

Canadian economic outlook: Resilience to be tested (again) in 2020

Burlington Chamber Economic Forecast

December 3, 2019

Josh Nye | Senior Economist | (416) 974-3979 | josh.nye@rbc.com

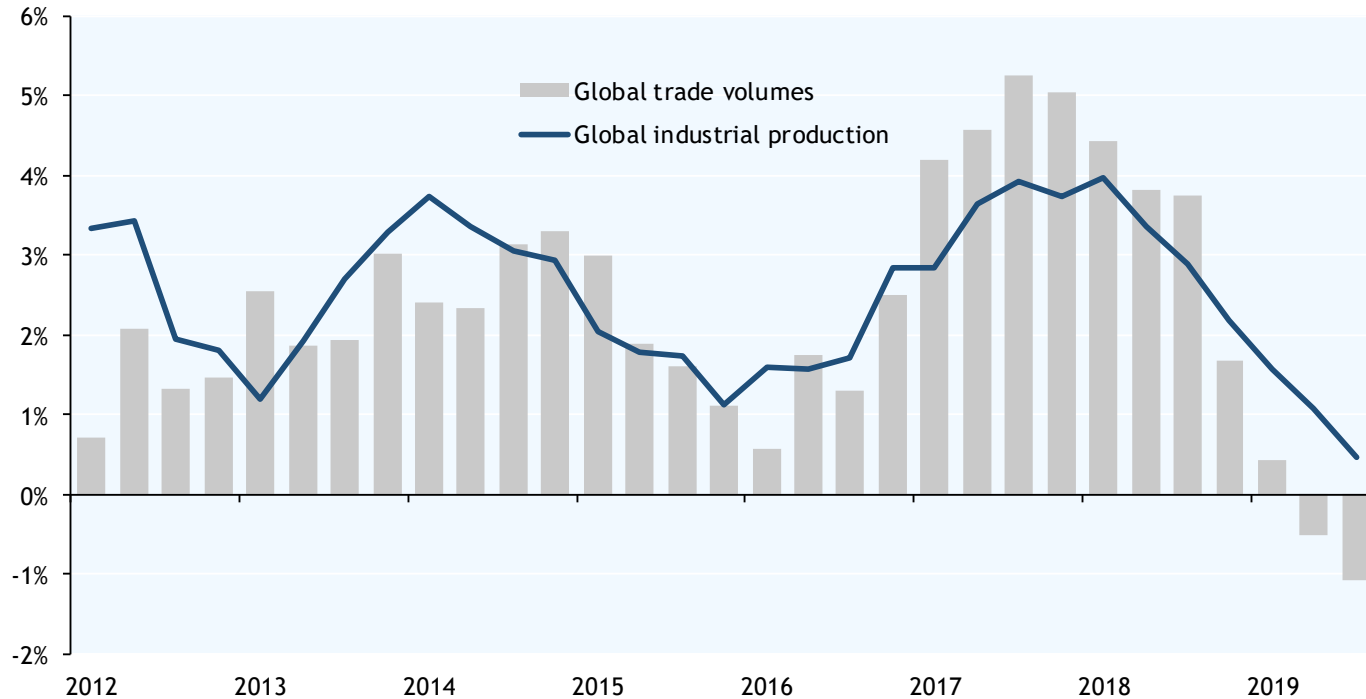
Visit our website: <http://www.rbc.com/economics/>



The global economy lost momentum in 2019, particularly in the industrial sector

Global trade and industrial production

year-over-year % change



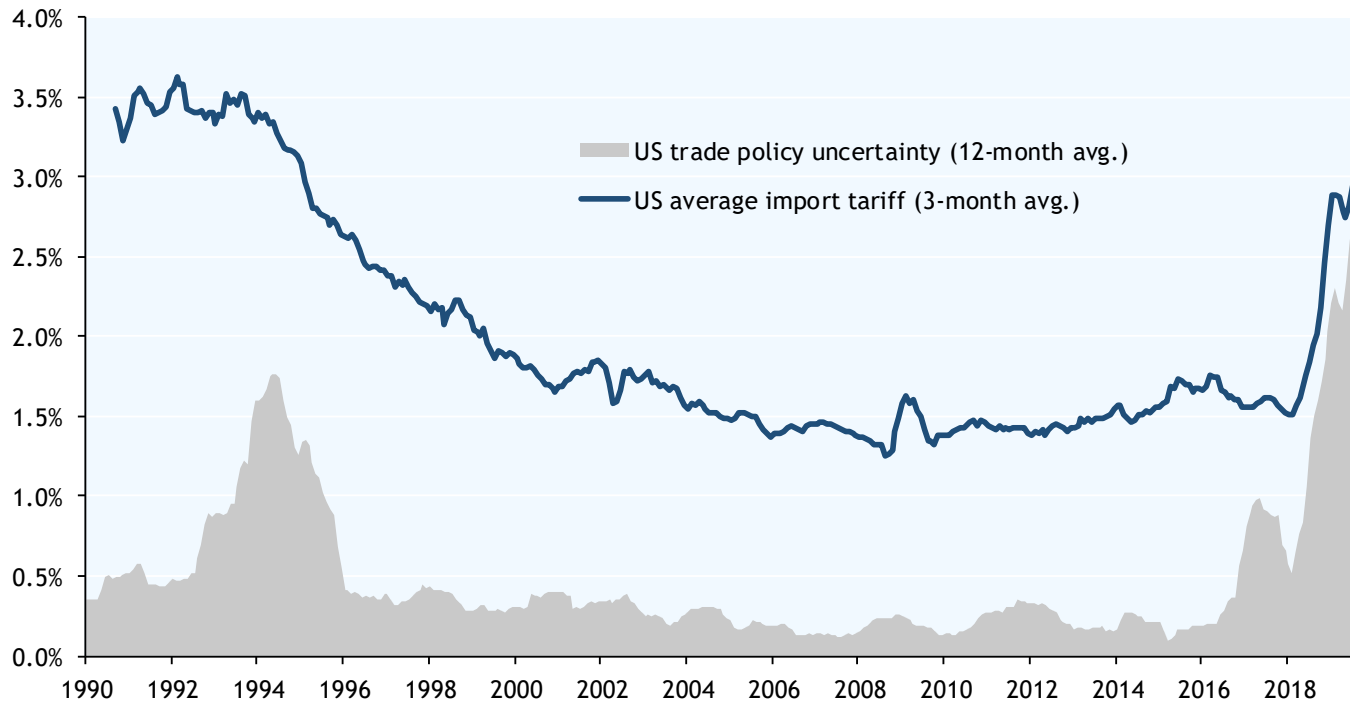
Source: Netherlands Bureau for Economic Policy Analysis, RBC Economics

- Global trade is contracting for the first time since 2008-09 (unusual outside of a recession)
- Global GDP growth is slowest in a decade (3.0% in 2019 vs. 3.7% in 2018); only modest pickup expected in 2020

Protectionist trade policies have dampened growth; a US-China trade deal would help resolve (some) uncertainty

