Economics

# ECONOMIC INSIGHTS

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## Provincial outlook: Where are the headwinds strongest?

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The Canadian economy is facing plenty of headwinds at the moment. Rapidly rising interest rates are bringing a correction in the housing market, and are expected to restrain wider consumer spending ahead as well. Meanwhile, a slowing global economy and supply chain issues are impacting manufacturing, and services companies are struggling with limited labour availability.

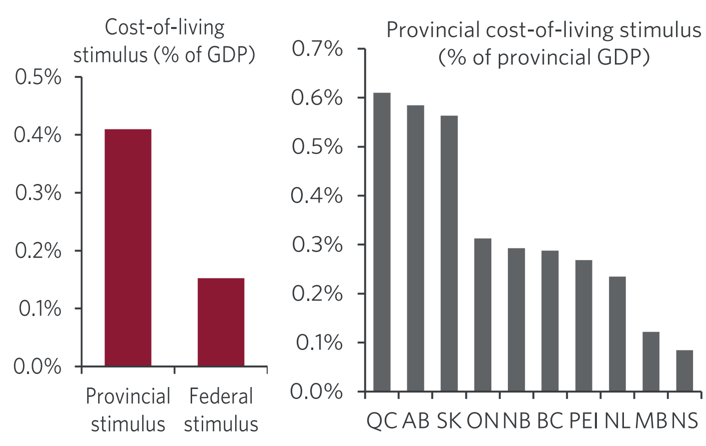
However, not all provinces will be impacted equally by these risks. Commodity-rich areas such as Saskatchewan and Alberta should see less of a slowing in consumer spending and housing due to the wealth being created within those economies, while Atlantic Canada appears to be holding onto gains in interprovincial migration linked to increased work-from-home capabilities and the diversification of their economies. That leaves areas of the country with the most indebted households, such as Ontario and BC, or the tightest labour markets, such as Quebec, to struggle the most for growth ahead.

### "Helping" with the cost of living

High inflation has been a problem for every province, and is eating away at some of the savings built up during the pandemic. However, the responses of provincial governments to "help" households with the cost of living increases has varied. We use quotation marks because, although these policies are put in place to help, where they are not well focussed they will also be adding to inflationary pressures.

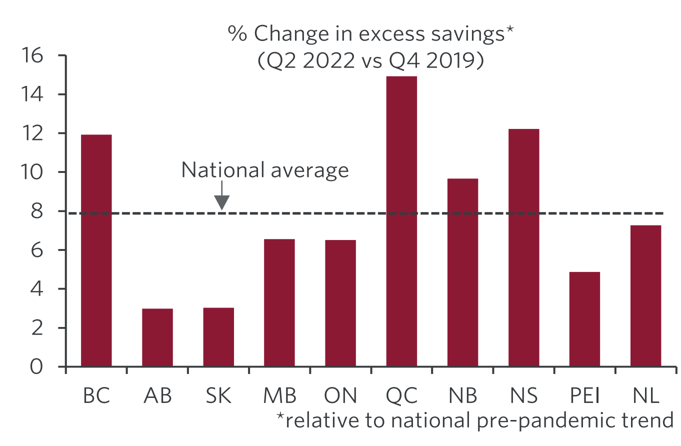
On aggregate, the stimulus provided by provincial governments this year has been more than twice that delivered at the Federal level (Chart 1). The largest stimulus has been doled out by Quebec although, with that province already having the tightest labour market and highest accumulated savings (Chart 2), the extra stimulus could simply prevent inflation from easing as quickly as in other parts of the country. Gains to the volume of economic activity will likely be muted.

**Chart 1: Provincial cost of living stimulus has exceeded Federal help (L), particularly in Quebec, Alberta and Saskatchewan (R)**



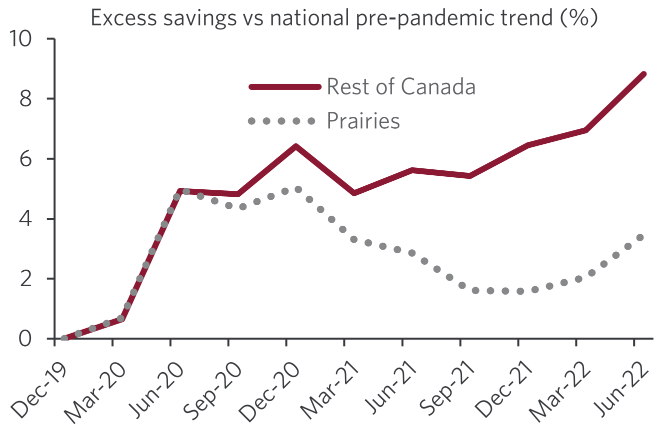

Source: Government Finance agencies, CIBC

**Chart 2: Accumulated savings were already highest in Quebec, but were low in Alberta, Saskatchewan**



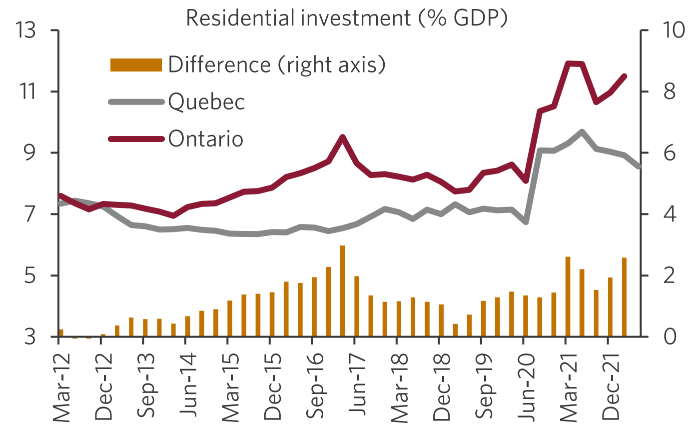

Source: Haver, CIBC

Chart 3: Excess savings in Saskatchewan, Alberta, Manitoba had already been largely run down by end 2021




Source: Haver, CIBC

Chart 5: Residential investment saw a bigger increase as a proportion of GDP in Ontario than in Quebec

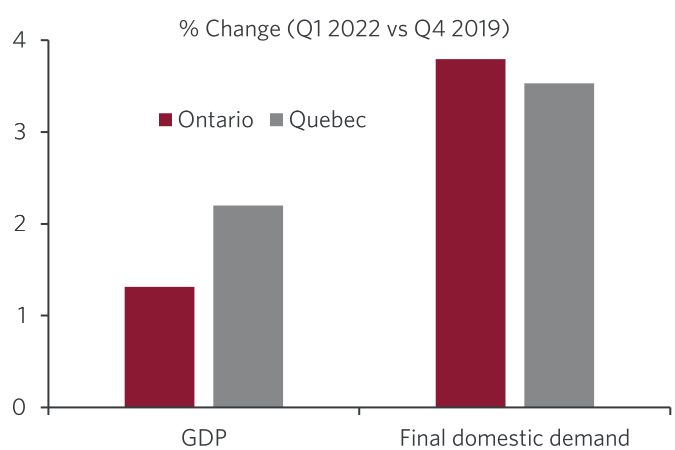



Source: Provincial finance agencies, Haver, CIBC

Coming close to Quebec in terms of cost-of-living stimulus are Alberta and Saskatchewan, as those provinces have distributed some of the tax take from high commodity prices to households. However, the stimulus here may add to the volume of economic activity, rather than just top up already bloated savings accounts.

Because Federal support received by households during the pandemic was proportionately less generous in provinces where wages tend to be above the national average, the build up of savings in Alberta and Saskatchewan was smaller. Indeed, excess savings had more or less been run down before the end of last year, before the provincial stimulus and an improving labour market helped add to them again (Chart 3). With labour markets in these provinces also not as tight as in Quebec, there seems to be greater scope for provincial fiscal stimulus to support the volume of economic activity rather than only adding to inflationary pressures.

