ECONOMIC & FINANCIAL OUTLOOK

Conditions Are Becoming Increasingly Favorable for an Upcoming Cut in Policy Rates

By Jimmy Jean, Vice-President, Chief Economist and Strategist

The global economic rebalancing remains difficult, as indicated by the soft end of the year 2023 that was experienced in Germany, France, the UK and Japan. After an encouraging cooldown last year, the inflation outlook is now complicated by shipping disruptions in the Red Sea and the Panama Canal that could re-ignite inflationary pressures in the goods-producing segment. Early surprises in goods inflation and producer price indexes in a few regions suggest that the disruptions could counterbalance the deflationary impact of China's economic slowdown on its exports. This had been a contributing factor to the disinflation trend globally.

It may complicate the calculus somewhat for some central banks. In the United States, Fed Chair Jerome Powell had opened the door to rate cuts back in December. That early signal was premature in retrospect. US growth has been remarkably resilient and inflation has shown unpleasant surprises lately. US economic strength is nonetheless being tested by a cooling job market, evidenced by downward revisions to payrolls numbers and a creeping unemployment rate. Consumer spending also began 2024 on a softer footing, although partly because of weather effects. On net, signals remain mixed and the Fed will want to see more consistent signs of disinflation before cutting rates, though we continue to believe that those signals will have sufficiently accumulated by June.

North of the border, the outlook presents its own set of challenges and contradictions. The headline Canadian GDP print was decent for the fourth quarter of 2023, but a closer examination revealed underlying weaknesses, notably in real GDP per capita and business investment. The Canadian economy struggles against a high household debt service ratio, rising consumer delinquency rates and surging business insolvencies. The saving grace for Canada's economy has been its strong population growth, which has helped normalize job vacancies. However, the labour market is now struggling to keep up, leading to a peculiar situation where consistent employment gains aren't preventing the job market from slackening. Importantly, signs indicate that the momentum in wage growth is beginning to soften, a crucial factor for the Bank of Canada as it considers the timing for rate cuts.

Meanwhile, the steamroller of mortgage renewals carries on. This year will be relatively forgiving, as the bulk of renewals in 2024 will involve mortgages initiated in 2019, mostly at fixed rates and at the peak of the last rate cycle. In contrast, the 2025 and 2026 cohorts, with a higher proportion of fixed-payment variable-rate mortgages, are likely to face significant lump-sum payments upon renewal. Canadians are preparing for this inevitability, as evidenced by a higher savings rate than in the United States. Combined with the higher mortgage payments, it's no surprise that consumer spending per capita has contracted for three straight quarters—a trend that should be sustained

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into 2024. Moreover, more financially squeezed households are struggling to keep up with auto loan and credit card payments. Outstanding balances on credit cards were up a whopping 12.7% as of December. Should these households reach their short-term borrowing limits, this could lead to further reductions in consumer spending.

So in essence, Canada's historically strong demographic growth has prevented it from suffering the same fate countries in Europe experienced late last year. But to paraphrase Robert Solow, one can see the mild recession everywhere but in the GDP and employment statistics. For the Bank of Canada, this means whatever few kilometers remain to be traveled on inflation, it doesn't need to speed through them. We think that it will come to this realization by June.

RISKS INHERENT IN OUR SCENARIOS

Inflation has come down, though it remains above target in most countries. The odds of additional interest rate hikes have dropped significantly, but interest rate cuts could be delayed if progress on inflation stalls. And other inflationary shocks aren't out of the question, especially given the impact of the shipping disruptions earlier this year. There's also a great deal of uncertainty surrounding the lagged effect of higher interest rates on economic growth. Economic activity materially slowed in Canada and other developed economies in 2023, but not in the United States. We could see sustained headwinds in the coming quarters. As mortgages continue to be renewed at higher rates, many Canadian borrowers could feel the squeeze. Higher unemployment could also lead to more acute challenges for the housing market. The US presidential election in November could be an inflection point that adds even more uncertainty. Fiscal deterioration in the United States and elsewhere could prompt credit ratings downgrades and possibly push longer-term interest rates higher. Worsening geopolitical tensions could also spell instability for the global economy, financial markets and commodity prices, particularly as the Israeli–Palestinian conflict escalates, or if the war in Ukraine intensifies again. From a currency perspective, if the global economy falls off a cliff, many investors may park their assets in US dollars, sending the greenback soaring.

Table 1
Global GDP Growth (Adjusted for PPP) and Inflation Rates

	Weight*	Real GDP Growth			Inflation Rate		
%		2023	2024f	2025f	2023	2024f	2025f
Advanced Economies	**38.7**	**1.6**	**1.3**	**1.7**	**4.6**	**2.6**	**2.2**
United States	15.7	2.5	2.1	1.8	4.1	3.1	2.3
Canada	1.4	1.1	0.9	2.0	3.9	2.3	2.4
Quebec	*0.3*	*0.1*	*0.5*	*1.4*	*4.5*	*2.4*	*2.2*
Japan	3.6	1.9	0.4	1.0	3.3	2.3	1.6
United Kingdom	2.3	0.1	0.2	1.5	7.4	2.6	2.2
Eurozone	11.9	0.5	0.6	1.6	5.5	2.3	2.1
Germany	*3.3*	*-0.1*	*0.3*	*1.5*	*6.0*	*2.5*	*2.2*
France	*2.3*	*0.9*	*0.8*	*1.6*	*4.9*	*2.4*	*2.0*
Italy	*1.9*	*1.0*	*0.6*	*1.4*	*5.7*	*1.9*	*2.0*
Other countries	4.2	1.3	1.4	2.2	4.7	2.7	2.2
Australia	*1.0*	*2.1*	*1.4*	*2.3*	*5.6*	*3.3*	*2.7*
Emerging and Developing Economies	**61.3**	**4.1**	**3.8**	**3.9**	**8.7**	**6.9**	**4.6**
North Asia	26.9	5.7	5.1	4.8	2.9	2.3	2.6
China	*18.5*	*5.2*	*4.8*	*4.1*	*0.2*	*0.6*	*1.6*
India	*7.2*	*7.7*	*6.3*	*6.6*	*5.7*	*4.7*	*4.6*
South Asia	5.2	4.1	4.2	4.4	3.5	2.6	2.6
Latin America	5.7	2.3	1.9	2.4	5.2	3.9	3.6
Mexico	*1.7*	*3.2*	*2.3*	*2.3*	*5.6*	*3.9*	*3.7*
Brazil	*2.3*	*2.9*	*1.7*	*2.3*	*4.2*	*3.9*	*3.9*
Eastern Europe	8.2	4.3	2.8	2.7	19.5	16.4	9.0
Russia	*3.2*	*3.6*	*3.0*	*1.3*	*5.9*	*5.1*	*4.7*
Other countries	15.3	2.2	2.7	3.4	19.9	15.8	9.7
South Africa	*0.6*	*0.7*	*1.2*	*1.9*	*6.1*	*5.0*	*4.6*
World	**100.0**	**3.2**	**2.9**	**3.1**	**7.1**	**5.3**	**3.8**

