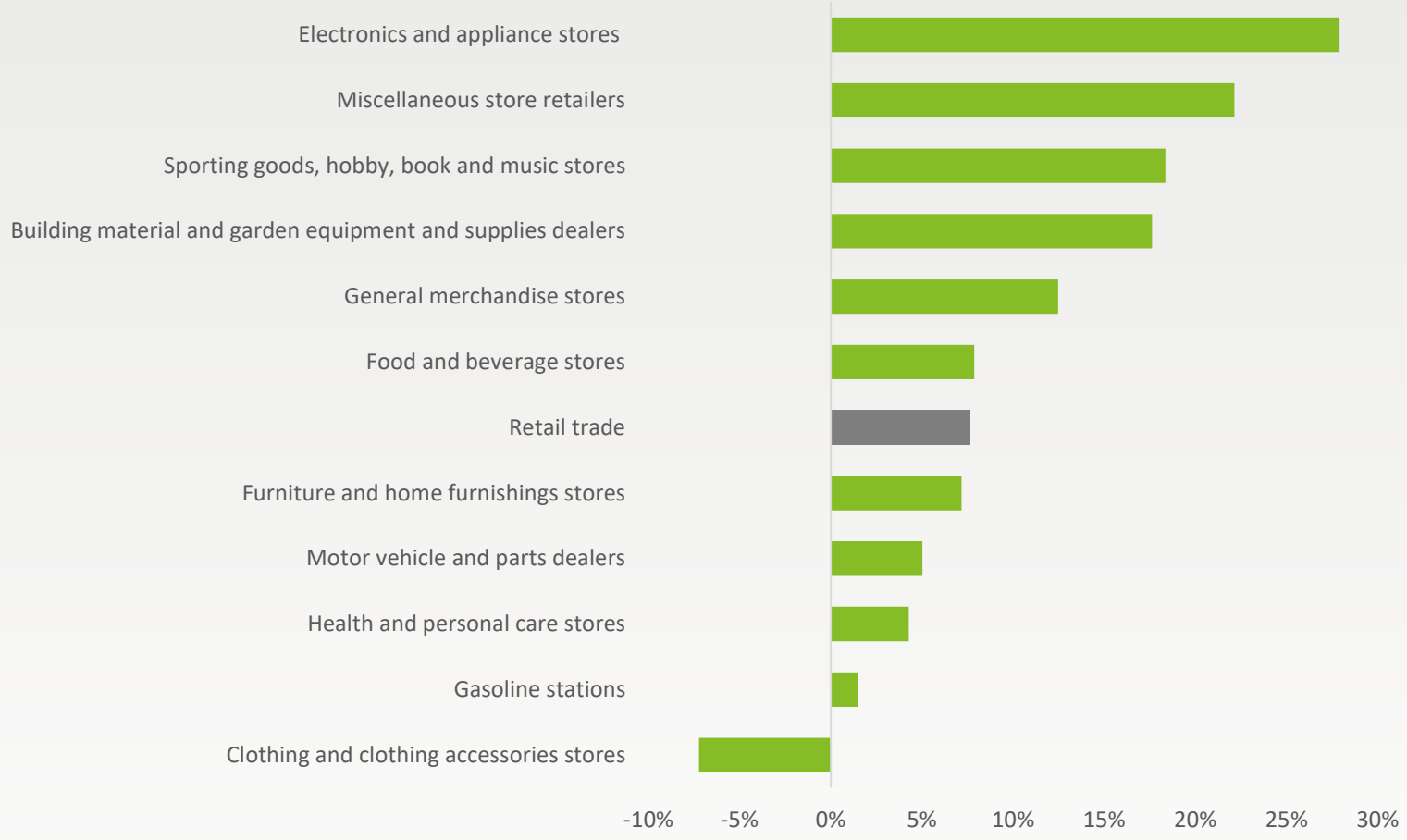
Sources: Statistics Canada, forecasts by Deloitte

With strong income growth, retail spending has been a bright spot in the recovery—for now

Despite fluctuating store openings and closures since the pandemic began, retail spending has fared very well. As of June 2021, it was up 7.6% after accounting for inflation.

- During the various waves of COVID-19 cases 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 many other sectors of the economy and certainly those that were also impacted by public health measures, such as food services and entertainment.
- As of June 2021, total retail sales were 8% above their pre-pandemic level. The gains are nearly as impressive when looking at the data in volume growth, which shows real retail sales up by 7.6% since February 2020.
- With consumers spending more time at home, we've seen a surge in spending on housing-related goods, including electronics and appliances, and building material and garden equipment. We've also seen a surge in recreational spending as evidenced by higher miscellaneous store receipts (which reflects cannabis purchases) and sporting goods and hobby stores sales.
- However, we expect retail spending growth to cool as consumers redirect their funds toward services as the reopening gains traction.

Change in retail sales, February 2020 to June 2021
(2012 constant prices)



Sources: Deloitte, Statistics Canada

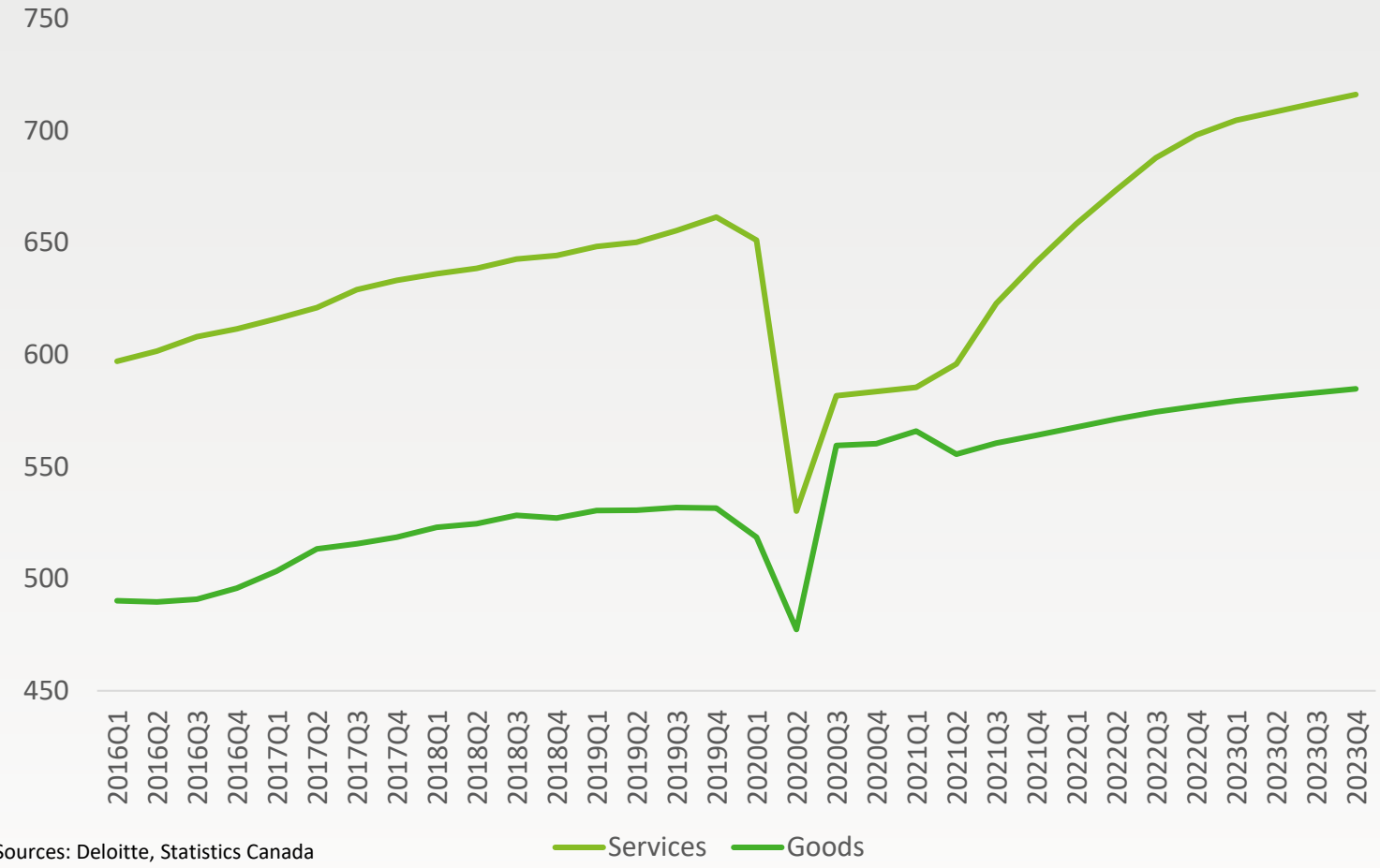
Consumer spending set to shift from goods to services

Households are in a good position to continue to support the economic recovery. We expect to see spending patterns shift now that restrictions primarily targeting service industries have been eased.

- Consumer spending fell by 6% in 2020, driven by a 10.3% decline in spending in the service sector and a 0.4% decline in goods.
- The declines on the goods side were not broad-based, with durable-goods spending increasing and non-durables posting a relatively mild decline of 3.3%.
- The composition of spending growth, or declines, reflects the public health situation. In the first and second quarter of 2020, when the first wave of the pandemic hit, we saw a fairly broad-based retrenchment in spending.
- After the initial reopening, we saw a distinct divergence in spending between goods and services. Goods spending shot up and continued to do well until the most recent quarter. Services have lagged to this point, but they are poised to lead the recovery in consumer spending over the remainder of this year and into 2022 and 2023.
- Fundamentals supporting the strong growth in consumer spending include a robust labour market and a high level of household savings that can be drawn down.
- Overall, total consumer spending is poised to grow by 5.1% this year and a blistering 6.8% in 2022.

Consumer spending on goods and services

(C$ billions; 2012 prices)



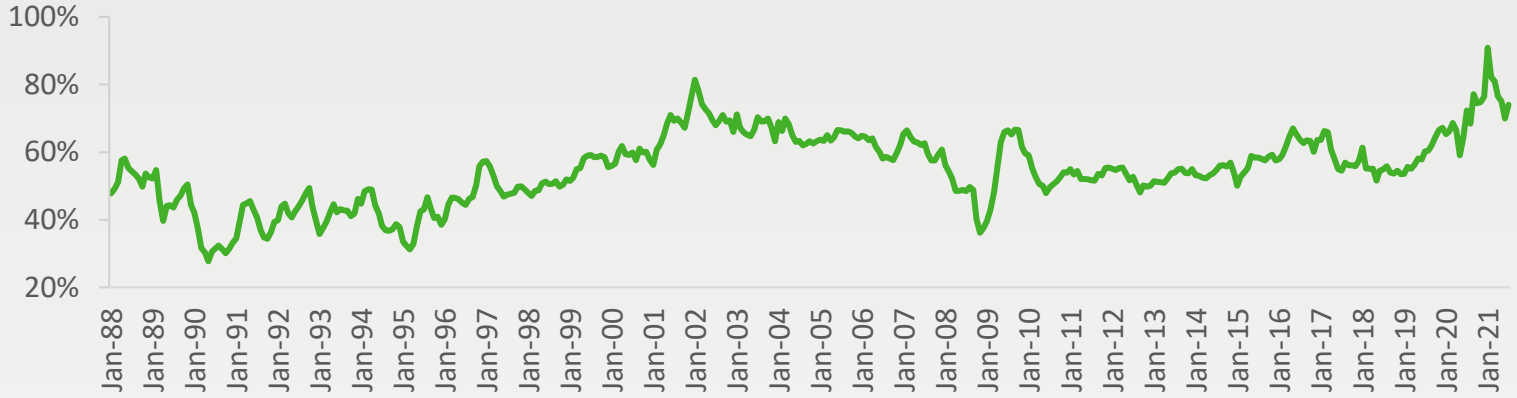
Sources: Deloitte, Statistics Canada

The housing market is showing signs of slowing

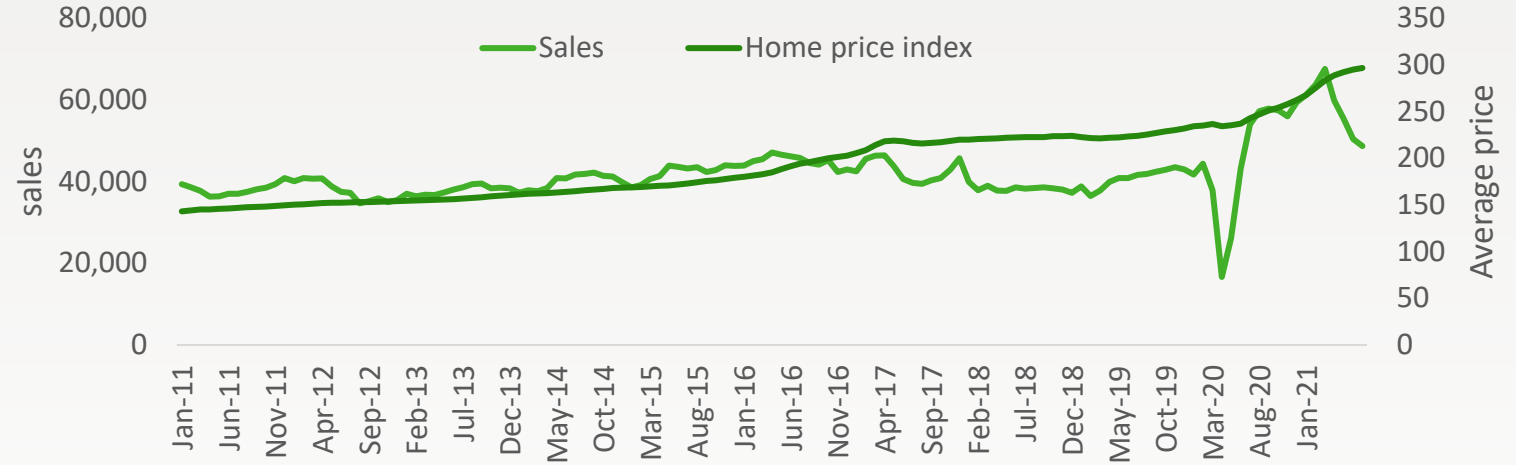
Investment in housing–new, resale homes, and renovations–all grew at an exceptionally strong pace in the second half of 2020 and into early 2021. Now, it's showing signs of slowing.

- Canada's housing market has been capturing headlines for months due to the remarkable pace of growth experienced after the first wave reopening and the strong activity that followed. Investment in ownership transfer costs, which measures real estate agent and lawyer fees related to housing transactions, increased by an incredible 1,873% in the third quarter of 2020 as the resale home market took off. Gains continued to build over the next six months, driving all-time-high records in the number of sales, the sales-to-new-listings ratio, and prices.
- Now the market is capturing different headlines due to the cooling resale-market conditions that began in April, as affordability, recent enhancements to mortgage stress testing, and a diminished sense of urgency to find a larger home to ride out the pandemic are all working to soften market conditions.
- While the resale market is already cooling, we've seen continued growth in new-home and renovation spending. That said, housing starts are coming down from their recent highs, which will weigh on investment, and the cooling in the resale market along with a continual reduction in the number of Canadians working from home is creating less incentive to invest in renovations.
- Our forecast calls for five consecutive quarterly declines in residential investment as the housing market continues to cool before growth resumes at a more typical pace.

