

# En perspective

## Report of Economic Climate

### Off to a great start... but a slowdown is in sight

**Gilles Soucy**  
Chief Economist

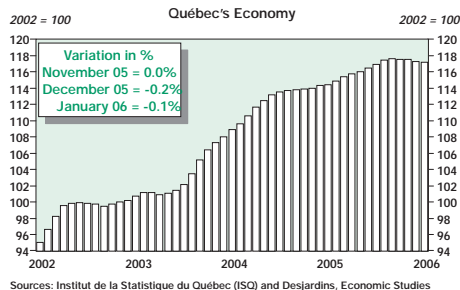
With 2006 getting off to a great start in the United States, we're in the process of assembling the final pieces that will give us an accurate picture of the end of 2005. The forecasts for 2006 and 2007 will be based on this picture: we therefore need as accurate a picture as possible. The release of revised U.S. current account data is presenting a less disastrous situation than had previously been expected. In the fourth quarter, real GDP will have grown 1.6% on an annualized basis rather than 1.1%, as had been announced previously.

The beginning of 2006 is packed with positive signs. January saw an acceleration in housing starts and building permits, an increase in industrial output, an ISM index (index of industrial activity) holding steady above the 50 point mark, and a surge in the leading indicator and consumption. However, job creation was disappointing and the consumer confidence level declined inversely with gas prices ... In spite of these more negative factors, the U.S. economy appears to be pumped, at least for the first few months of the year.

This rapid start is also a return of the pendulum following a fourth quarter that was somewhat out of step with prior quarters. However, this kind of advance puts at centre stage the issue of whether or not the Federal Reserve should conti-

Continued on page 2...

## DESJARDINS LEADING INDEX



### At a glance

#### Québec housing market: autopsy of the current slowdown

**Hélène Bégin**  
Economist

After the effervescence of recent years, the residential sector is on a downward track. New construction started to dip last year, moving off 2004's cyclical peak. 2006 will be marked by a general decline since the sales of existing properties will also begin a downward trend. A number of factors will limit activity. On one hand, the ascent of house prices in recent years and, to a lesser degree, the rise of mortgage interest rates that started in mid-2005 will limit the pool of potential buyers. As for supply, greater availability of rental apartments, increase in the inventory of unoccupied new housing, and broader selection on the resale market confirm that the frenzied pace is a thing of the past.

Continued on page 7...

## Financial Industries

### A remarkable boom for Desjardins Group over the last ten years

**Danny Bélanger, Mario Couture**  
Economists

Desjardins Group is first and foremost a diversified financial cooperative with more than 5,600,000 members. It is a network of slightly over 600 member caisses/branches, approximately 1000 service centres, nearly 3000 ATMs, with over than 40,000 employees working in its various entities. In Canada, it is by far the largest institution of its type, while on the global scale, it is one of the biggest financial cooperatives.

Over the last ten years, the Group has seen a remarkable boom. Its global assets, which totalled \$81B in 1995, exceeded \$120B at the end of 2005. In addition to caisses in Québec, Desjardins Group also includes member caisses/branches in Ontario, New Brunswick and Manitoba. Moreover, it is present in every Canadian province, through its various subsidiaries. It offers a complete line of financial services and products, from traditional credit and savings products, to life, health, property and casualty insurance coverage, investment fund sales, and securities brokerage and wealth management services.

In spite of fierce competition, over the last few years, the Group has continued to expand in Canada, and has, in particular, consolidated its Québec positions.

Continued on page 9...

# Report on Economic Climate

## HIGHLIGHTS

### United States

- ✘ The U.S. economy's growth in the fourth quarter was anaemic, but 2006 is getting off to a strong start, particularly due to a resurgence by consumption. The increase in real GDP will be particularly vigorous in the first quarter, with this enthusiasm fading over the course of the year.
- ✘ In real estate, new construction is soaring, but sales of new and existing homes are losing momentum. The climate is less optimistic than it was last summer, for both builders and buyers: the real estate market is on the verge of slowing.
- ✘ The slowdown could, in turn, decelerate economic activity in the U.S. The levelling off of prices for real estate assets and the rise in interest rates will encourage savings by households : households should also moderate the pace of consumption.

### Canada

- ✘ Canada ended 2005 at a slower pace. Annual real GDP growth was 2.9%. In 2006, the year will start strong and then decelerate as the quarters progress: GDP will advance by close to 3%.
- ✘ Surging energy prices triggered extensive inflation fears in 2005. As Canada's economy is less dependent on fossil fuels than it was in the 70s and 80s, it is less vulnerable to a rapid rise in inflation.

### Québec

- ✘ The Québec economy is currently in a period of moderate growth. The progress of the Desjardins Leading Index (DLI) suggests a slowdown given the many obstacles limiting the Québec economy's advance, particularly its manufacturing sector.
- ✘ Québec ranks below the average and behind Ontario for investment intentions for 2006. In the manufacturing sector, there is no plan for increasing efforts from 2005 levels, which is a concern.

## TO WATCH

- ✘ Employment growth in the United States, Canada and Québec will take the pulse of their respective economies in terms of vitality for the start of the year. The data, to be released on April 7, will help wrap up the first quarter.
- ✘ Québec's economic accounts will be released on March 27, laying the framework for the 2006 forecast scenario for Québec.

- Continued from page 1

nue its monetary tightening beyond March 26. It is too early to rule on this issue, particularly since many factors could hinder the economy's unbridled surge. A slowing of the pace is already expected for the second half of the year. Moreover, while no one is expecting crude oil prices to get out of control, there are many factors in place that could keep prices at current levels or higher. Disputes early in the year between Russia and the Ukraine, the tension created by Iran's return to its nuclear program, the potential for civil war to break out in Iraq and attacks in Saudi Arabia are some of the factors that have had an upside impact on prices, and demonstrate how fragile the current balance is. Based on the information currently available, we believe the risks to prices are more upward than downward for the early part of the year.

The other risk factor that could have troubling consequences would be the onset of a bird flu pandemic. While a few firms have published disaster scenarios, no one can predict what the probabilities are, or accurately quantify the consequences of the phenomenon. Crisis management by the authorities in each country could make all the difference; for now, we are not including the likelihood of an epidemic in our projections.

The outlook for the United States is as follows: Growth slowing as of the second half of 2006 and a mid-cycle slowdown in 2007. Real GDP will rise by about 3.2% this year, then 2.7% next year.

