



## Ontario Economic Forecast 2022-2024

Ontario's economy will traverse challenging times ahead due to headwinds from multiple fronts. Multi-decade high inflation combatted by rising interest rates will slow economic activity. Add to that the spectra of new, more virulent COVID-19 variants, the prospects of increased public health restrictions cannot be taken off the table for the upcoming fall/winter seasons.

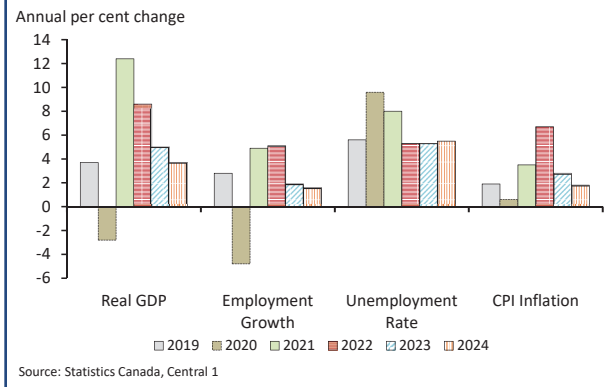
While Ontario will face challenges from the ongoing housing market correction, inflation and interest rate hikes affecting consumer confidence and spending, Ontario is not forecast to dip into a recession. Economic activity will decelerate over the forecast horizon but remain slightly above or at trend as the forecast horizon moves beyond 2022. Population growth via immigration will offset headwinds mentioned previously and help with ongoing skilled labour shortages. Continued government investments will also lift economic activity and offset declining business investments as residential spending (down 4.7 per cent in 2022) and lower business capital formation (down 0.8 per cent in 2022) act as a drag. Uncertainty will cloud business investments over the next two years before rebounding by 2024. Real GDP growth is forecast to come in at 3.0 per cent in 2022 then moving closer to long term trend by 2023 and 2024 in the range of 1.8 to 2.1 per cent. Employment growth comes in at 5.1 in 2022 as employers continue to rebuild, particularly in the services sector, and grow closer to 2.0 per cent over the remainder of the forecast.

Nominal GDP is forecast to grow by 8.6 per cent in 2022, lifted by inflation and increased economic activity thereafter decelerating to 5.0 per cent and 3.7 per cent in 2023 and 2024, respectively.

### Inflation and macro-economy uncertainty clouds outlook

External macro-economic trends are increasingly uncertain with risks of a deep growth slowdown as central banks move quickly to rein in inflationary pressures which have surged across the globe and reached 40-year highs in the U.S. and Canada.

### Tighter monetary policy to corral inflation but at the cost of slower economic growth



Drivers of inflation have been multi-pronged with the combination of pandemic supply chain disruptions, unprecedented pandemic fiscal stimulus and rotation to goods demand. These factors have been amplified by the war in Ukraine which has further shocked global energy and food prices. Moreover, China's COVID-zero strategy and lockdowns continue to delay supply chain recoveries.

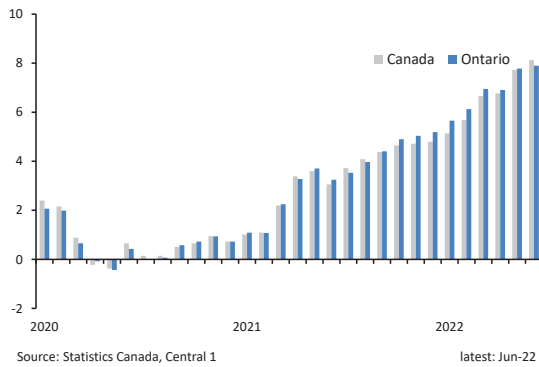
The extreme and unpredictable pandemic-era themes are weighing on global growth prospects as inflation reduces real household income, while energy and food scarcity increasingly become a challenge for Europe and emerging market economies. Knock-on effects of the war are slowing growth, with downside risks if Russian supply of energy is further restricted. Purchasing Managers Index (PMI) values are in decline and sat only marginally in expansionary territory into June despite easing of some Chinese COVID-19 restrictions, pointing to deteriorating conditions. The latest OECD global outlook output growth at 3 per cent this year, or 1.5 per cent lower than its December outlook, with a similarly subdued expansion in 2023.

### What goes up must come down but when?

Intertwined with these shocks are central banks looking to move quickly to rein in inflation and risks of higher inflationary expectations which triggered a sharp upswing in bond yields. The U.S. Fed signaled

## Ontario continues to face record inflationary pressures

Year-over-year change in consumer price index, per cent



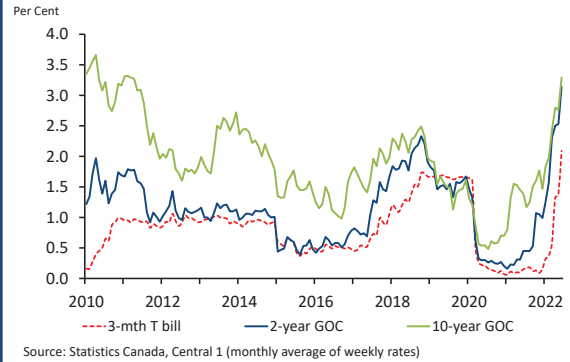
a series of aggressive rate hikes this year which could lift the federal funds rate to 3.4 per cent or up 200 basis points by year-end. That said, this combination of high inflation, energy prices and rising rates is already curbing U.S. growth. Purchasing Manager Indices (PMI) are in decline, real consumer spending has turned over, sentiment is weak and housing volumes are in decline. While risk of a U.S. recession has increased with flagging GDP growth in the first half, the U.S. labour market remains supportive and continues to churn out jobs at a solid pace with the unemployment rate remaining excessively low at 3.6 per cent. Nevertheless, broad deterioration in momentum will, in our view, be enough to meaningfully curtail inflation into 2023 and put the brakes on excessive rate tightening both in magnitude and duration. Commodity prices have recently retrenched sharply, preceding a turn in inflation pressure. Long bond yields have also recently declined, suggesting markets are expecting less upward rate pressure as economic activity slows.

The Canadian economy is expected to decelerate but remain in solid shape despite the downdraft of slowing global and U.S. growth, reflecting a lift from strong but waning commodity prices, higher investment, a tight labour market and robust population growth. Following the 100-basis point Bank of Canada rate hike in July, we expect the policy rate to reach 3.25 per cent in late 2022 which will curtail interest-rate-sensitive sectors like housing and durable goods spending. A slower economy and dampening inflation next year introduces the spectra of rate cuts later in 2023.

## Economic recovery at risk by correcting housing markets and slower household consumption

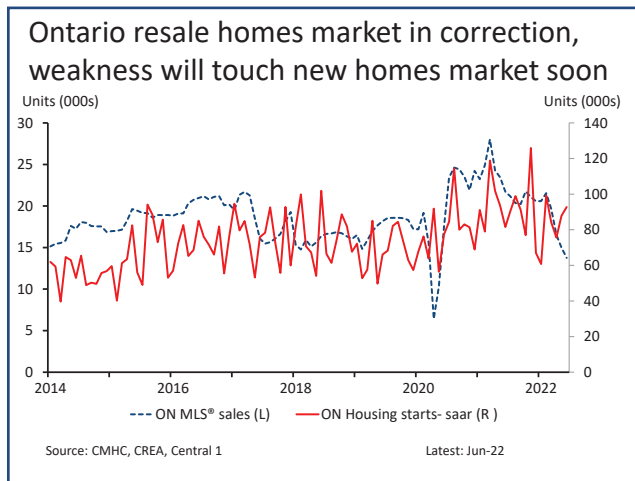
Household consumption is forecast to increase 4.4 per cent in 2022, surpassing last year's 4.1 per cent growth but then settle lower over the forecast horizon moving up 2.3 per cent and 1.7 per cent by 2023 and