f: forecast; PPP: Purchasing Power Parities, exchange rate that equates the costs of a broad basket of goods and services across countries; * 2022.
World Bank, Consensus Forecasts and Desjardins Economic Studies

FINANCIAL FORECASTS

The major central banks are maintaining a cautious approach to inflation but are generally becoming more dovish about the future path of interest rates. Inflation doesn't have to return to target before monetary easing begins. Any progress on inflation will be enough to increase real interest rates, which will make key rate cuts warranted to prevent them from becoming too restrictive. We expect five 25 basis-point cuts to the Canadian overnight rate and four to the US rate this year. Further easing is likely to follow in 2025, but we don't think rates will return to their ultra-low pre-pandemic levels.

The stock markets' recent surge is seemingly incompatible with our outlook for an economic slowdown. We're forecasting more modest gains for the rest of 2024. Further price increases from oil and several other commodities seem unlikely over the coming months, but we may quickly see oil and commodity prices start to spike again once investors think global economic growth is firmly back on a positive path. Lower interest rates in Canada will probably curb the potential for a rally by the Canadian dollar, which may struggle to get back above US$0.75.

Table 2

Summary of Financial Forecasts

End of period in %	2023		2024				2025			
(unless otherwise indicated)	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key Interest Rate										
United States	5.50	5.50	5.50	5.25	5.00	4.50	4.25	4.00	3.50	3.25
Canada	5.00	5.00	5.00	4.75	4.25	3.75	3.25	2.75	2.50	2.25
Eurozone	4.50	4.50	4.50	4.25	3.75	3.25	3.00	2.75	2.50	2.25
United Kingdom	5.25	5.25	5.25	5.00	4.75	4.25	3.75	3.50	3.25	3.00
Federal Bonds										
United States										
2-year	5.14	4.33	4.55	4.20	3.95	3.65	3.35	3.15	3.05	3.00
5-year	4.64	3.86	4.15	3.90	3.75	3.60	3.45	3.25	3.15	3.10
10-year	4.57	3.87	4.20	3.95	3.80	3.70	3.55	3.40	3.30	3.30
30-year	4.70	4.02	4.35	4.15	3.95	3.75	3.60	3.45	3.35	3.35
Canada										
2-year	4.87	3.88	3.95	3.60	3.35	3.00	2.65	2.35	2.30	2.30
5-year	4.25	3.17	3.45	3.25	3.05	2.80	2.70	2.55	2.50	2.50
10-year	4.03	3.10	3.35	3.25	3.10	3.00	2.85	2.70	2.65	2.65
30-year	3.81	3.02	3.30	3.15	3.05	2.95	2.80	2.70	2.70	2.75
Currency Market										
Canadian dollar (USD/CAD)	1.36	1.32	1.36	1.35	1.33	1.34	1.35	1.35	1.34	1.33
Canadian dollar (CAD/USD)	0.74	0.75	0.74	0.74	0.75	0.75	0.74	0.74	0.75	0.75
Euro (EUR/USD)	1.06	1.10	1.08	1.08	1.10	1.11	1.12	1.12	1.13	1.13
British pound (GBP/USD)	1.22	1.27	1.27	1.28	1.30	1.30	1.31	1.32	1.34	1.35
Yen (USD/JPY)	149	141	150	144	140	136	133	130	128	127
Stock Markets (Level and Growth)*										
United States – S&P 500	4,770		Target: 5,000 (+4.8%)				Target: 5,180 (+3.6%)			
Canada – S&P/TSX	20,958		Target: 21,800 (+4.0%)				Target: 23,220 (+6.5%)			
Commodities (Annual Average)										
WTI oil (US$/barrel)	78 (72*)		82 (85*)				83 (81*)			
Gold (US$/ounce)	1,940 (2,030*)		1,900 (1,815*)				1,800 (1,800*)			

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

Overseas

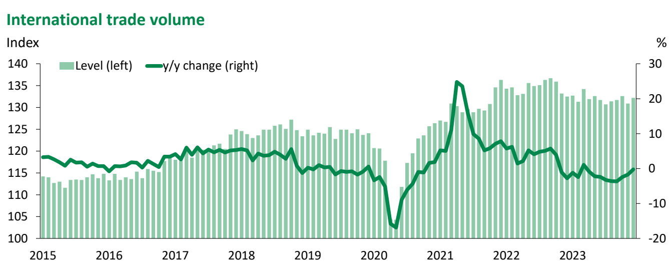
Major Economies Will Continue to See Flat Growth

FORECASTS

Most indicators suggest that the fourth-quarter declines in real GDP in Europe and the UK are unlikely to get worse. We think these economies will stagnate, with nearly flat quarterly prints in the first half of 2024. This should help keep inflation on a downward path and enable the European Central Bank and Bank of England to consider cutting rates around the end of the second quarter. In China, early-year indicators have shown some improvement, but the situation remains precarious. Global real GDP growth is expected to come in at 3.2% in 2023, 2.9% in 2024 and 3.1% in 2025.

