# BMO Blue Book

Spring 2022

The BMO Blue Book is published by BMO Economics and Canadian Commercial Banking. It combines the expertise of BMO's economists with that of its business bankers and features an economic report for Canada at large and each province. This edition also features an outlook for six key business sectors: technology & innovation, agriculture, real estate finance, automotive, hospitality and transportation.

This edition specifically emphasizes the impacts of inflation given its recent increase and the corresponding effects across the economy.

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# BMO Blue Book — Spring 2022

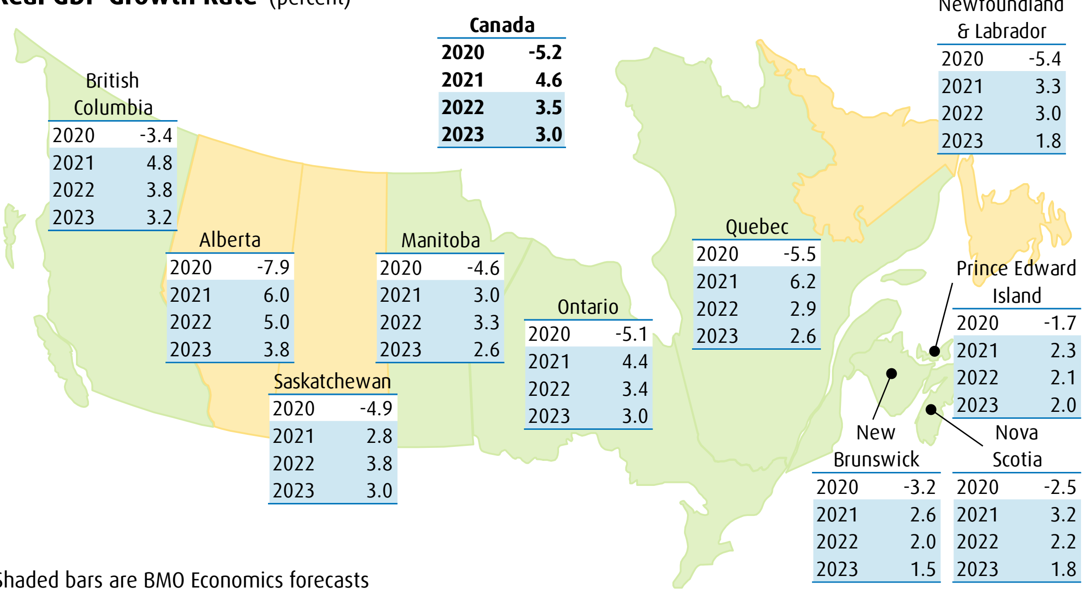
**Douglas Porter, CFA,**
Chief Economist

## Growth and Inflation Across the Nation

The Canadian economy is growing at a strong pace, with most industries and segments of the job market fully recovered from the pandemic, and the Bank of Canada now tightening policy. Real GDP is likely to expand 3.5% this year, cooling from the 4.6% pace in 2021, but still running well above potential growth. Meantime, with inflation proving to be persistent and meaningfully above the Bank of Canada's target, look for a further steady stream of interest rate hikes into 2023.

**Provincial GDP**

**Real GDP Growth Rate** (percent)



| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| **Canada** | **-5.2** | **4.6** | **3.5** | **3.0** |
| British Columbia | -3.4 | 4.8 | 3.8 | 3.2 |
| Alberta | -7.9 | 6.0 | 5.0 | 3.8 |
| Saskatchewan | -4.9 | 2.8 | 3.8 | 3.0 |
| Manitoba | -4.6 | 3.0 | 3.3 | 2.6 |
| Ontario | -5.1 | 4.4 | 3.4 | 3.0 |
| Quebec | -5.5 | 6.2 | 2.9 | 2.6 |
| Newfoundland & Labrador | -5.4 | 3.3 | 3.0 | 1.8 |
| Prince Edward Island | -1.7 | 2.3 | 2.1 | 2.0 |
| New Brunswick | -3.2 | 2.6 | 2.0 | 1.5 |
| Nova Scotia | -2.5 | 3.2 | 2.2 | 1.8 |

Shaded bars are BMO Economics forecasts

Regionally, all provinces are expanding, and above-potential growth is expected across the country this year. **British Columbia** looks to post above-average 3.8% growth, as post-flood repair and rebuilding add to solid underlying strength. Regardless of any disaster-related swings in reported GDP, the province looks fundamentally strong.

