

# En perspective

## Report of Economic Climate

### 2005: Deceleration in the United States and stability in Canada

**Gilles Soucy**  
Chief Economist

Uncle Sam's real GDP growth attained 4.4% for 2004. Despite the fact that our neighbour has a tailwind, a decrease in speed is to be expected in 2005. The advance of real GDP is estimated at 3.5% this year, and it will be very similar for the 2006 horizon.

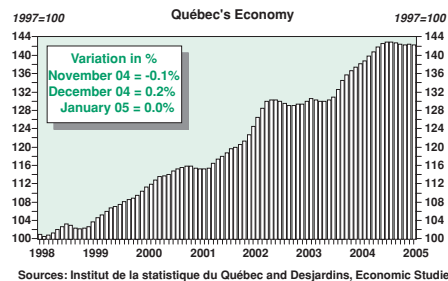
Consumption will remain vigorous in 2005 but will be less feverish than in 2004. The 2.2 million jobs created last year will allow US households to maintain their spending, although without it moving at the same speed as in 2004. The forerunner signals of automobile sales and the slowdown in the residential sector give a glimpse of some loss of steam. On the flip side, the services sector will pick up the ball. As this sector makes up nearly 60% of the US economy, it will be one of the pillars of growth in 2005. Concurrently, the Fed will continue with its policy of very gradual rate hikes.

In Canada, 2005 will be the image of 2004; moderate growth, but below our economy's potential. Real GDP advanced by 2.8% last year and could do as much this year to attain about 2.6%.

The strength of domestic demand will be what allows the economy to record gains. Consumption will be sustained by the 285,000 jobs created in 2004. Housing starts will slide from 233,431 units to around 218,000 this year. On the

Continued on page 2...

## DESJARDINS LEADING INDEX



### Overview

#### Rental units: The cycle high has been reached

**Hélène Bégin**  
Economist

Multi-dwelling real estate investment has been going through a very favourable time in Québec since the beginning of the decade. The scarcity of rental units, combined with the softness in interest rates, has considerably increased building profitability, by the same token making this type of investment very attractive. The appetite has been such that the volume of transactions has matched the heady days of the late 80s. That said, the brutal plunge back to earth of that period of expansion left the various stakeholders in the rental market with a bad taste in their mouths and fears of a similar collapse are resurfacing. Is reliving that nightmare a possibility? This time, the stage seems set instead for a gradual adjustment of the market. Unlike the end of the 80s, construction of rental units has gone ahead with almost clinical precision, which has itself extended the shortage situation. This will gradually fade, but it will take a year or two before returning to a reasonable balance. Some market sectors and segments, nonetheless, face the danger of a more abrupt about-face.

Continued on page 7...

## Financial Industries

### Desjardins Group maintains expansion in 2004

**Danny Bélanger, Mario Couture**  
Economists

Expansion by Desjardins Group remained strong in 2004. Among other areas, expansion was notable in financial wealth management, individual and business financing activities and in the fields of life and health insurance, and property and casualty insurance.

In the financial wealth management sector, last year's indecisiveness on the stock markets had negative repercussions on the growth in value of individuals' financial assets in Québec, primarily on savings products in investment funds and securities. However, in spite of this less favourable environment, Desjardins Group came through 2004 with flying colours in the field.

With regard to financing activities, the enthusiasm of both individuals and businesses in making expenditures, combined with the feeding frenzy in the housing market, resulted in a demand for loans by these segments in 2004 that was among the heftiest in fifteen years. Here again, with the results it posted last year, Desjardins Group succeeded in moving up in the vanguard of the most performing financial institutions.

Last, Desjardins Group was also very active in the sale of life and health insurance, and property and casualty insurance products in 2004.

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# Report on Economic Climate

## HIGHLIGHTS

### United States

- ✘ Economic conditions remain favourable in the United States: real GDP grew by 4.4% in 2004 and is up through 13 consecutive quarters. The pace should slow down to position itself around 3.5% this year and 3.6% in 2006.
- ✘ The creation of 262,000 jobs during February was like a balm: the gain of 20,000 jobs in the manufacturing sector drew the attention. Hiring in that sector had not been registered since August 2004.
- ✘ The budget proposal by President Bush to the US Senate at the start of the year contains some oversights that give the illusion of an improvement in public finances. Nonetheless, the situation might be less idyllic than it appears.

### Canada

- ✘ Canada finished 2004 with reserve. The reduction in exports, combined with the strong rise in imports, undermined the growth of our economy. The balance sheet for 2004 shows 2.8% and growth of real GDP should be in the neighbourhood of 2.6% in 2005 and 3.3% in 2006.
- ✘ Forecasts for corporate investment in 2005 are optimistic. Growth of 6% is forecast this year and the manufacturing sector is in the lead with an estimated rise of 14.9% relative to last year.

### Québec

- ✘ Similarly to Canada, the Québec economy slowed in the fourth quarter of 2004. Foreign trade was negatively affected by the appreciation of the loonie, which perched itself above 80 cents US.
- ✘ In 2005, corporate investment will increase by 4.8%. The manufacturing sector will increase expenditures in tools and machinery by 6.5% in order to boost its competitiveness.

## TO WATCH

- ✘ The data on the Québec GDP for the fourth quarter and the whole of 2004 will be released on March 24. The final data on US GDP for 2004 will come out on March 30.
- ✘ The evolution of the Desjardins Leading Index (DLI), which has been well able to forecast the course of Québec's economy up to now, is something to keep an eye on. The DLI's peaking since mid-2004 is disquieting.

- Continued from page 1

other hand, renovation will be full steam ahead and maintain residential spending. Corporate investments will be up thanks to the exceptional operating profits reaped last year.

In all likelihood, exports will grow moderately and the advance in imports will be much higher, which will melt away the trade balance. Our forecasts are these: a hard year for international trade where the strength of imports once again causes net exports to sag. For 2006, the picture changes somewhat, as exports grow more rapidly, to a degree replenishing the balance sheet on trade flows. The Canadian economy should at that point advance to slightly beyond its potential, say around 3.3%.

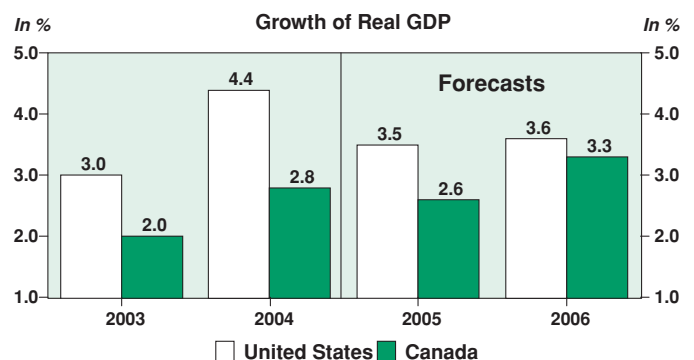
In such a context, the Bank of Canada will not rush ahead with interest rate increases before the summer of 2005 and might even wait until the fall. The result will be a negative rate gap with US rates for the next year.

