#1 MEILLEUR PRÉVISIONNISTE GLOBAL – CANADA
FOCUS ECONOMICS ANALYST FORECAST AWARDS 2022
#1 BEST OVERALL FORECASTER – CANADA

ECONOMIC & FINANCIAL OUTLOOK

Signs of Fractures Are Beginnig to Show

HIGHLIGHTS

- The global economy slowed in the second half of 2022, but not as severely as anticipated. There have even been signs of improvement since the start of the new year. China is enjoying a rebound now that most of its draconian public health measures have been lifted. In the eurozone, rising PMIs are pointing to stronger economic growth, and real GDP is likely to increase in the first quarter after stagnating last fall. A more difficult period will probably follow as key rate hikes start to bite harder.
- In the United States, despite a positive start to the year on the employment and consumer spending fronts, things are set to cool for the first quarter of 2023, with annualized real GDP growth expected to clock in at just under 1.5%. Contractions are likely to follow as key rate hikes start to take more of a toll across the economy.
- Canadian economic growth surprised economists by stalling in Q4 2022. But despite this weakness, we've upgraded our forecast for real GDP growth in the first half of 2023 due to an improved outlook for domestic demand to start the year. That said, our baseline forecast continues to call for a short and shallow recession in 2023, which will weigh on the labour market, wage growth and inflation.
- In Quebec, although real GDP rose in October and November after several months of weakness, the recession scenario isn't off the table just yet. According to a number of indicators, Quebec's economy is heading for a major downturn, despite the continued strength of the labour market. And even if key interest rates are done rising, they'll remain high in 2023, hitting debt-ridden consumers and businesses hard.
- As pressures on the financial system have begun to emerge, market participants have become less complacent regarding the fallout of the rapid and aggressive rate hiking cycle. The large spread between deposit rates and money market securities coupled with quantitative tightening has created problems in the US regional banking system. The Federal Reserve (Fed) will need to carefully balance the tightening in financial conditions stemming from these developments with the threat of persistently high inflation. We still expect a few more hikes in the US, whereas we expect the Bank of Canada to stay sidelined until year-end.
- The short-order economic picture isn't very bright, and it comes with a side of great uncertainty. Unfortunately, it's a necessary step in cleaning up the economic fundamentals, reining in inflation and keeping it low. The central banks' ability to control inflation will be a crucial component in more vigorous medium-term growth. Furthermore, growth could also hinge on an uptick in investments in lower-carbon economies. The more pronounced aging of the population in certain economies also argues for greater investment.

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RISKS INHERENT IN OUR SCENARIOS

Inflation is showing signs of slowing, but it remains high around the world and could even rebound in some countries. This could prompt central banks to continue raising interest rates or keep them higher for longer. Significant further tightening remains the biggest risk to the global economy. The economic slowdown may therefore still turn out to be worse than expected still, despite some more positive data recently. If things get more difficult for the global economy, Canada could see weaker exports and worsening terms of trade. Higher unemployment and interest rates could also mean a bigger housing market correction in Canada. So far, Europe's economy has avoided a deepening energy crisis, but it will continue to struggle to meet its energy needs and will remain vulnerable to price fluctuations due to the war in Ukraine. The war continues to inject significant uncertainty into our forecast, particularly for commodity prices. Current diplomatic tensions between the US and China could lead to additional trade restrictions. Nothing can be taken for granted on the financial stability front, either, as evidenced by the recent collapse of three US banks and the emergency response from the Federal Reserve and US Treasury. Smaller US financial institutions could face ratings downgrades and higher funding costs. This could further restrict the supply of credit and amplify the slowdown. A deeper economic slowdown could mean more bankruptcies and sharper price corrections in multiple asset classes. Investors may demand higher risk premia and be more critical of government decisions that could worsen public finances or undermine central banks. We'll also need to keep an eye on US debt ceiling talks, which promise to be fraught and could drive further volatility in bond yields and the US dollar. But if the global economy deteriorates sharply, risks are tilted more to a rapid appreciation of the US dollar, especially against the currencies of countries considered more economically and financially fragile. That could leave some economies even more vulnerable, potentially leading them to a foreign debt crisis.

TABLE 1
World GDP growth (adjusted for PPP) and inflation rate

	WEIGHT*	REAL GDP GROWTH			INFLATION RATE		
%		2022f	2023f	2024f	2022f	2023f	2024f
Advanced economies	**38.7**	**2.7**	**0.6**	**1.1**	**7.1**	**4.4**	**2.4**
United States	15.7	2.1	0.9	1.4	8.0	3.9	2.5
Canada	1.4	3.4	0.6	0.9	6.8	3.3	2.0
Quebec	*0.3*	*2.7*	*-0.2*	*0.8*	*6.7*	*3.4*	*2.0*
Ontario	*0.5*	*3.7*	*0.0*	*1.0*	*6.8*	*3.3*	*1.9*
Japan	3.7	1.0	0.4	0.8	2.5	2.1	1.2
United Kingdom	2.3	4.0	-0.5	0.7	9.1	6.7	2.9
Eurozone	11.9	3.5	0.4	0.8	8.4	5.5	2.6
Germany	*3.3*	*1.9*	*-0.2*	*0.7*	*6.9*	*6.2*	*2.9*
France	*2.3*	*2.6*	*0.4*	*0.7*	*5.2*	*4.8*	*2.5*
Italy	*1.8*	*3.8*	*0.1*	*0.1*	*8.2*	*6.4*	*2.4*
Other countries	4.2	2.9	1.0	1.5	5.8	4.2	2.4
Australia	*1.0*	*3.7*	*1.7*	*1.5*	*6.6*	*5.3*	*3.1*
Emerging and developing economies	**61.3**	**3.5**	**3.4**	**4.0**	**8.4**	**6.9**	**4.7**
North Asia	26.8	4.0	5.2	5.2	4.1	3.8	3.4
China	*18.6*	*3.0*	*5.2*	*5.0*	*2.0*	*2.5*	*2.5*
India	*7.0*	*7.0*	*5.6*	*6.0*	*6.7*	*5.0*	*5.0*
South Asia	5.1	5.4	4.0	4.3	4.8	3.8	2.9
Latin America	5.8	3.4	0.7	1.9	9.1	5.4	4.1
Mexico	*1.8*	*3.1*	*0.8*	*1.7*	*7.9*	*5.1*	*4.1*
Brazil	*2.3*	*3.0*	*0.7*	*1.6*	*9.5*	*5.5*	*4.4*
Eastern Europe	8.1	0.4	0.1	2.4	27.0	16.7	10.4
Russia	*3.3*	*-2.1*	*-2.0*	*1.1*	*13.8*	*6.1*	*5.0*
Other countries	15.5	3.3	2.8	3.3	10.4	11.7	7.6
South Africa	*0.6*	*1.8*	*1.3*	*1.8*	*7.0*	*5.7*	*4.9*
World	**100.0**	**3.2**	**2.4**	**2.9**	**7.9**	**5.9**	**3.9**

f: forecasts; PPP: Purchasing Power Parities, exchange rate that equates the costs of a broad basket of goods and services across countries; * 2021.
Sources: World Bank, Consensus Forecasts and Desjardins Economic Studies

