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Economic Analysis of Ontario

Volume 16 • Issue 1 | ISSN: 0834-3980

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Economics

Ontario Economic Update and Outlook

The economy is moving faster than forecasters can keep up. The global economy is now in a trade war as of this forecast. After hitting Canada with tariffs over the past month, and Canada responding in kind, the U.S. tariff war has gone global. Liberation Day slapped blanket import tariffs on nearly all U.S. trading partners, with key partners seeing hugely debilitating tariff rates (albeit exempting Canada from the latest round). Policies of the Trump administration remain unpredictable and often not anchored to rational economic logic.

This outlook, which will undoubtedly be revised, has been reduced. Ontario's economy is expected to slip into a shallow recession this year, as tariffs lead to reduced exports, while weaker profits and uncertainty curtail new business investment. These impacts will filter through the domestic economy through lower employment, weaker consumer spending, and delayed housing rebound. An expected deceleration in the U.S. economy and global economic growth further contributes to a weaker trade environment.

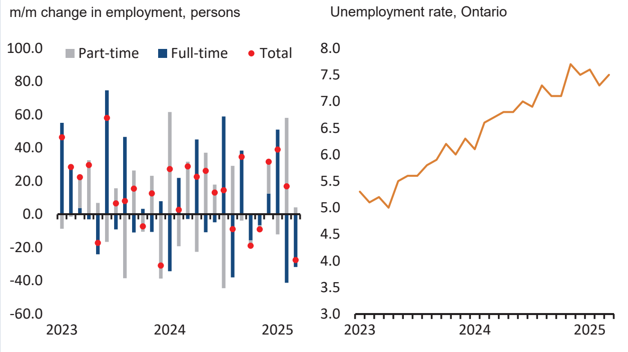
Annual GDP growth declines to 0.8 per cent driving weaker employment growth and higher unemployment rate to an average 7.2 per cent in 2026. Housing will see lower volumes due to fewer sales and weak prices before turning up.

Current environment

The severity of the Trump trade war and economy uncertainty is only now creeping in to Ontario's hard economic data but more evident in the confidence measures. This is to be expected as economic data lags the reality on the ground, and it takes time for businesses and households to adjust behaviour.

Recent economic data crop captures the late-2024/early-2025 period and while generally mild if not modest, could prove boisterous compared to what lies ahead. Labour market conditions have been mixed with employment up over the three months into February and year-over-year employment growth was a solid 2.4 per cent. That said, part-time hiring led gains as full-time work slipped while slack has picked up. Job creation has underwhelmed compared to a still robust pace of population growth. Federal policies to reduce the number of temporary residents and slow net immigration are ongoing, and while population growth has fallen sharply from the recent peak, levels remain moderately high. During the fourth quarter, Ontario population growth slipped to 1.5 per cent year-over-year, down from a 3.2 per cent pace at mid-year. The unemployment rate has soared to 7.3 per cent to the highest level since early 2022 even as labour force participation rates have declined. The highest jobless rates have been in Toronto and Windsor-Sarnia

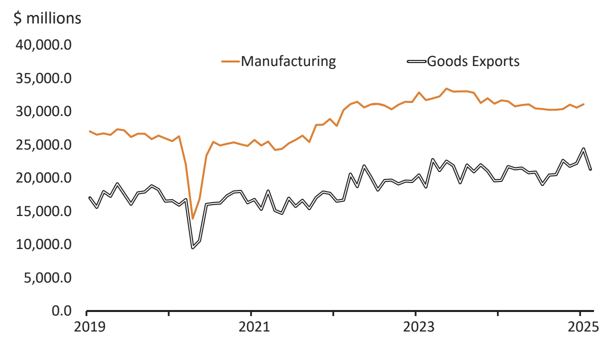
Labour market had gained traction in prior months



Source: Statistics Canada, Central 1

Early year economic trends have been subdued. Retail spending has climbed in recent months, in part reflecting the temporary GST/HST holiday, but at 2 per cent y/y, was negative after adjusting for CPI inflation and population growth. Manufacturing sales have also struggled over the past year and trending lower despite a January uptick. A surge in exports was a bright spot (9.4 per cent in January and 23 per cent y/y) but owed in large part to U.S. firms front loading imports to get in front of potential tariffs on Canadian goods. U.S. international imports surged 10 per cent in January, with Ontario shipments to the U.S. up 14 per cent m/m, and 27 per cent y/y.