However, all forecasts contain risks. The first unknown remains the evolution of our currency. Many factors will limit the heating up of the loonie: the less rapid rise in the prices of raw materials and the rate gaps that favour US rates. The element that weighs the heaviest in the balance is still the evolution of the US dollar and over this, Canada has absolutely no influence.

The other unknown is the price of oil. If it were to stay for several months above US\$55/barrel, it could slow the world economy and, by ricochet, the Canadian economy. For the moment, our forecasts anticipate an annual average fluctuating inside a range of US\$40/barrel to US\$48/barrel. ■

March 7, 2005

## THE UNITED STATES WILL LEAD CANADA ONCE AGAIN IN 2005 AND 2006



Sources: Bureau of Economic Analysis, Statistics Canada and Desjardins, Economic Studies

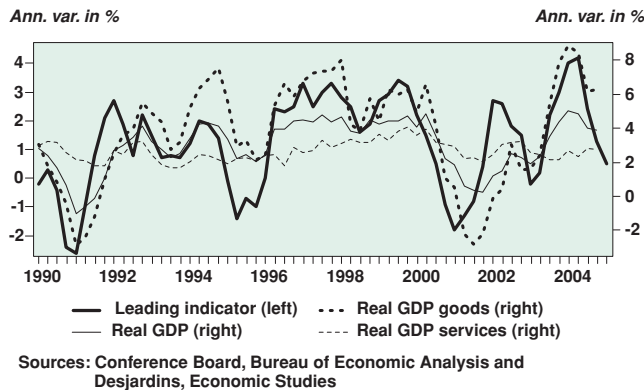
# The US Economic Climate...

By Francis Généreux, Economist

## Growth is still on the menu for 2005

Economic conditions in America remain favourable to the United States where real GDP is now up through 13 quarters. US economic growth is still focused on consumption, although other factors such as corporate investment are also at the table. Since household spending should remain lively enough, growth will remain good, but it could still weaken in 2005—especially after the solid 4.4% gain recorded by real GDP in 2004. One of the elements that are signalling some slowdown is the leading indicator which, despite two months of growth at the end of last year, began to decline in January. Other factors, like the recent weakness in automobile sales and the slowdown in the residential sector, should also contribute to the deceleration of the economy, particularly on the goods side. Fortunately, activity in services seems to be picking up; as the sector makes up nearly 60% of the US economy, growth will remain sustained in the United States throughout the year. Real GDP should advance by about 3.5% in 2005.

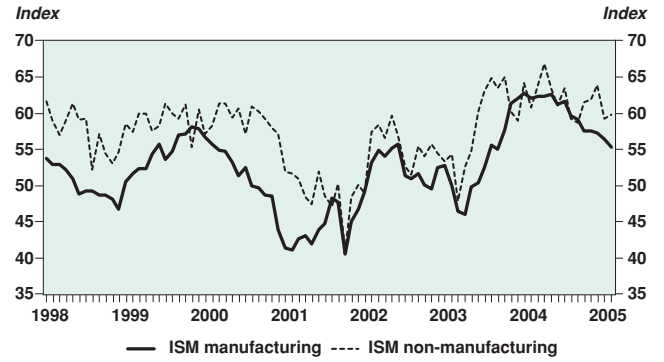
## UNITED STATES: THE LEADING INDICATORS SHOWS A SLOWDOWN IN THE PRODUCTION OF GOODS



## The ISM indices are giving contradicting messages

The dichotomy between goods and services naturally comes from the corporate side, primarily with regard to changes in the ISM indices. The non-manufacturing ISM, which represents activity in services, remains much higher than the index related to the manufacturing industry, and even increased in February. The manufacturing ISM, conversely, has been on a down trend for several months, although it's staying above the pivotal 50 level that marks the boundary between growing and declining activity. But the picture is not entirely gloomy for manufacturing businesses. They created 20,000 jobs in February, the first gain since August 2004. This result went along with strong growth in hiring in services (+207,000) and construction (+30,000). The total gain of 262,000 jobs in February can be seen as some very good news that breaks the disappointing downward trend that distinguished the labour market over the months before.

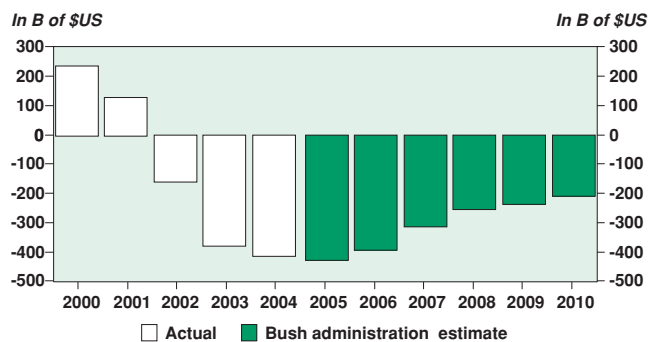
## UNITED STATES: THE ISM MANUFACTURING INDEX IS DECREASING MORE RAPIDLY THAN THE ISM NON-MANUFACTURING



## A very unlikely budget proposal

We will not be able to count heavily on the US government sector to speed up economic growth in 2005 and 2006. President Bush recently made public the White House budget proposal for the next fiscal year. He's proposing to Congress to reduce spending not related to defence and national security. Such measures would allow the federal government to decrease its deficit from US\$427B (the forecast for 2005) to US\$390B in 2006. Unfortunately, this goal is highly implausible. First, it would be a great surprise if Congress were to accept all of the proposed cuts. Second, the budget proposal seems to overlook many of the expenses that must inevitably arise in the next few years. Meaning, there's no mention of an assessment of the cost of military operations in Iraq and Afghanistan. The costs of reforming social security and tax reform have also been sidelined. These lapses, intentional or not, allow the Bush administration to show an improvement in the public finances for the coming years and, thereby, meet an election promise. But, we must keep in mind that the picture will not be as rosy as the one President Bush and his team are trying to paint. ■

## UNITED STATES: THE WHITE HOUSE HINTS AT AN IMPROVEMENT IN THE TAX SITUATION



# The Canadian Economic Climate...

By Joëlle Noreau, Economist

## Q4 results contained no surprises

Real GDP posted growth of 1.7% (at an annualized rate) in Q4 in Canada, below that of the United States (3.8%). Once again, the strength of domestic demand allowed the economy to record gains. Consumer spending, the frantic activity in construction starts and in renovation, as well as corporate spending, sustained the economy. The increase in inventory, particularly in wholesale trade, topped off growth. The reduction in exports and the strength of imports played negatively on the results. That means real GDP stands at 2.8% for 2004.