In Canada, the economy's pace slowed at the end of 2005, but it did not dip as much as it did south of the border. The result for real GDP growth for 2005 is 2.9% in 2005, as in 2004. The year's start looks promising, and real GDP growth could be over 3% in 2006, very close to its growth potential. However, the Canadian economy's development will rely more on the western part of the country, which will continue to benefit from high raw materials prices. As the economy is getting the year off to a strong start, a rate hike should be expected in April. Another hike could be ordered in May, depending on developments for the Canadian economy and the value of the Canadian dollar. As in the United States, Canada's GDP growth will slow gradually as the quarters progress. Growth will be below 3% next year. ■

March 6, 2006

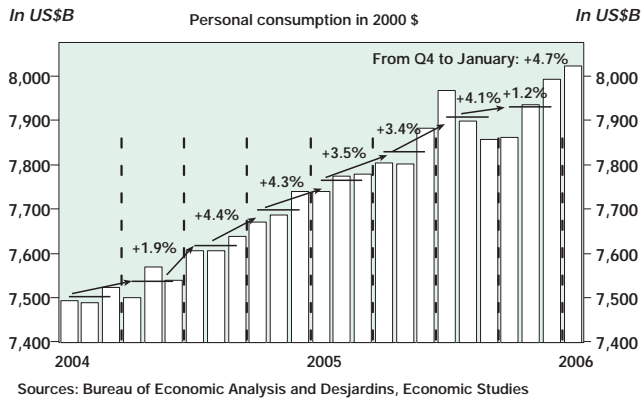
# The US Economic Climate...

By Francis Généreux, Economist

## Good start to 2006 for the American economy

Many economic indicators show that American economic growth will accelerate in early 2006. Remember that activity made only slight progress as 2005 came to a close, with an annualized quarterly gain in real GDP of just 1.6% (which is still an improvement over the preliminary estimate of 1.1%). The main culprit was anaemic growth in consumption, particularly where durable goods were concerned. Fortunately, since the beginning of the year, the situation in this area seems to be improving. The annualized average for vehicle sales for the first two months of the year is 35% higher than it was at the end of 2005, despite the dip in vehicle sales in February. In addition, consumption growth in January shows a strong 4.7% increase from the average last fall. This means that even if the situation calms down in February and March, growth by consumption and therefore real GDP will be particularly strong during the first quarter of 2006.

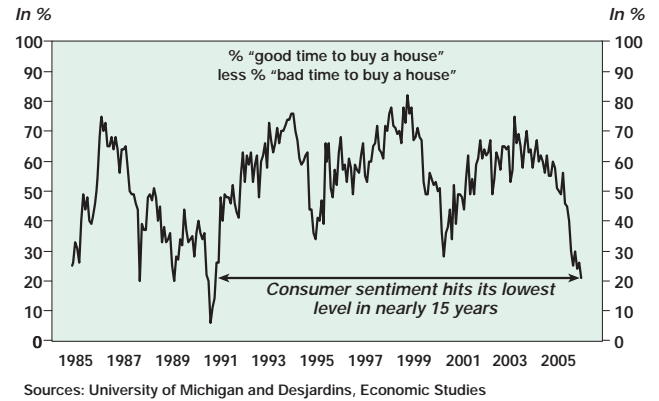
## UNITED STATES: REAL CONSUMPTION STARTS 2006 ON THE RIGHT FOOT



## Heading for a slowdown in the real estate market ...

However, real estate market statistics have been more mixed in early 2006. On one hand, residential construction saw a surprising amount of growth in January as a result of a very favourable climate. Starts even hit their highest level since 1973! However, demand for homes did not repeat this solid performance. Sales of new and existing homes diminished. Moreover, as new Federal Reserve chair Ben Bernanke remarked recently, "some signs of slowing in the housing market have appeared in recent months." Homebuilder confidence has been falling since last summer, homes are staying on the market longer and the monthly inventory of homes is rising. In addition, the proportion of consumers who feel that the real estate market is currently favourable to buying a home is clearly declining. We can therefore assume that the real estate market is on the verge of slowing.

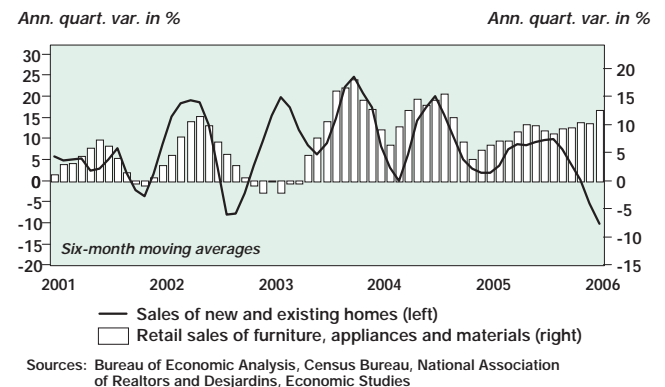
## UNITED STATES: HOUSEHOLDS LESS AND LESS OPTIMISTIC ABOUT THE REAL ESTATE MARKET



## ... and the consequences for households and economic growth

Up to now, economic growth has benefited greatly from the real estate market's solid performance. The increase in home prices and relatively low interest rates allowed American households to convert their real estate equity into capital through the refinancing of mortgage loans. Moreover, the increase in wealth associated with the real estate market's appreciation and the high level of home sales affected retail sales, household financial investments and expenses related to renovations. However, a slowdown in the real estate market could trigger a deceleration in American economic activity. The levelling off of prices for real estate assets and the rise in interest rates will support a recovery by household savings. Households should moderate consumption, leading to a drop of the pace of economic growth and, in keeping with our scenarios, a slight slowdown that should culminate in 2007. ■

## UNITED STATES: RETAIL SALES HAVE, TO DATE, BENEFITTED FROM THE REAL ESTATE BOOM



# The Canadian Economic Climate...

By Joëlle Noreau, Economist

## No surprises as the year ended

Canada closed the year at a slower pace. Real GDP rose 2.5% in the fourth quarter, down from the previous quarter's 3.5% increase. The three pillars of growth were investment spending, exports and personal expenditure, which saw lively growth from October to December. In exchange, growth in imports was such that it made the trade balance (exports-imports) negative.

The balance for 2005 is as follows: real GDP growth of 2.9%. This result is due to strong (4.3%) domestic demand supported by vigorous consumer spending, among other things. 2006 will be slightly different. Even if GDP growth nears 3%, the consumption and housing components will be less dominant. On the other hand, businesses will be contributing with major investments and rising exports. The Canadian economy will slow its pace after a rather dynamic first quarter.

