Economics | Forecast / Outlook Reports

Economic Analysis of Ontario

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central 1 Economics

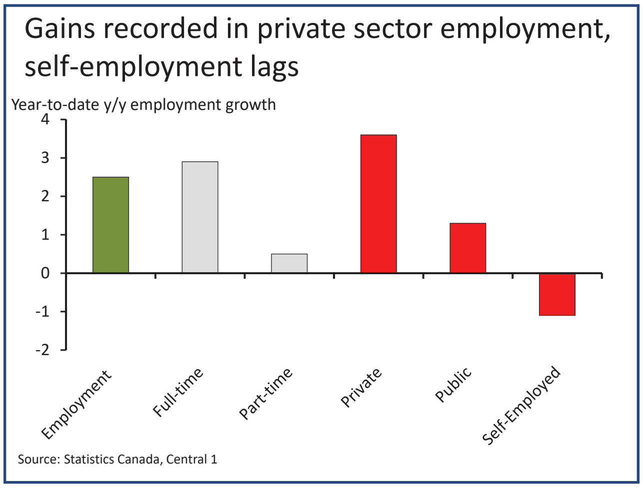
Ontario Economic Update and Forecast, 2023-2025

Ontario economic performance has shown signs of waning in the third quarter after a moderately strong first half, albeit still outperforming the country as a whole. Ontario's real GDP grew at an annualized rate of 3.1 per cent in Q1 and 0.6 per cent in Q2, propelled by household spending, non-residential investment and to a lesser extent, trade. More growth was seen in the goods-producing industry as the manufacturing industry grew by 2.9 per cent during the quarter. The return of supply chains to normalcy and rising auto sales boosted performance in this sector. Services sector saw a minor rise of 0.1 per cent. Residential investment contracted for a sixth consecutive quarter.

Conditions have continued to deteriorate into the third quarter. Retail spending is negative in nominal terms, a contraction made deeper in real terms given higher prices. Consumers are pulling back in response to inflation and interest rate shocks, and in anticipation of more to come for homeowners with mortgage debt. The high indebtedness of households in the province means they will continue to suffer from increasing interest rates. Insolvencies in the province have been higher year-over-year each month of 2023 and more financial struggles brought on by elevated rates and inflation are going to put a damper on consumer spending in the second half of the year.

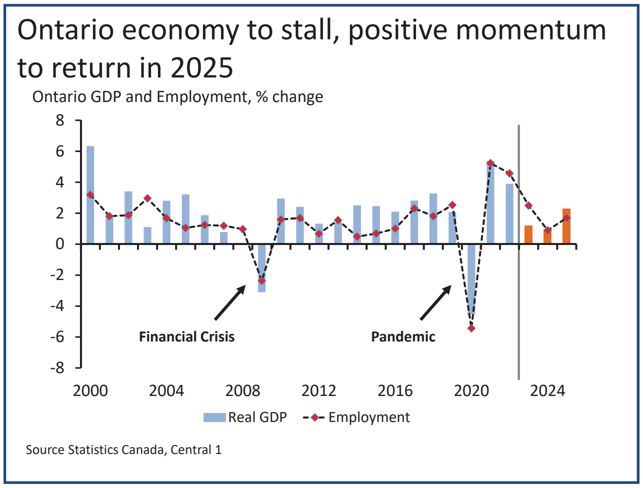
Housing markets conditions have again deteriorated after the temporary upswing early in the year as higher interest rates have squeezed out demand, contributing to accelerated sales decline to lows seen in November 2008, notwithstanding the early pandemic pullback. Prices are again facing downward pressure and curbing incentives to build.

While somewhat resilient, the labour market is following suit as employment has stalled and unemployment rate at six per cent was the highest since early 2022. Employment growth in recent months has been concentrated in the services industries, namely in professional/scientific/technical services, healthcare and social assistance and education. Still, average weekly wages have risen, with year-over-year gains hovering above 4 per cent in June and July compared to the near 2 per cent in earlier months of 2023.



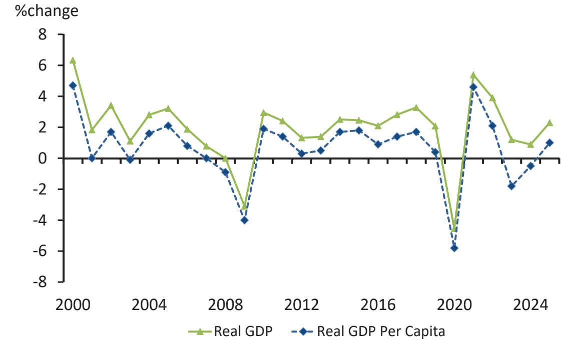
Ontario Outlook: Consumer spending underpins Ontario economic slowdown

Consistent with the broader national picture, Ontario economic growth is forecast to remain sluggish into 2024 before gaining some traction again in 2025. Real GDP growth slows to 0.9 per cent following a 1.2 per cent expansion in 2023 as consumers and businesses pull back amidst uncertainty, offsetting some gains in exports. Indeed, in the absence of robust population growth, real aggregate output and income would be expected to contract. Nominal GDP slows to 3.2 per cent in 2024 but rebounds to near four per cent in 2025 driven by a 2.3 per cent real expansion.



This outlook aligns with a broad deceleration in the Canadian and global economy, with the U.S. still holding steady despite an anticipated slowdown. Tight monetary policy via high interest rates continues

Declines in per capita GDP signals deterioration in living standards

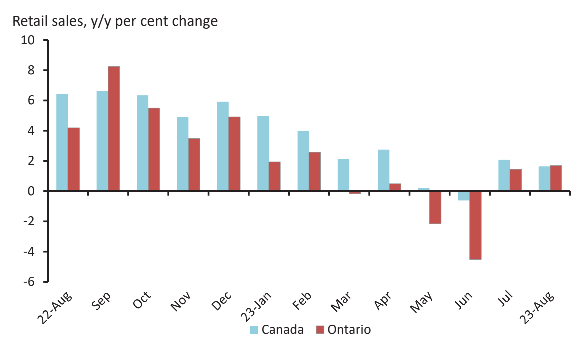


Source Statistics Canada, Central 1

to filter through the economy and impact interest-sensitive sectors and broader demand as debt-service costs rise.

Consumers are financially struggling despite relatively strong wage growth and will face further challenges in 2024 as an increasing number of household budgets become strained by the impacts of mortgage rate renewals, still elevated inflation, and a moderating labour market. Consumer spending has already flagged in Ontario, trending less than 2 per cent above year ago levels. The tailwind of robust population growth is still supporting aggregate spending, but this only masks the stress on individual households which will face a wave of mortgage renewals at much higher rates in 2024 and 2025. Even as population growth remains high, forecast consumer spending is about one per cent this year, and a stall in 2024 as households retrench from interest sensitive items and discretionary purchases. Population growth and lower interest rates should ultimately lift consumption at a stronger pace in 2025.

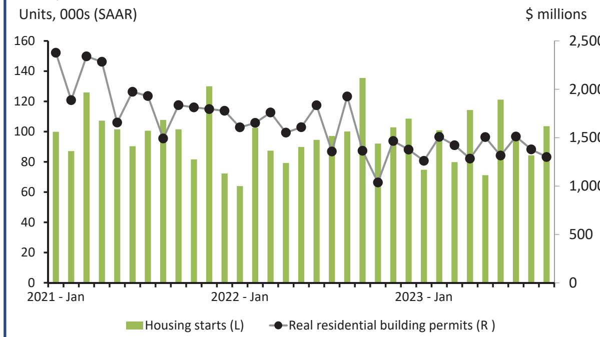
Ontario retail spending weakness points to retreat in consumer demand



Source: Statistics Canada, Central 1

Housing does not look much better, although this year's drag is unlikely to repeat. The current down leg in the housing market portends weak market conditions in early 2024. Excessive exuberance during the pandemic which drove stratospheric home prices reversed sharply in 2022 with sharp higher mortgage rates. This year's mild early upturn proved fleeting with another leg up in borrowing costs cutting purchasing power even further and turned buyer confidence on its head. Declining prices continue into early 2024 before declining interest rates lift demand through the second half of the year. The direct impact of weaker housing demand has already impacted residential investment through lower transaction demand, but negative wealth effects and higher mortgage payments upon renewal will factor into lower consumer spending.

Residential construction holds up, but expected to decline

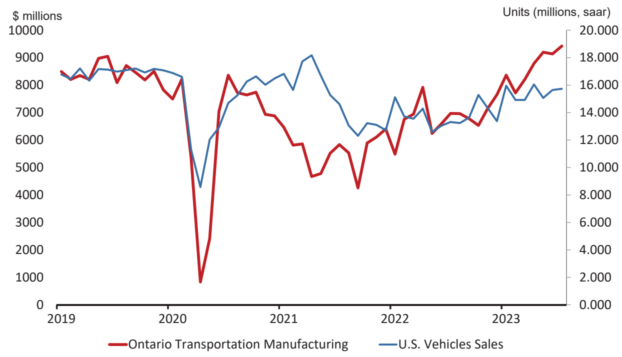


Source: Statistics Canada, Central 1

Ontario's desperate need for housing supply is unlikely to improve, and we see it getting worse. After holding up relatively well this year, only close to 82,000 housing starts are forecast for 2024 despite measures to boost construction, including abolishing GST on rental construction. High financing costs and market uncertainty dwarfs these incentives, amplifying the province's housing shortage. This contributes to further deterioration in rental affordability and support for home prices following the current downtrend. Housing starts rebound to 96,100 units in 2025.

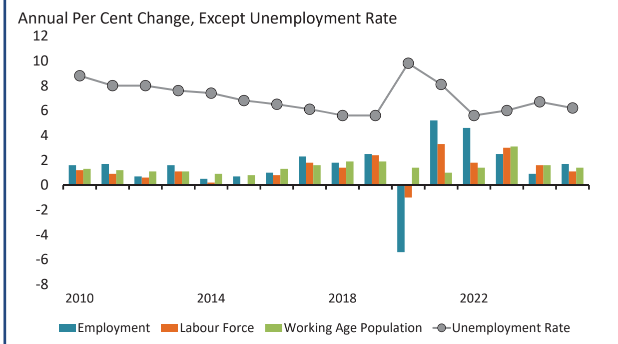
The U.S. economy naturally plays a huge role for Ontario given strong trade linkages of final and intermediary goods in manufacturing. While lower than the early 2000s, 80 per cent of Ontario's international goods exports are still shipped south, while over 50 per cent of imports are from the U.S. making it by far Ontario's most important international trade partner. Surprisingly robust U.S. growth has supported international goods export growth of 12 per cent through three quarters, driven by the 18 per cent increase to the U.S. Recovery in supply chains and resilient consumer demand has driven a recovery. Trade momentum is likely to temper with economic conditions but remains a growth driver. The U.S. is not anticipated to enter recession, while a low Canadian dollar should prove beneficial to both goods exports and tourism services.

Manufacturing industry growth boosted by higher auto sales



Source: Statistics Canada, Central 1

Unemployment rate to exceed 6.5 per cent, on slowing economy and robust population



Source: Statistics Canada, Central 1

Nevertheless, business conditions have weakened with high interest rates and slowing consumer demand. Small business optimism has sunk, with 12-month outlooks near pandemic lows and alongside negative short-term readings point to a rough road ahead. Declining corporate profits, forecast to drop 11 per cent this year if not more, will remain under stress as wage growth remains relatively firm. Firms will likely temper investment, particularly in sectors like financial services and retail although there remains support from government supported sectors like electric vehicle manufacturing and an emphasis on critical mineral mining. Inventory levels have shrunk as firms curb excesses. Government spending is likely to remain on the rise but at a more moderate pace despite the economic drag on tax revenue as government deficits persist to maintain spending.

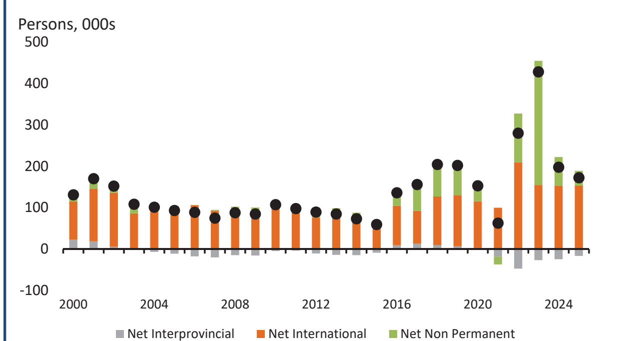
Ontario jobless rate jumps to 6.7 per cent as population swells

Employment growth slows with the economy but remains in positive territory next year at 0.9 per cent following a 2.5 per cent increase in 2023. Notwithstanding the 2020 pandemic collapse, this would mark the lowest growth since 2015. Firms are still hesitant to lay off staff given the tight pandemic hiring environment, but more are likely to turn to layoffs as conditions ease. While total employment holds up despite softening demand in the economy, Ontario's unemployment rate is forecast to rise through most of 2024 owing largely to population driven expansion of the labour force and elevated participation rate. The unemployment rate averages 6.7 per cent in 2024 after averaging 5.8 per cent this year. Slack in the labour market and declining job vacancies is anticipated to curb wage growth momentum which falls below three per cent in 2024.

Weaker employment growth and wages contribute to a deceleration in aggregate compensation growth for 2024 to 3.1 per cent after a forecast 6.9 per cent in 2023. Corporate profits hold steady next year after this year's decline.

Population growth

International immigration to drive population growth, non-permanent flow to slow



Source: Statistics Canada, Central 1

The flood of newcomers to Canada has been a stunning development over the past year as already high levels of immigration was overwhelmed by an even greater number of non-permanent residents through work visa and student inflows. The province's population ballooned more than three per cent even as a greater number of Ontario residents moved to other provinces in search of more affordable housing and lifestyles. While providing some support for the economy through consumption channels and taming of labour shortages, it has also led to more acute challenges for shelter costs, particularly for rental market. This upswing is unlikely to change course any time soon as federal immigration targets are set to reach 500,000 persons across Canada by 2025, while there have not been concrete restrictions on temporary residents. A slowdown in the economy could slow some of this momentum, but this forecast pegs population growth at around 1.5 per cent in 2024 and 1.3 per cent in 2025 largely on a more normal but still elevated inflow of temporary residents. This continues to put pressure on the housing market.

Bryan Yu
Chief Economist
Central 1 Credit Union
byu@central1.com
www.central1.com

Eloho Ennah
Economic Analyst
Central 1 Credit Union
eennah@central1.com

ON Forecast Table

Provincial Forecast

	2021	2022	2023	2024	2025
GDP at market prices	10.3	10.4	3.8	3.2	3.8
Real GDP, expenditure-based	5.2	4.2	1.2	0.9	2.3
Household consumption	4.4	6.1	1.3	0.2	2.6
Government expenditure	6.9	1.8	1.9	2.2	1.4
Government capital formation	0.9	-2.7	4.1	5.1	0.4
Business capital formation	10.0	-8.2	-4.4	-2.3	4.7
Residential structures	14.3	-16.9	-10.3	-0.1	9.4
Machinery and equipment	12.8	3.7	3.4	-3.7	0.6
Non-residential structures	2.3	0.4	0.3	-3.5	2.6
Final domestic demand	5.9	1.6	0.3	0.4	2.7
Exports	1.3	4.3	4.1	2.7	1.2
Imports	5.7	4.0	1.8	0.6	2.1
Net exports, $2012 bil.	-7.1	-6.2	3.0	11.9	8.2
Employment	5.2	4.6	2.5	0.9	1.7
Unemployment rate (%)	8.1	5.6	6.0	6.7	6.2
Personal income	5.2	6.4	6.1	3.4	4.9
Disposable income	4.1	5.9	5.9	3.3	5.0
Compensation of employees	9.2	9.3	6.9	3.1	4.7
Net operating surplus: Corporations	13.7	5.8	-10.5	-0.1	2.0
CPI	3.5	6.8	3.4	2.5	2.0
Retail sales	9.3	10.2	1.0	2.1	4.3
Housing starts, 000s	100.1	96.1	88.4	81.7	96.1
Population Growth (%)	0.6	2.0	3.0	1.5	1.3
Key External Forecasts					
U.S. Real GDP	5.7	2.1	2.2	1.4	1.8
Canada Real GDP	4.9	3.5	1.2	0.8	1.5
European Union Real GDP	5.3	3.5	0.8	1.3	1.5
China Real GDP	8.1	3.0	4.7	4.3	4.0
Japan Real GDP	2.2	1.0	1.3	1.0	0.9
Canada 3-month t-bill, %	0.1	2.4	4.8	4.0	2.7
Canada GoC long-term Bond, %	1.8	2.9	3.4	3.2	3.1
U.S.-Canada Exchange Rate, cents/dollar	79.8	76.8	75.0	74.0	77.5
Crude Oil WTI USD$ per barrel	68.0	95.0	75.0	80.0	75.0