

CANADA UPDATE

Gus Faucher
Chief Economist

Stuart Hoffman
Senior Economic Advisor

William Adams
Senior Economist

Kurt Rankin
Economist

Abbey Omodunbi
Senior Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

RECOVERY REMAINS ON TRACK: CONSUMERS WILL DRIVE ECONOMY THROUGH 2022

Canada's economy has shown resilience in the face of wave after wave of lockdowns

Canada's economy has shown resilience in the face of successive waves of lockdowns. After inflation-adjusted GDP plunged 13.1% (unannualized) in the first half of 2020, the economy has made up nearly all the lost ground, with real GDP just 1.4% below its pre-pandemic level in the third quarter of this year. Real GDP growth roared back in the third quarter, with the economy expanding 5.4% (annualized) after shrinking 3.2% in the second quarter.

With the relaxation of restrictions, lower COVID cases, and higher vaccination rates, Canada's economy is regaining momentum in the second half of the year. Consumer spending and exports will drive Canada's economy through the end of 2021 and into 2022. PNC forecasts real GDP growth of 5.0% in 2021 and 3.5% in 2022. As in the U.S., the biggest downside risk in the near term is the pandemic, which could lead to new restrictions in Canada and weigh on economic growth.

Supply chain disruptions held back exports in the second quarter

A pullback in residential investment and lower exports as supply chain disruptions held back manufacturing of motor vehicles and electrical parts drove the second quarter's contraction (Chart 1). Notwithstanding this setback, the prospects for growth are upbeat. Consumer spending will be a major tailwind after playing a minor role in the economic recovery to date. Canadian households saved C\$212 billion in 2020 and the household savings rate climbed to 11.0% in the third quarter of this year from 2.7% in the fourth quarter of 2019, positioning consumers to raise spending through 2022. Consumer spending and gross fixed capital formation have been the largest contributors to growth since the recovery began. Consumer spending and gross capital formation are also the only components of Canadian GDP that are above the pre-crisis level. Investment in residential structures has likely peaked and will be a drag on growth in the near term as affordability issues weigh on buyers, existing home supply rises, and the Bank of Canada guides interest rates higher.

Canada's housing market has been on a tear for close to a decade. House price growth accelerated

CHARTS 1 & 2: SUPPLY CHAINS UNDER PRESSURE; CONSUMER FINANCES ARE NOT IN GREAT SHAPE DESPITE CRISIS-ERA SAVINGS

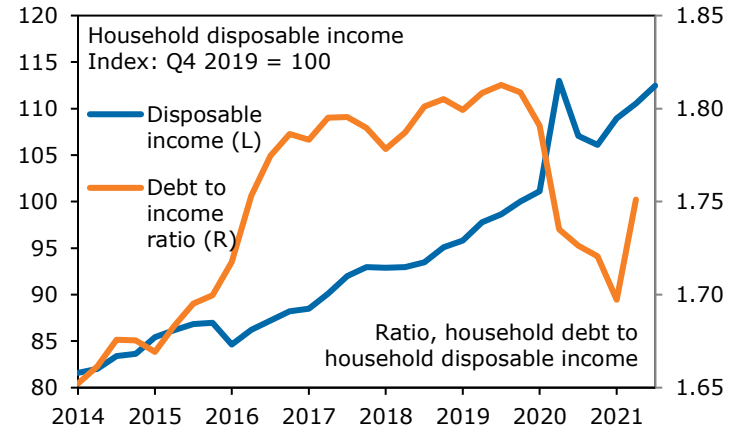
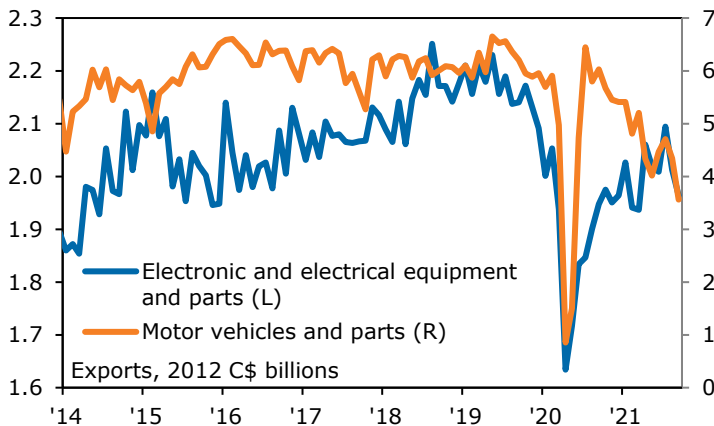


