Monthly Economic Monitor - Canada
Economics and Strategy

NATIONAL BANK OF CANADA
FINANCIAL MARKETS

December 2024 /January 2025

Canada : Ready for landing

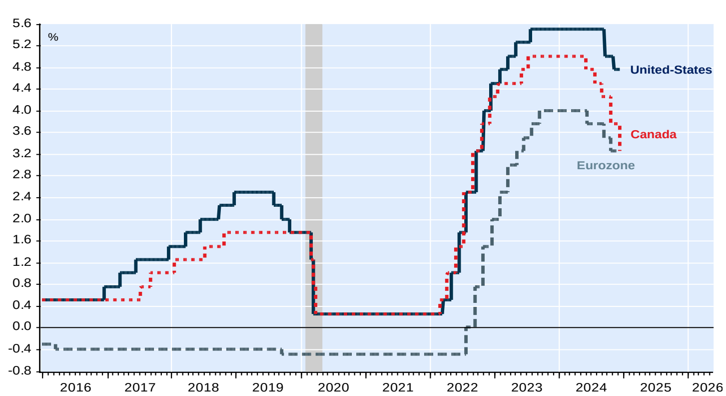
By Matthieu Arseneau and Daren King

Summary

- For the second time in a row, the central bank announced a 50 basis point cut with the aim of normalizing monetary policy. The BoC's haste contrasts with the attitude of other major central banks, and is entirely justified insofar as inflation is under control in Canada and the economy has continued to deteriorate recently. Weakness could persist for some time in an environment where inventory levels are high and the deterioration in the labour market is probably not over, as evidenced by the further decline in profits in the last quarter.
- But it's not all doom and gloom. The residential housing market has come back to life and that's good news, especially as this sector of activity often has a major indirect impact on spending on renovation and retailing. Thanks to the interest rate cuts that have been made, the conditions now appear to be in place for GDP per capita to stabilize and the unemployment rate to stop rising in the first half of 2025. In the coming months, we will therefore be able to determine whether the central bank has achieved a soft landing or whether it has inflicted more damage on the economy than was necessary in its fight against inflation.
- We expect GDP growth of 1.4% in 2025 and 1.5% in 2026, slightly higher than the 1.2% we estimate for potential economic growth, held back by a weak demographic outlook.
- Obviously, this outlook could be disrupted by an escalation in trade tensions with the United States. We remain hopeful that, in the months ahead, Canada will be able to demonstrate that it can be a key ally in the implementation of the US economic security agenda, which includes, in addition to domestic re-industrialisation, tighter border controls and the promotion of energy security.

Throughout the autumn, the Bank of Canada felt it was best to bring the policy rate closer to the range it considers neutral (2.25% to 3.25%) as quickly as possible. Indeed, after lowering it by 50 basis points in October, it repeated this action in December. The BoC's eagerness contrasts with the attitude of the other major central banks, and is entirely justified given that inflation is under control in Canada and the economy has continued to weaken recently.

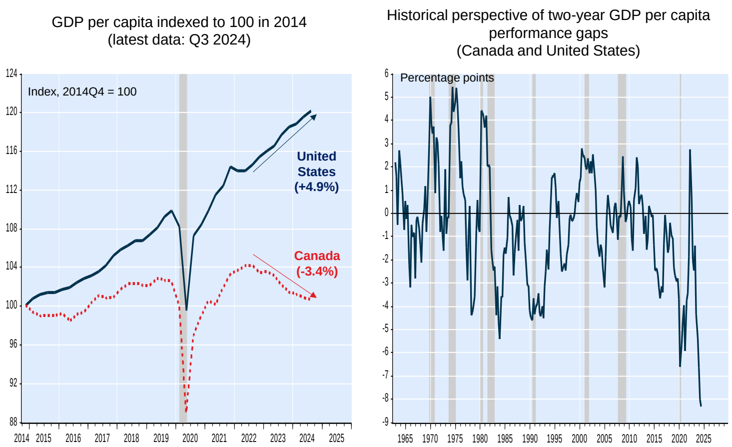
Canada: Another major cut in the policy rate in December
Central bank policy rates



