BEST'S SPECIAL REPORT

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Economic Review
October 23, 2024

Canadian Economy: GDP Growth in 2025 a Tailwind for Insurers Despite Challenges

A favorable labor market, rising asset prices, and falling inflation are supporting Canada's economy

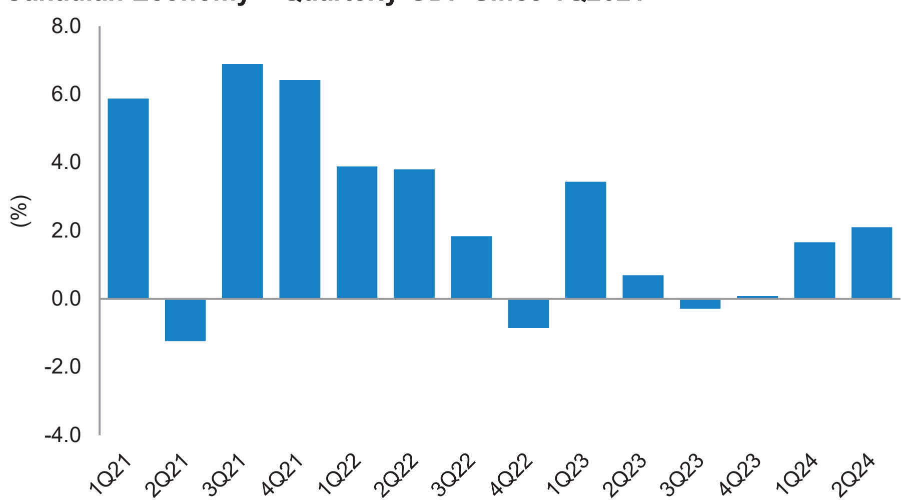
Principal Takeaways

- Canada's economy continues to grow, supported by a still favorable labor market, rising asset prices, and falling inflation.
- However, population growth has started to outpace job creation, resulting in wage growth slowing and the unemployment rate increasing.
- Housing affordability remains a concern, given the significant increase in home prices.

In 2023, Canada's economic growth slowed significantly, to 1.1%, from an annual rate of 3.8% in 2022, as the cumulative effects of higher interest rates, natural disasters, and a slowdown in global economic activity subdued growth for most of the year. In the first quarter of 2023, the Canadian economy grew by 3.4%, with domestic spending and an uptick in exports supporting growth. However, economic activity slowed significantly during the rest of 2023: 0.7% in the second quarter, -0.3% in the third quarter, and 0.1% in the fourth quarter, with the economy barely avoiding a technical recession (two consecutive quarters of economic growth) in the second half of 2023.

Growth picked up to 1.7% in the first quarter of 2024 (**Exhibit 1**), as investment, consumption, and housing activity increased, and beat market expectations in the second quarter, growing by 2.1%. However, the primary driver of growth was government spending, as consumer spending softened. Although the Bank of Canada (BOC) started lowering the policy rate in the second

Exhibit 1
Canadian Economy – Quarterly GDP Since 1Q2021



Source: Statistics Canada

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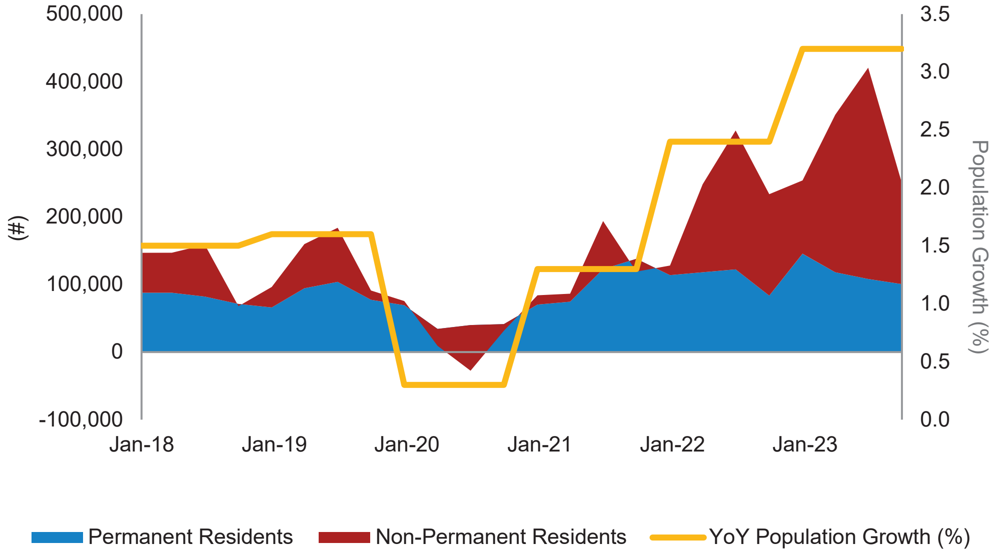
Exhibit 2
Canadian Economy – Population Growth



Source: Statistics Canada

quarter of 2024, the lagged effect of monetary policy and a still relatively high interest rate will likely remain a drag on economic activity for most of 2024. However, growth is expected to pick up later in the year and into 2025, as borrowing costs ease and private investment and household spending pick up speed. The IMF is projecting GDP to grow 1.2% in 2024 and 2.3% in 2025.

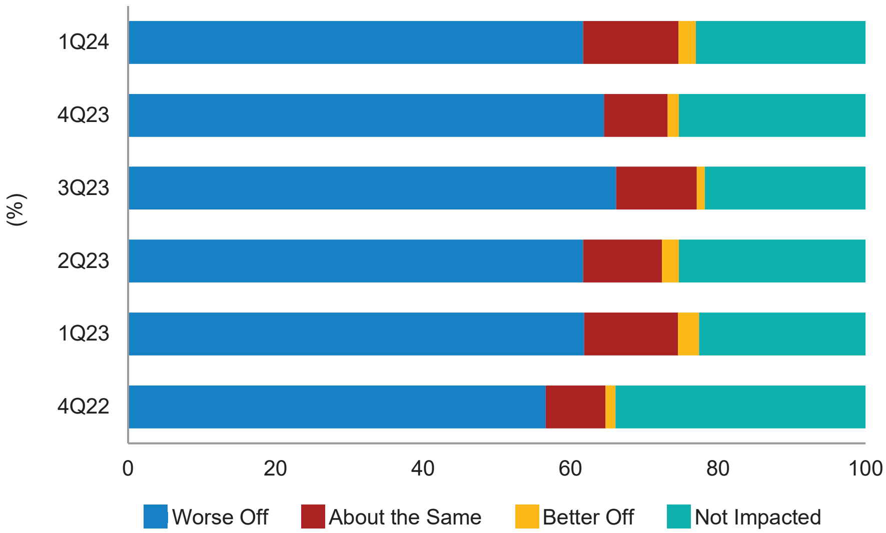
Immigration has also played a role in Canada's economy. Immigration has surged since the pandemic, with a net increase of more than one million temporary residents. Population growth in 2023 has been estimated at around 3%, a multi-decade high (**Exhibit 2**). However, population growth is expected to return to more historical rates over the near term, to 1.0% in 2025 and 2026, as the government has plans to reduce the number of worker visas and cap the number of international student permits. The rise in immigration has helped support growth and fill labor gaps, with the BOC estimating that immigration in 2022 and the first half of 2023 boosted economic growth by 2%-3%. However, the rise in population has also led to challenges, particularly in the labor and housing markets.

A Mixed Consumer Outlook

Personal consumption, which accounts for approximately 60% of Canada's GDP, supported Canada's economy in 2023. Consumers are being supported by a relatively favorable albeit weakening labor market, rising asset prices, and falling inflation. Additionally, the BOC began easing monetary policy, lowering its policy rate, which should also be a tailwind for both consumers and businesses.

