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That was close: Canada looks set to dodge a recession

Economic outlook | April 2024

Introduction

The good news about Canada's recent economic performance is that the economy ended 2023 with better-than-expected growth, the labour market has held up into 2024, and population growth remains robust. The less-good news is that a number of worrisome trends continue to weigh on the economy: sticky underlying inflation, a rising number of business insolvencies, increasing household mortgage delinquencies, slowing export growth, declining productivity, and soft investment intentions.

Against this backdrop, we remain cautious about the near-term outlook. But based on its current trajectory, Canada appears likely to skirt a recession and even seems poised to begin recovering from its current slump in the second half of this year.

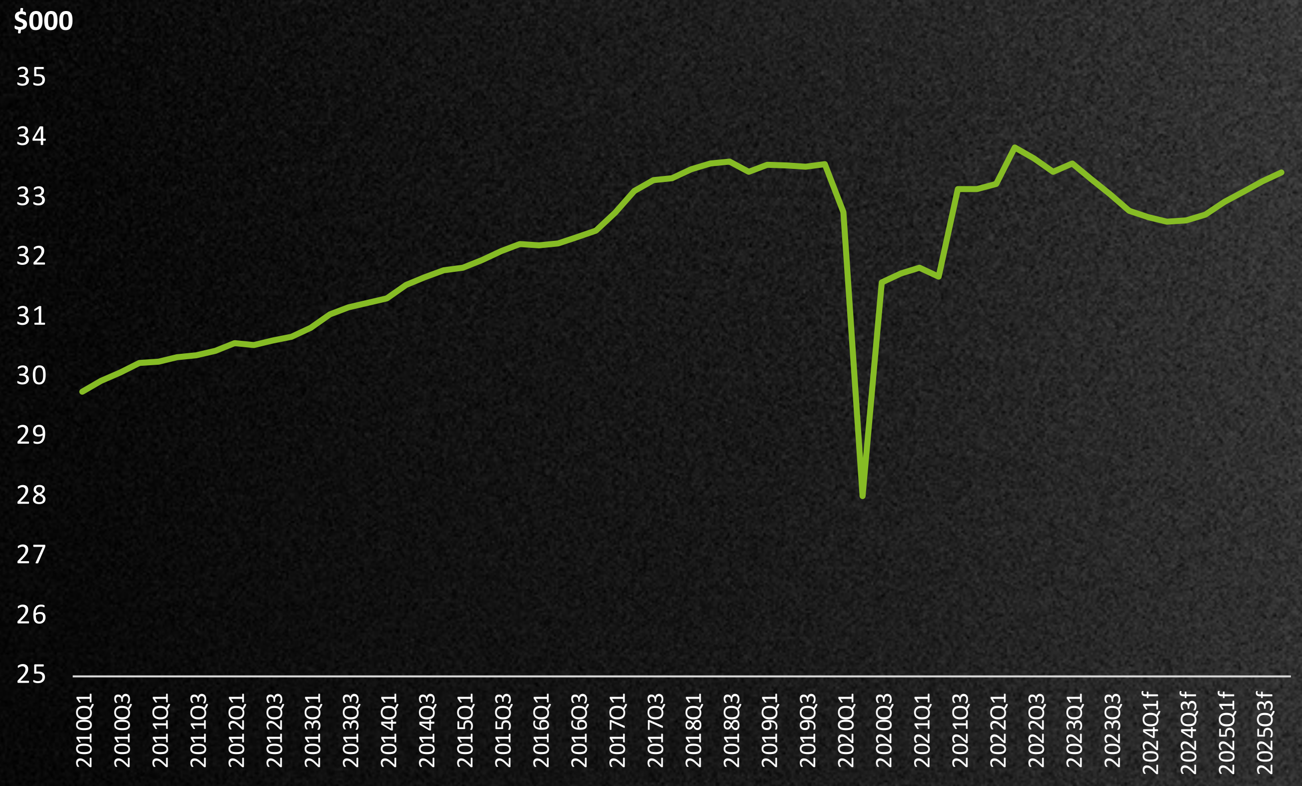
A few key assumptions underpin our forecast, including robust GDP growth in the United States, a continued deceleration in inflationary pressures, interest rate cuts by the Bank of Canada expected to begin in June, and a steady flow of newcomers to Canada to support domestic demand for goods and services.