NBC Economics and Strategy (data via Refinitiv)

The economy grew at an annualized rate of just 1.0% in the third quarter, well below the Bank of Canada's estimate of potential growth in 2024 (2.4%) and its forecast published in October of 1.5%. This pace was insufficient to stabilize GDP per capita, which fell for the sixth consecutive quarter in the context of a restrictive monetary policy. The cumulative fall in GDP per capita since the start of the interest rate hikes now stands at 3.4%, this is unprecedented outside of the recession. Over the same period, GDP per capita in the United States has risen by 4.9%, against the backdrop of an economy driven by public deficits four times higher than in Canada as a percentage of GDP. A performance gap of this magnitude had not been seen for more than seven decades and explains the divergences between central bankers.

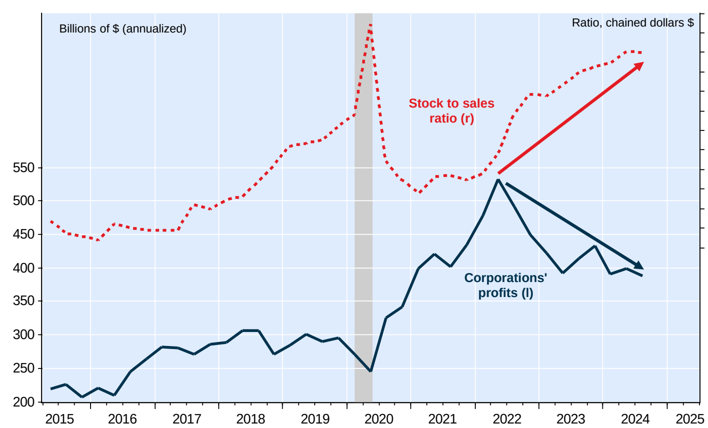
Canada: GDP per capita continues its downward trend



NBC Economics and Strategy (Data via Statistics Canada)

There was nothing to suggest that per capita GDP would recover in the final quarter of the year, given that GDP growth in September was just 0.1%, and the preliminary figure for October is similar. We have also been warning our readers for several months about the risk to growth posed by the high level of inventories. The fall in inventory investment cut growth by no less than 1.3% in the third quarter, a phenomenon that could continue into 2025. Consumption was solid in the third quarter, supported by good wage growth. However, the labour market will have to stop deteriorating for this pace to be maintained. Nothing can be taken for granted in this respect, especially given the downward trend in profits, which are at their lowest level since the fourth quarter of 2020.

Canada: Some risks remain for the economic outlook
Stock to sales ratio (total economy) and corporate profits



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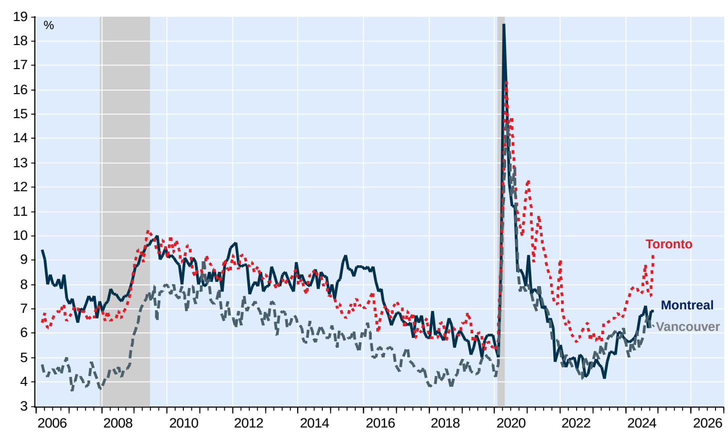
As we thought, the perception that the labour market had stabilized in September and October on the back of a slight fall in the unemployment rate was nothing more than a mirage. Indeed, after a sharp fall in the activity rate in the previous two months, which had masked the damage, there was a risk of the opposite happening, with many people returning to the search for work. This is what happened in November, leading to the sharpest rise in the unemployment rate in eight months. It now stands at 6.8%, its highest level for 38 months, and since January 2017 excluding the pandemic. In the Greater Toronto Area, the unemployment rate is a staggering 9.2%, the highest since May 2012, excluding the pandemic.

