

## The Canadian Modeling System December 2022 Projection Summary

In the midst of a relatively well coordinated international campaign to reduce inflation, many countries are worried that their economies are either in recession or likely to enter one shortly. The duration and depth of the feared downturn remains a very open question with coincident recessions among trading partners possibly exacerbating the situation. Further confounding the outlook is the risk of another wave of pandemic-related illness and public health measures. Canada's economy is expected to have slowed in 2022 with output growth of 3.5% and employment growth of 3.9% while the unemployment rate fell to 5.2%. A mild recession will slow economic growth in 2023 to 2.5% while the unemployment rate rises to 5.7%.

### 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: 2022**<sup>i</sup> 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 **November 2022 Short-Term Energy Outlook (STEO)**<sup>ii</sup> for 2021 and 2022 and their "Reference Case Scenario" from the **Annual Energy Outlook 2022**<sup>iii</sup> 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 (October 2022)**<sup>iv</sup> report for the period up to 2027.

The outlook for real GDP other than Canada is also consistent with those published by the International Monetary Fund's **World Economic Outlook Update (October 2022)** report for the period up to 2027.

A set of charts and tables summarizing the December 2022 (F22B) projection is available at [www.qedinc.ca](http://www.qedinc.ca). A set of detailed forecast tables are available upon request (subject to terms and conditions). The December 2022 projection is based on information that is current as of December 5, 2022. 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.

The countries explicitly included in the CMS plus the Eurozone region countries currently account for just 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.

The reemergence of super-power conflicts, higher transportation costs and a quest for reliable sources of supply will lead to a reorientation of global trading relationships in the next few years. While the transition to this new state will benefit some sectors, it is likely that global output will remain permanently below what was anticipated before the pandemic. Government borrowing to support households and businesses negatively impacted by the pandemic will introduce some level of fiscal drag and higher interest rates start leading to rapidly rising debt service costs threaten household current spending on goods, services, and housing. The U.S. economy is expected to slow to 1.6% growth in 2022 and then just 1.0% in 2023 while Canada's trade-weighted foreign demand index grew 2.3% in 2022 and is expected to slow to 1.7% in 2023. Commodity prices surged 32.8% in 2022 led by energy commodities and are then expected to retreat 20% over the next few years.

## National Outlook

After sitting on the sidelines throughout 2021, the Bank of Canada finally acted to try and slow inflation by embarking on an aggressive round of interest hikes in 2022. More are expected in 2023 although a widely anticipated recession and a reduction in inflationary pressures may lead to the Bank changing course in the second half of 2023.

Canada's economy is expected to have slowed in 2022 with output growth of 3.5% and employment growth of 3.9% while the unemployment rate fell to 5.2%. A mild recession will slow economic growth in 2023 to 2.5% while the unemployment rate rises to 5.7%. Confounding the domestic and international outlook is, however, the risk of another wave of pandemic-related illness and public health measures.

The Bank of Canada and the central banks of our major trading partners will seize the opportunity provided by the current interest rate cycle to re-establish "normal" interest rate relationships for the next few decades. This will provide them with additional flexibility to employ traditional monetary policy to address future economic shocks. The Canada-US exchange rate is expected to depreciate marginally in 2023 and remain relatively stable for the remainder of the decade. Canada's nominal effective exchange rate will follow a similar pattern.<sup>1</sup>

Coincident recessions across Canada's trading partners could negatively impact the duration and depth of the feared downturn and limit export opportunities for Canadian businesses. A reorientation of global trading relationships in favour of reliable strategic partner nations could provide some near-term support for Canadian exporters but it is expected to grow a disappointing 3.1% in 2023.

The relatively tight labour market across much of Canada coupled with higher prices for most goods and services has fueled pressure for higher wages that is likely to persist until there is clear evidence that

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<sup>1</sup> 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.

inflation has returned to the Bank of Canada's target range. Despite rapid population growth, high debt levels, high interest rates, high real estate prices, and limited gains in real per capita disposable income will limit gains in the housing market for the balance of the decade.

Business spending on new capital is estimated to have fallen 3.1% in 2022 and then the weaker economy and higher interest rates are expected to further slow growth to just 1.3% in 2023. While business investment growth will rise it will be consistent with Canada's anticipated modest economic growth over the next few decades.

### The Provincial and Territorial Outlook

Most of the country is expected to grow in 2022 with rates varying from 9.0% in the Yukon Territory to -2.0% in Newfoundland and Labrador. Positive economic growth is also expected across most of the country in 2023 also with a relatively wide range of outcomes with New Brunswick and Ontario being the star performers.

After two years of strong employment growth in 2021 and 2022, employment growth will slow to 1.4% in 2023 and 0.3% in 2024. The national unemployment rate rises to 5.7% in 2023 and 6.2% in 2024 and remains relatively stable for the next few decades across all provinces. Economic and employment growth varies across the country over the projection period based on differences in population growth.

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Publication available from:

<sup>i</sup> <https://population.un.org/wpp/>

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

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

<sup>iv</sup> <http://www.imf.org/en/publications/weo/>