FINANCIAL FORECASTS

As pressures on the financial system have begun to emerge, market participants have become less complacent regarding the fallout of the rapid and aggressive rate hiking cycle. The large spread between deposit rates and money market securities coupled with quantitative tightening has created problems in the US regional banking system. The Federal Reserve, the Federal Deposit Insurance Corporation (FDIC) and the US Treasury have taken major steps to help alleviate these issues. Still, concerns have maintained global sovereign bond yields at lower levels and seen a re-steepening of yield curves as market participants price in fewer rate hikes, and even some rate cuts, this year. Risk assets have been volatile as a result of the uncertainty but we expect them to trend weaker as economic activity slows. The Canadian dollar has also been dragged lower, in part due to a flight-to-safety trade. Barring further financial turmoil in the near term, the Fed looks likely to raise rates a bit further to address high inflation before pausing in the spring. In Canada, recent data broadly justify the Bank of Canada's decision to pause hikes in early March. We continue to expect the BoC to keep to the sidelines and to start easing monetary policy towards year-end.

TABLE 2
Summary of financial forecasts

END OF PERIOD IN % (UNLESS OTHERWISE INDICATED)	2022		2023				2024			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key interest rate										
United States	3.25	4.50	5.00	5.25	5.25	5.25	4.50	3.50	2.75	2.75
Canada	3.25	4.25	4.50	4.50	4.50	4.25	3.50	3.00	2.50	2.50
Eurozone	1.25	2.50	3.50	4.00	4.00	4.00	4.00	3.50	3.00	2.50
United Kingdom	2.25	3.50	4.25	4.25	4.25	4.25	4.25	3.75	3.25	2.75
Federal bonds										
United States										
2-year	4.26	4.54	4.35	4.30	4.25	3.90	3.40	3.20	2.80	2.70
5-year	4.08	3.97	3.90	3.95	3.90	3.55	3.20	2.95	2.80	2.70
10-year	3.80	3.83	3.65	3.70	3.60	3.45	3.05	2.95	2.90	2.80
30-year	3.76	3.94	3.70	3.75	3.60	3.40	3.00	2.95	2.90	2.85
Canada										
2-year	3.79	4.06	3.80	3.70	3.55	3.25	3.00	2.85	2.55	2.40
5-year	3.32	3.41	3.05	3.15	3.20	3.15	2.95	2.65	2.50	2.35
10-year	3.16	3.30	2.95	3.00	2.95	2.95	2.80	2.70	2.60	2.50
30-year	3.09	3.28	2.95	3.05	3.00	2.95	2.80	2.65	2.50	2.40
Currency market										
Canadian dollar (USD/CAD)	1.38	1.36	1.37	1.39	1.40	1.37	1.33	1.28	1.25	1.27
Canadian dollar (CAD/USD)	0.72	0.74	0.73	0.72	0.72	0.73	0.75	0.78	0.80	0.79
Euro (EUR/USD)	0.98	1.07	1.06	1.05	1.05	1.08	1.12	1.14	1.15	1.15
British pound (GBP/USD)	1.12	1.20	1.20	1.17	1.18	1.21	1.25	1.28	1.30	1.32
Yen (USD/JPY)	145	131	132	127	124	120	115	113	111	110
Stock markets (level and growth)*										
United States – S&P 500	3,840		Target: 3,650 (-4.9%)				Target: 3,950 (+8.2%)			
Canada – S&P/TSX	19,385		Target: 19,000 (-2.0%)				Target: 20,600 (+8.4%)			
Commodities (annual average)										
WTI oil (US$/barrel)	95 (80*)		76 (74*)				82 (83*)			
Gold (US$/ounce)	1,800 (1,815*)		1,860 (1,870*)				1,740 (1,670*)			

f: forecasts; WTI: West Texas Intermediate; * End of year.
Sources: Datastream and Desjardins Economic Studies

Overseas

Will the Global Economy Stay This Resilient?

FORECASTS

The global economy slowed in the second half of 2022, but not as severely as anticipated. There have even been signs of improvement since the start of the new year. China is enjoying a rebound now that most of its draconian public health measures have been lifted. Growth is expected to settle after this spike, but the overall gain for 2023 should be fairly substantial. In the eurozone, rising PMIs are pointing to stronger economic growth, and real GDP is likely to increase in the first quarter after stagnating last fall. A more difficult period will probably follow as key rate hikes start to bite harder. The biggest challenge is in the United Kingdom, where confidence is lower and labour disputes are proliferating. After 3.2% growth in 2022, global real GDP is projected to grow by just 2.3% in 2023 before climbing 2.9% in 2024.

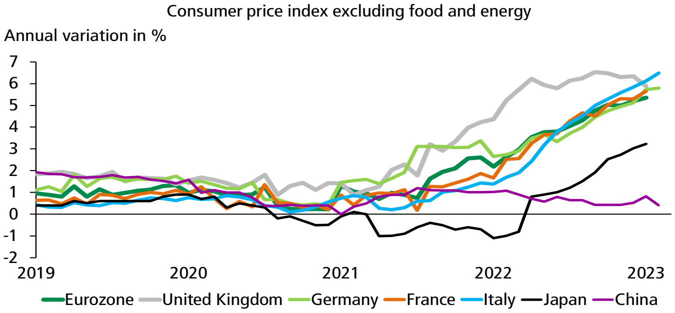
A More Stable Base for Commodity Prices

Supply chains have continued to improve in recent months. Container shipping rates have dipped back below their pre-pandemic levels. Unusually mild weather during the depths of Europe's winter carried the continent through the energy crisis without too much trouble. And natural gas is back to pre-pandemic prices. Meanwhile, oil prices were relatively stable as the year began, despite the risk of recession, geopolitical tensions and the Chinese economy's rebound. Although there's a chance that prices remain relatively resilient, they're expected to fall somewhat on the back of the slowdown in demand caused by weak global economic growth. This should contribute to the slowdown in headline inflation in most countries. That said, core inflation remains very high globally (graph 1) and could prove fairly stubborn over the coming quarters.

Eurozone: Can a Recession Really Be Avoided?