Canada: The deterioration in the GTA is staggering
Jobless rate in Toronto, Montreal and Vancouver



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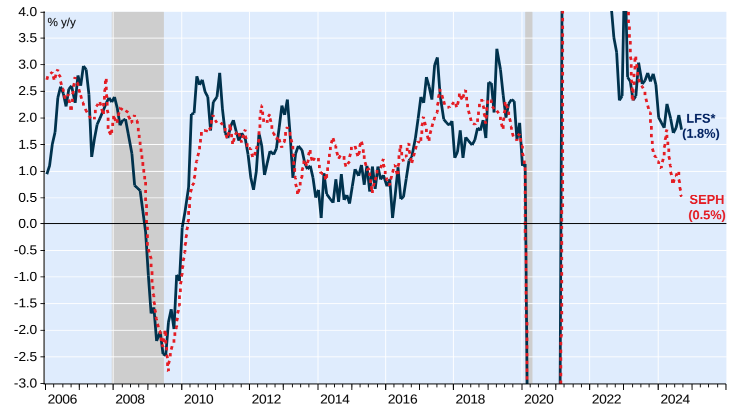
Nevertheless, some observers have described the data for November as solid, as the number of jobs created remains relatively high by historical standards. The strong growth in Canada's population continues to make it difficult for some to analyse the state of the economy. This is because, by stimulating potential growth, demographic trends have raised the bar of what constitutes good economic data. For this reason, we attach very little importance to changes in the number of jobs and prefer to focus on the measures that correct these figures for the sharp rise in population, namely the unemployment rate and the employment rate, which indicate a rapid deterioration in the labour market. But we believe there is another reason not to place too much emphasis on absolute figures. In September, Statistics Canada warned against using absolute figures from the Labour Force Survey (LFS) to assess the state of the labour market, as they are distorted by the use of 12-month moving averages to construct series for the non-permanent resident population. As these series look to the past, they do not yet reflect the slowdown in population growth observed since the Canadian government tightened immigration rules. This methodology contributes to inflating the size of the labour force and employment gains indicated by the LFS. This is shown by a comparison of the LFS results with those of the Survey of Employment, Payrolls and Hours (SEPH), a survey based on establishments rather than population estimates. The LFS shows strong year-on-year employment growth of 1.8%, while the EERH shows anaemic growth of 0.5%.

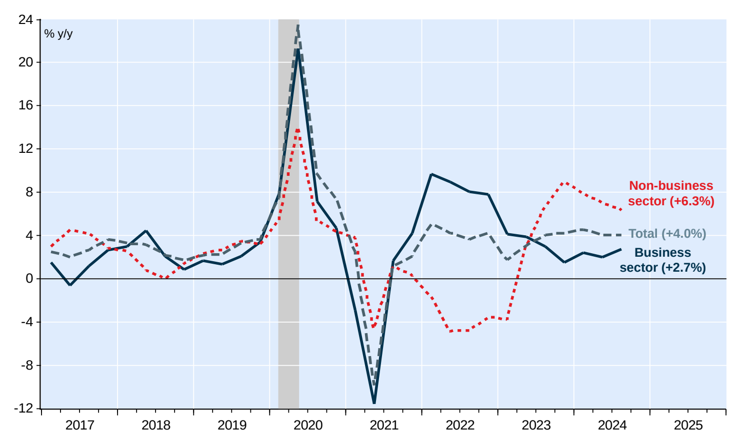
Canada: Don't be fooled by the job gains shown by the LFS survey
SEPH employment vs LFS employment (adjusted to be comparable), Last data: September 2024



* Labour force survey employment adjusted to be comparable to SEPH (Non-farm paid employee adjusted for multiple job-holders)
NBC Economics and Strategy (data via Statistics Canada)

Other observers fear that inflation will be too high, given that wage growth remains strong. We believe that these fears are exaggerated. Productivity accounts data provide a complete picture of employee compensation, including wages and benefits. It is true that hourly pay growth remains high (at 4.0%, above the average of 3.0% seen between 1999 and 2019), despite the deterioration in the labour market. However, an analysis by segment shows that this strength is concentrated among civil servants (+6.3% over the year), who have obtained compensation for past losses in purchasing power. Private sector employees, on the other hand, recorded more moderate wage growth (+2.7%), in line with the weakness of the labour market. Since most of the CPI basket is produced by private companies, this composition of wage pressures, concentrated in the public sector, should be less worrying for the central bank's inflation outlook.

