Economics | Forecast / Outlook Reports

Economic Analysis of Ontario

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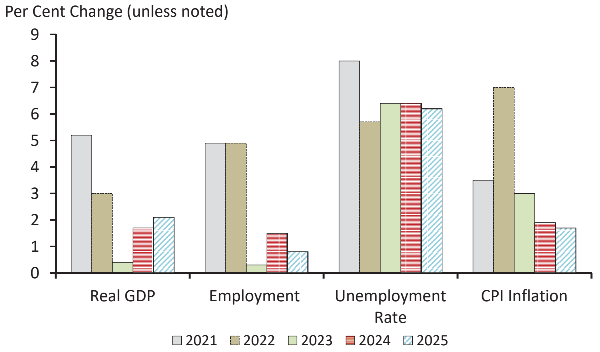
central 1 Economics

Highlights:

- Ontario economy to slow to 0.4 per cent growth in 2023 on higher interest rates and global growth downturn
- Unemployment rate increases to 6.5 per cent in 2023, firms hold onto workers amidst high job vacancy rate
- Downtrend in housing sales to spread to new home construction with starts down to 75,200 units in 2023 but recovery in 2024 supported by population growth
- Export and manufacturing held back by U.S. economic slowdown, vehicle sector

Ontario growth to decelerate sharply



Source: Statistics Canada, Central 1

Ontario Economic Outlook Update 2022-2025

There is no shortage of uncertainty in the economy as we cap off 2022 and move into 2023. The macro-economic environment is one of high inflation with central banks aggressively attempting to rein in these pressures at the cost of a potential recession and housing market meltdowns, ongoing risks related to the war in Ukraine, the ever-present risk of new COVID-19 variants, and other geo-political tensions.

This global deterioration of economic conditions will curb Canadian economic conditions, increasing the spectre of a mild recession in 2023. As Canada's largest province, Ontario is not immune given strong export ties to the U.S., more highly indebted consumers, and a sharper deterioration in the housing market.

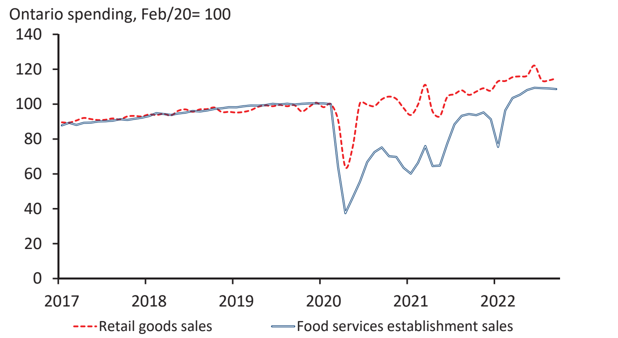
Growth in Ontario real Gross Domestic Product (GDP) is forecast to slip to 0.4 per cent in 2023 after 3.0 per cent this year. Growth recovers to 1.7 per cent in 2024 and 2.1 per cent in 2025. The province faces a deeper housing cycle downturn and pullback in housing starts, while consumption slows with higher interest rates, inflation and hiring slowdown. A tight labour market is expected to moderately cool but remains supportive of activity, as does strong population growth, but the unemployment rate is forecast to rise to nearly 6.5 per cent over the next three years. Inflation declines with the national pattern.

Current economic conditions slowing after robust start to 2022

Ontario's economy recovered sharply during the first half of 2022 following the uneven growth patterns in 2021 and relatively strict public health measures. After a moderately strong rebound in 2021 where GDP growth reached 5.2 per cent in line with the national increase of 5.0 per cent nationally, Ontario's economy continued to gain momentum early this year. Annualized growth of more than 4 per cent during the first two quarters has handily outpaced national growth of 3.3 per cent over the same period as the economy played catch up.

Consumer demand has rebounded after lagging other regions in 2021 as relatively more stringent pandemic health measures eased and the labour market tightened. Year-to-date retail goods spending through August rose 14 per cent ahead of same-period 2021 and relative to pre-pandemic trend, with gains owing to a combination of higher gasoline prices and broader recovery in spending. Spending has increasingly rotated back towards in-person interactions driving services-sector demand as people make up for lost pandemic experiences and tourism gains. Household expenditure growth, particularly for services has driven headline GDP. Drag from interest rates and inflation has been partly cushioned by the strong labour market, and accumulated savings during the pandemic have provided further financial firepower this year.

