Canada Viewpoint

Canada: Top 5 questions for 2024

07 February 2024

Economics
Canada

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Will the rise in population help the economy in 2024?

We believe so, mainly by continuing to increase potential growth, although in the short term it has mixed effects on inflation. Canada has experienced a dramatic increase in its population since 2022, with non-permanent residents leading the expansion. Net international migration growth dominates the natural increase in population (births less deaths). The increase in population raises the labor force and allows the country to growth with less inflationary pressure. However, the newcomers demand housing which in the short and medium terms exacerbate the shortage of housing, putting upside pressure on inflation through shelter.

Will Canada's activity accelerate or decelerate in 2024?

We expect GDP growth to accelerate from 1.1% in 2023 to 1.3% in 2024 and to 2.4% in 2025 (we expected 0.9% for 2024 and 2.0% for 2025 before). So, we expect the economy to accelerate but to still growth below potential this year (potential growth is about 2.0%). We increase our GDP growth forecast following the strong GDP print in the US at the end of 2023 and the still tight labor market in Canada at the turn of the year. We still expect a relatively weak economy in the first half of 2024, but we expect growth to accelerate to above a 2% rate in the second half of the year, in part supported by looser financial conditions. The risks to our GDP growth forecast are balanced.

When and by how much will the BoC cut in 2024?

We expect the Bank of Canada (BoC) to start its cutting cycle in June 2024 and to cut 25bp at every subsequent meeting to put the policy rate at 3.75% by end-2024 (125bp total cuts this year). We then expect the BoC to continue cutting to put the policy rate at 3.00% by April 2025 (terminal rate). We expect the BoC to have a faster and deeper cutting cycle than the US Fed. We expect the BoC to cut because the economy has been growing below potential for some time and we expect inflation to converge to the 2% target in 2025. The risk to our call is that the BoC starts the cycle later. An earlier start of the cutting cycle is unlikely as the BoC is waiting for core inflation to show a clear downward trend and this will still take a few months. Another risk is that the BoC does a more gradual cycle than what we expect given resilient core inflation.

What matters most for 10y rates in Canada?

Big questions for CAD rates in 2024 include (1) when will BoC start cutting (2) how fast will they cut and (3) what will the market price for the "terminal" rate or the trough of the cutting cycle? We think the terminal rate pricing will be the most important rate driver this year. The market may be underpricing BoC rate cuts and pricing a higher terminal. If incoming data comes in as we expect, we believe market pricing will shift and we will likely see CAD rates rally.

Where is USD/CAD headed in 2024?

We like to maintain a bullish bias for the CAD vs USD in 2024 and see the pair falling to 1.30 by year-end. We see limited near-term bearish CAD drivers stemming from Canada. More material USD/CAD downtrend should form once Fed cutting cycle begins.

BoC: Bank of Canada

WTI: West Texas Intermediate

WCS: Western Canadian Select

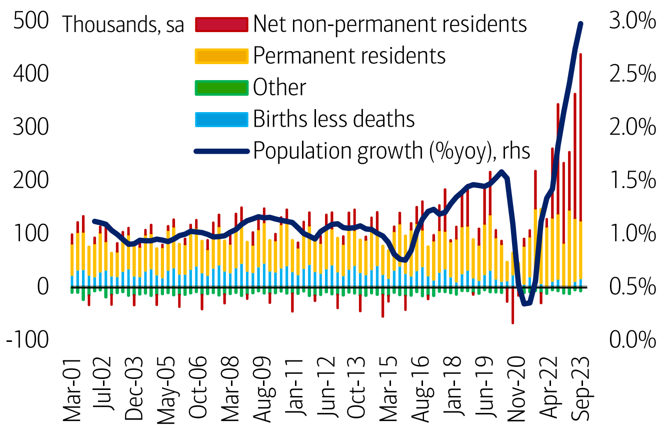
SPR: Strategic Petroleum Reserve

SPX: S&P 500 index

Will the rise in population help the economy?

We believe so, mainly by continuing to increase potential growth, although in the short term it has mixed effects on inflation. Canada has experienced a dramatic increase in its population since 2022, with non-permanent residents leading the expansion (Exhibit 1). Net international migration growth dominates the natural increase (births less deaths) in population (Exhibit 2). We look at the impact on the labor and housing markets.

Exhibit 1: Contributions to population growth
Non-permanent residents are leading the boom in population growth



Source: BofA Global Research, Haver, StatCan, BoC

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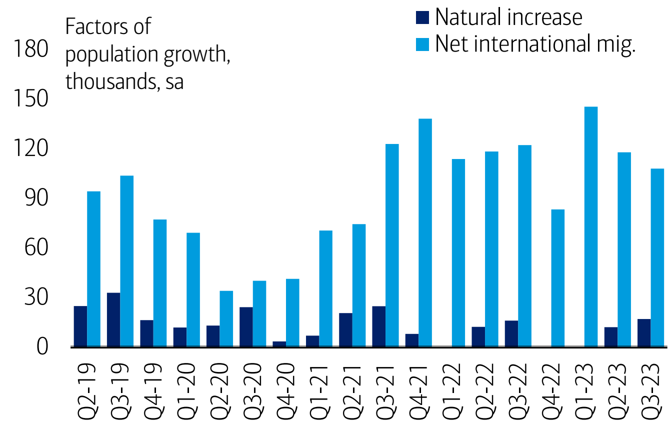
Exhibit 2: Components of population growth
Immigration is Canada's dominant source of population growth



Source: BofA Global Research, StatCan

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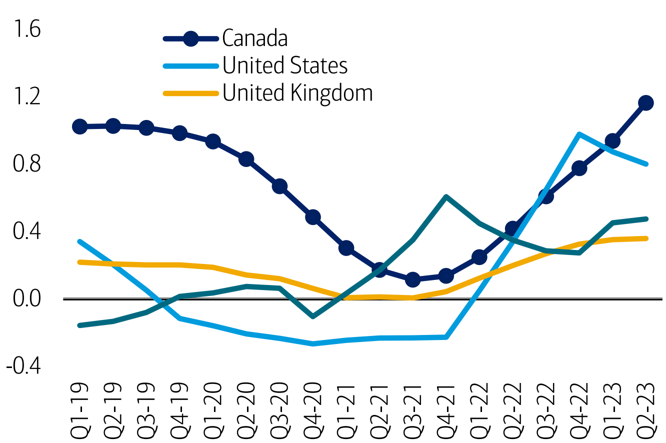
Regarding the labor market, immigration bolsters potential output through the expansion of the labor supply. The Bank of Canada (BoC) estimates that since the start of 2022, immigration has boosted the level of potential GDP by 2% to 3% (potential GDP grows at about 2.0%). Overall, this influx of newcomers offsets the negative effects of Canada's aging population, making the country's working-age population grow faster than that of the US, the Euro Area, and the UK (Exhibit 3). Moreover, immigrants (permanent residents) and non-permanent residents are the biggest contributors to the increase in total hours worked observed since 2021 (Exhibit 4).