Chart 4: Ontario's GDP recovery has been slower than Quebec's, despite strength in domestic demand




Source: Provincial finance agencies, Haver, CIBC

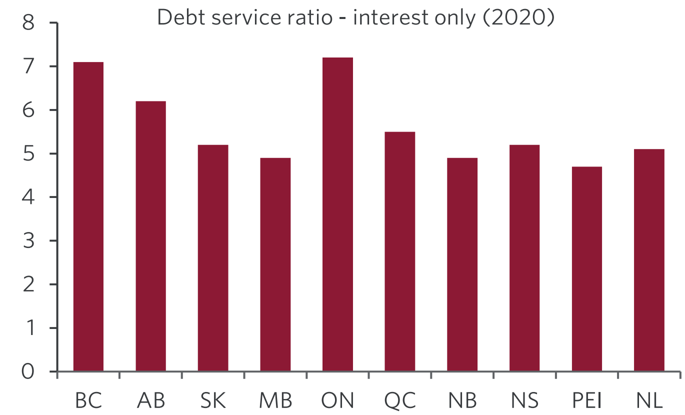
## New risks emerge for Ontario and BC

For Ontario, this year and next were supposed to represent a period of above-average growth as supply chain issues, which have impacted the auto industry particularly hard, faded. The impact of those supply chain issues on Ontario's GDP can easily be seen when comparing its recovery with Quebec's (the only other province for which quarterly figures are available). Early this year, Ontario's GDP recovery was trailing Quebec's by around 1%, despite a slightly stronger rebound in final domestic demand (Chart 4). That highlights just how much weakness in exports and inventories impacted Ontario's overall growth rate last year.

However, even though supply chain issues in the auto industry are starting to ease, progress has been fairly slow. Moreover, new risks have emerged for the Ontario economy, stemming from rapidly rising interest rates. Those interest rate increases are quickly cooling housing resale and renovation activity, and with those sectors becoming an even larger share of the Ontario economy up until the first quarter of this year, that means a bigger negative impact on overall growth (Chart 5).

The impact of higher interest rates will also be felt more broadly. After years of chasing higher house prices by taking on larger mortgages, households in BC and Ontario have higher debt levels and by extension pay the most interest to service that debt (Chart 6). With interest rates now rising on revolving debt, and with term debt coming due having to be refinanced at higher rates, households in these provinces will find their ability to spend on other items being squeezed particularly hard.

Chart 6: Years of debt accumulation leave BC and Ontario households most vulnerable to higher interest rates




Source: Statistics Canada, CIBC

## Canadians moving to the Atlantic, reversing demographic woes

As we move beyond the next few turbulent quarters, trend growth in each province will be determined by demographics and the outlook for the labour force. With population aging and the bulk of baby boomers nearing retirement, many provinces, especially those with an older population, will need to rely on international or interprovincial migration. This is particularly true for the Atlantic provinces, but also for Quebec and British Columbia.

Ontario has a relatively young population, in part due to strong immigration. As the new home of almost half of the 270k international migrants coming to Canada in the second quarter of this year, the province remains a very popular destination. However, the unaffordability of housing in the province, which worsened considerably during the pandemic, has resulted in an exodus of existing residents towards other provinces, particularly in the Atlantic region (Chart 7). This trend, which started during the pandemic, shows no sign of slowing, as the second quarter of this year marked the largest net drop in interprovincial migration for Ontario in more than 50 years.

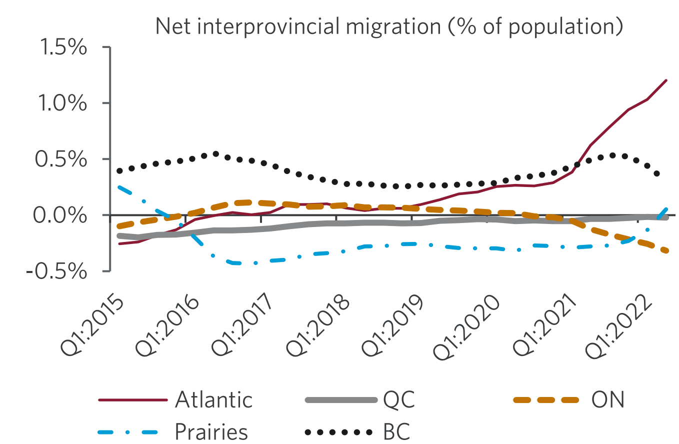
While these interprovincial losses offset only a fraction of the gains from international immigration in Ontario, they are a significant boon for the Atlantic provinces. The Atlantic's older population long spelled trouble for future growth, but in at least a partial reversal of fortune, the pandemic has turned the region into an attractive destination for Canadians seeking more affordable house prices. The work-from-home revolution has opened up options to many people across the country, who are no longer tied to a location because of work.