Average US import tariff rate

customs duties as a percent of goods imports



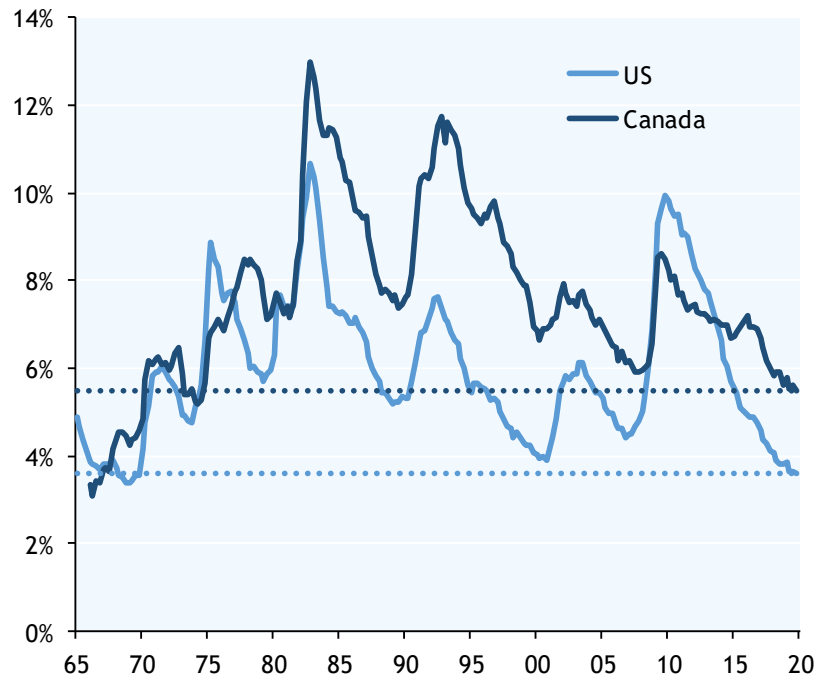
Source: US Treasury, Census Bureau, PolicyUncertainty.com, RBC Economics

- The US has raised tariffs on \$350 billion in Chinese imports; further hikes threatened but negotiations ongoing
- Uncertainty about trade policy (not just regarding China) is weighing on business sentiment and investment

Modest inflation (despite very low unemployment) is giving central banks flexibility to lower interest rates

Unemployment rate

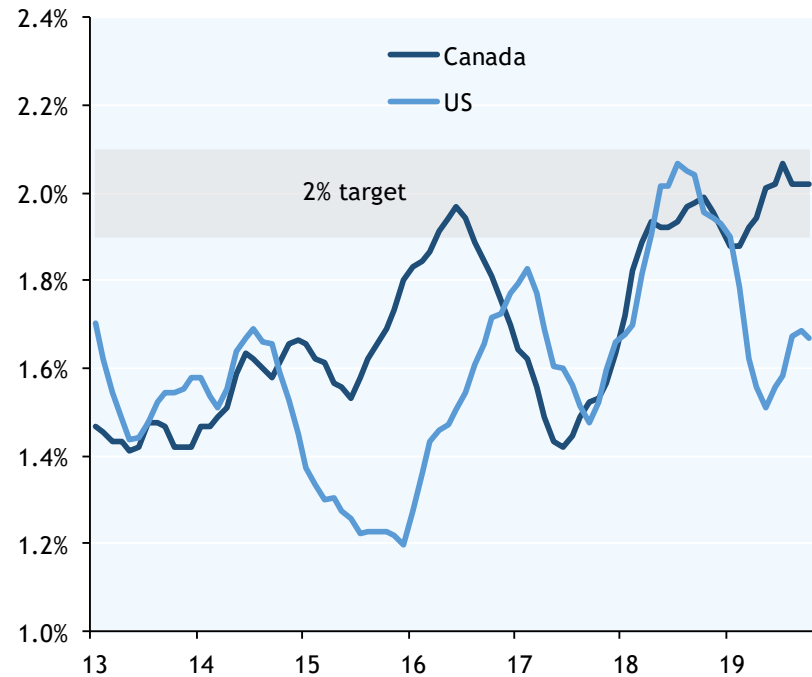
quarterly average



Source: StatCan, BEA, RBC Economics

Core inflation

year-over-year % change (3-month average)

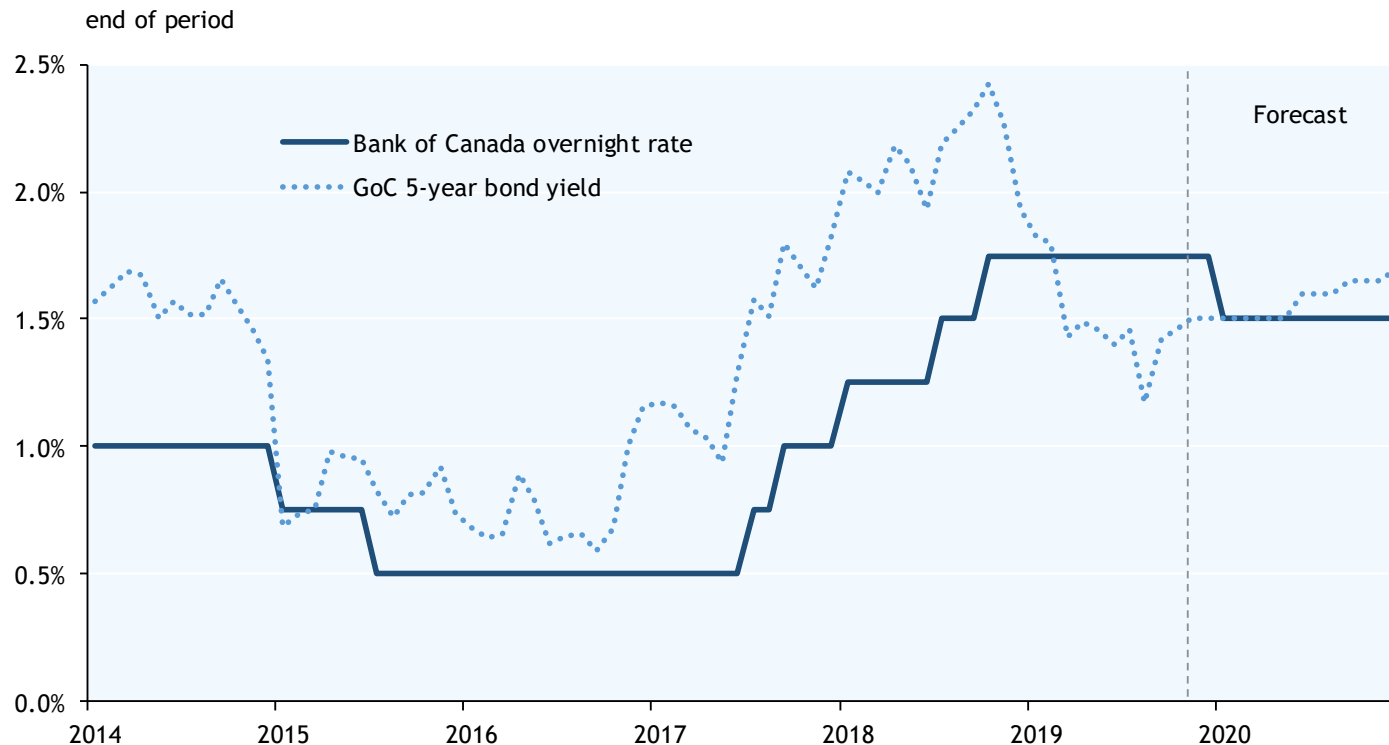


Source: StatCan, BEA, RBC Economics

- Unemployment rates in Canada and the US are the lowest in decades; firms are complaining of labour shortages
- Canadian inflation has been close to the BoC's target for nearly two years; the Fed has had less success hitting 2%

The BoC has held interest rates steady, but easing by other central banks reduced borrowing costs in 2019

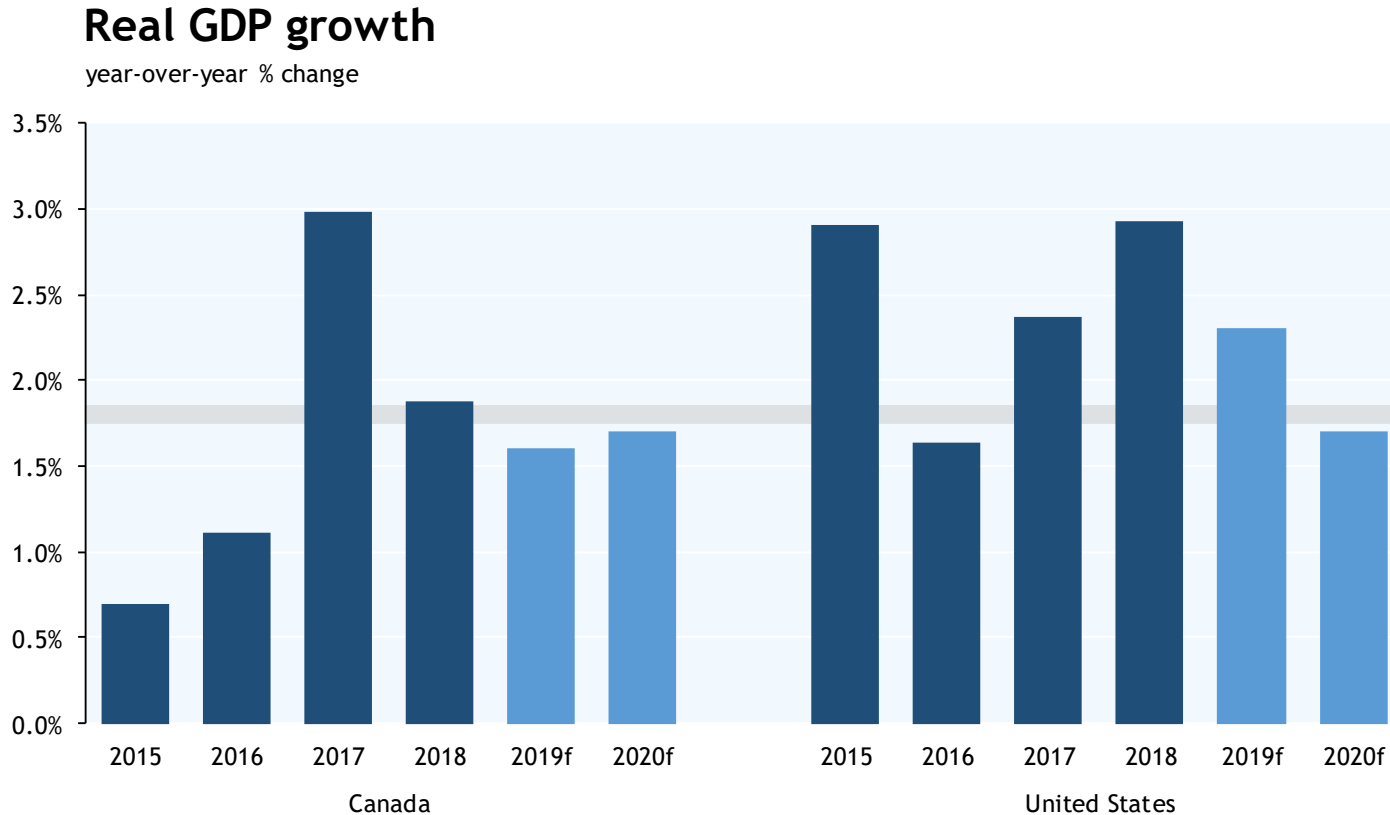
BoC overnight rate and 5-year yields



Source: Bank of Canada, RBC Economics

- The US Fed cut rates by 75 basis points in the second half of 2019; ~40 central banks eased globally in 2019
- Canadian borrowing costs have declined despite the BoC holding its policy rate steady

Growth in Canada and the US is expected to be below “trend”; recession risk is elevated but not our base case



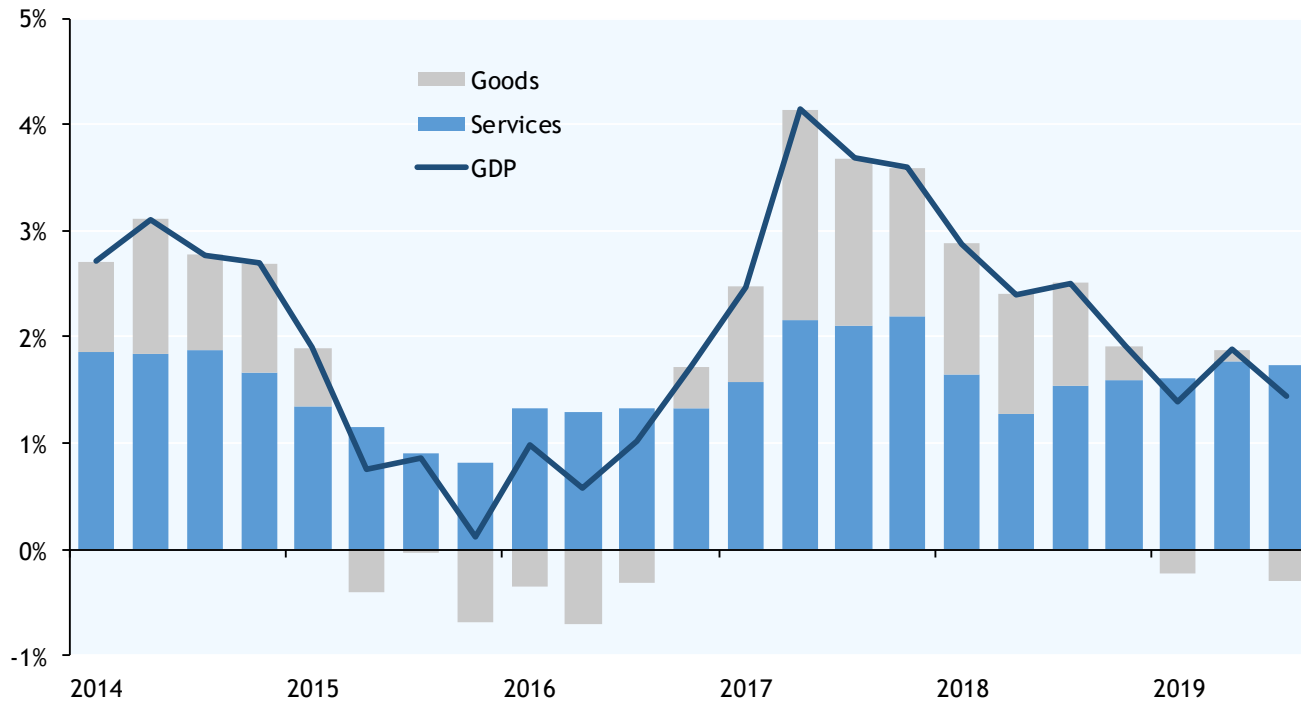
Source: Statistics Canada, BEA, RBC Economics

- Canada and the US have limited room to grow beyond their longer-run potential (demographics + productivity growth)
- Risk of a downturn is greater in the late stages of the business cycle, but hard to anticipate the trigger for a slowdown

Canada's industrial sector slowed in 2019 but services activity has remained solid

Canadian GDP growth: goods and services contributions

year-over-year % change and percentage point contributions



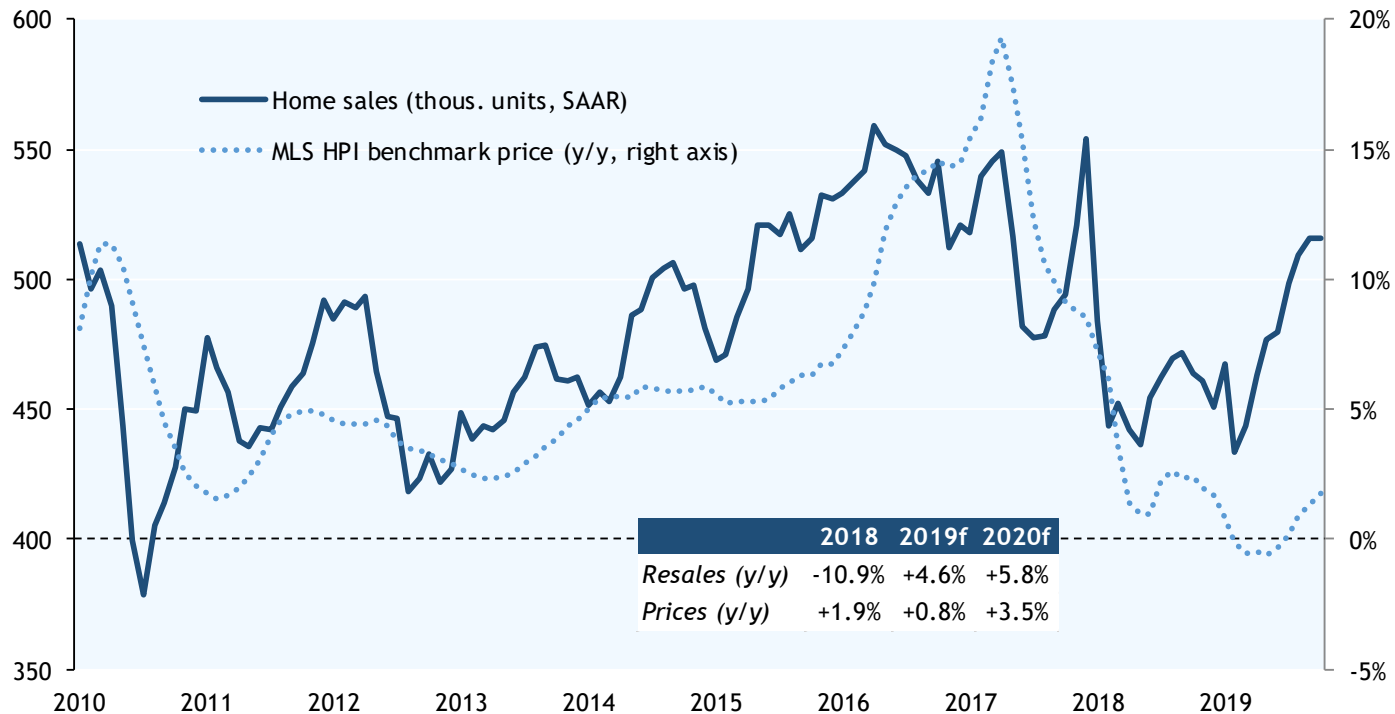
Source: Statistics Canada, RBC Economics

- Canada's oil and gas sector slowed in 2019; transportation constraints remain a headwind
- Growth in manufacturing has slowed but not as sharply as in several other economies

Canadian housing rebounded after policy changes and rate hikes slowed activity in 2018

Canadian home sales and prices

thousands of annualized units (left axis) / year-over-year price growth (right axis)



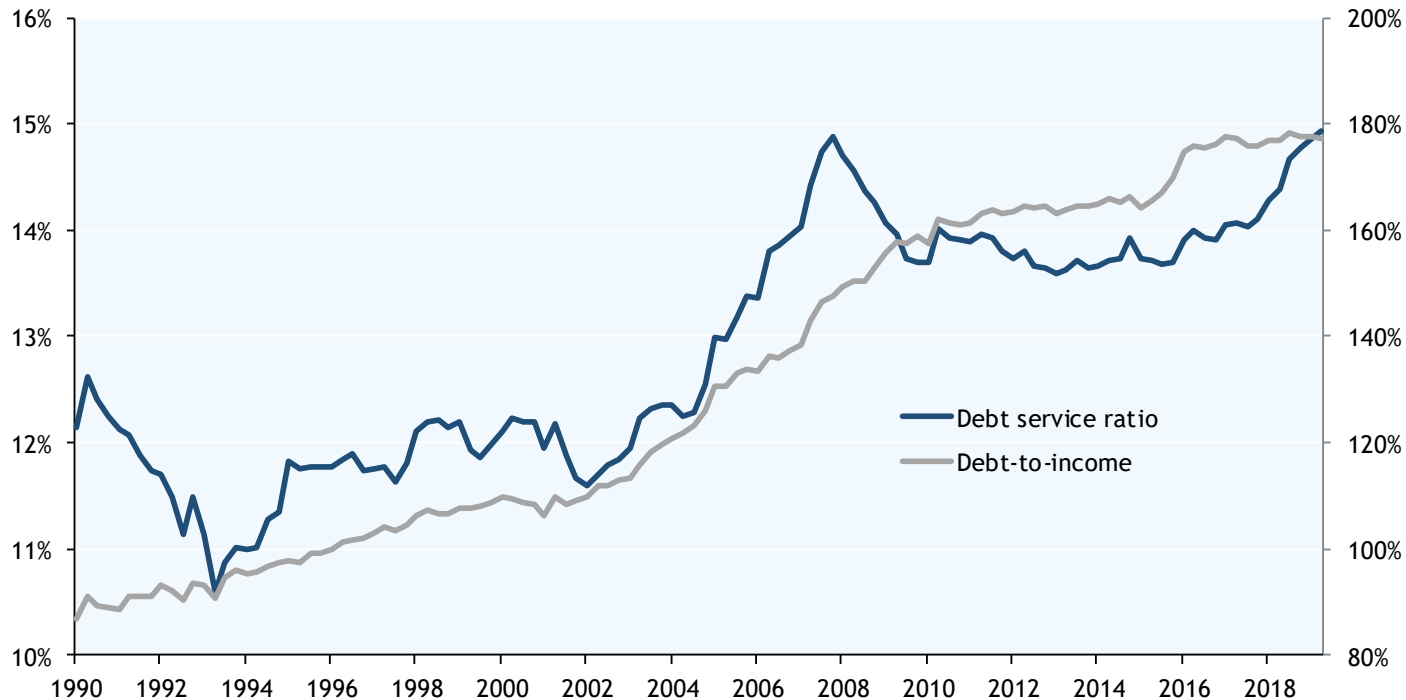
Source: CREA, RBC Economics

- Home sales were up 11% y/y in October and homebuilding activity remains strong
- Supply-demand balance is back in favour of sellers, putting upward pressure on prices

Household debt and debt servicing costs are at record highs— a challenging environment for the BoC

Canadian household debt and debt service ratio

household debt and debt payments as a share of personal disposable income



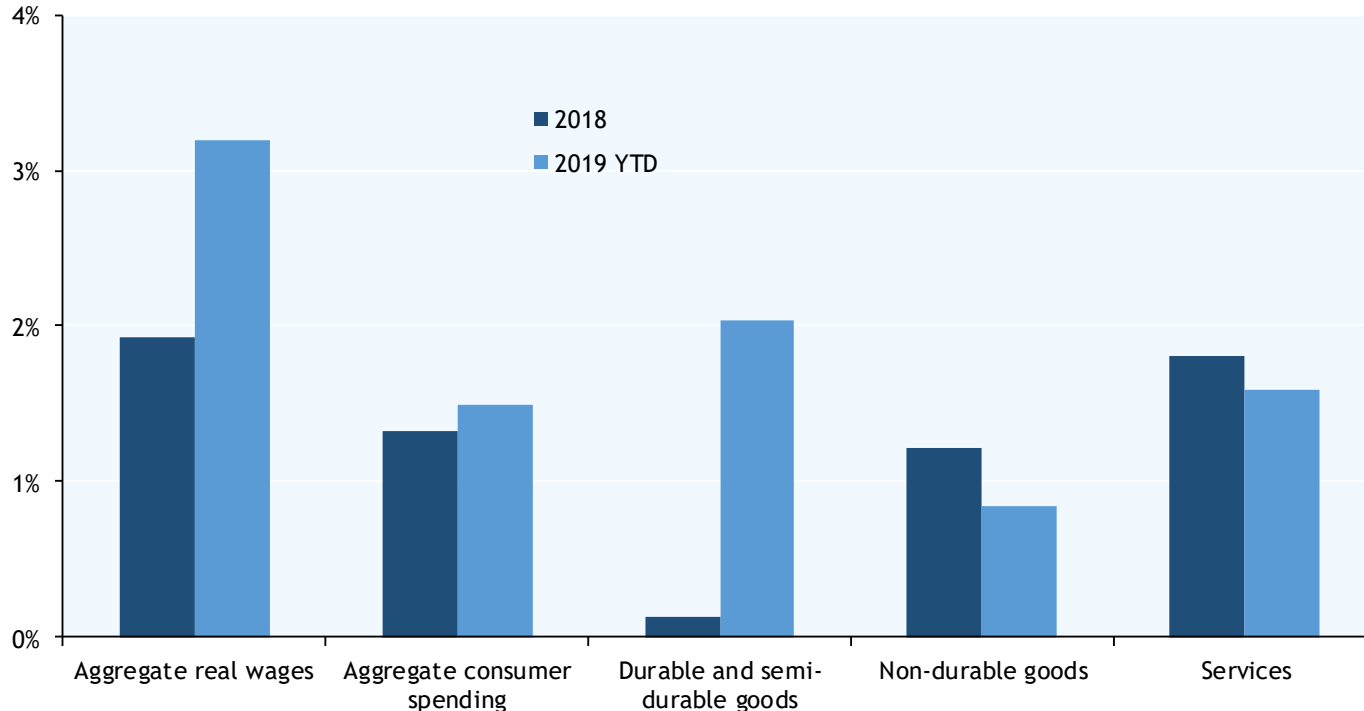
Source: Statistics Canada, RBC Economics

- Household debt-to-income is at a record high; the average Canadian owes \$1.77 in debt for every \$1 of income
- That makes households more sensitive to rising interest rates; debt service payments are now at a record high

A strong labour market has supported income growth and given consumer spending a slight boost

Canadian income and spending growth

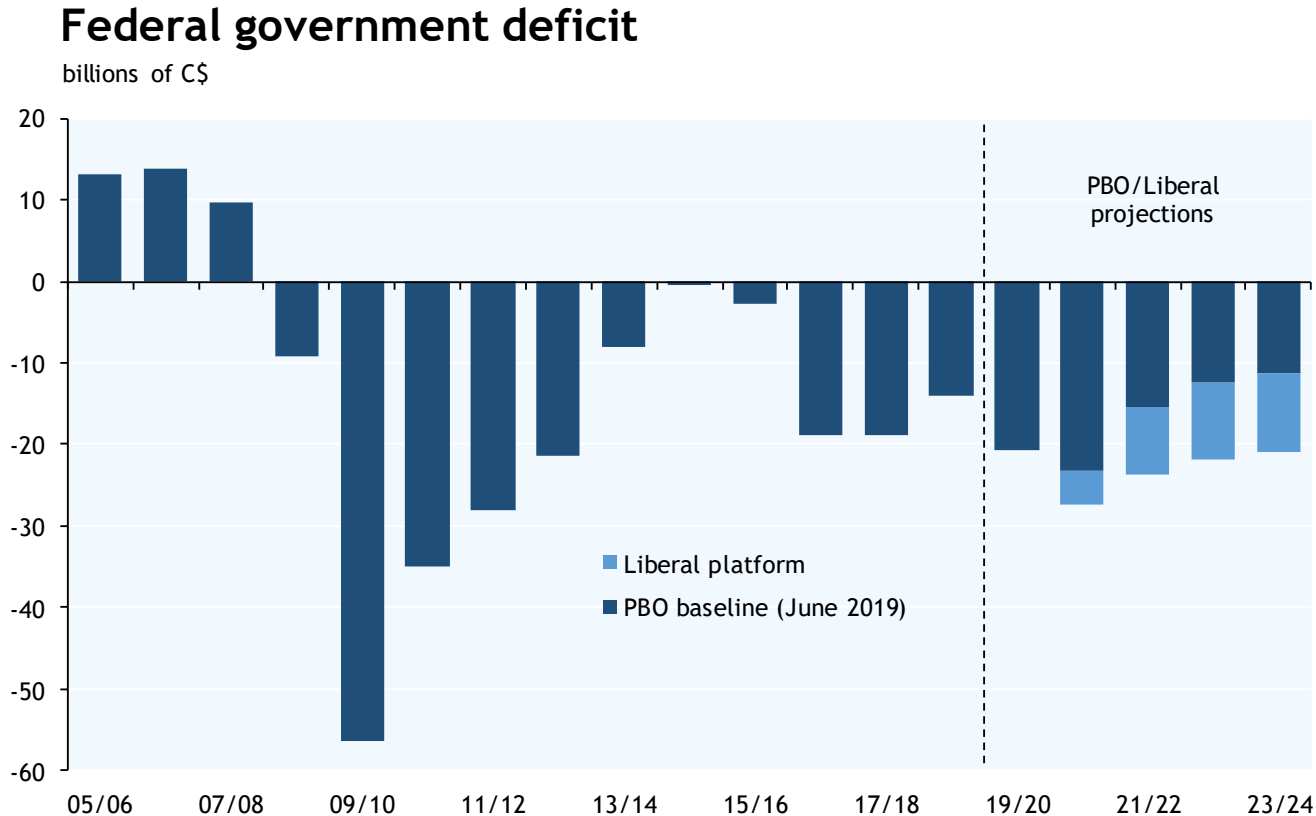
inflation-adjusted, seasonally-adjusted annualized percent change



Source: Statistics Canada, RBC Economics

- Rising interest rates were a headwind for consumers last year; less pressure this year with market rates declining
- Robust job gains and rising wages have contributed to strong household income growth

We're still waiting on a new budget, but the Liberals' election platform suggested more stimulative fiscal policy is on the way



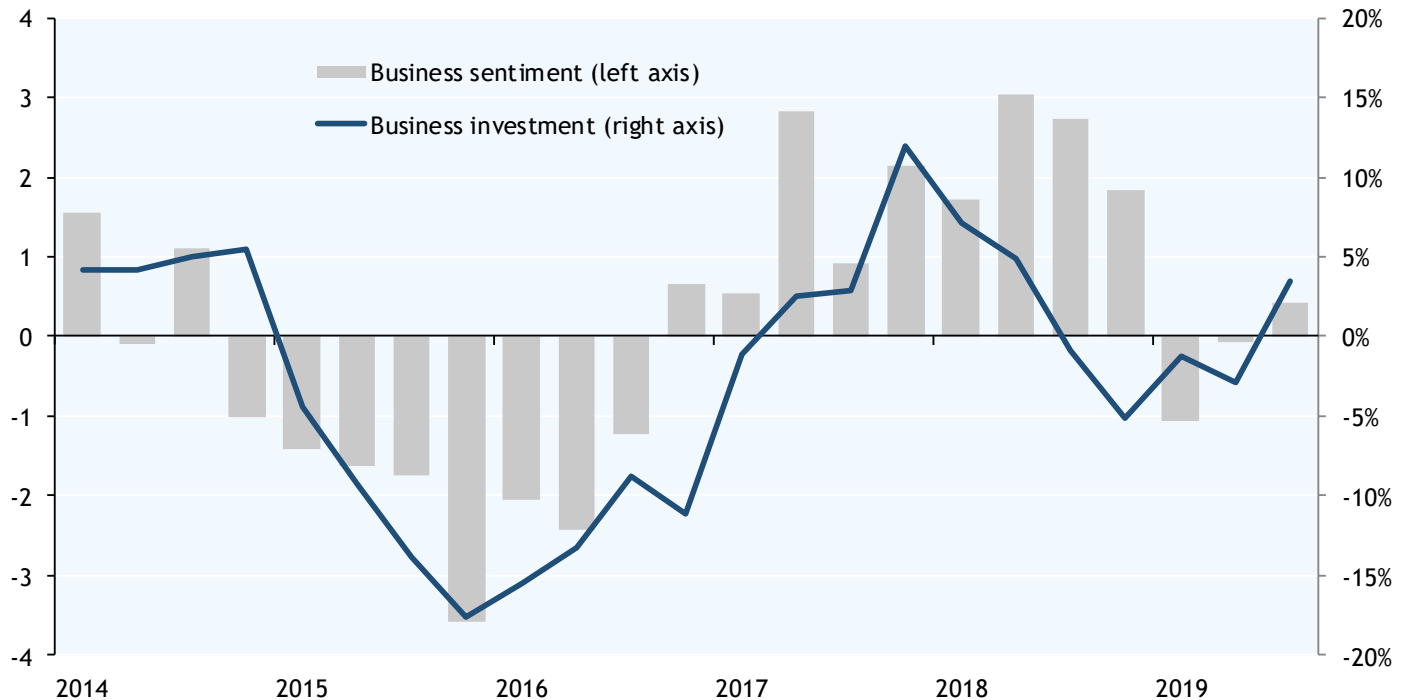
Source: Department of Finance, PBO, Liberal platform, RBC Economics

- Last year's \$14 billion deficit represents 0.6% of GDP (compare with US deficit of ~4.5%)
- Canada has the lowest central government debt-to-GDP in the G7, leaving room for fiscal stimulus if the economy slows

Rising trade tensions have hurt business sentiment, and capital spending has been sluggish

Business sentiment and investment

BoC business sentiment index (long-term average=0) and year-over-year investment growth (percent)



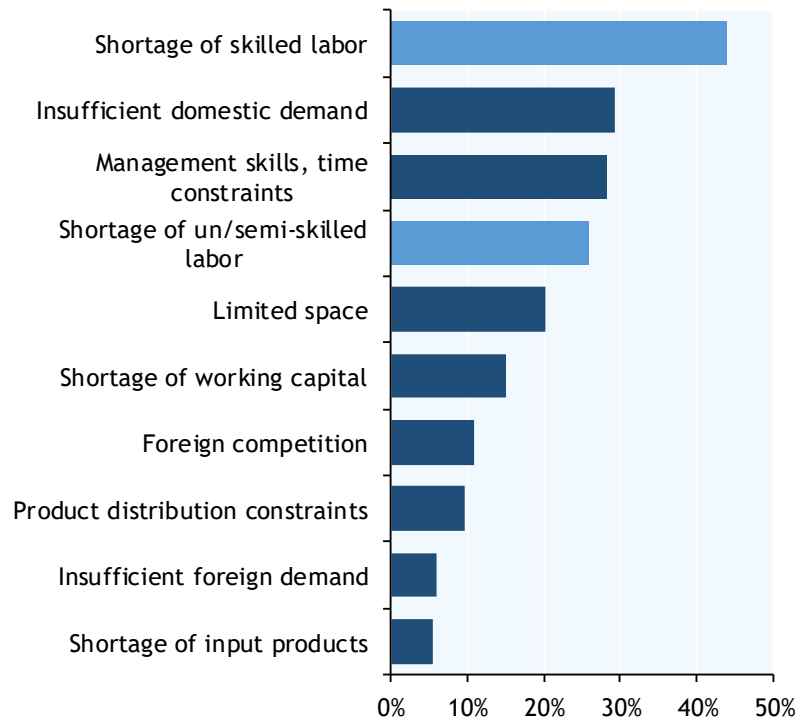
Source: Bank of Canada, Statistics Canada, RBC Economics

- BoC survey shows overall business sentiment has softened amid slower growth and rising trade tensions
- Investment intentions remain solid but firms don't seem to be following through—capex has been weak

Businesses see capacity constraints as a greater impediment to sales growth than trade policy and foreign demand