Canada: Public sector keeps wage inflation high
Total compensation per hour worked



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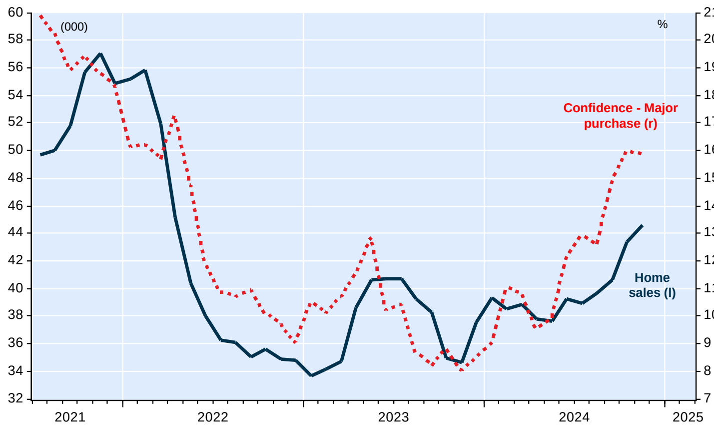
A few months ago, an upturn in activity in the housing sector would have been viewed unfavourably by the central bank, which would have kept rates restrictive for longer. In November, home sales in Canada rose for the fourth month in a row, reaching their highest level since April 2022. This was due to a growing proportion of consumers judging that now is a good time to make a major purchase, probably thanks to the interest rate cuts that have taken place since the summer.

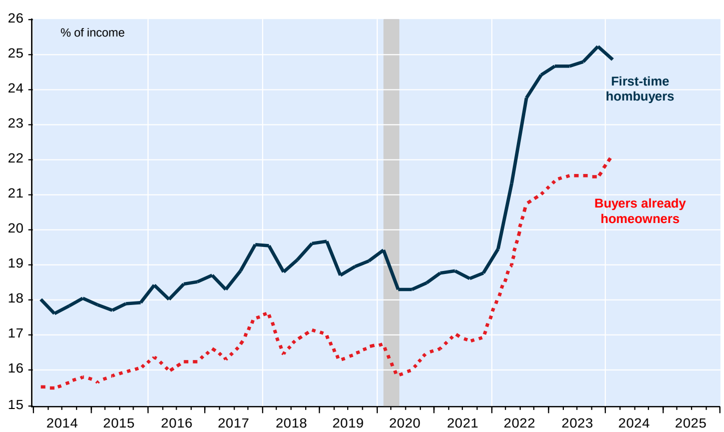
Canada: Homebuyers emerge from long hibernation
% of consumers say it's a good time to make a major purchase and home sales



NBC Economics and Strategy (data via Statistics Canada and Conference Board of Canada)

However, we do not think that the Bank of Canada is worried about this rebound, when the objective is to see the economy strengthen. This upturn could indeed contribute to the economic recovery, especially as the housing sector often has a significant indirect impact on renovation spending and retail trade. However, it should be noted that housing affordability remains an issue. With prices high and interest rates still elevated, first-time buyers have to spend a much larger proportion of their income on housing, which limits their other expenses.