In 2005, consumer spending will be sustained by the full-time jobs created over last year. The housing sector will slow its pace but remain very dynamic. The question of the vitality or sluggishness of exports remains at the heart of concerns given the strength of the Canadian dollar. For the time being, the growth of the economy is estimated at around 2.6% for 2005. The economic horizon looks to be better for 2006, when real GDP could exceed the 3% limit.

## CANADA : REAL GDP AT MARKET PRICE (IN %)

Annualized growth rate in %

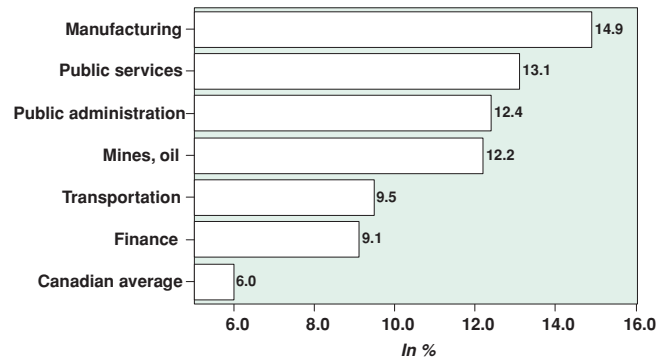
	2004				2004
	I	II	III	IV	
<b>GDP</b>	<b>2.8</b>	<b>4.5</b>	<b>2.9</b>	<b>1.7</b>	<b>2.8</b>
Consumption	6.2	1.9	3.6	4.1	3.5
Res. construction	8.6	6.9	5.1	7.0	8.4
Bus. investment	5.2	5.3	7.0	9.3	6.1
Gov't spending	3.2	1.4	1.0	1.0	1.6
<b>Final dom. demand:</b>	<b>5.5</b>	<b>2.4</b>	<b>3.5</b>	<b>4.4</b>	<b>3.8</b>
Exports	4.9	17.9	-3.4	-3.5	4.9
Imports	4.3	9.6	14.2	8.4	8.2
<b>Var. of inventories</b>					
<b>(in 1997 C\$ billions)</b>	<b>4.2</b>	<b>1.8</b>	<b>18.3</b>	<b>22.4</b>	<b>--</b>

Sources: Statistics Canada and Desjardins, Economic Studies

## Investment: The forecasts for 2005 are optimistic

The forecasts for corporate investment in 2005 are giving a dynamic picture of the Canadian economy. Growth of 6% in investment spending is expected, which comes on the heels of an 8.5% increase in 2004. This boom in spending on capital assets and equipment will counterbalance the reduced pace expected in new construction. The manufacturing sector is in the lead with growth of 14.9% relative to 2004. This is a catch up after a 1.4% decrease in investments seen last year. The focus will be mainly on machinery and equipment. The industrial capacity utilization rate that is flirting with its highs, the rise in value of the Canadian dollar and the stronger competition are lending a more pressing tone to these expenditures.

## CANADA: INVESTMENT GROWTH: THE SECTORS THAT WILL RECOVER THE MOST IN 2005

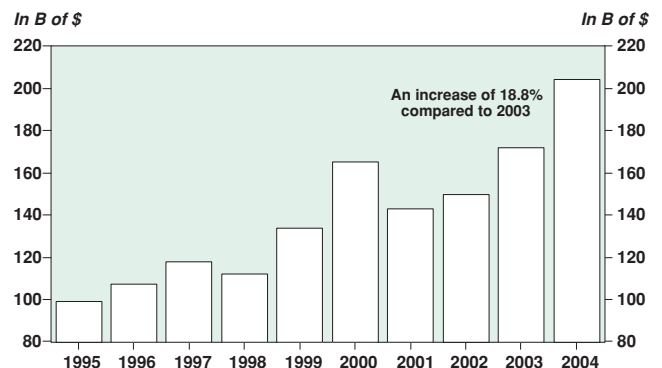


Sources: Statistics Canada and Desjardins, Economic Studies

## Corporate profits jumped in 2004

We might have thought that the rise in value of the Canadian dollar had chipped away at corporate profits last year: that was not the case. Earnings grew 18.8% last year compared to 2003. In the manufacturing sector, profits climbed 33.9%. Parallel to that, bankruptcies by Canadian businesses declined by 8.1% relative to the year before. Behind this seemingly positive picture lies a less exultant reality: earnings growth was less energetic in the second half of the year. That said, the trend in manufacturing deliveries at the end of 2004 augurs more modest results for the first quarter of 2005. The weak appreciation in metal prices expected this year will reduce expectations for the metals primary processing industry. Still, 2004's gains will make it possible to invest in maintaining—even improving—the competitiveness of Canadian businesses in 2005. ■

## CANADA: INCOME FROM OPERATIONS IS UP



Source: Statistics Canada

# The Québec Economic Climate...

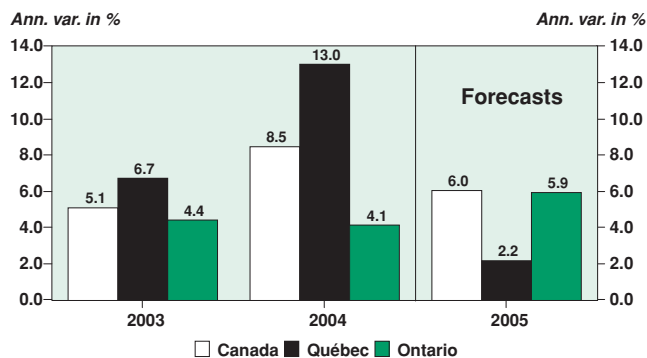
By H el ene B egin, Economist

## The economy's tempo slows

The results of Qu bec's economic growth in the fourth quarter will be known on March 24. Similarly to Canada, a net deceleration of the economy is to be expected. The province's foreign trade has been negatively affected by the strength of the dollar, which is maintaining itself above 80 cents US. The many layoffs announced recently by manufacturers, incidentally, serve as an illustration of the hardships in the industrial sector. For example, take the loss of 800 jobs at Viasystems of Montr eal, an electronics components business that has turned to delocalization in China to deal with world competition.

In the short run, the adjustment period will continue for Qu bec's economy. Manufacturing production will slow activity, but economic growth will still be visible. Households, which remain the pillar of the economy, will continue to support the advance of real GDP.

