Economic Viewpoint

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Medium-term issues and forecasts

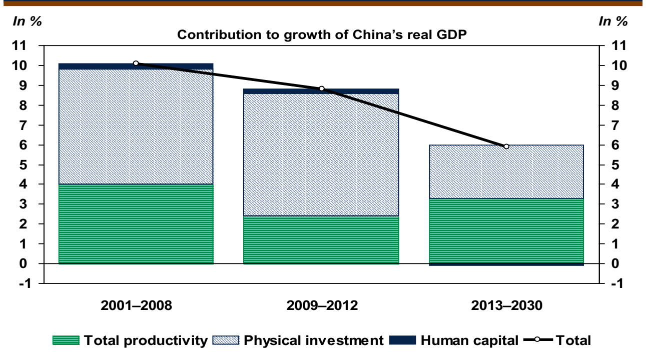
Several factors will limit how far up interest rates can go

The moderate growth that we are seeing in the current economic cycle and the existence of numerous risks are prompting the central banks to keep a cautious stance. This situation will probably continue in the medium term. Cyclical challenges will persist for a few more years, not to mention that demographic changes will increasingly affect growth. Nor should we look for any significant waning of risks. The European economy will remain fragile, as will those of many emerging countries. Many countries are also facing public finance problems, which will require a long period of adjustments. While key interest rate hikes are likely to begin in 2015, the potential for upwards movement is less than it was in the previous cycle. The pace of rate increases will probably also be slower.

INTERNATIONAL ISSUES

In the medium term, the robustness of growth in the global economy will likely be influenced by two major factors. First, the advanced economies will keep recovering from the heavy toll of the latest crisis. This should boost demand for commodities and support a rally in international trade. On the other hand, this normalization will probably lead to a tightening of financial conditions; the central banks will abandon the measures they adopted during and after the crisis. Second, the long-term adjustments that have already started to have a negative influence on the growth rates of the leading emerging countries will continue. Part of their recent weakness was due to the anaemic growth of the advanced countries, but another part stems from the necessity of restoring balance after years of excess. The emerging countries will no longer be able to rely so much on exports, nor will they be able to benefit from enormous flows of capital encouraged by low interest rates around the globe. A slowdown in investment is anticipated, especially in China. The International Monetary Fund estimates that China's potential real GDP growth is in the process of dwindling to around 5.5%, compared with 9.0% between 2009 and 2012 and 10.0% in the 2000s (graph 1).

Graph 1 – The slowdown in economic growth in China will continue



Sources: International Monetary Fund and Desjardins, Economic Studies

In the United States, the growth cycle should proceed at a fairly good clip. In 2016, the recession will have been over for seven years, but we estimate that U.S. real GDP will still be below its potential. It will therefore be too early to see any signs of another cyclical downturn. Real GDP growth will remain fairly brisk thanks to a lull in budgetary policy uncertainty, rising confidence levels and a new surge in investments supported by new, local sources of energy (shale gas and oil). However, the United States will increasingly feel the effects of demographic changes, which are already having an impact on labour force growth. This will help the jobless rate go down, but will also prevent the economy from returning to potential growth as high as before the financial crisis.

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CANADIAN ISSUES

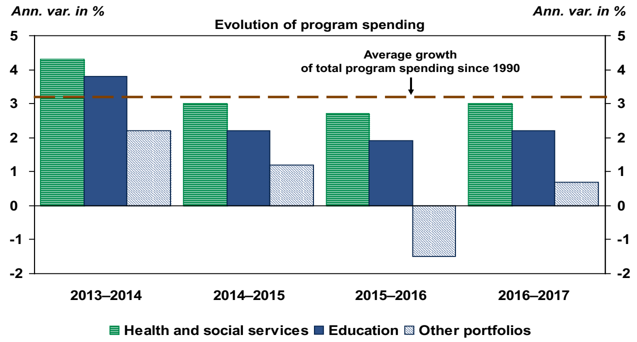
Many major pipeline projects are currently under review, but none are yet under construction. While alternatives such as transport by rail are currently in use, the future of Canada's energy sector depends on developing new ways of moving western oil. Should these constraints persist, they could curb investments in new production capacity to a significant degree in the years ahead.