## Interest rates rise sharply trying to quell inflation



2024, respectively. Ontario has faced some of the strictest and longest lasting public health restrictions during this pandemic with the latest round of restrictions lifted as recently as the first quarter of 2022. With that, people have undertaken a brisk pace of “revenge spending” as social and economic life has re-opened once again. This has front loaded household spending. Also lifting household spending is inflationary pressures passed onto consumers and strong homeownership investments — up until interest rates started rising. Inflation is forecast to average 6.7 per cent in Ontario in 2022 which will dampen household spending into the second half of 2022 as consumers tighten belts and focus on necessary expenditures like food and shelter. Moreover, increased shelter costs via higher interest rates will eat away at discretionary spending. During the pandemic, many households rushed to homeownership supported by exceptionally low interest rates. Many of these households took variable mortgage rates that are now climbing very quickly and eating away at a larger portion of households’ take-home pay, contributing to lessened consumer activity beyond the first half of 2022. With some of these trends continuing until at least 2024, household spending will decelerate over the next two years coming in at 2.3 per cent and 1.7 per cent in 2023 and 2024, respectively.

Increased monthly carrying costs is also dampening homeownership demand considerably and this is one sector in the economy that is feeling recessionary pressures. At the height of the rush to homeownership, the average valuation in February 2022 was up over 50 per cent from pre-pandemic levels in February 2020. Cheap credit, the need for more space and many people leaving the big centres drove demand for housing which outpaced supply keeping the market in firm sellers’ market for many months. Now that the Bank of Canada has started to tighten rates to try and quell inflationary pressures, the homeownership market has screeched to a halt. With June data in the

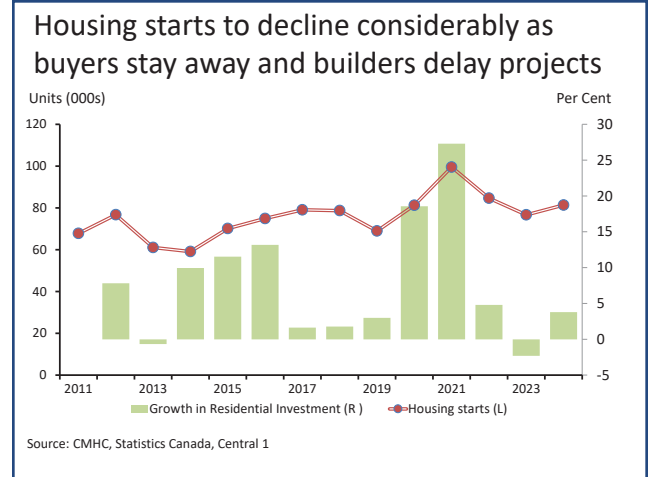


books from the Canadian Real Estate Association (CREA), home sales are down over 26 per cent in 2022 compared to a year ago. Moreover, average home valuations remain elevated at over 31 per cent (\$887,658) in June 2022 from pre-pandemic activity but are sliding monthly as buyers are staying away in larger numbers and those still in the market are aggressively negotiating lower prices.

As home equity shrinks and inflation and increased interest rates continue to bite demand for housing will continue to dwindle. This has also dampened renovation spending. Renovation spending was significant prior to the current slowdown as many homeowners renovated homes to attract higher sale prices once on the market. With the incentive to sell not as strong, renovation spending has started edging down. Moreover, with many households largely settled into remote/ work-from-home schemes, the need to renovate home spaces to accommodate school and work activities has also waned.

Weaker activity in the resale market flows through into new home construction. After a record-setting year where over 100,000 new housing units broke ground, housing starts are forecast to decline in 2022 (down 15.4 per cent) and in 2023 (down 9.4 per cent) before rebounding by 2024. Typical drivers for new housing demand such as population growth and labour market growth will be supportive but offset by increased construction costs and skilled labour shortages dampening supply. For example, the City of Toronto raised development charges by 50 per cent<sup>1</sup> in mid-July — these increased costs may lead to cancellation of projects in that region. Should other regions follow this example, this will compound the decline in new construction activity.

