# Economic Analysis of Ontario

Volume 11 • Issue 1 | ISSN: 0834-3980

## Ontario Economic Outlook 2020 - 2023

**Highlights:**

- COVID-19 public health crisis and necessary measures to stem viral spread cutting economic activity
- Ontario growth to contract nearly three per cent with downside risks
- Unemployment rate to peak above 10 per cent
- Authorities work to bridge the household and business incomes through pandemic
- Growth rebound of four per cent in 2021 contingent on epidemic curve

It is fair to say the world and our daily lives have changed as COVID-19 spread around the globe pushing authorities to act forcefully to protect their health systems with unprecedented shutdown of commerce, and implementation strong fiscal measures to bridge their economies through the pandemic.

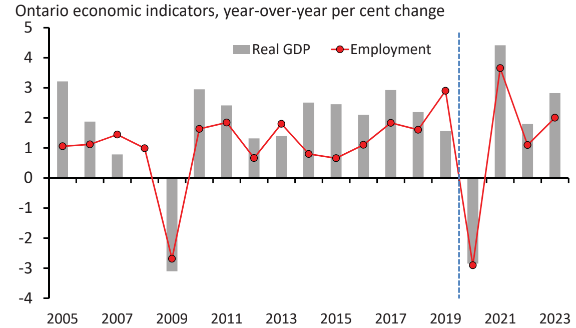
Canada faces the same struggle while also weathering a crisis in its oil sector. The economy will contract by nearly three per cent this year, with risk to the downside. Ontario's economy will largely track the national figures, the nature of a global shock and its sizeable share of the national economy. Provincial gross domestic product is forecast to decline 2.8 per cent this year on consumer driven weakness and contraction in the services sectors, although lower economy activity will generally be observed outside small band of essential sectors. Activity bounces back into 2021 by more than four per cent as the epidemic eases and activity rebounds on stronger consumer spending and housing. Nevertheless, there will be substantial economic damage in the short run as businesses shutter, and unemployment surges above 10 per cent by the third quarter, despite annual unemployment averaging above eight per cent.

*Global health crisis drives a global economic downturn*

COVID-19 has thrust countries into the greatest health crisis in over a century as the virus which originated

Ontario economy to contract sharply on COVID-19, services worst hit

Ontario economic indicators, year-over-year per cent change




Source: Statistics Canada, Central 1 Credit Union

in China continues to spread across continents. High contagion of the respiratory virus and risks to health systems has led to unprecedented measures to limit the spread. Countries have closed their borders to non-resident travel; adding to a plunge in tourism demand, social distancing policies, all while group gathering including major events and professional sports have been suspended. Lockdowns are in place in countries including Italy, Spain, and the U.K. limiting movements to essential services. The U.S. is experiencing an acceleration in cases with the federal and state governments declaring states of emergencies, and the country is at risk as the next epi-centre of the health crisis with states such as New York and California already imposing 'stay in place' policies.

While in some respects secondary to the health crisis the global economy has entered a deep economic downturn as measures to stem the spread have ground economic activity to a standstill. Data remains scarce given publishing lags, but the downturn is in the order of magnitudes. Purchasing Managers' Indices (PMI) across European economies have experienced the sharpest declines on record in February amidst economic disruption to both services and industrial activity, surpassing those observed during the Great Financial Crisis. Downturns in the services sectors have been particularly deep. U.S. PMIs also fell sharply, but the epidemic spread lagged that observed in Europe and Asia. Unemployment has surged as firms have laid off individuals. U.S. unemployment applications hit 3.2 million in the week of March 21 marking a 3 million increase from the previous week. China's economy is rebounding after sharp contraction in February due to spread of CO-

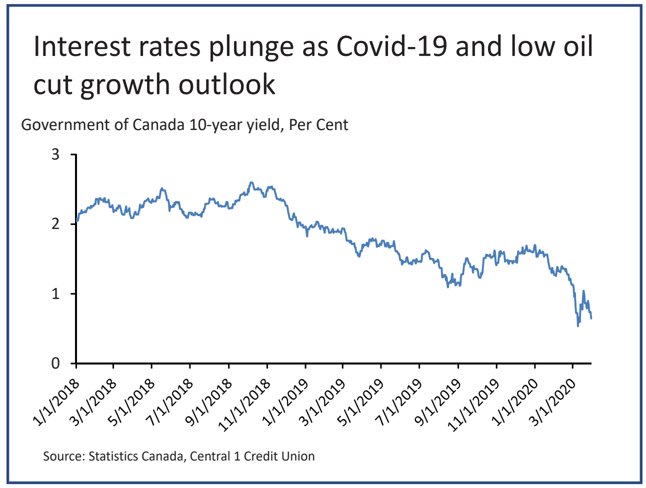
VID-19 earlier this year, but will feel the second-order impacts of the contraction among western economies.