The condition of Canada's real estate market will remain a significant concern. Our scenario calls for a gradual slowdown, but the risk of a more severe correction will continue to exist as long as the main housing markets, including Toronto and Vancouver, keep on booming.

The recent signs of acceleration in the economy and in inflation confirm that the Bank of Canada is heading, slowly but surely, towards monetary tightening, which should soon send bond yields climbing. However, it seems increasingly probable that Canadian key interest rates will remain lower than those that were observed in recent upward cycles, and that they might level off at around 3% in 2018. Persistent headwinds such as less favourable demographic trends, public finances under pressure and high household debt levels will keep curtailing interest rate hikes, especially in Canada.

Given that the wave of baby boomers was particularly strong in Quebec, the population of that province will age more quickly. The number of persons between the ages of 15 and 64 will actually fall, while in the rest of Canada, that population segment will merely see slower growth. Quebec's economic growth potential, which has been 2.3%, on average, over the past 20 years, will slow to around 1.5%. Apart from the cyclical rebound expected in 2014 and 2015, which will enable real GDP growth to temporarily achieve a pace of around 2%, times will be quite tough in the years after that.

Graph 2 – Program spending growth will be weak over the next few years in Quebec



Sources: Ministère des Finances du Québec and Desjardins, Economic Studies

The precarious state of public finances is another major issue facing Quebec, with probable repercussions for the economy. The government must strictly control its budget in the short and medium terms, review its taxation structure soon, and take a good look at its program spending.

The state of public finances will also bear watching in Ontario, but the desired recovery in the manufacturing sector will be even more crucial for the province's economic growth. Major productivity issues have been raised, and investments will have to be made to improve the competitiveness of Ontario's manufacturers.

Table 1
United States: medium-term major economic and financial indicators

In % (except if indicated)	Annual average							Average	
	2012	2013	2014f	2015f	2016f	2017f	2018f	2006-2013	2014-2018f
Real GDP (var. in %)	2.8	1.9	2.0	3.1	3.2	2.9	2.6	1.5	2.8
Total inflation rate (var. in %)	2.1	1.5	2.0	2.0	2.2	2.1	2.1	2.5	2.1
Unemployment rate	8.1	7.4	6.4	5.9	5.6	5.3	5.0	7.0	5.6
S&P 500 index (var. in %)*	13.4	29.6	6.0	7.9	6.0	5.0	5.0	7.2	6.0
Federal funds rate	0.25	0.25	0.25	0.50	1.75	2.55	3.40	1.67	1.69
Prime rate	3.25	3.25	3.25	3.50	4.75	5.55	6.40	4.67	4.69
Treasury bills—3-month	0.09	0.06	0.10	0.55	1.75	2.60	3.35	1.40	1.67
Federal bonds—10-year	1.78	2.34	2.90	3.45	3.75	3.95	4.00	3.30	3.61
Federal bonds—30-year	2.92	3.45	3.65	4.00	4.20	4.30	4.30	4.07	4.09
WTI** oil (US$/barrel)	94	98	100	102	104	105	105	83	103
Gold (US$/ounce)	1,669	1,411	1,250	1,150	1,050	950	1,000	1,128	1,080

f: forecasts; * The variations are based on observation of the end of period; ** West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Table 2
Canada: medium-term major economic and financial indicators

