CANADIAN
MANUFACTURERS
& EXPORTERS

2021 YEAR IN REVIEW
2022-23 ECONOMIC OUTLOOK

WAR COMPOUNDS SUPPLY CHAIN TURMOIL

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WHO WE ARE

ABOUT OUR CHIEF ECONOMIST

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Alan is a member of the National Policy team where he is responsible for developing and executing CME's major national research projects, conducting CME's macroeconomic analysis to support the organization across the country, leading our tax policy efforts, and be a leading voice representing the interests of the association and members with government and with the public.

Before joining CME, Alan spent 19 years at The Conference Board of Canada where he held multiple roles, including the Associate Director of the Centre for Municipal Studies. Alan's background includes expertise in municipal, regional, and national economic matters including economic forecasting and analysis.

ABOUT CANADIAN MANUFACTURERS & EXPORTERS

Canadian Manufacturers & Exporters (CME) is Canada's largest trade and industry association, and the voice of manufacturing and global business in Canada.

CME directly represents more than 10,000 leading companies nationwide. More than 85 per cent of CME's members are small and medium-sized enterprises. As Canada's leading business network, CME – through various initiatives, including the establishment of the Canadian Manufacturing Coalition – touches more than 100,000 companies from coast to coast, engaged in manufacturing, global business, and service-related industries.

CME's membership network accounts for an estimated 82 per cent of Canadian manufacturing production and 90 per cent of all goods and services exports.

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FIVE KEY TAKEAWAYS

1. RISKS TO THE OUTLOOK REMAIN ELEVATED

The risks to Canada's economic outlook remain elevated. While the coronavirus is becoming less of a threat—thanks to vaccines, therapeutics, and growing population immunity—new variants and future waves that prolong the pandemic and lead to renewed economic disruptions cannot be ruled out. This is especially true for Canada, given that we have very low hospital capacity which can be easily overwhelmed, with fewer ICU beds per capita than almost any other developed country.

On top of this, the Russian invasion of Ukraine has added another source of uncertainty and volatility in the global economy. Western countries, including Canada, will pay an economic price by levying severe economic sanctions (although Canada's food and raw material producers and exporters will benefit from higher prices). In its April outlook report, the IMF projects that global real GDP growth will come in at 3.6% this year, 0.8 percentage points lower than its January forecast, with the downgrade largely reflecting the negative economic impact of the war.

2. SUPPLY CHAIN DISRUPTIONS AND HIGH INFLATION WILL PERSIST FOR LONGER THAN EXPECTED

Along with the lingering impact of the pandemic, the situation in Ukraine will prolong supply chain disruptions and keep inflation elevated for longer than previously expected. In particular, the Russian invasion of Ukraine is driving up prices for oil, wheat, and other major commodities. For 2022, the IMF expects inflation to average 5.7% in advanced economies and 8.7% in emerging market and developing economies—1.8 and 2.8 percentage points higher than projected in January.

The war has huge repercussions for manufacturers, households, and policymakers alike. For manufacturers, already strained supply chains are being thrown into yet more turmoil. By inhibiting production, supply chain disruptions will continue to inhibit economic growth. For households, higher inflation will leave them with less money to spend, another dynamic that will slow the economy. And, for the Bank of Canada, with the near-term outlook for inflation depending heavily on how supply chain disruptions evolve, the conflict is making their job of reining in inflation without jeopardizing the recovery much more challenging.

3. CANADA'S ECONOMIC RECOVERY HAS BEEN IMPRESSIVE, AND THE NEAR-TERM OUTLOOK IS SOUND

By most measures, Canada's recovery from the pandemic has been impressive. Several factors explain this better-than-expected rebound: extraordinary fiscal and monetary stimulus, the economy's growing ability to withstand restrictions on activity compared to when they were first introduced in the spring of 2020, and the rollout of vaccines. Recent GDP figures and labour market indicators together confirm that economic slack has been absorbed. Canada's economy expanded by a robust 4.6% last year, including a very strong annualized gain of 6.7% in the fourth quarter. As well, the February 2022 Labour Force Survey (LFS) showed that the unemployment rate had moved below its level from February 2020 and that total hours worked had moved above this threshold, leaving little doubt that the economy was at full employment.

Although the Canadian economy had strong momentum heading into 2022, the arrival of the highly transmissible Omicron variant slowed activity at the start of the year. Fortunately, the economy bounced back quickly in February as restrictions were lifted. Despite the elevated risks to the outlook, real GDP growth is forecast to come in at an impressive 4.2% this year, before slowing to 2.7% in 2023.

4. NEAR-TERM ECONOMIC PROSPECTS VARY WIDELY BY PROVINCE

While the overall near-term economic outlook is positive, prospects vary widely by province. In particular, economic growth this year is expected to be strongest in the west, especially in commodity-producing provinces that will receive a lift from higher energy and food prices as well as from a rebound in agricultural production. Alberta (+5.8%) and Saskatchewan (+5.7%) are forecast to lead the country in economic growth this year, with BC (+4.3%) and Manitoba (+4.1%) also posting solid gains.

While near-term real GDP gains are also expected to remain above historical trends in the other provinces, growth will be tempered by the fallout of higher inflation on business and household budgets. In central Canada, Ontario's economy is expected to grow by 4.2%, matching the national average, while Quebec's economy is projected to expand by 3.6%. Economic prospects are somewhat more muted on the east coast, with real GDP growth forecast to reach 2.7% in PEI, 2.6% in New Brunswick, and 2.5% in both Newfoundland and Labrador and Nova Scotia.

5. CANADA'S LONG-RUN POTENTIAL ECONOMIC GROWTH IS WEAK, REINFORCING THE NEED FOR A COMPREHENSIVE INDUSTRIAL STRATEGY

Finally, while Canada has enjoyed an impressive recovery to-date, economic growth is expected to slow sharply as life gradually returns to some sort of normality. Unfortunately, Canada's long-term growth prospects are weak, with the Office of the Parliamentary Budget Officer pegging our long-run real GDP growth at just 1.7 per cent. The weak outlook is largely attributable to Canada's aging population, which will lead to a slowdown in labour force growth. Boosting immigration is only a partial solution to our deteriorating demographic profile.

To raise Canada's long-run potential economic growth, policymakers need to place a greater emphasis on improving labour productivity growth, which has been relatively lacklustre compared to many other developed economies. But this improvement will only come if Canada also turns around its weak business investment performance, as it has a major influence on the speed at which an economy can grow. For example, when manufacturers build new factories and purchase new machinery, they increase the productive capacity of the economy, lift labour productivity growth, and drive economic prosperity. The stakes are high. The long-term rate of productivity growth has profound implications for individual wage growth, corporate competitiveness, and the ability to raise government revenue to pay for key public programs and services.

The bottom line is that to build a more competitive, innovative, and resilient economy, the federal government must work with our sector to implement a comprehensive industrial strategy. With the pandemic exposing the fragility of supply chains, the potential for reshoring manufacturing in Canada has become a real possibility. This, along with the enormous potential of Canadian firms to tap into the rapidly growing clean technology sector, suggest that there is no better time to build a more vibrant Canadian manufacturing sector.

EXECUTIVE SUMMARY

ECONOMIC OUTLOOK

Canada's economic growth prospects over 2022-23 are highly uncertain, though the near-term outlook is sound. Thanks to vaccines, therapeutics, and growing population immunity, the coronavirus is becoming less of threat. Nevertheless, new variants and future waves that prolong the pandemic and lead to renewed economic disruptions cannot be ruled out. And even with the pandemic receding, its economic fallout is still being felt through supply chain disruptions, severe labour shortages, and high and persistent inflation. On top of this, the Russian invasion of Ukraine has added another source of uncertainty and volatility in the global economy. Notwithstanding these significant risks, the Canadian economy is forecast to expand by 4.2% this year and 2.7% next year, following a 4.6% gain in 2021. (See Table ES1.)