**Alberta, Saskatchewan and Newfoundland & Labrador** are also benefitting from the surge in oil prices. We look for WTI oil to average $100 this year, before pulling back to around $85 in 2023, which will provide significant income support to these provinces. Alberta real GDP growth will likely lead the country at 5.0% this year, in part thanks to a rebound in oil production, but also because of broadening strength in consumer activity and housing. Longer term, there's no question that the broader shift away from fossil fuels will force some adjustment in these regions, but the near-term outlook is solid.

**Manitoba** is traditionally the most stable economy on the provincial landscape, with a diverse industry providing a cushion. While the drought was a difficult challenge last year, stability remains the norm, with growth expected at 3.3% in 2022. For the Prairies as a whole, **this year's crop** is not just important for the regional outlook, but also for world food prices, after a brutal drought last year and very tight global grain stocks. A return to a more normal crop could provide a windfall for the sector amid record grain prices, with Saskatchewan also benefitting from surging potash prices.

**Ontario's** economy entered the pandemic with the strongest growth trends in more than 15 years, but with the largest urban centre and some of the more restrictive COVID-related measures in the country, the expansion was somewhat slower to take hold. But the economy is expanding vigourously now, and service-related businesses, especially within the GTA, look to return to higher levels of activity on a more sustainable basis than during earlier pandemic waves, even as housing activity cools. Real GDP should expand 3.4% this year and 3.0% in 2023, both around the national average.

Similarly, **Quebec** is on pace to re-establish itself as a driver of the Canadian economy, although real GDP growth should soften to 2.9% in 2022 after a country-leading 6.2% bounce last year. The province will face headwinds from higher gas prices and mortgage rates, but a relatively subdued Canadian dollar provides some relief for Central Canada compared to past oil price spikes.

Finally, **Atlantic Canada** is faring well, with growth in the region expected to run above potential this year. As travel flows resume more significantly for the summer 2022 season, the region will stand to benefit. Population flows are also a very positive story, as migration from other regions of Canada is driving consumer demand and housing.

**Christine Cooper,**
Co-head,
Canadian Commercial Banking

**Nadim Hirji,**
Co-head,
Canadian Commercial Banking

## Business Environment National Overview

Consumers and businesses—from smaller and scaling organizations to large corporations—continue to contend with one of the most challenging times in recent history. While restrictions continue to be lifted coast to coast and Canadians are adapting to the "new normal", organizations are faced with new challenges. From growing geopolitical risks, rising inflation, supply chain distributions, rising interest rates to commodity price fluctuations, the need to adapt is ever present. We have an on the ground view of what the outlook looks like across the largest sectors of the Canadian economy.

Thankfully, our clients and the Canadian economy have showed resiliency reflected by strong balance sheets, high household savings, inventory re-stocking and an interest rate environment that remains relatively low. We are encouraged by the growth prospect for the remainder of the year based on strong vaccination rates, unemployment rates at near record lows and seeing rapid growth in several sectors such as tourism and hospitality following two difficult years.

As we look across specific sectors, businesses operating in the agriculture and agribusiness industry are well positioned in 2022. Strong global demand combined with higher commodity prices will contribute to the sector's growth. Vital contributors to the food supply chain, our clients are investing in new technologies to increase automation, adapting their production to changing consumer habits and finding creative ways to attract labour.

Technology and innovation continue to be shining stars in Canada, and few sectors have grown faster than information and communications technologies. Every day, more and more Canadian technology success stories emerge which is something we are proud to support. Businesses of all sizes have accelerated their investments in software and demand for digital solutions continues to soar. While finding skilled labour remains one of the biggest hurdles for this industry, the sector is well equipped for sustained growth through a strong entrepreneurial community.

Never has the transportation sector been in such demand and a key success factor as today. Organisations with strong logistics are poised to outshine their competitors and the transportation sector plays an important part in this narrative. The forces at play are varied and make forecasting supply and demand difficult. Headwinds include rising oil prices, semi-conductor shortages and effects of the pandemic that are still being felt. But we are seeing strong demand for new truck and trailer production that, combined with innovative transportation strategies, make this sector poised to evolve.

We view our commitment to stand with our customers in both prosperous as well as challenging times as a competitive differentiator and as an obligation of our partnerships. Throughout these uncertain times, we continue to develop innovative and creative ways to support our clients with their individual needs. We have also hosted many thought leadership forums, which we hope have helped to add value during these challenging times. We operate as partners and, as the bank for business, we always stand behind our clients to find opportunities to help them on the way back up and facilitate their long-term growth.