In % (except if indicated)	Annual average 2012	2013	2014f	2015f	2016f	2017f	2018f	Average 2006-2013	2014-2018f
Real GDP (var. in %)	1.7	2.0	2.2	2.5	2.2	2.0	1.8	1.6	2.1
Total inflation rate (var. in %)	1.5	0.9	1.9	1.8	2.0	2.0	1.9	1.7	1.9
Employment (var. in %)	1.2	1.3	0.7	1.1	1.0	0.9	0.8	1.2	0.9
Employment (K)	202	224	127	204	188	171	154	201	169
Unemployment rate	7.2	7.1	6.9	6.6	6.4	6.2	6.0	7.1	6.4
Housing starts (K)	215	188	185	179	185	190	195	200	187
S&P/TSX* index (var. in %)	4.0	9.6	11.0	10.0	8.0	7.0	6.0	4.3	8.4
Canadian dollar (US$/C$)	1.00	0.97	0.92	0.94	0.93	0.92	0.91	0.95	0.92
Overnight funds	1.00	1.00	1.00	1.10	1.85	2.50	3.00	1.93	1.89
Prime rate	3.00	3.00	3.00	3.10	3.85	4.50	5.00	3.84	3.89
Mortgage rate									
1-year	3.18	3.08	3.15	3.40	4.20	4.75	5.10	4.65	4.12
5-year	5.27	5.23	5.00	5.35	5.70	5.95	6.05	5.99	5.61
Treasury bills—3-month	0.95	0.97	0.95	1.15	1.95	2.55	3.00	1.78	1.92
Federal bonds									
2-year	1.12	1.11	1.20	1.80	2.45	2.95	3.10	2.16	2.30
5-year	1.37	1.63	1.80	2.55	2.95	3.25	3.30	2.65	2.77
10-year	1.87	2.26	2.55	3.05	3.35	3.50	3.50	3.19	3.19
30-year	2.45	2.83	3.00	3.45	3.65	3.75	3.75	3.61	3.52
Canada/U.S. rate spreads									
Treasury bills—3-month	0.86	0.91	0.85	0.60	0.20	-0.05	-0.35	0.38	0.25
Federal bonds—10-year	0.09	-0.07	-0.35	-0.40	-0.40	-0.45	-0.50	-0.11	-0.42
Federal bonds—30-year	-0.47	-0.62	-0.65	-0.55	-0.55	-0.55	-0.55	-0.46	-0.57

f: forecasts; * The variations are based on observation of the end of period.
Sources: Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

Table 3
Quebec and Ontario: medium-term major economic indicators

Var. in % (except if indicated)	Annual average 2012	2013	2014f	2015f	2016f	2017f	2018f	Average 2006-2013	2014-2018f
Quebec									
Real GDP	1.5	1.1	1.7	1.9	1.6	1.5	1.4	1.4	1.6
Total inflation rate	2.1	0.7	1.3	1.7	1.9	2.1	2.0	1.6	1.8
Employment	0.8	1.2	0.4	1.0	0.5	0.4	0.2	1.1	0.5
Employment (K)	31	48	15	40	20	15	10	41	20
Unemployment rate (%)	7.8	7.6	7.6	7.3	6.8	6.0	5.6	7.8	6.7
Retail sales	1.2	2.5	1.9	3.3	2.5	2.3	2.1	3.3	2.4
Housing starts (K)	47	38	39	41	38	35	35	47	38
Ontario									
Real GDP	1.3	1.3	1.9	2.6	2.5	2.1	1.8	0.8	2.2
Total inflation rate	1.4	1.0	2.0	1.8	2.0	2.2	2.0	1.8	2.0
Employment	0.8	1.4	0.8	1.2	1.2	1.0	0.9	1.0	1.0
Employment (K)	52	96	58	86	84	71	65	64	73
Unemployment rate (%)	7.8	7.5	7.3	7.0	6.8	6.6	6.4	7.5	6.8
Retail sales	1.6	2.3	2.2	3.9	4.5	4.1	3.9	2.8	3.7
Housing starts (K)	77	61	58	56	60	64	68	67	61

f: forecasts
Sources: Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies