March/April 2025

Canada: Solid growth, fragile future

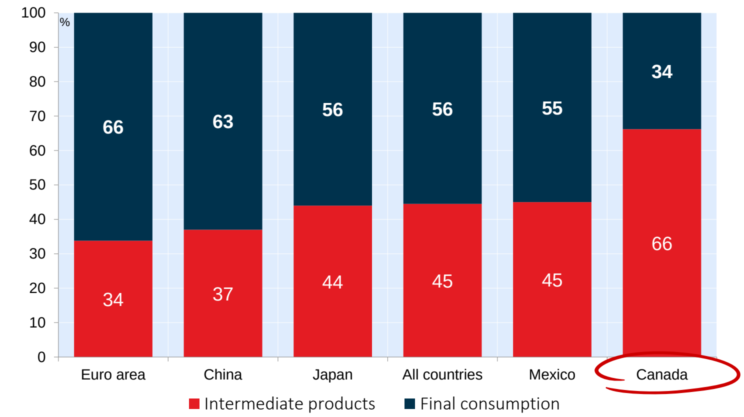
By Matthieu Arseneau and Daren King

Summary

- Canada is more than ever caught between a rock and a hard place, tensions running high with its main trading partner, whose protectionist bent is now undeniable. We still hold out some hope that the US administration will recognize Canada as a trading partner of choice and grant it preferential status.
- This current uncertainty is unfortunate, as the conditions seemed ripe for a soft landing for the economy, with the central bank having been able to cut its policy rate by 225 basis points since June 2024. Indeed, the economic recovery has recently exceeded economists' expectations, with the Citi Economic Surprise Index reaching its highest level in almost three years.
- But the upturn is likely to be short-lived, if consumer confidence level is anything to go by, which was at a record low in February. It turns out that the context of tariff uncertainty has pushed insecurity related to the job market and major purchases (house, car, etc.) to extreme levels. A weakening of the Canadian labour market is all the more likely as consumer pessimism is shared by business owners.
- We maintain GDP growth of just 1.2% in 2025. A better starting point than previously estimated is offset by a significant weakening of the economy in the second and third quarters. As a result, the unemployment rate is expected to rise in the 7.0% to 7.5% range over the next few months (6.6% in February).

Canada is more than ever caught between a rock and a hard place, tensions running high with its main trading partner, whose protectionist bent is now undeniable. Already, Canada has been hit with 25% tariffs on steel and aluminum from the United States. The 25% tax was also initially announced by the President on all goods with the exception of energy and potash, taxed at 10%, but USMCA-compliant products were eventually exempted. Around 40% of goods sent to the U.S. are in this situation, and an additional similar proportion could become compliant as well. So, for the time being, the scale of the tariffs is limited, but the situation remains highly uncertain, and we'll have to wait until April to see more clearly what so-called reciprocal tariffs the US intends to put in place on each country. We still hold out some hope that the U.S. administration will recognize Canada as a trading partner of choice and grant it preferential status. As we mentioned in the previous Monthly Economic Monitor, Canada is the United States' second largest trading partner, accounting for 14% of its trade in goods, but only 5% of its total trade deficit. If we exclude the energy sector, which the Americans so badly need for their reindustrialization, their country has a trade surplus. What's more, 66% of Canadian exports to the U.S. are used as inputs in U.S. production, well above the 45% average of other U.S. trading partners. Canada is therefore an important partner for U.S. companies producing on U.S. soil, not a competitor seeking to capture market share from U.S. consumers.

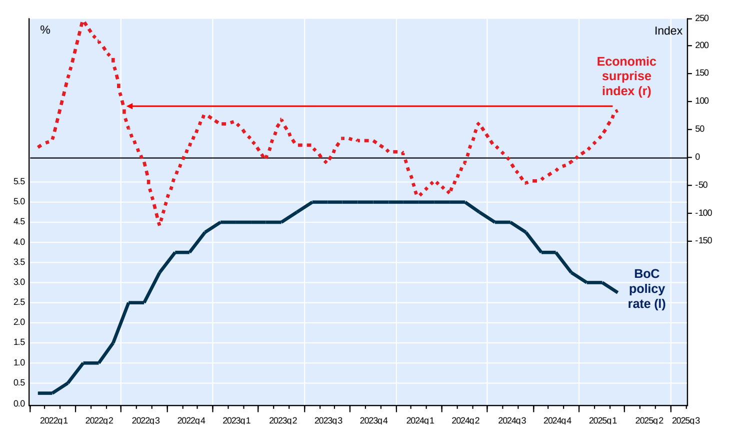
Canada: A major partner for companies producing on American soil
Share of U.S. imports meant for intermediate products vs. destined to final consumption



NBC Economics and Strategy (data via San Francisco Fed 2019)

This current uncertainty is unfortunate, as the conditions seemed ripe for a soft landing for the economy, with the central bank having been able to cut its policy rate by 225 basis points since June 2024, with inflation under control. Indeed, the economic recovery has recently exceeded economists' expectations, with the Citi Economic Surprise Index reaching its highest level in almost three years.

Canada: An economic resurgence in the wake of interest rate cuts
Bank of Canada policy rate and Citi economic surprise index



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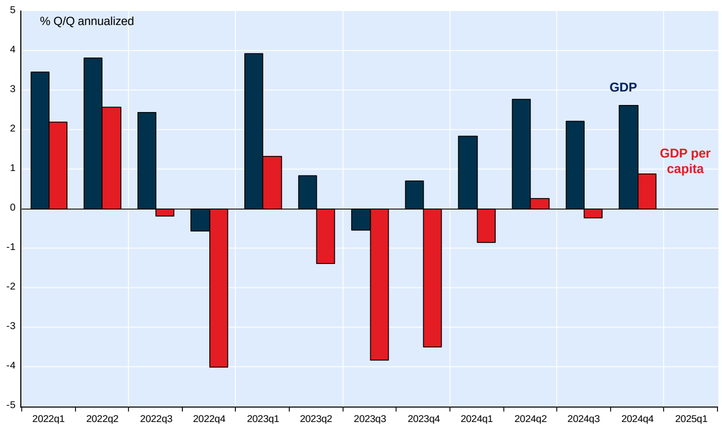
The economic accounts data released for the fourth quarter spoke for themselves. Annualized growth of 2.6% was well above the consensus of 1.7%, and third-quarter growth was revised sharply upwards (from 1.0% to 2.2%). The Q4 performance, at a time when population growth is slowing, is most welcome, as it allows GDP per capita to increase at its strongest pace for 7 quarters.

Canada: Best performance of GDP per capita in 7 quarters
Gross domestic product and gross domestic product per capita



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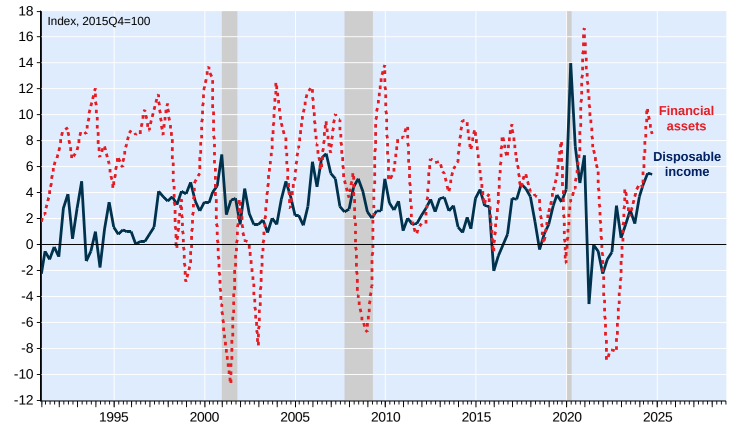
Canada: Consumers with deep pockets
Real disposable income and real financial assets