## CANADA: REAL GDP AT MARKET PRICES

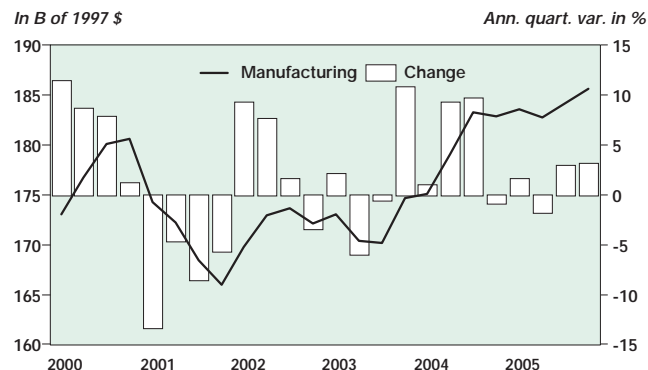
	2005				2005
	I	II	III	IV	
<b>GDP</b>					
Consumption	6.1	3.8	2.4	2.9	4.0
Res. construction	-2.2	6.7	2.5	1.4	3.3
Bus. investment	11.9	4.4	13.8	12.9	9.1
Gov't spending	3.3	3.1	4.4	4.6	3.8
<b>Final dom. demand</b>	<b>5.4</b>	<b>3.9</b>	<b>4.2</b>	<b>4.3</b>	<b>4.3</b>
Exports	3.3	-0.5	7.4	9.6	2.3
Imports	7.7	-3.2	10.2	11.4	7.0
Change of inventories (In M of 1997 \$)	17,724	12,944	14,401	11,937	14,252

Sources: Statistics Canada and Desjardins, Economic Studies

## Positive contribution by the manufacturing sector

In the fourth quarter, the manufacturing sector made a positive contribution to GDP growth. The machinery sector, transportation materials, metallic products and non-metallic mineral products in particular supported manufacturing production at the end of the year. Despite the appreciation of the Canadian dollar, the increase in energy costs and the intensifying foreign competition, the manufacturing sector still managed to make gains in 2005. However, manufacturers of non-durable goods (especially clothes and textiles) were affected more strongly by international competition. Note that, on the whole, growth in production was slower in 2005 than it was in 2004. In addition, the factors that slowed the manufacturing sector's progress in 2005 will be present in 2006. Therefore, the competition for market share in Canada and the United States will be fierce as the Canadian dollar stands to increase to close to US\$0.90. Efforts should continue

## CANADA: THE MANUFACTURING SECTOR CONTRIBUTED TO GROWTH IN 2005



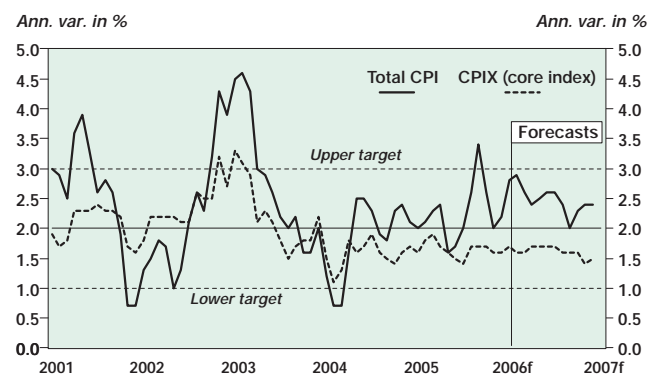
Source: Statistics Canada

to focus on enhancing our competitiveness. Even though production gains are anticipated, they will be modest. Moreover, the manufacturing sector will again lose jobs in 2006, for the third time in the last four years.

## Inflation growth will be contained in 2006

The dizzying ascent of energy prices triggered many inflation concerns last year. The scenarios for this year are in line with what was observed last year: average price for crude oil in the neighbourhood of US\$55-70/barrel, which does not rule out excursions above or below this range. In short, we do not expect prices to increase as quickly as in 2005. However, in light of the limited leeway producing countries have to increase production, the risks for 2006 are to the upside. Note that the Canadian economy is much less dependent on fossil fuel than it was in 1973 and 1980. Consequently, it is less vulnerable than it was at that time to oil shocks and a precipitous increase in inflation. ■

## CANADA: GLOBAL INFLATION SHOULD REMAIN BELOW THE UPPER TARGET



Sources: Statistics Canada and Desjardins, Economic Studies

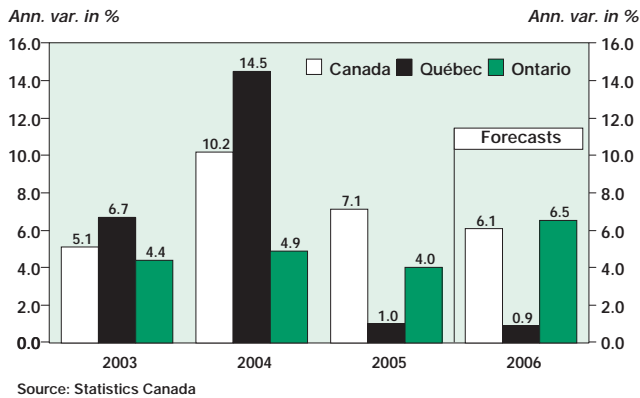
# The Ontario Economic Climate...

By Mathieu D'Anjou, Economist

## Positive outlook for investment

According to a Statistics Canada survey, growth in investments should accelerate in Ontario this year. The rise in value was 4% last year, with the three main investment categories (plants, equipment and housing) posting similar progress. Growth should hit 6.5% in 2006, despite a reduction in spending on housing. Non-residential construction and investment in equipment will accelerate significantly, however, especially due to a surge in the utilities sector. The crying need to increase electric power generation in Ontario should translate into over \$6 billion in investment in public utilities this year, an increase of 56%. Unfortunately, it seems that investment will be much less lively on the manufacturing side (1.9%), as the sector's adjustment period is well underway. The Statistics Canada survey gives an encouraging outlook and supports our forecast for accelerating investment by Ontario businesses this year.