Exhibit 3: Working-age population comparison
Canada's working-age population is growing faster than that of its peers



Source: BofA Global Research, Haver, BoC

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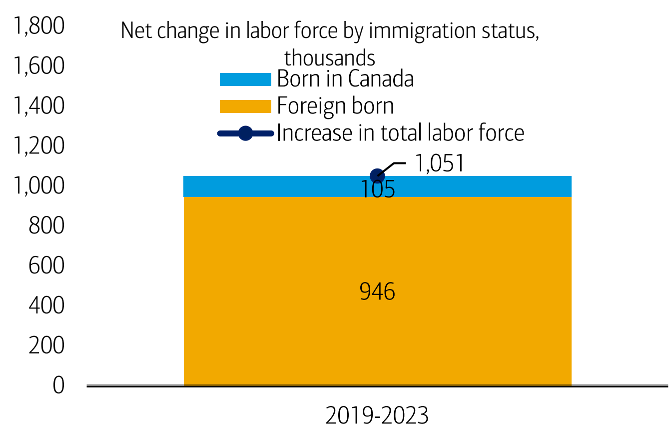
Exhibit 4: Net change in labor force (2019-2023) breakdown
Foreign-born workers have greatly enlarged the Canadian workforce



Source: BofA Global Research, StatCan

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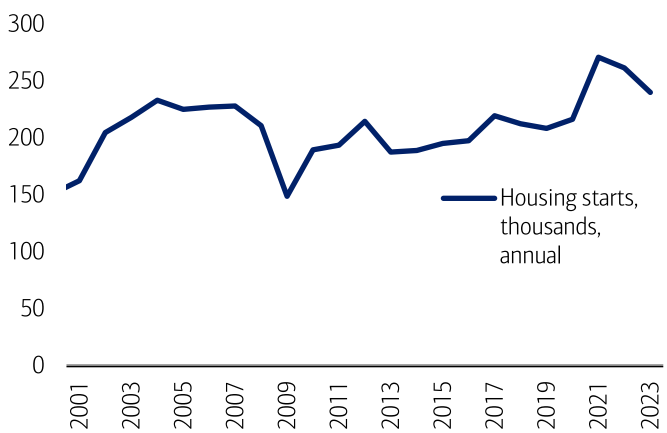
The increase in labor supply is one of the reasons that the economy was able to grow above potential for some time with inflation falling at the same time, in our view. The enlargement of the labor force has translated into a downward pressure for inflation. Having said that, the increase in potential output will probably not be reflected in higher growth in 2024 given the high interest rate environment the economy is in. Recent GDP growth figures portray a weak economy, hampered by the effects of restrictive monetary policy, and this fragility will likely remain at least during the first half of 2024. But when activity picks up again, the additional labor supply could act as a multiplier.

On the housing market implications, the large number of immigrants arriving to Canada pose a large upward pressure for inflation – at least in the short term. The marked population uptick translates into higher demand for housing while supply can barely keep up (Exhibit 5), which leads to an observable fact in the Canadian economy: shelter inflation has been one of the top contributors to inflation in the past year. While it is true that part of this shelter inflation is due to the high interest rate set by the BoC, mainly mortgage interest costs, other components of shelter inflation tend to offset the uptick in said costs. This time, the offsetting is not happening at the same degree as in past times, even with a deceleration in economic activity.

Exhibit 5: Housing starts

Housing starts decelerated for a second year in a row amid population boom



Source: BofA Global Research, Haver, Canada Mortgage and Housing Corporation

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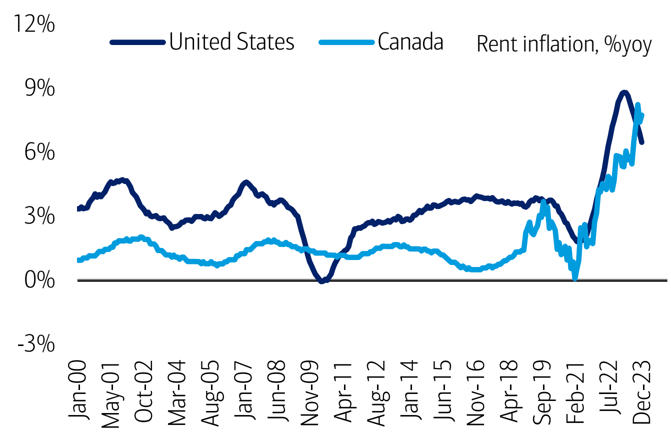
Exhibit 6: Rent inflation, Canada vs US

Rent inflation is easing in the US while remaining sticky in Canada



Source: BofA Global Research, Haver

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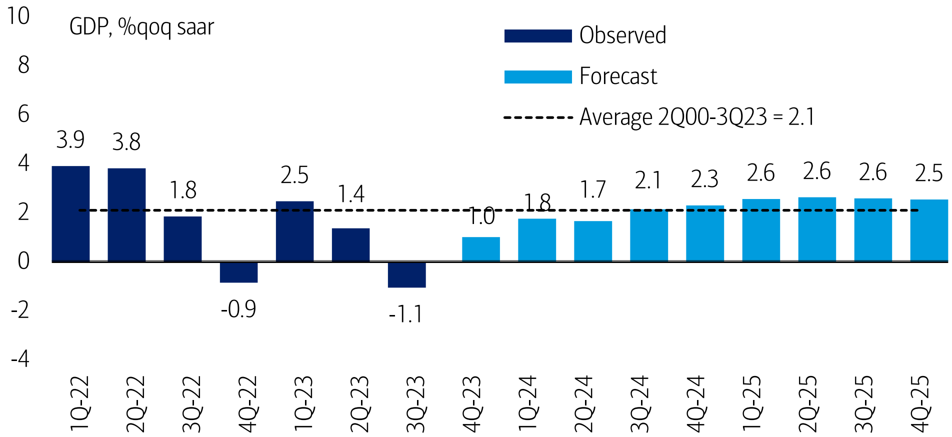
Canada's most recent Fall Economic Statement (November 22) laid out a plan to boost housing supply, but this will likely not have an immediate effect on housing prices. Like many structural problems, housing will take time and sufficient government action to solve – with tangible effects in the mid-to-long-term. This means that shelter inflation will likely remain the top contributor to inflation for the foreseeable future, which poses a risk to the BoC's inflation target of 2%, and thus for an eventual easing cycle. For example, one can look at the trajectory of rent inflation in the US and Canada and realize the problem the country faces compared to its nearest peer (Exhibit 6).

Will Canada's activity accelerate or decelerate?

We expect GDP growth to accelerate from 1.1% in 2023 to 1.3% in 2024 and to 2.4% in 2025 (we expected 0.9% for 2024 and 2.0% for 2025 before). So, we expect the Canadian economy to accelerate but to still growth below potential this year (potential growth is about 2.0%) (Exhibit 7).

Exhibit 7: Canada's GDP growth forecast

We expect Canada to grow 1.1% in 2023, 1.3% in 2024 and 2.4% in 2025



Source: BofA Global Research estimates

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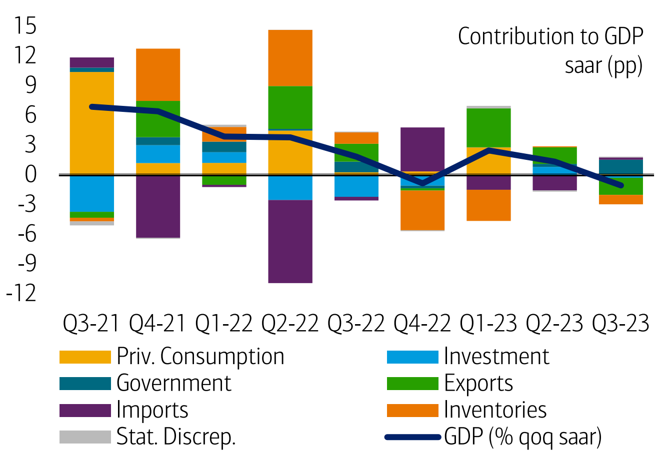
The Canadian economy decelerated in 2023 with a contraction in 3Q 2023 (-1.1% qoq saar) (Exhibit 8). The deceleration was mostly due to weak external demand, as the domestic economy fared better than overall GDP (Exhibit 9). On the supply side of the economy, services continued to support the economy, and the weakness was mostly due to the goods-producing industries (Exhibit 10).