The US economy's strength in recent months has been broad-based, with strong growth in all subcategories of GDP. We expect that strength to moderate a bit in the coming months, but the story is generally positive. Consumer spending, investment, and government spending will all grow by at least 2% in 2024, while exports will increase by more than 4%. Job growth is expected to slow, however, since current levels of job creation are not sustainable given an aging population and slow population growth. Overall, despite an expected slowdown in the coming quarters, we expect the US economy to post real growth of 2.4% this year and 1.4% in 2025.

Introduction

Here at home, after one of the most rapid monetary tightening campaigns in decades, inflation is finally within the Bank of Canada's target range. Weak demand, which is keeping real GDP growth below its potential, is expected to continue keeping inflation on a slow but steady downward track until it returns to the 2% target. Despite this, the Bank is taking a cautious approach to reducing short-term interest rates, with the first cut now expected in June. As interest rates are reduced through this year and next, the cost to service debt loads will ease, resulting in firmer household spending and a revival in business investment that will propel an economic recovery. Finally, continued strong population growth will provide additional support, paving the way for real spending per person to return to pre-pandemic levels.

Figure 1: Real household consumer spending per person (2017 dollars)



f = forecast
Sources: Statistics Canada, Deloitte

Introduction

While the positive factors will enable stronger growth toward the end of 2024, the negative ones will weigh on Canada's near-term economic prospects. On the household front, consumers continue to struggle with the dual impacts of persistent inflation and high interest rates. Statistics Canada data from the fourth quarter of 2023 shows that obligated debt payments are now consuming 15% of household incomes because mortgage interest payments have nearly doubled since the start of 2022. Further, Equifax Canada reported a worrying uptick in missed mortgage and credit payments in the fourth quarter of 2023.[1] According to the credit reporting agency, the year-over-year mortgage delinquency rate increased 135.2% in Ontario and 62.2% in British Columbia, the two most indebted provinces in the country. This pressure on household budgets will continue to build in the coming months as more households renew their mortgages at higher rates.

Businesses are also buckling under the strain of high interest rates, with insolvencies up by more than 41% in 2023 and 129.3% year over year in January.[2] These cash-cautious businesses are facing weak demand, high credit costs, and pressure to increase wages. Against this backdrop, it's unsurprising that investment intentions have decelerated sharply on the heels of last year's outright decline.

Overall, Canada's economy is likely to remain stuck in neutral in the first half of this year, squeaking out gains of below 1% at annual rates per quarter. This will limit real GDP growth to 1% this year despite better economic fortunes expected toward the end of the year when the recovery accelerates thanks to lower interest rates and inflation. We then expect the economy to grow 2.9% in 2025.

[1] The Canadian Press, "Equifax says mortgage-holder in B.C., Ontario, increasingly missed payments during Q4," CBC News, March 5, 2024.
[2] The Canadian Press, "Canadian business insolvencies more than double in January, led by bankruptcies," CTV News, March 5, 2024.

Fiscal and monetary policy

Fiscal and monetary policy

Central to our outlook is how inflation evolves over the coming months and, therefore, monetary policy, since the recovery is contingent on a reduction in the Bank of Canada's key policy rate. The good news is that measures to cool inflation have made significant progress, with the inflation rate slowing to 2.8% this February, a hair lower than January (2.9%) and a far cry from its peak above 8% in June 2022. That being said, the factors that are keeping inflation elevated are not likely to reverse in the near term. Housing costs remain the biggest headwind as Canadians renew their mortgages at higher rates. Mortgage holders aren't the only ones feeling the squeeze, though—higher costs are being passed through to renters, too. Further, wage pressures continue to run well above inflation without any commensurate increase in productivity, and that is driving up unit labour costs for businesses and making it difficult to contain inflation.