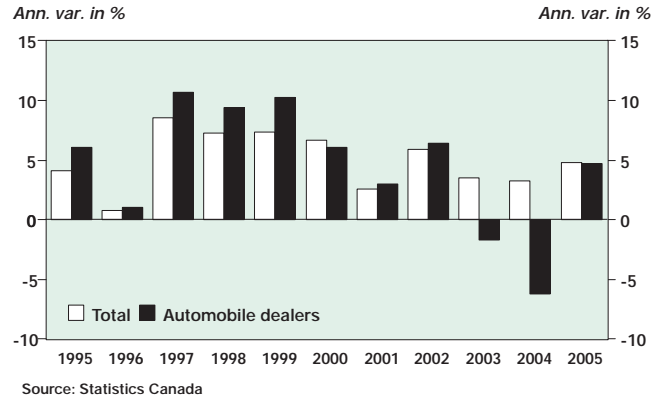
## ONTARIO: ACCELERATING INVESTMENT IN 2006



## Retail trade picked up in 2005

Ontario merchants saw the value of their sales increase by 4.7% last year, a significant acceleration following an increase of 3.2% in 2004. A recovery by automobile dealers, where sales advanced by 4.6% in 2005 after dropping 6.1% the previous year, explains the faster growth. With dealer sales excluded, growth was 6.3% in 2004 and 4.7% in 2005. The rise in fuel prices resulted in spikes of more than 10% in sales at gas stations for each of the two preceding years. Drug stores also posted sharp increases in sales in 2004 and 2005. While 2005's results are good, growth is less lively than it was in the late 90s, before the IT bubble burst. We expect households to moderate consumption slightly in 2006, while retail sales will increase by about 4.3%.

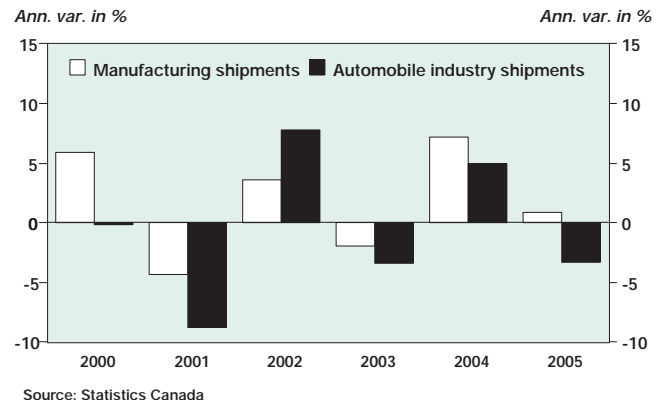
## ONTARIO: GOOD YEAR FOR RETAIL TRADE



## Weak growth in the manufacturing sector

In 2005, manufacturing deliveries in Ontario grew by only 0.8%, in current dollars, a result slightly below that for Canada as a whole. This near-stagnation is not surprising: the manufacturing sector must cope with the appreciation of the Canadian dollar, surging oil prices and competition from Asian countries. Note that Ontario lost 36,000 manufacturing jobs last year. Shipments by the important automobile industry, which account for over one third of Ontario shipments, diminished by more than 3%. As elsewhere in the country, the clothing and textile sectors posted a marked reduction in shipments. Emerging countries took advantage of a reduction in trade barriers to increase their presence in the Canadian clothing market. Conversely, manufacturers of machinery and IT and electronic products had an excellent year, benefiting from the increase in investment by North American corporations. Growth for Ontario's manufacturer shipments should remain moderate in 2006. The automobile industry's difficulties will continue and, overall, the economic context will remain thorny for manufacturers. ■

## ONTARIO: WEAK GROWTH IN SHIPMENTS, DROP IN THE AUTOMOBILE INDUSTRY



# The Québec Economic Climate

By H el ene B egin, Economist

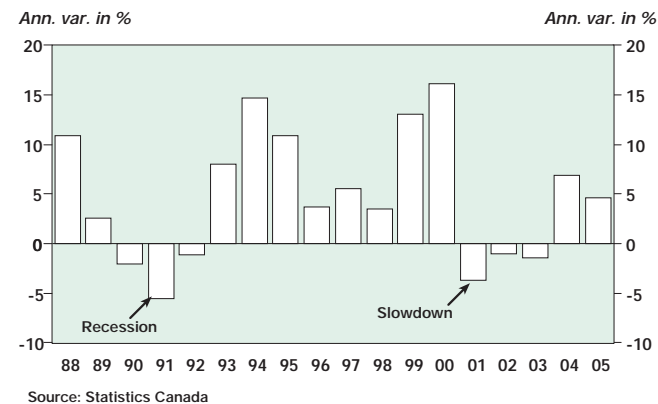
## Economic growth is holding steady but ...

The Qu ebec economy is currently in a period of moderate expansion. Real GDP growth has been around 2% since 2003, a rate slightly slower than its full potential, which is assessed at 2.5%. The weakness in the Desjardins Leading Index (DLI), which has persisted since last autumn, remains a concern for the province's economic outlook, however. If the DLI takes its time in recovering, the risks of a short-term slowdown would be heightened. At the moment, this announcement is premature, but the numerous uncertainties affecting the Qu ebec economy give rise to some thought. The loonie's appreciation and high oil prices are looming over a manufacturing sector that is already grappling with intensifying foreign competition. Moreover, the troubles facing the forestry and paper industries are having a harsh impact on economic activity in some parts of Qu ebec.

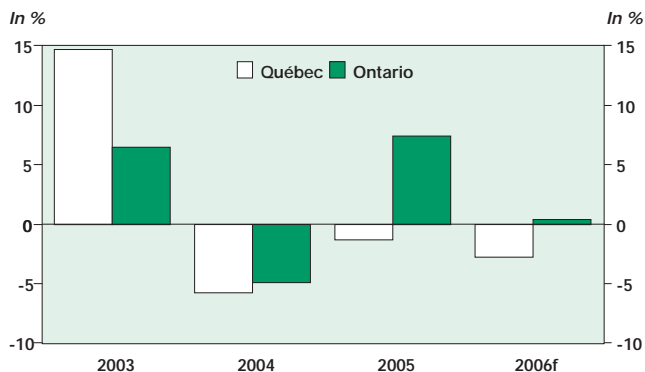
## Disappointing investment outlook

Statistics Canada disclosed the results of the investment intentions survey at the end of February. Qu ebec performed dismally in comparison to its neighbours with weak growth of 0.9% in investments expected in 2006. This places the province far behind Ontario (+6.5%) and the country as a whole (+6.1%). In the private sector, the 0.5% drop in investment intentions is at odds with the increase of 5.1% for Canada as

## QU EBEC: MANUFACTURING SHIPMENTS INCREASE



## QU EBEC: DECREASE OF MANUFACTURER INVESTMENT IN MACHINERY AND EQUIPMENT



a whole, caused by the energy boom in the west. In the public sector, the rise of 5.2% pales in comparison with the 10.4% forecast for the country.

