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The Regional Municipality of Durham Information Report

From:	Commissioner of Finance
Report:	#2024-INFO-45
Date:	July 12, 2024

Subject:

Economic Update – Softening Economic Backdrop Leads to Bank of Canada Rate Cut

Recommendation:

Receive for information.

Report:

1. Purpose

1.1 This report updates Regional Council on the economic environment, as monitored by the Finance Department, including key economic indicators and their impacts on the local economy and Durham Region programs.

1.2 Economic highlights include:

- On June 5, 2024, the Bank of Canada lowered its overnight interest rate by 25 basis points to 4.75 per cent, the first reduction in four years after holding the key policy rate at 5% since last hiking rates in July 2023.
- Canadian Real Gross Domestic Product (GDP) increased by 0.4 per cent in 2024 Q1, after posting no change in 2023 Q4 (revised down from 0.2 per cent). The economy grew by 1.7 per cent on an annualized basis in 2024 Q1 missing expectations by 0.8 per cent, while 2023 Q4 was revised lower from 1.0 per cent to 0.1 per cent.
- The Labour Force Survey (May 2024 data) by Statistics Canada released on June 7, 2024, indicated that employment was little changed in May and that the unemployment rate ticked up 0.1 percentage points in the month to 6.2%.
- On June 5, 2024, the Toronto Regional Real Estate Board (TRREB) reported that GTA home sales remain low and there was no spring pick-up, as was seen in the housing market last year.

- Higher supply and lowered demand also resulted in downward pressure on the resale price. According to TRREB, the average home price in the GTA decreased 2.5 per cent from $1,195,409 in May 2023 to $1,165,691 in May 2024.Ontario Inflation, as measured by the 12-month change in the Consumer Price Index (CPI), increased by 3.0%, slightly more than the national rate of 2.9%.

2. Previous Reports and Decisions

2.1 This report updates the March, 2024 Report #2024-INFO-12 “Higher Interest Rates are Having the Intended Effect as Inflation Retreats and Growth and Spending Slow”.”

3. Bank of Canada Interest Rate Decrease

3.1 On June 5, 2024, the Bank of Canada (BoC) lowered its overnight interest rate by 25 basis points to 4.75 per cent, after the Consumer Price Index (CPI) edged down in April to 2.7 per cent. This was the first reduction in four years after holding the key policy rate at 5% since last hiking rates in July 2023. The move was not a surprise with markets pricing roughly 75% odds of a cut before the announcement as data continued to provide evidence that underlying inflation is easing, and policy no longer needed to be as restrictive.

3.2 The reduction in rates marked the beginning of the central bank easing monetary policy towards more ‘normal’ levels of interest rates after a prolonged and difficult battle with rising inflation pressures. That still, however, leaves monetary policy firmly in ‘restrictive’ territory – the change in interest rates is the equivalent of the central bank easing off the brakes rather than stepping on the gas.

3.3 The pivot is entirely possible because of persistently lower inflation readings over the last year. The BoC’s core CPI measures started to ease more significantly in 2024 and averaged at 1.85% on a three-month annualized basis at last count in April. That alongside the currently soft economic backdrop provided sufficient evidence that “monetary policy no longer needs to be as restrictive”.

3.4 The BoC in its statement also highlighted ongoing softening in labour market conditions as growth in employment lags that of the working age population and pointed to wage pressures “that look to be moderating gradually”.

3.5 Moving forward, the BoC expects unwinding in price pressures will persist, especially with the Canadian economy still running in excess supply (demanding less than what’s produced). The BoC’s forecast per the April Monetary Policy Report is for headline CPI to continue to trend lower and reach the 2% target in 2025, despite improving economic outlook in the meantime.

3.6 With the first interest rate cut now having materialized, the focus will shift towards the pace and amount of further rate cuts. On that front, the BoC offered few clues outside of reiterating that upside inflationary risks still remain, and decisions will be made "one meeting at a time".

3.7 Contrary to expectations, CPI data released on June 25, 2024, indicated that inflation jumped to 2.9 per cent in May on a year-over-year basis, weaking the case for a rate cut in July.

3.8 There are several risks to the outlook for economic growth and inflation which the Bank of Canada will be monitoring to inform future rate decisions, namely:

(a) A large number of households renewing mortgages in 2025 could curb spending and dampen economic activity and inflation more than expected. Alternatively, consumption could rebound more than expected as consumer confidence recovers.

(b) Persistently strong wage growth and weak productivity could lead to inflationary pressures in services prices. Currently, disinflation in goods prices is offsetting upward pressure in service prices.