Table ES1
World Economic Outlook Projections
Real gross domestic product growth

	2021	2022	2023
World	6.1	3.6	3.6
Canada	4.6	4.2	2.7
China	8.1	4.4	5.1
Euro Area	5.3	2.8	2.3
India	8.9	8.2	6.9
Japan	1.6	2.4	2.3
Mexico	4.8	2.0	2.5
South Korea	4.0	2.5	2.9
United Kingdom	7.4	3.7	1.2
United States	5.7	3.7	2.3

Sources: CME; IMF World Outlook—April 2022.

Canada's recovery is partly attributable to a relatively strong global economic rebound. Although it remained hobbled by the pandemic, the global economy still managed to climb by 6.1% in 2021, a marked improvement from the 3.1% contraction in 2020. Unfortunately, economic activity slowed considerably in late in 2021 and early 2022 as the Omicron variant spread rapidly around the world, resulting in higher and more broad-based inflation than anticipated. The global recovery was further knocked off course by Russia's unprovoked invasion of Ukraine. The war is compounding global supply chain disruptions and intensifying inflationary pressures from higher commodity prices. Western countries, including Canada, are also paying an economic price by levying severe economic sanctions (although Canada's food and raw material producers and exporters are benefitting from higher prices).

In addition, wide-ranging COVID-related lockdowns in China—including in key manufacturing hubs—have also slowed activity there and are exacerbating bottlenecks in global supply chains. To bring inflation under control, central banks in many countries are tightening monetary policy. At the same time, governments are reining in spending to tackle high deficits built-up over the pandemic. In its April 2022 outlook, the International Monetary Fund projected that global real GDP growth will come in at 3.6% in both 2022 and 2023—0.8 and 0.2 percentage points lower than its January forecast. The downgrade largely reflects the economic fallout from the war in Ukraine.

Crucially for Canada's prospects, the US economy also bounced back strongly last year, with real GDP up 5.7%, the fastest pace of growth since 1984. Unfortunately, the US economy will be unable to match last year's pace of growth this year, especially with first quarter growth taking a hit from the Omicron wave. As well, given higher-than-expected inflation, the Federal Reserve will need to embark on a faster and more pronounced tightening of monetary policy. While interest rate hikes will help rein in inflation, it will also cool economic growth, especially by weighing on residential housing activity. Indeed, higher interest rates, along with the fading impact of the economic reopening, is projected to push US real GDP growth down to 3.7% in 2022 and to 2.3% in 2023.

MANUFACTURING OUTLOOK

The manufacturing sector has experienced a fairly solid rebound since suffering a massive decline in the spring of 2020. However, the recovery has been slower than expected, weighed down by persistent supply problems and severe labour shortages. Still, despite the many challenges facing the industry, both manufacturing sales and manufactured goods exports hit record highs last year. The lion's share of the increase was due to a huge run-up in prices, reflecting the inflationary pressures stemming from supply chain bottlenecks. After controlling for inflation, manufacturing sales and manufactured goods exports both climbed at much more moderate rates.

Similarly, manufactured goods imports also jumped last year, in line with stronger domestic demand. Accordingly, despite the record export performance, Canada continued to run a substantial trade deficit in manufactured goods, indicative of years of sluggish investment and a decline in global competitiveness. In fact, the trade deficit came in at $147.6 billion in 2021, similar to the average of the past five years.

Going forward, manufacturing output is expected to continue expanding over the near term, although several factors will hold back growth. First, supply chain disruptions and labour shortages, which limited the sector's recovery last year, will continue to weigh on the industry in 2022. Second, with pandemic restrictions easing, consumer spending is expected to rotate back toward services and away from goods. Third, as mentioned above, manufacturing investment in Canada has been sluggish for many years, and this greatly limits the sector's growth potential. After reaching 4.5% last year, real manufacturing output growth is forecast to decelerate to 3.5% in 2022 and to 3.2% in 2023. (See Table ES2.)

Table ES2
Real GDP Growth by Major Manufacturing Subsector
Canada

	2021	2022	2023
Manufacturing	4.5	3.5	3.2
Food and beverage	5.0	3.1	2.2
Wood product	8.8	2.5	2.3
Paper	0.7	2.0	2.5
Petroleum and coal product	3.9	3.6	2.6
Chemical	2.7	3.7	2.4
Plastics and rubber products	10.0	3.3	3.1
Non-metallic mineral products	11.2	2.0	2.8
Primary metal	1.5	4.0	2.7
Fabricated metal	1.7	3.0	3.1
Machinery	14.0	2.4	2.5
Transportation equipment	-4.0	8.9	7.7
All others	6.4	1.3	3.0

Sources: Statistics Canada; CME.

Among major subsectors, transportation equipment manufacturing is expected to see the fastest growth over the next two years, assuming the global semiconductor shortage continues to ease. In contrast, output growth is expected to slow to a more sustainable pace in several subsectors that enjoyed vigorous rebounds in 2021, including the wood product, plastics and rubber product, non-metallic mineral product, and machinery industries.

As with output, manufacturing employment has also enjoyed a sharp rebound over the economic recovery, ending 2021 up 1.2% compared to its pre-pandemic level. However, job growth in the sector is expected to slow over the next two years, mirroring trends in the overall economy, with manufacturers hiring 28,600 workers this year and an additional 14,500 workers next year, down from the 62,200 added to payrolls in 2021. While this is a conservative forecast, as it is far less than the number of current job openings, it recognises the sector's ongoing challenge of attracting and retaining workers.

The combination of strong demand for labour and constrained supply has led to rapidly tightening labour market conditions in Canada's manufacturing sector. After jumping to a record high of 13.3% in April 2020, the sector's unemployment rate has fallen dramatically since, hitting 2.9% in March 2022, matching a record low. Not surprisingly, wages gains are starting to pick up. In fact, year-over-year wage growth came in at 6.6% in March 2022, the fourth largest increase on record. These extraordinarily tight conditions are consistent with CME's own research which shows that labour and skills shortages are among the most pressing challenges facing manufacturers today.

Finally, Statistics Canada's Capital and Repair Expenditures Survey indicates that investment spending in Canada's manufacturing sector will be flat this year, continuing a string of disappointing results and jeopardizing the sector and overall economy's longer-term prospects. While machinery and equipment investment in the sector is forecast to rise 5.5% to $17.0 billion, surpassing the level achieved in 2019 before the pandemic started, capital expenditures on non-residential construction are expected to fall by 16.3% to $4.7 billion in 2022, the lowest level since 2017. Along with alleviating labour and skills shortages, improving Canada's business climate to attract more investment and stimulate growth and job creation must be a policy priority for all levels of government.

2021 YEAR IN REVIEW

Canadian Economy

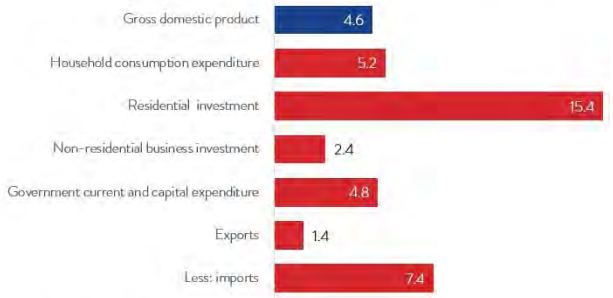
OVERVIEW

The Canadian economy experienced a strong rebound in the second half of 2021, following a Delta variant-induced decline in the second quarter. (See Chart 1.) Economic growth surged as the easing of public health measures boosted consumer spending on services and exports rebounded in line with growing foreign demand. The Canadian economy ended the year on a high note, expanding at an annualized rate of 6.7% in the fourth quarter, building on the 5.5% gain in Q3. This left full-year 2021 real GDP growth at a robust 4.6%, bouncing back from the steep 5.2% drop observed in 2020.

Chart 1
Economy Strengthened in the Second Half of 2021
Canada (Real GDP, q/q % change, seasonally adjusted at annualized rates)

Source: CME; Statistics Canada.

Chart 2
Economic Rebound Driven by Household Spending and Housing Market Activity
Canada (Real GDP growth by expenditure type, 2021 over 2020)

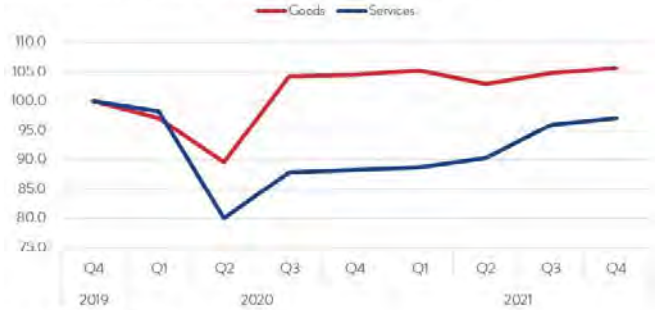


Source: CME; Statistics Canada.

Households were a big driver of last year's growth, as consumer spending and housing market activity both recorded outsized gains. (See Chart 2.) Household spending on food and beverage services and on clothing was particularly strong last year, reflecting the impact of a reopening economy.[1]

> "This left full-year 2021 real GDP growth at a robust 4.6%, bouncing back from the steep 5.2% drop observed in 2020."

Chart 3
Households Shift Spending to Goods from Services Over Pandemic
Canada (household consumer expenditure, 2019Q4=100, seasonally adjusted)



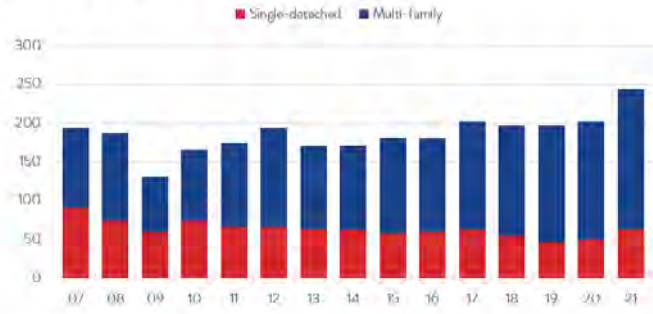
Sources: CME; Statistics Canada.

Canadians responded to lockdowns with a dramatic shift in spending to goods from services, but this is now gradually reversing. (See Chart 3.) Consumers shopped more online during the pandemic and changed what they bought. Unable to travel or eat out, they spent more on things to fill their homes including furniture, computers, TVs, video game systems, and home gym equipment. This increase in spending on goods was also partly fueled by unprecedented government financial assistance. While household spending in Canada fell at an average annual pace of 0.7% over 2020-21, spending on goods increased 2.1% per year, while spending on services fell 2.9% per year.

1 Statistics Canada, "The Daily, Gross Domestic Product, Income and Expenditure, Fourth Quarter 2021."

At the same time, working from home, savings from less travel, and rock-bottom mortgage rates convinced Canadians to pour money into the housing market last year.[2] Builders started construction on 244,700 new homes in 2021, a record high. (See Chart 4.) The multi-family segment was particularly strong, with 181,000 new units breaking ground. This, along with humming renovation activity, lifted residential investment by 15.4% in 2021, the fastest pace of growth since 1983. But even with record high housing starts, supply of housing remains one of the Canada's most pressing challenges. This will need to be addressed if the country will be able to accommodate the rising numbers of immigrants needed to fill vacant job openings.

Chart 4
Housing Starts Hit Record High in 2021
Canada (housing starts, 000s)



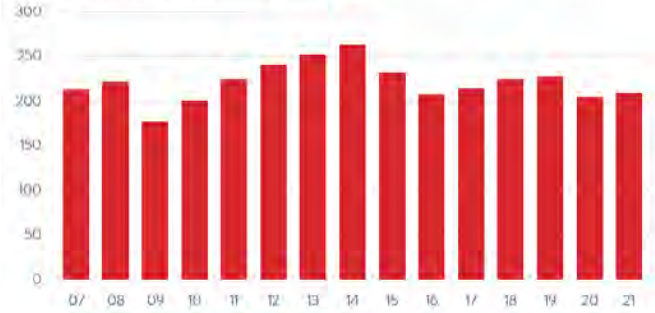
Source: CMHC Starts and Completions Survey.

> "While exports of goods and services rose 1.4% to $624.8 billion in 2021, imports surged 7.4% to $645.9 billion."

In contrast to the huge jump in residential investment, non-residential business investment staged a much less impressive recovery in 2021. This is concerning because it continues a long-run trend of weak business investment that threatens Canada's economic potential and future prosperity. While the overall economy expanded by 4.6% last year, non-residential business investment was up a more moderate 2.4%. (See Chart 5.) This was nowhere near enough to offset the 10.1% decline observed in 2020. This is yet further evidence that policy reforms to boost business investment should be a key government priority.

Finally, international trade acted as a drag on growth last year. While exports of goods and services rose 1.4% to $624.8 billion in 2021, imports surged 7.4% to $645.9 billion. All told, international trade subtracted 0.9 percentage points from Canada's total GDP growth in 2021, with final domestic demand expanding by 5.5%, outpacing overall GDP growth of 4.6%.

Chart 5
Non-Residential Business Investment Sees Only Slight Recovery in 2021
Canada (non-residential business investment, billions $ 2012)



Source: Statistics Canada.

2 Statistics Canada

INFLATION EMERGES AS MAJOR STORY

Inflation emerged as a major story in 2021, as strong demand for goods collided with pandemic-induced shortages to create a perfect storm of rapid price hikes. Indeed, the consumer price index (CPI) rose 3.4% on an annual average basis in 2021, the fastest pace since 1991 when inflation reached 5.6%. (See Chart 6.) Inflation heated up as the year progressed, reaching 4.8% in December, and has continued to strengthen in the early stages of 2022, hitting a 31-year high of 6.7% in March.

Chart 6
Inflation Increases at Fastest Pace Since 1991
Canada (consumer price index, annual average percentage change)

Sources: CME: Statistics Canada.

Energy prices have been a major driver of inflation. Excluding energy, the annual average CPI climbed by a more pedestrian 2.4% in 2021, up from 1.3% in 2020 and 2.3% in 2020. More recently, however, supply constraints have been colliding with robust demand to put upward pressure on a broadening range of prices.

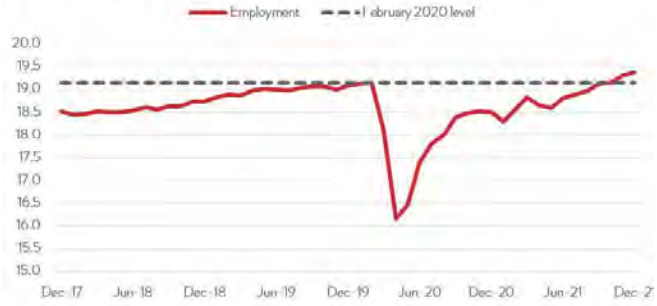
> "The consumer price index (CPI) rose 3.4% on an annual average basis in 2021, the fastest pace since 1991 when inflation reached 5.6%."

LABOUR MARKET POSTS STRONG RECOVERY, LIFTS RETAIL SPENDING

Canada's labour market was a bright spot last year, with employment bouncing back quickly following a record drop in the spring of 2020, with the pace of the rebound far exceeding the expectations of private forecasters. By October 2021, employment rolls exceeded their pre-pandemic levels, indicating that the economy fully recouped its COVID-losses in just 19 months. (See Chart 7.) This compares very favourably to the 39-month average in the three previous recessions.

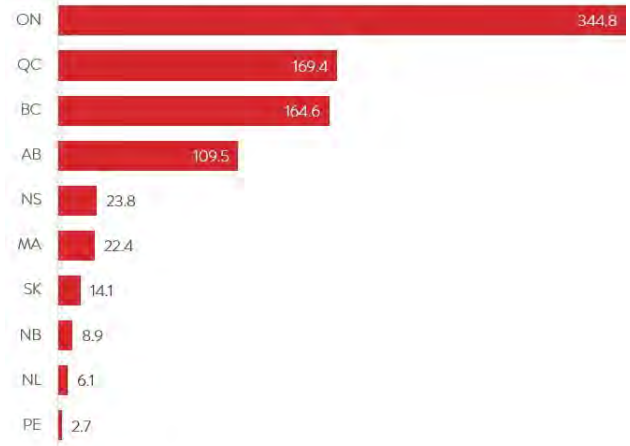
In annual terms, the total level of employment averaged 18.9 million in 2021, considerably higher than the average of 18.0 million in 2020 and very close to 19.0 million in 2019. In more good news, most of the jobs created last year were full-time (640,700 full-time jobs versus 225,500 part-time jobs).