Sales-to-new-listings ratio



Resale homes sold and home prices



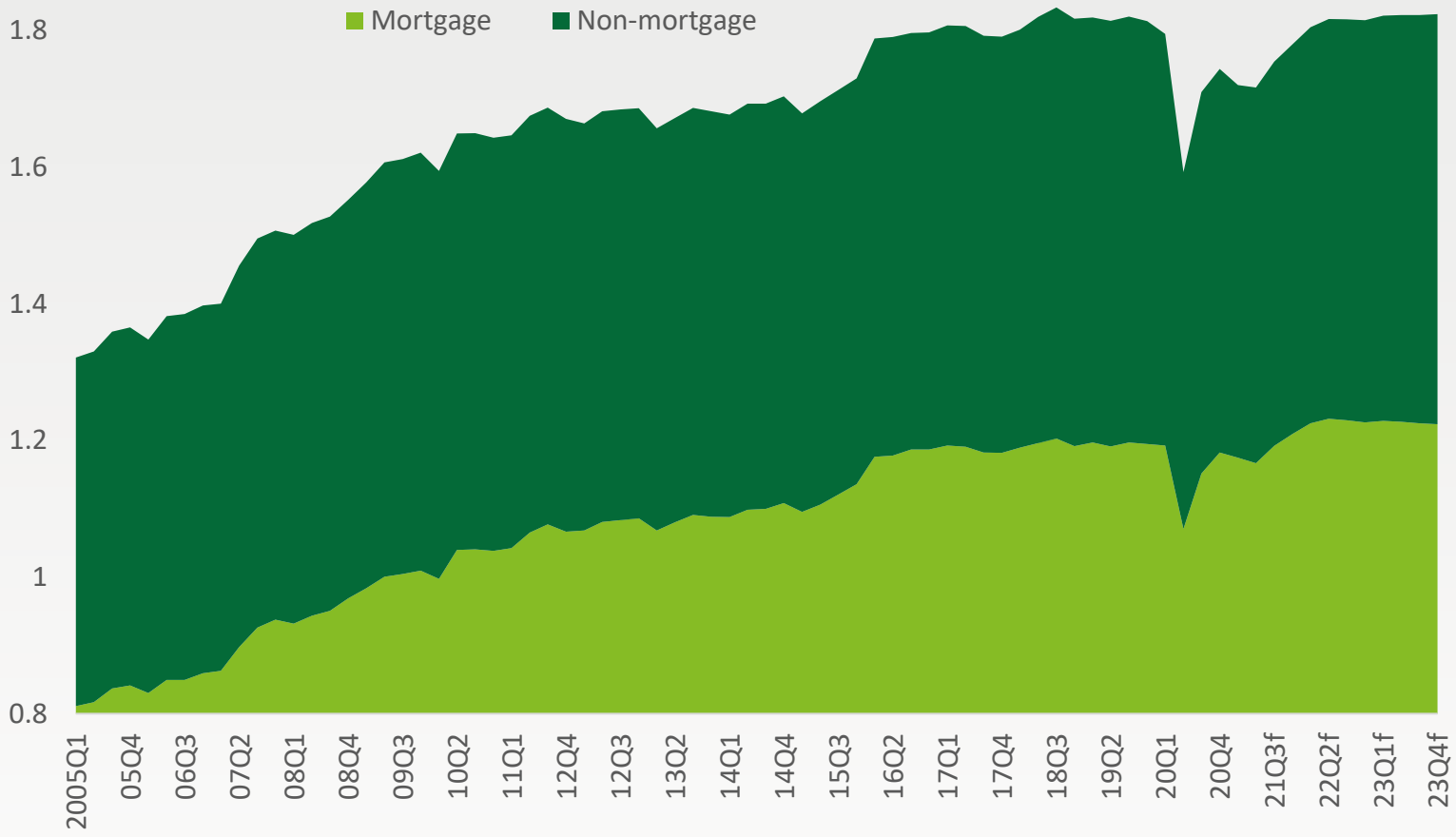
Sources: Deloitte, Statistics Canada

Higher house prices translated into higher mortgage debt for households

Household debt was one of the main risks to the Canadian economy before the COVID-19 pandemic happened. It has once more resurged as a concern.

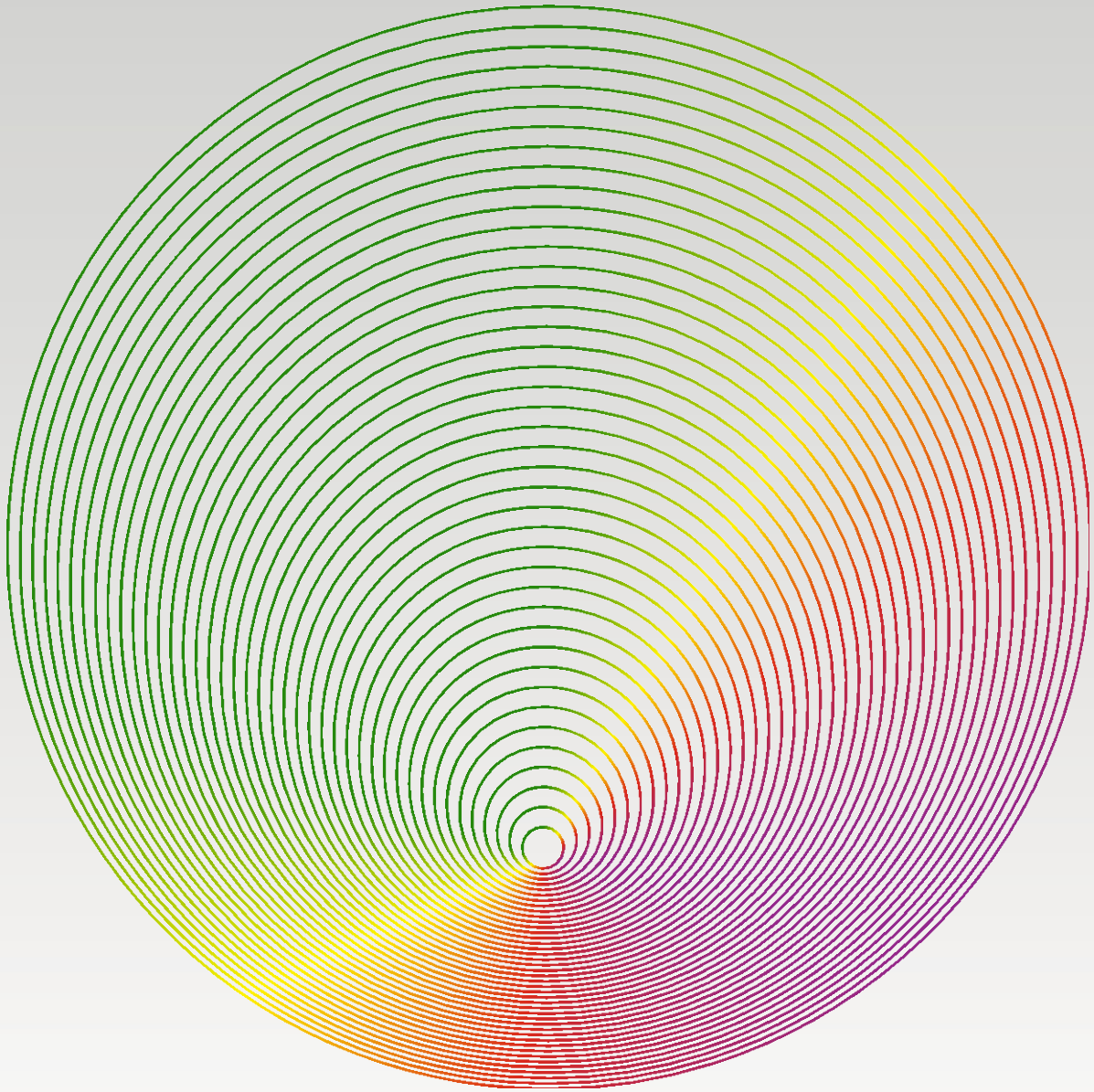
- The COVID-19 pandemic hit the economy at a moment where elevated household indebtedness already represented a key vulnerability to the economy.
- From March 2020 to January 2021, mortgage debt has increased by a record $99.6 billion. It happened in a context where home prices were rising and short-term interest rates were being held at their effective lower bound, two factors that can easily stimulate new mortgage debt. With housing activity now cooling and higher interest rates expected in the coming years, mortgage debt should stabilize.
- Non-mortgage debt has decreased during the pandemic. Many households used their disposable income to pay down non-mortgage debt—e.g., credit card debt and consumer loans—since the opportunity to spend money was limited during the lockdowns. However, the increase in mortgage debt has offset this decline in consumer debt.
- As interest rates begin to rise in 2022, higher interest payments will weigh on the housing sector and consumer spending. However, the level of rates will remain low and the increase is expected to be gradual.