The result is that the Bank of Canada has maintained its policy rate at 5% since July 2023, recently noting that more downward movements in core measures and underlying inflation are needed before it makes any cuts. Our forecast is that inflation pressures will continue to ease this year, albeit at a gradual pace and coupled with relatively flat economic growth. The Bank will likely be in position to start making cuts in June. Overall, we forecast a total 75 basis-point reduction in the Bank's policy rate by the end of 2024, with the overnight rate landing at its neutral rate of 2.75% a year later.

Fiscal and monetary policy

One factor holding back progress on the inflation front is that fiscal policy is working at odds with monetary policy. Last year, real government consumption and investment grew at nearly double the pace of the overall economy. Given that the federal and collective provincial/territorial governments are facing substantive budgetary shortfalls, continuing to grow their spending faster than the overall economy is not sustainable. As such, we expect to see real government spending growth slow to the pace of economic growth this year and then fall below GDP growth in 2025. Despite this relative restraint, we don't expect the federal or collective provincial balance to return to surplus this decade.

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Households and businesses

Households

One area of the Canadian economy that has held up remarkably well is the labour market. This could reflect employment acting as a lagging indicator and/or the reluctance of companies to lay off the staff that was so difficult to hire as we emerged from the COVID-19 pandemic. The continued job growth we're seeing likely reflects a bit of both factors. However, given the current economic softness, we predict that employment gains will slow sharply this year. With population growth remaining robust, the softening in job gains will push the unemployment rate above 6% in the second quarter of the year. The unemployment rate is expected to trend upward for the better half of 2024, peaking in the third quarter and reversing course in 2025 as the recovery begins.

Wage growth remains robust and is expected to hover around 5% in the first quarter before decelerating as the unemployment rate rises. After averaging 4.9% in 2023 as workers in a relatively tight labour market fought for raises during a period of high inflation, average weekly wages are expected to ease to a year-over-year pace of 2.9% by the fourth quarter of this year.

Canada's population continues to grow at eye-popping levels, up 1.25 million over the past year as of the fourth quarter of 2023. Nevertheless, **real consumer spending** remains weak. To appreciate this, it's necessary to look at spending in per capita terms. Last year, real consumer spending per person fell by 1.1%, faster than the 0.9% drop observed in 2009 when the global economy was in recession due to the worldwide financial crisis. While labour markets have remained favourable emerging from the latest disruptive global event—the pandemic—the fact remains that high inflation and higher debt-servicing costs are constraining the ability of households to spend.

Households

Will that change soon? The good news is that the pain of the recent inflation adjustment is largely behind us and, even with a moderation in employment growth, real household disposable income should gain 2.7% this year. That's up from the modest 1.8% growth last year. The less-good news in the near term is debt-servicing: as of the fourth quarter of 2023, the share of disposable income that Canadian households paid to service their debt reached 15%, up 0.5 percentage points on a year-over-year basis. While that might not sound like a lot, household disposable income was valued at $1.6 trillion in the fourth quarter—so 0.5% means that compared to last year, households collectively have $8.2 billion less to spend and save.

With interest rate relief expected a bit later than in our previous forecast, household spending on goods and services will remain modest over the first half of 2024. This will leave real consumer spending with growth of just 1.3% this year, down from 1.7% last year. Next year should be much better as interest rates come down, the economy picks up, and pent-up demand is unleashed, letting households increase their inflation-adjusted spending by 3.2%.

One sector particularly susceptible to interest rate changes is **residential investment**. The resale housing market accelerated sharply soon after the pandemic hit as a desire for more space, strong income growth, and rock-bottom interest rates fuelled demand. However, appetite for existing homes cratered when interest rates began to rise and, between the first quarter of 2022 and the final quarter of 2023, real ownership transfer costs (the economic accounts measure of resale market transactions) fell by a staggering 38%. Renovation activity was similarly impacted but the scale of the decline was not as pronounced.

After what was certainly a rough ride over the last two years, better times are ahead, spurred by demand that has been accumulating since monetary tightening began. However, that will have to wait until the market gets clearer signs from the Bank of Canada that interest rate relief is coming. We don't think the market will have to wait too long, with the resale market expected to pick up next quarter.