Chart 7
Strong Job Market Recovery
Canada (employment, all industries, millions, seasonally adjusted)



Sources: CME: Statistics Canada.

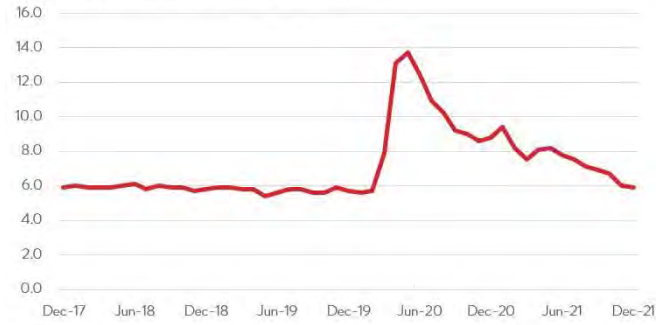
Chart 8
Job Gains Concentrated in Ontario, Quebec, and BC
Canada (change in employment, all industries, 2021 over 2020, 000s)



Source: Statistics Canada.

Regionally, all provinces experienced job gains in 2021, with Ontario contributing the most to the growth, generating an annual average of 344,800 net new jobs. (See Chart 8.) This was followed by Quebec (+169,400), BC (+164,600), and Alberta (+109,500). In 7 of 10 provinces, employment had returned to its pre-pandemic level by the end of the year. Only Newfoundland and Labrador, New Brunswick, and Saskatchewan still had lost ground to make up.

Chart 9
Jobless Rate Closing in on Pre-Pandemic Rate
Canada (unemployment rate, all industries, percentage)



Source: Statistics Canada.

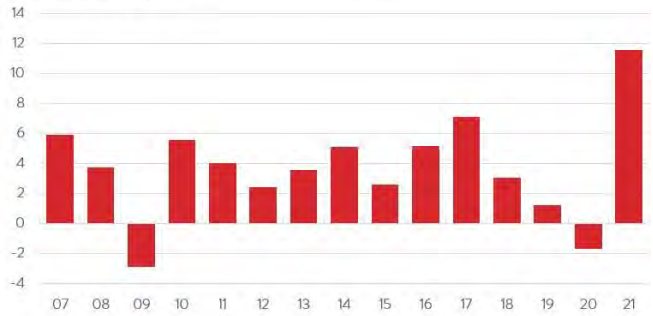
On the downside, the strong rebound in employment, combined with constrained labour supply, has led to severe labour shortages across several industries. The headline unemployment rate fell steeply throughout 2021 from 9.4% in January to only 5.4% by December, just shy of the 5.7% level of February 2020. (See Chart 9.) At the same time, the number of job vacancies is at a record high and is more than two times the level of 2015.

Chart 10
Real Wages Fell Throughout Most of the Year
Canada (average hourly wage rate, consumer price index, y/y % growth)

Source: Statistics Canada.

Tight labour market conditions often translate into strong wage growth. However, wage gains remained contained most of the year, though they started picking up as the year ended. Also, the wage gains workers did earn were more than eaten away by inflation in the final 10 months of the year. (See Chart 10.) In other words, real wages fell throughout most of 2021.

Chart 11
Retail Sales Bounce Back After Rare Decline in 2020
Canada (retail sales, % growth)



Source: Statistics Canada.

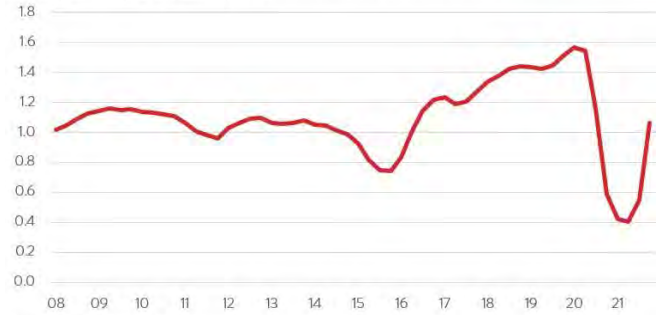
Despite an erosion in their purchasing power, households remained in a spending mood in 2021. Canadian retailers finished 2021 with $673.4 billion in sales, up 11.6% from 2020. (See Chart 11.) This increase came in the wake of a 1.7% decline in 2020, when retail sales experienced its largest drop since the 2009 global financial crisis.

> "Canadian retailers finished 2021 with $673.4 billion in sales, up 11.6% from 2020."

CANADA'S POPULATION GROWTH SLOWED BY PANDEMIC RESTRICTIONS

Labour market shortages were exacerbated by a significant slowdown in population growth in the initial stages of the pandemic. Canada's population growth came to a near halt as travel bans and closed borders slowed immigration and kept temporary workers and students out. Mortality caused by COVID-19 was also a contributing factor. This marked a sharp reversal for a country that has relied upon rapid population numbers to drive its economy in recent years, with immigrants fueling a solid increase in the labour force. In fact, Canada's population increased by a mere 0.5% between July 2020 and July 2021, the slowest rate of growth since 1916, a period when Canada was at war. (See Chart 12.) By comparison, the population grew at an average pace of 1.4% between 2018 and 2019 before the pandemic started.

Chart 12
Border Restrictions Curbed Population Growth During Pandemic's First Wave
Canada (year-over-year population growth)



Sources: CME; Statistics Canada.

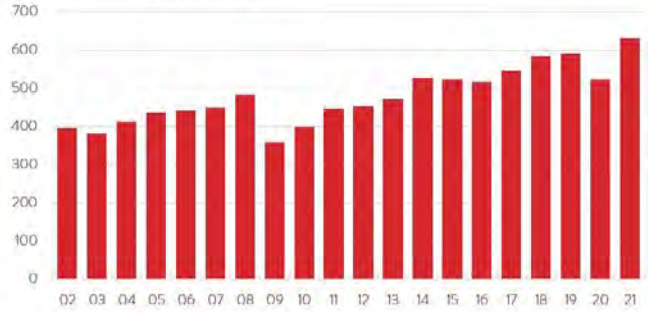
On the positive side, the government has made a concerted effort to boost immigration levels in subsequent months to offset this shortfall. Partly as a result, population growth accelerated to 1.1% in the fourth quarter of 2021, edging closer to the recent pre-pandemic average.

> "Canada's population increased by a mere 0.5% between July 2020 and July 2021, the slowest rate of growth since 1916."

INTERNATIONAL TRADE ENJOYS COMEBACK

Canada's international trade in 2021 was marked by global supply issues that created significant uncertainty and disrupted production in many industries and countries. Despite these challenges, total exports jumped 20.7%, increasing from $522.8 billion in 2020 to a record high of $630.9 billion in 2021. (See Chart 13.) Export prices played a key role in last year's increase. When the effect of prices is removed, exports in constant dollars rose at much more modest pace of 1.9%, leaving real exports 5.4% below the level of 2019.

Chart 13
A Record Year for Exports
Canada (merchandise exports, billions $)

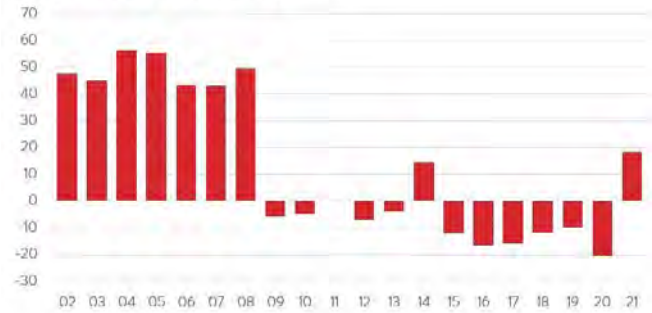


Source: Statistics Canada.