Given the cascading spread of the virus across economies, timing of downturns will vary. Nonetheless, fast-moving and often revised forecasts pegs a Q2 economic contraction in U.S. GDP of anywhere from 20 – 30 per cent on an annualized basis.

In Canada, a similar story has played out as authorities look to “flatten” the epidemic curve. Provinces have declared a combination of public health and broader states of emergency. The border has been closed to non-essential travel, while international entries have been suspended to non-Canadians/ Permanent Residents. Events have been postponed, non-essential services have virtually been halted due to the drop in demand, and in some cases government directives have closed restaurant dining, non-essential retail, and personal services.

The unprecedented and rapid reduction in economic activity have forced businesses, which are in survival mode amidst limited working capital, to reduce staff and layoff workers. While data is still forthcoming, it is clear the downturn is deep amidst survey and anecdotal evidence. The Canadian Federation of Independent Businesses’ monthly Business Barometer showed a drop in its index of about 30 points from February to March, which was lower than observed in the Great Financial Crisis. The federal government noted in its communiques that 1.5 million persons had applied for employment insurance over a two-week period in March. This is more than six times a normal March reflecting the speed and ferocity of the adjustment.

Central 1’s national outlook forecasts an 18.2 per cent annualized contraction in Q2 following a 2.5 per cent contraction in Q1 as services- sectors bear the brunt of the downturn.[1] On a full-year basis, Canada’s economy contracts by close to three per cent. Our base scenario is for the economy to begin its turnaround in the third quarter as the epidemic eases, and the economy enters a vigorous rebound phase. The combination of federal fiscal measures to bridge businesses and households through the health and economic crisis and beyond including significant wage subsidies for small business and tax deferrals, extended income benefits for individuals who are not covered by traditional employment insurance benefits will provide important support in the short-term and




a base for the recovery. The federal government has also boosted credit availability through channels such as the Insured Mortgage Purchase Program via CMHC, credit facilities, reduction in capital buffer requirements, and programs via Export Development Canada and Business Development Bank of Canada. Growth for 2021 is forecast to reach 4.4 per cent, as government support provides a reasonable launchpad for business return to normalcy, and low interest rates propel housing demand, and significant pent up demand is unleashed.

The Bank of Canada has slashed its policy rate to 0.25 per cent with two unscheduled 50 basis point inter-meeting rate cuts in March, and instituted additional bond buying programs to lower borrowing costs and keep the credit market functioning. It should be noted that rates are supportive in the current environment as debt financing costs decline but not a trigger for growth in the near-term. Its role in the functioning of credit market is more important. Low rates will provide a boost when the economy re-opens for business.

*Ontario in the same boat*

Ontario’s economy like its provincial peers will contract this year on the impact of COVID-19 on business activity and household spending. Central 1’s outlook is for real GDP growth to contract by 2.8 per cent in 2020 followed by a 4.4 per cent rebound in 2021 and fluctuates around a 2.0 to 2.5 per cent thereafter. We recognize that current risk is on the downside given uncertainty surrounding the evolution of the epidemic curve.

Like most other regions, contraction in the economy will be led by household spending and service-oriented export activity in the tourism- related sectors. Restrictions on non-essential border travel, suspen-

1 https://www.central1.com/wp-content/uploads/2020/03/ECON_COMMENTARY_CDN_VIRUS_RECESSION.pdf

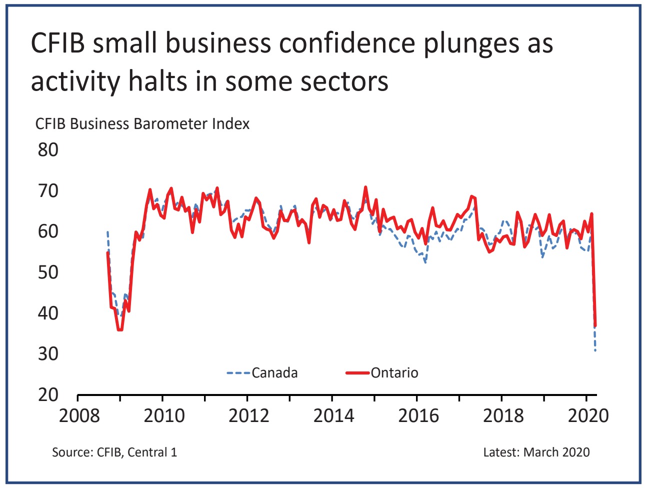
sion of international travel outside on international entries, and lower travel demand has decimated the accommodations and foodservices sectors, and related retail industries. Domestic demand for non-essential items amidst social distancing measures, and mandatory closure of non-essential workplaces has led temporary suspension of activity for many retailers. An increase in demand at grocers, and online spending is insufficient to make up for the gap. A spike in layoffs, and concerns about job security further has consumers hunkered down for the time being. Household consumption is forecast to contract three per cent in 2021.

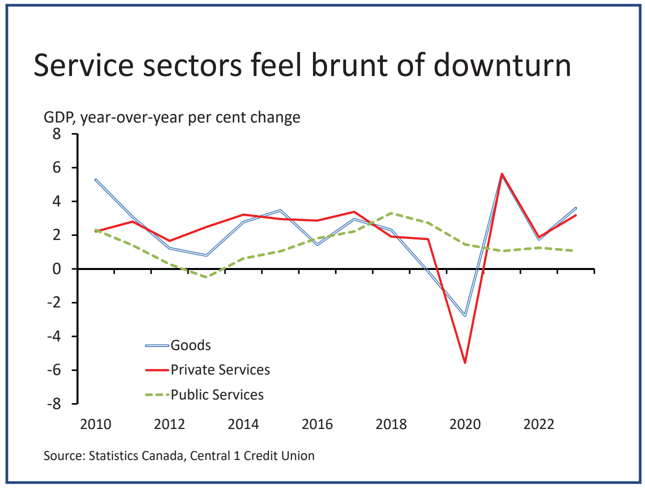
Exports are forecast to contract six per cent this year. Service-sector exports related to tourism will be especially hard hit this year, but manufacturing products will also contract significantly. The downturn in global economic activity, and COVID-19 related suspension in production of the major auto makers, has ramifications across the supply chain. Adding to this is the collapse in oil prices and weaker investment spending. Re-tooling by some manufacturers to produce personal protective equipment and other sanitization products to aid in health efforts is outstanding and necessary given the current environment, while also maintaining workers. Secondary, however is that the economic value will be less than in a normal functioning economy.

Increased government spending, driven by necessary spending on the health crisis, is one of the few areas of expansion though dwarfed by contractions in the broader economy.

The COVID-19 shock has decimated a swath of business activity. Small business sentiment in Ontario has been in freefall over the past month like the rest of Canada amidst the collapse in revenues. The seismic shift has led to sharp job cuts across by enterprises large and small. The labour market is expected to average a near three per cent decline in employment representing more than 200,000 workers. The average unemployment rate reaches 8.2 per cent for the year, but averages near 10 per cent in the third quarter.

Households and businesses face enormous challenges in this current health crisis but we expect government measures to blunt the impact on household and business finances to allow many to stay afloat, albeit still wounded. Expansion of federal income aid to Canadians who are ineligible for employment insurance benefits, increased Canada Child Benefits, and others will provide support. Meanwhile, some small and medium sized organizations will be eligible for a 75 per cent wage subsidy, and interest free loan. Businesses will also be able to defer federal and provincial tax payment/filings.




Support by various levels of governments sets the stage for the stronger economic rebound, although deficits will rise sharply. This is inevitable, with the alternative being long-term damage to the economy and economic capacity if businesses shutter permanently. Ontario's economy was operating at a moderately strong pace prior to intensification of the global pandemic with unemployment near 5.4 per cent of the labour force, modest growth near 1.7 per cent with a thriving tech sector, and a rapidly growing population.

Underlying the current situation is a strong base for activity that should bounce back. Population growth, which is forecast to decline to one per cent this year, jumps to 1.8 per cent in 2021. Consumer demand rebounds quickly, although a tourism rebound will be protracted. Housing which is expected to ease this year due to the economic environment, and likely delays in permitting in municipalities will surge due as underlying demand remains high. Housing starts climb from 55,000 units this year to 78,000 in 2021, while prices surge amidst low interest rates and rising demand. Manufacturing will depend on evolution of the U.S. situation, although we anticipate it will also be supportive of growth.

We are mindful of the negative risks in the current environment, which in large part reflects assumptions of the epidemiological curve. The epidemic may take longer to get under control than our expectation of a few months, with potential for a second wave of infections. These would cause a more pronounced downturn in the short term, while a return to normal could very well be delayed as social distancing measures continue, and sectors only slowly return to more normal operations.