Canada: First-time buyers have fewer resources
Median proportion of income spent on mortgage payments

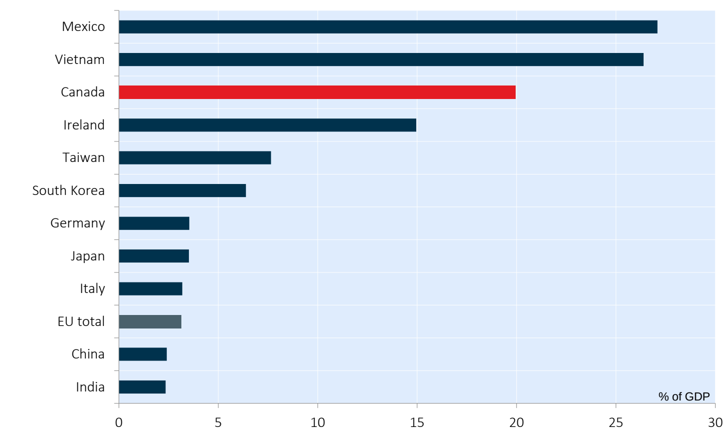


NBC Economics and Strategy (data via Bank of Canada)

Thanks to the interest rate cuts that have been made, the conditions now appear to be in place for GDP per capita to stabilize and the unemployment rate to stop rising in the first half of 2025. In the coming months, we will therefore be able to determine whether the central bank has achieved a soft landing or whether it has inflicted more damage on the economy than was necessary in its fight against inflation. The good news is that variable rate borrowers are breathing a little easier after being hit hard. According to our calculations, the savings made by these borrowers could, at a macroeconomic level, offset the payment shock faced by those who have to renew their mortgages this year. In addition, government largesse, such as the GST holiday and the $200 cheques that will be sent to Ontarians, could also stimulate consumption. We expect GDP growth of 1.4% in 2025 and 1.5% in 2026, slightly higher than the 1.2% we estimate for potential economic growth, held back by a weak demographic outlook.

Of course, these perspectives could be disrupted by escalating trade tensions with the United States, a fear exacerbated by President-elect Trump's threat to impose 25% tariffs on his two USMCA partners. While these threats are worrying, we can take some comfort from the fact that they are based primarily on border security considerations, rather than an explicit desire to favour local production in the US. We believe that a greater effort to reduce border porosity could be enough to defuse the pressure coming from Washington. These threats have already had some effect, with the federal government announcing $1.6 billion for border security in its economic update. However, uncertainty remains for Canada, which has the sixth-largest trade surplus with the United States. The economic impact of tariffs could be significant, given that goods exports to the United States account for around 20% of Canada's GDP.

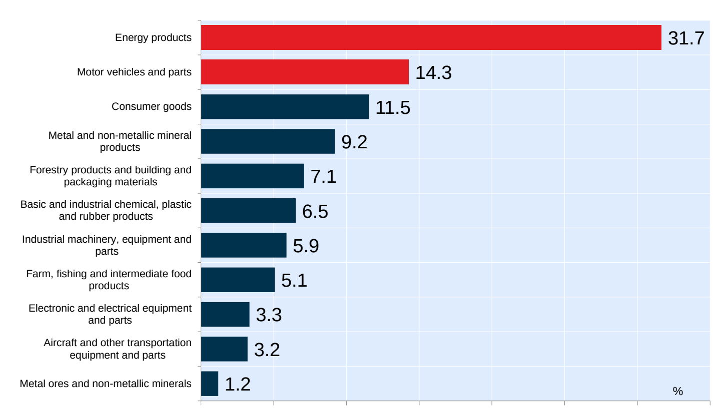
World: In Washington's crosshairs
Merchandise exports to the U.S. as a percentage of exporter GDP, as of 2023



NBC Economics and Strategy (data via the Census Bureau and the IMF)

This does not mean, however, that the US economy would not suffer the repercussions of a trade war with Canada, since US exports to Canada account for almost 7% of its GDP. What's more, the composition of Canadian exports makes us skeptical about the possibility of across-the-board tariffs. No less than 32% of Canadian exports are energy products. With 60% of its oil imports and all of its natural gas imports coming from Canada, the United States simply cannot do without this partnership if it wants to achieve energy independence in North America and maintain competitive prices to encourage local industrialization. What's more, around 14% of Canadian exports to the US are in the automotive sector, a highly integrated industry. Imposing tariffs would seriously disrupt a complex supply chain in which American producers play a dominant role. We remain hopeful that, in the months ahead, Canada will be able to demonstrate that it can be a key ally in implementing the US economic security agenda, which includes, in addition to domestic re-industrialization, tighter border controls and the promotion of energy security (Analysis by Stéfane Marion and Angelo Katsoras).