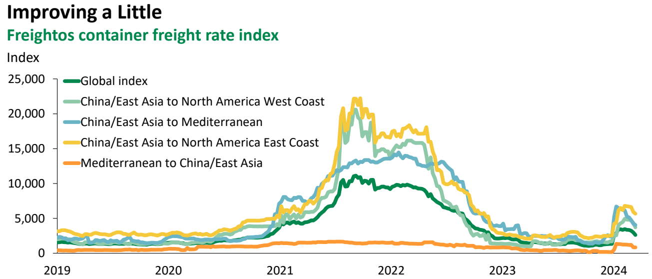
The global economy slowed sharply at the end of last year. Of the G7 countries, only the United States and Italy avoided flat or negative real GDP in the third or fourth quarter of 2023. This broad-based weakness is also apparent in global trade volumes, which were lower at the end of 2023 than they were a year earlier (graph 1). Attacks on vessels in the Red Sea and the drought-induced water levels in the Panama Canal also impacted trade early this year, disrupting container shipping, pushing up freight costs and causing delays. The situation has since improved a little (graph 2), but the impacts appear to have already hampered progress in the fight against inflation.

Graph 1
Global Trade Has Slowed in the Past Year



CPB Netherlands Bureau for Economic Policy Analysis and Desjardins Economic Studies

Graph 2
Shipping Costs Soared at the Beginning of the Year, but the Situation Is Improving a Little

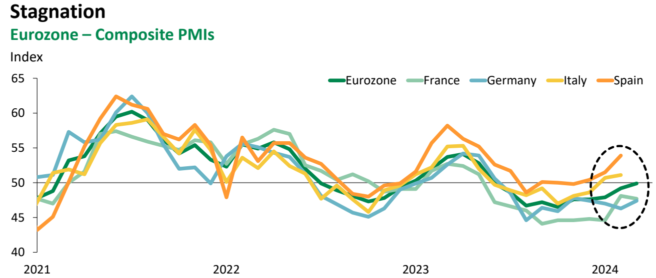


Freightos, Datastream and Desjardins Economic Studies

West Texas Intermediate (WTI) oil prices have also risen in recent weeks and are now at close to US$80 per barrel, partly because the Organization of the Petroleum Exporting Countries and its partners (OPEC+) extended its voluntary production cuts until the second quarter. The price of WTI is expected to gradually rise to around US$85 per barrel by the end of 2024.

The eurozone economy already appears to be in a technical recession, with real GDP contracting in the third and fourth quarters of 2023. However, the declines were very slight, and minor revisions would be enough to shift the situation. Final domestic demand also remained positive over the same period; the main detractors from real GDP were inventories and net exports. For now, the eurozone economic situation would be better described as stagnation than a traditional recession. Nothing is indicating that things will change dramatically early in 2024. PMIs have improved a little but are still generally under 50 (graph 3). Eurozone industrial production plummeted in January, while real retail sales remain below where they were last fall, despite a small monthly increase. Inflation continues to slow, but the latest figures are less encouraging than a few months ago. That said, we can still expect the European Central Bank to start cutting rates in June. Looser monetary policy and continued disinflation should help boost growth in the second half of 2024.

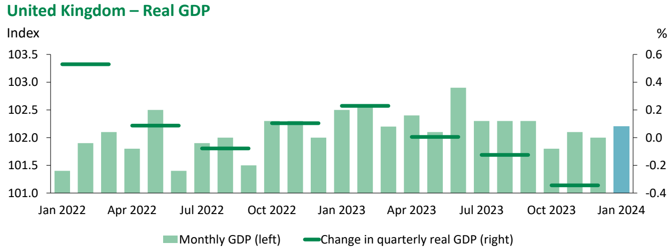
Graph 3
Eurozone PMIs Have Improved Slightly but Generally Still Indicate Stagnation



S&P Global, Datastream and Desjardins Economic Studies

We're seeing a similar situation in the United Kingdom, where real GDP dipped in the third and fourth quarters of 2023. Unlike in the eurozone, UK real consumer spending also declined in the second half of last year. However, monthly real GDP edged up 0.2% in January on the back of a rebound in retail sales, which is an encouraging sign for the beginning of 2024 (graph 4). UK inflation should also continue falling, although progress has been slower in recent months. The Bank of England is also expected to start cutting rates in June.

Graph 4
The UK's January Real GDP Growth Is a Positive Step, but the Economy Remains Fragile

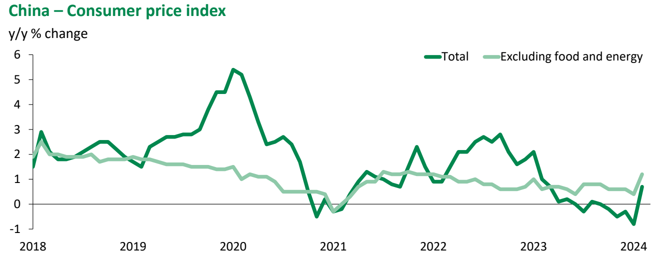


Office for National Statistics and Desjardins Economic Studies

In Japan, the revised real GDP print for the fourth quarter of 2023 meant that the country avoided a technical recession. That said, non-annualized GDP growth of 0.1% hardly offsets the 0.8% decline we saw in the third quarter. We expect Japan's economy to grow modestly for the rest of the year and this should limit the potential for further interest rate hikes by the Bank of Japan

Meanwhile in China, the government unveiled its economic ambitions for 2024 at its "Two Sessions" meetings in early March. It lowered its annual real GDP growth target to 5.0% from 5.2% last year. However, China isn't certain to achieve this target amid ongoing turmoil in the country's property market and several infrastructure projects being put on the backburner. That said, inflation turned positive again in February after four consecutive months of decline (graph 5). While one month of price growth isn't enough to say that China has solved its deflation issue, it's a step in the right direction.

Graph 5
Chinese Inflation Has Suddenly Turned Positive Again



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United States

The Economy Remains Resilient, but Could Encounter Headwinds

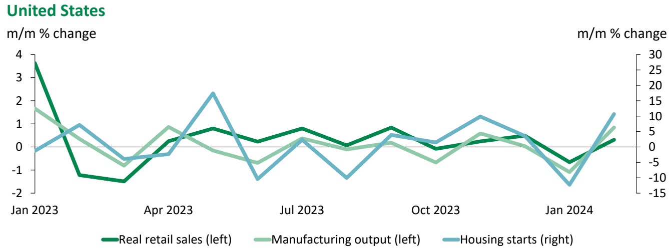
FORECASTS

US real GDP posted solid annualized growth of 3.2% in the fourth quarter of 2023. Some indicators were less convincing at the beginning of 2024, but the slowdown remains moderate and we're expecting growth of around 2% in the first quarter of this year. We're anticipating slower growth in the second quarter, but we don't expect a sharp decline in economic activity or significant job losses. All in all, we're projecting annual real GDP growth of 2.1% in 2024 and 1.8% in 2025. Inflation should continue to slow, but both service prices and wages are struggling to fall in line with the Fed's 2% target.

After strong annualized real GDP growth of 4.9% in the third quarter of 2023, we saw another decent advance of 3.2% in the fourth quarter. Aside from the post-pandemic bounce, we haven't seen two consecutive quarters of such solid gains since 2014. These increases in real GDP occurred alongside a strong labour market, with nearly 1.3 million jobs created in the second half of 2023. Core inflation slowed from an annual rate of 4.8% in June 2023 to 3.9% in December. Strong productivity levels meant that production and employment prints diverged from inflation. Productivity climbed 3.9% at an annualized rate in the second half of 2023, the biggest six-month gain since 2009.

Did this strong performance continue in early 2024? Based on the indicators published so far this year, the situation is mixed. The labour market still appears robust, with the establishment survey showing a total of 504,000 jobs created in January and February, much higher than the consensus forecast. However, other indicators struggled in January, probably due to much worse weather than in December. Consumer spending, manufacturing output and construction were down at the beginning of the year. Fortunately, these weaknesses seem to have been short-lived, and February's modest rebounds in retail sales and industrial production are encouraging (graph 6). As such, we expect annualized first-quarter real GDP growth to come in at close to 2%.

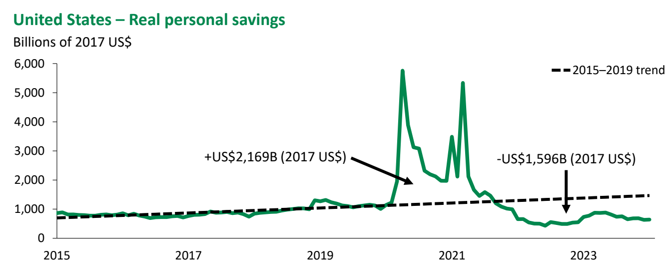
Graph 6
After January's Cold-Weather Challenges, Things Started Improving in February



U.S Census Bureau, Bureau of Labor Statistics, Federal Reserve Board and Desjardins Economic Studies

But can we assume that the US economy will remain immune to any weaknesses? Our baseline scenario is another slowdown in the second quarter. Gasoline prices fell considerably in the last few months of 2023, but are now rising again and impacting consumer confidence. Some labour market indicators are also less positive than jobs reports would suggest, and the unemployment rate has edged up in recent months. Layoffs are increasing too. Household savings accumulated since the pandemic are gradually being used up (graph 7) and interest rates are still very high. Existing home sales remain weak and consumer credit growth has slowed sharply for term loans. These factors could drag second-quarter real GDP growth down below 1%, a level we've been seeing in other major advanced economies for some time.

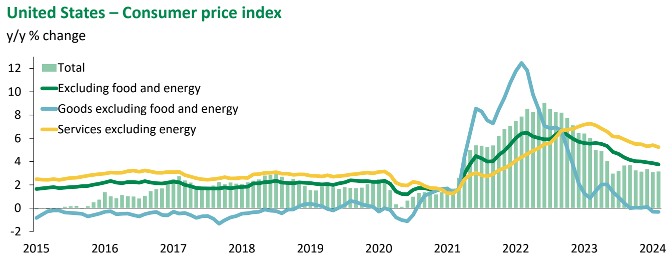
Graph 7
Americans' Excess Savings Are Dwindling



Bureau of Economic Analysis and Desjardins Economic Studies

Inflation has fallen significantly since peaking in the summer of 2022, but the final stretch is proving the most challenging. Headline inflation is essentially at the same level as it was in summer 2023. Core inflation improved in the second half of last year, but progress is much slower now. January and February's consecutive 0.4% monthly increases in the core consumer price index exceeded forecasts and are above what is required for inflation to quickly return to the Fed's 2% target. Goods inflation has slowed considerably, but service inflation remains sticky

Graph 8
Service Inflation Is Struggling to Slow Sufficiently



Bureau of Labor Statistics and Desjardins Economic Studies

(graph 8). However, lower real GDP growth should eventually help bring inflation to heel.

Table 3
United States: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2023 Q3	2023 Q4	2024 Q1f	2024 Q2f	2024 Q3f	2024 Q4f	Annual Average 2022	Annual Average 2023	Annual Average 2024f	Annual Average 2025f
Real GDP (2017 US$)	**4.9**	**3.2**	**1.8**	**0.6**	**1.1**	**2.0**	**1.9**	**2.5**	**2.1**	**1.8**
Personal consumption expenditures	3.1	3.0	1.9	0.7	1.4	1.8	2.5	2.2	1.9	1.8
Residential construction	6.7	2.9	5.8	2.1	2.3	4.2	-9.0	-10.6	3.6	2.4
Business fixed investment	1.4	2.4	0.7	0.6	1.3	1.7	5.2	4.4	1.6	1.7
Inventory change (2017 US$B)	77.8	66.3	55.0	35.0	20.0	20.0	128.1	46.5	32.5	25.0
Public expenditures	5.8	4.2	2.5	2.3	1.9	2.0	-0.9	4.0	3.1	2.0
Exports	5.4	6.4	5.0	0.5	0.0	1.5	7.0	2.7	2.6	1.3
Imports	4.2	2.7	3.5	1.0	1.0	1.0	8.6	-1.6	1.8	1.2
Final domestic demand	3.5	3.1	2.0	1.0	1.5	1.9	1.7	2.2	2.1	1.8
Other Indicators										
Nominal GDP	8.3	4.9	5.2	2.9	3.7	3.7	9.1	6.3	4.7	2.6
Real disposable personal income	0.5	2.2	1.9	0.3	1.0	2.3	-6.0	4.2	1.5	1.9
Employment[1]	1.7	1.6	1.8	0.9	0.8	0.8	4.3	2.3	1.4	0.8
Unemployment rate (%)	3.7	3.7	3.8	4.2	4.3	4.2	3.6	3.6	4.1	4.1
Housing starts[2] (thousands of units)	1,371	1,485	1,455	1,457	1,485	1,510	1,551	1,423	1,477	1,553
Corporate profits*[3]	-0.6	1.1	3.0	2.5	0.2	1.1	9.8	0.5	1.7	3.5
Personal savings rate (%)	4.3	3.9	4.1	4.0	3.9	4.1	3.3	3.6	4.0	4.2
Total inflation rate*	3.6	3.2	3.2	3.1	3.1	3.0	8.0	4.1	3.1	2.3
Core inflation rate*[4]	4.4	4.0	3.8	3.5	3.3	2.9	6.2	4.8	3.4	2.3
Current account balance (US$B)	-801	-788	-784	-789	-797	-795	-972	-828	-791	-798

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

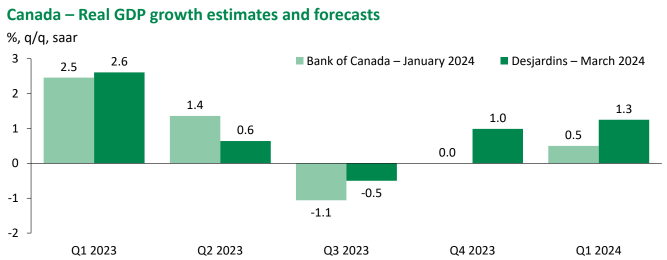
Canada

The Outlook Has Improved, but The Story is Largely the Same

FORECASTS
The Canadian economy has continued to surprise, with Q4 2023 real GDP beating expectations and data so far in Q1 2024 teeing up a strong start to the year. This alone would have forced us to revise up our outlook for 2024. But add to this surging population gains, and headline real GDP and consumption growth should be higher than previously forecast this year even as they continue to deteriorate on a per capita basis. To turn this erosion of living standards around, productivity needs to pick up going forward. However, there is little on the horizon to suggest this will be the case.

As the end of the first quarter of 2024 comes into view, much has changed in just the few short weeks since we published our last forecast of the Canadian economy. The release of Q4 2023 real GDP is the largest driver of changes to our outlook, as better-than-expected economic activity to end last year teed up a solid handoff to 2024. And not only did Q4 economic activity beat forecasters' projections, including the Bank of Canada's, but data so far in Q1 2024 are off to a stronger start as well (graph 9). We would need to revise up our outlook for 2024 based on these data alone.

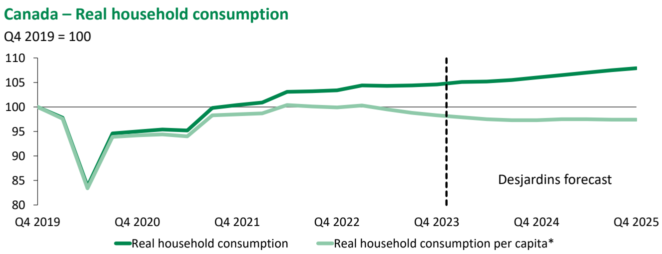
Graph 9
Real GDP Growth Is Coming in Faster than Previously Projected



Bank of Canada, Statistics Canada and Desjardins Economic Studies

But it's not just a story of recent data. It's what's driving this upside surprise. Population growth continues to outpace expectations. That has helped to keep headline consumption advancing even as it falls on a per capita basis (graph 10). And this doesn't look set to change any time soon. For instance, Canada's working-age population—people ages 15 and over—rose by 3.2% on a year-over-year basis in the first two months of 2024. At the same time, employment growth decelerated in these same months to 1.8% from 2.3% in the final quarter of 2023, pointing to an unemployment rate that will gradually move higher, holding back the consumption of individual households. This will be further exacerbated by the ever-increasing headwinds from mortgage renewals, which are set to accelerate in 2025 and 2026. The Bank of Canada wants to avoid creating a crisis by keeping borrowing costs too high for too long, and we think it will likely begin cutting rates in June. However, even as interest rates start coming down this year, households that took on or renewed mortgages during the pandemic are going to be subject to much higher borrowing costs than before. And as we've learned from past recessions, Canadians will do whatever it takes to stay in their homes, choosing to cut consumption and increase savings instead.

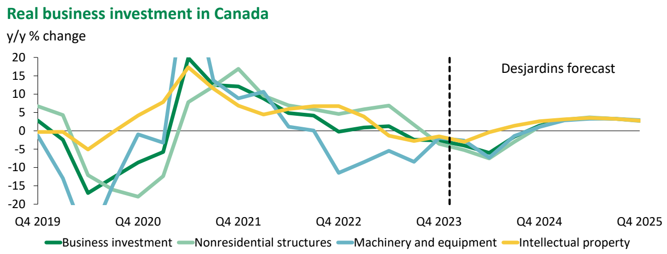
Graph 10
Real Consumption Per Capita is Down and Unlikely to Rebound Soon



* Population ages 15 and over from the Labour Force Survey.
Statistics Canada and Desjardins Economic Studies

To get out of this predicament, productivity growth needs to pick up in Canada. It edged modestly higher in Q4 2023 after falling for five consecutive quarters, but the downward trend is clear. And with business investment having contracted sharply at the end of 2023 and no clear catalyst for it to pick up in the first half of 2024, it's tough to see what will propel productivity higher in the coming quarters. If you look stateside, solid business investment over the past decade has been driven by investment in information processing equipment, software, and research and development. In Canada, not so much (graph 11 on page 10). Real investment here is lower than it was a decade ago. And even when the energy sector is excluded, average annual growth in real business investment is barely better than one third of that in the United States since 2014. As such, we don't see much hope for productivity growth to dramatically improve over the medium term, with the ongoing increase in population likely to

Graph 11
Business Investment Should Slow Further into Early 2024



Statistics Canada and Desjardins Economic Studies

persist as the primary driver of aggregate economic activity. This could mean living standards, as measured by real GDP per capita, don't pick up much in the coming years either.

Table 4
Canada: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2023		2024				Annual Average			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2022	2023	2024f	2025f
Real GDP (2017 $)	**-0.5**	**1.0**	**1.3**	**0.9**	**1.4**	**1.9**	**3.8**	**1.1**	**0.9**	**2.0**
Final consumption expenditure [of which:]	2.3	0.2	2.4	1.1	1.4	1.7	4.5	1.7	1.4	1.7
Household consumption expenditure	*0.5*	*1.0*	*1.8*	*0.4*	*1.1*	*1.7*	*5.1*	*1.7*	*1.0*	*1.7*
Government consumption expenditure	*6.7*	*-1.9*	*3.9*	*3.0*	*2.3*	*2.0*	*3.2*	*1.5*	*2.4*	*2.0*
Gross fixed capital formation [of which:]	-4.1	-3.8	-1.0	0.6	2.7	3.6	-2.4	-3.2	-0.7	2.9
Residential structures	*8.7*	*-1.7*	*-0.7*	*-0.6*	*2.2*	*3.5*	*-12.1*	*-10.2*	*0.7*	*3.0*
Non-residential structures	*-14.3*	*-11.6*	*-3.7*	*0.2*	*3.7*	*4.4*	*6.7*	*2.6*	*-3.8*	*3.2*
Machinery and equipment	*-19.8*	*-5.7*	*-3.7*	*1.4*	*2.6*	*4.1*	*-0.3*	*-6.2*	*-2.6*	*3.1*
Intellectual property products	*-3.7*	*-0.6*	*1.6*	*1.3*	*3.3*	*4.3*	*6.0*	*-0.5*	*0.1*	*3.2*
Government gross fixed capital formation	*2.4*	*3.2*	*3.2*	*2.8*	*2.7*	*2.5*	*4.2*	*5.5*	*2.4*	*2.4*
Investment in inventories (2017 $B)	33.3	32.0	31.9	31.9	30.3	28.8	55.3	33.9	30.7	29.4
Exports	-1.3	5.6	-3.0	-0.1	1.6	1.9	3.2	5.7	0.7	2.5
Imports	1.1	-1.7	-2.0	-0.1	1.4	1.6	7.6	1.0	-0.1	2.3
Final domestic demand	0.8	-0.7	1.6	1.0	1.7	2.2	2.8	0.5	0.9	2.0
Other Indicators										
Nominal GDP	6.5	6.6	1.1	2.4	3.5	3.4	11.8	2.7	3.6	3.2
Real disposable personal income	5.8	1.4	1.1	3.0	4.2	-1.8	-0.1	1.8	2.3	2.7
Employment	1.7	1.9	1.8	-0.4	1.1	1.7	4.0	2.4	1.3	2.1
Unemployment rate (%)	5.5	5.8	5.8	6.3	6.5	6.5	5.3	5.4	6.3	6.2
Housing starts[1] (thousands of units)	256	244	225	212	218	220	262	242	219	235
Corporate profits*[2]	-21.5	-9.7	2.8	12.9	12.1	11.0	14.7	-18.1	9.6	6.6
Personal savings rate (%)	6.3	6.2	6.0	6.6	7.4	6.5	5.4	5.5	6.6	7.5
Total inflation rate*	3.7	3.2	2.9	2.3	2.0	2.0	6.8	3.9	2.3	2.4
Core inflation rate*[3]	3.4	3.4	2.9	2.6	2.4	1.9	5.0	3.9	2.4	2.1
Current account balance ($B)	-4.7	-1.6	-3.2	-3.7	-4.1	-4.7	-10.3	-17.8	-15.6	-28.3

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

Quebec

Strikes Are Clouding the Picture, but Economic Conditions Should Improve

FORECASTS

After multiple disruptions in 2023, Quebec's economy should gradually recover in 2024. First, employees in the education and healthcare sectors returned to work in January, which should help drive a rebound in real GDP in the first quarter of 2024, after three negative quarters in a row. Second, gradual cuts to key interest rates starting in June should improve economic conditions from mid-2024. We expect Quebec's real GDP to grow by 0.5% in 2024 and 1.4% in 2025, following near-zero growth of 0.1% in 2023.

The turmoil caused by the strikes in the education and healthcare sectors remains a key factor in this latest update to Quebec's economic outlook. Real GDP by industry fell 0.4% in November following a 0.3% gain in October. Education sector output declined 2.4% during the month due to the start of the labour dispute. However, these difficulties account for just under half of November's slide in real GDP. Several other sectors also lost ground, indicating widespread weakness. Higher interest rates are clearly still biting in Quebec.

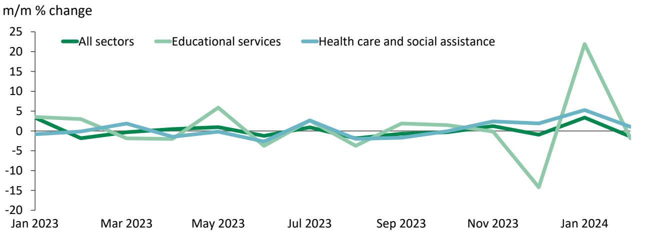
That said, our initial estimates assumed that the strikes would have a much greater negative impact than they did. This is encouraging for December, when real GDP likely fell again due to the extended labour dispute, albeit less than initially anticipated. Ultimately, we're forecasting a slight contraction in real GDP for the fourth quarter of 2023, on top of the declines in the second and third quarters. While these successive decreases mean that Quebec's economy is in a technical recession, we're not calling it a traditional recession. It's hard to talk about a true recession when domestic demand continues to grow as it did in the third quarter, and the strikes have clouded the economic picture.