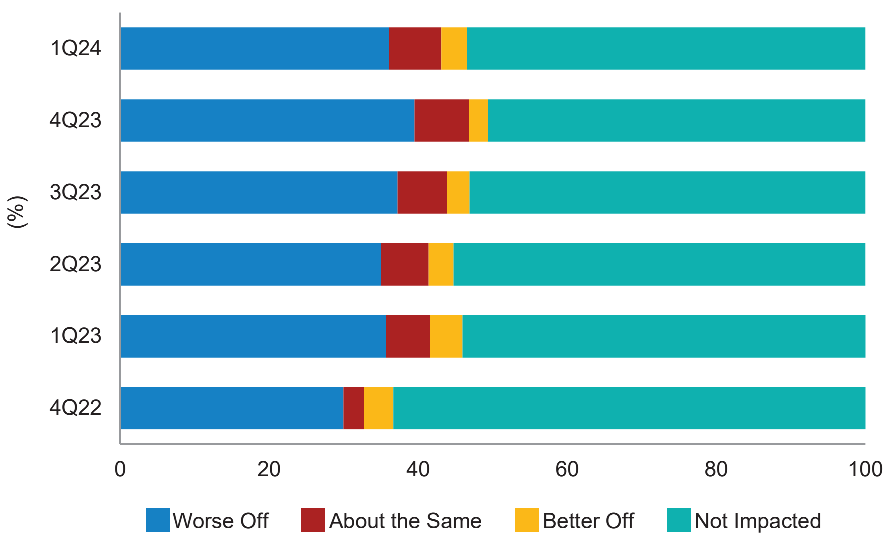
Consumer sentiment continues to improve despite interest rates and inflation. According to the Canadian Survey of Consumer Expectation – First Quarter of 2024, "Consumers still feel the negative effects of inflation and interest rates on their spending, and the cost of living remains their top financial concern. However, the share of consumers feeling worse off is slightly smaller than it was last quarter—a sign that the negative impacts of inflation and interest rates are no longer broadening" (**Exhibits 3 and 4**). Consumers continue to delay large purchases and save money. The consumer saving rate in the second quarter reached 7.2%, well above its 20-year historical average. The savings rate in the second quarter of 2024 is the highest it has been in 20 years, excluding the pandemic era (**Exhibit 5**).

Exhibit 3
Canadian Economy – Impact of Higher Inflation



Source: Canadian Survery of Consumer Expections, 2Q24

Exhibit 4
Canadian Economy – Impact of Higher Interest Rates



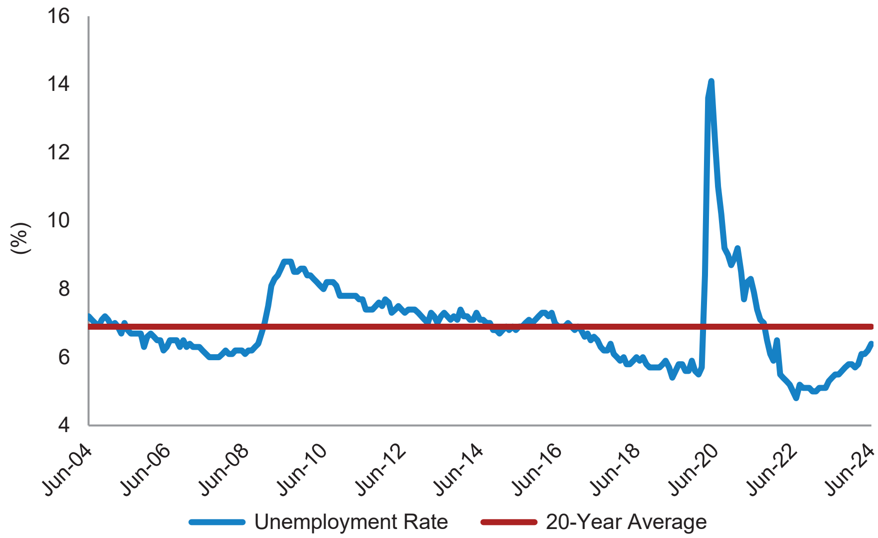
Source: Canadian Survery of Consumer Expections, 2Q24

