Economic growth to remain respectable in Canada despite the adverse impact of lower oil prices: TD Economics

TORONTO – The continued slide in crude oil prices is expected to weigh on Canadian economic growth over the next few years, although it is likely to be tempered by offsets in the form of ultra-low interest rates, a weaker Canadian dollar, resilient growth in the key U.S. export market and energy savings to consumers.

"No matter how you parse it, the overall impact on the Canadian economy of lower oil prices is negative," notes TD Chief Economist Craig Alexander. "That said, there are offsets to lower oil prices on the economy, and some regions are going to benefit from these economic tailwinds more than others."

All told, TD Economics is forecasting that the Canadian economy will grow by around 2% in 2015 and 2016. However, much of this growth is expected to come from non-oil producing provinces, as energy-rich regions of the country see growth slow relative to recent trends.

Sliding commodity prices are expected to have the most adverse effect on corporate profits in 2015 with a notable spill-over into business investment and, ultimately, households through softer employment and income growth. Indeed, the unemployment rate could reach 7% by the end of this year, before falling back toward 6.7% by the end of 2016.

Income growth in Canada is also expected to be hard hit, as nominal GDP is likely to expand by a mere 1.3% in 2015. Weak income growth is likely to be particularly acute in oil-producing provinces, and will therefore act as a significant drag on their governments' revenues. "This is the slowest pace of income growth outside of a recession in recent memory," adds Alexander.

Fortunately for consumers, they will continue to be handed some relief in the form of lower prices at the pumps. TD Economics estimates that, for the average Canadian household, these savings will amount to about $800 in 2015. However, about three-quarters of this saving will be needed to pay for the higher cost of consumer goods resulting from the lower dollar.

With energy prices and the dollar expected to move lower over the next few months, TD Economics is forecasting headline and core Consumer Price Index (CPI) inflation to move in different directions. Led lower by falling oil and natural gas prices, headline CPI inflation is expected to dip into negative territory in the second quarter of this year, before moving higher over the outlook. In contrast, core CPI inflation is forecast to stay in and around 2% over the projection, as the lower dollar keeps the cost of imported goods elevated.

With the Canadian economy subject to these cross-currents, the Bank of Canada is expected to keep interest rates on hold through to the end of 2016. With most indicators pointing to an economy that has weakened but is underpinned by solid fundamentals, lower interest rates for longer will no doubt be welcomed by households. As such, we expect the Canadian housing market to hold up, albeit likely to expand at a more moderate pace and with significant diversity in outcomes across regions.
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