## QU BEC: THE MANUFACTURING SECTOR SLOWS REAL GDP GROWTH



Source: Statistics Canada

## Corporate investment: 2005 will be moderate

According to Statistics Canada's survey, company investment (excluding housing) will grow by 4.8% this year. This is a net slower rhythm than in 2004 (8.2%) due to a lesser contribution by the private sector. Nonetheless, the outlook is encouraging in the manufacturing sector with regard to modernization. Investment in tools and machinery should increase by 6.5% this year after pulling back in 2004. Textile, pulp and paper and wood plants are posting strong increases of 63%, 54% and 38% respectively in the amounts invested in machinery and equipment. These sectors, which are more vulnerable to the rising dollar, seem to be taking the necessary track to stay on course. Conversely, projects to build new installations or expand existing facilities will drop 26% in 2005 unless further projects materialize during the year. This means that manufacturers will prefer investments that increase productivity in order to position themselves more effectively in the context of fierce international competition.

## QU BEC: INVESTMENT OUTLOOK FOR 2005

	Variation as a %			
	All sectors		Manufacturing	
	2004	2005	2004	2005
Private	13.7	0.0	--	--
Public	10.6	9.5	--	--
Total*	8.2	4.8	-5.2	1.4
Machinery and equipment	8.6	3.4	-2.3	6.5
Construction	7.5	6.8	-18.4	-26.3

\*excluding housing  
Source: Statistics Canada

## Exports have hit the ceiling

The high level of the currency is having very tangible effects on Qu bec's exports. The strong pickup in shipping abroad begun at the start of 2004 has weakened subsequently and given way to marking time. The year ended on the same trend, as exports remained practically unchanging in December. The sustained growth of the US economy, which hovered around 4% in the second half of 2004, will not end up being enough to maintain the vitality of exports. But, the balance sheet for the year is positive, with a 7.7% (current \$) rise in the value of international exports. Those headed for the US advanced 4.9% to attain 56 billion dollars in 2004. Shipments to other countries grew by 16.3% due primarily to the increase to the UK (+20%), Japan (+30%) and China (+27%). So, exports destined for the United States declined from 83.2% in 2003 to 81.7% last year in favour of destinations overseas. ■



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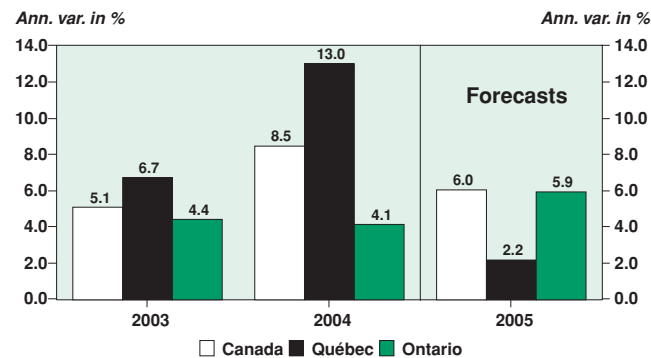
# The Ontario Economic Climate

By Mathieu D'Anjou, Economist

## Investment: Ontario places below the Canadian average in 2004

The Statistics Canada survey on private and public investment allows us to draw quite a detailed picture of capital expenditures. In all, the value of investments advanced by 4.1% last year in Ontario. Growth in public investment moderated to 2.9%, after a jump of more than 10% in 2003. Private investment, on the other hand, increased by 4.4% thanks—mainly—to a further surge of 8% in housing. The financial, information, real estate services and mining sectors also contributed significantly to investment growth in 2004. The 4.1% rise in investment in Ontario is somewhat disappointing when compared to the 8.5% increase for Canada as a whole. An even stronger surge in housing and much more vigorous public investment to a great extent explain the better performance in the rest of Canada. However, Ontario should make up the lost ground in 2005.

## INVESTMENT: ONTARIO WILL REGAIN STRENGTH IN 2005

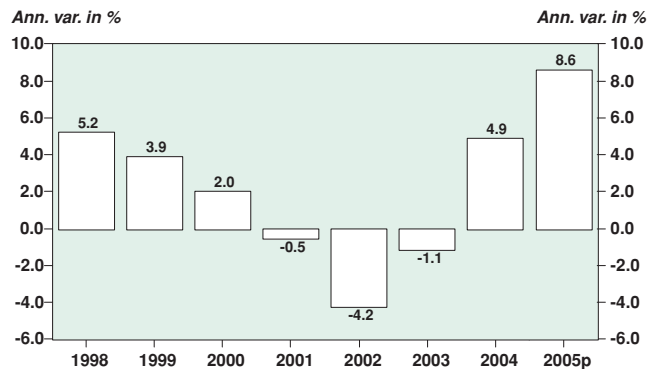


Source: Statistics Canada

## Businesses will invest strongly this year

Statistics Canada also published its investment outlook for 2005. Growth in capital expenditures should accelerate to 5.9% in Ontario this year, a result similar to Canada's. The rise will be widespread; an increase in investments is forecast in 15 of the 21 sectors of the Ontario economy. One large exception is housing—counting for nearly 30% of capital expenditures—which will stagnate in 2005. The slowdown in housing is no surprise after the remarkable upsurge of the last six years. Public investment will regain all of its strength and advance by close to 10% due to government administrations and utilities. Despite the stagnation in housing, private investment will advance by 5%. After some tough years, the manufacturing sector foresees increasing capital expenditures by more than 12% in 2005. The rise will affect almost all manufacturing industries. Primary metal manufacturing, stimulated by the rocketing of commodities prices, will stand out with a swell of 44%. The prospect of an 8.6% rise in private expenditures on machinery and equipment supports our forecast that business investment will be in the forefront of Ontario's economic growth this year.

## ONTARIO: GROWTH OF PRIVATE INVESTMENT IN MACHINERY AND EQUIPMENT ACCELERATES

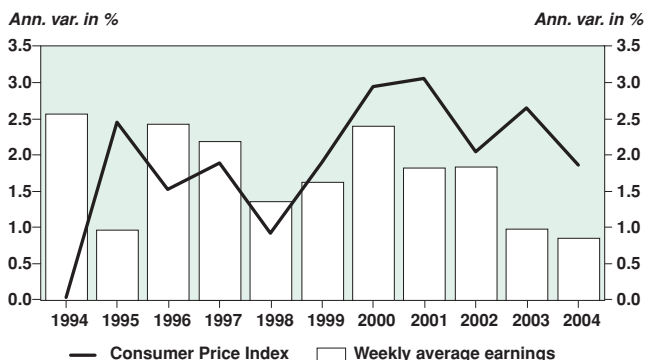


Source: Statistics Canada

## Salaries increase weakly

Employees' weekly average earnings advanced only 0.9% in Ontario last year to reach \$739.26. This weak growth is far from enough to make up for the 1.9% rise in the cost of living as measured by the Consumer Price Index (CPI). The situation is not new; it is necessary to go back to 1998 to find growth in earnings higher than the advance in the CPI. In spite of that, Ontario households have continued to spend happily over the last few years, which has had the effect of reducing their rate of savings. Savings have declined from 7.6% of personal disposable income in 1998 to 1.6% in the third quarter of 2004. It must be noted that the significant rise in value of their assets—particularly the 47% jump in the price of houses since 1998—has allowed Ontario households to get richer, at least on paper, despite the disappointing growth in their pay. ■

## ONTARIO: EARNINGS LAG BEHIND THE CPI FOR THE 6<sup>TH</sup> YEAR



Source: Statistics Canada

# Overview...

- Continued from page 1

## Supply is slowly adjusting

The end of the 80s was distinguished by a boom in the construction of rental units, fed by a surge in speculation. The excesses, magnified by the recession at the beginning of the 90s, took nearly ten years to be absorbed. This situation is unlikely to recur in the current cycle. The moderate expansion has met real demand, while speculative building is practically non-existent.