Consumer demand rebounds, rotation towards services continues

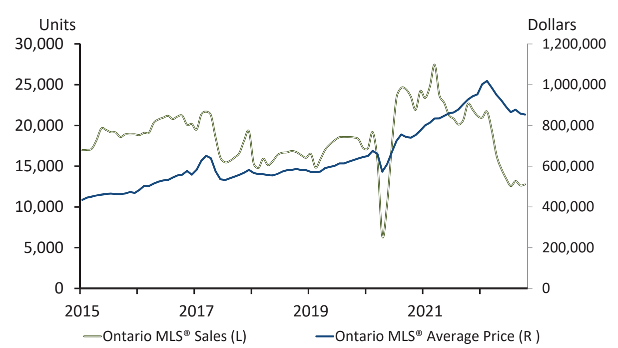


Source: Statistics Canada, Central 1

Strong corporate profits and a pause in pandemic-era spending have lifted business investment as firms look to expand with stronger economic conditions. Rising profits reflect stronger industrial production and export terms of trade. Manufacturing sales have climbed 20 per cent and exports are up 15 per cent with robust growth among both durable and non-durable goods. Auto-related manufacturing has continued to recover following supply-chain oriented challenges.

In contrast, the housing market has sharply retreated with higher mortgage interest rates triggering lower home sales and residential investment. Home sales have fallen 44 per cent over the first ten months compared to same-period 2021. While this partly reflects soaring demand during the pandemic, sales flow is 35 per cent below pre-pandemic 2020 as access to homeownership has been decimated by punishing rate hikes and elevated home prices. While prices have fallen 15 per cent from peak levels, they are still more than 20 per cent above pre-pandemic levels. The deteriorating resale market is reducing renovation activity but the pass through to housing starts occurs with a lag.

Housing market slowdown a drag on economic activity



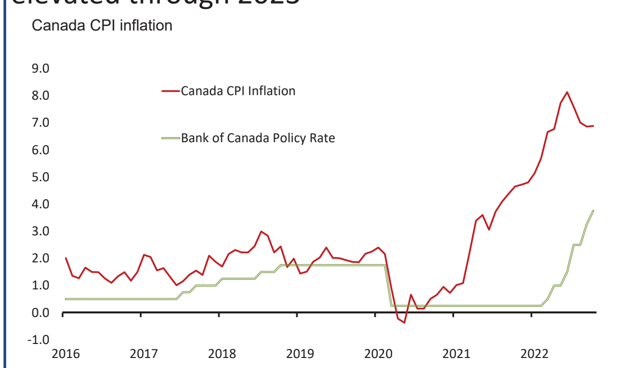
Source: CREA, Central 1

Labour market data has improved, although the latest trends have pointed to a lull in job creation and signals slowing momentum with employment growth slipping towards a 4 per cent rate. While picking back up in October, trends were weaker in the back half of the year. Labour shortages, either in warm bodies or skills, is a challenge for Ontario organizations but is less acute than other regions. The unemployment rate has moved just shy of 6 per cent after slipping to 5.1 per cent at mid-year, although wages continue to rise.

Global economic environment remains uncertain, expected to curb Ontario economic growth

While the economic data is steady, it is also stale and anticipated to give way to deteriorating patterns through the first half of 2023. Inflation-driven interest rate hikes, both domestically and abroad, have triggered rapid interest rate hikes. The U.S. Fed has signaled a terminal rate that could move to 5 per cent and we forecast a Bank of Canada rate of 4.25 per cent by early 2023.

Policy interest rates to move higher, remain elevated through 2023



Source: Statistics Canada, Bank of Canada, Central 1

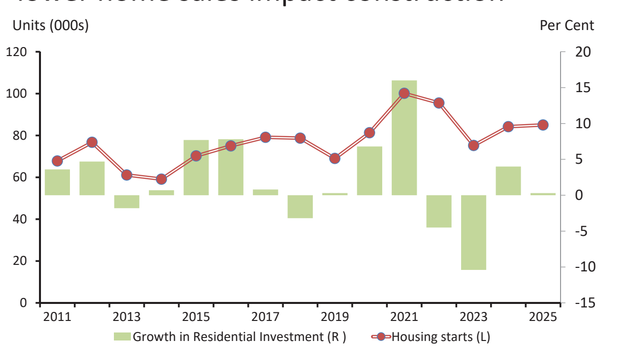
The shock of higher interest rates and eroding real incomes contributes to a slowing in global economic growth. A recession in the U.S. is expected to officially emerge during the first half of 2023 but conditions deteriorate earlier, while the broader global economy decelerates to the slowest rate of expansion since 2001, notwithstanding the Great Financial Crisis and early pandemic period. In return, Canada's economy is set to stumble and a no growth to mild recessionary environment would not be a surprise in early 2023. Growth in Canadian GDP tumbles to 0.6 per cent in 2023 before rebounding to near 2 per cent in 2024 onwards.

