



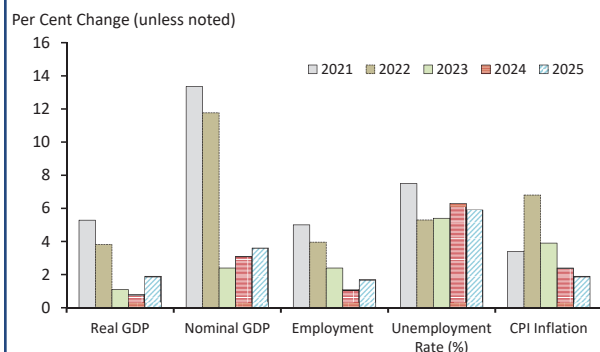
## Canada Economic Outlook, 2024-2025

### ***Stagnation or recession in the Canada' Economic Transition Year?***

After grappling with high inflation and unprecedented interest rate hikes over the past two years, Canadians can look forward to modest relief this year but not before navigating a choppy and potentially painful transition period. Even as central bankers shift their focus to interest rate cuts as inflation normalizes and economies slows, the long lags of monetary policy tightening will continue to impact the economy.

After a stagnant second half of 2023, pressures will continue as highly indebted households grapple with the cost of mortgage renewals while business conditions slow. Population growth supports aggregate spending, but masks deterioration in financial health at the household level while adding further pressures on the housing market, where we expect increased traction beginning in the second quarter. We forecast GDP (Gross Domestic Product) growth to decline to 0.8 per cent this year after a 1.1 per cent expansion last year. Employment holds steady but the unemployment rate hits the mid six per cent range as population gains lead to a bulge in the working age population. Improved conditions are anticipated for 2025.

#### Canadian economic patterns slow in 2024 before rebound



#### *Conditions ripening for rate cuts, but timing elusive*

Canada's economic performance and our outlook comes amidst an unpredictable international backdrop. The U.S. economy has remained resilient and inflation patterns have eased, while China's economy

struggled, and oil prices declined. War remains an unwelcome part of the current environment, creating unimaginable pain and suffering while also adding to supply-side risks in the economy.

The U.S. is most important for Canada given trade and financial linkages, and it is laying the path for easing interest rates. Despite the rapid increase in the Fed rate and bond yields for much of last two years, U.S. economic growth remained robust. GDP growth reached 3.3 per cent during the third quarter after a 4.9 per cent expansion in the third quarter to push full-year growth of about 2.5 per cent. Fears that the economy may enter an interest rate induced recession have subsided with forecasts now leaning towards a soft landing -- normalized inflation in the absence of significant job loss. Inflation is in decline, and while CPI (Consumer Price Index) measures are still a bit firm largely due to laggy shelter costs, the Fed's preferred Personal Consumption Expenditure (PCE) has fallen below two per cent.

With a dual mandate of inflation and full employment, the Fed will look to support growth rather than counteract which could trigger rate reductions of about 100 basis point this year. Bond yields have fallen sharply since November, and even with some uneven patterns, the Fed will likely cut at least three times this year.

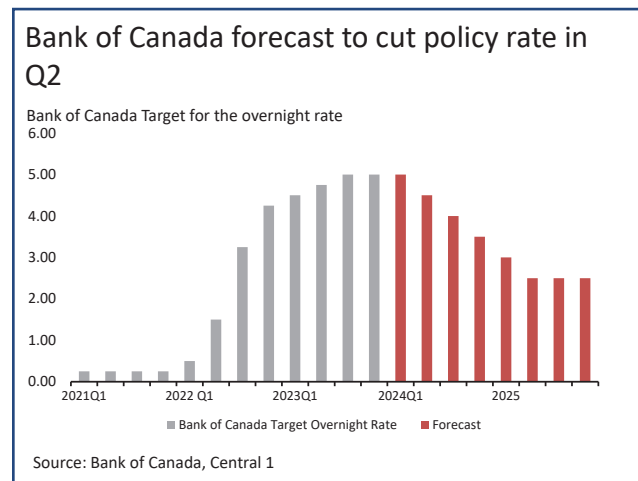
The Bank of Canada tone has been more cautious and for good reason. Inflation remains sticky near 3.5 per cent and in months that headline inflation fell to about 3 per cent, it has not quite stuck the landing with high shelter related costs and firm wage growth still problematic. That said, the Bank's latest policy decision has signaled peak in rates with the only question being duration of the current level. We expect a cut by mid-year as the economic slowdown sufficiently curbs inflation. We expect inflation to return to two per cent by the third quarter. Moreover, we expect near-term inflation to be discounted in part given tighter monetary policy does little to lower shelter costs and mortgage interest is behind a substantial share of current inflation. Excluding mortgage rate increases leaves inflation near 2.5 per cent.

