

The Canadian Modeling System June 2021 Projection Summary

Canada's economy is in the process of opening up once again, and the toll that lockdowns have taken on households, businesses and governments will become more apparent in the coming months. Despite current public acceptance of higher levels of public indebtedness, some level of fiscal drag is inevitable, especially once interest rates start to rise and debt service costs threaten to become unsustainable. Canada's economy is expected to rebound in 2021 with output up 6.5% and employment up 4.1% as the unemployment rate falls to 7.5%. Economic growth will slow in 2022 to 3.3% with the unemployment rate falling again to 7.2%.

External Economic Environment Assumptions and Outlook

The assumptions behind the external economic environment are drawn from several sources: (i) the United Nations (UN) Department of Economic and Social Affairs Population Division, (ii) the United States Energy Information Administration (EIA) and (iii) the International Monetary Fund.

Population projections for all countries (other than Canada) are consistent with the UN's "Medium Variant Scenario" from the **World Population Prospects: 2019 Revision**ⁱ publication. The countries explicitly included in the CMS plus the Eurozone region countries currently account for just over half of the world's population, but the UN expects this proportion to shrink as population growth in other countries exceeds that of Canada's principal trading partners.

Forecasts of the WTI oil price and Henry Hub natural gas spot price are taken from the EIA's **May 2021 Short-Term Energy Outlook (STEO)**ⁱⁱ for 2021 and 2022 and their "Reference Case Scenario" from the **Annual Energy Outlook 2021**ⁱⁱⁱ with projections to 2050. Short-term forecasts of U.S. real GDP and the GDP deflator are taken from the IMF while projections to 2050 for U.S. real GDP, the GDP deflator and short and long-term interest rates are also taken from the EIA's publications.

The global outlook for non-energy commodity U.S. dollar prices represented in the CMS are broadly consistent with those published by the International Monetary Fund in their **World Economic Outlook Update (April 2021)**^{iv} report for the period up to 2026.

The outlook for real GDP other than Canada is also consistent with those published by the International Monetary Fund's **World Economic Outlook Update (April 2021)** report for the period up to 2026. The countries explicitly included in the CMS plus the Eurozone region countries currently account for just

A set of charts and tables summarizing the June 2021 (F21B) projection is available at www.qedinc.ca. A set of detailed forecast tables are available upon request (subject to terms and conditions). The June 2021 projection is based on information that is current as of June 1, 2021. The reader should note that the national level data used in the CMS is based on the provincial and territorial economic accounts which differ in timing, value and conception from Canada's quarterly national accounts data.

This projection is developed using QEDinc's Canadian Modeling System (CMS) which consists of a set of stochastic general equilibrium macroeconomic models for Canada, its provinces and territories. Documentation for the CMS is available upon request.

over three quarters of the world's output. Unlike the population share for the group of "other countries," the share of GDP for Canada's principal trading partners is expected to remain relatively constant over the projection period.

It remains to be seen which aspects of the global economy are permanently damaged by the crisis and which will recover relatively quickly. It seems likely, however, that global output is likely to remain permanently below what was anticipated before the pandemic. Western governments borrowed heavily to support households and businesses negatively impacted by the pandemic and, despite current public acceptance of higher levels of public indebtedness, some level of fiscal drag is inevitable, especially once interest rates start to rise and debt service costs threaten to become unsustainable.

The U.S. economy is expected to rebound 6.4% in 2021 and then slow to 3.5% growth in 2022 while Canada's trade-weighted foreign demand index will grow 6.1% in 2021 and 3.8% in 2022. Commodity prices will surge 30.1% in 2021 led by energy commodities and then remain relatively flat for a few years.

National Outlook

While 2021 is certainly a better year than the year we all wish we could forget, it has not lived up to the sense of hope we had at the start of the year as new variants of the virus sparked crippling public health measures to cope with a surge in new cases and hospitalizations along with delays in vaccine shipments and concerns about their safety and efficacy. While many of these issues have faded and the economy is in the process of opening up once again, the risk that a new variant of the virus could erupt and plunge us all back into lockdown remains a worry.

Canada's economy is expected to rebound in 2021 with output up 6.5% and employment up 4.1% as the unemployment rate falls to 7.5%. Economic growth will slow in 2022 to 3.3% with the unemployment rate falling again to 7.2%.

The Bank of Canada has been on the front lines of the struggle to preserve our economy by financing massive borrowing by federal and provincial governments to fund new income support and stabilization programs. And while they are expected to keep the Bank Rate low until at least next year, a commodity price boom and accelerating wage and prices could, however, lead to rapid increases in interest rates by 2022 to contain inflationary pressures. The Canada-US exchange rate is expected to appreciate to \$0.80 and then remain relatively stable for the next few years. Canada's nominal effective exchange rate will follow a similar pattern.¹

The rebound in economic activity across Canada's key export markets in 2021 is expected to have a major impact on Canada's export performance with real international exports rising 12%. Rapid export growth is expected to continue in 2022 before slowing to match the commodity price cycle.

¹ The countries explicitly included in the CMS plus the countries in the Eurozone region represent almost 95% of the total trade-weights in the Bank of Canada's nominal Canadian Effective Exchange Rate.

With a return to work for many Canadians and the prospect of higher wages, household spending is expected to grow 4.4% in 2021 and 3.6% in 2022. Perhaps the most interesting economic consequence of the pandemic has been its impact on housing markets around the globe. In Canada, residential investment spending is expected to rise 5.7% this year after the explosive 12.2% growth last year and continue to exhibit strong growth for another couple of years. Rising interest rates later in the decade will, however, impede spending growth as a growing share of disposable income will be required to service the mountain of debt accumulated over the last decade.

Business spending on new capital is expected to rise 9.9% in 2021 and then to slow to a level of growth consistent with Canada's anticipated modest economic growth over the next few decades.

The federal government's **Budget 2021**^v catalogued the wide-ranging set of measures taken to help households and businesses remain solvent during the pandemic and its actions to ensure a robust recovery – and the fiscal consequences for the federal government. This forecast reflects the measures described in that publication and was informed by the consensus forecast published in it.

The Provincial and Territorial Outlook

All parts of this country are expected to participate in the rebound in economic activity this year following the 2020 Covid slump. Real GDP growth in 2021 is anticipated to vary from lows of 4.7% in Prince Edward Island and 3.9% in the Yukon Territory to highs of 7.8% in Saskatchewan and 8.8% in the Northwest Territory. Positive economic growth is also expected across the country in 2022 also with a relatively wide range of outcomes with Ontario being the star performer.

A rebound in employment this year helps bring the unemployment rate down in all provinces but the declines in this rate become much smaller in 2022 and return to around pre-pandemic levels by the middle of the decade. Barring future disturbances, all provinces should experience modest economic growth over the next couple of decades.

Publication available from:

ⁱ <https://population.un.org/wpp/>

ⁱⁱ <https://www.eia.gov/outlooks/steo/>

ⁱⁱⁱ <https://www.eia.gov/outlooks/aeo/>

^{iv} <http://www.imf.org/en/publications/weo/>

^v <https://www.budget.gc.ca/2021/home-accueil-en.html>