This time, builders were much more disciplined in adding traditional rental units. The absence of an attractive tax environment and less-favourable market conditions slowed the rebound in housing starts. The rise in the costs of building apartments (10% in three years) has increased the rents needed to make the new units profitable to a much higher level than rents for existing properties. Although this element puts a damper on building, the situations are different according to market segment.

The recent rise in housing starts for rental units is chiefly attributable to the building of retirement homes and to the addition of new high-end traditional apartments. These two niches are characterized by high rents, which make it easier to turn a profit on such projects. Conversely, construction of mid- to low-range rental buildings has been quite limited, as the rents for new apartments are much higher than those for existing units on the market. Government programs—Logement abordable Québec and Accès-logis—nonetheless stimulated construction in this market segment.

Contrary to the end of the 80s, the rebound in construction has been moderate, so that 2004's 1.7% rental unit vacancy rate remains below the 3% equilibrium threshold. This avoids the risk of a brutal plunge in housing starts similar to that of the 90s. Although equilibrium has not yet been achieved, rental apartment housing starts should begin to sag sometime this year. Actually,

**The shortage of rental units is coming to an end.**

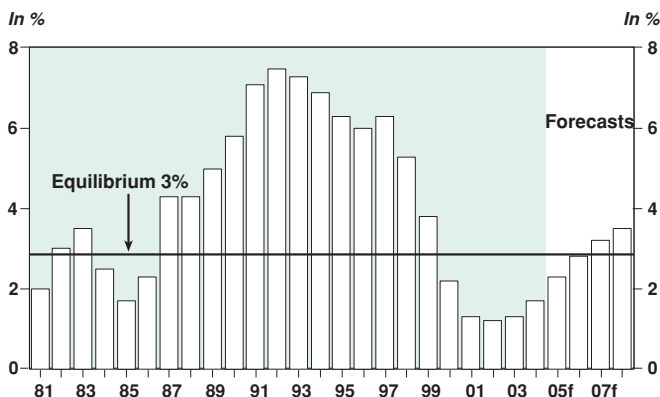
the market segments that have fuelled the growth of the last few years are getting to the saturation point in several places. First, fewer high-end units will be built in order to let the surplus slim down in certain sectors. Second, while the retirement home market remains tight just about everywhere, the pace should slow since it is unsustainable in the medium term. After reaching 12,167 units in 2004, rental apartment housing starts in the main urban centres could slump to below 10,000 units this year.

## The wind is turning in the high end

Given the good profitability of the niche, the construction of high-end units has been favoured over the last few years. While the shortage persists in medium-range and low-end units, there are enough superior class apartments to meet current need and some sectors are even showing a surplus. The boom in construction and the strong move toward ownership seen recently have contributed to bringing the vacancy rate beyond the equilibrium threshold of 3%. In the Greater Montréal area, 3.3% of high-end units (rent above \$900) are vacant. But, the market still remains tight in downtown neighbourhoods, with 2% of units available, while vacancy totals 6.5% (the surplus) in the suburban neighbourhoods off the Island of Montréal. In the Québec City area, high-end units are concentrated in Sainte-Foy, where several luxury projects have taken shape in the last two years. The arrival on the market of these new units has exceeded demand as a good number of them haven't yet found takers. As a result, the vacancy rate for units with a monthly rent higher than \$900 climbed to 11.5% in the Québec City region in 2004.

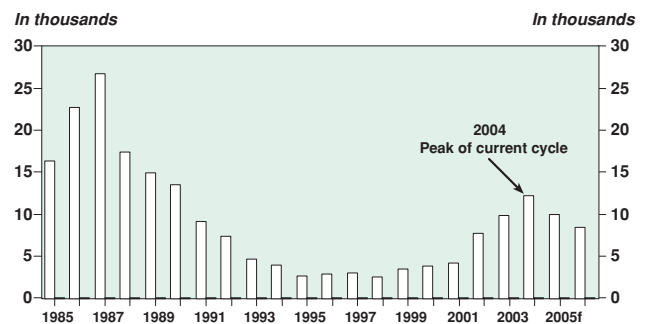
The vacancy rate for high-end units will escalate more rapidly than for the whole of the market within a short time. The arrival en masse of luxury condos for rent will broaden the choice for renters and sharpen competition to attract them. Actually, the strong construction of condominiums of this type over the last few years, especially in Québec City and Montréal, has made it harder to unload them. In the absence of sales, leasing reduces the financial burden on developers who turn unsold units over to property managers. Currently, about 10% of condos are occupied

### VACANCY RATE FOR RENTAL HOUSING HEADING TOWARD EQUILIBRIUM



Sources: Canadian Mortgage and Housing Corporation (CMHC) and Desjardins, Economic Studies

### RENTAL HOUSING STARTS\* THE PEAK IS ALREADY BEHIND US



\*Urban centres of 10,000 residents and over  
Sources: Canadian Mortgage and Housing Corporation (CMHC) and Desjardins, Economic Studies

# Overview

by tenants. This portion should increase in the short run, concurrently with the completion of new, higher priced condo projects.

Managers and owners of high-end apartment buildings are already feeling the effects of this additional supply. The market for units with a monthly rent of \$1,500 to \$3,000 is undergoing a clear slowdown in Montréal. This will limit rent increases in the future in order to remain competitive with the rents asked for rental condos. In addition, the notion of customer service is regaining importance, along with building maintenance; these were sometimes neglected in past years. With the end of the real estate cycle, the wind is turning progressively to rental housing, and the high-end segment is the first to feel the changing trend.