Ratio of household debt to disposable income



Canadian outlook

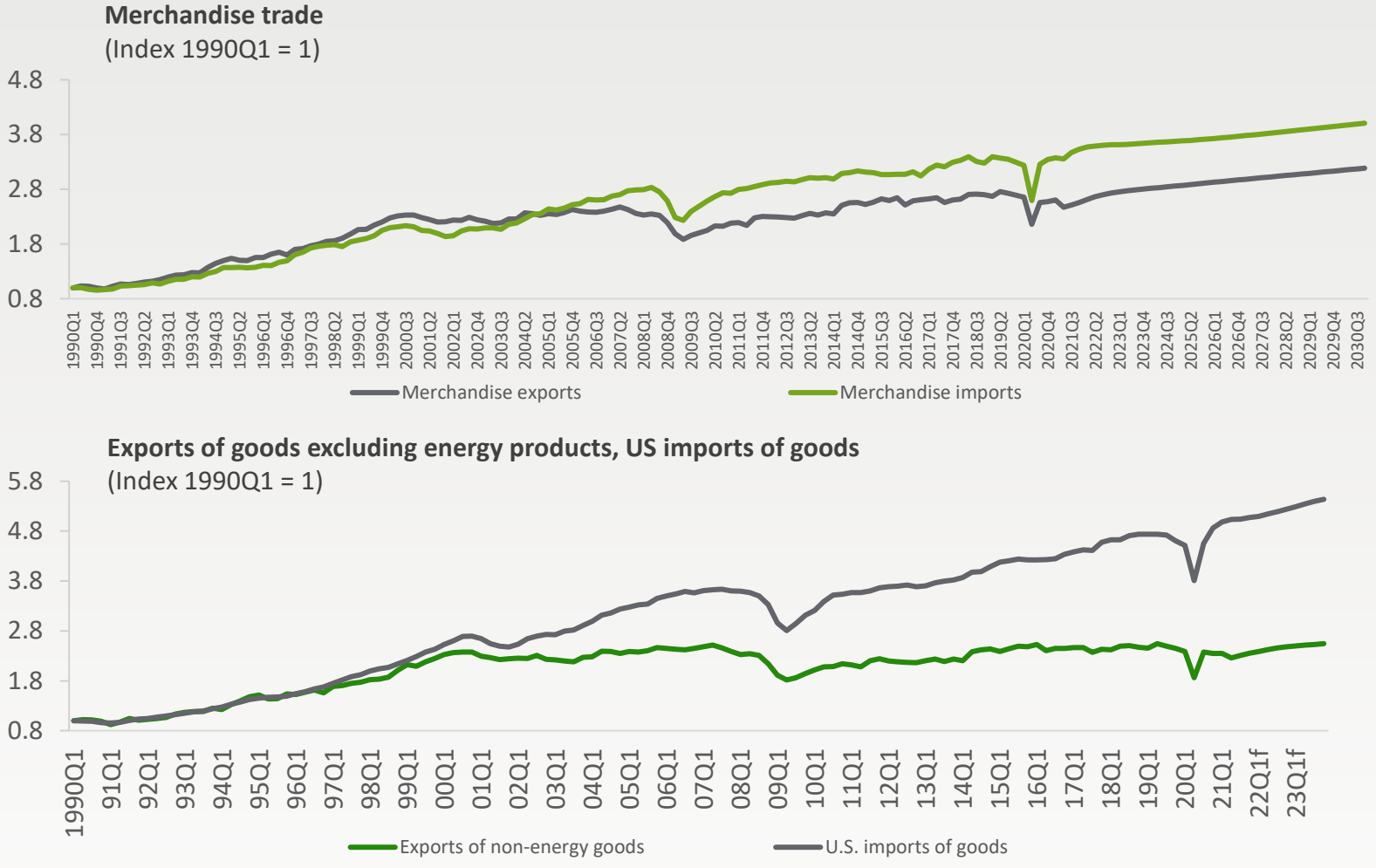
Business sector



Strong demand south of the border will create opportunities for Canadian exports

With the US economy roaring back to life, Canada enjoys robust demand for our products. However, sustaining export growth beyond the initial bounce-back will require better business investment.

- Exports of energy products have fueled much of the increase in merchandise trade over the last decade. However, weak energy investment will weigh on this sector's ability to expand further. We expect energy exports to fall by 1.3% in 2021 before rebounding modestly in 2022.
- This will leave the non-energy side to pick up the slack. However, non-energy investment has been stagnant for years despite strong demand from our trading partners. Better performance will require increased investment to expand capacity.
- This year, growth in merchandise exports has been bolstered by the surge in commodity prices. However, as the US housing market cools, lumber exports are expected to return toward more normal levels. Recently, falling lumber prices have cast a shadow on the short-term outlook for wood exports, which are forecasted to fall by 7.4% in the 2022.
- While droughts have hampered crop exports, particularly for wheat, canola and other grains, they should bounce back in 2022. What will boost merchandise exports long-term, however, is better growth in manufacturing exports, such as aircraft equipment, electronic equipment, and motor vehicles and parts. After declining by 13% in 2020, these categories have only rebounded by 2.8% this year.