**Robert Kavcic,**
Senior Economist

# Provincial Economies

All Canadian provinces are growing at a solid above-potential pace. With the most arduous pandemic restrictions hopefully behind us, we can now go back to focusing on more traditional drivers of relative economic strength within Canada. Demographics, resource prices, fiscal capacity and various industry trends are examples of these drivers that are again starting to take on more importance, and create some disparities in the growth outlook.

Meantime, inflation is a serious economic issue today, with the headline rate in Canada running at 5.7% y/y as of February, the highest in 31 years. What's notable is that, **inflation is not only broad-based across spending categories, but also across the country as well**. This reflects the massive pandemic-era increase in demand for goods, scarcity in the labour market, and a jump in commodity prices. We believe that inflation will ultimately cool toward the 2% target, but only after a series of Bank of Canada and Federal Reserve interest rate hikes temper demand.

**Provincial Inflation Dashboard**
Latest Month (y/y % chng)

| | Canada | BC | AB | SK | MB | ON | QC | NB | NS | PE | NL |
|---|---|---|---|---|---|---|---|---|---|---|---|
| All Items | 5.7 | 4.7 | 5.5 | 4.7 | 6.1 | 6.1 | 5.4 | 6.0 | 5.7 | 7.4 | 5.1 |
| Ex. Food & Energy | 3.9 | 3.6 | 3.1 | 2.5 | 4.8 | 4.4 | 3.8 | 3.5 | 3.0 | 4.1 | 7.5 |
| Food | 6.7 | 5.8 | 6.2 | 6.2 | 5.2 | 7.4 | 6.3 | 7.2 | 7.3 | 7.1 | 2.9 |
| Rented Accommodation | 4.2 | 5.1 | 2.8 | 0.8 | 1.9 | 5.1 | 3.5 | 5.2 | 3.6 | 16.5 | 1.3 |
| Owned Accommodation | 6.2 | 8.2 | 3.5 | 3.3 | 9.6 | 6.7 | 5.4 | 4.7 | 3.2 | 5.2 | 12.7 |
| Utilities | 12.4 | 8.2 | 24.7 | 9.8 | 6.7 | 13.3 | 6.0 | 8.1 | 15.4 | 31.6 | -0.5 |
| Household Operations | 2.7 | 0.8 | 0.9 | 3.6 | 3.2 | 3.2 | 4.1 | 1.6 | 1.2 | 3.8 | 0.9 |
| Clothing | 1.2 | 0.9 | 2.0 | -1.9 | 0.4 | 2.8 | -0.9 | 0.4 | 0.6 | -0.7 | 10.2 |
| Transportation | 8.7 | 4.1 | 10.1 | 7.3 | 11.2 | 9.0 | 9.3 | 11.9 | 11.5 | 11.2 | 2.5 |
| Health & Personal Care | 3.1 | 2.6 | 0.4 | 3.3 | 1.2 | 3.9 | 3.7 | 2.3 | 3.4 | 4.0 | 2.3 |
| Recreation & Education | 4.1 | 4.9 | 4.7 | 4.3 | 4.5 | 3.6 | 4.5 | 5.6 | 3.2 | 0.2 | 0.0 |

*Sources: BMO Economics, Haver Analytics*

## British Columbia

The B.C. economy is expected to grow 3.8% this year, slightly ahead of the 3.5% rate estimated for all of Canada. The provincial economy has navigated some massive shocks relatively well, including the pandemic and floods. More sustained re-opening, travel activity and capital spending should support above-average economic growth.

The unemployment rate is expected to drop to an average of 4.7% in 2022, challenging for the lowest level in Canada. Employment was relatively quick to recover pandemic losses.

The housing market remains extremely strong, with Vancouver benchmark prices up 21% y/y as of February. Condo prices gained momentum through the turn of the year, in addition to persistent strength in the single-detached market.

The Province of British Columbia is projecting a $5.5 billion deficit in FY22/23, which weighs in at 1.5% of GDP. That marks a deterioration from a nearly balanced budget for FY21/22.

## Alberta

The Alberta economy is expected to lead the country with 5.0% growth this year, as the surge in oil prices reinvigorates consumer and business confidence. Growth should soften to 3.8% next year, but that would again lead the provincial pack with some firmness in oil prices, even assuming the acute geopolitical-driven spike fades.

After slumping through 2020, oil production has returned to, or near, capacity levels that prevailed before the pandemic. Capital spending growth in the industry looks very firm for the year ahead, but the level of spending remains less than half of its 2014 peak. Even if we don't expect a resurgence in new project investment, cash flow in the sector looks extremely well-supported, which will bolster local incomes and government revenues.