Exhibit 8: GDP by components and its contribution (pp unless stated)

GDP fell in 3Q, driven by a weaker external demand. Government consumption, however, supported GDP.



Source: BofA Global Research, Stat Canada, Haver

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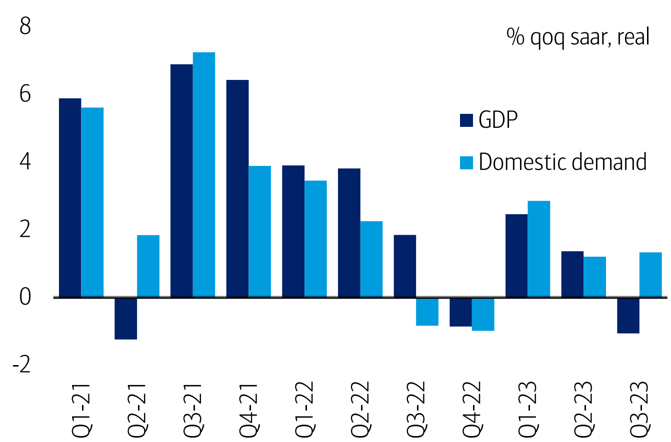
Exhibit 9: GDP and domestic demand in Canada (% qoq saar, real)

A resilient domestic demand could support the economy



Source: BofA Global Research, Stat Canada, Haver

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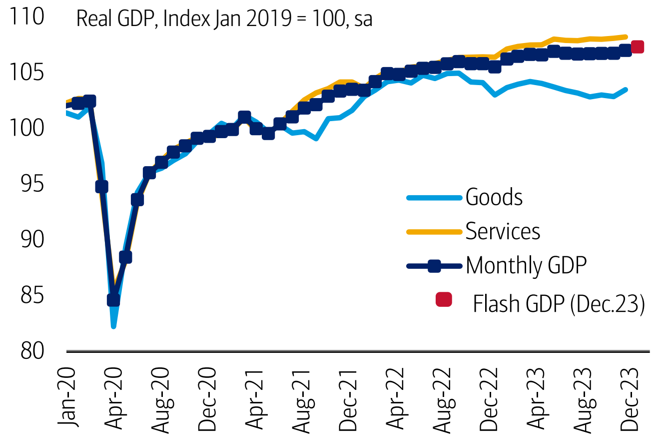
The Canadian economy was weak in 2023 despite the US economy growing above potential and ending the year growing above 3% qoq saar. In our view, the Canadian economy was weaker than the US economy for two main reasons. The first is that monetary policy in Canada is more powerful than in the US and hence a tight monetary policy had a higher impact in Canada than in the US. The second is that Canada did not have the large fiscal stimulus than the US had in 2023.

Exhibit 10: Canada's monthly GDP

Goods supported the November's print. GDP is expected to grow in Dec.



Source: BofA Global Research, Stat Canada, Haver

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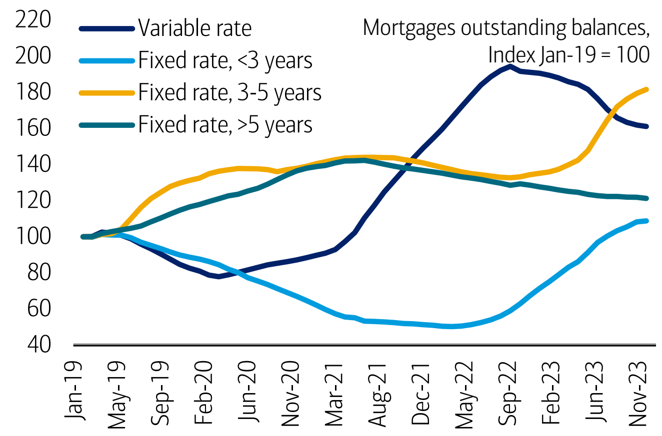
Exhibit 11: Mortgages' outstanding balances in Canada by product

Fixed 3- and 3-5-year mortgages' balances are rising, signaling a potential hedge against possible rate cuts



Source: BofA Global Research, Bank of Canada

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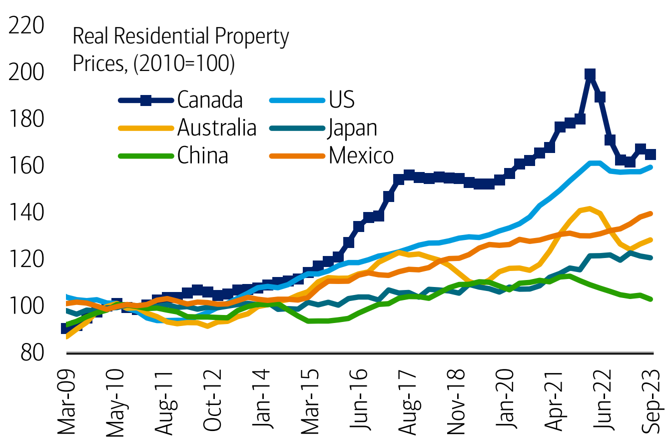
On the impact of monetary policy on the economy, a key feature of the Canadian economy is that variable rate mortgages with 5-year horizons are more prevalent than, for instance, the US, where more mortgages where fixed during the pandemic at low rates for 30 years (Exhibit 11). The increase in rates in Canada was followed by a drop in the real price of houses (Exhibit 12) and the eventual fall of building permits (Exhibit 13).

Exhibit 12: Real residential property prices in Canada

Property prices in Canada have fallen more than in other economies



Source: BofA Global Research, BIS, Haver

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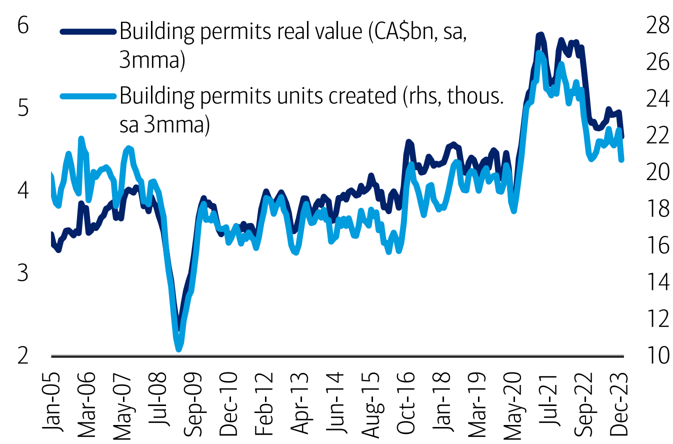
Exhibit 13: Building permits in Canada

High interest rates are still cooling down the housing market



Source: BofA Global Research, Stat Canada, Haver

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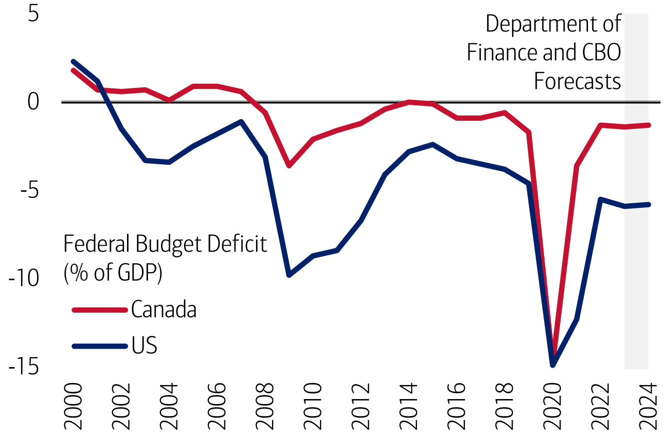
Another reason why the Canadian economy underperformed the US economy in 2023 is that there was a large fiscal stimulus in the latter, which was not matched by the Canadian federal deficit (Exhibit 14). In Canada the deficit has not increased in recent years, although it is true that the fiscal consolidation that was supposed to followed the pandemic has not materialized and is not in current official forecasts (Exhibit 15).