Front-loading of U.S. imports boost activity, but to retreat

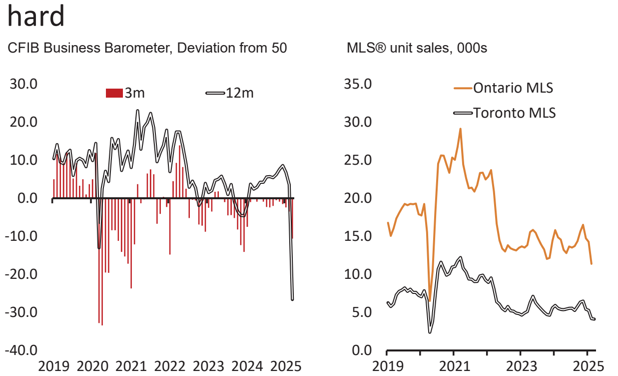


Source: Statistics Canada, Central 1

While not reflected in the hard data, conditions are certainly getting worse in real-time. U.S. tariffs, and Canadian retaliatory tariffs are in place. While there has been a temporary reprieve in segments such as autos, and USMCA covered goods representing about 40 per cent of exports, and lower value goods through de minimus exemptions, Canadian exporters have felt the pinch since early March, with steel and aluminum tariffs biting on March 12 onwards. Retaliatory tariffs on U.S. goods are also impacting input costs of imported goods, although potentially lifting demand for domestically produced substitutes.

Nevertheless, uncertainty is the enemy of confidence and businesses and consumers are downbeat. Business sentiment has crumbled with the near constant threats of new tariffs on Canada. The CFIB business barometer plummeted to historic lows in March, as businesses signaled concerns about demand and looked to taper future investment due to tariff uncertainty. Ontario small business confidence was second lowest among provinces when looking out over 12 months. A persistent trade war would represent a long-term structural change in the economy and reduced levels of activity, and for businesses and the economy, sales and hiring.

Uncertainty hits businesses and home sales hard



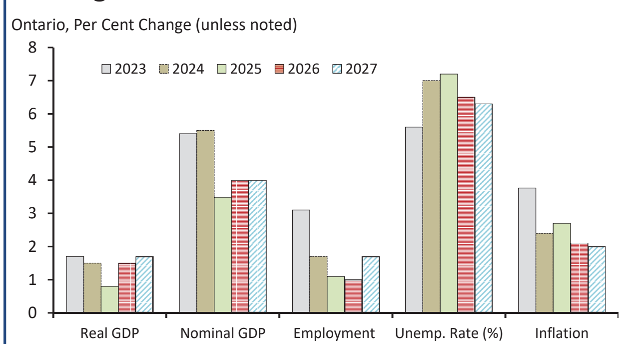
Source: CFIB, CREA (Ontario to Feb, Toronto to Mar), Central 1

The housing market is an early bell weather for confidence and the economy. With home purchases as one, if not, the largest purchase in a household's lifetime, perceived risks to the economic and job security have further cut into an already soft market. Despite support for declining interest rates and federal measures to boost access to financing have been supportive, home sales plunged 20 per cent m/m and 23 per cent y/y in February, with prices in decline. Already weak housing starts (-30 per cent y/y) face further pressure from the inactive resale market.

Forecast

Ontario's economy is expected to slip into a shallow recession this year, as tariffs lead to reduced exports, while weaker profits and uncertainty curtail new business investment. These impacts will filter through the domestic economy through lower employment, weaker consumer spending, and delayed housing rebound. An expected deceleration in the U.S. economy and global economic growth further contributes to a weaker trade environment.

Economy slows, shallow recession expected during 2025



Source: Statistics Canada, Central 1

While the trade scenario is fluid, and the U.S. and Canada have implemented tariffs and retaliatory tariffs on a large swath of goods, our assumption remains that the effective rate of tariffs on Canadian goods will ultimately decline to 5-10 per cent.

The Trump administration's Liberation Day announcement exempted Canada from additional reciprocal tariffs but prior actions under executive order remained. Canada is in fact in a better relative position than other countries. That said, there are still Section 232 steel/aluminum tariffs (impacting Hamilton), 10 per cent tariffs on some energy and potash items, while the U.S. also slapped 25 per cent tariffs on imported vehicles – which includes Canada, but only on the non-U.S. origin component. Our estimate based on 2024 U.S. import data and applying 2025 tariff policies is that the effective rate on Canadian goods is about 12 per cent, which compares to less than 0.5 per cent prior to 2025.

Ontario will be hard hit from what is effectively a12.5 per cent tariff on vehicles, and the risk is that parts shipped to the U.S. will ultimately face tariffs based on share of origin. That said, USMCA compliant goods remain non-tariffed. Details are complicated and likely to change going forward.

We continue to expect tariff measures to be relaxed over time, as job loss and higher prices south of the border create opportunities for negotiations. It is also possible that any moves are quickly paused or reversed given economic damage to U.S. companies, and upside impacts on inflation. Scenario analysis published by groups including the Bank of Canada, and Peterson Institute of International Economics, and others has modelled impacts of 1 to 4 per cent from baseline outlooks under varying tariff scenarios.

In our recent national outlook, the broader economy faces a turbulent period due to trade risks and the evolution suggests weaker than projected economic growth of closer to 1.0 per cent nationally this year before rebounding. Monetary policy is forecast to be expansionary. While tariffs are inflationary and monetary policy as a tool is limited, we expect deterioration in the economy to lead to interest rate cuts to smooth the transition for households and businesses. The Bank's policy rate is forecast to fall to 2.00 per cent by the end of the year despite higher short-term inflation before moving higher in 2026.

Global recession risks are also higher.