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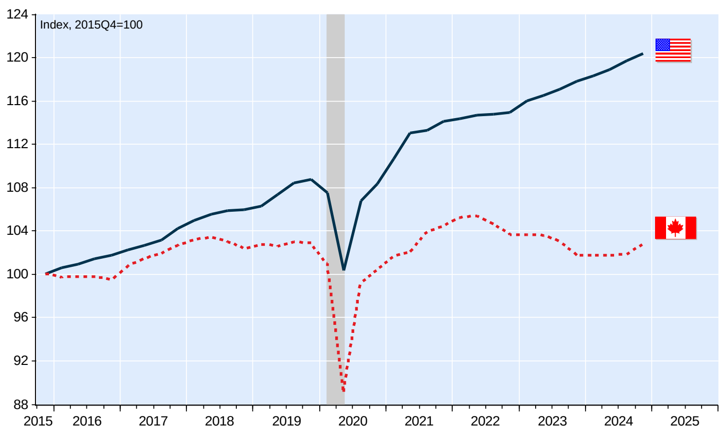
The performance would have been even better had it not been for the negative contribution of inventories, which was not, however, surprising. We have been warning our readers of such a possibility for some time, given the high inventory levels in the economy. Businesses therefore drew on inventories to meet booming domestic demand, which grew at an annualized rate of 5.6%, enabling the first notable increase in per capita domestic demand since 2022.

Canada: Final domestic demand finally picks up
Final domestic demand per capita (chained dollars)



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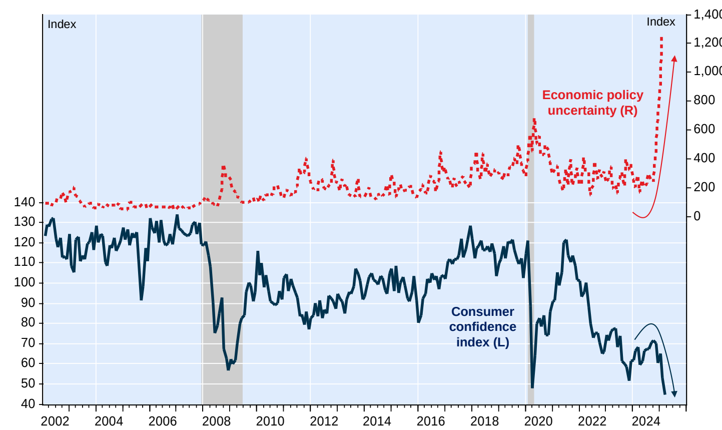
In addition to the residential sector and investment in machinery and equipment, consumption was also very strong, at 5.6%. Adding to solid growth in incomes and financial assets over the past year, there is reason to believe that interest rate cuts, which have given a respite to variable-rate borrowers, have also contributed to this strength.

But the upturn is likely to be short-lived, if consumer confidence levels are anything to go by. In February, they hit a record low, surpassing the lows seen at the height of the COVID recession and the global financial crisis. It turns out that the context of tariff uncertainty has pushed insecurity related to the job market and major purchases (home, car, etc.) to extreme levels.

Canada: Consumers have never felt worse as trade war loom
Consumer confidence index and economic policy uncertainty



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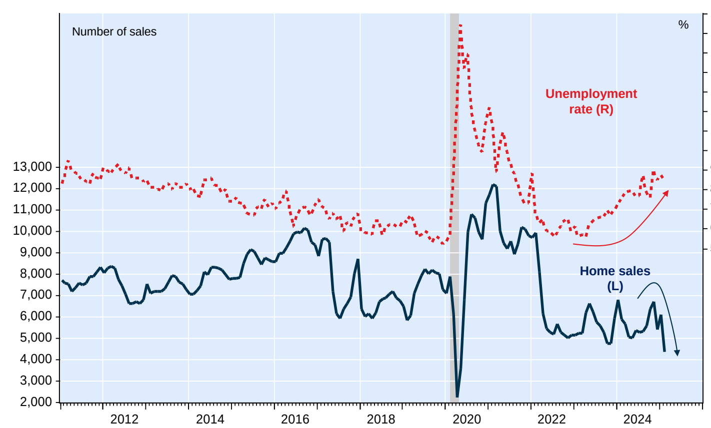
This reluctance has already been reflected in weak home sales, which had been showing good momentum at the end of last year. In February, home sales fell by 9.8%, the third consecutive contraction. The widespread nature of the weakness was evident, with all four major provinces posting significant declines. Ontario recorded a 20.2% decline, while sales in the Greater Toronto Area fell by 29%. The only time sales were so weak was during the COVID-related lockups and the global financial crisis. The job market in the Queen City has deteriorated sharply in the wake of monetary tightening since 2022. In February, the unemployment rate stood at 8.5%, while among young people aged 15 to 24, it reached 19.2% (3-month moving average). A difficult job market like this, which is set to deteriorate further, does not bode well for the real estate market.