The manufacturing sector's investment intentions are of particular concern. Manufacturers do not plan to increase their investments in machinery and equipment in 2006 at a time when modernization efforts should, conversely, be on the rise. Because of growing international competition, Qu ebec is at a crossroads in terms of maintaining its place on the international stage. With the decline in investments in modernization, which has been ongoing since 2004, gains in competitiveness are far from being a sure thing for Qu ebec manufacturers.

## Manufacturing shipments: weak increase in 2005

2005 was not an easy year for manufacturers who had to cope with the Canadian dollar's appreciation, surging oil prices and the growing competition from Asian countries. However, the outcome was not a disaster, as the 4.5% increase in the value of shipments is nothing like the sharp declines seen in the recession at the beginning of the '90s or even in the economic slowdown in 2001. The solid performance by the American economy, where growth reached 3.5% last year, was the mainstay for export businesses. The deceleration by the U.S. economy expected for the end of 2006 and the beginning of 2007 could, however, hit the industrial sector hard. ■



**Desjardins**  
Economic Studies

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The opinions given in this newsletter are those of the authors and do not necessarily reflect the official position of the F ed eration des caisses Desjardins du Qu ebec (FCDQ).

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# At a glance...

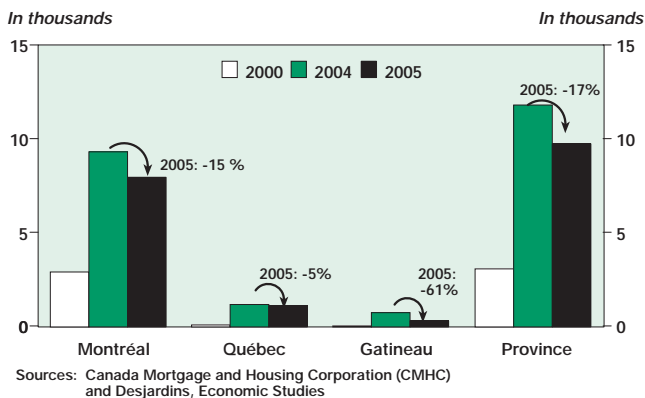
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## Condo market takes a break

In spite of the recent drop in starts, the construction of condominium properties has increased substantially in the last five years. In the Greater Montreal area, the number of new apartments went from 3000 at the start of the decade to over 9000 at its peak in 2004. In Québec City, fewer than 100 condos were built in 2000, while the figure has multiplied ten times since then. This type of construction, which had only made a small breakthrough in Gatineau in the 1990s, finally took off, reaching 760 units in 2004. Construction of condominium apartments also expanded outside the major centres, as in Drummondville, Granby, Shawinigan and Saint-Jean-sur-Richelieu, but for now activity remains quite limited. The Greater Montreal area leads with 80% of starts province wide, followed by Québec (10%) and Gatineau (5%).

**New construction will slow down again in 2006.**

### CONDOMINIUM STARTS: IN SPITE OF THE RECENT DIP, THE MARKET HAS GROWN IN THE LAST 5 YEARS



In the context of shortages of rental housing units and low mortgage interest rates, this type of housing was favoured as a starter home, particularly in the lower price ranges. On the resale market, less pricey condos are still popular and the signs of slowing are less obvious. For now, the number of sellers per buyer is below the equilibrium, which is deemed to be between 8 and 10. For example, for units under \$150,000, the ratio is 4 in Montréal, 6.5 in Québec City and 7 in Gatineau.

The situation for higher price ranges is very different. Baby-boomer enthusiasm for this type of housing, for which the tenure is gradually changing, has certainly stimulated demand in recent years. Because luxury units were delivering good profits for developers, construction has slightly outstripped demand in some locations. As a result, the inventory of unsold

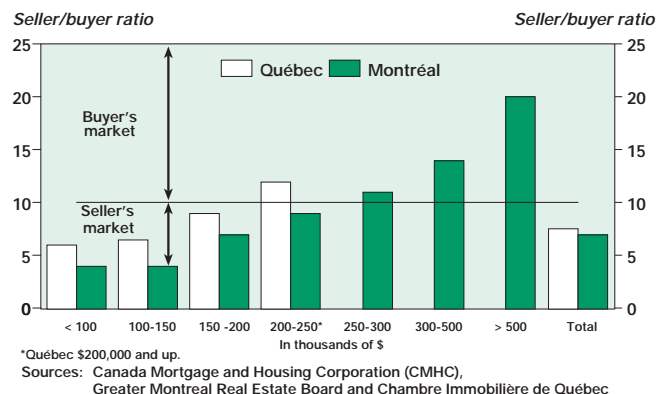
new condos soared in 2005. In Greater Montreal, about 2000 units remained to be moved at the end of the year, which is substantial given that 8000 new condominium properties came onto the market last year. In Québec City, about 250 apartments were left without takers at the end of 2005, equivalent to one quarter of the starts for the whole year.

Since unsold new units compete with the secondary market, the latter softened substantially in the course of last year. According to the Canada Mortgage and Housing Corporation (CMHC), a number of new condominium properties were entrusted to real estate agents to find buyers. In Greater Montreal, realtor listings have thus increased 46% in the last year. Times to sale have increased, reaching 75 days in the last quarter of 2005 compared to 66 in the same period of last year. The condo market will be the first to return to equilibrium, and a number of

market zones in the metropolitan Montréal area are already there. Québec and Gatineau are also almost at equilibrium overall, although there are surpluses in the higher price ranges. Expensive condos are therefore more vulnerable to a slight drop in price in the short term in some sectors. For all categories combined, price increases will get closer to the inflation rate (about 2.5%) in 2006.

All in all, even though condominium apartments are very popular with baby boomers, an adjustment is required in the short term. The intense construction of recent years has resulted in some saturation in the high-end market, particularly in Québec, Montréal and Gatineau. Condo starts will continue to weaken for a year or two, but should then rebound as the population ages. The 65-74 year old cohort, which is increasingly heading toward this type of housing, will grow at a faster pace within the next five years. Developers who target this customer group will therefore do well.

### RESALE MARKET: THE HIGH-END CONDO MARKET IS SATURATED

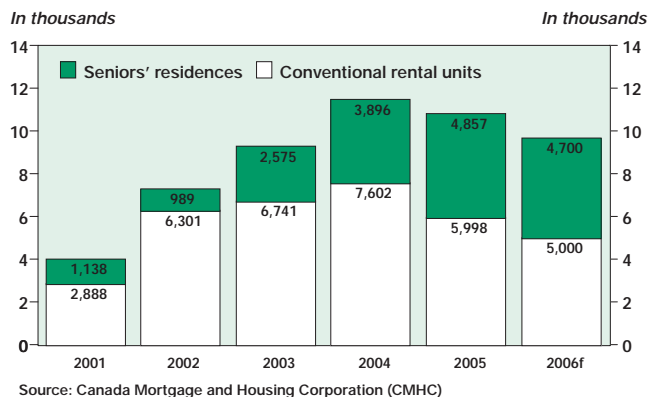


# At a glance

## Seniors' residences booming

Construction of seniors' residences has seen a real boom since 2001. The number of starts has quadrupled, reaching almost 5000 units last year, that is, 45% of the rental housing units built in Québec. This enthusiasm is due to average rents that are above \$1000, which helps make the projects cost effective. While the niche looks likely to have a promising long-term future, as the population ages, demand will not surge immediately. In effect, the wave of baby boomers—born between 1946 and 1966—will only invade the market starting in ten years, as the older boomers close in on the 70 mark. In the short run, there is good potential for this type of residence, but caution is required. Following the recent construction boom, the shortage is on the way to being removed and some sectors are already saturated. Keep an eye on the results of this spring's CMHC seniors' housing survey. It is highly likely that vacancy rates will have gone up, which will bring down construction in 2006.

### RENTAL UNIT STARTS: SENIORS' RESIDENCES UP SHARPLY



Moreover, there will also be fewer starts for conventional rental housing units this year. Although the shortage has not been completely eliminated (provincial vacancy rate of 2% in 2005), there are already upmarket surpluses in some areas. In Gatineau, 13.9% of rental units priced at \$900 and up are vacant. In Québec City, 6.1% of units going for over \$1000 are not occupied. Greater Montreal is characterized by a slight surplus (3.8%), but there is still a shortage in the Laval/North Shore and South Shore areas. In the other urban areas, the statistics do not allow a surplus in the higher rental price ranges to be detected. Construction of rental housing will thus be down again this year as a result of lesser upmarket need.

## Less demand for homes

The resale market is on the way to equilibrium and buyers are finally getting back some negotiating power. For the moment, the market is still tight in most urban areas, and annual

price increases are between 5% and 10%. As for condos, the slowdown is hitting the more expensive residences first. There is already a surplus of single-family dwellings in the higher price ranges in a number of places in the province, such as Québec City, Montréal and Gatineau. The buyers have the advantage for homes priced at more than \$250,000 in Laval and Montréal's North and South Shores, with average times to sale of close to three months compared to two months a year ago.

The market began to soften last year, and 2006 will mark the start of a decline in the number of sales. There will also be fewer construction starts for houses, with a second yearly decrease of 15% being expected. With more properties for sale on the existing home market, fewer buyers will look to new construction. The somewhat higher cost of new construction will act as a brake, particularly in the context in which mortgage rates have gone up since mid-2005.

### THE HOUSING START DECLINE IS GENERALIZED IN QUÉBEC

	2004	2005	2006f
Total	58,448	50,910	43,000
Var. in %	16.2	-12.9	-15.5
Houses	32,912	27,682	24,000
Var. in %	8.2	-15.9	-13.3
Apartments	25,536	23,228	19,000
Var. in %	28.6	-9.0	-18.2
Incl:			
Condos*	11,797	9,755	7,500
Var. in %	34.4	-17.3	-23.1
Rental units*	12,167	11,567	9,700
Var. in %	22.7	-4.9	-16.1

\*Urban centres with populations of 10,000 and up only.

Sources: Canada Mortgage and Housing Corporation (CMHC) and forecasts by Desjardins, Economic studies

It's a fact: residential construction is cyclical. In the past, peak periods have been followed by a brutal drop in housing starts. Construction that is too fast with respect to population growth, sometimes accompanied by a recession, can be followed by a lengthy soft patch, as was the case in the 90s. This time, the boom in starts was focused on eliminating the housing shortage, and did not lead to a generalized surplus. Only a few sub-markets, like high-end condos and rental housing units, are seeing a slight surplus in some locations. They will thus undergo a more pronounced slowdown in the short term. Since the housing market is quickly approaching equilibrium, starts will move in tandem with the increase in the number of households over the next five years. The Institut de la Statistique du Québec is projecting an annual 35,000 to 40,000 increase in the number of households, which will be a reference for housing starts. This is well below the peak of 58,448 new housing units reached in 2004, and establishes the guidelines for the second half of the decade. ■

# Financial Industries...

- Continued from page 1

## Personal savings: substantial increase in wealth

Economically speaking, the past ten years have been particularly fruitful for Québec. Annual GDP growth reached 2.8% on average, between 1996 and 2005, compared to the 1.7% seen the previous ten years. The job market was also very dynamic throughout this period: job creation climbed by 1.7%, on average, compared to 1.0% from 1986 to 1995. This strength also had a positive effect on households' real after tax income, which has gone up by 2.0% on average since 1996, compared to the weaker 1.7% increase seen over the ten preceding years.

This context has favoured ongoing accumulation of financial assets by individuals. Québec households have made significant gains in wealth in the last ten years. Their financial assets, which totalled \$362.3B on December 31, 2005 compared to \$172.0B in 1995, grew by 110.7% during this period, representing a non-negligible average annual gain of 7.7%.

These gains were achieved in part by channelling a significant share of savings into higher-risk savings products, such as mutual funds and other securities (e.g. Treasury bills, bonds, shares, etc.). This type of saving amounted to \$228.7B at the end of last year, compared to only \$59.9B at the end of 1995. Thus, their weight relative to the total financial assets of Québec households has nearly doubled in ten years, going from 34.8% to 63.1% last December 31.

In fact, the context of low interest rates and periods of stock market euphoria made a sizeable contribution to financial institutions' off balance sheet savings products such as mutual funds and other securities. For example, interest rates paid on five-year term deposits were 7.06% on average in 1995, while they were 2.71% in 2005. The Toronto Stock Exchange's S&P/TSX index rose by 139.1% (or an annual average of 9.1%). Therefore, it comes as no surprise that on-balance sheet savings products, such as GICs, guaranteed annuities, savings bonds, etc., have seen their popularity decline in recent years.