Inflation and rate forecast remain highly uncertainty. Wage growth will need to come down, which we view as being an outcome of declining job vacancy rates and population induced labour force growth

from a slowing economy. That said, wage growth has remained more robust than anticipated. Global supply-side risks from the attacks on cargo ships in the Red Sea could also keep inflation higher, albeit temporarily.

This forecast sees the Bank of Canada cutting in April with a policy rate of 3.5 per cent by year-end with risk that cuts are delayed until mid-year and by extension a higher year-end rate of closer to four per cent. Further reductions to 2.5 per cent are forecast for 2025.

While rate reductions are in sight, this is a transitional year for the Canadian economy with lagged effects of preceding interest rate hikes and slowing external conditions contributed to extending the weak growth trajectory. Several key themes will persist.

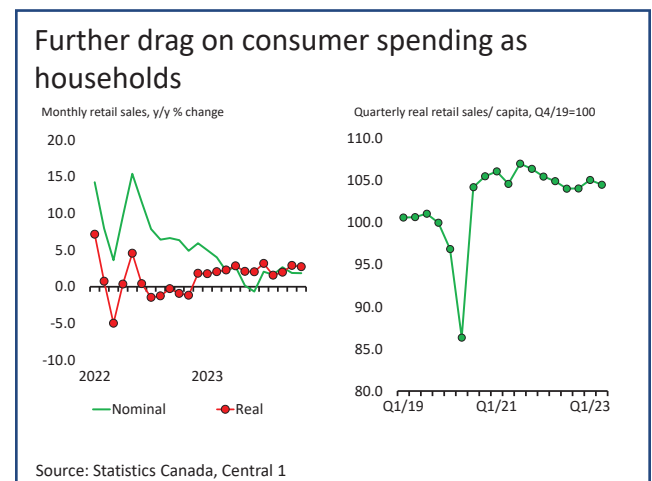
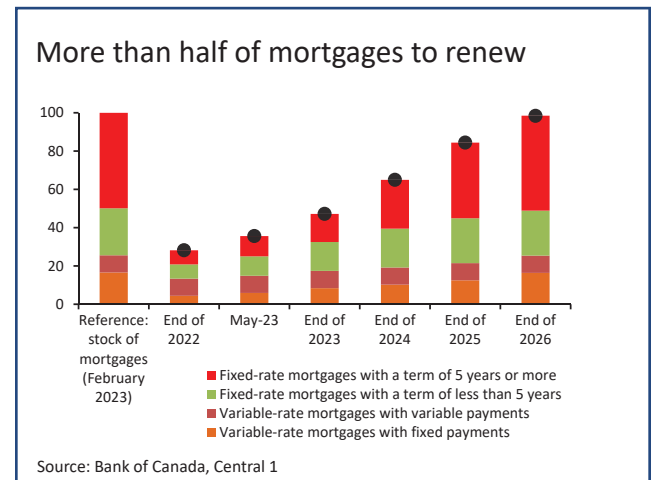


### Debt bulge and mortgage cliff to hamper growth

Highly indebted Canadian households are already feeling the pinch of higher interest rates, contributing to stagnant spending. Retail spending rose only 2 per cent last year, and real consumption was flat in the third quarter which contributed to a GDP contraction of 1.1 per cent (annualized). Conditions do not look much better for Q4 with our forecast for a mild bump of 0.5 per cent. Household consumption will remain a drag as the “mortgage cliff” materializes. A significant portion of mortgage renewals kick in over the next two years and at much higher rates. This will mean payment shocks of more than 30 per cent for some households. CMHC (Canada Mortgage and Housing Corporation) pegs this number at about 2.2 million mortgages. This will trigger weaker consumer spending as consumers pivot their spending and a greater share of income goes towards debt servicing.