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| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|
| **Ontario Forecast Table** | | | | | | | |
| GDP at market prices | 4.6 | 3.7 | 4.1 | -2.1 | 5.7 | 3.3 | 4.3 |
| Real GDP, expenditure-based | 2.9 | 2.2 | 1.6 | -2.8 | 4.4 | 1.8 | 2.8 |
| Household consumption | 4.1 | 2.5 | 2.0 | -3.0 | 4.3 | 1.7 | 3.3 |
| Government expenditure | 2.0 | 3.7 | 2.8 | 1.5 | 1.1 | 1.6 | 1.2 |
| Government capital formation | 7.9 | 6.2 | 1.2 | 0.2 | -1.9 | 0.2 | 3.0 |
| Business capital formation | 3.8 | 1.4 | -1.5 | -6.7 | 9.1 | 1.0 | 4.6 |
| Residential structures | 0.6 | -3.3 | -3.0 | -7.2 | 13.2 | 2.5 | 7.7 |
| Machinery and equipment | 13.9 | 11.5 | -0.8 | -8.0 | 4.4 | 0.9 | 2.6 |
| Non-residential structures | 3.2 | 1.0 | 1.4 | -3.7 | 5.0 | -2.0 | -0.6 |
| Final domestic demand | 3.7 | 2.6 | 1.5 | -2.5 | 4.1 | 1.5 | 3.0 |
| Exports | 0.4 | 0.9 | 2.8 | -6.1 | 5.4 | 2.1 | 2.4 |
| Imports | 3.1 | 1.6 | 1.3 | -4.7 | 6.0 | 1.1 | 3.2 |
| Net exports, $2007 bil. | -4.6 | -7.4 | -1.6 | -7.0 | -9.6 | -5.6 | -9.1 |
| | | | | | | | |
| Employment | 1.8 | 1.6 | 2.9 | -2.9 | 3.7 | 1.1 | 2.0 |
| Unemployment rate (%) | 6.0 | 5.6 | 5.6 | 8.5 | 6.8 | 6.6 | 5.9 |
| Personal income | 4.5 | 4.5 | 4.1 | -1.5 | 4.7 | 3.0 | 3.9 |
| Disposable income | 4.6 | 4.7 | 3.8 | -1.5 | 5.2 | 3.0 | 3.8 |
| Net operating surplus: Corporations | 2.7 | -0.9 | 4.3 | -6.3 | 8.1 | 3.3 | 2.2 |
| CPI | 1.7 | 2.4 | 1.6 | 1.2 | 1.7 | 1.6 | 1.6 |
| Retail sales | 7.7 | 4.4 | 2.2 | -3.7 | 6.7 | 3.1 | 5.1 |
| Housing starts, 000s | 79.1 | 78.7 | 69.0 | 55.3 | 75.8 | 76.0 | 86.7 |
| Population Growth (%) | 1.4 | 1.7 | 1.7 | 1.0 | 1.8 | 1.5 | 1.3 |
| **Key External Forecasts** | | | | | | | |
| U.S. Real GDP | 2.4 | 3.0 | 2.3 | -2.3 | 3.7 | 2.0 | 2.2 |
| Canada Real GDP | 3.1 | 2.0 | 1.6 | -3.0 | 4.6 | 2.1 | 1.8 |
| European Union Real GDP | 2.7 | 1.5 | 1.2 | 0.4 | 1.8 | 1.6 | 1.7 |
| China Real GDP | 6.0 | 6.6 | 6.1 | 4.9 | 6.4 | 5.7 | 5.5 |
| Japan Real GDP | 1.9 | 0.8 | 0.7 | -0.2 | 1.1 | 0.9 | 0.8 |
| Canada 3-month t-bill, % | 0.7 | 1.4 | 1.7 | 0.3 | 0.5 | 1.0 | 1.3 |
| Canada GoC long-term Bond, % | 2.2 | 2.4 | 1.8 | 1.1 | 1.5 | 1.8 | 2.0 |
| U.S.-Canada Exchange Rate, cents/dollar | 77.1 | 77.2 | 76.2 | 73.0 | 74.0 | 75.0 | 77.0 |
| Crude Oil WTI USD$ per barrel | 50.9 | 65.0 | 57.0 | 33.0 | 44.0 | 50.0 | 55.0 |
| Henry Hub Natural Gas Price, US$ per mmbtu | 3.0 | 3.2 | 2.6 | 2.0 | 2.5 | 2.7 | 2.9 |

**Terms**

Published by the Economics Department of Central 1 Credit Union, 1441 Creekside Drive, Vancouver, B.C. V6J 4S7 

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