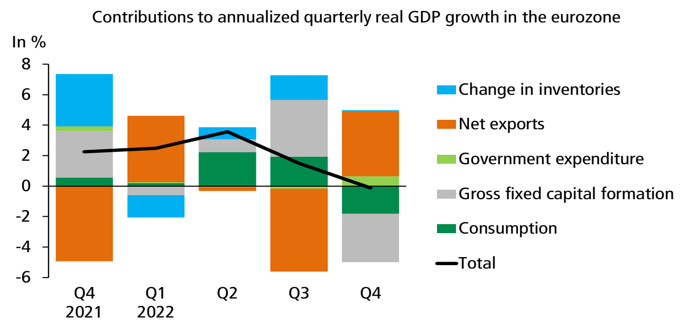
The eurozone could be in for a challenging period ahead. At the end of 2022, the economy was beset by problems related to the war in Ukraine, including a direct impact on energy supply from the Russian invasion, as well as falling real household income and declining confidence indexes. Furthermore, eurozone real GDP edged down at the end of 2022, even if the 0.1% annualized dip was negligible compared to what was feared. Still, lower real consumption (-3.4% annualized) and investment (-13.6%) are signs of a very fragile economy. This has been offset by modest gains in government spending, business inventories, real exports and—most importantly—a steep 7.4% drop in imports (graph 2). But the situation still looks challenging as we enter 2023.

GRAPH 1
Core inflation continues to rise almost everywhere



Sources: Datastream and Desjardins Economic Studies

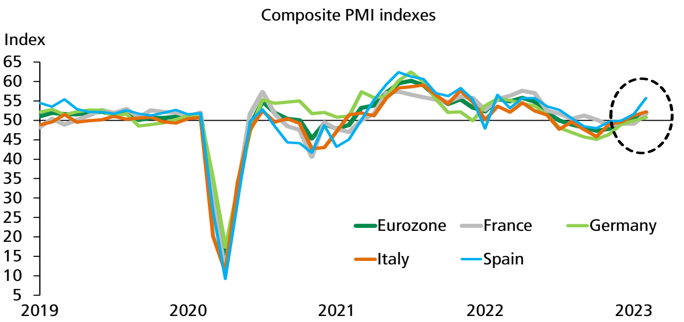
GRAPH 2
Although eurozone real GDP only suffered a modest dip at the end of 2022, consumption and investment are down



Sources: Eurostat and Desjardins Economic Studies

However, the worst was avoided due to the unseasonably mild winter weather, which kept energy demand down. In the past two months, consumer and business confidence indexes have improved, and PMIs are back above the 50 mark (graph 3 on page 5). The labour market is holding up for now, and retail sales even increased slightly in January after several months of decline. This suggests that growth could resume as early as the first quarter of 2023. However, as in most other advanced countries, key rate hikes have yet to show their full impact across the economy. Countries should brace themselves though, especially since inflation is still very high in the eurozone and the European Central Bank seems dead set on continuing to raise key rates. We therefore expect eurozone real GDP to contract further in 2023.

GRAPH 3
Eurozone PMI indexes climb back above 50

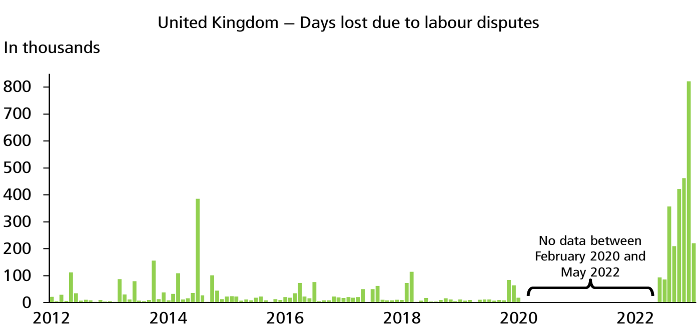


Sources: IHS/Markit, Datastream and Desjardins Economic Studies

United Kingdom: Still Wobbly

After a 0.7% annualized decline in the third quarter of 2022, UK real GDP dodged another sinkhole, eking out an annualized gain of 0.1%. Falling exports were the main headwind to the country's still fragile growth. January's monthly real GDP rose by 0.3%, but carry-over growth remains negative due to December's 0.6% drop. Furthermore, many labour disputes continue to drag down economic activity (graph 4)—and with it consumer confidence—which is not showing the same improvement in the UK as in the eurozone. As such, further declines in UK real GDP appear likely.

GRAPH 4
The British economy is disrupted by the strikes

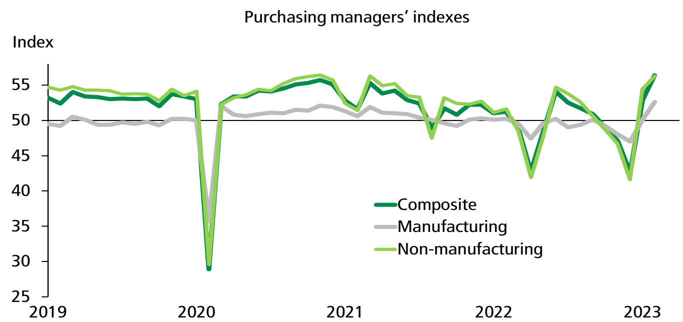


Sources: Office for National Statistics and Desjardins Economic Studies

Will the Chinese Economic Rebound Last?

By jettisoning its zero-COVID policy in December, China is poised to gain back some growth. This is expected to translate into more stable industrial production and higher consumer confidence. The Manufacturing and Non-manufacturing PMIs have already rebounded, to 52.6 and 55.6, respectively, in February (graph 5). However, beyond this initial surge, the task of boosting the economy will be harder. The real estate market is still stalled, and weakening global demand for goods will likely drag down industrial production. China's real GDP is expected to see growth of 5.2% in 2023.

GRAPH 5
Chinese PMIs have rebounded



Sources: National Bureau of Statistics of China and Desjardins Economic Studies

United States

Don't Expect 2023's Strong Start to Last

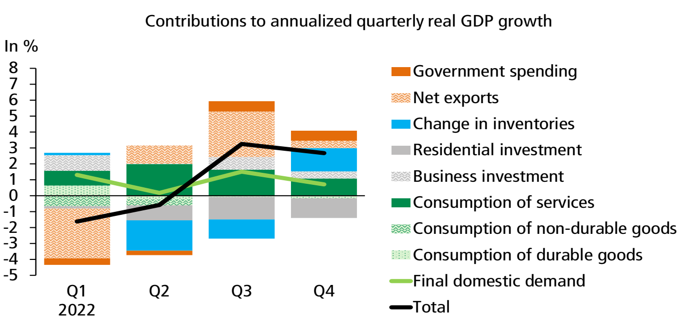
FORECASTS

The US economy as measured by real GDP grew an annualized 2.7% in the final quarter of 2022. Despite a positive start to the year on the employment and consumer spending fronts, things are set to cool for the first quarter of 2023, with annualized real GDP growth expected to clock in at just under 1.5%. Contractions are likely to follow as key rate hikes start to bite harder across the economy, probably causing some deterioration in the labour market but also bringing down inflation. We project the US economy will start picking up steam again in 2024.