The job market is recovering quickly, with the unemployment rate now below 7% after topping 15% in early 2020. Given the strong near-term outlook in the province, we expect Alberta's unemployment rate to cross below the national average next year, an impressive turnaround after lagging since 2015.

Renewed economic optimism and a tightening job market have awakened the housing market in a hurry. Prices in Calgary have jumped 16% y/y, rising to record highs and quickly reversing a six-year slump. The commercial real estate backdrop remains tougher, with high vacancy rates in the downtown office market persisting.

The Province of Alberta is projecting a balanced budget in FY22/23 ($511 million surplus) for the first time in eight years, helped by past spending restraint and the surge in oil prices. The dramatic turn also repositions Alberta with the lowest net debt burden in Canada.

## Saskatchewan

The Saskatchewan economy will likely grow a solid 3.8% this year, creeping back above the national average after underperforming in seven of the past eight years.

The resource sector has regained strength alongside higher oil and potash prices. While oil production has yet to reclaim pre-COVID levels, incomes will be very well supported. Meantime, potash prices have soared amid geopolitical turmoil, and BHP's go-ahead of the massive Jansen project will support activity for the next five years until reaching expected production. Indeed, capital spending intentions in the province look strong this year, with the highest overall growth expected since 2010.

The unemployment rate is falling quickly, dipping below 5% for the first time since mid-2015 as the job market tightens. Still, the province continues to see net interprovincial outflows to other even stronger jurisdictions.

The Province of Saskatchewan is projecting a $463 million deficit in FY22/23, much smaller than the $2.2 billion shortfall now expected in FY21/22. The improvement comes as spending pulls back from very elevated levels.

## Manitoba

The Manitoba economy is expected to grow 3.3% this year, somewhat behind the national increase, and after a relatively weaker performance in 2021. Growth is estimated at 3.0% for 2021, versus 4.6% for all of Canada, with challenging crop conditions weighing on output. Manitoba remains a stable province, with exposure to many industries but no excessive weight in any one sector.

The unemployment rate fell to 4.8% as of February, now comfortably below pre-COVID levels. The improvement reflects strong job gains over the past six months as the labour force has also been posting steady growth.

Housing activity is extremely strong, but not yet quite as overheated as many other parts of the country. Sales volumes are well down from early-2021 peaks, but are still running roughly 15% above pre-COVID norms. The benchmark price in Winnipeg was up 13.6% y/y in February.

The Province of Manitoba's FY22/23 budget is pending. As of the latest fiscal update, the FY21/22 deficit was pegged at $1.1 billion, or a modest 1.5% of GDP.

## Ontario

Ontario's economy is expected to post 3.4% growth this year, a shade below the national average and softening after a 4.4% bounce in 2021. Early-year COVID-related restrictions again disrupted the recovery, but the impacts were temporary and proved to be less significant than in prior waves. As the economy reopens more broadly, Ontario (and the GTA) stand to benefit from renewed spending on services.

The job market is very strong, with employment powering to a record high as of February, as both full- and part-time positions have fully recovered their pandemic-era losses. Service-sector jobs also sit at a record high, despite a still-large gap in accommodation & food services employment. Finance, professional services and technology-based industries have been hiring at a strong and almost uninterrupted clip through the pandemic.

Housing markets across Ontario are still exceptionally strong, if not overheated. Sales across the province are still running almost 30% above pre-COVID norms. Suburban single-detached, smaller towns, rural and cottage markets have seen dramatic growth, and the downtown condo market has more recently joined in. Benchmark single-detached prices in the GTA are up 38% y/y, while condos are now up 30% y/y. The extreme demand will now be tested by higher mortgage rates, with the Bank of Canada beginning what we expect will be a quick series of interest rate hikes that should ultimately balance the market. Meantime, supply remains robust, with a record number of units under construction after housing starts topped 100k in 2021.

In the commercial real estate sector, downtown office vacancy rates have eased to 9.7%, according to CBRE, from a high of 12.4%. Net absorptions have turned positive, but rent growth remains under pressure. Some other sub-sectors, such as industrial, remain extremely strong.

The Province of Ontario's FY22/23 budget is pending ahead of an early June election.

## Quebec

The Quebec economy likely posted robust 6.2% growth last year, potentially leading the country out of the pandemic. Growth is expected to slow to a more modest 2.9% this year, but that would remain well above potential for the province. Quebec was in a position of relative strength before the pandemic, and we remain optimistic on the growth outlook in the coming few years.