However, consumer debt continues to rise, as well as mortgage delinquencies. Equifax's Canada Market Pulse Consumer Quarterly Credit Trends for the first quarter 2024 notes that consumer debt rose by 3.5% year over year from the first quarter of 2023, to CAD 2.5 trillion. Mortgage delinquencies are still below pre-pandemic levels but are rising, particularly in the higher priced areas of British Colombia and Ontario. The number of homeowners missing mortgage payments is up over 20% annually in the first quarter. Credit card delinquencies have surpassed pre-pandemic levels, with more consumers not paying their full balance each month. Some consumers may be under greater financial strain, although the recent drop—and expected further drop—in interest rates may provide more relief in the near term.

Exhibit 5
Canadian Economy – Household Savings Rate

Source: Statistics Canada, AM Best calculations

Exhibit 6
Canadian Economy – Unemployment Rate



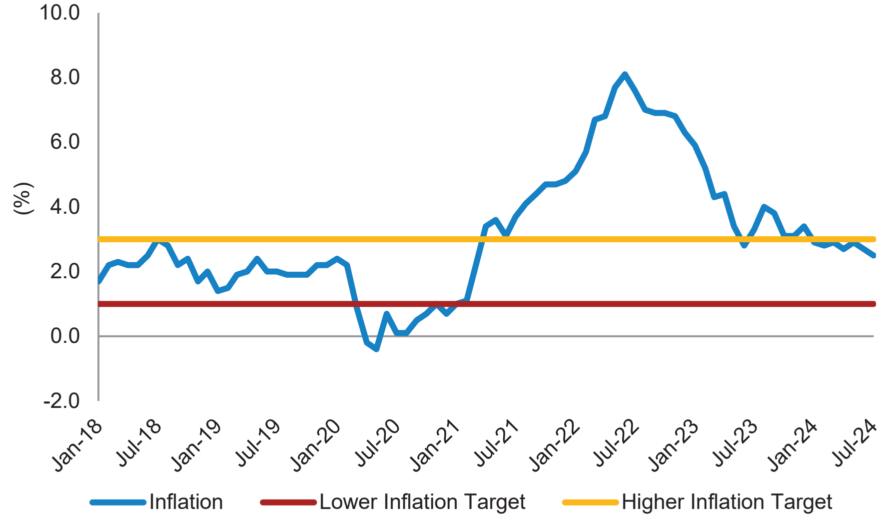
Sources: Statistics Canada, AM Best calculations

Employment and Wages

Population growth has started to outpace job creation, resulting in wage growth slowing and the unemployment rate increasing. The unemployment rate climbed to 6.4% in July 2024, a full percentage point higher than the average unemployment rate in 2023, and above the pre-pandemic rate of 5.5% in January 2020. However, the current unemployment rate remains lower than the 20-year historical average of 6.9% (**Exhibit 6**).