U.S. Liberation Day, which spared Canada, slammed the global economy hard with huge tariffs on countries (and outposts) across the globe. As noted elsewhere, these were less retaliatory and tied to trade deficits. Severe tariffs likely slow economic growth but also drive global inflation higher, particularly as major economies retaliate. There is evidence of this occurring already. Ontario could benefit on a relative basis especially if tariffs ease in North America, but this is from a shrinking pie of economic activity.

This forecast has Ontario's economy growing at 0.8 per cent in 2025, which is below the Canadian pace of 1.0 per cent. However, growth is driven largely by a stronger hand off in Q4 and early-year momentum which is expected to deteriorate during the middle quarters before growth turns modestly positive at 1.5 and 1.7 per cent in 2026 and 2027. The labour market moves in tandem with GDP growth, while the unemployment averages close to seven per cent.

Ontario underperforms the national economy due to higher exposure to tariffs through high export share to the U.S., vehicle and steel production, and minimal energy exports which are tariffed at a lower rate. Parts exports could also be impacted going forward, but for now are exempt if USMCA compliant. Broadly, tariff effects will likely decline as more firms move towards USMCA compliance to reduce or eliminate tariffs on goods.

Ontario has elevated U.S. export share, but CUSMA could shelter many sectors

Source: Statistics Canada, Central 1

Work by the Canadian Chamber of Commerce points to metro areas with high vulnerability to the tariffs based on export intensity to the U.S. and as a share of their local economies. Ontario takes five of top ten spots, with high exposure in Windsor, Kitchener-Cambridge-Waterloo, Guelph and Hamilton – unsurprisingly, heavily connected to the auto sector and steel. The latter already faces a 25 per cent tariff, with the former also facing the same, although we do anticipate relief via USMCA, and other exemptions. Provincially, 77 per cent of Ontario international goods exports are shipped to the U.S., second only to Alberta (where energy is tariffed lower) and New Brunswick. More than 30 per cent of U.S. bound exports are motor vehicle and parts. Exports are forecast to fall 1.0 per cent this year but contingent on carveouts, exemptions and relaxation of measures. Export risk is to the downside. A deterioration in exports, trade disruptions and persistence of economic threats will continue to hamper business confidence, which is forecast to reduce machinery and equipment spending by 4 per cent this year.

Consumer spending growth is forecast to slow to about 1.3 per cent for the next two years. Economic weakness and slower job growth contribute to the deceleration. Population growth is forecast to come in at about 0.5 per cent per year due largely to federal measures to reduce temporary residents. This should hit the Ontario student-segment hard, but we also anticipate an uptick in asylum seekers to Canada reflecting more hardline U.S. immigration policies that could impact inflows to Canada. Government spending is forecast to continue to rise near two per cent marking impacts of fiscal response to the tariff environment and measures to support hard hit sectors.

Ontario's housing market remains sluggish as weaker consumer confidence, economic risk, and excess inventory continues to hold back sales activity despite underlying shortages and lower interest rates. Home sales fall eight per cent this year before a stronger rebound in 2026 of 15 per cent. Levels remain modest even with the rebound, while home prices fall 3 per cent before recovering in part next year. Weak housing markets will be temporary as underlying demand remains supported while long-term supply is held back by low housing starts. Starts fall to 65,000 units this year from 74,500 in 2024 before rising in 2026 and 2027. Residential construction investment falls 1.8 per cent this year.

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Ontario Key Indicators, % change

Indicator	2023	2024	2025	2026	2027
Nominal GDP	5.4	5.5	3.5	4.0	4.0
Real GDP	1.7	1.5	0.8	1.5	1.7
Household consumption	1.5	2.0	1.3	1.3	1.5
Durables	2.4	2.3	2.0	2.0	1.5
Non-durables	-6.7	-2.0	1.0	4.0	5.0
Services	1.9	2.8	-1.8	1.5	2.0
Government consumption	5.1	3.0	0.0	1.1	2.0
Investment	-1.9	3.0	-4.0	1.5	3.0
Residential	-5.8	1.0	2.5	1.0	2.0
Non-Residential	4.4	-1.0	-1.0	1.7	2.0
Construction	0.7	-1.5	-0.8	1.4	2.0
M&E	-1.9	3.0	-4.0	1.5	3.0
Government Investment	-5.8	1.0	2.5	1.0	2.0
Exports	4.4	-1.0	-1.0	1.7	2.0
Imports	0.7	-1.5	-0.8	1.4	2.0
Employment	3.1	1.7	1.1	1.0	1.7
Unemployment Rate	5.6	7.0	7.2	6.5	6.3
Population Growth	3.2	3.2	0.6	0.4	1.0
CPI	3.8	2.4	2.7	2.1	2.0
Housing Starts	89,300	74,573	65,000	75,000	95,000
CREA MLS Sales	168304	173425	159,551	183,484	192,658
	-12.4	3.0	-8.0	15.0	5.0
CREA Average Price	876519	872931	846,743	872,145	907,031
	-6.4	0.4	-3.0	3.0	4.0

Source, Statistics Canada, CREA, Central 1