Exhibit 14: Federal budget deficit for the US and Canada (% of GDP)
Similar deficits in the pandemic, but Canada did not had stimulus in 2023



Source: BofA Global Research, Canada Department of Finance, CBO, Haver

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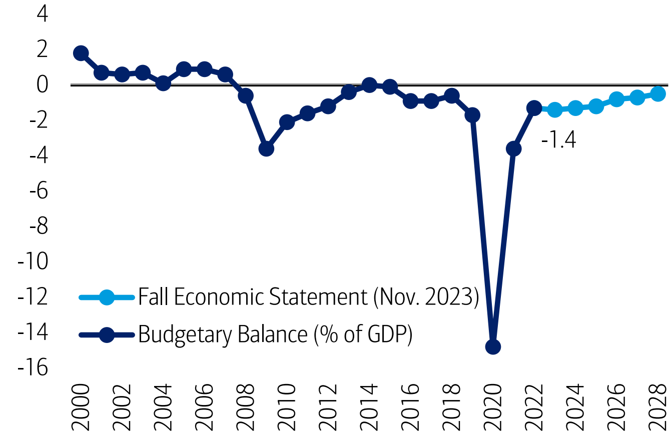
Exhibit 15: Canada's Budget Deficit (% of GDP)
Canada has projected a budget deficit for the next 5 years



Source: BofA Global Research, Canada Department of Finance, Haver

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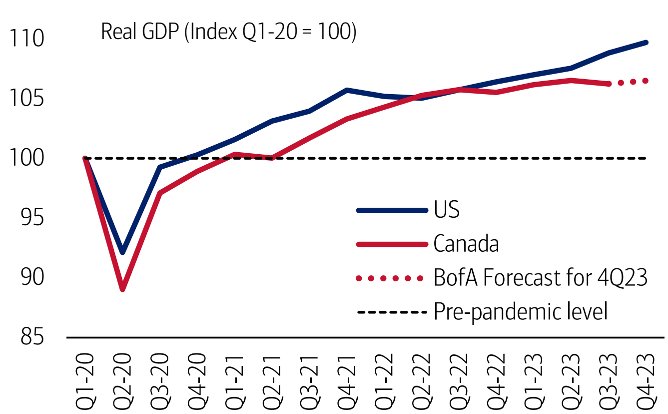
For 2024 we expect the Canadian economy to accelerate somewhat (but still grow below potential) on several factors. The first is that the US economy continues to growth above potential, which is a tailwind for Canada. We do expect a soft landing in the US this year, but at least for now growth in the US is likely to keep helping Canada (Exhibit 16). The second is that oil prices are likely to remain supportive (Exhibit 17). On the domestic front, expectations have already turned for the better (Exhibit 18) and a still tight labor market is likely to continue helping domestic consumption (Exhibit 19). Finally, the nearshoring/reshoring/friendshoring of production factors from Asia to North America, will likely continue to support Canada, although the latter is a more medium-term factor.

Exhibit 16: Canada and the US real GDP comparison
The US had a strong economy in Q4. This could support Canada's GDP



Source: BofA Global Research, Bureau of Economic Analysis, Stat Canada, Haver

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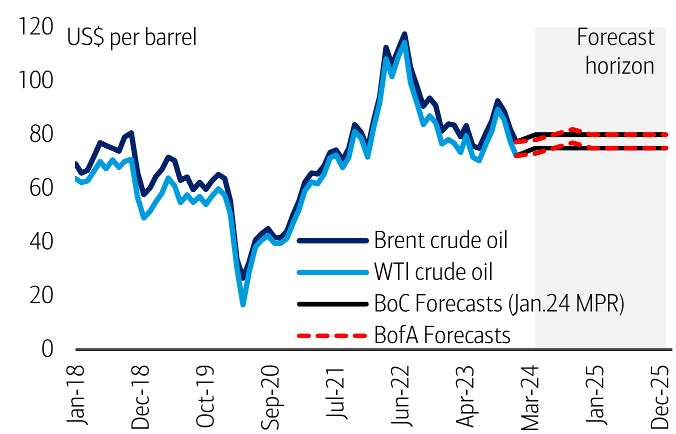
Exhibit 17: Crude oil prices
High oil prices will bolster Canada's economy given its energy balance



Source: BofA Global Research estimates, Bank of Canada, Bloomberg

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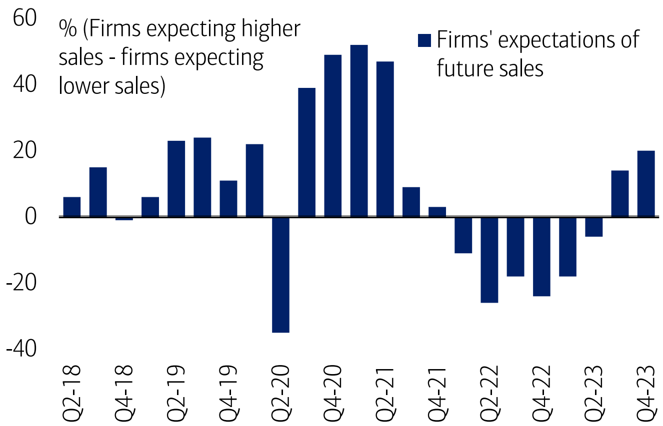
All in all, we increase our GDP growth forecast following the strong GDP print in the US at the end of 2023 and the still tight labor market in Canada at the turn of the year. We still expect a relatively weak economy in the first half of 2024, but we expect growth to accelerate to above a 2% rate in the second half of the year, in part supported by looser financial conditions. The risks to our GDP growth forecast are balanced. The main risk to the downside is that high interest rates lower investment and consumption of durable goods. The main risk to the upside is a "no-landing" scenario in the US.