That said, the surge in oil prices has tilted some relative strength back to Western Canada, and Quebec is typically at the losing end of that shift. Still, the current situation should be more muted than, for example, the mid-2010s period of relative weakness —the loonie has not surged along with oil prices, which will contain the impact on exports and manufacturing, while past capital spending and employment booms in Alberta are unlikely to repeat, limiting the draw on labour from Quebec.

The housing market is extremely strong, with sales and prices in Montreal still surging. Benchmark prices in that city were up more than 20% y/y in February. This partly reflects the impact of record-low mortgage rates and increased demand for larger homes, consistent with other major cities. Residential construction has responded, with housing starts in Quebec topping a record 70k units in 2021.

The Province of Quebec is projecting a $3.0 billion deficit in FY22/23, or a modest 0.6% of GDP. The 2022 budget's flagship measure, a $500 direct cash payout to 6.4 million individuals before the end of March, will cost $3.3 billion, and eyes will now turn to an October election.

## New Brunswick

The New Brunswick economy is expected to grow 2.0% this year, softer than the national average. Keep in mind that the pandemic contraction was also much milder than most other regions, so there has been less ground to make up.

The unemployment rate dipped below 8% early in 2022, which is in line with trends seen in the three years before the pandemic. Employment in impacted industries, such as trade and accommodation & food, has fully recovered the 2020 decline, leaving service-sector employment above pre-COVID levels. The participation rate, however, remains low, currently more than a full percentage point below February 2020 levels.

Population growth has surged to 1.7% y/y, the fastest pace since the mid-1970s, led by a rebound in international immigration and a surge in provincial migrants into the province. The latter has come as families look for space and affordability in a new hybrid/remote-work environment. The consequence has been a surge in local rent and home prices.

The Province of New Brunswick revised its FY21/22 estimate from a $244 million deficit to a $488 million surplus, though it will narrow to $35 million in FY22/23. Small surpluses persist through FY24/25, highlighting the strong turnaround in the Province's fiscal situation.

## Nova Scotia

The Nova Scotia economy is expected to grow 2.2% this year, cooling after a strong 3.2% rebound last year. Atlantic Canada more broadly has been relatively sheltered from COVID cases and associated lockdowns, so there has been less ground to make up. But, demographic strength and a rebound in tourism should still support well above-potential growth in the near term.

At the turn of the year, international travel flows into Canada were up from the pandemic lows, but still running at only 30% of 2019 levels. With border restrictions eased, the summer 2022 season should be the strongest one for travel activity since the pandemic began.

The job market is also strong. The unemployment rate plunged to 6.6% in February, as employment continues to rise, now more than 2% above pre-COVID levels. Full-time employment has surged, while part-time jobs have been more volatile alongside choppy hotel & restaurant hiring.

Resale housing market activity is still extremely strong, even after sales have fallen sharply from early-2021 highs. Activity continues to trend well above pre-pandemic norms, with interprovincial inflows piling onto a rebound in international immigration. The average sale price in Halifax-Dartmouth has surged to nearly $600k, up from about $330k in late-2019.

The Province of Nova Scotia is estimating a $506 million deficit for FY22/23, or 1% of GDP. Shortfalls are expected to persist over the next four fiscal years, while the net debt burden gradually rises.

## Prince Edward Island

The PEI economy will likely expand 2.1% this year as the recovery continues at a solid pace. Recall that the province was enjoying a significant boom before the virus broke out, leading the country in economic growth in 2019. There are some signs of strength continuing, including demographic flows and a likely return of tourism activity.

Tourism and seasonal visitors during the summer months are major drivers of local economic activity, and both of those sources remain challenged. However, with Atlantic and Canadian travel opening back up, and the appetite apparently now stronger, U.S. and Canadian inbound travel should have its strongest summer since the pandemic began. Meantime, an influx of people, both from abroad and from other parts of Canada, will continue to support robust housing demand.

The unemployment rate is trending around 9%, relatively low for the province alongside a jump in employment to record highs. Full-time hiring ran a very strong clip through 2021, with momentum continuing early this year.

The Province of Prince Edward Island is projecting a $93 million budget deficit for FY22/23, about $66 million larger than the previous year. That will weigh in at modest 1% of GDP, though that marks a 0.7 ppt deterioration from FY21/22.

## Newfoundland & Labrador

The Newfoundland & Labrador economy is expected to expand 3.0% this year, a second year of solid growth, with incomes getting an additional boost from surging oil prices. The province was in a challenged position pre-COVID, but is emerging in better shape, with a notable boost to government royalty revenues incoming.