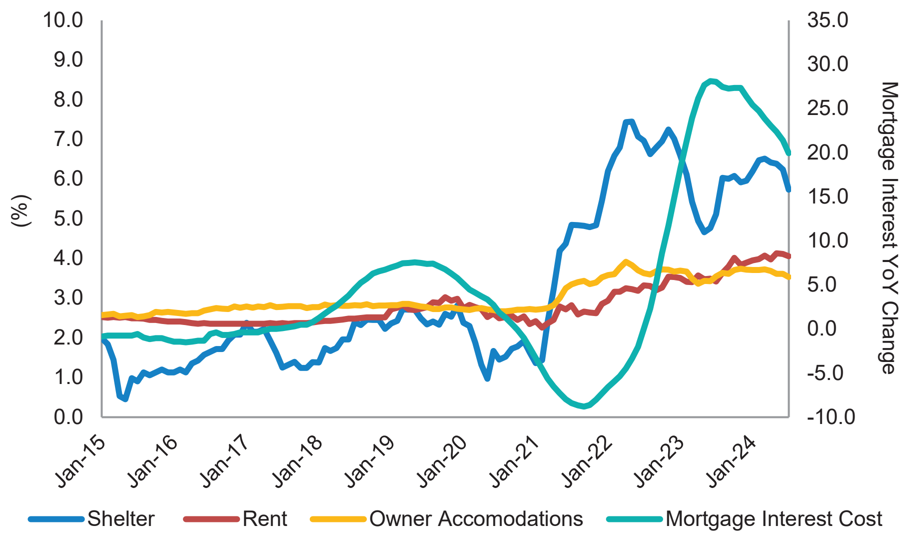
Wage growth has started to moderate but is still relatively high when compared with historical averages. According to Tiff Macklem, Governor of the BOC, "Depending on the measure you look at, wage growth peaked between 4.5% and 6%. This was roughly twice the pre-pandemic average of 2% to 3%." But as the labor market rebalanced, and inflation fell, wage growth eased to around 4%.

Exhibit 7
Canadian Economy – Headline Inflation



Source: Statistics Canada

Exhibit 8
Canadian Economy – Housing Inflation



Sources: Canadian Real Estate Association, Bank of Canada

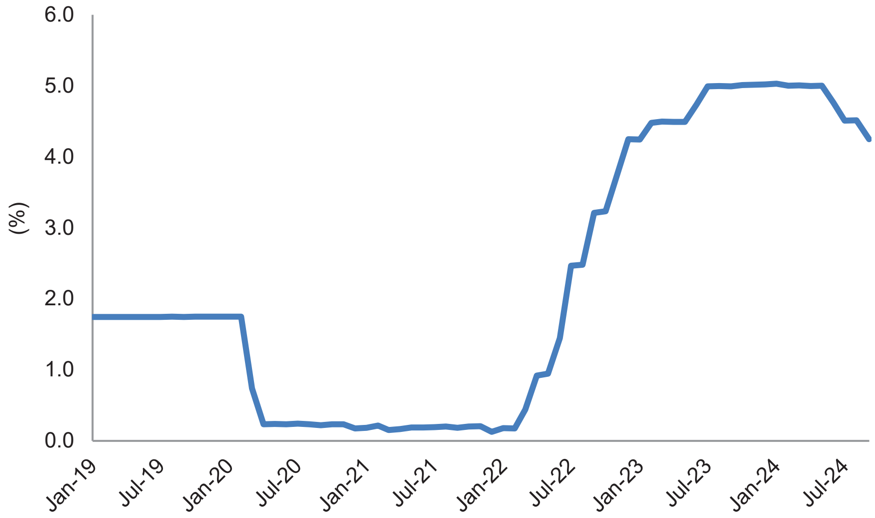
The most recent Business Outlook Survey notes that job vacancies are becoming easier to fill, and businesses expect wage growth to slow in the future.

Inflation Continues To Decline Towards Central Bank Target

Inflation declined from its peak of 8.1% in June 2022 to 3.4% in 2023 and is expected to fall further in 2024, as wage growth moderates. Headline inflation has been below 3.0% since January 2024, having fallen further in July 2024, to 2.5%. This decline has brought inflation within the BOC's target range of 1.0%-3.0% and its lowest reading since March 2021 (**Exhibit 7**). Prices for goods have fallen, and food prices are now increasing at a much more modest rate. However, shelter and rent prices, as well as mortgage interest costs, continue to rise, albeit at a slower pace, keeping overall inflation elevated (**Exhibit 8**).