Real GDP slows to 0.4 per cent in 2023

Ontario's economy is expected to follow a consistent but moderately sharper downturn in 2023 given relatively higher debt loads in the province, a steeper housing market correction and greater trade linkages to the U.S. GDP growth is forecast to slow to 0.4 per cent after expanding by 3.0 per cent in 2022 and recover to 1.7 per cent in 2024 and 2.1 per cent in 2025.

The housing market will remain a drag on the economy. While a drop in existing home transactions largely impacts 2022 growth, fewer renovations and impact of weaker housing market conditions and pre-sales will reduce housing starts going forward. As many construction projects are planned years in advance and have a long buildout period, specifically multi-family starts, a slowdown in new construction is a multi-year process. Higher interest rates will also make rental family housing less profitable. Housing starts decline to 95,500 units this year and nearly 75,200 units in 2023 before bouncing towards 85,000 units in 2024 and 2025. This housing downturn in the resale and new home market will prove temporary. While conditions are slow, it does not negate the need for substantially more homes in the future as Canada looks to add nearly 500,000 new Canadians annually at mid-decade. We anticipate a resurgence in home sales and price acceleration partway through 2024 as pent-up demand is unleashed with declining interest rates.

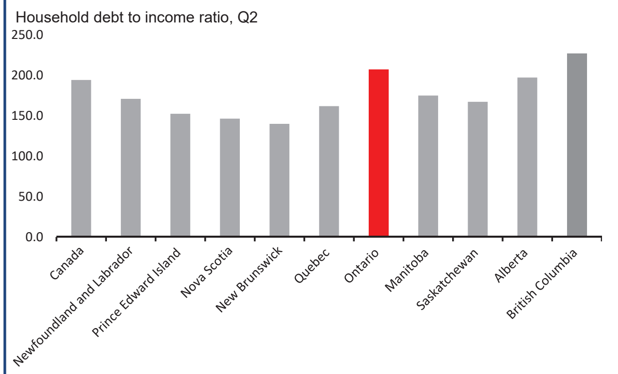
Housing starts to retreat as higher rates, lower home sales impact construction



Source: CMHC, Statistics Canada, Central 1

Household consumption is forecast to tread water. Households will slow spending as inflation continues to exceed wage gains and higher interest rates further strain budgets. Ontario's household debt-to-income ratio is second only to B.C., reflecting higher home values in the province. Households will shift dollars toward higher interest payments, specifically variable rate mortgages and other revolving debt, and curb spending on goods. That said, services-spending continues to expand due to pent-up demand. Government contribution to growth, which picked up during the pandemic and fueled job creation, is expected to return to longer-term growth trends above 1 per cent after spiking during the pandemic.

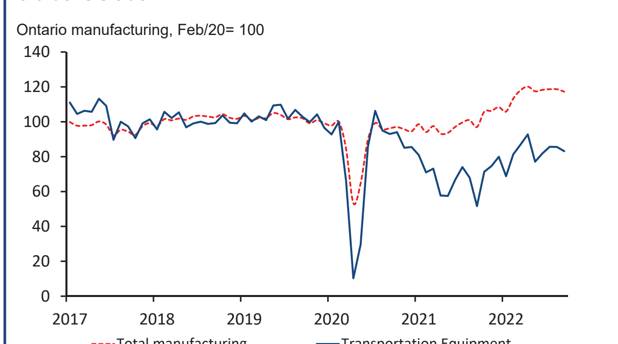
Ontario household more interest rate sensitive



Source: Statistics Canada, Central 1

Ontario exporters are likely to feel more of a pinch relative to other regions of Canada. The U.S. share of Ontario's domestically produced goods exports at 78 per cent is third highest among provinces. While Alberta is the highest among the pack, it largely owes to shipments of energy products while Ontario exports are dominated by intermediate goods and manufacturing. Despite improving supply chains, new vehicle sales in the U.S. remained sluggish and we expect this to persist as more Americans remain under the strain of high inflation while economic conditions cool. Indeed, the University of Michigan index of consumer sentiment is at a recession level, while the housing cycle is also negative. By extension, recovery in Ontario business investment slows with export demand although supported by expenditures to lift productivity.