While oil production remains burdened by declining reserves (Hibernia and White Rose), and a disruption at Terra Nova, Hebron continues to churn out steady output. And, the value of output has surged alongside higher prices.

The unemployment rate is well down from 2020 highs, sitting around the 12.5% level as of early 2022. Employment has recovered all of the losses seen over the past two years, but the longer-term trend is likely stable around current levels, after some further modest near-term growth.

Tourism-related employment remains a clear weak spot, but travel flows should return more meaningfully this summer.

The Province of Newfoundland & Labrador's FY22/23 budget is pending on April 7th. High oil prices will boost revenues meaningfully for the fiscal year.

### Provincial Economic Summary

| | BC | AB | SK | MB | ON | QC | NB | NS | PE | NL | Canada |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Real GDP Growth** (chain-weighted : year/year change) | | | | | | | | | | | |
| 2021 | 4.8 | 6.0 | 2.8 | 3.0 | 4.4 | 6.2 | 2.6 | 3.2 | 2.3 | 3.3 | 4.6 |
| 2022 | 3.8 | 5.0 | 3.8 | 3.3 | 3.4 | 2.9 | 2.0 | 2.2 | 2.1 | 3.0 | 3.5 |
| 2023 | 3.2 | 3.8 | 3.0 | 2.6 | 3.0 | 2.6 | 1.5 | 1.8 | 2.0 | 1.8 | 3.0 |
| **Employment Growth** (year/year % change) | | | | | | | | | | | |
| 2021 | 6.6 | 5.2 | 2.6 | 3.5 | 4.9 | 4.2 | 2.6 | 5.4 | 3.7 | 3.0 | 4.8 |
| 2022 | 3.5 | 4.1 | 2.4 | 2.5 | 5.1 | 3.2 | 2.0 | 2.8 | 3.3 | 1.2 | 4.0 |
| 2023 | 2.1 | 2.2 | 1.0 | 1.2 | 2.2 | 1.8 | 0.9 | 0.8 | 0.4 | 0.2 | 2.0 |
| **Unemployment Rate** (percent) | | | | | | | | | | | |
| 2021 | 6.5 | 8.6 | 6.5 | 6.4 | 8.0 | 6.1 | 9.0 | 8.4 | 9.4 | 12.9 | 7.4 |
| 2022 | 4.7 | 6.1 | 4.9 | 5.1 | 5.5 | 4.8 | 8.0 | 7.1 | 8.7 | 12.1 | 5.5 |
| 2023 | 4.5 | 5.2 | 4.7 | 4.9 | 5.5 | 4.7 | 7.8 | 7.0 | 8.7 | 11.9 | 5.3 |
| **Housing Starts** (thousands) | | | | | | | | | | | |
| 2021 | 47.7 | 31.9 | 4.3 | 8.0 | 101.2 | 71.1 | 4.0 | 6.0 | 1.2 | 1.3 | 277 |
| 2022 | 43.0 | 32.0 | 3.0 | 8.0 | 90.0 | 60.0 | 3.0 | 4.0 | 1.3 | 0.6 | 245 |
| 2023 | 42.0 | 31.0 | 3.0 | 6.5 | 84.0 | 55.0 | 2.8 | 4.0 | 1.2 | 0.6 | 230 |
| **Consumer Prices** (year/year % change) | | | | | | | | | | | |
| 2021 | 2.8 | 3.2 | 3.8 | 3.2 | 3.5 | 3.8 | 3.8 | 4.1 | 5.1 | 3.7 | 3.4 |
| 2022 | 5.5 | 5.2 | 5.0 | 5.4 | 5.7 | 5.3 | 5.3 | 5.3 | 5.8 | 5.0 | 5.5 |
| 2023 | 3.6 | 3.8 | 3.4 | 3.2 | 3.5 | 3.3 | 3.1 | 3.2 | 3.0 | 3.0 | 3.5 |

*Shaded bars are BMO Economics forecasts*

**Andre Salvi,**
Senior Vice President and Head, Technology & Innovation Banking Group

**Devon Dayton,**
Managing Director and Head, Technology & Innovation Banking Group

## Technology and Innovation

The technology and innovation sector has seen a sea change in the past year. At the start of the pandemic, the demand for these firms drove significant growth. Remote work became the norm, and companies in the space embraced the new normal—hiring from a wider labour pool with employees from diverse geographies. It was common to hear leaders in the space assert that they may never move back to office environments again and were embracing hiring strong talent, at all levels, in different locations.