That said, this will not be calamitous provided the labour market remains steady and financial stress remains modest heading into the wave. Wage growth and pandemic era savings have been elevated,

and mortgage stress tests at mortgage origination provided some cushion. While these factors should prove sufficient to avoid a wave of mortgage defaults, households will likely pare spending while delinquencies and insolvencies rise.



### Population boil to cool to a simmer

Moreso than any other time in memory, population growth has been a key story driving activity and complicating the outlook. The latest available quarter saw more than 430,000 newcomers to Canada (+1.1 per cent), with historic four quarter growth of more than 1.2 million or 3.2 per cent. With a population a fraction of the size, Canada's population growth nearly matched the U.S. (1.3 million but only 0.4 per cent). Population gains have more than doubled the pace prior to the pandemic, as net non—permanent residents soared, dwarfing already high levels of traditional immigration flows. Net non- permanent residents are driven by students, temporary workers, and refugee inflows. Historically the ratio of non-permanent inflows to immigration has fluctuated near 20 per cent, albeit rising to 50 per cent just prior to the pandemic. Levels have jumped to about 150 per cent of traditional inflows in recent quarters.

There is little debate that population growth is needed and necessary to support the future labour market, but the current pace has proven unmanageable and unhealthy for the economy. While helping to avoid a technical recession, growth has far outpaced economic activity driving real GDP per capita, risking lower living standards. The rapid inflow has generated severe strains on the housing market, particularly rentals and a mismatch in infrastructure spending.

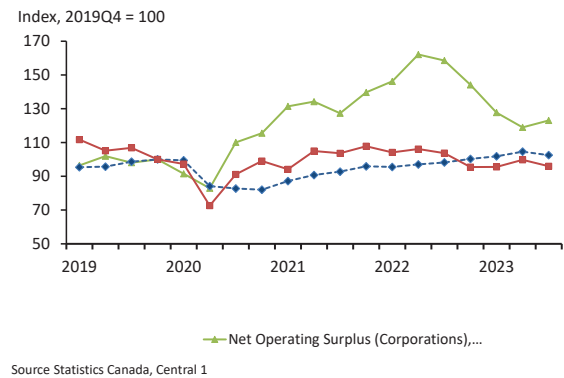
Uncapped inflows are coming to an end as the record inflows become political dynamite. Levels are expected to remain elevated by historical standards as federal targets for landed immigrants holds near half a million people per year. However, net non-temporary inflows will be curtailed based on new federal measures. The federal government has announced a two-year cap on new international student visas at a level consistent with expiring visas, which means no net new entries, albeit this does not affect graduate students or those in primary or secondary schools. This will help bend the population curve, but it is worth noting that the bulk of the change in net non-permanent residents over the past two years were work permits.

We expect population growth to remain high in 2024 at 2.4 per cent before tracking towards 1.5 per cent in 2025. This will potentially bend the curve for housing affordability but will be insufficient without more supply coming on stream.

#### *Feedback effects on business*

Business conditions will also slow. Corporate profits have declined over the past year and sentiment has weakened amidst slowing demand. Business insolvencies are on the rise as the Bank of Canada's BoS (Business Outlook Survey) points to a period of more muted hiring and business investment. The latter is already reeling with declining spend on machinery and equipment which is down 10 per cent from mid-2022 and expected to remain subdued. While owing to both weak domestic conditions and slower growth in export markets, this is particularly unhelpful for Canada's economy which is struggles with productivity growth while economic capacity is insufficient to match the soaring population, contributing to declining real per capita output. Lack of private sector investment contributes to lackluster growth over the forecast period. However, there will be pockets of strength. Canada's critical minerals strategy and large investments in electric vehicle battery manufacturing and other technologies provides some lift in Ontario. In contrast, government spending will continue to grow and offset some of this weakness as provincial and federal spending has shown no signs of austerity.