Chart source: Statistics Canada

during the pandemic thanks to extremely low mortgage rates, supply shortages, and remote work policies; existing home sales rose 38% in 2020 and investment in residential structures is 10.9% above its pre-crisis level. The housing boom has contributed to even higher levels of household indebtedness: Even with household disposable income up by more than 10% since the pandemic began, the household debt-to-disposable income ratio remains near the all-time high (Chart 2). In response to fears of an impending crisis, the government proposed a 1.0% tax on vacant foreign-owned properties in the next federal budget, to be effective January 1, 2022. Even so, demand for housing will remain strong while borrowing costs remain low and immigration policies remain inviting.

Higher energy and housing prices will put upward pressure on inflation in the near term

As in the U.S., inflation has been running hot in Canada. After annual CPI inflation averaged 1.9% between 2000 and 2019, it has overshot the upper limit of the Bank of Canada’s 1% to 3% target range since April 2021 due to year-over-year comparisons with months in which prices outright declined in 2020, reopening pressures, supply-chain disruptions, and rising raw material costs. CPI inflation rose to 4.7% in October in year-ago terms, the highest since March 2003. Energy, transportation services and durable goods have been big contributors to price increases this year. Higher energy and housing prices (shelter is the largest-weighted component of the consumer price basket) will also put upward pressure on inflation in the next couple of months. Like the Fed, the Bank of Canada views the recent inflation spike as mostly short-lived and transitory.

The Canadian dollar will give back some of its 2021 gains as the Fed tapers and oil prices stabilize

After beginning quantitative easing (QE) in March 2020 in response to the pandemic, the BOC was one of the first major central banks to start reducing (“tapering”) QE in April 2021. Their C\$2 billion in long-term bond purchases in September 2021 were down from a peak of C\$5 billion between April and October of 2020. The BOC completed the taper of its QE program in October, ending net purchases of long-term Canadian government bonds. With an improved economic outlook, PNC expects the BOC to raise the benchmark policy rate 0.25 percentage point at both the July 2022 and October 2022 monetary policy decisions, to 0.75%.

With a less accommodative stance from the Bank of Canada, the global economy recovering, and crude oil prices rising, investors have flocked into the Canadian dollar. The currency appreciated a net 3.8% between April 21—when the BOC announced the beginning of the taper—and June 30. PNC expects the Canadian dollar to be lifted by higher energy prices in the near term, then weakened in the next couple of years as the Fed unwinds monetary stimulus and as global oil prices stabilize (See Chart 3).

CHART 3: LOONIE TO GAIN GROUND BY YEAR-END, THEN EDGE LOWER AS THE FED TAPERS AND ENERGY PRICES STABILIZE



Chart sources: Bloomberg, The PNC Financial Services Group

Visit <http://www.pnc.com/economicreports> to view the full listing of economic reports published by PNC’s economists.

Disclaimer: The material presented is of a general nature and does not constitute the provision of investment or economic advice to any person, or a recommendation to buy or sell any security or adopt any investment strategy. Opinions and forecasts expressed herein are subject to change without notice. Relevant information was obtained from sources deemed reliable. Such information is not guaranteed as to its accuracy. You should seek the advice of an investment professional to tailor a financial plan to your particular needs. © 2021 The PNC Financial Services Group, Inc. All rights reserved.