Exhibit 18: Expected future sales by firms* (%)
When asked, more firms expect higher sales in the next 12 months



Source: BofA Global Research, Stat Canada. *% of firms expecting higher sales in the next 12 months minus % of firms expecting lower sales in the next 12 months

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Exhibit 19: Unemployment rate (%)
Unemployment keeps rising, but has remained at 5.8% since November

Source: BofA Global Research, Stat Canada, Haver

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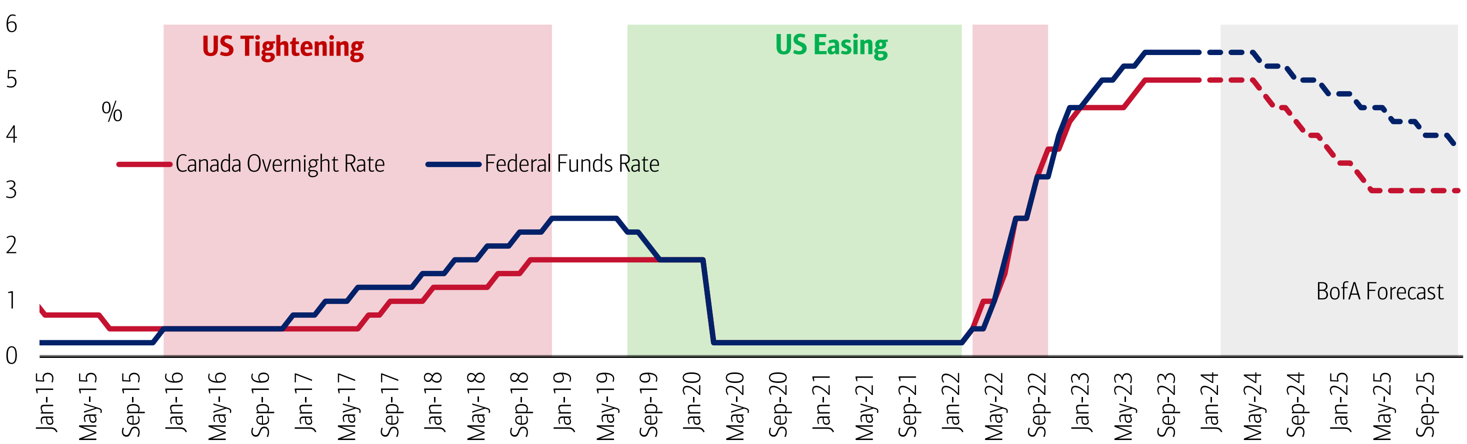
When and by how much will the BoC cut in 2024?

We expect the Bank of Canada (BoC) to start its cutting cycle in June 2024 and to cut 25bp at every subsequent meeting to put the policy rate at 3.75% by end-2024 (125bp of cuts this year). We then expect the BoC to continue cutting to put the policy rate at 3.00% by April 2025 (terminal rate) (Exhibit 20). We expect the BoC to have a faster and deeper cutting cycle than the US Fed (Exhibit 21).

Exhibit 20: Monetary policy in the US and Canada
We expect a more aggressive cutting cycle for the BoC



Source: BofA Global Research estimates, Bank of Canada, US Fed, Bloomberg

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We expect the BoC to cut because the economy has been growing below potential for some time, and we expect a negative output gap going forward, and because we expect inflation to reach the 2% target in 2025 (Exhibit 22 and Exhibit 23). Under these conditions we expect the BoC to move to a neutral policy stance by 2025. We use 3% as neutral policy rate for Canada.

The risk to our call is that the BoC starts the cycle later. For instance, the July meeting has a Monetary Policy Report (MPR), so it is a strong candidate as well. An earlier start of the cutting cycle is unlikely as the BoC is waiting for core inflation to show a clear downward trend and this will still take a few months. Another risk is that the BoC does a more gradual cycle than what we expect given resilient core inflation.

Exhibit 21: Monetary policy path forecasts for the BoC and the Fed

We expect the BoC to start its cutting cycle along with the Fed, but to be more aggressive

Date	BoC	Change (bp)	Fed	Change (bp)
Jan-24	5.00		5.50	
Feb-24	5.00		5.50	
Mar-24	5.00		5.50	
Apr-24	5.00		5.50	
May-24	5.00		5.50	
Jun-24	4.75	-25	5.25	-25
Jul-24	4.50	-25	5.25	
Aug-24	4.50		5.25	
Sep-24	4.25	-25	5.00	-25
Oct-24	4.00	-25	5.00	
Nov-24	4.00		5.00	
Dec-24	3.75	-25	4.75	-25
Jan-25	3.50	-25	4.75	
Feb-25	3.50		4.75	
Mar-25	3.25	-25	4.50	-25
Apr-25	3.00	-25	4.50	
May-25	3.00		4.50	
Jun-25	3.00		4.25	-25
Jul-25	3.00		4.25	
Aug-25	3.00		4.25	
Sep-25	3.00		4.00	-25
Oct-25	3.00		4.00	
Nov-25	3.00		4.00	
Dec-25	3.00		3.75	-25

Source: BofA Global Research, Bank of Canada, US Fed

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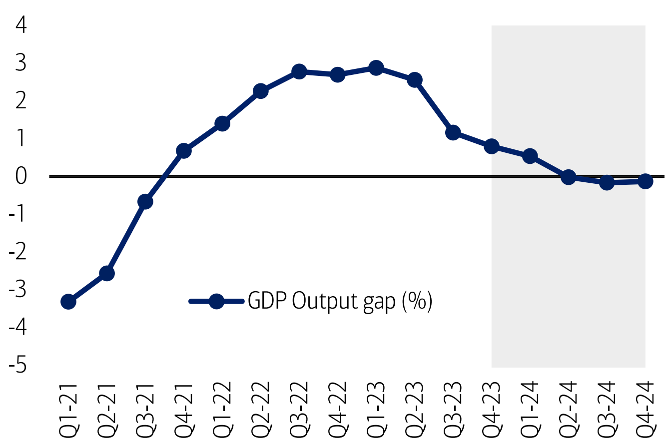
Exhibit 22: Output gap in Canada (%)

We expect a mild negative output gap in 2024



Source: BofA Global Research estimates, Stats Canada

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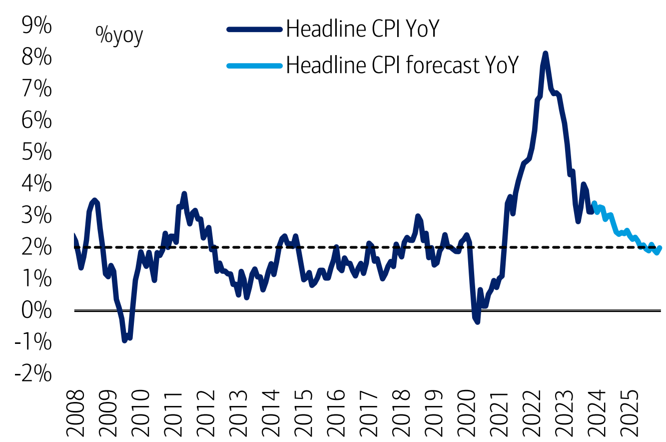
Exhibit 23: Inflation forecast

We expect inflation at 2.5% by end-2024 and at 2.0% by end-2025



Source: BofA Global Research estimates

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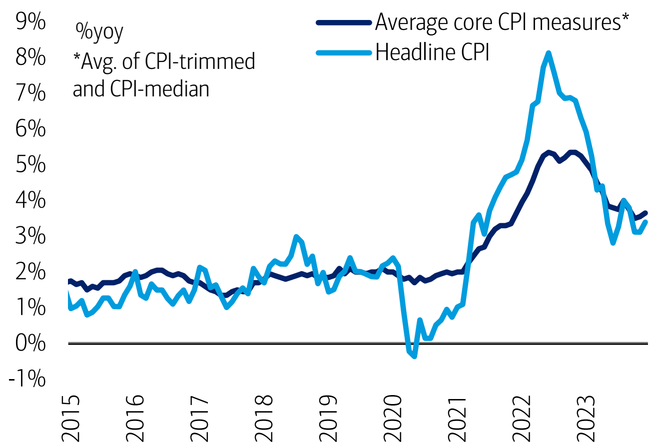
Despite the upward revision that we are doing to our GDP growth expectations, we do not think the better-than-expected activity is enough to deter the BoC from cutting this year. For instance, 4Q 2023 GDP will be close to 1% qoq saar, while the BoC was expecting around 0.0% as recently as in the January MPR, but the governor Tiff MacKlem said in an interview when questioned about this (after the flash GDP release): "I still think the fourth quarter is going to be a fairly weak number, certainly well below potential output growth." In fact, the BoC has already removed its hiking bias.

The main reason why we expect the BoC to delay the start of the cutting cycle to mid-year is because core inflation has been very resilient to the downside, and the BoC has been clear it wants to see "further and sustained easing in core inflation." When we look at December's inflation print (Exhibit 24), where headline inflation increased, we get two main takeaways: shelter inflation is the most important component of headline inflation holding back the progress seen in every other category, and core accelerated for the second month in a row due to goods inflation (as services decreased).

Shelter inflation is mostly a byproduct of the structural problem of low housing supply in Canada relative to the ample demand caused by the immigration surge the country is experiencing (mortgage interest cost is also driven up by the high interest rate set by the BoC). This lack of sufficient housing supply could prove to be one of the biggest obstacles to the BoC's inflation target of 2%, as shelter inflation has been stuck around 6% yoy for some time (Exhibit 25), even at a time of economic fragility.

Exhibit 24: Headline and core inflation in Canada (% yoy)
The uptick in both headline and core could stall BoC's decision to cut



Source: BofA Global Research, Stat Canada

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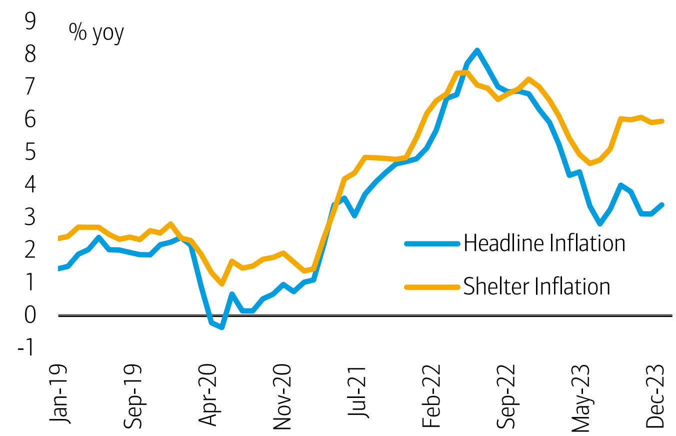
Exhibit 25: Headline inflation and shelter inflation (% yoy)
Headline Inflation has been in part driven by shelter inflation



Source: BofA Global Research, Stat Canada, Haver

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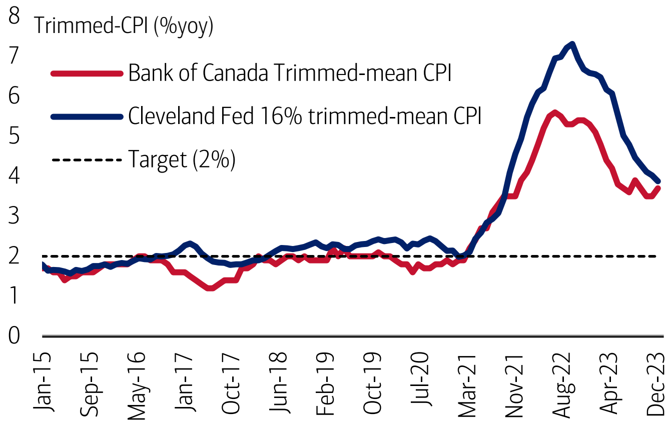
Regarding core inflation, the first point to notice is that "heavy" measures of inflation such as using trimmed means show that inflation in Canada has been more resilient than in the US (Exhibit 26). The second point is that we can see that goods inflation had driven the deceleration in core but has recently picked up while services inflation is only on a modest downward path (Exhibit 27). These dynamics in goods and services have compounded such that we are now seeing an acceleration in the average of the two measures of core inflation (trimmed and median). Still, we expect the slowdown in economic activity to continue pressuring core prices down. As we have discussed before, core inflation is the key metric to assessing the possibility of an easing cycle.

Two other factors are of importance in the inflation discussion: wage growth and inflation expectations. The Labor Force Survey for December showed wage growth still above average and picking up steam, contrary to the BoC's objectives (Exhibit 28). Moreover, unemployment has had mild increases since September, reflecting a labor market that is making slow progress in easing. On the inflation expectations side, the most recent Canadian Survey of Consumer Expectations showed significant progress in the reduction of consumers' inflation expectations; however, they remain high and above target, mainly the short-term expectations (Exhibit 29). These two are another front where the BoC would like to see more progress on to start a cutting cycle.

Exhibit 26: Core inflation comparison (Canada vs. US, % yoy)
Core inflation is not trending down in Canada



Source: BofA Global Research, Stat Canada, US Fed

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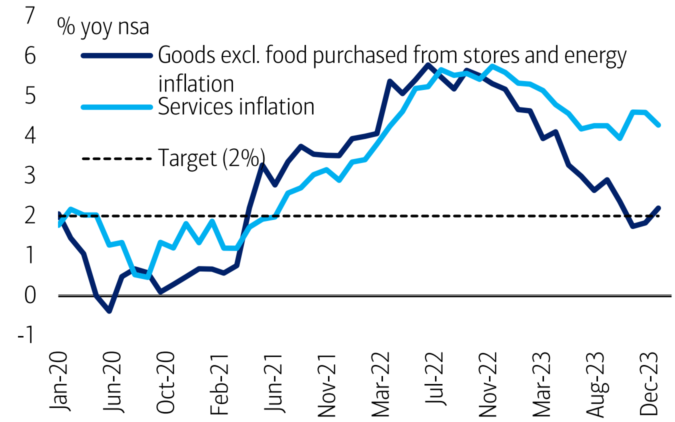
Exhibit 27: Components of core inflation (% yoy)
Goods inflation broke its downward trend, while services is still decreasing



Source: BofA Global Research, Stat Canada

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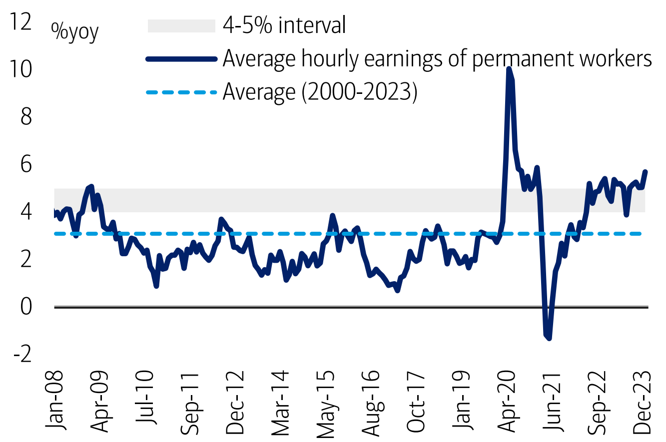
Exhibit 28: Nominal wage growth (%)
Nominal wages remain above 5%, and will likely keep the BoC on hold



Source: BofA Global Research, Stat Canada, Haver

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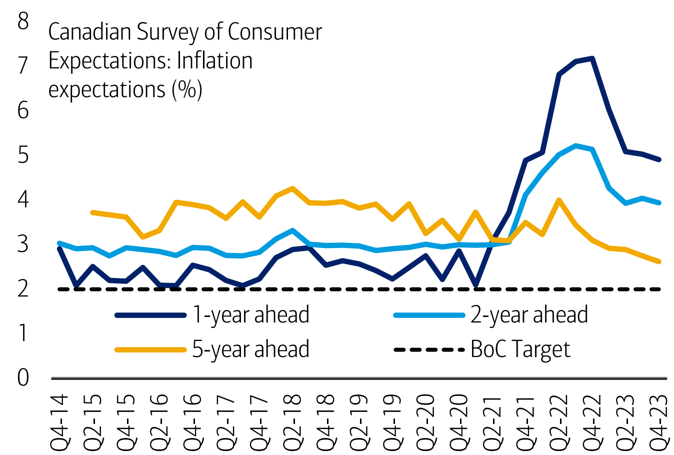
Exhibit 29: Inflation expectations (Canadian Survey of Cons. Expect.,%)
Consumers expect high inflation in the short-term



Source: BofA Global Research, Bank of Canada

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What matters most for 10y rates in Canada?