1 <https://www.theglobeandmail.com/canada/article-toronto-city-council-hikes-development-charges-adding-tens-of/>



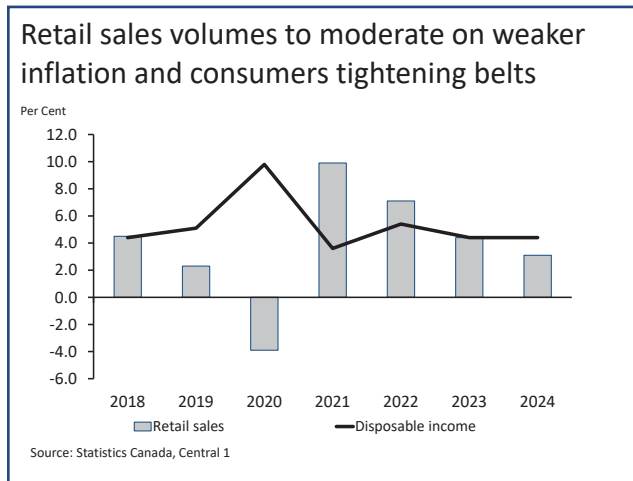
## Headwinds in manufacturing will slow down exports' growth in 2022

Manufacturing activity in Ontario has fully rebounded from the shock felt early in the pandemic. As of May 2022, manufacturing sales volumes are 14.2 per cent higher than they were in February 2020. Of course, this does not only account for a recovering sector getting closer to full output, but also higher production and labour costs being passed on to clients.

Over the course of 2022, manufacturing sales volumes have trended higher than any prior year from 2019 to now but recently volumes have been trending down. As inflation, higher interest rates, and higher production and wage costs bite, even if most of these costs are flowed through to the consumer, many consumers are rethinking some purchases and beginning to cut budgets.

At the start of the pandemic, demand for new cars and parts increased as people preferred to spend on a car than ride public transportation. That may still be the case but increased cost pressures, not only by producers due to increased costs for commodities but for consumers, will continue to affect growth in this area. Prohibitive costs for energy, gasoline in particular, will not help demand for new cars and trucks in the short run.

Some of the weakness in this area will be offset by increased sales volumes for food, beverages and tobacco, as well as petroleum and coal products as consumers focus more on necessary goods and spending into the back half of 2022.



Like manufacturing, exports have fully rebounded. As of May 2022, export volumes are 18.9 per cent higher than they were pre-pandemic. Similar reasons for the rebound in manufacturing are driving the rebound in exports. The most recent data sees a significant slowdown in key areas of exports such as motor vehicles and parts, aircraft and other transportation equipment, and metal and non-metallic mineral products. While exports are forecast to grow at 6.1 per cent in 2022, this is a bit slower than our previous forecast (6.3 per cent in last outlook) given increased trade headwinds the further we go into 2022. The outlook improves by 2023 as world trade rebalances and exports are forecast to increase by 4.6 per cent and then an additional 1.9 per cent by 2024.

## Employers will continue to intensely compete for labour in 2022, some headwinds in the second half of 2022

Ontario's labour market has been hard-hit during this pandemic, particularly the client-facing services sector. With restrictions lifted in all but a few remaining areas like subways, long-term care homes, etc., the economy continues to rebound, supported by increased social and economic activity. Ontario's

labour markets remain tight as skilled and non-skilled labour shortages persist. In June, the unemployment rate reached 5.1 per cent lower than the 5.5 per cent posted in May. As population increases in 2022 from larger flows of immigrants, this will add a much-needed boost to the labour force. By the end of 2022, the average unemployment rate is forecast to come in a bit higher than it is now at 5.3 per cent, due to labour force growth outstripping employment growth, which is forecast to be a robust 5.1 per cent. The service sector will continue to rebound but the goods sector will face some headwinds due to ongoing supply chain issues and increased costs. Construction and manufacturing will also be affected.