As we can see in the table on page 10, Desjardins Group has been able to adapt to this new state of affairs. Its Québec market share in the off-balance sheet savings market went from 4.2% in 1995 to 11.7% in 2005. During this period, it also nearly doubled its presence in the mutual funds field, and more than tripled its presence in the securities brokerage sector.

**This context favoured sustained growth in financial assets...**

## Consumer and business credit: more sustained demand from households

Since the mid-1990s, Québec's economic prosperity has resulted in a fairly strong demand for credit by consumers. In effect, personal loans and residential mortgage loans, which totalled \$171.1B on December 31, 2005, have gone up by 6.1% on average since 1996.

On one hand, consumer loans, including personal lines of credit and credit card, grew by 7.8% annually between 1996 and 2005. On the other hand, home mortgage loans posted a slightly less pronounced increase during this period, 5.4%.

This result, however, obscures a pace that was much more solid between 2001 and 2005 than it was during the five years prior: 8.7% versus 2.3%. This marked acceleration can be attributed to the real estate boom Québec has been experiencing since the turn of the millennium, with residential construction hitting levels unseen since the late 80s.

Resales of existing homes were also very lively. The number of transactions per year remained above 50,000 sales, while a new record was set in 2005 with 70,649 transactions. To top it off, the average selling price for a home has jumped by 65.8% since 2001.

For businesses, demand for bank loans was not as strong as for consumers over the past ten years. Commercial and industrial loans have practically stagnated since 1996, posting annual average growth of only 0.8%. Judging from Canadian data, other forms of financing picked up the slack during this period; leasing, for example, saw its receivables go from \$6B in 1995 to \$25B at the end of last year. The stock and bond markets have also been experiencing some demand in the last ten years. In fact, bonds outstanding reached \$268B at the end of 2005, as opposed to \$109B ten years earlier, while the shares outstanding were almost \$300B compared to \$170B in 1995.

Demand for loans from farmers was fairly strong in the last ten years, with average annual growth of 9.6% in Québec. The significant increase in the value of agricultural land (nearly 7% per year) and milk quotas has a lot to do with this strength. The surge still conceals a significant slowdown since 2003, however, which began with the discovery of a case of mad cow disease in Canada and the moratorium imposed on the pork industry.

Lastly, Desjardins Group has, over the years, maintained its role as a leader in the financing of Québec's economic activity, with a market penetration rate extending to almost a third of total current loans to individuals and businesses.

# Financial Industries...

## PERSONAL SAVINGS ACTIVITIES

As at December 31, in M\$	2005			2000			1995		
	Chartered Banks	Desjardins Group	Total market <sup>7</sup>	Chartered Banks	Desjardins Group	Total market <sup>7</sup>	Chartered Banks	Desjardins Group	Total market <sup>7</sup>
<b>ON-BALANCE SHEET PERSONAL</b>									
<b>SAVING<sup>2</sup></b>	59,513	57,321	133,625	48,103	45,224	108,466	50,885	41,692	112,039
• Market share (in %)	44.5	42.9	100.0	44.3	41.7	100.0	45.4	37.2	100.0
<b>OFF-BALANCE SHEET PERSONAL</b>									
<b>SAVINGS*, INCLUDING:</b>	150,923	26,815	228,659	108,787	11,646	165,751	40,447	2,487	59,911
• Market share (in %)	66.0	11.7	100.0	65.6	7.0	100.0	67.5	4.2	100.0
MUTUAL FUNDS <sup>3</sup>	25,253	9,294	105,056	16,025	4,774	74,597	5,060	996	21,992
• Market share (in %)	24.0	8.8	100.0	21.5	6.4	100.0	23.0	.,5	100.0
RETAIL BROKERAGE <sup>4</sup>	125,670	17,695	155,918	92,762	6,935	116,549	35,387	1,497	45,529
• Market share (in %)	80.6	11.3	100.0	79.6	6.0	100.0	77.7	3.3	100.0
<b>SOCIAL INVESTMENT FUNDS</b>									
IN VENTURE CAPITAL <sup>5</sup>	0	583	7,240	0	0	4,217	0	0	1,450
• Market share (in %)	0.0	8.1	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>									
	210,436	84,136	362,284	156,890	56,870	274,217	91,332	44,179	171,950
• Market share (in %)	58.1	23.2	100.0	57.2	20.7	100.0	53.1	25.7	100.0
<b>RRSPs<sup>7</sup></b>	51,946	25,856	118,687	40,204	17,593	90,627	25,503	13,425	54,329
• Market share (in %)	43.8	21.8	100.0	44.4	19.4	100.0	46.9	24.7	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: \$39,555 million in 2005, \$29,612 million in 2000 and \$9,060 million in 1995.

## FINANCING ACTIVITIES

As at December 31, in M\$	2005			2000			1995		
	Chartered Banks	Desjardins Group	Total market <sup>8</sup>	Chartered Banks	Desjardins Group	Total market <sup>8</sup>	Chartered Banks	Desjardins Group	Total market <sup>8</sup>
<b>CONSUMPTION</b>									
	31,068	13,221	54,790	19,827	9,703	36,970	14,257	7,815	25,968
• Market share (in %)	56.7	24.1	100.0	53.6	26.2	100.0	54.9	30.1	100.0
<b>HOME MORTGAGES</b>									
	59,798	45,544	116,352	38,015	29,018	76,722	31,051	26,102	68,625
• Market share (in %)	51.4	39.1	100.0	49.5	37.8	100.0	45.2	38.0	100.0
<b>CONSUMER CREDIT</b>									
	90,866	58,765	171,141	57,842	38,721	113,692	45,308	33,917	94,593
• Market share (in %)	53.1	34.3	100.0	50.9	34.1	100.0	47.9	35.9	100.0
<b>COMMERCIAL &amp; INDUSTRIAL</b>									
	22,111	11,807	47,945	24,492	9,651	45,563	23,413	10,005	44,159
• Market share (in %)	46.1	24.6	100.0	53.8	21.2	100.0	53.0	22.7	100.0
<b>FARM</b>									
	4,170	4,645	11,292	3,135	3,249	8,076	1,657	1,916	4,496
• Market share (in %)	36.9	41.1	100.0	38.8	40.2	100.0	36.9	42.6	100.0
<b>BUSINESS CREDIT</b>									
	26,281	16,452	59,237	27,627	12,900	53,639	25,070	11,921	48,655
• Market share (in %)	44.4	27.8	100.0	51.5	24.0	100.0	51.5	24.5	100.0
<b>TOTAL</b>									
	117,147	75,217	230,379	85,469	51,621	167,331	70,378	45,838	143,248
• Market share (in %)	50.8	32.6	100.0	51.1	30.8	100.0	49.1	32.0	100.0