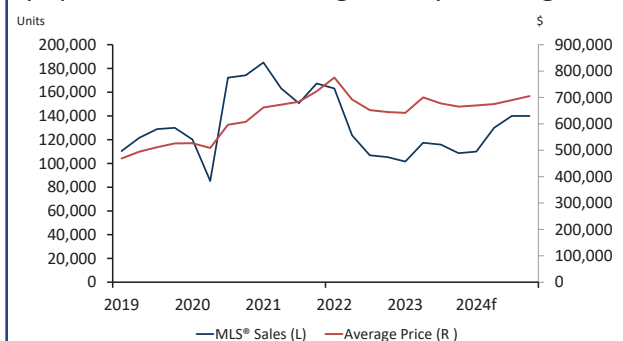
#### Declining profits contributes to downturn in investment



#### *Housing ready to turn but construction delayed*

Mixed conditions are seen from the Canadian housing market. As the first to dip into an interest rate driven downturn, lower mortgage rates could drive a notable boost in housing transactions as soon as the second quarter. Homes sale showed a spring of life in December after declining through the back half of the year, but this was unlikely the start to a new upward trend. Nevertheless, conditions are ripening with a swell of housing demand on sidelines created by population gains, high interest rates, and demand from Millennials and Gen Z means buyers are looking for entry points into the market. A similar pattern was evident in early 2023 when a calming of fixed rate pricing triggered a sharp increase in sales flow. Conditions have kept housing supply low, prices high and rents have soared. Housing sales could see a surge in the spring by 10 – 15 per cent, after adjusting for a normal seasonal increase, bringing the trend back to near pre-pandemic levels. Price levels are also set to rise alongside sales transactions, but we do not expect another double-digit surge. Affordability remains severely compromised since the pandemic and even a modest decline in interest rates will keep prices out of reach of many households. Nevertheless, we have been surprised in the past at the length of which buyers will stretch to access homeownership and prices could rise more than anticipated due to constrained supply.

#### First to recover? Interest rate cuts, swelling population to lift housing sales, prices lag

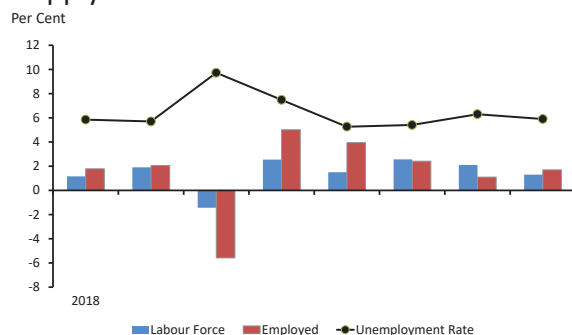


While the existing home market gains traction, an uptick in housing construction is delayed. Despite all levels of government jumping on the supply bandwagon after decades of thumb twiddling, it will remain difficult to expedite new housing given the flow through impact of higher interest rates. Canadian housing starts fell 7 per cent last year, and further declines are forecast for 2024. Pre-sale conditions for condominium projects were challenging and rental products were similarly constrained. B.C. is at the forefront of housing policy with zoning adjustments for multi-family construction, standardized construction plans, and municipal naughty lists, and while starts rose in 2023, this was due entirely to multi-family condos in Metro Vancouver where projects were planned and pre-sold years in advance. We expect this to decline in 2024. Going forward, lower interest rates could boost single-family construction and renovations, but multi-family starts will take longer to increase.