With employees in the education and healthcare sectors back at work, certain activities likely rebounded in January, which should mean the province's real GDP turns positive again in the first quarter of 2024. For example, when corrected for seasonal variations, the number of hours worked in the education sector surged 21.9% between December and January (graph 12). After an undoubtedly bleak second quarter, we should begin to see an improvement in economic growth in the second half of 2024 and 2025 as the Bank of Canada starts to gradually cut interest rates in June.

However, uncertainty will remain high for several more quarters. While the housing market should eventually benefit from lower interest rates and strong demand due to population growth, forecasting remains challenging. Although rates will come down, many households will have to renew their mortgages at higher rates between now and 2026, which may push them to further reduce their discretionary spending. Retail trade data also showed a sharp year-over-year decline in certain discretionary sales, such as building material and garden equipment and supplies, furniture, home furnishings, electronics and household appliances, as well as apparel and accessories.

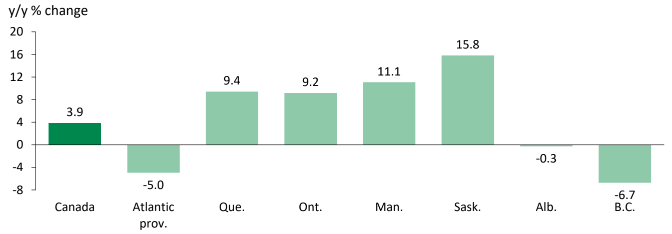
The latest outlook published by Statistics Canada is forecasting a 9.4% increase in non-residential business investment for 2024, which is higher than the national average and could boost the province's economic growth (graph 13). Healthy gains in manufacturing, healthcare, mining and wholesale trade are

Graph 12
Hours Worked in Education Plunged in December and Bounced Back in January, While the Healthcare Sector Was Flat
Quebec – Hours worked per sector*



* Seasonally adjusted.
Statistics Canada and Desjardins Economic Studies

Graph 13
Business Investment Outlook for 2024
Capital expenditures excluding public administration*



* Non-residential construction, machinery and equipment.
Statistics Canada and Desjardins Economic Studies

possible. However, with many sectors still facing headwinds, whether these intentions translate into actual investments is far from certain. Historically, business confidence remains very low, and weak domestic and foreign demand is still a major concern. In addition, the number of insolvencies is rising among Quebec businesses, particularly since the Canada Emergency Business Account (CEBA) forgiveness repayment date has now passed.

Table 5

Quebec: Major Economic Indicators

Annual average % change (unless otherwise indicated)	2021	2022	2023f	2024f	2025f
Real GDP (2017 $)	**6.7**	**2.5**	**0.1**	**0.5**	**1.4**
Final consumption expenditure [of which:]	6.0	4.1	1.8	1.6	2.0
Household consumption expenditure	*5.5*	*4.9*	*2.4*	*1.4*	*2.2*
Government consumption expenditure	*7.3*	*2.2*	*0.0*	*2.0*	*1.5*
Gross fixed capital formation [of which:]	11.1	-2.7	-7.0	0.8	3.3
Residential structures	*13.7*	*-11.7*	*-17.7*	*0.4*	*3.9*
Non-residential structures	*5.1*	*6.1*	*-0.8*	*-0.2*	*2.8*
Machinery and equipment	*22.6*	*-4.9*	*-6.2*	*0.7*	*2.3*
Intellectual property products	*12.0*	*2.3*	*2.3*	*1.5*	*2.8*
Government gross fixed capital formation	*4.5*	*7.4*	*1.0*	*2.1*	*4.0*
Investment in inventories (2017 $M)	-462	11,097	6,646	-210	-24
Exports	5.6	0.5	2.2	1.5	3.0
Imports	8.4	6.0	0.7	2.7	4.5
Final domestic demand	7.1	2.5	-0.1	1.4	2.3
Other Indicators					
Nominal GDP	11.6	8.4	3.8	2.9	3.3
Real disposable personal income	1.9	1.6	-0.7	2.8	3.0
Weekly earnings	2.9	4.1	3.6	4.6	2.7
Employment	4.3	3.0	2.4	0.7	1.9
Unemployment rate (%)	6.1	4.3	4.5	5.5	5.7
Personal savings rate (%)	14.8	12.6	11.8	12.9	13.3
Retail sales	14.4	8.5	3.6	5.4	1.7
Housing starts[1] (thousands of units)	67.8	57.1	38.3	42.6	51.3
Total inflation rate	3.8	6.7	4.5	2.4	2.2

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

Medium-Term Issues and Forecasts

Prosperous or Bleak Years Ahead?

We remain optimistic about the medium term for several reasons. Inflation is expected to continue falling and stabilize around 2%, and interest rates will come down from current levels. In Canada, rapid population growth is expected to further support demand and push economic growth towards 2%. Investment could be increased to support this demographic growth, but will likely be held back by other factors, including red tape, labour shortages and a lack of financial resources to bring projects to fruition. The global geopolitical environment will probably also remain challenging. Donald Trump's increasingly possible return to the Oval Office would exacerbate trade tensions. There are also serious doubts about the pace of the energy transition, which could be delayed due to a lack of support from governments, many of which will have to work harder to balance their budgets in the medium term.

Population Growth Should Continue to Underpin Canada's Economy

Canada experienced a rapid increase in population in 2023. Although we assume that population growth will moderate to about 1.5% per year in the medium term, it would still be higher than in the United States. This should put real GDP gains at a similar level to our southern neighbour, where higher productivity will continue to contribute more to growth. Real GDP per capita will advance much more slowly in Canada than in the United States. For now, we believe it's unlikely that productivity will increase significantly in Canada in the next few years.