## The investor's point of view

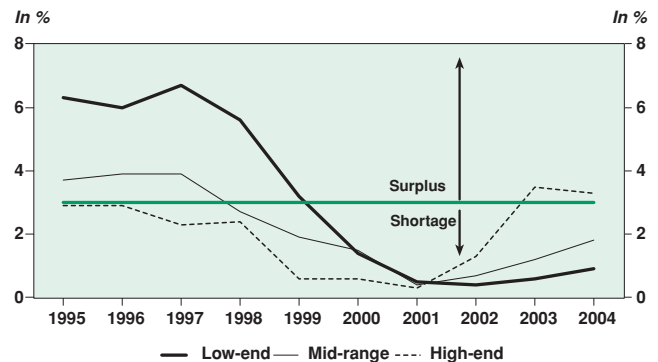
The province's rental apartment market was long snubbed by investors, particularly foreign interests. The perception of the Québec market has recently become very favourable across Canada and internationally, triggering a massive influx of capital. Investors from the United States, Europe and even Israel (following on the changes to the laws on foreign investment) have bought rental buildings, chiefly in Québec City and Montréal. The low vacancy rate for rental housing and low interest rate levels are behind this appetite.

Since 2001, rental building transactions have approached a billion dollars annually, buoyancy similar to that of the end of the 80s. The upturn in the number of transactions coincided with the start of the housing shortage, which improved apartment operating income. Afterward, the scarcity of buildings for sale caused the number of transactions to slump, but the increase in prices nonetheless maintained strong activity. What's in store for the future?

Even if the peak of the cycle is probably behind us, investors are staying in "buy" mode for 2005. Businesses operating in the multi-dwelling real estate market have considerable cash and look to new acquisitions to expand their portfolios. Buildings for sale are rare, so the increase in prices will continue in the short term.

The risk of a correction is certainly present in the context where buildings are overvalued. Some sectors are currently overheating and the high prices of the transactions should warn caution. A market as cyclical as real estate can sometimes hold surprises and buying buildings for hefty prices can turn out to be hazardous in the long run. Multi-dwelling rentals, however, have the advantage of producing stable income, which for the time being is moderating investors' concerns with regard to low capitalization<sup>1</sup> rates on the order of 7% to 8%. But, building operating margins are becoming slimmer and slimmer and the expected upturn in interest rates will reduce them even further.

## MONTRÉAL: THE SHORTAGE OF HIGH-END HOUSING IS A THING OF THE PAST



Source: Canadian Mortgage and Housing Corporation (CMHC)

Institutional investors and large-scale real estate companies such as FPI Boardwalk, CAP REIT and GWL, which enjoy substantial liquidity, have solid enough positions to withstand the change in context. But, these players own about 20% of the rental buildings in Québec. That means most investors are individuals who can be more vulnerable to market adjustments. While the risk seems limited for the moment due to the low vacancy rate and soft interest rates, these exceptionally favourable conditions will fade progressively. The vacancy rate for rental housing is on the way to finding its equilibrium and should achieve it within a year or two.

To conclude, even if the returns from multi-dwelling buildings decrease, they will remain attractive compared to other investment vehicles. For example, interest rates on ten-year bond will approach 5% between now and the end of 2005 and will rise only moderately over the next few years. In this context, investor interest in rental buildings should remain relatively high. Still, real estate market cycles have a habit of being pronounced. The related risks, as compared to other types of assets, must be taken into consideration, particularly when the market has reached its zenith as is the case at present. ■

<sup>1</sup> The capitalization rate is a performance measurement that refers to a building's income relative to its sale price.

# Financial Industries...

- Continued from page 1

## Personal savings: Quebecers have accumulated \$334B in financial assets

The stock markets' episodes of indecision in 2004 impacted negatively on the rate at which Quebecers accumulated financial assets during the period. Across the country, the Toronto Stock Exchange's S&P/TSX Index grew by 12.5%, whereas it had experienced a 24.3% rise to the end of 2003. Similarly, Quebecers' individual financial assets, which were \$333.7B as at December 31 last year, grew by 8.1% (or \$25.0B), compared to a rate of 9.5% (or \$26.9B) for the previous year.

The fact is that the larger and larger proportion of their financial wealth that is exposed to the caprices of stock market activity is a factor behind this trend. In fact, this slowdown in their assets in 2004 has its origins mainly in the slower advance of their savings in investment funds (including segregated funds), securities (e.g. Treasury bonds, bonds, stocks, etc.) and corporate venture capital funds<sup>1</sup>. These savings, which totalled \$206.9B as at last December 31, posted an annual increase of 10.9% (or \$20.3B) compared to a rise of 13.4% (or \$22.0B) recorded at the end of 2003.

Note that the weight of these investments compared to all of the financial wealth of Québec households has doubled since 1994, rising from 30.7% to 62.0%. Investments made in more traditional savings products such as deposits have naturally seen their relative size take the reverse trend over the same past ten years (69.3% to 38.0%). In point of fact, the positive behaviour of the stock markets and the marked decrease in interest rates over the same period have pushed Quebecers to turn to savings products that are generally riskier but that offer higher potential for return.

In financial wealth management, Desjardins Group has a starring role on the Québec stage. Due to the broad expertise it has developed in the field over the years in order to continuously adapt itself to the growing needs of its members and customers in the area of portfolio diversification, it has become a leader in Québec. As at December 31, 2004, the financial assets entrusted to it, including deposits, investment funds, securities and the Capital régionale et coopératif Desjardins totalled \$79.3B compared to a volume of \$72.5B on record at the end of 2003, for an increase of 9.4% (or \$6.8B). This is a more rapid advance than that achieved by the industry as a whole over the same period, which has enabled it to increase its share of the Québec market to attain around 24.0%.

<sup>1</sup> Including the FTQ Solidarity Fund, the Fondation CSN and Desjardins' Capital regional et cooperative.

## Personal and business credit: a demand that has grown in strength

In Québec, 2004 was the image of 2003 on the economic level. In fact, real GDP growth did not exceed 2.0% due primarily to the weakness of the foreign trade sector that suffered further from the rise in value of the Canadian dollar. This means that the Québec economy was kept afloat by the drive of domestic demand, i.e. by the sustained advance in consumer spending, by the boom in the housing market and by the wave of corporate investment. So, it's not surprising that the demand for credit by individuals and business was more in the pink last year.

Outstanding loans to individuals and businesses by all financial institutions in Québec, which totalled \$211.2B as at December 31, 2004, were up 8.4% (or \$16.4B) compared to an increase of 6.7% (or \$12.3B) on record for 2003. For its part, Desjardins Group was able to take advantage of this economic context so favourable to its business development. Its loans portfolio (excluding institutional credit) grew by 9.4% (or \$6.0B) to achieve \$69.1B as at last December 31, while it had advanced only 9.2% (or \$5.3B) during the preceding year. That means this strength enabled it to gain more ground in Québec in terms of market share to attain around 33.0%.

Residential mortgage credit was the most sought after loan category in 2004. The headiness of the Québec residential sector was naturally responsible for this strong demand. Housing starts jumped 16.2%, to arrive at 58,448 units, resales of existing houses made for about 65,000 transactions and expenditures for renovations grew by nearly 10.0%. On top of that, the appreciation of a bit more than 14.0% in the average sale price in the field is another factor in the equation.