We believe there are several factors that will drive CA rates in 2024: (1) the BoC starting month for cuts (2) the pace of cuts and (3) the market pricing of terminal – which is the lowest point the BoC is priced to cut to in the cycle. The terminal rate will likely be a function of the level of inflation threat and the extent of growth slowing. The higher the inflation threat, the more difficult it will be for the market to price a lower terminal rate. In the next couple of quarters, we think terminal rate pricing – currently at 3% - will be the primary driver of CAD 10y rate levels.

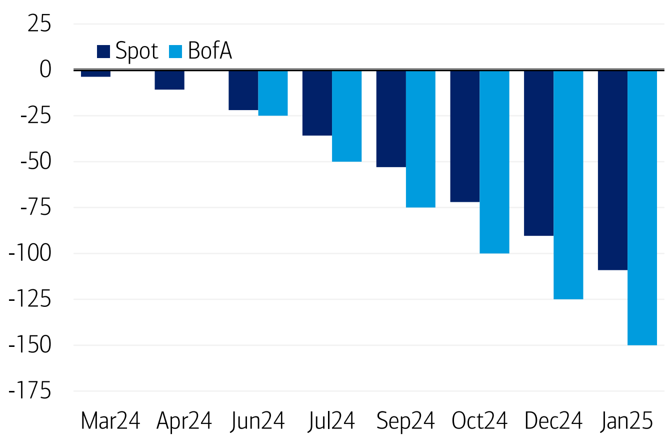
The Bank of Canada has recently pushed back on near-term expectations of rate cuts given sticky inflation. Outside of a significant downturn or a shift in central bank communication, market pricing of cuts will likely continue to be pushed out until core inflation is consistently slowing and below 3% YoY. The market currently prices in the first full cut for the BoC at the July meeting with just 75bps of cuts priced in for 2024 vs our outlook for 125bps.

If inflation declines as we expect and growth continues to slow, the BoC may cut sooner and a bit more aggressively. A sooner start to cuts could steepen the CAD yield curve, all else equal, but should also result in expectations of deeper cuts, i.e., a lower terminal rate or "trough" in the cutting cycle, which is currently priced for Aug 2027. A lower terminal pricing could offset steepening pressure by reducing long-term rates which are mostly a function of the terminal rate.

Because of the shape of the forward curve, which is similar in many countries that price cuts, the terminal rate is the main determinant of 10y rates. This is because the 10y rate is the compounded policy path over 10 years, and the path essentially falls to a level that remains approximately stable once the terminal level is reached. Because the terminal level is achieved in less than 3 years, the bulk of the forwards that determine 10y and 30y rates are near the terminal level. This is the case in the US as well, with terminal fluctuating recently between 3.4% (today's rate) and 3% at the end of 2023.

Lower market pricing of terminal would likely result from conditions that allow the BoC to begin delivering cuts. This is because the market's terminal pricing represents a probability-weighted blend of outcomes including tail risks of sticky high inflation (higher terminal) and tail risks of harder landings (lower terminal). If the BoC begins to deliver cuts this year, we would expect the high-side tail risks to diminish in probability and lead to a lower terminal rate, which could drive lower 10y CAD rates vs current market pricing. We expect this could also drive CAD rate outperformance vs US and UK rates (see Global Rates Year Ahead: 2024: Cloudy with a chance of landing and Pay UK rates vs Canada in front-end). If the BoC keeps rates elevated for longer, it could also foster conditions for a harder landing which would likely lead to a lower trough in the expected policy rates priced.

Exhibit 30: BoC MPR-dated CORRA OIS rate cut exp. vs. BofA f'casts, bp
Market pricing of cuts has been paired back due to hawkish CB guidance



Source: Bloomberg, BofA Global Research

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Exhibit 31: Government bond yield forecasts
10y YE'24 above forwards

	Q1 24	Q2 24	Q3 24	Q4 24
2y	4.20	3.75	3.25	3.00
5y	3.75	3.70	3.65	3.60
10y	3.70	3.65	3.65	3.60

Source: BofA Global Research estimates

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Exhibit 32: Swap rate forecasts
We look for 10yr swap rate at 4% by year-end

	Q1 24	Q2 24	Q3 24	Q4 24
2y	4.60	4.15	3.65	3.40
5y	4.10	4.05	4.00	4.00
10y	4.10	4.05	4.05	4.00

Source: BofA Global Research estimates

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We forecast the 10y rate at 3.6% at year-end 2024 which is close to spot levels. We think risks are likely skewed to the downside. A lower terminal on benign inflation data could drive not only a rally in yield levels but also exerts flattening pressure on the yield curve – depending on how aggressive the market prices the early stages of cuts. The faster the expected cuts, the steeper the curve, but the lower the terminal, the flatter the curve. So, these are offsetting factors. While the BoC remains on hold, a lower terminal could invert the yield curve further. With 2-10 slope now at -65bp, the CAD curve shows a large inversion (although not as inverted as the -130bp reached last year). We are not confident about curve steepening because of these conflicting forces of terminal rate impact versus the timing of cuts. We view the steepener also as vulnerable to strong consensus views not only in CAD but in the US and other regions. We lean towards long duration as having a potentially more attractive asymmetric risk reward than the curve steepener as we enter an unknown cutting cycle in 2024.

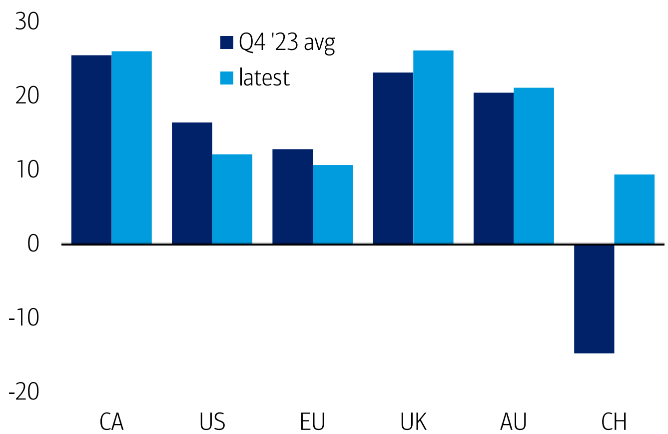
Where is USD/CAD headed in 2024?