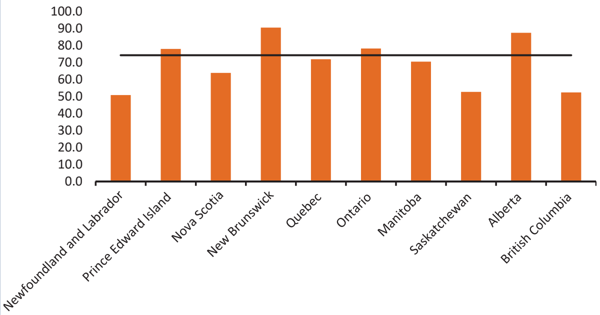
Manufacturing sales rise despite drag from auto sector



Source: Statistics Canada, Central 1

Greater exposure to U.S. economy through trade

U.S. share of domestic exports, 2017-2021 average



Source: Statistics Canada, Central 1

With an economy set to stall, employment will similarly soften. Employment growth is forecast to climb at a rate near 0.3 per cent for both 2023 and 1.5 per cent in 2024. Robust population growth, which spiked to 2.2 per cent on a July-over-July basis this year due to a surge in non-permanent residents, is expected to fall back but remain high at 1.5 per cent in 2023 followed by growth of 1.3 per cent thereafter. Population growth supports demand in the economy but will also provide a much-needed source of labour supply. Ontario's unemployment rate is forecast to climb above 6.5 per cent in 2023 and trends near this pace owing to the increase in population. Wage growth is expected to decelerate to under 3.0 per cent in 2023 and 2024 from 4.0 per cent this year.

Inflation is forecast to decelerate to 3.0 per cent in 2023 from nearly 7.0 per cent in 2022, in line with broader trend before moving to 2.0 per cent in 2024. A slowdown in gross domestic income will largely flow through deceleration in corporate profits as labour markets and lagged impact of consumer inflation lift wages. Nominal GDP reaches nearly 10.0 per cent this year before ranging from 3.0-4.0 per cent in 2023 and 2024.

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Terms

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ON Forecast Table

Provincial Forecast	2021	2022	2023	2024	2025
GDP at market prices	10.3	9.7	3.5	3.2	3.8
Real GDP, expenditure-based	5.2	3.0	0.4	1.7	2.1
Household consumption	4.4	4.0	0.1	1.2	1.8
Government expenditure	6.9	1.4	1.5	1.5	1.4
Government capital formation	0.9	7.1	2.6	4.0	-2.5
Business capital formation	11.8	-0.9	-7.0	-0.1	2.0
Residential structures	14.3	-4.5	-10.4	4.0	0.3
Machinery and equipment	12.8	7.3	-6.1	-1.4	6.0
Non-residential structures	2.3	1.7	-0.9	-5.0	3.1
Final domestic demand	5.9	2.4	-1.1	1.2	1.5
Exports	1.3	5.8	1.7	2.0	3.4
Imports	5.7	4.4	-1.3	1.9	3.0
Employment	4.9	4.9	0.3	1.5	0.8
Unemployment rate (%)	8.0	5.7	6.4	6.4	6.2
Personal income	8.7	6.0	3.2	3.9	4.2
Disposable income	4.1	5.6	3.1	4.0	4.4
Compensation of employees	9.2	9.4	2.8	4.6	3.9
Net operating surplus: Corporations	13.7	7.6	3.0	-2.7	4.4
CPI	3.5	7.0	3.0	1.9	1.7
Retail sales	9.3	10.7	2.0	2.4	3.5
Housing starts, 000s	100.1	95.5	75.2	84.2	85.0
Population Growth (%)	0.5	2.1	1.5	1.3	1.3
Key External Forecasts					
U.S. Real GDP	5.2	1.5	0.3	1.8	1.7
Canada Real GDP	5.2	3.2	0.6	1.7	1.9
European Union Real GDP	5.3	3.1	0.1	1.8	1.8
China Real GDP	8.1	3.0	4.0	4.8	4.5
Japan Real GDP	1.6	2.4	2.3	1.5	1.2
Canada 3-month t-bill, %	0.1	2.3	4.1	3.2	2.5
Canada GoC long-term Bond, %	1.8	3.3	3.3	2.8	2.6
U.S.-Canada Exchange Rate, cents/dollar	79.9	76.3	76.0	79.0	80.0
Crude Oil WTI USD$ per barrel	68.0	95.0	85.0	85.0	85.0