Desjardins Group participated in the real estate boom—that recalls, more modestly, the boom experienced in the 1980s—by facilitating access to ownership for many of its members and customers in 2004. Its portfolio of residential mortgage loans increased by 12.3% (or \$4.5B) last year to achieve \$41.1B as at December 31 compared to growth of 10.0% (\$3.3B) for 2003. As a result, its relative size in this market swelled to 39.0%, by far ahead of its closest competitors.

Last, Desjardins Group is also very present in commercial and industrial financing in Québec. In 2004, it succeeded in consolidating the already very close ties it had with a number of small and medium-size businesses as well as with larger scale companies. Its outstanding commercial and industrial loans attained \$11.1B as at last December 31, up by 4.9% (or \$518M) from the year before. Thanks to these excellent results, its sector market share jumped to 23.5%.

**Desjardins Group is also  
very present in  
commercial and industrial  
financing in Québec.**

# Financial Industries...

## PERSONAL SAVINGS ACTIVITIES

As at December 31, in M\$	2004			1999			1994		
	Chartered Banks	Desjardins Group	Total market <sup>f</sup>	Chartered Banks	Desjardins Group	Total market <sup>f</sup>	Chartered Banks	Desjardins Group	Total market <sup>f</sup>
<b>ON-BALANCE SHEET PERSONAL SAVINGS<sup>2</sup></b>									
	58,070	56,529	126,860	46,263	43,769	104,237	49,670	41,029	107,984
• Market share (in %)	45.8	44.6	100.0	44.4	42.0	100.0	46.0	38.0	100.0
<b>OFF-BALANCE SHEET PERSONAL SAVINGS*. INCLUDING:</b>									
	140,207	22,804	206,870	98,134	10,256	148,579	33,105	1,873	47,814
• Market share (in %)	67.8	11.0	100.0	66.0	6.9	100.0	69.2	3.9	100.0
<b>MUTUAL FUNDS<sup>3</sup></b>									
	20,559	7,320	90,177	14,569	4,461	66,924	4,853	987	18,367
• Market share (in %)	22.8	8.1	100.0	21.8	6.7	100.0	26.4	5.4	100.0
<b>RETAIL BROKERAGE<sup>4</sup></b>									
	119,648	15,003	142,372	83,565	5,795	106,131	28,252	886	35,328
• Market share (in %)	84.0	10.5	100.0	78.7	5.5	100.0	80.0	2.5	100.0
<b>SOCIAL INVESTMENT FUNDS IN VENTURE CAPITAL<sup>5</sup></b>									
	0	481	6,336	0	0	3,402	0	0	1,016
• Market share (in %)	0.0	7.6	100.0	0.0	0.0	100.0	0.0	0.0	100.0
<b>ON- AND OFF-BALANCE SHEET PERSONAL SAVINGS*. INCLUDING<sup>6</sup></b>									
	198,277	79,333	333,730	144,397	54,025	252,816	82,775	42,902	155,798
• Market share (in %)	59.4	23.8	100.0	57.1	21.4	100.0	53.1	27.5	100.0
<b>RRSPs<sup>7</sup></b>									
	47,391	25,473	107,842	37,537	18,088	84,602	22,481	13,497	48,195
• Market share (in %)	43.9	23.6	100.0	44.4	21.4	100.0	46.6	28.0	100.0

\* Double-counting taken into account by subtracting, from the total market, mutual funds sold through securities brokerage firms. Here are the amounts subtracted: \$32,015 million in 2004, \$27,878 million in 1999 and \$6,897 million in 1994.

## FINANCING ACTIVITIES

As at December 31, in M\$	2004			1999			1994		
	Chartered Banks	Desjardins Group	Total market <sup>g</sup>	Chartered Banks	Desjardins Group	Total market <sup>g</sup>	Chartered Banks	Desjardins Group	Total market <sup>g</sup>
<b>CONSUMPTION</b>									
	27,054	12,425	47,982	16,883	9,644	32,650	13,860	7,434	25,242
• Market share (in %)	56.4	25.9	100.0	51.7	29.5	100.0	54.9	29.5	100.0
<b>HOMEMORTGAGES</b>									
	53,960	41,092	105,249	36,995	28,369	76,071	30,233	25,879	67,775
• Market share (in %)	51.3	39.0	100.0	48.6	37.3	100.0	44.6	38.2	100.0
<b>COMMERCIAL &amp; INDUSTRIAL</b>									
	22,122	11,104	47,332	23,712	9,226	43,931	22,533	9,863	43,710
• Market share (in %)	46.7	23.5	100.0	54.0	21.0	100.0	51.6	22.6	100.0
<b>FARM</b>									
	3,893	4,527	10,678	2,832	2,895	7,329	1,526	1,823	4,213
• Market share (in %)	36.5	42.4	100.0	38.6	39.5	100.0	36.2	43.3	100.0
<b>TOTAL</b>									
	107,029	69,148	211,241	80,422	50,134	159,981	68,152	44,999	140,940
• Market share (in %)	50.7	32.7	100.0	50.3	31.3	100.0	48.4	31.9	100.0

# Financial Industries...

## INSURANCE ACTIVITIES (premiums underwritten<sup>9</sup>)

LIFE AND HEALTH INSURANCE				
Main companies	2003		2002	
	M\$	In%	M\$	In%
<b>Desjardins Group</b>	<b>1,580</b>	<b>18.0</b>	<b>1,314</b>	<b>16.1</b>
Sunlife of Canada	1,117	12.7	1,109	13.6
Industrial Alliance	919	10.5	839	10.3
Great West	843	9.6	657	8.1
SSQ Life	750	8.5	672	8.2
Standard Life	521	5.9	641	7.9
L'Unité	452	5.1	2	0.0
Manulife	429	4.9	481	5.9
La Capitale Assurances MFQ	293	3.3	260	3.2
London et Midland	277	3.2	10	0.1
<b>Subtotal</b>	<b>6,338</b>	<b>72.1</b>	<b>5,328</b>	<b>65.3</b>
<b>Banks</b>	<b>237</b>	<b>2.7</b>	<b>229</b>	<b>2.8</b>
<b>TOTAL</b>	<b>8,792</b>	<b>100.0</b>	<b>8,159</b>	<b>100.0</b>