After falling in the first two quarters of 2022, US real GDP had a strong second half of the year, recording annualized increases of 3.2% in Q3 and 2.7% in Q4. Key contributors to the fourth quarter gain included a sharp rise in business inventories and an improvement in net exports (graph 6). But both of these are relatively volatile factors that will be hard to count on in 2023.

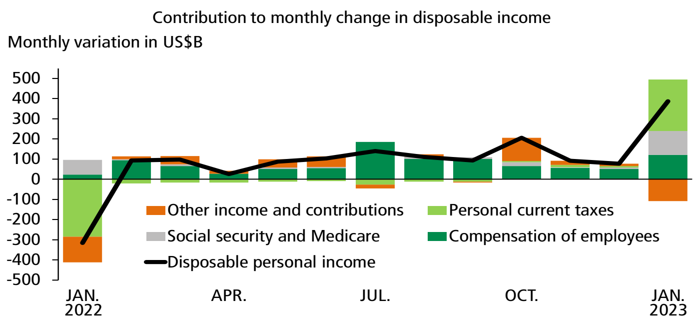
Consumer spending growth slowed at the tail end of 2022, with retail sales down in both November and December. But January saw them both rebound strongly—part of a slew of positive economic indicators for the month. One contributing factor to January's good showing was the warmer weather, especially after the big storm that hit over the holidays. Household income also got a boost from inflation adjustments to tax brackets and benefits (graph 7). That's on top of strong employment income growth, with 506,000 new jobs added in January and 311,000 in February. But despite the jobs gain, things started to look a little less sunny in February, with unemployment up and retail sales down. Still, an annualized real GDP growth rate of just under 1.5% is being forecast for the first quarter. And while it may be a drop from the previous quarter, it's better than recent forecasts.

GRAPH 6
Much of the US growth at the end of 2022 came from rising business inventories



Sources: Bureau of Economic Analysis and Desjardins Economic Studies

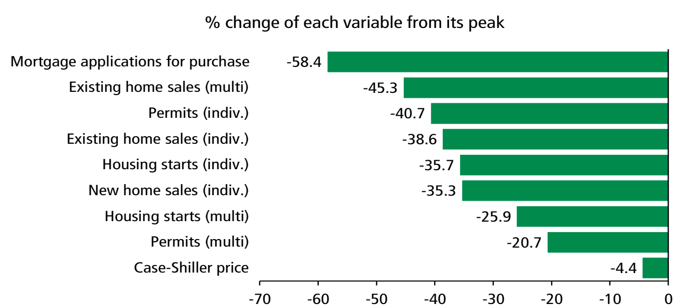
GRAPH 7
US household disposable income rose sharply in January



Sources: Bureau of Economic Analysis and Desjardins Economic Studies

The outlook should be gloomier later on, however. While it's true the US economy has successfully absorbed 450 basis points of rate hikes from the Federal Reserve so far, sooner or later the tightening will start to take a toll. The housing sector has already been feeling the impact (graph 8). Although sales of new single-family homes are starting to stabilize, investment in residential structures is expected to continue to detract from real GDP growth. The Fed's surveys on bank lending practices also show tightening credit conditions for both households and

GRAPH 8
The US housing market is still far from recent highs

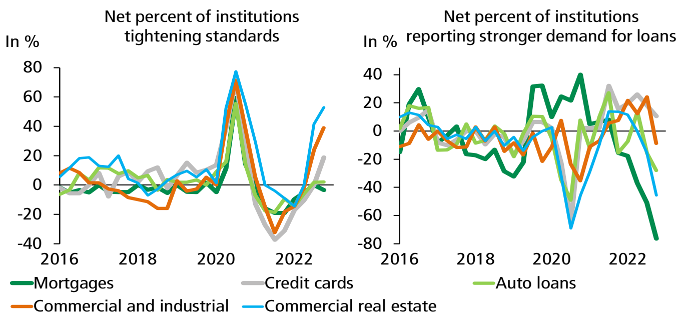


Sources: Datastream and Desjardins Economic Studies

businesses (graph 9), and borrower demand is on the decline. Furthermore, recent news out of the US banking sector, with the collapse of Silicon Valley Bank and two other institutions, is a sign of some weakness. That said, this isn't 2008, and our baseline scenario doesn't forecast a contagion effect. But we do anticipate slowing real consumer spending and business investment over the next few quarters. Business inventories are also likely to decline amid weak demand and high inventory financing costs.

The effects of rate hikes on the economy should also eventually hit the labour market. Job openings are expected to fall first, followed by net layoffs, which should help temper wage-driven inflationary pressures. Consumer price index readings should continue to come down as the economy slows, energy and commodity prices stabilize or fall, rent prices drop further and businesses run down their inventories. Over the course of the year, inflation is projected to move closer to the Fed's 2% target.

GRAPH 9
US banks have tightened credit conditions and are seeing weaker demand



Sources: Federal Reserve Board and Desjardins Economic Studies

TABLE 3
United States: Major economic indicators

QUARTERLY ANNUALIZED % CHANGE (UNLESS OTHERWISE INDICATED)	2022		2023				ANNUAL AVERAGE			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2021	2022	2023f	2024f
Real GDP (2012 US$)	**3.2**	**2.7**	**1.4**	**-0.5**	**-1.2**	**-0.1**	**5.9**	**2.1**	**0.9**	**1.4**
Personal consumption expenditures	2.3	1.4	2.8	0.2	-0.8	0.0	8.3	2.8	1.3	1.3
Residential construction	-27.1	-25.9	-10.0	-8.3	-6.2	-3.3	10.7	-10.7	-15.1	0.9
Business fixed investment	6.2	3.3	5.2	-0.4	-3.4	-1.6	6.4	3.8	2.0	2.0
Inventory change (US$B)	38.7	136.3	75.0	20.0	-30.0	-55.0	-19.4	124.9	2.5	1.2
Public expenditures	3.7	3.6	1.9	1.5	1.5	1.5	0.6	-0.6	2.1	1.2
Exports	75.0	-1.6	7.4	-1.0	-1.5	-0.5	6.1	7.2	3.6	1.1
Imports	-7.3	-4.2	5.5	-3.0	-4.5	-3.0	14.1	8.2	-1.6	0.4
Final domestic demand	1.5	0.7	2.4	0.0	-1.0	-0.1	6.7	1.7	0.8	1.4
Other indicators										
Nominal GDP	7.7	6.7	5.5	1.6	1.6	2.0	10.7	9.2	4.7	3.7
Real disposable personal income	3.2	4.8	3.4	1.9	-2.8	-2.6	1.9	-6.1	1.8	0.3
Employment[1]	3.4	2.5	2.7	1.0	-0.8	-1.2	2.9	4.3	1.8	-0.1
Unemployment rate (%)	3.6	3.6	3.6	3.8	4.3	4.8	5.4	3.7	4.1	5.1
Housing starts[2] (thousands of units)	1,450	1,405	1,308	1,260	1,225	1,212	1,605	1,556	1,251	1,302
Corporate profits*[3]	5.5	5.0	4.0	-1.5	-2.0	-2.5	22.6	7.2	-0.6	2.7
Personal saving rate (%)	3.2	3.9	4.3	4.7	4.2	3.6	11.9	3.7	3.7	3.4
Total inflation rate*	8.3	7.1	5.8	4.0	3.2	2.6	4.7	8.0	3.9	2.5
Core inflation rate*[4]	6.3	6.0	5.5	4.9	4.0	3.3	3.6	6.1	4.4	2.4
Current account balance (US$B)	-868	-848	-854	-840	-821	-806	-846	-950	-830	-825