Exports of energy products posted the largest increase at 82.8%, thanks mainly to higher prices. Other major contributors to growth included forestry products and building and packaging materials (+31.8%), metals and non-metallic mineral products (+15.3%), and consumer goods (+13.9%). Only one industry experienced a dip in exports last year; exports of motor vehicle and parts fell 4.3%, attributable to the global semiconductor shortage that has dented auto production worldwide.

Merchandise imports also hit a record high, climbing from $543.2 billion in 2020 to $612.6 billion in 2021, equivalent to a 12.8% increase. Higher prices also had a positive impact on annual imports, but to a lesser extent than exports. In constant dollars, imports were up 8.3% last year.

Chart 14
Canada Records First Trade Surplus Since 2014
Canada (merchandise trade balance, billions $)



Source: Statistics Canada.

With exports strongly outpacing imports, Canada posted a merchandise trade surplus of $18.2 billion in 2021. (See Chart 14.) This was the country's first surplus since 2014, and the largest one since 2008.

Manufacturing Sector

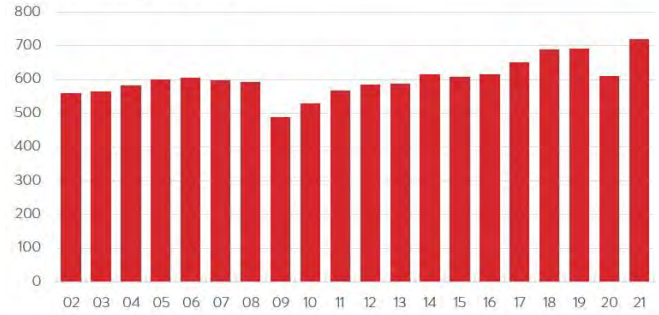
OVERVIEW

The manufacturing sector has experienced a fairly solid recovery since suffering a massive decline in the spring of 2020. However, the recovery has been slower than expected, weighed down by persistent supply problems and severe labour shortages.

> "Despite the many challenges facing the industry, manufacturing sales rose 17.5% to a record high of $718.4 billion in 2021."

MANUFACTURING SALES CLIMB TO RECORD HIGH

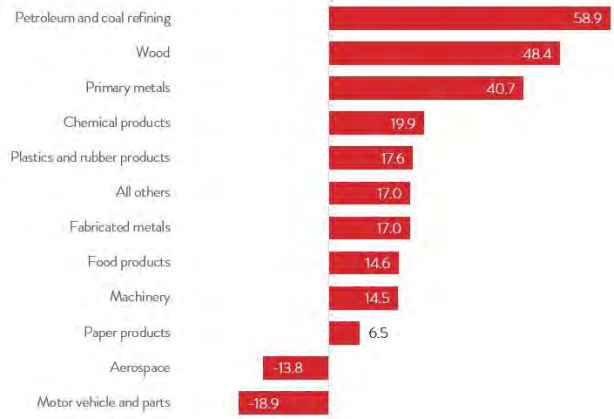
Chart 15
Manufacturing Sales Hit Record High in 2021
Canada (manufacturing sales, billions $)



Source: Statistics Canada.

Despite the many challenges facing the industry, manufacturing sales rose 17.5% to a record high of $718.4 billion in 2021, more than making up for the 11.7% decline in 2020. (See Chart 15.) The lion's share of the increase was due to a huge run-up in prices, reflecting the inflationary pressures stemming from supply chain bottlenecks. After controlling for inflation, manufacturing sales climbed by a more moderate 4.2% to $597.0 billion, leaving real sales 6.5% below the level of 2019.

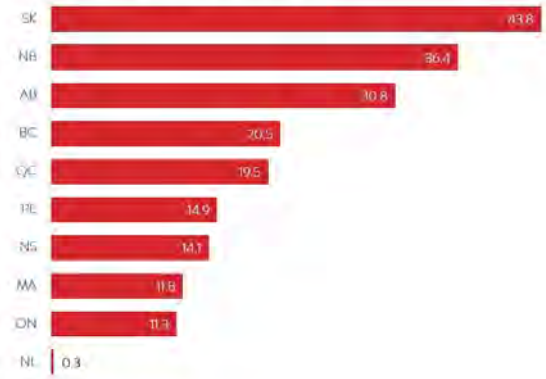
Chart 16
Petroleum and Coal Products Industry Boasts Largest Increase in 2021
Canada (manufacturing sales by major industry, % change, 2021 over 2020)



Sources: CME; Statistics Canada.

Four-fifths of last year's increase in total current dollar sales was attributable to just five industries: petroleum and coal (+58.9%), primary metal (+40.7%), wood product (+48.4%), food (+14.6%), and chemical product (+19.9%). (See Chart 16.) Overall, sales increased in 9 of 11 major industries, with motor vehicle and parts (-18.9%) and aerospace product and parts (-13.8%) the only ones to post declines.

Chart 17
Manufacturing Sales Up in All Provinces
Canada (manufacturing sales growth, %, 2021 over 2020)



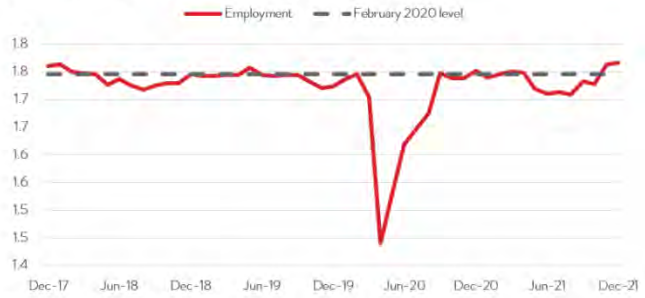
Sources: CME; Statistics Canada.

Regionally, manufacturing sales in current dollars increased in every province in 2021. (See Chart 17.) The gains in Ontario (+11.3%) and Quebec (+19.5%) were primarily due to higher sales in the primary metal and petroleum and coal product industries, more than offsetting lower sales in the key transportation equipment industry. Higher sales of petroleum and coal products and of food were the main growth drivers in Alberta (+30.8%).

STRONG REBOUND IN MANUFACTURING EMPLOYMENT

Like the overall workforce, manufacturing employment experienced a stunning decline in the spring of 2020 during the first wave of the pandemic, but it enjoyed a sharp V-shaped rebound in the ensuing months. In fact, the sector's employment returned to its February 2020 level by September 2020—fully recouping its pandemic losses in a remarkable seven months. (See Chart 18.)

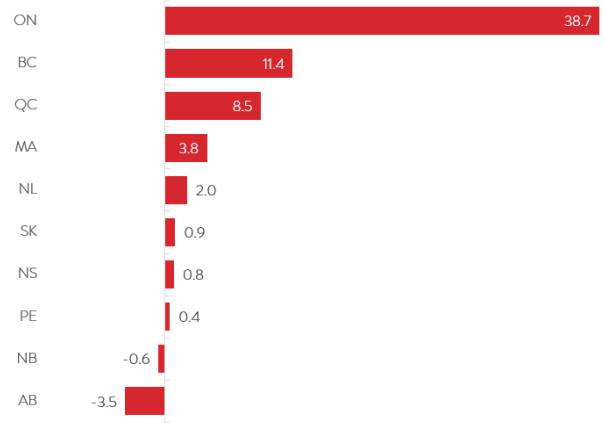
Chart 18
Manufacturing Employment Above Pre-Pandemic Levels
Canada (employment, manufacturing, millions, seasonally adjusted)



Sources: CME; Statistics Canada.

Since that time, however, manufacturing employment has been up and down, reflective of supply chain disruptions and challenges hiring and retaining workers. Still, it ended 2021 up 1.2% compared to its pre-pandemic level. On an average annual basis, employment increased 3.7% last year, following a 3.9% decline in 2020. A total of 1.74 million people worked in the industry last year.

Chart 19
Ontario Drives Employment Gains in Manufacturing
Canada (change in employment, manufacturing, 2021 over 2020, 000s)



Source: Statistics Canada.

> "Employment increased 3.7% last year, following a 3.9% decline in 2020."

Regionally, the 2021 increase in manufacturing employment was widespread, spanning 8 of 10 provinces. (See Chart 19.) Job growth was strongest in Ontario where 38,700 manufacturing workers were added to payrolls. This was followed by BC (+11,400) and Quebec (+8,500). At the other end of the spectrum, Alberta suffered the steepest decline in manufacturing employment last year (-3,500). Employment also shrank in New Brunswick, but by a more modest 600.

Chart 20
Tight Labour Market Conditions in Manufacturing
Canada (unemployment rate, manufacturing, percentage)

Source: Statistics Canada.

The combination of strong demand for labour and constrained supply led to rapidly tightening labour market conditions in Canada's manufacturing sector. After jumping up to an 11-year high of 7.1% in 2020, the sector's unemployment rate fell to 4.5% in 2021, just slightly above its pre-pandemic average. (See Chart 20.) The unemployment rate in manufacturing ended the year significantly below the all-industry average, continuing a trend that has persisted for many years. At the same time, job vacancies in the sector remained at a record high in last year's fourth quarter (81,435), more than double its 2015 level.

While these tight conditions did not translate into rapid wage gains last year, wage growth has been picking up speed in the early months of 2022. In fact, year-over-year wage growth hit 6.6% in March 2022, the fourth largest increase on record. The rise in job vacancies and the shrinking unemployment rate are both consistent with CME's own research which shows that labour and skills shortages are among the most pressing challenges facing manufacturers today.

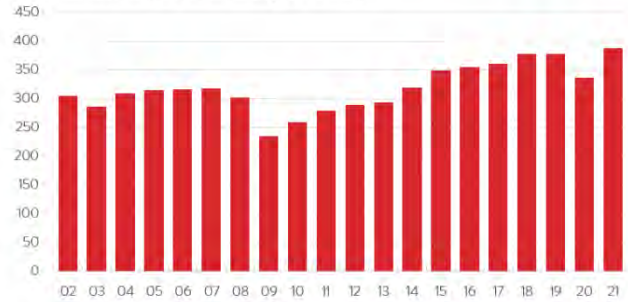
TRADE IN MANUFACTURED GOODS ACHIEVES ALL TIME HIGH IN 2021

Like overall merchandise exports, exports of manufactured goods also hit a record high in 2021, rising 15.4% to $387.4 billion, bouncing back from an 11.1% decline in 2020. (See Chart 21.) The increase in exports spanned 19 of 21 sectors, with the primary metal (+39.4%), wood product (+55.8%), and petroleum and coal product (+60.2%) industries contributing the most to growth. The only notable decline in exports came in the transportation equipment industry (-4.6%). Exports of beverage and tobacco products were also down, but by only 0.8%.

Chart 21

Exports of Manufactured Goods Also Hit Record in 2021

Canada (merchandise exports, manufactured goods, billions $)



Source: Statistics Canada.

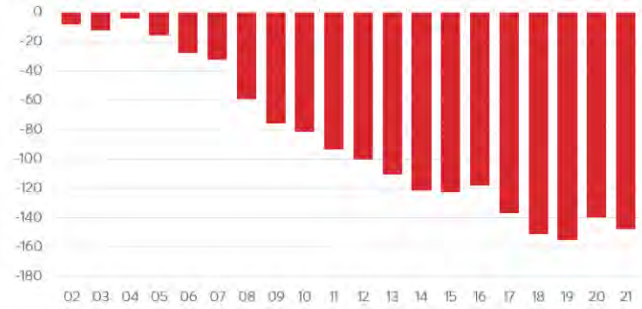
On a dollar-value basis, most of this export growth was in shipments to the United States—of the $51.8 billion increase in manufacturing exports in 2021, $44.2 billion or 85.4% was generated by higher exports to our southern neighbour. Gains elsewhere were much more modest. Among Canada's nine largest non-US trading partners, manufacturing exports to Mexico, Japan, South Korea, Norway, United Kingdom, Germany, and France were up, while exports to the Netherlands and China were down.

Imports of manufactured goods also achieved a record high last year, rising 12.6% to $535.0 billion, following a 10.7% decline in 2020. All industries but one saw higher imports last year, with only the textile product mills industry (-25.1%) posting a decline. The primary metal (+48.6%), chemical (+16.5%), and machinery (+15.0%) industries were the main growth drivers.

Chart 22

Canada Continues to Run Significant Trade Deficit in Manufactured Products

Canada (merchandise trade balance, manufactured goods, billions $)



Source: Statistics Canada.

Unfortunately, Canada continues to run a substantial trade deficit in manufactured goods, indicative of years of sluggish investment and a decline in global competitiveness. In 2021, the trade deficit came in at $147.6 billion, similar to the average of the past five years. (See Chart 22.) Canada typically runs a trade surplus in just 5 of 21 industries: wood product, food, primary metal, paper, and petroleum and coal product. Among the 16 industries posting deficits, the largest ones are typically in the computer and electronic product, transportation equipment, chemical, and machinery industries.

> "Exports of manufactured goods hit a record high in 2021, rising 15.4% to $387.4 billion."

2022-23 ECONOMIC OUTLOOK

Global Economy

The global economy continued to recover in 2021, though it remained hobbled by the pandemic, as the world was hit by subsequent waves of the Delta and Omicron variants, both of which have delayed a return to some sort of normality. Pandemic outbreaks in critical links of global supply chains resulted in longer-than-expected supply disruptions, further feeding inflation in many countries. Still, despite these difficulties, global economic growth reached 6.1% in 2021, a marked improvement from the 3.1% contraction in 2020.[3] (See Table 1.)

Table 1
World Economic Outlook Projections
Real gross domestic product growth

	2021	2022	2023
World	**6.1**	**3.6**	**3.6**
Canada	4.6	4.2	2.7
China	8.1	4.4	5.1
Euro Area	5.3	2.8	2.3
India	8.9	8.2	6.9
Japan	1.6	2.4	2.3
Mexico	4.8	2.0	2.5
South Korea	4.0	2.5	2.9
United Kingdom	7.4	3.7	1.2
United States	5.7	3.7	2.3

Sources: CME; IMF World Outlook—April 2022.

Unfortunately, the global economy entered 2022 on a weaker position than previously expected with the Omicron variant continuing to spread. The global recovery was further knocked off course by Russia's unprovoked invasion of Ukraine. The war is compounding global supply chain disruptions and intensifying inflationary pressures from higher commodity prices. Western countries, including Canada, are also paying an economic price by levying severe economic sanctions (although Canada's food and raw material producers and exporters are benefitting from higher prices).

In addition, wide-ranging COVID-related lockdowns in China—including in key manufacturing hubs—have also slowed activity there and are exacerbating bottlenecks in global supply chains. To bring inflation under control, central banks in many countries are tightening monetary policy. At the same time, governments are reining in spending to tackle high deficits built-up over the pandemic. In its April 2022 outlook, the International Monetary Fund projected that global real GDP growth will come in at 3.6% in both 2022 and 2023—0.8 and 0.2 percentage points lower than its January forecast.[4] The downgrade largely reflects the economic fallout from the war in Ukraine.

Both Ukraine (-35.0%) and Russia (_8.5%) will experience large GDP contractions this year, the former due to the direct impact of the invasion and the latter the result of severe economic sanctions and the severing of trade ties. Still, the economic consequences of the war are being felt far beyond Ukraine's borders, mainly through disruptions to commodity markets, trade, and financial linkages.[5]

Among major economies, the Euro Area is paying a particularly heavy price, largely attributable to its heavy reliance on Russia for oil and gas. Supply chain disruptions have also hurt some industries with the war and sanctions further hindering production of key inputs.[6] As a consequence, the 2022 GDP growth forecast for the Euro Area has been revised down to 2.8% (1.1 percentage points lower than in January). The economy is expected to continue to moderate next year, with growth decelerating to 2.3%.

The United Kingdom also suffered a similar downward revision to its economic outlook. The IMF has cut UK's 2022 GDP growth projection by 1.0 percentage points to 3.7%. Consumption is expected to be weaker than expected as inflation erodes households' purchasing power. At the same time, higher costs associated with Brexit will continue to weigh on international trade activity. Next year looks even worse, with output forecast to climb by just 1.2%.