# Financial Industries...

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

LIFE AND HEALTH INSURANCE				
Main companies	2004		2003	
	M\$	In%	M\$	In%
<b>Desjardins Group</b>	<b>1,579</b>	<b>18.0</b>	<b>1,580</b>	<b>18.0</b>
Great West	1,221	13.9	1,116	12.7
SunLife of Canada	1,084	12.3	1,117	12.7
Industrial Alliance	988	11.2	965	11.0
SSQ	807	9.2	750	8.5
Standard Life	637	7.3	521	5.9
Manulife	543	6.2	523	5.9
La Capitale	312	3.6	293	3.3
Transamerica	206	2.3	202	2.3
Royal Bank (RBC)	191	2.2	133	1.5
<b>Subtotal</b>	<b>7,568</b>	<b>86.2</b>	<b>7,200</b>	<b>81.9</b>
<b>Banks (including RBC)</b>	<b>303</b>	<b>3.4</b>	<b>237</b>	<b>2.7</b>
<b>TOTAL</b>	<b>8,784</b>	<b>100.0</b>	<b>8,792</b>	<b>100.0</b>

PROPERTY AND CASUALTY INSURANCE				
Main companies	2004		2003	
	M\$	In%	M\$	In%
ING Canada	1,075	15.3	1,018	15.2
<b>Desjardins Group</b>	<b>850</b>	<b>12.1</b>	<b>807</b>	<b>12.0</b>
AXA Canada	661	9.4	634	9.4
Aviva Canada	453	6.5	455	6.8
Promutual Group	451	6.4	409	6.1
La Capitale	313	4.5	276	4.1
The Co-operators	283	4.0	273	4.1
AIG	266	3.8	277	4.1
Northbrige	214	3.0	207	3.1
Lloyd's	219	3.1	204	3.0
<b>Subtotal</b>	<b>4,785</b>	<b>68.2</b>	<b>4,560</b>	<b>67.9</b>
<b>Banks</b>	<b>220</b>	<b>3.1</b>	<b>214</b>	<b>3.2</b>
<b>TOTAL</b>	<b>7,017</b>	<b>100.0</b>	<b>6,715</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: slight surge felt in 2005

Note that the Autorité des marchés financiers will only publish its 2005 annual report on life, and property and casualty insurance activities in Québec in June 2006. Nevertheless, we can briefly outline the trends it will likely observe.

In the life and health insurance industry, active companies will have collected about \$9.0B in life insurance, health insurance and annuity premiums, for a gain of 2.5% from 2004, when they totalled \$8.8B.

Specifically, individual and group insurance activities, including accident and health coverage, will have generated nearly \$7.5B in gross direct premiums, up by 2.0% from 2004 (\$7.3B). In terms of annuities, individuals increased subscriptions by only 3.0%, totalling \$843M (\$818M in 2004). Due to last year's strong stock markets (e.g., the S&P/TSX index jumped by 21.9%), it is safe to bet that many households opted for segregated funds, a riskier product than GICs, but one that offers a better potential return. For example, net sales of

individual segregated funds in Canada were \$3.4B in 2005, according to Toronto's Investor Economics Inc., compared with \$2.5B in 2004 and \$1.0B in 2003. As for group annuities, they will have grown by 7.5% to \$682M (\$634M in 2004).

In Québec in 2004, there were over one hundred companies specializing in the life and health insurance sector, with a total of \$8.8B in premiums. As shown on the table above, despite the high number of companies, the concentration there is still fairly significant. In fact, the three largest life insurers were billionaires, taking 44.2% of premiums collected in Québec. This proportion totals 86.2% if we consider the ten largest companies.

Among these titans, Desjardins Financial Security, a subsidiary of Desjardins Group, headed the ranks with a premium volume of \$1.6B and a market share of 18.0%. Great West and SunLife took second and third position with penetration rates of 13.9% and 12.3% respectively. Lastly, for the first time ever, in 2004, a bank, the Royal Bank of Canada, was one of the ten largest life insurance companies in Québec, with more than \$190M in premiums underwritten in this industry.

# Financial Industries

## Property and casualty insurance: a new slowdown

The pace of growth for property and casualty insurance in Québec appears to have slowed down over the last year. In fact, premiums subscribed appear to have increased by about 2.0% to total \$7.2B. This is a slowdown compared to 2004, in which premiums increased by 4.5% to \$7.0B.

The flagging housing market in Québec last year was one reason for this weakening. Housing starts reached 50,910 units, a slide of 12.9% from the previous year, for which they were 58,448 units (+16.2%). Resales of existing homes were also a bit less vigorous, with an increase of only 2.0% in transactions. Moreover, Québec households were prudent about buying new vehicles. Sales in this sector were 408,707 units, an annual increase of less than 1%. Remember that about 60% of property and casualty insurance premiums are on automobiles and housing.

Lastly, as we can see from the table on page 11, this sector included only a single billionaire in 2004, European giant ING, which collected 15.3% (or \$1.1B) of premiums subscribed in Québec. Desjardins Group, through its subsidiaries Desjardins General Insurance and The Personal, were close behind with a premium volume of \$850M and a 12.1% relative share. It thus outperformed another European giant, AXA. We can also see that this industry is somewhat less concentrated, as the ten largest property and casualty insurance companies collected 68.2% of the premiums subscribed in 2004, compared to 86.2% for the ten largest life and health insurers.

## Asset administration and management: a climate that is conducive to business development

The Toronto Stock Exchange's S&P/TSX index closed the year with a significant gain of 21.9%, bringing the index's appreciation since December 2002 to 70.4%. In this context, we could surmise that assets in custody and under management have seen very sustained growth during this period. For example, according to Investor Economics Inc., mutual funds in Canada, including the segregated funds of insurance companies and other companies offering similar products, appear to have jumped by approximately 15% in 2005, while assets in custody with securities brokers grew by approximately 20% the same year. As for assets in Canadian pension funds, we estimate that they grew by close to 15% last year. We can therefore expect businesses specializing in administering and managing wealth to have posted solid growth in their business volumes last year.

Desjardins Group is particularly active in these two markets in Québec and in the rest of Canada. For example, assets administered and managed on behalf of others totalled \$241B in 2005, up by 18.2% from 2004. In terms of wealth management, the Group managed \$13.2B last year, an increase of 27.1% from the previous year (\$10.4B). ■

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