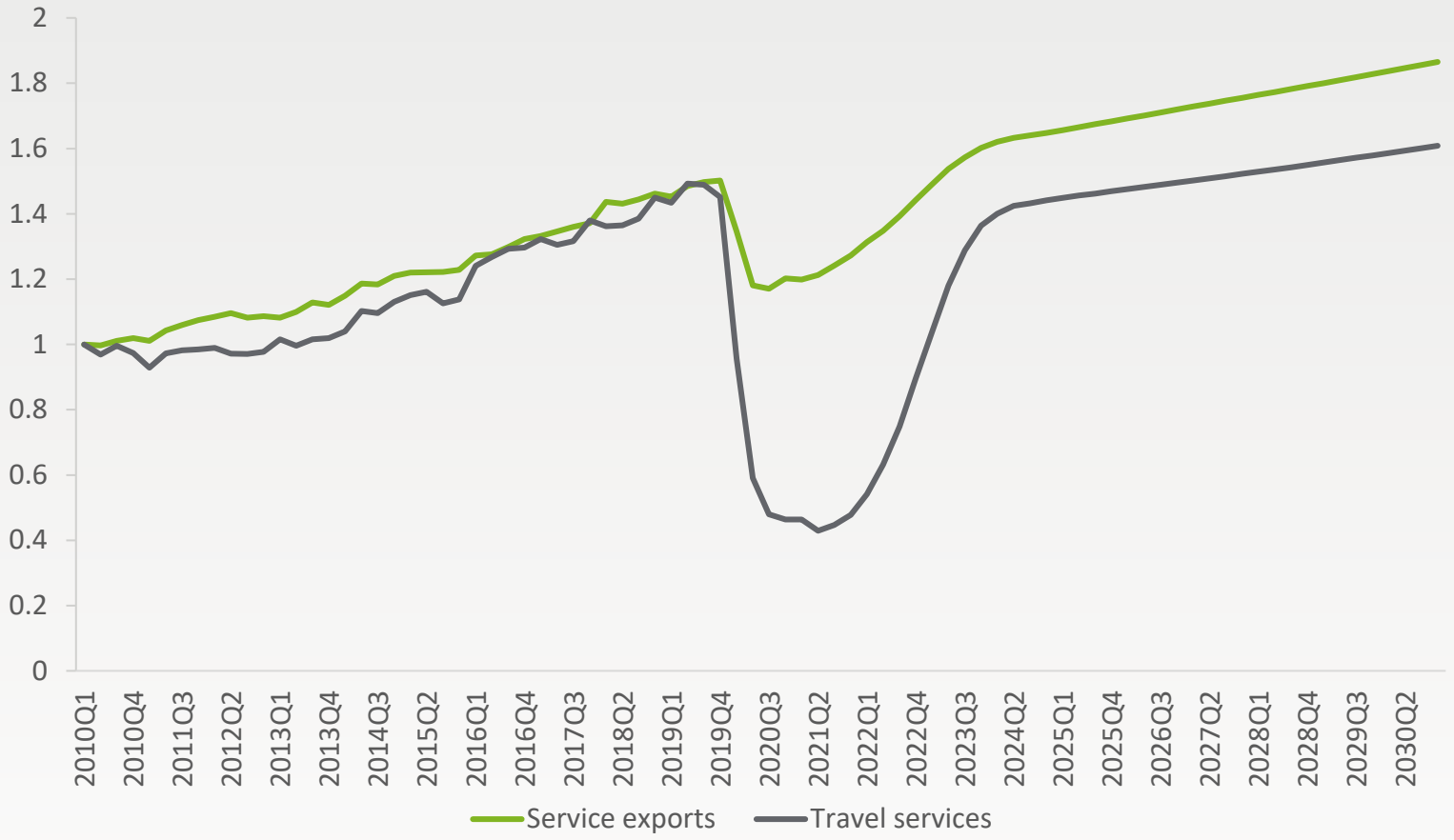
Sources: Statistics Canada, forecasts by Deloitte

International travel is slow to pick up, keeping service exports sluggish

Exports of services, which are heavily influenced by travel, have been expected to rebound as restrictions ease. The recovery is occurring at a slower pace than anticipated, however, given the evolution of the Delta variant and uneven vaccine access around the world.

- Services trade has plummeted due to the lack of international travellers and the restricted ability to serve domestic clients during lockdowns.
- As the health crisis subsides and the borders reopen, likely in late 2021, services exports are expected to rebound.
- According to Statistics Canada, the recovery in services exports and imports has been slow, although growth is expected to pick up in late 2021 as more Canadians are vaccinated.
- We expect it will take years for the services sector to fully recover. International and domestic tourism will likely have a slow recovery as new variants weigh on confidence. Businesses are also expected to make do with less business travel, as they have become accustomed to using video conferencing.
- We do not foresee output in this industry returning to its pre-pandemic levels until 2025.

Exports of services
(Index 2010Q1 = 1)



Sources: Statistics Canada, forecasts by Deloitte

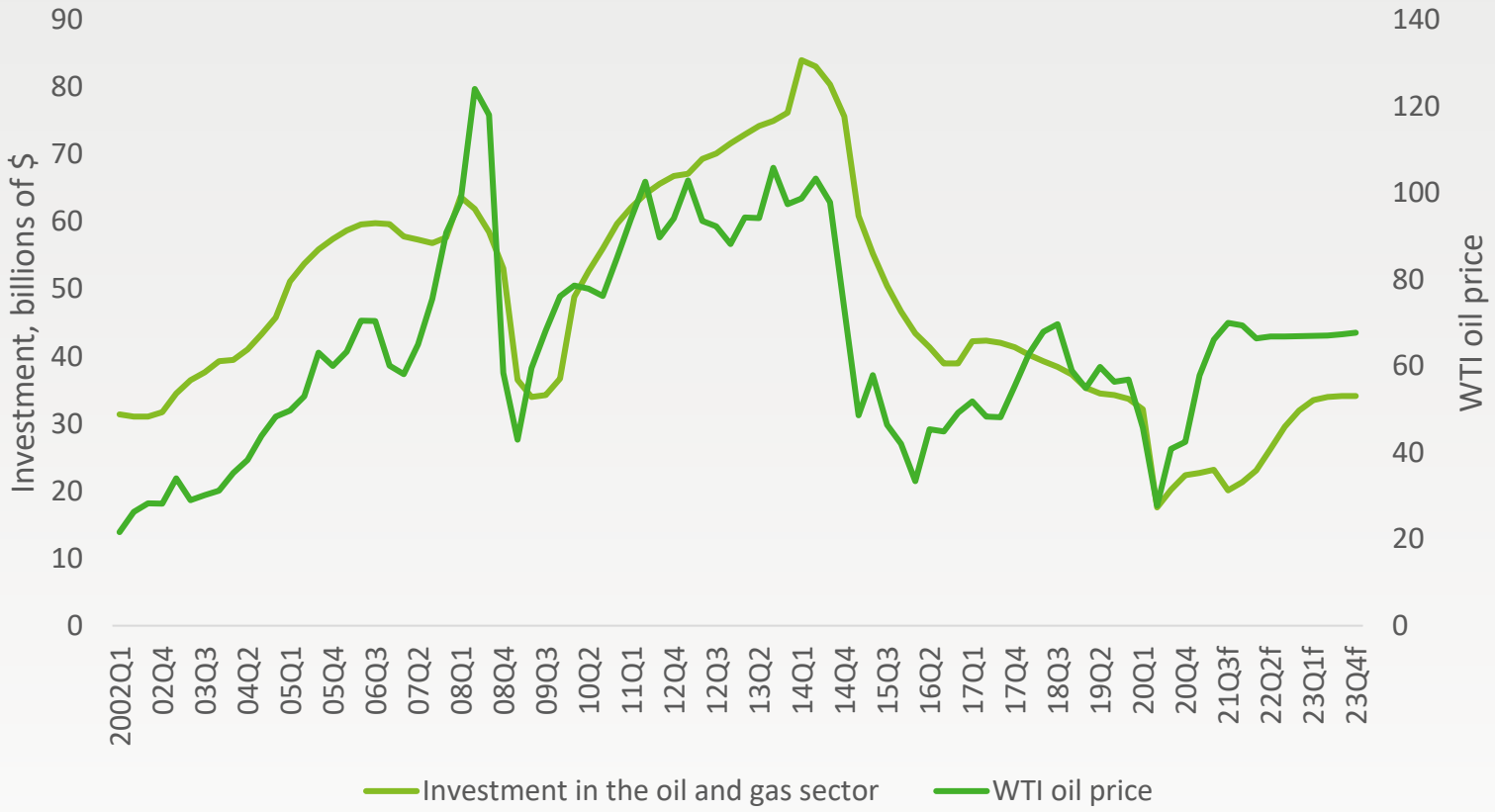
The oil and gas sector is expected to see limited investment despite strong oil prices

Investment is expected to fall for the second consecutive year in 2021 and post only a modest recovery in 2022. This will limit growth in energy exports.

- Oil prices tumbled as the pandemic first swept across the globe, given the uncertainty of how long it would last and when demand would recover. The speed of the recovery in demand took many by surprise, and oil prices have risen much faster than expected. WTI oil prices are currently hovering just over US$72/bbl, well above their pre-pandemic levels of about US$63/bbl.
- Prices are expected to ease slightly from current levels. The WTI price is projected to fall to an average of US$66.7/bbl in 2022 before increasing slightly to US$67.3/bbl in 2023.
- Some of the strength in oil prices is temporary, reflecting production shutdowns due to Hurricane Ida. Demand growth is also weakening as further waves of COVID-19 take some of the steam out of the global recovery. Meanwhile, supply will see strong growth as OPEC continues to unwind cuts made during the pandemic.
- Prices at these levels will not be enough to incentivize oil producers to commit to major increases in investment. Investment in the oil and gas sector is set to fall by another 5.6% in 2021, after a 33% drop in 2020.
- While investment in 2022 is expected to improve, it will remain at relatively low levels compared with the last decade.

Oil prices and business investment

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



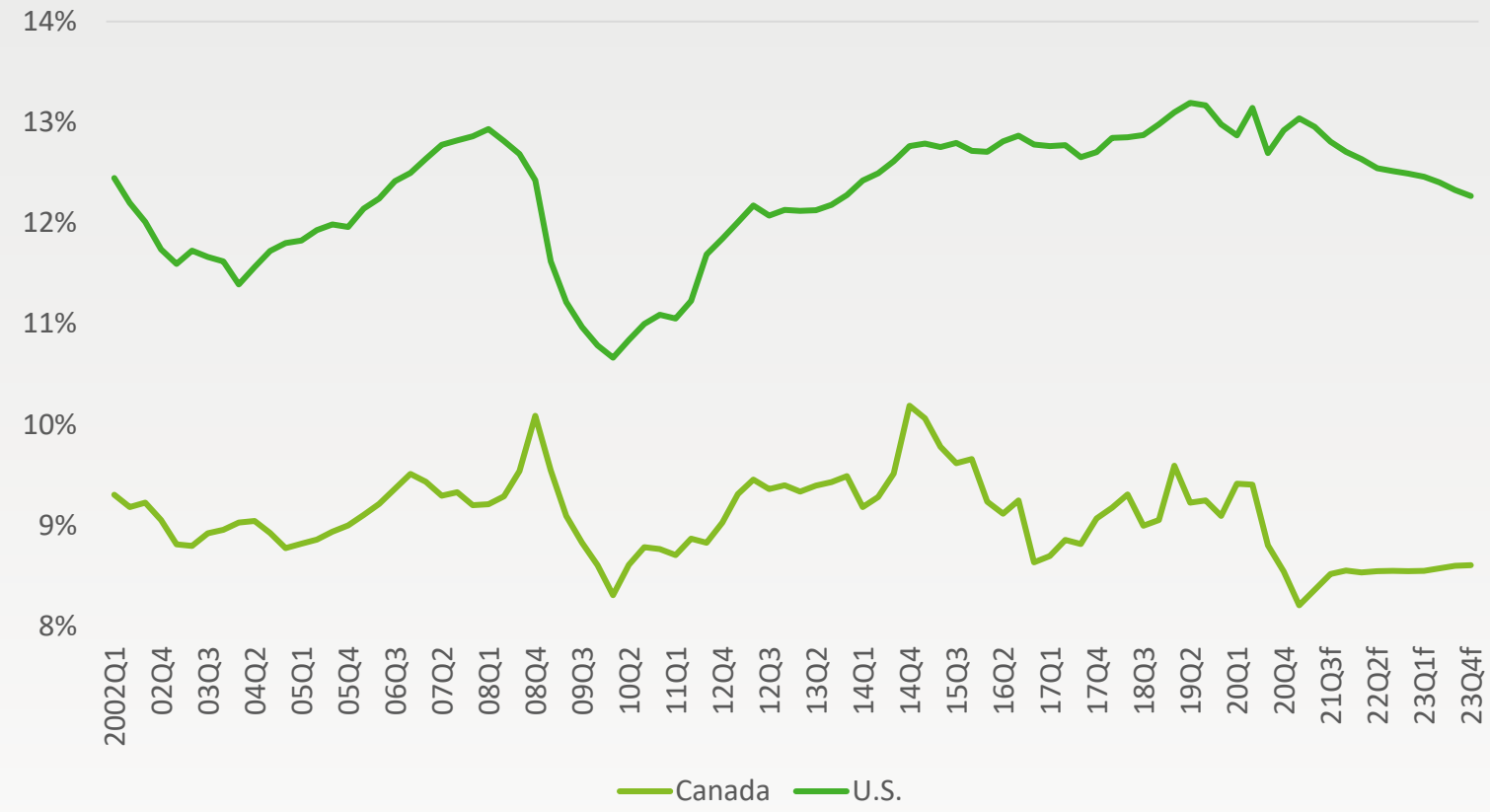
Sources: Statistics Canada, forecasts by Deloitte

Weak non-energy investment will be a drag on long-term economic growth

Improving merchandise exports will require stronger business investment. Unfortunately, we expect only a modest increase in 2021 and 2022.

- Non-energy business investment fell by 8.1% in 2020.
- Based on a weak recovery in the first half of 2021, we now expect an increase in business investment of just 1.9% in 2021.
- The recovery should gain steam in 2022, with 6% growth projected. Even still, investment will remain below already modest pre-pandemic levels until 2023.
- This is a significantly worse performance than experienced in the United States, where investment as a share of GDP is far higher. Numerous factors are weighing on Canadian investment, including the availability of labour, electricity costs, comparative taxes, and relative competitiveness.
- With investment levels expected to remain subdued, the business capital stock is projected to decline in 2021 and 2022. In terms of machinery and equipment, which is closely tied to productivity growth, the amount of capital stock has already declined for six consecutive years.

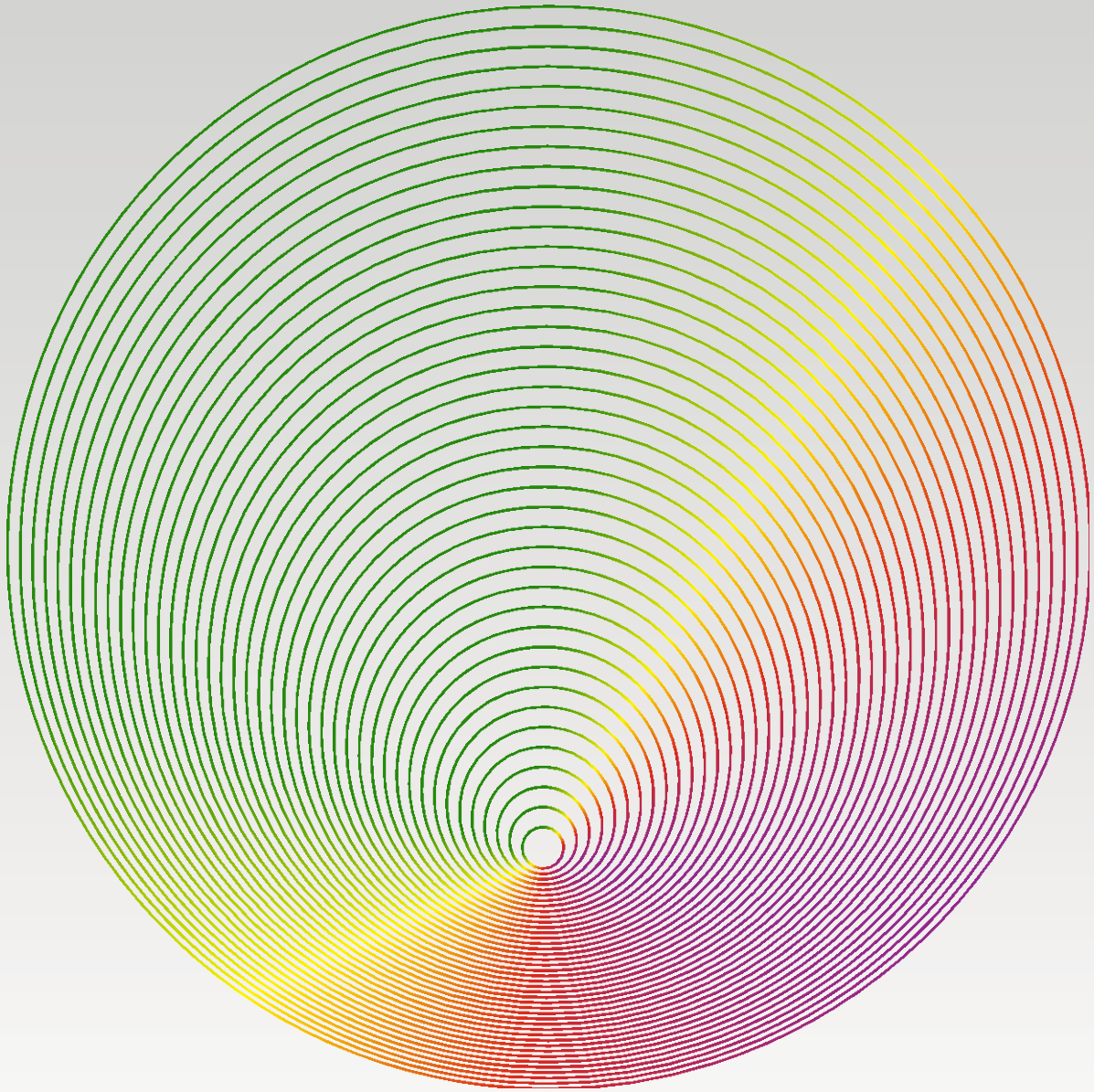
Non-energy business investment
(Percent of GDP)



Sources: Statistics Canada, BEA; forecasts by Deloitte and Oxford Economics

Canadian outlook

Monetary and fiscal policy



Monetary policy stays accommodative as inflation ramps up

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

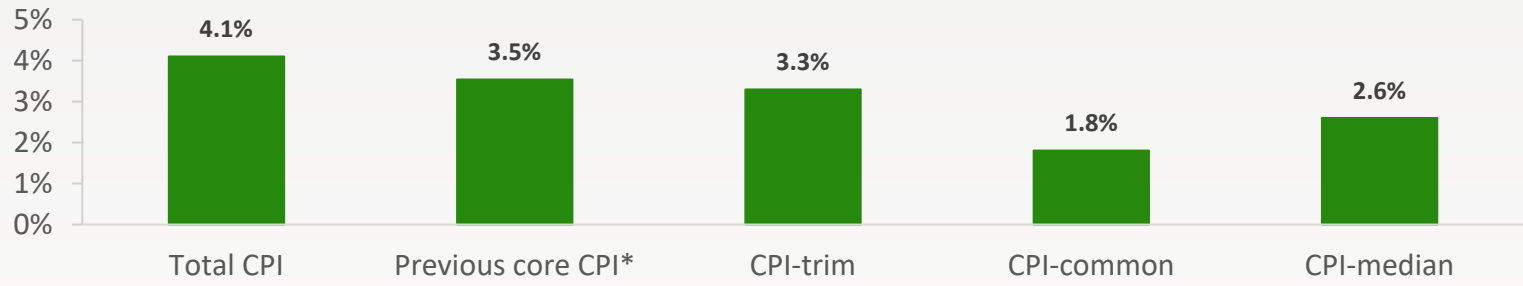
- The Bank of Canada's target rate remains at its effective lower bond. Its quantitative easing (QE) program has been reduced to a pace of $2 billion per week and it continues to provide forward guidance on the path of the overnight rate. We're not expecting any interest rate changes before the second half of next year.
- Supply bottlenecks, base-year effects, and inflation expectations are all pushing up inflation. Rising price pressures are evident by the increase of the Bank of Canada's three measures of core inflation. Total CPI inflation has remained above the upper half of the 1-3% target band. However, due to the temporary nature of the factors lifting inflation, the Bank of Canada is expecting it to ease back to 2% in 2022. The Bank will only rise its policy interest rate when inflation will be sustainably above its 2% target. Our forecast expects the first hike to happen during the fourth quarter of 2022.
- As we do of the Bank of Canada, we expect the US Federal Reserve to conclude its bond purchases (although reinvesting to maintain the size of the balance sheet) before raising interest rates. The Fed has a dual mandate, so it will monitor inflation risk but will also want evidence that the labour market is moving towards full employment. As the end of Powell's term approaches, the nomination, or renomination, of a Chair for the Federal Reserve is bringing additional uncertainty on the market.

Bank of Canada assets

($C billions)

Measures of Canadian inflation

(August 2021, year-over-year growth)



* CPI less 8 most volatile components and indirect taxes

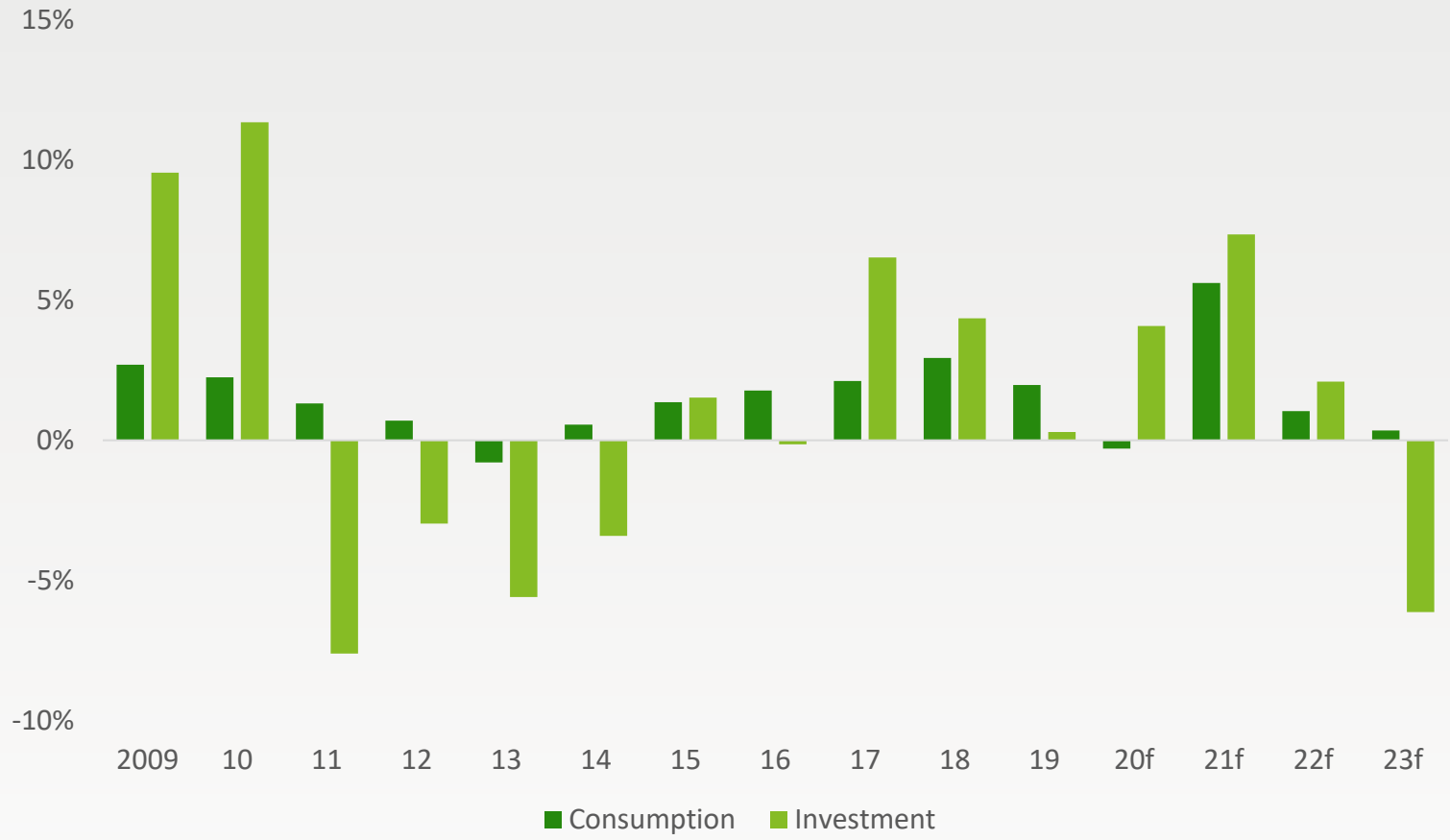
Sources: Statistics Canada, forecasts by Deloitte

Fiscal policy will depend on the new government

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.

- The post-election federal government looks little different than it did before Canadians headed to the polls. Accordingly, we expect federal spending growth over the next few years to follow the budget estimates released in April. That means elevated levels of spending will continue this year and into 2022.
- Government spending is projected to continue to increase over the next few years. But overall spending on goods and services and investment is expected to fall in 2023 as stimulus spending declines and provincial governments focus on balancing their books.
- The withdrawal of fiscal stimulus is projected to be slow, and deficits at the federal and provincial levels are expected to persist over the time period of this forecast.
- Federal and provincial debt increased substantially during the pandemic-created recession. Federal debt is expected to peak at 55% of GDP in 2021-22 and many provinces have similar debt ratios, which brings the total debt borne by taxpayers to over 100% of GDP in many provinces. While these levels are affordable for now, they do leave us more vulnerable to another crisis or rising rates in the future.

Real government spending growth



Sources: Statistics Canada, forecasts by Deloitte

Concluding remarks

Canada’s economic recovery is on solid ground, but its long-term prospects face challenges

The nation’s economic recovery is undoubtedly on a slower path than expected a few months ago. The point when the global pandemic ends, or at least stops having significant negative economic affects, remains highly uncertain and, until that time, the economy continues to be subject to the path of the virus. That we have seen in the recent data: Canada’s economy contracted in April and May as the third wave of the virus gripped the country, and then may have dipped again in July. These very short-term fluctuations in economic growth are likely to persist as long as the pandemic does.

Despite the uneven and slower growth profile, Canada’s near-term economic growth trajectory remains solid. Households and governments are in a position to increase their spending. The global rebound and the recovery in commodity prices will help fuel short-term export growth, while business investment is set to accelerate from very low pandemic levels. These factors will fuel economic growth by 4.9% this year and 4.3% in 2022. A key risk to the outlook is the possibility of higher inflation, which we are monitoring closely.

The outlook gets murkier as we look further ahead. Consumers and governments are highly leveraged and that will impact their ability to constantly increase their spending. While businesses are expected to increase their spending over the near term and exports will increase, investment in Canada has been chronically weak and this is limiting our ability to increase our exports. One challenge as we move forward is how to shift the composition of economic growth so that it is not as dependent on the accumulation of household and government debt.

Sadly, the latest federal election did not tackle the issue of economic competitiveness, as it would not resonate with voters. As articulated in our first Catalyst report, *A vision for a thriving Canada in 2030*, the Canadian economy is struggling with an aging population, weak investment and poor productivity. This will constrain Canadian economic growth in the coming years, which will make rebalancing government finances difficult. The consumer and government led recovery from the pandemic will not resolve these deeper economic challenges.

Appendix

Key economic indicators

	2020	2021				2022				20A	21F	22F
	Q4A	Q1A	Q2A	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F			
Real economic activity												
Gross domestic product	9.3	5.5	-1.1	3.5	5.7	5.4	4.4	4.3	3.0	-5.3	4.9	4.3
Consumption expenditure	2.5	3.6	2.0	8.4	6.0	5.5	4.2	4.1	3.0	-4.4	5.2	5.1
• Durable goods	-1.3	2.7	-6.8	0.4	1.1	3.0	3.5	2.9	1.7	-3.3	11.9	1.7
• Services	1.3	1.3	7.3	19.4	12.4	11.1	9.5	8.9	6.1	-10.3	4.2	11.1
Residential investment	16.9	42.1	-12.4	-12.7	-10.1	-9.5	-6.3	-3.9	-1.7	4.1	16.6	-8.5
Non-residential fixed investment	5.9	-5.8	12.1	0.8	10.7	7.3	11.2	10.1	7.4	-13.6	-0.4	8.5
• Non-residential structures	-6.3	1.9	5.1	-0.5	13.0	9.0	13.4	11.5	8.2	-11.3	-4.5	9.3
• Machinery & equipment	28.1	-16.7	24.9	2.8	7.2	4.7	7.6	7.9	6.1	-17.4	6.6	7.1
Government consumption & investment	6.1	7.1	3.8	3.6	3.4	1.5	-1.2	-1.1	-1.5	0.4	5.9	1.2
Exports of goods & services	4.1	3.3	-15.0	7.1	7.9	9.4	8.7	7.2	5.7	-10.0	1.6	6.5
Imports of goods & services	11.6	4.3	-0.1	14.0	8.7	6.7	5.1	4.6	4.1	-11.2	8.3	6.8
Prices												
Consumer price index (y/y)	0.8	1.5	3.3	3.0	3.1	2.8	2.2	2.2	2.2	0.8	3.1	2.2
Implicit GDP price index (y/y)	1.9	6.1	9.1	7.1	5.9	3.1	1.3	1.4	1.7	1.9	5.9	1.7
Labour market												
Employment	9.9	1.0	2.5	6.9	1.7	2.4	1.5	1.4	1.5	-5.1	4.5	2.5
Unemployment rate (%)	8.8	8.4	8.0	7.2	7.0	6.9	6.8	6.7	6.6	9.6	7.7	6.7

Note: Unless otherwise noted, all figures are expressed as annualized % changes.
Sources: Statistics Canada, Bank of Canada. Forecast by Deloitte Economic Advisory, as of **September 14, 2021**.

Financial market indicators

	2020	2021				2022				20A	21F	22F
	Q4A	Q1A	Q2A	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F			
Interest rates (%)												
Overnight rate target	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.25	0.25	0.50
3-month T-bill	0.10	0.08	0.12	0.17	0.17	0.18	0.19	0.19	0.45	0.10	0.17	0.45
1-year GoC note	0.17	0.14	0.21	0.27	0.36	0.43	0.46	0.49	0.76	0.17	0.36	0.76
2-year GoC note	0.24	0.20	0.36	0.45	0.44	0.45	0.45	0.45	0.63	0.24	0.44	0.63
5-year GoC note	0.41	0.71	0.92	0.85	0.83	0.83	0.83	0.82	0.97	0.41	0.83	0.97
10-year GoC bond	0.66	1.22	1.46	1.22	1.20	1.19	1.18	1.17	1.28	0.66	1.20	1.28
Yield curve spread (pp)												
3-month vs. 10-year	0.56	1.15	1.34	1.05	1.03	1.00	0.99	0.97	0.83	0.56	1.03	0.83
2-year vs. 10-year	0.43	1.02	1.10	0.77	0.75	0.74	0.73	0.72	0.65	0.43	0.75	0.65
Foreign exchange												
USD/CAD ($C)	1.30	1.27	1.23	1.23	1.22	1.22	1.21	1.21	1.20	1.30	1.22	1.20
CAD/USD (US cents)	0.77	0.79	0.81	0.81	0.82	0.82	0.83	0.83	0.83	0.77	0.82	0.83

Sources: Statistics Canada, Bank of Canada. Forecast by Deloitte Economic Advisory, as of **September 14, 2021.**

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