Households

The new-home construction market is also having a rough patch. It's facing a cyclical downturn as uncertain demand, high interest rates, and elevated material costs impact the willingness of real estate developers to build new homes. On the buyers' side, demand is accumulating as surging population growth boosts the number of households in the country, but high ownership costs–reflecting mortgage rates and purchase prices–are holding many on the sidelines. Against this backdrop, new-home construction has fallen on a year-over-year basis for the past five quarters and is expected to remain under pressure in the near term. Conditions are expected to improve before year-end.

Structural demand for housing is determined by new household formation, so Canada's recent population boom is leading to demand for new homes. As interest rates come down and confidence in the housing market returns, we expect to see new-home construction increase from 244,000 units in the first quarter of 2024 to 260,000 units by the last quarter of 2025.

Demand is accumulating as surging population growth boosts the number of households.

Businesses

Business investment continues to fall at a worrying pace. Real non-residential business investment contracted by 7.7% in the final quarter of last year following a 13.9% slump in the third quarter. A major factor in this decline was the drop in engineering structures investment (-15.1%), likely due to the near completion of major projects such as the LNG Canada terminal in British Columbia. Investment in machinery and equipment also took a hit, dropping by 5.6%, primarily due to a reduction in capital spending on aircraft and other transportation equipment.

Among other factors, elevated interest rates are likely to limit the recovery in business investment this year. According to the Statistics Canada 2024 capital investment intentions survey, nominal (not adjusted for inflation) business capital expenditures on construction and machinery and equipment are expected to expand by 3.9% in 2024, much slower compared to the strong growth seen over the 2021-2022 period.

Weak investment intentions are hardly surprising given the persistent high interest rates that are weakening the economy and eroding business confidence. According to the Bank of Canada's latest Business Outlook Survey, businesses are increasingly concerned about uncertain economic conditions, cost pressures, and softer sales.[3] The share of organizations reporting a decline in sales in the past year has been creeping up since the beginning of 2023 to stand above pre-pandemic levels. To cope with softer demand and tighter credit conditions, businesses are increasingly delaying their investment plans, focusing more on maintenance and repair rather than expanding operations.

[3] Bank of Canada, Business Outlook Survey—Fourth Quarter of 2023, January 15, 2024.

Businesses

One bright spot is the strong growth in transportation equipment manufacturing, which is projected to double this year. This is primarily because of several large-scale electric vehicle (EV) battery manufacturing facilities, notably the $7-billion Volkswagen plant in Ontario and the $7-billion Northvolt battery plant in Quebec. In addition, several large hydrogen projects are expected to ramp up in Canada this year, including the $15-billion Nujoi’qonik project and the $8-billion EverWind Burin Peninsula Green Fuels project in Newfoundland and Labrador, and the $6-billion EverWind Point Tupper Green Hydrogen/Ammonia project in Nova Scotia. These investments will be partially offset by a drop of over 40% (in real terms) in pipeline investments as work wraps on Coastal GasLink and the Trans Mountain expansion, as noted earlier.

With the completion of those energy projects, improving domestic demand, and lower interest rates, the outlook is more positive for 2025. Overall, after increasing by 1.2% this year, real non-residential investment is poised to gain 4.1% in 2025.

On the **trade front**, the expected slowdown in US economic growth will create headwinds for Canada's export sector. Our forecast calls for a sharp slowdown in consumer spending south of the border for the next few quarters, since pandemic savings have largely been depleted and the impact of past interest-rate increases finally work their way through the economy. Indeed, we’re starting to see the lagged effect in the delinquency rates on consumer loans, now at their highest in over a decade. Given the slowdown in domestic demand in the United States, we expect to see only modest demand for Canadian goods this year.

Businesses

In addition, we anticipate agricultural exports will remain subdued because the majority of field crops experienced a considerable reduction in stock levels year over year. That is largely the result of adverse weather conditions in Western Canada, which resulted in a marked decrease in yields.[4] According to the federal government's Outlook for Principal Field Crops, though, agricultural exports are expected to recover during the 2024-2025 crop year, so the softness is anticipated to be confined to the near term.

One sector set to benefit in 2024 is the oil industry. The completion of the Trans Mountain expansion pipeline project will add to export capacity and drive an uptick in oil drilling.