f: forecasts; * Annual change; [1] According to the establishment survey; [2] Annualized basis; [3] Before taxes; [4] Excluding food and energy.
Sources: Datastream and Desjardins Economic Studies

Canada

Recession Delayed but Not Avoided in Canada

FORECASTS

Canadian economic growth surprised economists by stalling in Q4 2022. But despite this weakness, we've upgraded our forecast for real GDP growth in the first half of 2023 due to an improved outlook for domestic demand to start the year. That said, our baseline forecast continues to call for a short and shallow recession in 2023, which will weigh on the labour market, wage growth and inflation. This should prompt the Bank of Canada to begin cutting interest rates by the end of 2023, spurring a rebound next year.

Economic activity in Canada stalled in the final quarter of 2022, taking many economists by surprise, including at the Bank of Canada. Inventories were the leading cause of the moribund Q4 print, offsetting the rebound in domestic demand from a contraction in the third quarter. Indeed, the change in inventories posted the largest drag on growth of any quarter since 1981. This long-awaited slowing in the pace of stockpiling was also broad-based, including reduced inventory accumulation in manufacturing, wholesale and retail goods excluding motor vehicles (graph 10).

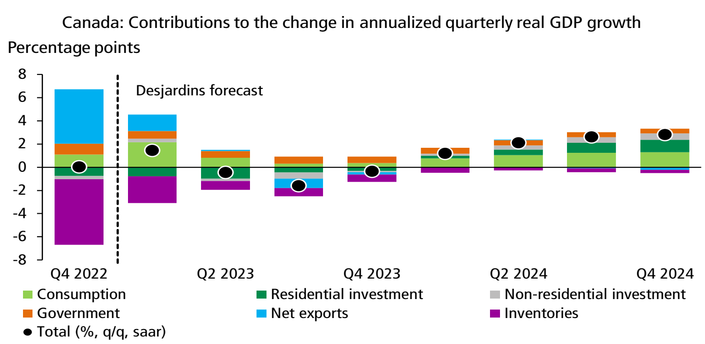
GRAPH 10
The drag from inventories on Q4 2022 was broad based

Sources: Statistics Canada and Desjardins Economic Studies

All indications so far in the first quarter of 2023 are for an advance in real GDP. Severe weather and pipeline shutdowns hit economic activity at the end of 2022, and much of that weakness is expected to have unwound in January. Auto sales have also continued at a solid pace to start the year, providing a tailwind to durable consumption for a second consecutive quarter. Business investment looks poised to post a positive print as well, undoing the weakness that characterized the end of 2022. Taken together, domestic demand is expected to accelerate to a still modest 1.3% annualized in Q1 2023. Net exports are also anticipated to make a significant contribution to growth in the quarter.

However, it's not all good news to start 2023. The downdraft from inventories is anticipated to continue in the first quarter of 2023 and beyond, albeit at a more tepid pace than in Q4 2022, as domestic demand slows (graph 11). Residential investment is also expected to be a drag in the quarter. While existing home sales and average prices have been falling at a slower pace recently, and have even increased in the occasional month, housing starts have begun to move sharply lower recently.

GRAPH 11
The anticipated recession in 2023 should be short and shallow

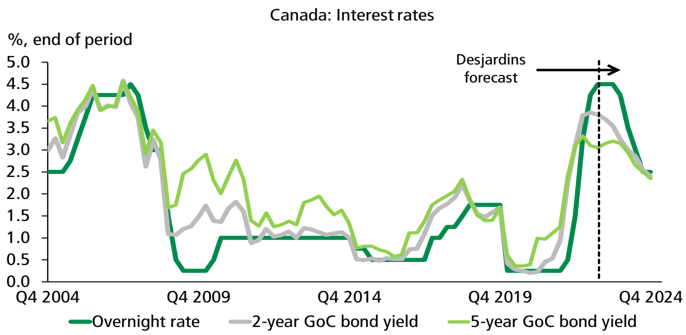


Sources: Statistics Canada and Desjardins Economic Studies

Looking beyond the near term, interest-rate sensitive parts of the economy should continue to weigh on growth as borrowing costs remain elevated. The Bank of Canada has made clear its intention to remain on hold for the foreseeable future while at the same time reducing the size of its balance sheet. In contrast, the Fed is continuing to tighten monetary policy, although it may end sooner than previously anticipated given recent financial system stress. The housing market will continue to bear the brunt of high borrowing costs, although more in new construction than transactions and renovations going forward (see our recent notes on the Canadian and Ontario housing markets). The consumer will also be challenged as rising mortgage costs, still-high inflation and a slowing labour market put the squeeze on their spending power. Governments will want to ride to the rescue, but rising deficits on a slowing economy and the insidious impact of inflation on expenditures should force them to keep some of their powder dry. Meanwhile, soft foreign demand is likely to weigh on exports and, hence, business investment at home, though still-strong oil and gas activity should continue to support non-residential capital outlays.

Declining economic growth through most of 2023 should push the unemployment rate higher, thereby keeping a lid on wage growth—a key indicator the Bank of Canada looks to when deciding the direction and level of interest rates. And since wage growth is an important driver of services inflation, a more muted advance there will complement the disinflationary outlook for energy and core goods inflation. This should ultimately prompt the Bank to cut interest rates by the start of next year, thereby laying the groundwork for falling longer-term bond yields and borrowing costs beforehand (graph 12). This should prompt a rebound in housing market and consumer activity in 2024.