Toronto: Resale market in the doldrums
Home sales and unemployment rate



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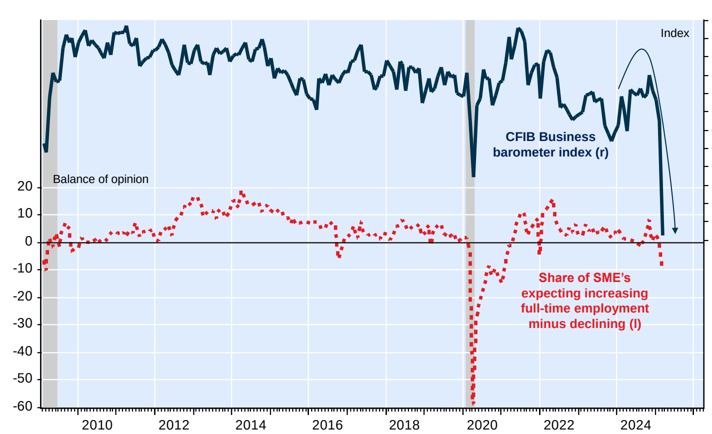
A weakening labor market in Canada is all the more likely as consumer pessimism is shared by business owners. CFIB's SME confidence index collapsed in March to a record low in the wake of repeated threats from the US administration. All sectors have fallen recently, and it's no surprise to see manufacturing and transportation among the three sectors with the lowest levels, along with accommodation and food services. The hiring intentions indicator also deteriorated sharply, with a greater proportion of companies now anticipating declines in the number of workers rather than increases. The indicator plunged to a level only seen during recessions.

Canada: Labour market at risk amid plunge in SME's confidence
CFIB business barometer index and hiring intentions



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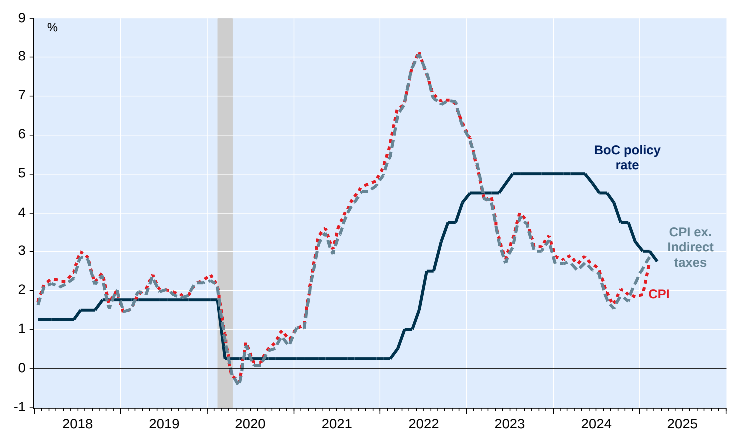
The Bank of Canada is in a dilemma at the moment. Economic data was strong in the fourth quarter of 2024, and the first quarter of this year is being temporarily boosted by strong exports, as US companies wanted to stock up on Canadian products ahead of the potential implementation of tariffs. Moreover, households have benefitted from government largesse (GST/HST rebates and Ford stimulus payments). These appear to have caused a surge in inflationary pressures at home, and for this reason the interest rate decision in April could be difficult. However, the uncertainty could last for some time yet, and that would be bad for the economy. Indeed, the US administration has hinted that, following the announcement of tariffs on a reciprocal basis in early April, a period of negotiation will follow. During this time, the current Canadian leader will have other things to worry about, namely trying to win an election to run the country for the next few years. We are maintaining GDP growth of just 1.2% in 2025. A better-than-estimated starting point is offset by a significant weakening of the economy in the second and third quarters. As a result, the unemployment rate is set to rise in the 7.0% to 7.5% range over the coming months (6.6% in February). The poor economic performance is likely to convince the central bank that further monetary easing is necessary, and we anticipate a policy rate of 2.0% by the end of the year.

Canada: The rise in inflationary pressures may be temporary
Policy rate and annual inflation



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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	1.5	1.2	1.0	2.4	0.2	1.7
Consumption	5.5	1.8	2.4	2.1	1.1	3.6	0.6	1.5
Residential construction	(10.6)	(8.5)	(1.1)	2.0	(0.6)	1.3	(2.2)	2.2
Business investment	6.4	1.0	(1.9)	(0.6)	(0.1)	2.6	(2.3)	1.2
Government expenditures	2.6	2.6	3.8	2.3	1.9	4.6	1.6	2.1
Exports	4.2	5.0	0.6	1.9	0.8	0.1	0.6	2.0
Imports	7.5	0.3	0.6	1.7	1.5	0.3	1.3	1.9
Change in inventories (millions $)	51,121	25,497	14,428	(4,253)	(1,903)	....	....	....
Domestic demand	3.3	1.1	2.0	1.9	1.1	3.5	0.5	1.7
Real disposable income	(0.3)	1.6	4.7	2.5	1.2	5.3	1.0	1.3
Employment	4.1	3.0	1.9	1.1	0.3	1.6	0.4	0.7
Unemployment rate	5.3	5.4	6.4	7.0	7.0	6.7	7.3	6.8
Inflation	6.8	3.9	2.4	2.3	2.0	1.9	2.3	2.1
Before-tax profits	17.9	(14.8)	(4.2)	4.3	2.9	(3.2)	(0.4)	4.0
Current account (bil. $)	(8.7)	(18.4)	(13.0)	(20.0)	(17.0)	....	....	....

** or as noted*

Financial Forecast**

	Current 3/21/25	Q1 2025	Q2 2025	Q3 2025	Q4 2025	2024	2025	2026
Overnight rate	2.75	2.75	2.50	2.25	2.00	3.25	2.00	2.50
Prime rate	4.75	4.75	4.50	4.25	4.00	5.25	4.00	4.50
3 month T-Bills	2.65	2.50	2.35	2.15	1.95	3.15	1.95	2.70
Treasury yield curve								
2-Year	2.51	2.50	2.35	2.15	2.05	2.94	2.05	2.65
5-Year	2.65	2.60	2.45	2.30	2.25	2.97	2.25	2.75
10-Year	3.01	2.95	2.80	2.70	2.65	3.24	2.65	2.95
30-Year	3.24	3.20	3.00	2.90	2.85	3.34	2.85	3.05
CAD per USD	1.44	1.47	1.45	1.42	1.40	1.44	1.40	1.37
Oil price (WTI), U.S.$	69	67	64	61	60	72	60	66

*** 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)	1.8	2.8	2.2	2.6	2.3	(1.5)	(0.2)	0.4
CPI (y/y % chg.)	2.8	2.7	2.0	1.9	2.4	2.2	2.2	2.3
CPI ex. food and energy (y/y % chg.)	2.9	2.8	2.5	2.1	2.6	2.8	2.9	2.8
Unemployment rate (%)	5.9	6.3	6.6	6.7	6.6	7.0	7.3	7.3

National Bank of Canada

Provincial economic forecast

	Real GDP (% growth) 2022	2023	2024e	2025f	2026f	Nominal GDP (% growth) 2022	2023	2024e	2025f	2026f
Newfoundland & Labrador	-1.9	-2.6	2.5	1.4	1.0	6.5	-5.5	3.5	1.0	1.9
Prince Edward Island	4.4	2.2	3.0	1.8	1.0	10.4	4.9	5.4	4.3	3.3
Nova Scotia	3.5	2.0	1.8	1.3	0.9	7.4	8.0	4.3	3.5	2.7
New Brunswick	2.0	1.6	1.5	1.0	0.7	10.4	3.2	4.2	3.7	2.8
Quebec	3.4	0.6	1.3	1.0	0.8	8.7	5.0	5.1	4.1	2.9
Ontario	4.1	1.7	1.2	1.0	0.8	9.4	5.4	4.2	3.5	2.6
Manitoba	4.2	1.7	1.2	1.2	1.0	10.8	4.5	3.7	3.5	2.5
Saskatchewan	7.2	2.3	1.6	1.8	1.7	30.4	-4.8	3.9	2.3	2.1
Alberta	6.0	2.3	2.8	1.8	1.7	24.4	-4.3	5.4	2.9	2.3
British Columbia	4.0	2.4	1.1	1.2	1.1	10.8	3.6	4.1	3.8	2.6
Canada	4.2	1.5	1.5	1.2	1.0	12.4	2.9	4.6	3.5	2.6

	Employment (% growth) 2022	2023	2024e	2025f	2026f	Unemployment rate (%) 2022	2023	2024e	2025f	2026f
Newfoundland & Labrador	4.0	1.7	2.7	0.2	0.2	11.1	9.8	10.0	10.2	9.9
Prince Edward Island	5.0	6.2	3.6	1.9	1.2	7.7	7.3	7.8	8.1	7.2
Nova Scotia	3.5	2.7	3.1	0.8	0.7	6.6	6.4	6.5	6.2	5.5
New Brunswick	2.9	3.4	2.8	0.8	0.6	7.2	6.6	7.1	7.2	6.7
Quebec	3.1	2.9	0.9	1.3	0.3	4.3	4.4	5.4	5.8	5.8
Ontario	4.8	3.1	1.7	0.9	0.2	5.6	5.6	7.0	7.8	7.8
Manitoba	3.6	2.7	2.6	0.8	0.4	4.5	4.9	5.5	7.2	7.2
Saskatchewan	3.5	1.6	2.6	0.9	0.6	4.6	4.7	5.5	5.8	6.2
Alberta	4.9	3.7	2.9	1.8	0.7	5.8	5.9	7.1	7.7	8.0
British Columbia	3.4	2.6	2.4	0.7	0.3	4.6	5.2	5.6	6.2	6.1
Canada	4.1	3.0	1.9	1.1	0.3	5.3	5.4	6.4	7.0	7.0

	Housing starts (000) 2022	2023	2024e	2025f	2026f	Consumer Price Index (% growth) 2022	2023	2024e	2025f	2026f
Newfoundland & Labrador	1.5	1.0	1.7	1.5	1.5	6.4	3.3	1.8	2.0	1.9
Prince Edward Island	1.0	0.9	1.2	1.1	1.1	8.9	2.9	1.9	2.0	1.9
Nova Scotia	5.6	7.1	7.4	6.8	7.0	7.5	4.0	2.3	2.2	2.0
New Brunswick	4.6	4.7	6.2	5.8	6.0	7.3	3.5	2.2	2.2	2.0
Quebec	58.5	39.9	48.7	47.0	49.0	6.7	4.5	2.3	2.4	2.0
Ontario	96.0	90.0	74.6	65.0	63.0	6.8	3.8	2.4	2.2	2.0
Manitoba	8.1	7.1	7.2	7.5	7.2	7.9	3.6	1.0	2.1	2.0
Saskatchewan	4.2	4.6	4.3	4.5	4.2	6.6	3.9	1.4	2.2	2.0
Alberta	36.4	35.9	47.8	50.0	48.0	6.5	3.3	2.9	2.3	2.0
British Columbia	46.7	50.6	45.8	43.0	41.0	6.9	4.0	2.6	2.6	2.0
Canada	262.7	241.8	245.0	232.2	228.0	6.8	3.9	2.4	2.3	2.0

e: estimate f: forecast

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

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