But now, some tech companies are embracing a return to the office. This unexpected changing of the narrative has seen businesses push for culture and collaboration—traits they feel are best established in an office setting.

Demand for tech employees remains high, so while offices are opening up, flexibility remains key to attracting and retaining talent.

The biggest focus, at least for private firms, is lower valuations seen in the public markets. Pandemic stocks are trading lower because there may not be the same amount of growth as the world reopens. While Private Capital remains robust, firms will balance raising debt or reducing burn in the face of potential lower valuations.

That said, software-based tech companies are still showing strength with firms continuing to need e-commerce platforms. The pandemic has certainly reinforced digitization needs, and the recent geo-political backdrop has been a boon for Cyber Security companies. Meanwhile, in biotech, firms working to fight COVID variants will no doubt find themselves in constant demand from governments and public health authorities for some time to come.

The recent increase in inflation is not affecting the sector significantly. Price changes on goods and commodities has had a minimal effect; so far the major wage increases are being caused by demand.

At the end of the day, we expect 2022 to continue to be a strong year for the technology sector.

**Lynda Taylor,**
Senior Vice President and Head, Agriculture and Agribusiness

**Janine Sekulic,**
National Director, Agriculture and Agribusiness

## Agriculture

While consumers are feeling the prices at the grocery store, Canadian production agriculture is feeling the pressure as costs to grow, produce and supply our food continue to escalate in these uncertain times.

Total 2021 Canadian crop production was 30% below average driven by the drought in the west; although good crops in Eastern Canada picked up some of the slack, normal precipitation this year is going to be critical to restore crop, pasture and feed supplies.

Input expenses—fertilizer, feed, fuel, seed, repairs, labor—have all risen exponentially given tight supplies and strong demand. While high commodity prices have been positive for grain/oilseed producers, the cost of feed (and sourcing it) has been an enormous challenge for livestock and dairy producers since mid-2021. This will not likely improve until a return to normal production.

The situation in Europe is having a major impact; Russia and Ukraine are huge global producers of fertilizer, grains, and oilseeds. The combined effect of the war and economic sanctions is removing supply from an already razor thin market and driving prices even higher.

Supply chains are still catching up after two years of serious disruption due to the pandemic. As the world emerges from lockdown, demand for virtually everything has surged and the cost to move goods is extremely high.

Despite all the headwinds, there are opportunities to lock in positive margins and that appears set to continue for the next 12 months. Production and price risk management is on everyone’s mind.

Canadian domestic canola and pulse production will be supported in the long run by increased processing capacity on the Prairies, reducing our reliance on export markets.

Constant uncertainty is contributing to almost unprecedented volatility. But amid the chaos, there are opportunities. Always resilient, Canadian producers are carefully navigating to grow and produce their best.

## Real Estate

**Michael Beg,**
Senior Vice President and Head,
Real Estate Finance

**Karla McCarthy,**
Head, Income Property Finance

Canada’s housing market has shown incredible strength through the COVID pandemic, and we see a continuation of that even with the advent of higher interest rates.

We see strong and growing tailwinds to help offset the interest rate headwinds. Coming into the pandemic, Canada saw record net immigration rates of 340,000 sustaining current demand and trending to 450,000 in forecasts. We looked to be above 200,000 net new household formations at that point two years ago, and fully expect that to trend higher. Now that we’re emerging from the various lockdowns, we also have returned to prepandemic levels of record employment. These two key factors play into housing demand and are contributing to the hot market.

Interest rate hikes will no doubt ease demand somewhat, but the aforementioned two demographic drivers won’t be impacted. There might even be a brief, modest amount of relief in prices for a quarter or two, some but not much help for buyers.

On the rental side, we also see strong and thus increasingly unaffordable markets, yet renting remains the most affordable way for many Canadians to have a home.

On the commercial side, industrial property demand spiked to support e-commerce fulfillment that surged during the pandemic. In the face of tight supply heading into the pandemic, industrial rents and property values have soared and vacancy is minimal. Retail, meanwhile, has showed a trend towards stabilization as those e-commerce trends were pushed to structural limits during the pandemic, with less room for e-commerce growth now.

With office space, the rise of hybrid work continues to place downward pressure on the market. All in, we estimate a 20 per cent demand impact that will take a couple more years to settle. But when it's all done, office will remain the predominant workplace, and a reconfigured office sector should resume growth in tandem with GDP.