GRAPH 12
We expect the Bank of Canada's next rate move to be a cut



Sources: Bank of Canada and Desjardins Economic Studies

TABLE 4
Canada: Major economic indicators

QUARTERLY ANNUALIZED % CHANGE (UNLESS OTHERWISE INDICATED)	2022		2023				ANNUAL AVERAGE			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2021	2022	2023f	2024f
Real GDP (2012 $)	**2.3**	**0.0**	**1.4**	**-0.5**	**-1.6**	**-0.4**	**5.0**	**3.4**	**0.6**	**0.9**
Final consumption expenditure [of which:]	1.1	2.1	3.4	1.7	1.1	1.1	5.4	4.0	2.3	1.6
Household consumption expenditure	*-0.4*	*2.0*	*4.1*	*1.5*	*0.5*	*0.6*	*5.1*	*4.8*	*2.3*	*1.4*
Government consumption expenditure	*4.8*	*2.4*	*1.8*	*2.3*	*2.4*	*2.1*	*6.4*	*2.0*	*2.2*	*1.9*
Gross fixed capital formation [of which:]	-6.5	-2.5	-0.8	-4.6	-3.6	-1.4	7.4	-1.5	-3.5	1.3
Residential structures	*-18.9*	*-8.8*	*-8.3*	*-10.5*	*-4.8*	*-3.5*	*14.9*	*-11.1*	*-11.2*	*1.3*
Non-residential structures	*9.4*	*10.2*	*0.8*	*-2.8*	*-4.1*	*-2.0*	*0.8*	*8.0*	*2.3*	*1.0*
Machinery and equipment	*-4.7*	*-27.6*	*4.6*	*-3.1*	*-10.8*	*-1.0*	*9.9*	*7.6*	*-6.0*	*0.4*
Intellectual property products	*5.1*	*11.6*	*6.2*	*2.0*	*2.0*	*2.0*	*4.0*	*0.6*	*5.6*	*2.1*
Government gross fixed capital formation	*-6.2*	*11.9*	*7.0*	*2.1*	*2.3*	*2.4*	*0.9*	*2.1*	*3.7*	*2.4*
Investment in inventories (2012 $B)	52.1	22.3	8.3	4.1	-0.1	-3.8	-4.1	37.8	2.1	-8.8
Exports	10.6	0.8	11.2	-1.5	-2.1	1.1	1.4	2.6	4.1	1.8
Imports	-2.0	-14.6	6.8	-1.9	0.6	1.8	7.8	7.2	0.3	2.4
Final domestic demand	-0.8	1.0	2.3	0.2	0.0	0.5	5.8	2.7	0.9	1.5
Other indicators										
Nominal GDP	-2.5	-2.7	-0.8	-0.8	-0.7	0.9	13.6	11.0	-0.3	2.6
Real disposable personal income	-1.0	7.7	8.9	-5.0	-3.6	-3.1	1.2	-0.6	1.7	1.5
Employment	-1.3	2.2	4.5	-0.9	-2.1	-0.5	5.0	4.0	1.3	0.7
Unemployment rate (%)	5.1	5.1	5.0	5.6	6.4	6.9	7.5	5.3	6.0	6.7
Housing starts[1] (thousands of units)	281	259	225	195	188	185	271	262	198	186
Corporate profits*[2]	15.8	-6.7	-14.7	-25.8	-20.0	-8.7	35.8	8.9	-17.8	6.3
Personal saving rate (%)	5.0	6.0	7.1	5.6	4.7	3.8	10.9	6.0	5.3	5.4
Total inflation rate*	7.2	6.7	5.3	3.1	2.6	2.2	3.4	6.8	3.3	2.0
Core inflation rate*[3]	5.4	5.3	4.7	3.6	3.0	2.6	2.3	5.0	3.4	2.1
Current account balance ($B)	-8.4	-10.6	-11.2	-13.0	-13.8	-13.5	-6.7	-10.8	-51.4	-52.0

f: forecasts; * Annual change; [1] Annualized basis; [2] Before taxes; [3] Excluding food and energy.
Sources: Datastream and Desjardins Economic Studies

Quebec

No Recession for Now, but the Economy Can't Hold Out Much Longer

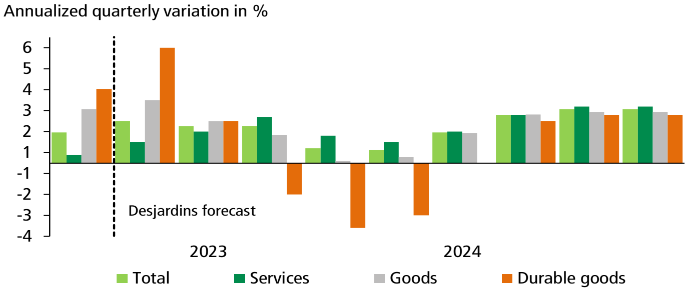
FORECASTS

Although real GDP rose in October and November after several months of weakness, the recession scenario isn't off the table just yet. According to a number of indicators, Quebec's economy is heading for a major downturn, despite the continued strength of the labour market. And, although key interest rates have stopped rising, they'll remain high in 2023, hitting debt-ridden consumers and businesses hard. The housing market slump will continue, and consumption will soon be hitting the brakes despite all the fiscal support. Patience will be a virtue until 2024, when the economy should gradually start to recover as interest rates decline. Until then, real GDP is likely to contract for a few quarters, which will inevitably wear down the labour market.

Consumers are being sorely tested by high inflation and the past year's series of rapid interest rate hikes. In 2022, however, several support measures for individuals enacted by the Quebec government ($740 million in January, $3.2 billion in the spring and $3.5 billion in early December) did ease the burden for households. Despite these measures and other federal and provincial packages announced for 2023, consumer spending is expected to slow significantly this year.

In fact, confidence in Quebec has plummeted close to a level usually seen during a recession. In 2023, households will feel the effects of the series of interest rate hikes more acutely, and the projected labour market decline will add another challenge. Durable goods purchases—which are always more sensitive to the cost of credit—are expected to decline, and growth in other types of spending should ease (graph 13). We'll likely see some improvement next year as interest rates fall.

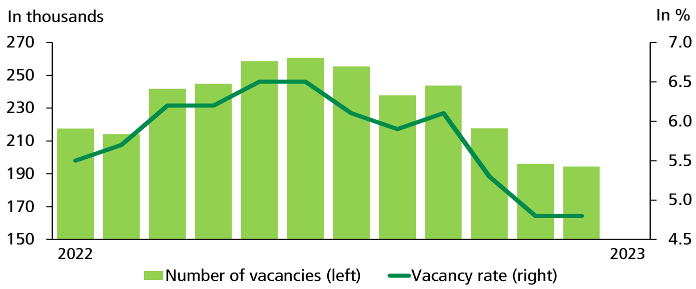
GRAPH 13
Consumer spending by Quebecers: the increase should slow and a decrease is even expected for durable goods



Sources: Institut de la statistique du Québec and Desjardins Economic Studies

The labour market has stood firm through the economy's turbulence so far, with unemployment holding close to its record low 3.9%. This positive momentum probably has a few more months left. Unlike in previous recessions, employment and the jobless rate are expected to take a little longer to adjust to the economic downturn. This time, the backdrop is quite different, as labour shortages caused the job vacancy rate to peak last year (graph 14). And although there are still plenty of jobs available, those vacancies are starting to dwindle. For a few more months, most workers who lose their jobs shouldn't have trouble getting hired elsewhere. After that, the number of job openings will decline to a certain threshold, limiting options for finding other employment. As a result, the number of people employed should fall, pushing the unemployment rate up to about 6% in the first half of 2024.