Canada: A significant share of energy products in exports
Exports by products as a proportion of total exports to the U.S., September 2024.12-month average



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Canada – Economic Forecast

*(Annual % change)**	*2022*	*2023*	*2024*	*2025*	*2026*	*Q4/Q4 2024*	*Q4/Q4 2025*	*Q4/Q4 2026*
Gross domestic product (2012 $)	4.2	1.5	1.3	1.4	1.5	1.7	1.5	1.5
Consumption	5.5	1.8	1.9	1.7	1.4	2.3	1.6	1.3
Residential construction	(10.6)	(8.5)	(1.5)	1.7	1.1	(1.4)	1.4	1.1
Business investment	6.4	1.0	(2.4)	(0.9)	2.1	(0.6)	1.4	2.5
Government expenditures	2.6	2.6	2.9	2.2	1.4	3.5	1.7	1.2
Exports	4.2	5.0	0.7	1.1	1.9	(0.5)	1.7	2.0
Imports	7.5	0.3	0.4	1.3	1.9	(0.2)	1.6	1.9
Change in inventories (millions $)	51,121	25,497	18,638	15,244	14,994	....	....	....
Domestic demand	3.3	1.1	1.5	1.6	1.5	2.1	1.6	1.4
Real disposable income	(0.3)	1.6	4.4	2.6	1.4	4.6	1.5	1.3
Employment	4.0	2.4	1.7	1.0	0.5	1.6	0.7	0.4
Unemployment rate	5.3	5.4	6.3	7.1	6.8	6.8	6.9	6.7
Inflation	6.8	3.9	2.4	1.9	2.0	1.8	2.0	2.0
Before-tax profits	17.9	(14.8)	(5.7)	(1.0)	3.8	(9.9)	0.2	4.7
Current account (bil. $)	(8.7)	(18.4)	(13.0)	(20.0)	(17.0)	....	....	....

** or as noted*

Financial Forecast**

	Current 12/18/24	*Q1 2025*	*Q2 2025*	*Q3 2025*	*Q4 2025*	*2024*	*2025*	*2026*
Overnight rate	3.25	2.75	2.50	2.25	2.25	3.25	2.25	2.75
Prime rate	5.25	4.75	4.50	4.25	4.25	5.25	4.25	4.75
3 month T-Bills	3.15	2.65	2.30	2.10	2.15	3.05	2.15	2.70
Treasury yield curve								
2-Year	3.07	2.65	2.40	2.25	2.30	2.90	2.30	2.75
5-Year	3.05	2.80	2.60	2.45	2.50	2.90	2.50	2.85
10-Year	3.23	2.95	2.80	2.65	2.65	3.10	2.65	3.00
30-Year	3.27	3.10	2.95	2.80	2.80	3.20	2.80	3.15
CAD per USD	1.43	1.45	1.42	1.39	1.38	1.41	1.38	1.36
Oil price (WTI), U.S.$	71	68	66	65	65	70	65	69

*** end of period*

Quarterly pattern

	Q1 2024 actual	*Q2 2024 actual*	*Q3 2024 forecast*	*Q4 2024 forecast*	*Q1 2025 forecast*	*Q2 2025 forecast*	*Q3 2025 forecast*	*Q4 2025 forecast*
Real GDP growth (q/q % chg. saar)	2.0	2.2	1.0	1.4	1.4	1.3	1.6	1.7
CPI (y/y % chg.)	2.8	2.7	2.0	1.8	1.8	1.8	1.8	2.0
CPI ex. food and energy (y/y % chg.)	2.9	2.8	2.5	2.0	1.9	2.1	2.2	2.4
Unemployment rate (%)	5.9	6.2	6.5	6.8	7.1	7.2	7.1	6.9