PROPERTY AND CASUALTY INSURANCE				
Main companies	2003		2002	
	M\$	In%	M\$	In%
ING Canada	1,018	15.2	993	16.0
<b>Desjardins Group</b>	<b>807</b>	<b>12.0</b>	<b>728</b>	<b>11.7</b>
AXA Canada	584	8.7	555	8.9
Aviva Canada	455	6.8	431	6.9
Promutual Group	409	6.1	364	5.9
La Capitale	276	4.1	244	3.9
The Co-operators	273	4.1	250	4.0
AIG	262	3.9	212	3.4
Fairfax	207	3.1	184	3.0
Lloyd's	204	3.0	199	3.2
<b>Subtotal</b>	<b>4,495</b>	<b>66.9</b>	<b>4,160</b>	<b>66.9</b>
<b>Banks</b>	<b>145</b>	<b>2.2</b>	<b>112</b>	<b>1.8</b>
<b>TOTAL</b>	<b>6,715</b>	<b>100.0</b>	<b>6,214</b>	<b>100.0</b>

Notes and sources

M\$ Millions of dollars

1. The total market includes other financial institutions not affiliated with the banks or the Desjardins Group, i.e. trust companies, life and health insurance companies, mortgage loan corporations, mutual fund promoters and independent brokers.
2. Including the savings of individuals transferable by cheque, non-transferable by cheque, term savings (including stock-market linked savings), government savings products, individual registered and non-registered annuities, and group RRSPs/RRIFs from life insurance companies.
3. Market results include all the mutual funds listed by the ISQ and the segregated funds estimated using data from CLHIA and Morningstar Canada.
4. The market results are estimated and include all the assets in safekeeping on behalf of individuals at securities brokerage firms, including the amounts they have invested in mutual funds.
5. This category encompasses the assets of the Fonds de solidarité of the FTQ, FondAction CSN, and Capital régional et coopératif Desjardins.
6. With the exception of banks and the Desjardins Group, the total excludes the mutual funds sold by securities brokerage firms.
7. The results of the banks and of the market are estimated and include conventional and self-administered RRSPs/ LIRAs.
8. The total includes, in addition to the institutions set out in Note 1, financial corporations, chain stores, the Caisse de dépôt et placement, the CMHC, the SHQ, the Business Development Bank of Canada, Investissement Québec, Farm Credit Canada and La Financière agricole du Québec.
9. Direct underwritten premiums.

Sources: Bank of Canada, Statistics Canada, Institut de la statistique du Québec (ISQ), Office of the Superintendent of Financial Institutions, Autorité des marchés financiers, Investment Funds Institute of Canada, Morningstar Canada, Canada Mortgage and Housing Corporation (CMHC), Journal Les Affaires, Investor Economics Inc., Canadian Life and Health Insurance Association and the Fédération des caisses Desjardins du Québec.

### Life and health insurance: \$8.8B in direct premiums

According to the last annual report available on life and health insurance, and property and casualty insurance activities in Québec, life and health insurance companies reaped \$8.8B in direct premiums in 2003, an increase of 7.8% (or \$633M) relative to the preceding year. This is a major slowdown of 13.3% (or \$959M) in the growth recorded in 2002. That said, the projections assumed for 2004, based on the trend observed in Canada since the final data for Québec will be released only next summer, report a slight acceleration, which should result in an advance in premiums of 9.0% (or \$791M), to attain about \$9.6B.

Specifically, note that premiums written for annuities underwent a marked deceleration in 2003. In fact, the pace seen in 2002 slumped from 48.7% to 10.4% to attain a volume of \$1.5B. The upswing in the stock markets during this period (e.g. the S&P/TSX grew by 24.3% in 2003), which favoured sales of segregated funds, is certainly a factor in investors' less robust appetite for guaranteed-return annuities. For example, outstandings for segregated funds sold by life and health

insurance companies jumped 15.3% in 2003 while it had decreased by 5.7% a year earlier.

Incidentally, note that the industrial structure of this market in Québec is characterized by a large number of businesses, of which the ten largest shared among themselves nearly 73.0% of all premiums collected for life insurance, health insurance and for annuities in 2003. This highly concentrated sector was, in spite of everything, made up of 130 companies specialized in the sale of life and health insurance and five others that also operated in property and casualty insurance. So, competition was very fierce in the field, where a few giants exist side by side with a multitude of small-scale firms.

In the vanguard is Desjardins Group, particularly its subsidiary, Desjardins Financial Security, which is in first place with a market share assessed at 18.0% in 2003, far ahead of Sun Life, which held second place with 12.7% and Industrial Alliance in third place with a share of 10.5%. Great West (9.6%) and SSQ Vie (8.5%) made up the last of the five largest companies in Québec that make up for nearly 60.0% of all premiums collected.

# Financial Industries

## Property and casualty insurance: weakened growth

In 2003, premiums written by property and casualty insurance companies in Québec totalled \$6.7B compared to a volume of \$6.2B recorded in 2002. This means they increased by 8.1% (or \$501M), which is a net lower rhythm than that registered for the preceding year (14.7%, or \$797M). Moreover, if the trend followed by the Canadian market in 2004 is used as a yardstick, growth in premiums should be sustained across Québec for last year, meaning that it should once again be in the neighbourhood of 8.0%. Only the upcoming publication of the annual report on insurance in the summer of 2005 can confirm this.

The truth is that the loss of steam noted in the advance in premiums written in 2003 relative to 2002 is a little amazing, given the exuberance of the Québec housing market during the same period. In fact, there were housing starts for 58,448 units, a level that exceeded the 1988 level (58,062), and close to 65,000 existing houses changed hands. However, keep in mind that the residential sector represents, good year or bad, only about 20.0% of the volume of property and casualty insurance premiums, the rest being shared by coverage for automobiles (43.0%), commercial goods (18.0%), liability (13.0%) and the other types (6.0%). That said, sales of new vehicles pulled back by 3.6% in 2004, which undoubtedly reduced new business opportunities for the companies operating in the domain.

Moreover, note that the industrial structure of the property and casualty insurance sector in Québec is different from that of life and health insurance due to its low level of concentration. Of the 176 businesses listed in 2003, the ten largest insurers cornered in the neighbourhood of 65.0% of the premiums written. Desjardins Group, through the activities of its subsidiaries Desjardins General Insurance and The Personal, in Québec, held second place with a market share assessed at

12.0%. The European giant, ING, was first with an estimated share of 15.2% at the same date.

## Asset administration and management: nearly \$204B entrusted to Desjardins Group

With off again, on again movement in 2004, developments on the stock markets presented a rather unsettled context for business development for companies operating in the field of asset administration and management. In fact, while financial assets invested in investment funds posted a more rapid advance than in 2003, assets managed in the securities brokerage sector saw their pace practically cut in half. What's more, in Canada, the assets held by private and public pension funds (excluding those of life and health insurers) grew by about 10.0% last year compared to a tempo of 12.0% recorded in 2003.

The aggregate of the financial assets for which Desjardins Group acted as trustee or manager totalled \$203.8B as at December 31, 2004, up by 18.2% (or \$31.4B) for the year compared to an increase of 18.3% (or \$26.6B) registered in 2003. This means that, in spite of the somewhat more difficult climate, Desjardins Group remained very active in the field. ■

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