CFIB: factors limiting sales growth

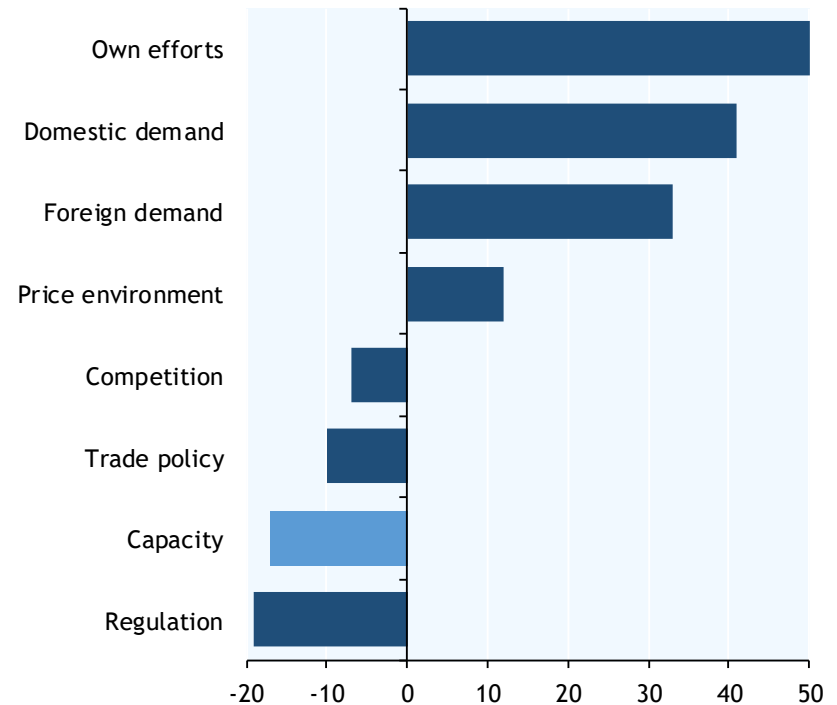
% of firms reporting, Q4/19



Source: CFIB, RBC Economics

BoC: factors supporting/limiting sales

balance of opinion, Q2/19



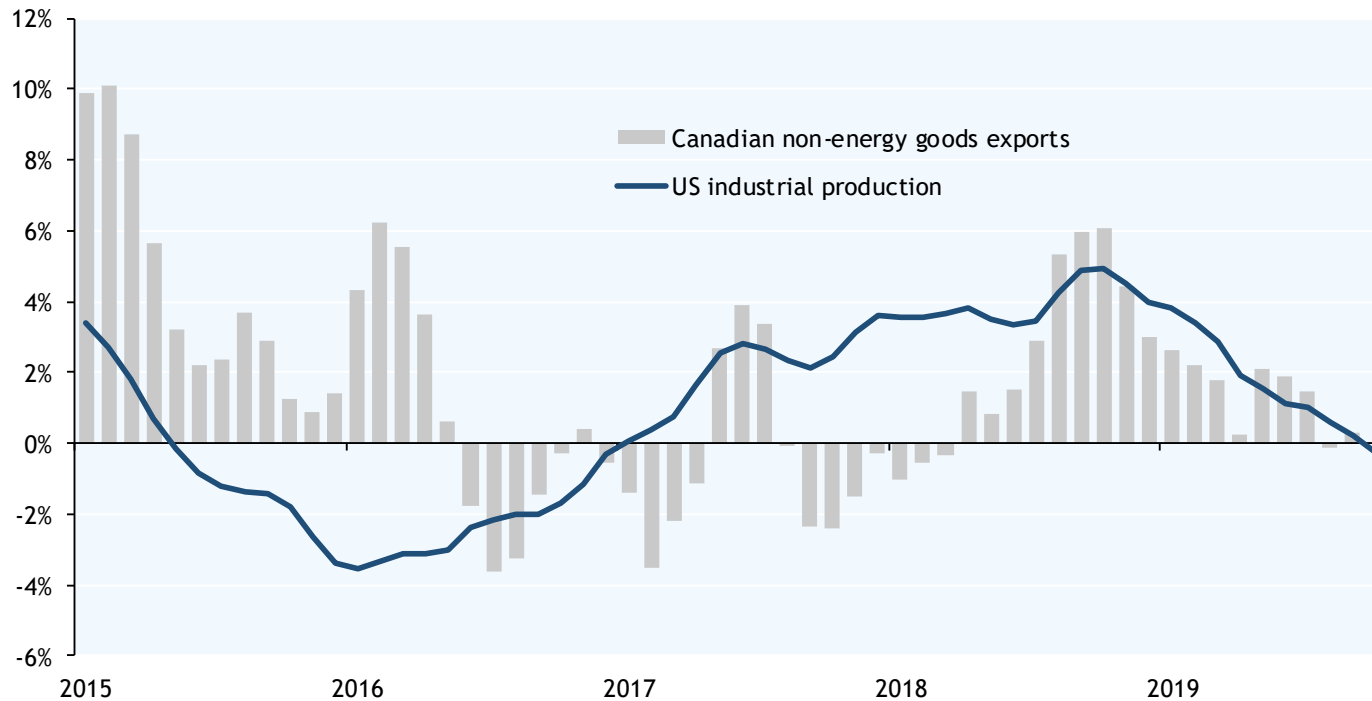
Source: BoC Business Outlook Survey, RBC Economics

- Trade tensions grab headlines, but capacity constraints and labour shortages seem to be a bigger issue for SMEs
- BoC Business Outlook Survey: regulation and capacity constraints are restraining sales more than trade policy

Non-energy goods exports have lost momentum amid a slowdown in key drivers of trade

Canadian non-energy export growth

year-over-year % change, 3-month average



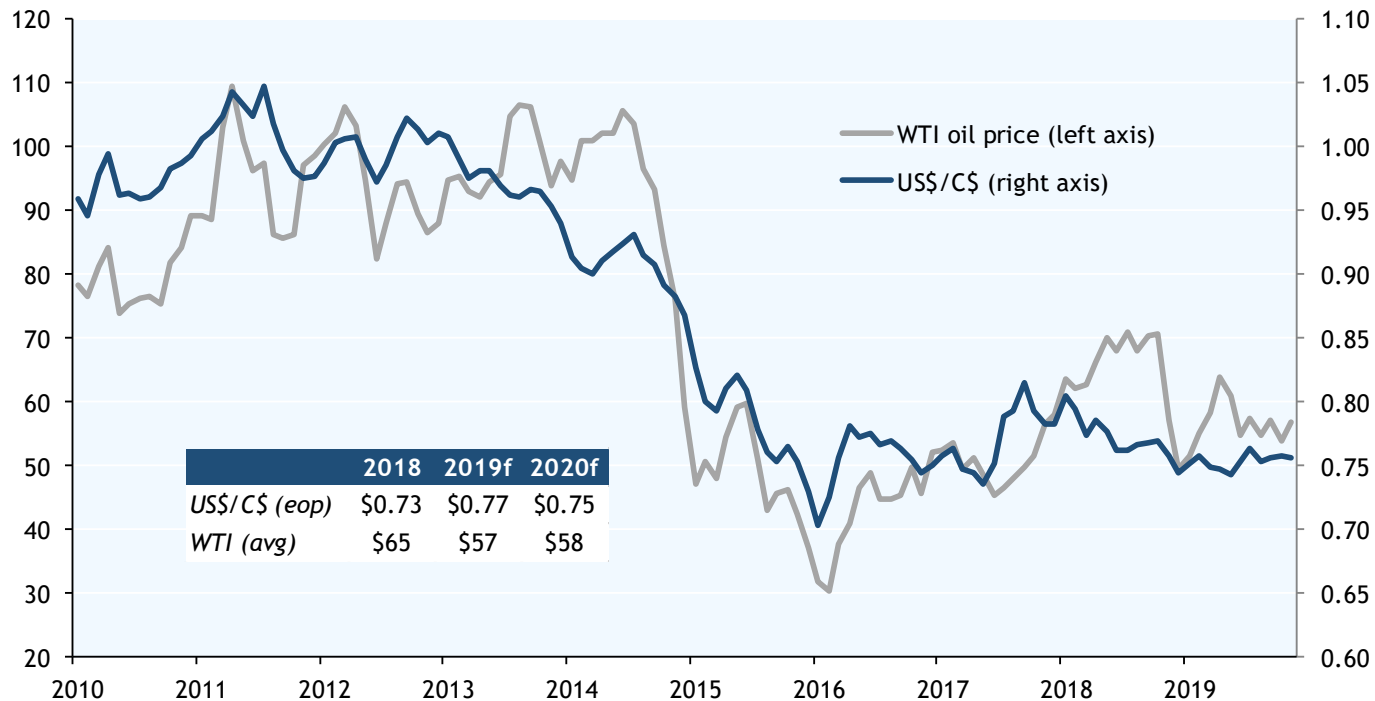
Source: Federal Reserve, Statistics Canada, RBC Economics