GRAPH 14
Job vacancies have started to decline in Quebec, but at around 4%, the unemployment rate remains low for the moment



Sources: Statistics Canada and Desjardins Economic Studies

In our latest *Spotlight on Housing*, we project that the residential sector will continue to deteriorate this year in Quebec. Housing starts were off 15.8% in 2022 and are projected to fall about 20% in 2023. With household borrowing capacity way down, demand for new homes is softening. And despite the rental housing shortage, some developers are postponing or cancelling projects because they're having trouble getting financing due to high interest rates. Existing home sales are expected to drop by 25% in 2023. That's about on par with last year's decline and a more than 20-year low. The average home price in Quebec

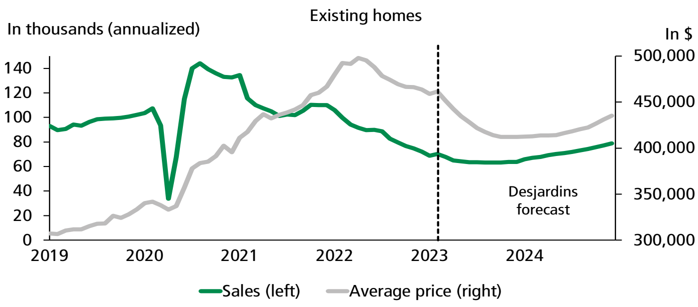
TABLE 5
Quebec: Major economic indicators

ANNUAL AVERAGE % CHANGE (UNLESS OTHERWISE INDICATED)	2020	2021	2022f	2023f	2024f
Real GDP (2012 $)	**-5.0**	**6.0**	**2.7**	**-0.2**	**0.8**
Final consumption expenditure [of which:]	-3.3	5.9	3.6	2.0	1.7
Household consumption expenditure	*-5.7*	*5.4*	*4.9*	*2.2*	*1.6*
Government consumption expenditure	*2.0*	*7.3*	*0.8*	*1.5*	*2.0*
Gross fixed capital formation [of which:]	-1.0	7.2	-2.0	-6.5	-1.4
Residential structures	*2.8*	*12.9*	*-10.4*	*-13.0*	*-0.1*
Non-residential structures	*0.6*	*-1.5*	*3.2*	*-4.8*	*-2.3*
Machinery and equipment	*-15.1*	*20.3*	*7.2*	*-4.1*	*-0.1*
Intellectual property products	*0.1*	*7.1*	*-2.9*	*-2.6*	*1.9*
Government gross fixed capital formation	*0.5*	*-3.5*	*4.5*	*0.6*	*1.9*
Investment in inventories (2012 $M)	-6,550	-431	6,214	-2,000	500
Exports	-7.8	2.9	2.3	0.2	1.5
Imports	-7.9	6.8	5.9	1.4	2.1
Final domestic demand	-2.9	6.2	2.4	0.2	1.1
Other indicators					
Nominal GDP	-1.9	11.8	9.8	2.7	3.1
Real disposable personal income	7.2	1.9	0.9	-0.3	1.1
Weekly earnings	7.9	2.9	4.1	3.9	3.1
Employment	-5.4	4.3	3.0	1.9	-0.5
Unemployment rate (%)	8.9	6.1	4.3	4.4	5.8
Personal saving rate (%)	17.4	14.6	10.5	6.6	5.3
Retail sales	0.4	14.4	8.5	3.6	3.5
Housing starts[1] (thousands of units)	54.1	67.8	57.1	44.0	49.0
Total inflation rate	0.8	3.8	6.7	3.4	2.0

f: forecasts; [1] Annualized basis.
Sources: Statistics Canada, Institut de la statistique du Québec, Canada Mortgage and Housing Corporation and Desjardins Economic Studies

is down nearly 10% from its April 2022 peak. That figure will likely hit 17% by the end of 2023. But the housing market should gradually rebound next year. Between the ongoing price correction and future mortgage rate cuts, affordability should improve. As existing home sales pick up, prices, housing starts and renovation spending should slowly recover in 2024 (graph 15).

GRAPH 15
In Quebec, the downward trend in residential real estate should continue in 2023 and a slow recovery is expected in 2024



Sources: Canadian Real Estate Association and Desjardins Economic Studies

While most businesses have weathered the many recent challenges fairly well, the coming months will be a bigger test. A growing number of companies expect rising interest costs to be an obstacle in the very near term. And SME confidence has faltered in the past few months, to the point that some caution is expected on business investments. Ultimately, the global economic slowdown will probably also mean less foreign demand and, by extension, lower exports for Quebec.

Medium-Term Issues and Forecasts

Sunny Side Up in the Medium Term

The short-order economic picture isn't very tasty, and it comes with a side of great uncertainty. Unfortunately, it's a necessary step in cleaning up the economic fundamentals, reining in inflation and keeping it low. The central banks' ability to control inflation will be a crucial component in more vigorous medium-term growth. Furthermore, growth could also hinge on an uptick in investments in lower-carbon economies. The more pronounced aging of the population in certain economies also argues for greater investment.

Low, Stable Inflation Is a Key Part of Economic Growth

We all probably know someone who's suffering from the recent interest rate hikes. It may seem hard to accept that the central banks need to put the brakes on the economy to bring inflation down. But what we must understand is that the situation would be even worse if the central banks sat on their hands.

Inflation affects everyone—unequally, perhaps, but no one is immune. The biggest impact is the loss of purchasing power, and those whose incomes are increasing the least suffer most. Obviously, this ends up affecting consumption. No need for interest rate hikes to slow the economy when inflation can do that job alone! Not to mention that interest rates would probably end up rising anyway, even if the central banks didn't intervene. Seeing inflation become entrenched, savers would demand higher interest rates to keep their savings from losing purchasing power over time. Thus, the economy could still be hurt by a possible rise in interest rates if inflation were left to its own devices .

Returning to low, stable inflation will afford us a brighter future, when people's purchasing power will be protected and interest rates will be lower than they are right now. This will drive consumption and investment.