#### *Labour market evolution a key gauge of inflation risk*

The labour market will remain a key gauge of the economy, inflation, and signal whether we see a hard or soft landing as 2024 progresses. Heading into the year, Canada's labour market stagnated. There was no net employment growth in December and the three-month trend came in at less than one per cent, annualized. The unemployment rate has held steady at 5.8 per cent and compares to about 5 per cent at the beginning of 2023. That said, this was largely owed to population growth and labour force expansion given employment was up 2.5 per cent year-over-year. Wage growth has remained uncomfortably high, including an acceleration in December to 5.4 per cent from 4.8 per cent which surely muddled the inflation rate outlook.

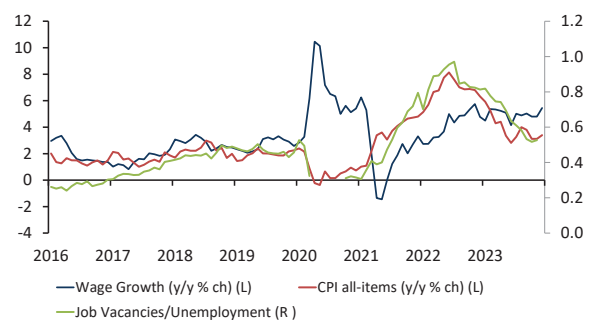
#### Unemployment rate to rise driven by labour supply



Source: Statistics Canada, Central 1

Nevertheless, we expect the labour market evolution to be constructive for inflation. Businesses are signaling less hiring in 2024 according to the BoS survey, while job vacancy rates are returning to pre-pandemic trends. That said businesses are hesitant to lay off workers, cognizant of the hiring challenges during the pandemic and need to onboard staff again when conditions improve. This could change as softening conditions embolden employers to make deeper cuts. With population growth still boosting the labour force, unemployment will rise even as employment holds steady. Vacancies relative to unemployment is anticipated to decline, curb wage growth and by extension, inflation. Canada's unemployment rate is forecast to peak near 6.5 per cent this year before declining through 2025.

#### Slack in labour market expected to temper inflation



Source: Statistics Canada, Central 1

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Canada Economic Outlook, % change (unless noted)					
	2021	2022	2023	2024	2025
Nominal GDP	13.4	11.8	2.4	3.1	3.6
Real GDP	5.3	3.8	1.1	0.8	1.9
Household Consumption	5.2	5.1	2.1	0.5	1.6
Residential Investment	14.6	-12.1	-9.0	3.0	5.0
Non-Residential Investment	8.7	4.0	1.3	1.0	2.0
Machinery and Equipment	14.0	-0.3	-6.0	-1.0	3.0
Government Consumption	5.4	3.2	2.0	2.3	2.2
Government Capital Investment	0.1	4.2	4.0	2.5	2.5
Exports	2.7	3.2	4.5	1.8	2.5
Imports	8.1	7.6	1.0	1.3	2.3
Labour Force	2.5	1.5	2.5	2.1	1.3
Employment	5.0	4.0	2.4	1.1	1.7
Unemployment Rate (%)	7.5	5.3	5.4	6.3	5.9
CPI Inflation	3.4	6.8	3.9	2.4	1.9
Population	0.6	1.8	3.0	2.4	1.5
Retail Sales	11.9	8.3	2.3	2.0	3.1
MLS® Unit Sales (000s)	666.3	499.0	443.5	500.0	550.0
% ch	20.8	-25.1	-11.1	12.7	10.0
MLS® Average Price (\$000s)	687.3	704.0	678.3	685.0	708.0
% ch	21.2	2.4	-3.6	1.0	3.4
Housing Starts (000s)	271.2	261.8	240.3	235.0	260.0
Singles	82.1	72.6	54.6	55.0	60.0
Multis	189.1	189.2	185.7	180.0	200.0
Bank of Canada Target overnight (eop)	0.25	4.25	5.00	3.50	2.50
2-year (eop)	0.99	4.02	3.91	3.10	2.70
10-year (eop)	1.47	3.29	3.06	3.20	3.20
CAD/USD	1.28	1.36	1.34	1.30	1.27

## Terms

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