- A slowdown in US manufacturing and capital spending, and slower global trade, doesn't bode well for Canadian exports
- Services exports, which account for 17% of total exports, are consistently growing at a 3-4% pace

A steady year for the Canadian dollar could continue into 2020 if global growth (and demand for commodities) doesn't falter

Canadian dollar and oil prices

WTI (US\$/barrel) and US\$/C\$



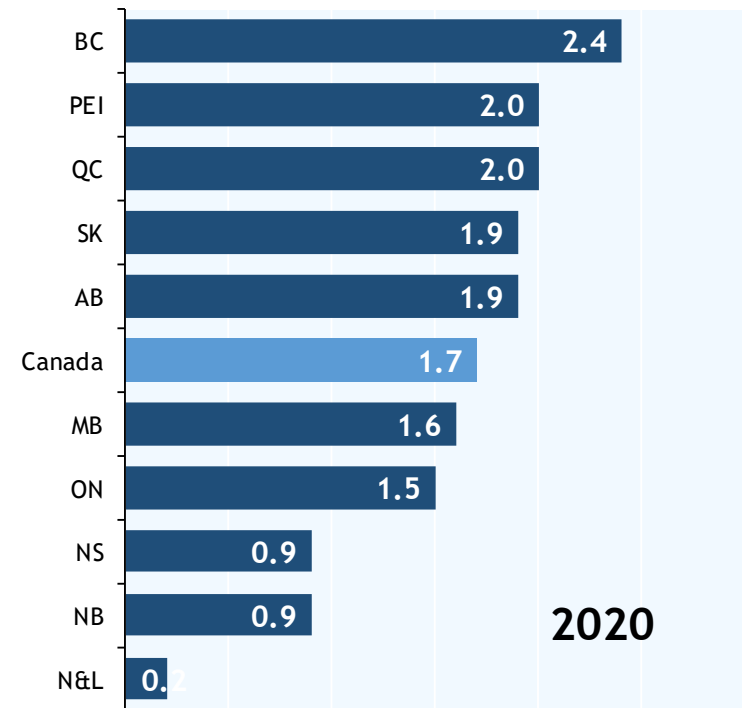
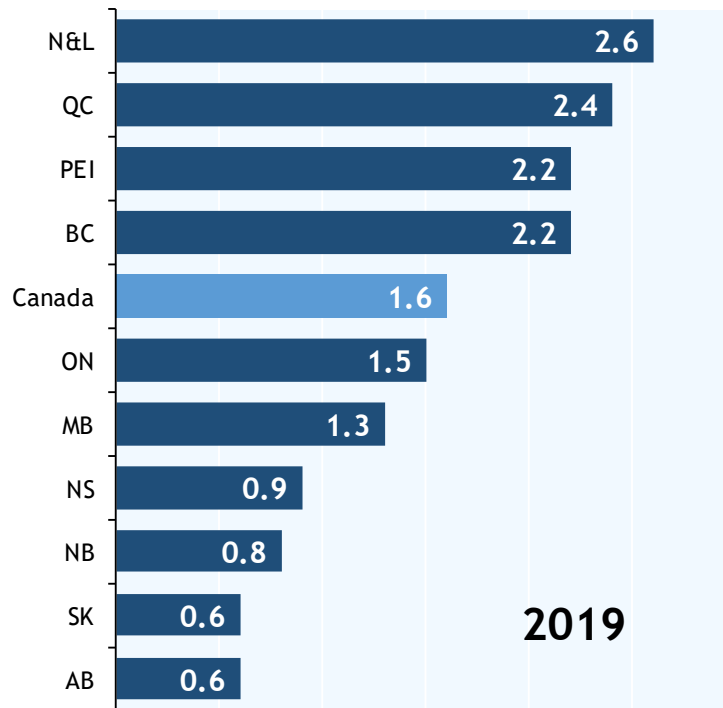
Source: Bank of Canada, EIA, RBC Economics

- The Canadian dollar has been remarkably steady around 75 cents this year
- Oil prices have been bounced around by growth concerns (negative for prices) and geopolitical tensions (positive)

Capital spending boosting growth in BC; Ontario facing external and fiscal headwinds

Provincial GDP growth

real GDP, year-over-year % change



Source: Statistics Canada, RBC Economics

- Major construction projects boosting BC and N&L economies; energy slowdown hitting Alberta
- Quebec's labour and housing markets are booming; Ontario facing some fiscal restraint

Latest research from RBC Economics and Thought Leadership

The recession roadblock

- Canadians who graduated during the recession have seen slower wage growth than past cohorts and are less likely to be in skilled/management positions

Untapped potential: Canada needs to close its immigrant wage gap

- Immigrants earn 10% less than those born in Canada; closing the gap could add \$50 billion to GDP

Big city rental blues: a look at Canada's rental housing deficit

- A rental housing deficit is driving up rents in Canada's largest cities; greater rental supply (particularly in Toronto) is needed to balance these markets

Visit our website for more (free!) research and to sign up for email updates:

<http://www.rbc.com/economics/>

And check out more content from our colleagues in Thought Leadership:

<https://thoughtleadership.rbc.com>

Summary

- **Global economy lost momentum in 2019, but industrial slowdown might be bottoming out and spill-over into other sectors appears to be modest**
- **A US-China trade deal would resolve some (but maybe not all) of the uncertainty that has held back business investment**
- **Central banks lowered rates this year but the BoC has been reluctant to follow; we see potential for a rate cut early next year amid slowing growth**
- **Canada's economy is getting a bit more support from the household sector but business investment remains sluggish—not the BoC's preferred combination!**
- **Geopolitical risks aren't the only issue for Canadian businesses—many firms point to labour shortages, capacity pressures and burdensome regulation**

The material contained in this report is the property of Royal Bank of Canada and may not be reproduced in any way, in whole or in part, without express authorization of the copyright holder in writing. The statements and statistics contained herein have been prepared by RBC Economics Research based on information from sources considered to be reliable. We make no representation or warranty, express or implied, as to its accuracy or completeness. This publication is for the information of investors and business persons and does not constitute an offer to sell or a solicitation to buy securities.

©Registered trademark of Royal Bank of Canada.

©Royal Bank of Canada.