As of June 2022, about 18% of Canadians who worked did so exclusively from home. Of those, almost 20% lived far enough from their worksite that they could not commute on a daily basis. In fact, across Canada, about 5% of those working from home reported to a worksite outside their province of residence, a proportion that is much higher in the Atlantic provinces and in the Prairies (Chart 8). With an estimated 40% of jobs in Canada that could be done remotely, the Atlantic provinces could benefit from a large pool of working-age people making it their home even if their work is, at least initially, in other provinces. According to Statistics Canada's population projection, interprovincial migration, which would have been a drag based on trends observed just a few years ago, could now drive almost half of the population growth in the region in the coming years.

## Housing market to reflect demographic shift

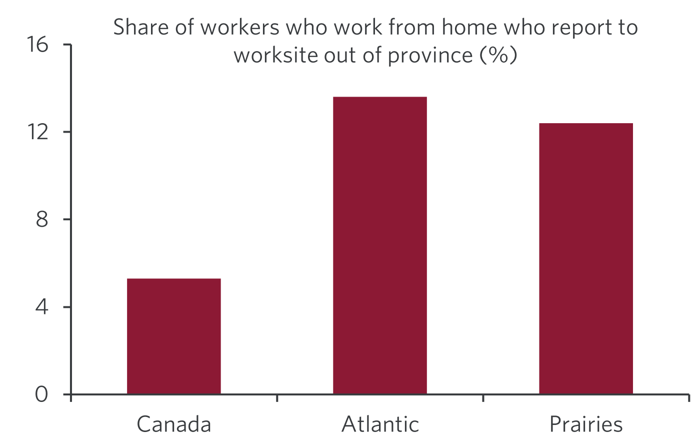
The outlook for population growth in each province is also reflected in the longer-term outlook for housing demand. In the short run, provincial housing markets will continue to be driven by the correction induced by the rapid rise in interest rates, the size of which depends on how inflated local markets had become during the pandemic. Ontario and British Columbia are seeing a rapid adjustment, while sales, and prices, are holding up better in the Prairies and in the Atlantic provinces (Chart 9).

Chart 7: Interprovincial migration has become a big boost to Atlantic Canada population



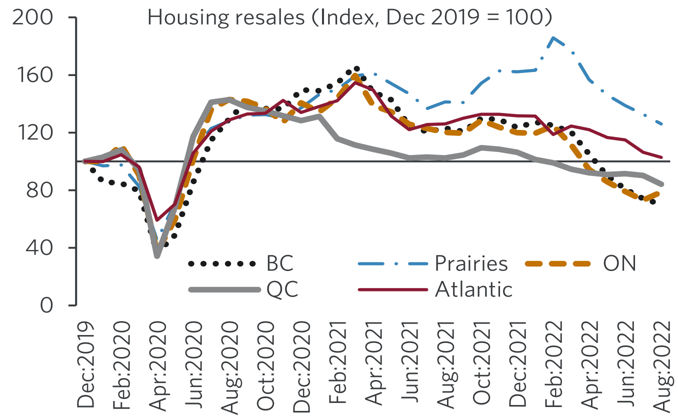

Source: Statistics Canada, CIBC

Chart 8: Many workers in Prairies and Atlantic Canada report to head office outside of province



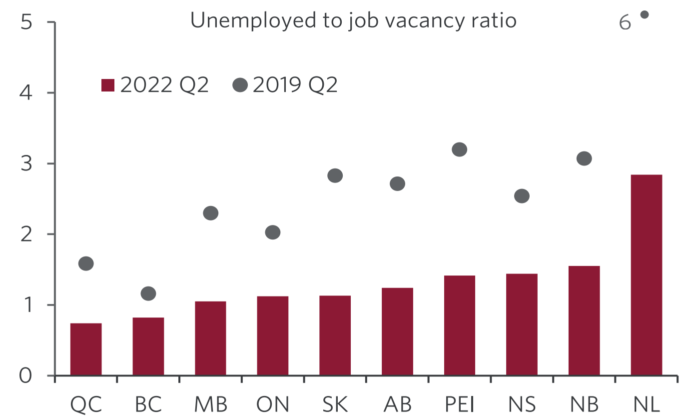

Source: Statistics Canada, CIBC

Chart 9: Housing resale activity still in line or above pre-pandemic levels in Atlantic Canada and Prairies




Source: CREA, Haver, CIBC

Chart 10: Post-pandemic Quebec has the tightest labour market




Source: Statistics Canada, CIBC

For the latter, this partially reflects continued strong demand from migration, both international and interprovincial, which added more to the population of the Atlantic provinces in the last year than to any other region in Canada.

Over 2023 and 2024, housing activity in Ontario and British Columbia could remain depressed as households continue to bear the weight of high interest rates. The slowdown in sales activity in 2022 will translate into weaker housing starts next year, given the typical lags. The situation should be better in the Atlantic and Prairies, where strong demand could see housing starts hold steady or even increase. In the long run however, high immigration in Ontario and BC means that housing construction will have to rebound. The large housing supply imbalances make that a requirement, although construction activity might continue to be impeded by labour shortages, putting upward pressure on prices once again by 2024 if mortgage rates have eased by that point.

## Tight labour markets across the country

Trends in international and interprovincial immigration are particularly important today because staffing shortages have been a defining feature of the pandemic recovery. While all provinces face tighter conditions than three years ago, the ratio of unemployed to vacancies ranges widely (Chart 10). By this measure, labour markets in the Atlantic provinces are not currently as tight as elsewhere in the country. However, that partially reflects the high proportion of seasonal jobs, which leads to a structurally higher number of unemployed for each vacancy. Quebec and BC both have fewer unemployed than job vacancies, which has resulted in strong wage pressure and will also be limiting real growth rates in those provinces.

As we look ahead, Atlantic provinces may see a tightening in labour market conditions if work-from-home staff moving to the region create demand without filling in-province vacancies. Wage inflation, which has already been high in the Maritimes over the past three years, could also remain elevated as local firms compete with out-of-province employers. This would work to further close the wage gap between the region and the rest of the country.

## Where the headwinds are strongest

As we look ahead to 2023 and 2024 the headwinds facing the Canadian economy will likely be felt most strongly in provinces with high exposure to housing and household debt (Ontario, BC) and in those with very tight labour markets and little population growth (Quebec).

Of course commodity-producing areas of the country will likely fare better thanks to higher prices and the desire of developed countries to find non-Russian alternatives (Table 1). However, unlike the pre-2014 period, this growth is not expected to come from large scale investments in the oil industry. Instead, the wealth being created by the resource sector is helping to fuel growth in other areas, and limiting the slowdown in housing demand.

On the east coast, the gains made during the pandemic in attracting workers from other provinces, and the technology, business and other such jobs they had, doesn't appear to be abating (or reversing) as quickly as we had previously expected. This will support overall growth within Atlantic Canada relative to what may have been expected pre-pandemic. However, with those newcomers also creating demand for housing and consumer-facing services, inflation in the region is also likely to remain firmer than what was typically seen prior to 2020.

## Provincial forecast tables

| | Table 1: Real GDP (Y/Y % chg) | | | | Table 2: Nominal GDP (Y/Y % change) | | | | Table 3: Unemployment rate (%) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Province | 2021E | 2022F | 2023F | 2024F | 2021F | 2022F | 2023F | 2024F | 2021A | 2022F | 2023F | 2024F |
| British Columbia | 5.9 | 2.8 | 0.6 | 1.1 | 13.4 | 7.8 | 2.3 | 3.3 | 6.5 | 4.8 | 5.4 | 5.5 |
| Alberta | 5.1 | 4.2 | 1.3 | 1.7 | 22.1 | 23.2 | 1.1 | 4.5 | 8.6 | 5.9 | 5.8 | 5.5 |
| Saskatchewan | 0.0 | 4.3 | 1.6 | 1.9 | 13.0 | 22.3 | 1.4 | 4.9 | 6.5 | 4.9 | 5.0 | 4.7 |
| Manitoba | 1.5 | 3.4 | 1.1 | 1.4 | 7.5 | 8.7 | 2.6 | 3.4 | 6.4 | 4.8 | 5.3 | 5.2 |
| Ontario | 4.4 | 2.8 | 0.3 | 1.3 | 10.9 | 8.8 | 2.0 | 3.5 | 8.0 | 5.5 | 5.9 | 5.9 |
| Québec | 5.6 | 2.9 | 0.5 | 1.2 | 12.1 | 8.9 | 2.2 | 3.4 | 6.1 | 4.2 | 4.8 | 5.0 |
| New Brunswick | 5.3 | 1.9 | 0.6 | 1.1 | 11.3 | 6.9 | 2.1 | 3.1 | 8.9 | 7.4 | 8.0 | 7.7 |
| Nova Scotia | 5.8 | 1.7 | 0.8 | 1.3 | 11.8 | 6.7 | 2.3 | 3.3 | 8.4 | 6.8 | 7.5 | 7.2 |
| Prince Edward Island | 6.6 | 1.5 | 1.1 | 1.4 | 12.6 | 6.5 | 2.6 | 3.4 | 9.3 | 7.4 | 8.2 | 7.9 |
| Newfoundland and Labrador | 1.2 | 3.3 | 0.9 | 1.5 | 14.2 | 21.3 | 1.1 | 4.0 | 12.9 | 11.1 | 11.0 | 10.8 |
| **Canada** | 4.5 | 3.1 | 0.6 | 1.4 | 13.0 | 11.3 | 1.9 | 3.7 | 7.4 | 5.3 | 5.7 | 5.7 |

Source: Statistics Canada, CMHC, CIBC.

Table 4: Canada forecast detail (real % change, SAAR, unless otherwise noted)

| Variable | 22Q1A | 22Q2F | 22Q3F | 22Q4F | 23Q1F | 23Q2F | 23Q3F | 23Q4F | 2021A | 2022F | 2023F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Real GDP Growth (AR) | 3.1 | 3.3 | 0.5 | 0.0 | -0.2 | 0.6 | 1.4 | 1.3 | 4.5 | 3.1 | 0.6 |
| Real Final Domestic Demand (AR) | 3.5 | 2.9 | 0.6 | 0.7 | 0.6 | 0.5 | 1.4 | 1.3 | 5.6 | 3.1 | 0.9 |
| Household Consumption (AR) | 2.6 | 9.7 | 2.7 | 1.2 | 0.7 | 0.2 | 1.7 | 1.1 | 5.0 | 5.5 | 1.6 |
| All Items CPI Inflation (Y/Y) | 5.8 | 7.5 | 7.2 | 7.0 | 5.5 | 2.8 | 2.5 | 2.1 | 3.4 | 6.9 | 3.2 |
| Unemployment Rate (%) | 5.8 | 5.1 | 5.2 | 5.3 | 5.5 | 5.7 | 5.9 | 5.9 | 7.4 | 5.3 | 5.7 |

Table 5: US forecast detail (real % change, SAAR, unless otherwise noted)

| Variable | 22Q1A | 22Q2A | 22Q3F | 22Q4F | 23Q1F | 23Q2F | 23Q3F | 23Q4F | 2021A | 2022F | 2023F |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Real GDP Growth (AR) | -1.6 | -0.6 | 2.0 | 1.5 | -0.2 | 0.3 | 1.4 | 0.7 | 5.9 | 1.8 | 0.7 |
| Real Final Sales (AR) | -1.8 | 1.4 | 2.1 | 1.3 | 0.2 | 1.0 | 1.8 | 0.9 | 5.7 | 1.1 | 1.1 |
| All Items CPI Inflation (Y/Y) | 8.0 | 8.6 | 8.3 | 7.3 | 5.3 | 2.9 | 2.1 | 1.8 | 4.7 | 8.1 | 3.0 |
| Core CPI Inflation (Y/Y) | 6.3 | 6.0 | 6.3 | 5.8 | 4.3 | 3.3 | 2.3 | 1.9 | 3.6 | 6.1 | 2.9 |
| Unemployment Rate (%) | 3.8 | 3.6 | 3.6 | 3.7 | 4.0 | 4.2 | 4.1 | 4.2 | 5.4 | 3.7 | 4.1 |

Table 6: Canadian interest rates (end of period)

| Variable | 2022 19-Oct | 2022 Dec | 2023 Mar | 2023 Jun | 2023 Sep | 2023 Dec | 2024 Jun | 2024 Dec |
|---|---|---|---|---|---|---|---|---|
| Overnight target rate | 3.25 | 4.25 | 4.25 | 4.25 | 4.25 | 4.25 | 3.50 | 3.00 |
| 98-Day Treasury Bills | 3.91 | 4.15 | 4.10 | 4.00 | 4.00 | 3.85 | 3.25 | 2.60 |
| 2-Year Government Bond | 4.10 | 4.35 | 4.00 | 3.75 | 3.55 | 3.10 | 2.50 | 2.25 |
| 10-Year Government Bond | 3.44 | 3.60 | 3.40 | 3.20 | 3.00 | 2.90 | 2.75 | 2.60 |
| 30-Year Government Bond | 3.42 | 3.50 | 3.45 | 3.25 | 3.10 | 3.00 | 2.75 | 2.45 |
| Canada - US T-Bill Spread | -0.08 | -0.10 | -0.15 | -0.10 | -0.05 | -0.15 | -0.40 | -0.55 |
| Canada - US 10-Year Bond Spread | -0.64 | -0.30 | -0.30 | -0.20 | -0.20 | -0.20 | -0.25 | -0.20 |
| Canada Yield Curve (10-year — 2-year) | -0.67 | -0.75 | -0.60 | -0.55 | -0.55 | -0.20 | 0.25 | 0.35 |

Table 7: US Interest rates (end of period)

| Variable | 2022 19-Oct | 2022 Dec | 2023 Mar | 2023 Jun | 2023 Sep | 2023 Dec | 2024 Jun | 2024 Dec |
|---|---|---|---|---|---|---|---|---|
| Federal funds rate | 3.125 | 4.375 | 4.375 | 4.375 | 4.375 | 4.375 | 3.875 | 3.375 |
| 91-Day Treasury Bills | 3.99 | 4.25 | 4.25 | 4.10 | 4.05 | 4.00 | 3.65 | 3.15 |
| 2-Year Government Note | 4.52 | 4.55 | 4.40 | 4.25 | 3.90 | 3.70 | 3.00 | 2.60 |
| 10-Year Government Note | 4.08 | 3.90 | 3.70 | 3.40 | 3.20 | 3.10 | 3.00 | 2.80 |
| 30-Year Government Bond | 4.08 | 3.80 | 3.50 | 3.30 | 3.15 | 3.00 | 2.75 | 2.60 |
| US Yield curve (10-year — 2-year) | -0.44 | -0.65 | -0.70 | -0.85 | -0.70 | -0.60 | 0.00 | 0.20 |

Table 8: Foreign exchange rates

| Exchange rate | 2022 19-Oct | 2022 Dec | 2023 Mar | 2023 Jun | 2023 Sep | 2023 Dec | 2024 Jun | 2024 Dec |
|---|---|---|---|---|---|---|---|---|
| CAD-USD | 0.73 | 0.72 | 0.73 | 0.73 | 0.75 | 0.76 | 0.76 | 0.78 |
| USD-CAD | 1.38 | 1.38 | 1.37 | 1.37 | 1.34 | 1.32 | 1.32 | 1.28 |
| USD-JPY | 150 | 140 | 138 | 136 | 135 | 130 | 127 | 124 |
| EUR-USD | 0.98 | 0.98 | 1.00 | 1.02 | 1.04 | 1.06 | 1.09 | 1.10 |
| GBP-USD | 1.12 | 1.09 | 1.11 | 1.12 | 1.14 | 1.17 | 1.21 | 1.23 |
| AUD-USD | 0.63 | 0.63 | 0.64 | 0.64 | 0.64 | 0.65 | 0.67 | 0.69 |
| USD-CNY | 7.23 | 7.10 | 7.10 | 7.00 | 7.00 | 6.90 | 6.85 | 6.80 |
| USD-BRL | 5.28 | 5.70 | 5.90 | 5.70 | 5.50 | 5.30 | 5.50 | 6.00 |
| USD-MXN | 20.1 | 21.5 | 21.0 | 21.5 | 21.3 | 21.5 | 22.0 | 22.5 |

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