(c) Cuts to interest rates could lead to an overheated housing market, given pent-up demand.

(d) The timing and impact of government plans to unwind the rapid growth in non-permanent residents could affect the forecast for inflation and growth. Strong population growth can put upward pressure on shelter inflation, particularly rents.

(e) Geopolitical tensions or worsening of regional conflicts abroad, and labour disruptions or climate events such as wildfires in Canada, could affect global oil prices, supply chains, and inflation.

3.9 The potential for divergent monetary policies between the US Federal Reserve and the Bank of Canada could put downward pressure on the Canadian dollar.

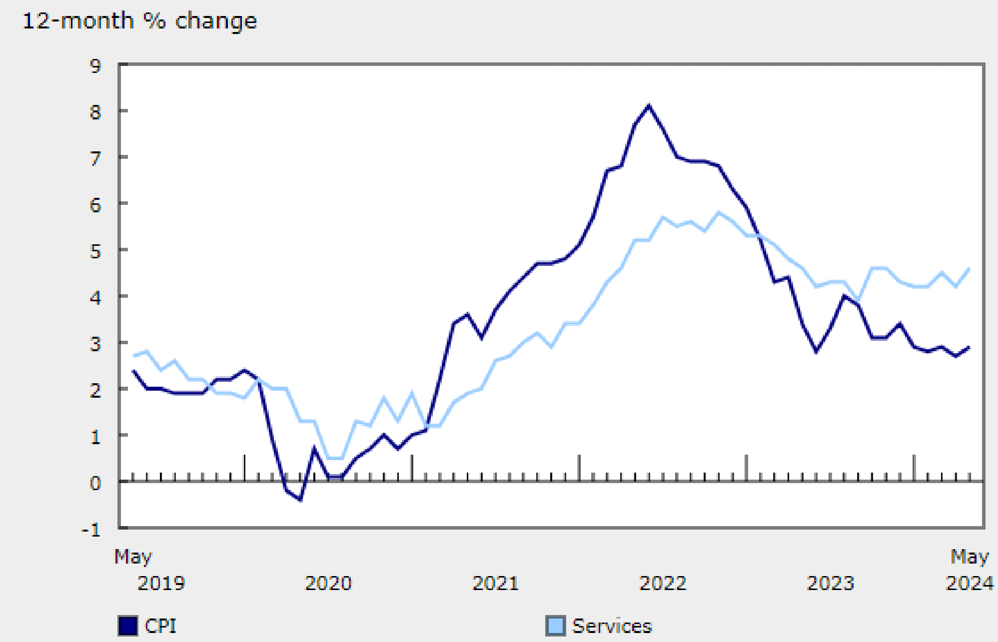
3.10 Bottom line: The June 5 rate cut from the Bank of Canada marks the first step of an easing cycle where interest rates are lowered back towards “normal” levels, and spells good news for Canadian households that have been contending with elevated borrowing costs. To be sure, interest rates themselves are still high – and will still be at levels the BoC views as ‘restrictive’ by the end of this year even if the expected 100 bps worth of cuts materialize. Still, the move itself signifies confidence among policymakers that the most likely path for future inflation in Canada is down. The BoC will get two additional monthly inflation and labour market reports, as well as the second quarter business and consumer surveys before the next scheduled policy decision in July. Those should all offer more clues on a few key pressure points that the BoC highlighted including housing, wage growth and inflation itself.

4. Consumer Price Index (CPI): Canadian Headline Inflation

4.1 Statistics Canada released its May update on Consumer Price Indices on June 25. The Consumer Price Index (CPI) rose 2.9% on a year-over-year basis in May, up from a 2.7% gain in April.

4.2 Acceleration in the headline CPI was largely due to higher prices for services, which rose 4.6% in May following a 4.2% increase in April. Faster price growth for services was led by cellular services, travel tours, rent and air transportation. Prices for goods (+1.0%) grew at the same rate as in April.

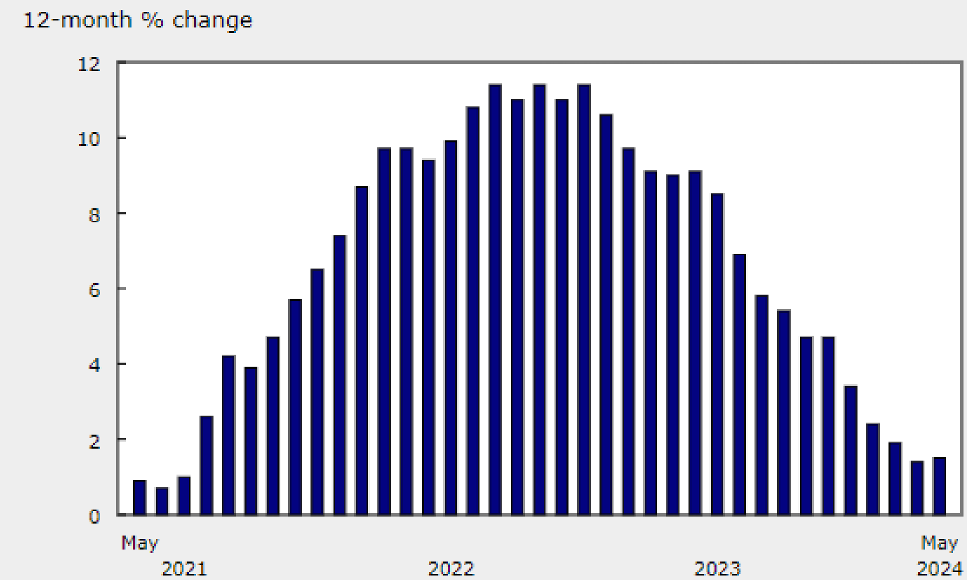
Chart 1: 12-Month Change in the Consumer Price Index (CPI) and Service Prices



Source(s): Table 18-10-0004-01.

4.3 Prices for food purchased from grocery stores rose 1.5% on a year-over-year basis in May following a 1.4% increase in April. Although slight, this was the first acceleration since June 2023. Prices for groceries remain elevated and have increased by 22.5% compared with May 2020.

Chart 2 – 12-Month Change in Prices for Food Purchased in Grocery Stores



Source(s): Table 18-10-0004-01.

4.4 Gasoline prices were down slightly from the April 2024 reading, however, have risen 5.6% on a year over year basis.

4.5 In Ontario, the year-over-year CPI increased by 3.0%, slightly more than the national rate of 2.9%.

5. Canadian Economic Growth Outlook

5.1 Canadian Real Gross Domestic Product (GDP) increased by 0.4 per cent in 2024 Q1, after posting no change in 2023 Q4 (revised down from 0.2 per cent). The economy grew by 1.7 per cent on an annualized basis in 2024 Q1 missing expectations by 0.8 per cent, while 2023 Q4 was revised lower from 1.0 per cent to 0.1 per cent.

5.2 Household spending rose by 0.7 per cent in the first quarter, primarily due to a 1.1 per cent increase in spending on services, primarily telecommunications services, rent, and air transport. Household spending on goods increased by 0.3 per cent, with higher expenditures on new trucks, vans, and sport utility vehicles.

5.3 On a per capita basis, household consumption expenditures increased by 0.1 per cent in 2024 Q1, following three quarters of declines. Per capita spending on services increased 0.5 per cent, while per capita spending on goods fell for a 10th consecutive quarter.

5.4 Business capital investment rose by 0.8 per cent in 2024 Q1, driven by increased spending on engineering structures, primarily within the oil and gas sector. Business investment in machinery and equipment increased by 1.6 per cent in

2024 Q1, coinciding with increased imports of industrial machinery, equipment and parts.

5.5 Weaker investment in inventories was the main factor that held back economic activity in 2024 Q1.

5.6 Housing investment also increased by 0.3 per cent in 2024 Q1, as resale activity rose by 7.1%. New housing construction increased slightly by 0.1 per cent in 2024 Q1. Costs related to new construction, such as taxes and closing fees upon ownership increased in the quarter and were mainly attributed to newly absorbed apartment units in Ontario.

5.7 Net trade provided a minor lift to GDP rising by 0.1 per cent, after providing a large offset in late 2023. The main driver of trade were exports of unwrought gold, silver, and platinum group metals and their alloys increasing amidst high demand for gold due to geopolitical uncertainty.

6. The Labour Market

6.1 Employment in Canada was little changed in May (+27,000) and June (-1,400). The unemployment rate increased to 6.4% in June and has risen 1.3 percentage points since April 2023.

6.2 Ontario posted little change in employment in June, however, the unemployment rate increased 0.3 percentage points to 7.0%, as more Ontarians were searching for work. The unemployment rate in Ontario has increased 1.9 percentage points from its recent low of 5.1% in April 2023. Employment rose by 3,000 in New Brunswick (+0.8 per cent) as well as by 2,600 in Newfoundland and Labrador (+1.1 per cent), meanwhile employment in Quebec declined by 18,000 (-0.4 per cent) in June, following little change in May.

6.3 There were declines in the number of people working in transportation and warehousing (-12,000; -1.1 per cent) as well as in public administration (-8,800; -0.7 per cent) in June. At the same time, there were more people employed in accommodation and food services (+17,000; +1.5 per cent) and in agriculture (+12,000; +5.5 per cent).

6.4 For men aged 25 to 54, employment was little changed (-14,000; -0.2%) in June, and the employment rate fell 0.5 percentage points to 86.6%. This extended a downward trend in the employment rate from a recent high of 88.2% in June 2023. The rate in June 2024 was comparable to the pre-pandemic average of 86.5% observed from 2017 to 2019. For women aged 25 to 54, employment rose in June 2024 (+19,000; +0.3%) and the employment rate held steady at 80.6%. The employment rate of women aged 25 to 54 has trended down from the record high of 82.0% in January and March of 2023, but remained above the pre-pandemic average observed from 2017 to 2019 (79.3%).

6.5 Average hourly wages among employees increased 5.4% in June on a year-over-year basis, following growth of 5.1% in May. Wage growth remained relatively widespread across the wage distribution. Total hours worked were down 0.4% in June, however, on a year-over-year basis, total hours worked were up 1.1%.

6.6 In June 2024, the proportion of employees who usually worked most of their hours from home was 15.1%, down from 21.5% in June 2022. This decrease was driven by a decline in the proportion of employees who usually worked mostly from home and whose office or work site was in the same city or nearby, down 6.4 percentage points to 11.4 per cent from June 2022 to June 2024.

7. Housing Trends

7.1 On July 4, 2024, the Toronto Regional Real Estate Board (TRREB) reported that Greater Toronto Area (GTA) home sales were lower compared to the same month last year as many buyers kept their home purchase decisions on hold. TRREB President, Jennifer Pearce noted, “The Bank of Canada’s rate cut last month provided some initial relief for homeowners and home buyers. However, the June sales result suggests that most home buyers will require multiple rate cuts before they move off the sidelines. This follows Ipsos polling for TRREB, which suggested that cumulative rate cuts of 100 basis points or more are required to boost home sales by any significant amount.” (TRREB, page 1).

7.2 Higher supply and lowered demand also resulted in downward pressure on the resale price. Between June 2023 and June 2024, GTA home sales are down 16.4 per cent, offsetting a 12.3 per cent rise in new listings, and resulting in a 1.6 per cent decrease in existing home resale prices. According to TRREB, the average home price in the GTA decreased from $1,181,002 in June 2023 to $1,162,167 in June 2024. New listings increased from 15,995 to 17,964 over the same period, while sales fell by 1,216 transactions.

Table 1 - Toronto Regional Real Estate Board: Summary of Select Existing Home Transactions (All Home Types – Average Price in Canadian $)

	Year-over-Year		Monthly Changes			
	23-Jun	24-Jun	Mar-24	Apr-24	24-May	24-Jun
Durham	999,787	956,428	936,166	943,840	954,942	956,428
York	1,391,215	1,385,139	1,334,655	1,326,533	1,340,032	1,385,139
Peel	1,145,515	1,077,628	1,062,171	1,106,045	1,071,480	1,077,628
Halton	1,294,251	1,252,642	1,244,298	1,297,545	1,271,115	1,252,642
Toronto	1,152,424	1,173,781	1,087,017	1,152,200	1,193,202	1,173,781

7.3 Table 1 provides GTA municipalities’ year-over-year price changes for resale homes. Prices in June 2024 decreased in 4 of the 5 GTA Regions, with Toronto being the exception having experienced slight price appreciation. The largest decreases occurred in Peel (-5.9 per cent) and Durham (-4.3 per cent). After Durham Region’s housing resale pricing peaked at $1,175,010 in June of 2022, Durham’s May 2024 average price is 19 per cent lower than this peak, despite increasing March to June 2024.

7.4 According to Canada Mortgage and Housing Corporation (CMHC), in the Oshawa Census Metropolitan Area (CMA), new housing starts from January 1 to May 31, 2024, increased by four compared to January 1 to May 31, 2023 (812 starts compared to 808). While the overall total is consistent, there has been a shift in the area and composition of starts across the CMA, which includes Whitby, Oshawa, and Clarington. The Town of Whitby led housing starts in 2023 over this period with 556 starts (of which 338 were apartment dwellings). For 2024 however, the City of Oshawa and Municipality of Clarington have led starts to May 31st, with Clarington adding 376 starts (339 apartment) and Oshawa adding 292 starts (291 being single, semi-detached or row housing).

8. Canadian Household Debt

8.1 The Canadian household debt servicing ratio (the ratio of debt payments to disposable incomes) edged down to 14.9 per cent in 2024 Q1 from the 15.0 per cent in 2023 Q4.

8.2 Total household debt payments grew by 7.8 per cent year-over-year – led by an 8.4 per cent surge in mortgage payments driven by higher interest costs. Growth in non-mortgage payments also rose sharply (+7.0 per cent). But household disposable income including interest payments also increased significantly– expanding by 8 per cent year-over-year to (slightly) outpace the growth in total debt payments.

8.3 Canadian households' debt to disposable income ratio lowered again in 2024 Q1, from 178 per cent in 2023 Q4 to 176.4 per cent, marking a fourth consecutive decline.

8.4 Household credit market debt edged up 0.9 per cent in Q1 as mortgage borrowing activity was softer in the face of continually weak affordability conditions.

8.5 Household net worth continued to expand in 2024 Q1, up by 4.6 per cent from a year ago. Recent gains in asset values were largely driven by the rally in equity markets into Q1, with S&P 500 and S&P/TSX Composite Indexes both jumping higher, by 10.2 per cent and 5.8 per cent respectively. Additionally, residential real estate values rose $213 billion in 2024 Q1, following two quarterly declines in the second half of 2023.

8.6 Canada's household savings rate rose to 6.9 per cent in 2024 Q1, from 6.2 per cent in the fourth quarter of 2023, given the household disposable income grew at a faster pace than consumption.

8.7 Bottom line: Higher interest rates continue to push up household debt payments. Disposable incomes have, for now, been keeping up to hold the household debt servicing ratio essentially unchanged over the last year. But household debt payments will continue to rise even with the pivot from the BoC to cut interest rates last month as the impact of previous rate hikes feed into household debt payments with a lag. And a softer labour market means income growth won't be sustained at its recent pace. The combination of rising debt payments and softer labour markets are expected to push the household debt service ratio higher over the second half of this year and will keep a cap on consumer spending growth even as interest rates edge lower.

9. Ontario Economic and Fiscal Outlook

9.1 According to the Financial Accountability Office of Ontario (FAO), Ontario's economic growth (as measured by growth in real GDP) slowed sharply in 2023 and is projected to slow even further to 1.1 per cent in 2024, reflecting the ongoing impact of higher interest rates on household spending and the housing market, and a weaker global environment. Ontario's economic growth is projected to improve over the 2025 to 2028 period as lower interest rates bolster household spending and residential investment.

9.2 Following a budget deficit of $5.9 billion in 2022-23, the FAO projects that Ontario's budget deficit will temporarily improve to $0.9 billion in 2023-24, smaller than the government's projection of a $3.0 billion deficit in the 2024 Ontario Budget. The FAO expects the budget deficit will widen to $6.4 billion in 2024-25 and improve gradually over the outlook, reaching a surplus of $1.8 billion in 2028-29, two years later than the government's plan for a budget surplus.

9.3 The FAO projects revenue growth will average 3.8 per cent per year from 2022-23 to 2028-29, slower than the 7.3 per cent average annual growth recorded during the COVID-19 pandemic. The FAO projects $1.0 billion less revenue in 2023-24 compared to the government's revenue projection and $3.9 billion lower by 2026-27, mainly reflecting the FAO's less optimistic outlook for corporate tax revenue.

9.4 The FAO projects spending growth will average 3.1 per cent per year from 2022-23 to 2027-28, slower than the 5.6 per cent average annual growth over the previous five years. The FAO's spending outlook does not include the estimated cost of some recently announced spending measures, including the Building Ontario Fund; the upload to the Province of the Gardiner Expressway, Don Valley Parkway and Ottawa Road 174; provincial support to Honda to build new electric vehicle and battery plants; and the refurbishment of the Ontario Legislative building.

10. Relationship to Strategic Plan

10.1 This report aligns with the following strategic goals and priorities in the Durham Region Strategic Plan:

- Economic Prosperity: To build a strong and resilient economy that maximizes opportunities for business and employment growth, innovation, and partnership.

11. Conclusions

The economy is slowing and anticipated to bring the inflation rate, as measured by CPI, closer to the two per cent BoC target later in 2024. The Bank lowered its key policy interest rate to align with this softening economic backdrop, and economists will be monitoring key data coming out of Statistics Canada to predict the timing of future reduction in rates lowering of rates.

Respectfully submitted,

Original Signed By

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