Maintain bullish CAD bias vs USD in 2024

We like to maintain a bullish bias for the CAD vs USD in 2024, and see the pair falling to 1.30 by year-end (CAD Year Ahead: 05 January 2024). Our economists believe the BoC may cut policy rates more aggressively than the Fed, but not by much in 2024. After the latest BoC and FOMC meetings in January, the BoC communications continue to tilt more to the hawkish side relative to other major G10 central bank peers (Exhibit 33). Current market pricing of BoC rate cuts for this year is largely in-line with our forecast. For now, our baseline view also has Canada avoiding a recession in 2024. As a result, we believe idiosyncratic bearish risks for CAD emerging domestically from Canada is limited, and we see 1.35 as a strong near-term resistance for USD/CAD.

Exhibit 33: The BoC is still one of the most hawkish central banks among major G10 peers

Central bank speeches hawk-dove score



Source: BofA Global Research, Bloomberg. A higher value corresponds to more hawkish central bank communication; a lower value corresponds to more dovish central bank communication.

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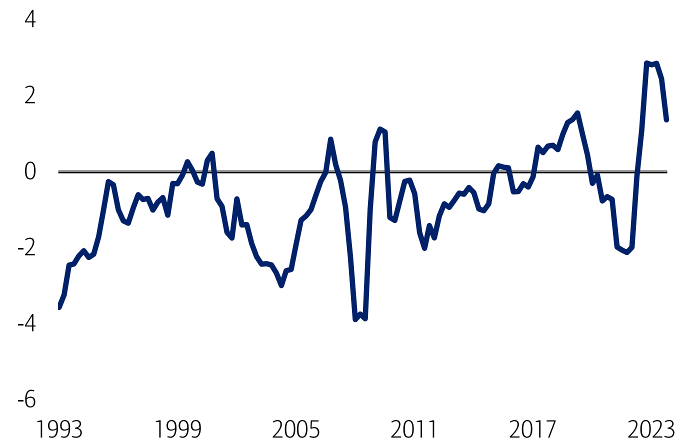
Exhibit 34: Fed real policy rate has plenty of room to converge lower towards rest of the advanced economies

US real policy rate spread over rest of the major G10 central banks



Source: BofA Global Research, Bloomberg. Chart shows the spread between real federal funds rate and the average real overnight policy rate between BoC, ECB (since 1999), RBA, and BoE. Real policy rate is calculated as the difference between nominal policy rate and CPI YoY.

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More material USD/CAD selloff could take place after Fed rate cuts begin

More material USD/CAD downtrend could take shape once the Fed cutting cycle begins, in our view. Start of the Fed cutting cycle historically has not always led to a weaker USD. But in 2024, we believe this could be a catalyst to trigger the next wave of USD selloff. The USD is still broadly overvalued by historical standards even after the Q4 '23 selloff (USD Year Ahead: 25 January 2024), with the Fed real policy rate having the most room to converge lower toward other central bank peers (Exhibit 34). Throughout 2023, the market has been torn between investors who subscribe to various economic landing scenarios. While consensus view has gradually shifted to a soft landing and bearish USD outlook, the positioning still has more room to grow. Once the Fed cutting cycle starts amid still-resilient growth for the US real economy, more USD bears should emerge. In G10, we believe currencies that are more cyclical like AUD and the Scandies should have the most upside (G10 FX Year Ahead: 20 November 2023). Nevertheless, the broad USD downtrend should also drive USD/CAD down toward our year-end target of 1.30. The risks to our view would be a surprise negative growth shock for Canada in 2024 or rising geopolitical risk keeping the USD supported.

Exhibit 35: Canada Economic Forecast Summary

Select macroeconomic forecasts

Real Economic Activity, %SAAR	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	2022	2023	2024	2025
Real GDP	2.5	1.4	-1.1	1.0	1.8	1.7	2.1	2.3	2.6	2.6	2.6	2.5	3.8	1.1	1.3	2.4
% Change, Year Ago	1.8	1.2	0.5	0.9	0.8	0.8	1.6	2.0	2.2	2.4	2.5	2.6	3.8	1.1	1.3	2.4
Final Domestic Demand	2.9	1.2	1.3	1.7	3.5	2.6	2.1	2.1	2.9	2.7	2.7	3.1	5.3	0.2	2.2	2.6
Household Consumption	5.3	-0.1	0.1	5.0	5.2	2.0	2.2	3.2	3.1	2.1	2.0	2.5	5.1	2.3	3.1	2.6
Residential Investment	-12.6	-4.2	8.3	9.0	6.0	3.0	3.0	4.0	4.0	4.0	1.2	4.0	-12.1	-9.4	5.1	3.5
Business Investment (non-res.)	5.6	8.4	-7.2	-1.8	-1.0	0.0	1.2	6.6	4.5	6.0	7.0	5.0	4.7	1.2	-0.5	4.8
Government	1.6	1.1	6.5	8.0	4.3	4.5	2.5	1.1	-0.1	1.5	1.4	2.5	3.3	2.5	4.6	1.4
Inventory change	31,831	31,181	25,399	5,444	1,021	1,630	774	-5,844	-3,613	-3,020	-1,753	-766	55,290	23,464	-604	-2,288
Exports	12.1	5.1	-5.1	-8.0	-5.0	-1.0	2.0	5.0	6.5	5.0	5.0	4.6	3.2	4.0	-2.8	4.6
Imports	4.0	4.4	-0.6	-5.0	1.0	2.2	2.0	4.0	7.0	5.0	5.0	6.0	7.6	0.6	0.4	4.8
Nominal GDP (C$bn, SAAR)	2,838	2,859	2,904	2,934	2,970	3,004	3,039	3,075	3,113	3,149	3,185	3,220	2,813	2,884	3,022	3,167
% SAAR	-0.2	3.1	6.4	4.2	5.0	4.7	4.7	4.8	4.9	4.8	4.6	4.5	11.8	2.5	4.8	4.8
Key Indicators																
Unemployment Rate (%)	5.1	5.3	5.5	5.8	6.0	6.2	6.4	6.5	6.5	6.5	6.3	6.2	5.3	5.4	6.3	6.4
Goods Trade Balance (C$bn, SAAR)	1.6	-24.7	3.3	1.3	-2.2	-3.9	-3.6	-2.6	-2.3	-1.5	-0.8	-1.1	19.7	-4.6	-3.1	-1.4
Current Account (% of GDP)	-1.0	-1.0	-0.4	-0.7	-1.1	-1.3	-1.1	-0.8	-1.2	-1.5	-1.7	-1.7	-0.4	-0.8	-1.1	-1.5
Inflation and Policy																
GDP Deflator (% SAAR)	-2.6	1.7	7.4	3.2	3.3	3.0	2.6	2.5	2.4	2.1	2.0	2.0	5.6	2.4	2.9	2.1
CPI (% Change, Year Ago)	5.2	3.5	3.6	3.2	3.2	3.0	2.5	2.5	2.3	2.1	2.0	1.9	6.8	3.9	2.8	2.1
Average of Core CPI (% Change, Year Ago)	4.8	4.0	3.8	3.6	3.2	3.0	2.8	2.6	2.4	2.2	2.0	2.0	5.0	4.0	2.9	2.2
Bank of Canada Overnight Rate (eop)	4.50	4.75	5.00	5.00	5.00	4.75	4.25	3.75	3.25	3.00	3.00	3.00	4.25	5.00	3.75	3.00
FX (eop)																
USDCAD	1.35	1.36	1.32	1.36	1.35	1.34	1.32	1.30	1.30	1.30	1.30	1.30	1.36	1.36	1.30	1.30

Source: BofA Global Research estimates

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