**Stephen Vermette,**
Managing Director and Regional Vice President,
Business Property Finance

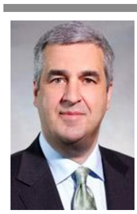
## Hospitality

BMO's hospitality clients have been through quite a journey through the COVID pandemic. What was originally thought to be a three-to-six month challenge has become a multi-year effort. But by and large clients are riding it out, and we have started to see the market moving back to a kind of normal.

Successfully navigating the recovery over the last two years can be attributed to a combination of patient and knowledgeable lenders, strong government support programs and the hospitality industry adjusting how they deliver their services in a highly efficient manner to adjust to current economic realities. We're particularly gratified at BMO to see our lending business for this sector evolve from recovery related financings in the first part of the pandemic to helping clients grow their businesses today. While our clients continue to manage through the recovery, this type of activity is evidence their tremendous efforts are paying off and the outlook is good.

Naturally, the current situation with higher inflation, and the corresponding higher interest rates, is affecting these businesses. Decisions are being driven by this new environment, affecting both the level of debt afforded by business and decisions relating to the type and term of interest rates associated with their debt. But that said, it's not holding owners back from executing on their plans. As they have for the past two years, they will adjust their strategies as required to manage a changing environment.

In short, decisions are being made with a long term perspective on the industry and with the help of partners who share the same view. For the hospitality industry, better days are ahead.



**Paul DeMarchi,**
Managing Director,
Transportation Finance

## Transportation

Strong demand for freight coupled with constrained global supply chains, including freight carrying capacity, provide a positive fundamental pricing backdrop for the trucking industry at the outset of 2022.

Further, skyrocketing prices for oil, nickel, aluminum, copper, wheat, etc., coupled with a likely shift in global sourcing of these commodities away from Russia/Ukraine, will be a strong incentive for increased production in those sectors. While other modes of transportation such as rail and pipeline will benefit disproportionately from increased flows of commodities, the ancillary macro tailwinds of positive employment and income trends, relaxing COVID restrictions, and a robust housing market provide a solid foundation for truck freight demand.

Driver availability has been gradually improving, given the duel incentives of strong earnings potential coupled with extraordinary government support now in the rearview. As such, and with OEM production of tractors and trailers likely to remain constrained into the second half of the year, equipment availability may soon surpass drivers as the top constraint on trucking capacity. But, regardless of the reason, industry capacity growth is expected to remain modest throughout the year.

However, the industry faces increasingly challenging headwinds. The outlook for rapidly increasing interest rates and the adverse effects of multi-decade high inflation on consumer purchasing power present a severe challenge to the sustainability of a robust domestic freight environment. Carriers, particularly smaller ones, are also struggling with rapidly rising operating costs. Already burdened with escalating costs for equipment, labor, and insurance, the sudden volatility in fuel prices has added a new assault on cash flows. From a supply-side perspective, critical components and raw materials are likely to remain constrained, with any improvement to be uneven due to lingering pandemic-related roadblocks and geopolitical-related dislocations. These impediments to the normalization of the global supply chain will continue to weigh on important sectors, most notably the truck freight-heavy automotive sector.

## Auto

**Robert Sadokierski,**
Senior Vice President and Head, Automotive Finance

The Canadian auto sector continues to adjust to a new normal created by the COVID pandemic. Dealers have done well, notwithstanding the inherent challenges. They successfully pivoted to a new reality, with more digital contact with customers and not relying as much on customer traffic in showrooms.

The industry does have to deal with a supply problem at the moment. It will take time to get circumstances back to something approaching pre-COVID levels.

One interesting factor in the industry is inflation. It’s happening with both new and used cars. The mismatch between supply and demand has led to price increases in both areas—used cars are now selling at historical highs.

Dealers are also keeping an eye on the effect of higher interest rates on auto purchases. Even with recent increases, rates are still near historic lows, so pullbacks by consumers are really just a question of perception instead of reality. But the effect is real; dealers are seeing fewer casual buyers with the market mostly taken up by people who are serious about buying a vehicle. Among those, there’s some backing off of the more expensive trim options, but purchases are still taking place.

Dealers aren’t in any difficulty as a result of any of this at the moment because of low inventories; it will be interesting to see what happens with the market once those issues are resolved. Auto manufacturers may, if they feel the need, provide subsidies to offset higher interest rates.

At a commercial level, the industry still has a high degree of fragmentation. We still see a significant number of single-point owners. However, over the last few years, the velocity of acquisitions has picked up.

By and large, dealers are looking at issues of concern and saying “this too shall pass.” The industry is strong, consumer interest is strong, so our clients are feeling positive.

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