Imports are expected to face challenges in the first part of the year due to weak consumer and business spending, with modest outlooks for consumption along with machinery and equipment investment exerting downward pressure on imports. However, an anticipated easing of monetary policy is likely to stimulate consumption and investment demand, leading to an acceleration in import growth. Overall, imports are expected to decline more than exports this year and therefore result in the trade sector contributing to GDP, although it will be modest compared to the gain last year.

[4] Government of Canada, Canada: Outlook for Principal Field Crops, 2024-02-16, February 16, 2024.

Provincial forecast

Provincial forecast

Newfoundland and Labrador was the only economy in Canada to experience a recession last year, but the outlook is brighter for 2024. Production resumed at the Terra Nova oil field at the end of 2023 and an anticipated return of the SeaRose floating vessel in Q3 should provide a boost to the province's oil production this year. Additional support to economic growth is the budding green hydrogen industry. Overall, real GDP in Newfoundland and Labrador is forecast to increase by 1.2% this year and 2.3% next year.

Provincial real GDP forecast (% change)

	2023f	2024f	2025f	2026f
Newfoundland and Labrador	-0.5%	1.2%	2.3%	0.8%
Prince Edward Island	1.8%	2.1%	2.8%	3.0%
Nova Scotia	1.5%	1.2%	2.8%	2.1%
New Brunswick	1.0%	0.9%	2.6%	1.9%
Quebec	0.3%	0.5%	2.4%	1.9%
Ontario	1.2%	0.8%	3.0%	2.5%
Manitoba	1.5%	0.9%	3.0%	3.2%
Saskatchewan	1.7%	1.4%	3.1%	3.6%
Alberta	2.1%	1.4%	3.2%	2.6%
British Columbia	1.1%	0.5%	2.9%	2.9%

f = forecast
Sources: Statistics Canada, Deloitte

Provincial forecast

Robust population growth and easing inflationary pressures are expected to support another solid year for household spending in Prince Edward Island. The continued inflow of immigrants to the province is expected to help ease labour shortages, particularly in the construction industry. With a forecasted growth rate of 2.1%, it's projected to top the provincial growth ranking this year. An easing of interest rates in the second half of 2024 and into 2025 will underpin growth in the island's important tourism and construction sectors, helping the economy grow by 2.8% next year.

The household sector, supported by above-historical population growth, and an expected upturn in capital expenditures related to projects such as the Michelin expansion and EverWind hydrogen project, are likely to be the dominant economic trends in **Nova Scotia** this year, helping the province post growth of 1.2% in 2024. A continued easing of inflation and expected lower interest rates next year will propel growth of 2.8% in the province in 2025.

Like other Maritime provinces, population growth has been robust in **New Brunswick**. Consumers here are less indebted than the national average and the household sector (consumption and residential investment) has held up comparatively well, positive trends that will continue in the near term. On the downside, New Brunswick's export sector relies on the United States, and with growth expected to gradually slow south of the border this year, the province is expected to feel the pinch. Overall, we forecast that New Brunswick's economy will grow by 0.9% this year and 2.6% in 2025.

Provincial forecast

The outlook for Quebec shows that weak gains in the household sector will be partially offset by strength in business investment. Its population growth continues to be the weakest in the country and without the economic injection from newcomers, we're seeing a more pronounced impact on consumer and residential investment related to high interest rates and inflation. The news is not all bad, however—non-residential investment is expected to increase this year. Sweden's Northvolt is set to build an EV battery plant in the province, marking the company's first venture outside Europe. To be built on a 170-hectare property near Montreal, this $7-billion project is the largest private investment in Quebec's history. Additionally, Rio Tinto has announced plans to invest $1.1 billion in expanding its lower-carbon aluminum smelter, Complexe Jonquière. With these two projects supporting growth, we expect to see real GDP increase by 0.5% in Quebec this year before it accelerates to a 2.4% pace in 2025.

A similar story is unfolding in **Ontario**, where strength in business investment is helping to offset weaker household spending. Households here are the second-most indebted in the country, so they're feeling the impact of higher interest rates—for example, mortgage delinquencies were up 135.2% year over year in the fourth quarter of 2023. Solid population growth is providing some relief to consumer-focused sectors but the outlook for 2024 remains weak. On the bright side, there's a lineup of new investments in the province's EV battery industry, including the Volkswagen EV battery plant, NextStar Energy battery plant (Stellantis and LG Energy Solution), and the Umicore facility. Strength in manufacturing investment will help the province grow at roughly the same pace as the national average this year before growth accelerates to a 3% pace next year.

Provincial forecast

Manitoba is positioned to experience moderate growth in the coming years, with slow growth in 2024 before picking up next year. Key developments on its ledger include the proposed expansion of Tanco Mine's lithium mining operation, currently the primary provider of lithium in the country, to supply the production of EV batteries, and exploration for other critical minerals. Mining has a better outlook than agriculture, a more traditional crop for the province: based on seeding intentions for barley, soybeans, and wheat, it looks like it will be another tough year for crop production, which will temper real GDP growth to 0.9%. Next year, an expected rebound in agriculture and interest rate relief will help push growth in Manitoba's economy up to 3%.

Moving westward, the economy of **Saskatchewan** is poised for relatively strong performance this year compared to that of the rest of the country. We're seeing strong investment in the province, driven by sizable investments in its potash industry. Couple this strength with solid population gains and relatively low household debt burdens, and Saskatchewan's economy is set to grow 1.4% this year and 3.1% next year. However, as we've seen in recent years, its economy is sensitive to fluctuations in resource production and prices. The possibility of weaker prices for potash, uranium, or oil and the potential for another hot, dry growing season are downside risks to the forecast.

Provincial forecast

Alberta's economy is doing well, thanks in part to a surge in population that has supported sustained employment growth and driven demand for residential investment. Combined with strong oil production, its economy is poised to be second in the provincial economic growth rankings this year before it tops the list in 2025, with real GDP growth of 1.4% and 3.2% respectively. Growth would be stronger this year if it weren't for the weakness on the investment front as work wraps on major projects such as the Trans Mountain expansion project. Indeed, the recent capital and repair expenditure survey by Statistics Canada flagged Alberta as one of the few provinces (along with British Columbia and New Brunswick) expecting a decline in nominal investment spending in 2024.

Households in **British Columbia** have the highest debt levels in the nation, which is reflected in our forecast for relatively subdued economic growth in 2024. A downturn in investment will add to the pain, with Statistics Canada's recent capital intentions survey pointing to a 5.4% decline in total investment spending in British Columbia this year; the worst showing among provinces. The good news is that the economic adjustment is expected to be short-lived—the anticipated lower interest rates will provide relief to BC homeowners and businesses starting in the second half of 2024. After posting growth of just 0.5% this year, the second-weakest in Canada, growth should rebound to a 2.9% pace in 2025.

Final thoughts

Final thoughts

Despite the challenge of high debt loads in an elevated interest rate environment, the Canadian economy looks set to achieve the somewhat elusive soft landing, one where it avoids a recession while inflation returns to target. But we're not yet out of the woods. Many homeowners still have to renew their mortgages at higher rates, and already we're seeing delinquencies rise. Our productivity performance remains anemic and business investment is waning, both of which create downside risk to the country's economic outlook in the near term. At least risks this time are not all on the downside; strong population growth is creating pent-up demand for both housing and consumer goods and services.

As it becomes increasingly clear that Canada's economy will avoid a recession and that interest rate cuts are on the horizon, we may see spending increase at a faster pace than predicted in this outlook. Overall, it seems the economic slump we've found ourselves in for much of the past year is slowly coming to an end—and we can look forward to better economic conditions by the second half of 2024.

Key economic indicators

	2023				2024				2023	2024f	2025f
	Q1	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f			
Real economic activity											
Gross domestic product	2.6	0.6	-0.5	1.0	0.4	0.8	2.6	3.8	1.1	1.0	2.9
Household consumption expenditure	4.1	-0.7	0.5	1.0	1.3	1.4	2.4	3.1	1.7	1.3	3.2
• Durable goods	3.8	-3.0	4.2	7.0	-1.5	-0.6	0.5	1.6	2.3	1.3	1.7
• Services	5.3	-1.4	2.4	0.4	3.0	2.5	3.1	3.5	2.6	2.1	3.4
Residential investment	-14.0	-3.5	8.7	-1.7	-0.4	3.4	4.6	6.6	-10.2	2.0	6.8
Non-residential fixed investment	1.8	15.0	-16.3	-9.5	3.2	7.8	9.4	9.3	-0.7	0.6	4.1
• Non-residential structures	3.4	10.6	-14.3	-11.6	2.3	5.7	5.1	7.1	2.6	-1.0	3.0
• Machinery & equipment	-0.8	23.3	-19.8	-5.7	4.7	11.3	16.8	12.8	-6.2	3.4	5.9
Government consumption & investment	3.5	-0.4	6.1	-1.1	-0.8	1.9	1.7	1.6	2.1	1.0	1.6
Exports of goods & services	14.1	4.3	-1.3	5.6	-6.0	-1.8	0.6	6.1	5.7	-0.3	4.1
Imports of goods & services	3.7	4.6	1.1	-1.7	-6.9	-0.5	1.0	3.3	1.0	-1.4	3.4
Prices											
Consumer price index (y/y)	5.2	3.5	3.7	3.2	2.8	2.5	2.3	2.2	3.9	2.4	2.0
Implicit GDP price index (y/y)	2.2	-0.4	1.7	3.0	3.4	2.6	1.1	0.0	1.6	1.8	1.1
Labour market											
Employment	3.9	1.8	1.7	1.9	1.7	1.2	1.5	1.9	2.4	1.6	1.9
Unemployment rate (%)	5.1	5.3	5.5	5.8	5.9	6.2	6.4	6.3	5.4	6.2	5.8

Notes: Unless otherwise noted, all figures are expressed as annualized % changes; f = forecast.
Sources: Statistics Canada; Bank of Canada. Forecast by Deloitte Economic Advisory, as of March 13, 2024.

Financial market indicators

	2023				2024				2023	2024f	2025f
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f			
Interest rates (%)											
Overnight rate target	4.50	4.75	5.00	5.00	5.00	4.75	4.50	4.25	5.00	4.25	3.00
3-month T-bill	4.48	4.65	5.11	5.08	4.95	4.91	4.63	4.39	5.08	4.39	2.89
1-year GoC bond	4.44	4.71	5.19	4.83	4.74	4.71	4.65	4.59	4.83	4.59	3.22
2-year GoC bond	3.84	4.12	4.75	4.27	4.09	3.85	3.65	3.45	4.27	3.45	2.90
5-year GoC bond	3.16	3.34	4.03	3.67	3.51	3.40	3.25	3.00	3.67	3.00	2.95
10-year GoC bond	3.03	3.08	3.70	3.56	3.42	3.40	3.30	3.25	3.56	3.25	3.25
Yield curve spread (pp)											
3-month vs. 10-year	-1.45	-1.57	-1.41	-1.52	-1.53	-1.51	-1.33	-1.14	-1.52	-1.14	0.36
2-year vs. 10-year	-0.81	-1.04	-1.05	-0.71	-0.67	-0.45	-0.35	-0.20	-0.71	-0.20	0.35
Foreign exchange											
USD/CAD (C dollars)	1.35	1.34	1.34	1.36	1.35	1.35	1.35	1.35	1.36	1.35	1.34
CAD/USD (US cents)	0.74	0.74	0.75	0.73	0.74	0.74	0.74	0.74	0.73	0.74	0.75

Notes: f = forecast. The overnight rate represents the end of the period. All other quarterly values are quarter averages. Annual figures reflect the end of the period as measured by Q4.
Sources: Statistics Canada; Bank of Canada. Forecast by Deloitte Economic Advisory, as of March 13, 2024.

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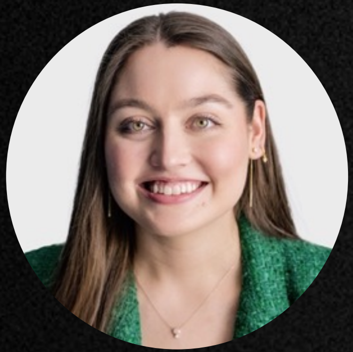

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