Other countries to see notable downgrades to the 2022 forecast include Japan (0.9 percentage points) and India (0.8 percentage points), as higher oil prices weigh down household consumption and investment and lead to lower net exports. For Japan, this comes on top of a more gradual recovery compared to many other major economies. Demography is a key factor, as Japan started aging and shrinking earlier. After growing by an estimated 1.6% last year, real GDP growth is projected to come in at 2.4% in 2022 and 2.3% in 2023. In contrast, despite the downgrade, economic growth in India is still forecast to come in at a robust 8.2% this year and 6.9% next year.

Along with the economic fallout from the war and an ongoing correction in the property market, China's economy is also being weighed down by fresh lockdowns in several major cities, with the government maintaining its "zero-COVID" strategy even in the face of the fast-spreading Omicron variant.[7] As such, real GDP growth is projected to decelerate from 8.1% in 2021 to 4.4% in 2022 before picking up slightly to 5.1% in 2023.

3 International Monetary Fund, World Economic Outlook: War Sets Back the Global Recovery.
4 International Monetary Fund.
5 International Monetary Fund.
6 International Monetary Fund.
7 Bank of Canada, Monetary Policy Report - April 2022."

US Outlook

The US economy rebounded at the end of 2021 after a period of slow activity associated with the spread of the Delta variant late in the summer, growing at a blistering annualized pace of 7.0% in the fourth quarter. For 2021 as a whole, the US economy expanded by 5.7%, fueled by in part by hefty fiscal stimulus packages. This marked the fastest pace of growth since 1984. (See Chart 23.)

Chart 23

US Economy to Moderate

United States (real gross domestic product growth)

Sources: US Bureau of Economic Analysis; IMF World Outlook—April 2022.

Unfortunately, prospects for the first quarter were downgraded due to the Omicron wave, which exacerbated the disruptions to demand and supply that festered over 2021. The one silver lining is the speed at which the Omicron wave receded, which should help to propel a rebound in the second quarter. Consumption is expected to be a key growth driver this year, supported by a strong labour market and households' ability to draw on savings stockpiled during the pandemic. In turn, solid domestic demand should provide a lift to non-residential business investment.

On the negative side, supply bottlenecks are expected to last longer than previously anticipated, as demand remains strong and the Russian invasion of Ukraine rattles global supply chains further. Accordingly, inflation is likely to remain elevated over the course of this year. Given higher-than-expected inflation, the Federal Reserve will need to embark on a faster and more pronounced tightening of monetary policy. While interest rate hikes will help rein in inflation, it will also cool economic growth, especially by weighing on residential housing activity. Indeed, higher interest rates, along with the fading impact of the economic reopening, is projected to push US real GDP growth down to 3.7% in 2022 and to 2.3% in 2023.

> "The Canadian economy is forecast to expand by 4.2% this year."

Canadian Outlook

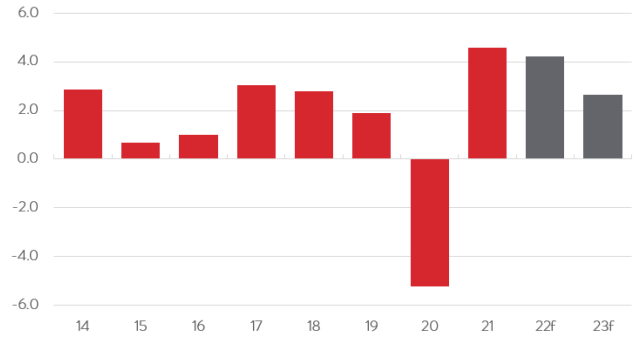
OVERVIEW

Canada's economic growth prospects over 2022-23 are highly uncertain. Thanks to vaccines, therapeutics, and growing population immunity, the coronavirus is becoming less of threat. Nevertheless, new variants and future waves that prolong the pandemic and lead to renewed economic disruptions cannot be ruled out. And even with the pandemic receding, its economic fallout is still being felt through supply chain disruptions, severe labour shortages, and high and persistent inflation. On top of this, the Russian invasion of Ukraine has added another source of uncertainty and volatility in the global economy. Notwithstanding these significant risks, the Canadian economy is forecast to expand by 4.2% this year and 2.7% next year, following a 4.6% gain in 2021. (See Chart 24.)

Chart 24

Canadian Economy to Post Relatively Strong Growth

Canada (real gross domestic product growth)



Sources: CME; Statistics Canada.

Household spending was a key contributor to growth last year and it will remain so once again this year, though spending on services will outpace spending on goods, reversing pandemic trends. Consumer spending will be supported by the excess savings accumulated over the pandemic, helping to offset the removal of government stimulus and the impact of rising interest rates.

Thanks to elevated commodity prices and solid foreign demand, export growth is expected to be strong this year and next, although the impact of the war and a slowing US economy will limit the pace of growth. While imports are also expected to pick up speed as economic conditions in Canada continue to normalize after the shock of COVID-19, it will not be enough to fully offset the increase in exports. As such, net exports are on track to add about 0.5 percentage points to GDP growth this year.

Although supply constraints and labour shortages continue to weigh on economic activity, business investment is expected to see a pick up in growth this year and next. Investment in the oil and gas sector is anticipated to be especially robust, thanks to higher energy prices. After coming in at a disappointing 2.4% in 2021, non-residential business investment growth is forecast to accelerate to 6.0% this year and to 7.2% next year. Still, by any measure, this is a slow recovery. If this forecast holds, non-residential business investment will not surpass its pre-pandemic level until this year's final quarter. In contrast, total economic activity has already fully recovered.

On the negative side, housing market activity is expected to cool off over the near term. After rising at a blistering pace of 15.4% last year, residential investment is poised to decrease by 2.0% in 2022, before edging up by 0.5% in 2023, as housing demand eases in line with rising interest rates. Despite these back-to-back declines, the level of residential investment will remain historically elevated. This, along with a more balanced resale market, should take some of the heat out of home prices.

Chart 25
Job Growth to Slow
Canada (employment, all industries, annual change, 000s)

Sources: CME; Statistics Canada.

Short-term hiring intentions remain solid going into 2022, but labour markets are already tight and room for job growth is therefore limited. The unemployment rate hit a record low in March and businesses across the country are having an incredibly challenging time finding the workers they need. Still, thanks to a strong hand-off from last year and solid momentum, the Canadian economy is expected to add an average of 490,000 net new jobs in 2022. (See Chart 25.) With the labour market recovery complete, job growth is expected to slow to about 218,000 next year, close to pre-pandemic rates of job creation.

While labour shortages have yet to translate into any meaningful wage gains for workers, this is likely to change this year, especially with inflation remaining elevated. Indeed, with inflation at its highest rate since 1991 and with the economic slack caused by the coronavirus pandemic now absorbed, the Bank of Canada raised interest rates for the first time in three years in early March, increasing the benchmark rate 25 basis points, and followed that up with a 50 basis points increase in April. The Bank's policy interest rate now stands at 1.0%, still below its February 2020 level of 1.75%. Further hikes are an almost certainty this year, as the Bank seeks to use its monetary policy tools to return inflation to the 2% target.

Surging prices for energy and other commodities caused by the Ukraine crisis will also have the effect of improving Canada's terms of trade—a measure of how much imports an economy can get for a unit of exports. While an improvement in the terms of trade usually results in a stronger Canadian dollar, investors tend to prefer the US dollar to other currencies in times of great uncertainty, so this will have the effect of tempering the loonie's rise. The loonie averaged 80 US cents in 2021. In RBC Economics 2022 Q1 forecast, they predict that the loonie will depreciate over the near term, averaging 79 US cents this year and 76 US cents next year.[8]

MANUFACTURING OUTLOOK

After enjoying a solid bounce back in 2021, manufacturing output is expected to continue expanding over the near term. However, three factors will slow the pace of the recovery. First, supply chain disruptions and labour shortages, which limited the sector's recovery last year, will continue to weigh on the industry in 2022. Second, with pandemic restrictions easing, consumer spending is expected to continue to rotate back toward services and away from goods. Third, manufacturing investment in Canada has been sluggish for many years, and this greatly limits the sector's growth potential. After reaching 4.5% in 2021, real manufacturing output growth is forecast to decelerate to 3.5% in 2022 and to 3.2% in 2023. (See Chart 26.)

Chart 26
Manufacturing Recovery Held Back by Supply Challenges
Canada (real gross domestic product growth, manufacturing)

Sources: CME; Statistics Canada.

Among major subsectors, transportation equipment manufacturing is expected to see the fastest growth over the next two years, coming in at 8.9% in 2022 and 7.7% in 2023. (See Table 2.) This outlook assumes that the global semiconductor shortage will continue to ease, and that the aerospace industry will see stronger demand as both business and leisure travel continues to pick up. However, even with this robust growth, the level of output in 2023 will still fall short of its 2019 level. In other words, the transportation equipment manufacturing industry is not expected to return to its pre-pandemic level of output until 2024.

8 RBC Economics, "Russian Invasion and Surging Inflation Take Over as Key Global Growth Risks."

Table 2

Real GDP Growth by Major Manufacturing Subsector

Canada

	2021	2022	2023
Manufacturing	**4.5**	**3.5**	**3.2**
Food and beverage	5.0	3.1	2.2
Wood product	8.8	2.5	2.3
Paper	0.7	2.0	2.5
Petroleum and coal product	3.9	3.6	2.6
Chemical	2.7	3.7	2.4
Plastics and rubber products	10.0	3.3	3.1
Non-metallic mineral products	11.2	2.0	2.8
Primary metal	1.5	4.0	2.7
Fabricated metal	1.7	3.0	3.1
Machinery	14.0	2.4	2.5
Transportation equipment	-4.0	8.9	7.7
All others	6.4	1.3	3.0

Sources: Statistics Canada; CME.

On the other hand, output growth this year is expected to slow to a more sustainable pace in several subsectors that enjoyed vigorous rebounds in 2021. This group includes the wood product, plastics and rubber product, non-metallic mineral product, and machinery industries.

Chart 27

Manufacturing Job Growth Also Set to Decelerate

Canada (employment, manufacturing, annual change, 000s)

Sources: CME; Statistics Canada.

Job growth in the manufacturing sector is expected to slow over the next two years, mirroring trends in the overall economy. Specifically, manufacturers are expected to hire 28,600 workers this year and an additional 14,500 workers next year, down from the 62,200 added to payrolls in 2021. (See Chart 27.) This would bring total employment in the sector to 1.78 million, up from 1.74 million in 2021. While this is a conservative forecast, as it is far less than the number of current job openings, it recognises the sector's ongoing challenge of attracting and retaining workers.

The combination of strong demand for labour and constrained supply has led to rapidly tightening labour market conditions in Canada's manufacturing sector. After jumping to a record high of 13.3% in April 2020, the sector's unemployment rate has fallen dramatically since, hitting 2.9% in March 2022, matching a record low. Not surprisingly, wages gains are starting to pick up. In fact, year-over-year wage growth came in at 6.6% in March 2022, the fourth largest increase on record. These extraordinarily tight conditions are consistent with CME's own research which shows that labour and skills shortages are among the most pressing challenges facing manufacturers today.

Chart 28

Mixed Outlook for Manufacturing Investment

Canada (non-residential capital expenditures, manufacturing, billions $)

Source: Statistics Canada.

Finally, Statistics Canada's Capital and Repair Expenditures Survey, released in February, indicates that investment spending in Canada's manufacturing sector will be flat this year, continuing a string of disappointing results and jeopardizing the sector and overall economy's longer-term prospects. On the one the hand, capital expenditures on non-residential construction are expected to fall by 16.3% to $4.7 billion in 2022, the lowest level since 2017. (See Chart 28.) On the other hand, machinery and equipment investment in the sector is forecast to rise 5.5% to $17.0 billion, surpassing the level achieved in 2019 before the pandemic started. The jump in M&E spending lines up with the results of the Bank of Canada's Business Outlook Survey—First Quarter of 2022, which found that more intense labour shortages and difficulties attracting and retaining workers are leading some firms to expand investment in digital technologies and automation.[9] Along with alleviating labour and skills shortages, improving Canada's business climate to attract more investment and stimulate growth and job creation must be a policy priority for all levels of government.

> "The sector's unemployment rate has fallen dramatically since, hitting 2.9% in March 2022."

9 Bank of Canada, "Business Outlook Survey - First Quarter of 2022."

PROVINCIAL OUTLOOK

All provincial economies have been significantly affected by the coronavirus crisis, although some have been hit harder than others. On the positive side, four provinces experienced such strong recoveries in 2021 that they fully reversed the contraction suffered in 2020: PEI, Nova Scotia, New Brunswick, and BC. Also, of the six provinces that still have lost ground to make up, three enjoyed robust real GDP gains last year: PEI (+6.6%), Quebec (5.6%), and Ontario (4.6%). On the downside, two provinces saw more muted recoveries and one suffered an outright decline. In 2021, real GDP rose by just 1.2% in both Newfoundland and Labrador and Manitoba, while it contracted by 0.3% in Saskatchewan.

According to RBC Economics latest forecast, all ten provincial economies are expected to expand this year.[10] Economic growth is expected to be strongest in the west, especially in commodity-producing provinces that will receive a lift from higher energy and food prices as well as from a rebound in agricultural production. In particular, Alberta and Saskatchewan are forecast to lead the 2022 growth rankings, with real GDP gains of 5.8% and 5.7%, respectively.

Table 3
Real GDP Growth by Province
Canada

	2021	2022	2023
Canada	4.6	4.2	2.7
Newfoundland and Labrador	1.2	2.5	3.0
Prince Edward Island	6.6	2.7	1.7
Nova Scotia	5.8	2.5	1.6
New Brunswick	5.3	2.6	1.5
Quebec	5.6	3.6	2.3
Ontario	4.6	4.2	2.8
Manitoba	1.2	4.1	2.6
Saskatchewan	-0.3	5.7	2.6
Alberta	5.1	5.8	3.8
British Columbia	6.2	4.3	2.6

Sources: Statistics Canada; CME; RBC Economics.

Economic growth in BC is forecast to come in at a robust 4.3% in 2022. While the devastating BC floods will continue to pose significant near-term challenges, repair work will also add to provincial economic growth. Manitoba's outlook is also strong, with real GDP expected to climb by 4.1% this year. The province's key agricultural sector will benefit from soaring canola and wheat prices as well as disruptions to European crop production that will boost demand for these products.[11]

In Central Canada, Ontario's economy is expected to expand by 4.2% this year, matching the national average, assuming that supply chain bottlenecks gradually ease. The reopening of GM's Oshawa plant, along with the recent announcements that Honda will upgrade its assembly plant in Alliston and that LG Energy Solutions, in partnership with Stellantis, will build an EV battery plant in Windsor, bode well for the outlook of the province's vital automotive sector. Meanwhile, Quebec is forecast to see real GDP gains of 3.6% this year, down from a 5.6% advance in 2021. The province will receive a lift from the removal of public health restrictions and from strong capital investment.

The Atlantic Canada region has seen an upswing in in-migration during the pandemic, largely attributable to more affordable housing, and this has helped to lift growth across the region. Still, compared to the rest of the country, economic prospects are somewhat more muted on the east coast, with real GDP growth forecast to reach 2.7% in PEI, 2.6% in New Brunswick, and 2.5% in both Newfoundland and Labrador and Nova Scotia. In the case of Newfoundland and Labrador, it is not expected to achieve a full economic recovery until 2023, later than all other provinces.[12]This is largely due to declining capital investment as major investment projects wind down and to a softer demographic outlook, although the recent approval of the Bay du Nord project represents a giant step forward for its long-term economic outlook.

10 RBC Economics, "Provincial Outlook - Provincial Economies Begin a New Chapter as Pandemic Threat Fades."
11 RBC Economics.
12 RBC Economics.

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