Underinvestment Remains a Challenge

There's no silver bullet that can boost productivity, but investment is often identified as key. Despite strong demographic growth, capital stock is barely advancing in Canada. Ideally, the increase in capital stock should equal or exceed population growth. In a recent analysis, we estimated that investment in Canada would have to increase by more than 5% per year to return to the previous uptrend in the capital stock to population ratio, assuming annual demographic growth of 1.5%. The challenge would be even greater if the population grew by around 3% per year.

Interest Rates Aren't the Only Factor When It Comes to Investment

While future interest rate cuts should help drive investment, other factors could still hold it back. One major factor in investment decisions is the red tape involved, an area where we don't anticipate any major changes. Another issue is the lack of capacity in construction—particularly on the labour side—to support higher investments. The international environment is also likely to remain challenging. The war in Ukraine is sadly dragging on, so the deep rift between the West and pro-Russian countries will remain. Closer to home, Donald Trump's potential return to the White House could throw us a curveball. Trade tensions rose sharply during his administration. He is also signaling he would be more restrictive on immigration, which could limit potential labour force growth. However, he may favour reduced regulation in his second term, which could boost investment in the United States.

Will Energy Transition Efforts Be Delayed?

Donald Trump's re-election could also slow the energy transition in the United States, and we may see the same in Canada and elsewhere. Quebec's government recently announced a gradual reduction in electric vehicle subsidies. While other measures to fight climate change may be adopted, this illustrates the choices that governments are facing. Needs are unlimited, resources aren't. Many governments are now having to get a handle on their finances as they emerge from several years of pandemic- and inflation-impacted policy. This won't be easy, and they will have to adjust some priorities for the next few years. If they can manage public funds more effectively, they could make a meaningful contribution to improving productivity.

Table 6

Major Medium-Term Economic and Financial Indicators

% (unless otherwise indicated)	Annual Average 2022	2023	2024f	2025f	2026f	2027f	2028f	Averages 2019–2023	2024–2028f
United States									
Real GDP (% change)	1.9	2.5	2.1	1.8	2.1	2.0	2.0	2.1	2.0
Total inflation rate (% change)	8.0	4.1	3.1	2.3	2.2	2.2	2.0	4.0	2.4
Unemployment rate	3.6	3.6	4.1	4.1	3.9	3.8	3.8	4.9	3.9
S&P 500 index (% change)[1]	-19.4	24.2	4.8	3.6	4.4	4.4	4.8	15.4	4.4
Federal funds rate	1.86	5.20	5.25	3.95	3.05	3.00	3.00	2.03	3.65
Prime rate	4.86	8.20	8.25	6.95	6.05	6.00	6.00	5.03	6.65
Treasury bills – 3-month	2.09	5.28	5.00	3.70	3.00	3.00	3.00	1.98	3.54
Federal bonds – 10-year	2.96	3.96	3.95	3.45	3.30	3.20	3.20	2.28	3.42
– 30-year	3.12	4.09	4.10	3.50	3.35	3.25	3.25	2.68	3.49
WTI oil (US$/barrel)	95	78	82	83	80	80	78	67	81
Gold (US$/ounce)	1,802	1,943	1,900	1,800	1,700	1,625	1,625	1,742	1,730
Canada									
Real GDP (% change)	3.8	1.1	0.9	2.0	1.9	2.0	1.9	2.3	1.8
Total inflation rate (% change)	6.8	3.9	2.3	2.4	2.0	1.9	2.0	3.3	2.1
Employment (% change)	4.0	2.4	1.3	2.1	2.0	2.1	1.9	1.6	1.9
Employment (thousands)	750	475	257	419	417	452	418	290	393
Unemployment rate	5.3	5.4	6.3	6.2	6.0	5.8	5.7	6.7	6.0
Housing starts (thousands of units)	217	271	219	235	242	234	232	240	232
S&P/TSX index (% change)[1]	-8.7	8.1	4.0	6.5	4.0	5.3	5.6	8.5	5.1
Exchange rate (US$/C$)	0.77	0.74	0.74	0.74	0.76	0.77	0.77	0.76	0.76
Overnight funds	1.95	4.74	4.60	2.85	2.25	2.50	2.50	1.85	2.94
Prime rate	4.14	6.94	6.80	5.05	4.45	4.70	4.70	4.05	5.14
Mortgage rate – 1-year	4.43	7.14	7.05	5.30	5.00	5.00	4.95	4.25	5.46
– 5-year	5.64	6.68	6.80	6.25	6.15	6.30	6.35	5.47	6.37
Treasury bills – 3-month	2.18	4.74	4.35	2.70	2.20	2.50	2.50	1.82	2.85
Federal bonds – 2-year	2.90	4.27	3.60	2.50	2.45	2.65	2.70	1.95	2.78
– 5-year	2.78	3.57	3.20	2.60	2.60	2.90	2.95	1.89	2.85
– 10-year	2.77	3.36	3.20	2.75	2.75	3.05	3.10	1.97	2.97
– 30-year	2.81	3.28	3.15	2.75	2.80	2.95	3.00	2.19	2.93
Yield Spreads (Canada – United States)									
Treasury bills – 3-month	0.09	-0.54	-0.65	-1.00	-0.80	-0.50	-0.50	-0.15	-0.69
Federal bonds – 10-year	-0.19	-0.60	-0.75	-0.70	-0.55	-0.15	-0.10	-0.31	-0.45
– 30-year	-0.31	-0.81	-0.95	-0.75	-0.55	-0.30	-0.25	-0.49	-0.56
Quebec									
Real GDP (% change)	2.5	0.1	0.5	1.4	1.7	1.6	1.6	3.1	1.4
Total inflation rate (% change)	6.7	4.5	2.4	2.2	2.0	2.0	1.9	3.6	2.1
Employment (% change)	3.0	2.4	0.7	1.9	1.4	1.1	0.9	1.2	1.2
Employment (thousands)	130	105	32	87	65	52	42	58	55
Unemployment rate	4.3	4.5	5.5	5.7	5.2	4.6	4.2	5.8	5.0
Retail sales (% change)	8.5	3.6	5.4	1.7	4.2	4.0	4.0	5.6	3.9
Housing starts (thousands of units)	57	38	43	51	51	53	57	53	51

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