National Bank of Canada

Provincial Economic Forecast

	Real GDP (% growth) 2022	2023	2024f	2025f	2026f	Nominal GDP (% growth) 2022	2023	2024f	2025f	2026f
Newfoundland & Labrador	-1.9	-2.6	2.5	1.5	1.0	6.5	-5.5	3.4	0.2	2.4
Prince Edward Island	4.4	2.2	3.0	2.0	1.5	10.4	4.9	5.5	4.2	3.9
Nova Scotia	3.5	2.0	1.5	1.2	0.8	7.4	8.0	3.7	3.0	2.6
New Brunswick	2.0	1.6	1.3	1.1	0.7	10.4	3.2	4.1	3.0	2.9
Quebec	3.4	0.6	1.3	1.1	1.1	8.7	5.0	5.1	3.0	3.3
Ontario	4.1	1.7	1.2	1.3	1.4	9.4	5.4	4.0	3.1	3.2
Manitoba	4.2	1.7	0.8	1.3	1.5	10.8	4.5	3.1	2.9	3.1
Saskatchewan	7.2	2.3	1.0	2.2	2.4	30.4	-4.8	1.5	2.0	3.0
Alberta	6.0	2.3	2.3	2.3	2.2	24.4	-4.3	4.9	2.2	3.9
British Columbia	4.0	2.4	1.0	1.5	1.7	10.8	3.6	4.0	3.3	3.6
Canada	4.2	1.5	1.3	1.4	1.5	12.4	2.9	4.2	2.9	3.3

	Employment (% growth) 2022	2023	2024f	2025f	2026f	Unemployment rate (%) 2022	2023	2024f	2025f	2026f
Newfoundland & Labrador	4.3	1.7	2.6	0.6	0.2	11.2	9.9	10.0	10.1	9.5
Prince Edward Island	5.3	5.7	4.0	2.3	1.4	7.5	7.4	7.8	7.9	6.7
Nova Scotia	3.6	2.7	3.2	1.0	0.8	6.6	6.4	6.4	6.1	5.1
New Brunswick	2.7	3.4	3.0	0.9	0.7	7.2	6.6	7.0	7.2	6.4
Quebec	3.1	2.3	0.6	0.8	0.5	4.3	4.4	5.4	6.1	5.7
Ontario	4.6	2.4	1.6	0.9	0.4	5.6	5.7	6.9	7.8	7.6
Manitoba	3.2	2.5	2.6	1.0	0.5	4.5	4.8	5.3	6.0	5.8
Saskatchewan	3.5	1.8	2.2	1.1	0.9	4.7	4.8	5.5	6.4	6.4
Alberta	5.2	3.6	2.9	1.6	0.9	5.8	5.9	7.0	7.9	7.8
British Columbia	3.1	1.6	1.8	0.9	0.3	4.6	5.2	5.5	5.7	5.7
Canada	4.0	2.4	1.7	1.0	0.5	5.3	5.4	6.3	7.1	6.8

	Housing starts (000) 2022	2023	2024f	2025f	2026f	Consumer Price Index (% growth) 2022	2023	2024f	2025f	2026f
Newfoundland & Labrador	1.5	1.0	1.7	1.8	1.9	6.4	3.3	1.9	1.7	2.0
Prince Edward Island	1.0	0.9	1.1	1.2	1.3	8.9	2.9	2.0	2.0	2.0
Nova Scotia	5.6	7.2	7.5	8.0	8.3	7.5	4.0	2.4	2.0	2.0
New Brunswick	4.7	4.9	6.5	7.0	7.2	7.3	3.5	2.3	2.1	1.9
Quebec	58.2	39.5	47.5	50.5	53.0	6.7	4.5	2.3	1.7	2.0
Ontario	96.1	90.0	75.0	86.5	89.5	6.8	3.8	2.4	2.0	2.0
Manitoba	8.1	7.1	7.4	7.5	7.8	7.9	3.6	1.1	2.2	2.0
Saskatchewan	4.2	4.6	4.5	5.0	5.2	6.6	3.9	1.5	2.0	2.0
Alberta	36.4	35.9	48.4	49.0	50.5	6.5	3.3	2.9	2.0	2.0
British Columbia	46.7	50.6	45.9	50.0	51.0	6.9	4.0	2.6	2.0	1.9
Canada	262.5	241.7	245.5	266.5	275.7	6.8	3.9	2.4	1.9	2.0

e: estimate f: forecast

Historical data from Statistics Canada and CMHC, National Bank of Canada's forecast.

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