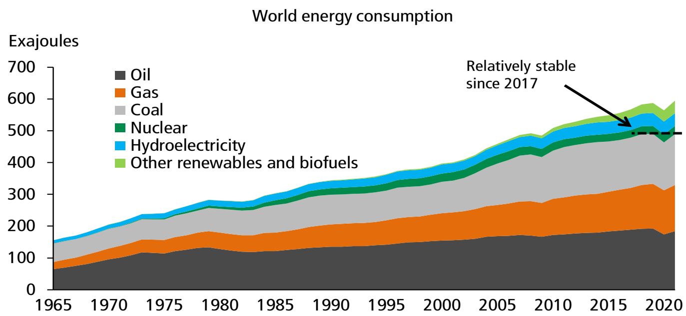
Less Carbon, More Investment

We talk a lot about the economy, inflation and jobs, but in the long term our standard of living also depends on our ability to limit pollution and the effects of climate change. Different countries have adopted ambitious goals, such as achieving carbon neutrality by 2050. Hitting these targets will require major investments, which will also have a positive impact on economic growth.

To really measure the scale of the task at hand, just look at how much fossil fuels are still being used. Despite the proliferation of renewable energy projects, fossil fuel consumption still hasn't decreased at all (graph 16). So far, new renewable energy capacity has only offset the global increase in energy consumption. Far more effort is needed, not just in terms of energy production but also in areas such as carbon capture, energy-efficient buildings and electric transportation.

It's hard to know how quickly these investments will be made, but at least it adds a layer of optimism to the mid- to long-range forecast. Rich as it is in various natural resources, Canada ought to do just fine, even if the fossil fuel sector starts to struggle. We expect prices of several commodities to remain high.

GRAPH 16
Global fossil fuel consumption has not yet started to drop



Sources: British Petroleum and Desjardins Economic Studies

Fewer Workers, More Machines

Labour shortages may also be another incentive to invest. Due to the aging population, labour shortages will still be a factor in many regions in the medium and long term. In addition, unemployment is projected to head back down to record lows, like in Quebec, for example. In order to grow, businesses will have to rethink how they operate, to compensate for fewer workers. The public sector could also find ways for greater efficiency.

TABLE 6
Major medium-term economic and financial indicators

% (UNLESS OTHERWISE INDICATED)	ANNUAL AVERAGE 2021	2022	2023f	2024f	2025f	2026f	2027f	AVERAGES 2018–2022	2023–2027f
United States									
Real GDP (% change)	5.9	2.1	0.9	1.4	2.9	2.4	2.1	2.1	2.0
Total inflation rate (% change)	4.7	8.0	3.9	2.5	2.3	2.2	2.1	3.6	2.6
Unemployment rate	5.4	3.7	4.1	5.1	4.7	4.4	4.2	4.9	4.5
S&P 500 index (% change)[1]	26.9	-19.4	-4.9	8.2	6.0	4.0	4.0	9.3	3.5
Federal funds rate	0.25	1.86	5.05	3.75	2.75	2.75	2.75	1.37	3.41
Prime rate	3.25	4.86	8.05	6.75	5.75	5.75	5.75	4.37	6.41
Treasury bills – 3-month	0.05	2.09	4.95	3.40	2.60	2.60	2.60	1.32	3.23
Federal bonds – 10-year	1.43	2.96	3.65	3.00	2.70	2.70	2.70	2.07	2.95
– 30-year	2.05	3.12	3.70	3.00	2.85	2.85	2.85	2.48	3.05
WTI oil (US$/barrel)	68	95	76	82	82	80	78	65	80
Gold (US$/ounce)	1,800	1,803	1,805	1,740	1,565	1,600	1,600	1,607	1,662
Canada									
Real GDP (% change)	5.0	3.4	0.6	0.9	2.6	2.2	1.8	1.6	1.6
Total inflation rate (% change)	3.4	6.8	3.3	2.0	2.0	2.0	2.0	3.0	2.2
Employment (% change)	5.0	4.0	1.3	0.7	2.2	1.7	1.4	1.4	1.5
Employment (thousands)	903	750	255	144	449	340	301	260	298
Unemployment rate	7.5	5.3	6.0	6.7	5.9	5.6	5.5	6.8	5.9
Housing starts (thousands of units)	217	271	198	186	222	241	235	234	216
S&P/TSX index (% change)[1]	21.7	-8.7	-2.0	8.4	6.0	5.0	5.0	4.5	4.5
Exchange rate (US$/C$)	0.80	0.77	0.72	0.78	0.78	0.77	0.78	0.77	0.77
Overnight funds	0.25	1.95	4.50	3.05	2.25	2.25	2.25	1.18	2.86
Prime rate	2.45	4.14	6.70	5.25	4.45	4.45	4.45	3.38	5.06
Mortgage rate – 1-year	2.80	4.43	6.20	5.45	4.70	4.55	4.45	3.52	5.07
– 5-year	4.79	5.64	6.50	6.40	5.95	5.90	5.75	5.18	6.10
Treasury bills – 3-month	0.11	2.18	4.30	2.80	2.25	2.20	2.20	1.15	2.75
Federal bonds – 2-year	0.48	2.90	3.70	2.80	2.30	2.30	2.30	1.49	2.68
– 5-year	0.95	2.78	3.20	2.70	2.30	2.30	2.30	1.60	2.56
– 10-year	1.36	2.77	3.00	2.70	2.40	2.40	2.40	1.75	2.58
– 30-year	1.85	2.81	3.05	2.65	2.40	2.40	2.40	2.01	2.58
Yield spreads (Canada – United States)									
Treasury bills – 3-month	0.06	0.09	-0.65	-0.60	-0.35	-0.40	-0.40	-0.17	-0.48
Federal bonds – 10-year	-0.07	-0.19	-0.65	-0.30	-0.30	-0.30	-0.30	-0.32	-0.37
– 30-year	-0.20	-0.31	-0.65	-0.35	-0.45	-0.45	-0.45	-0.48	-0.47
Quebec									
Real GDP (% change)	6.0	2.7	-0.2	0.8	2.1	1.7	1.5	1.9	1.2
Total inflation rate (% change)	3.8	6.7	3.4	2.0	2.0	2.0	2.0	3.0	2.2
Employment (% change)	4.3	3.0	1.9	-0.5	2.0	1.6	1.1	1.1	1.2
Employment (thousands)	177	130	80	-25	90	75	50	49	54
Unemployment rate	6.1	4.3	4.4	5.8	5.0	4.3	3.7	6.0	4.7
Retail sales (% change)	14.4	8.5	3.6	3.5	5.5	5.2	5.0	5.7	4.6
Housing starts (thousands of units)	68	57	44	49	51	52	53	55	50

f: forecasts; WTI: West Texas Intermediate; [1] Changes are based on end-of-period data.
Sources: Datastream, Statistics Canada, Institut de la statistique du Québec, Ontario Ministry of Finance, Canada Mortgage and Housing Corporation and Desjardins Economic Studies