Exhibit 9

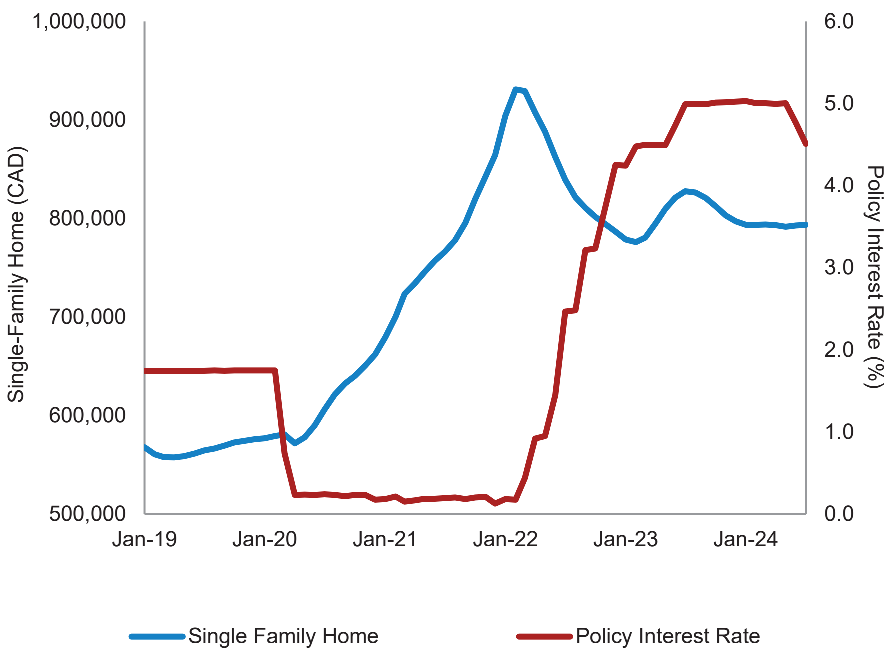
Canadian Economy – Bank of Canada Policy Rate



Source: Bank of Canada

Exhibit 10

Canadian Economy – Average Price Single Family Home



Sources: Canadian Real Estate Association, Bank of Canada

With inflation now within its targeted range, the BOC has started to focus more on the downside risks to the economy, particularly the country's weakening labor market and slowing economy. The bank commenced easing monetary policy, cutting its policy rate by 25 basis points in June 2024, and again by 25 basis points in July 2024 and August 2024, bringing the policy rate to 4.25%. Analysts believe the BOC will continue to cut interest rates in 2024 and 2025 to support the economy and the labor market (**Exhibit 9**).

Housing Affordability a Concern

Housing prices have been volatile since 2019 (**Exhibit 10**). According to the Canadian Real Estate Association (CREA), the average price of a single-family home was less than CAD 570,000 in January

2019, rose to a peak of CAD 931,000 in February 2022, and was nearly CAD 794,000 in July 2024. The price of a single-family home increased by over 60% from January 2019 to February 2022 and by almost 40% from January 2019 to July 2024. According to the BOC, concerns about housing affordability have grown over the last two years, with almost 40% of Canadians reporting being very concerned about their ability to afford housing or rent, compared to 30% in the spring of 2022.

According to the Equifax's Canada Market Pulse Consumer Quarterly Credit Trends for the first quarter 2024, mortgage debt represents nearly three quarters of total consumer debt. Consumers are concerned about payment shock, particularly for mortgage renewals, as those who financed homes during the pandemic will likely renew their mortgages at higher rates throughout 2024 to 2027. Monthly payments for nearly 10% of mortgage renewals increased by more than CAD 500 in the first quarter. Consumers have compensated by extending mortgage terms or switching lenders to find lower mortgage rates.

Housing prices have been impacted by interest rates and a lack inventory, particularly for affordable housing. The gap between supply and demand for housing has been exacerbated by a growing population, which has increased the number of homes needed. To correct the imbalance, the Canada Mortgage and Housing Corporation (CMHC) estimates that an estimated 3.5 million more housing units are needed, to return housing to affordable levels. The government is trying to correct this imbalance through the CAD 6 billion Canada Housing Infrastructure Fund. The fund seeks to build more houses (nearly four million new homes by 2031) and to reduce the red tape required to build, to accelerate the process.

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