Personal incomes are forecast to increase by 5.9 per cent in 2022 as employers try to entice workers to fill vacant jobs.

In 2023 and 2024, the unemployment rate is forecast to come in at 5.3 per cent and 5.5 per cent, respectively. Hiring growth is expected to stabilize towards longer-term trend, growing at 1.9 per cent in 2023 and 1.6 per cent in 2024.

The notion that tighter monetary policy and inflationary pressures may lead to decreased consumer spending in the back half of 2022 is baked into this labour market forecast — a notion which could lead to some increased slack in the labour market.

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## ON Forecast Table

Provincial Forecast							
	2018	2019	2020	2021	2022	2023	2024
GDP at market prices	4.3	3.7	-2.8	12.4	8.6	5	3.7
Real GDP, expenditure-based	3.4	2	-5.1	4.3	3	2.1	1.8
Household consumption	3	1.6	-7.8	4.1	4.4	2.3	1.7
Government expenditure	4	1	-0.2	5.5	1.2	1.2	1.7
Government capital formation	2.7	-3.9	3.1	5.7	6.9	2.1	3.8
Business capital formation	4.6	0	0.6	11.8	-0.8	-3.4	1.5
Residential structures	-3.2	0.3	6.8	16	-4.7	-5.1	1.7
Machinery and equipment	6.9	-0.5	-12.6	14	7.6	-4.1	3.5
Non-residential structures	14.3	1.4	-0.1	3.9	2.1	1.5	0
Final domestic demand	3.3	1	-4.3	6	2.5	0.8	1.7
Exports	2.9	2.3	-7.3	0.8	6.1	4.6	1.9
Imports	2.5	0.6	-8.9	6	4.7	2.2	2.3
Employment	1.7	2.8	-4.8	4.9	5.1	1.9	1.6
Unemployment rate (%)	5.7	5.6	9.6	8	5.3	5.3	5.5
Personal income	4.6	4.6	7	5.1	5.9	4.5	4.3
Disposable income	4.4	5.1	9.8	3.6	5.4	4.4	4.4
Compensation of employees	6.1	4.4	-0.3	9.2	9.7	5.1	4.7
Net operating surplus: Corporations	1.6	-1.3	10.2	24.5	2.9	3.5	-0.8
CPI	2.4	1.9	0.6	3.5	6.7	2.8	1.8
Retail sales	4.5	2.3	-3.9	9.9	7.1	4.4	3.1
Housing starts, 000s	78.7	69	81.3	100.1	84.7	76.7	81.4
Population Growth (%)	1.7	1.6	1.4	0.5	1.5	1.6	1.6
Key External Forecasts							
U.S. Real GDP	2.9	2.3	-3.4	5.2	2.6	1.8	2.1
Canada Real GDP	2.7	1.6	-5.6	4.9	3.8	2.4	2
European Union Real GDP	1.8	1.6	-6.5	5.3	1.2	2.3	2
China Real GDP	6.7	5.9	2.3	8.1	4	5.1	4.8
Japan Real GDP	0.6	-0.2	-4.5	1.6	2.4	2.3	1.5
Canada 3-month t-bill, %	1.4	1.66	0.42	0.13	2.2	3.1	2.8
Canada GoC long-term Bond, %	2.33	1.73	1.08	1.8	3	2.8	2.6
U.S.-Canada Exchange Rate, cents/dollar	77.2	75.4	74.6	79.9	78.6	79.6	80.3
Crude Oil WTI USD\$ per barrel	65	57	39	68	100	90	85
Henry Hub Natural Gas Price, US\$ per mmbtu	3.17	2.57	2.03	4.06	5.43	4.17	3.5