

ECONOMIC & FINANCIAL OUTLOOK

2024 Outlook: A Pyrrhic Victory over Inflation

Jimmy Jean, Vice-President, Chief Economist and Strategist

The year 2023 started with much apprehension on the effects that aggressive monetary policy tightening globally would have on economies around the world. When it comes to GDP, outcomes have varied significantly. Through much skepticism, the US managed to keep growing above potential, and yet inflation has receded substantially. Canada's economy managed to avoid a technical recession in the middle of the year, but it would have been a different story were it not for a record pace of demographic growth. Meanwhile in Europe, there are many indications that a recession might have started in the second half of the year, whereas China continues to weaken under the plight of the property market correction and the attendant impact on confidence.

The good news is that the enemy of excess inflation is weakened. Demand–supply imbalances are fading in many jurisdictions, excess demand for workers has been fulfilled to a large extent and monetary policy lags continue to operate. Spring 2024 will mark the second anniversary of the first rate hikes in North America, implying that the peak effects of high interest rates will be witnessed throughout the year. It will still be a long and winding road to get inflation to 2% given wage stickiness and, in cases such as Canada, the effects of the large housing supply gap on shelter inflation. But steady progress should give central banks enough confidence to be able to start dialing back monetary restraint.

The bad news is that conditions will continue to be painful for households and businesses. We expect Canada's GDP to barely grow on an annual basis in 2024. The need to save more to address the mortgage renewal cycle was among

the reasons for nearly flat consumer spending during much of 2023, but with about half of borrowers still having to renew, these pressures are guaranteed to be sustained into 2024. Businesses are approaching the year with elevated concerns, as demand is weakening and wage costs keep climbing. As is typical in such phases of the economic cycle, non-residential business investment will be a casualty. For a country whose stock of capital is declining and that urgently needs to improve its productivity track record, this is highly concerning. While some areas such as purpose-built rental construction and clean manufacturing will benefit from robust policy incentives, Canada's prosperity relies on broad-based innovation and technological adoption. Absent a turnaround on the productivity front, Canada will see its GDP per capita continue to fall in 2024.

There are a number of risks to the outlook. One of them is the US presidential campaign, which will dominate airwaves, but won't have any significant impact until 2025. A Trump win would be more destabilizing from a trade point of view and on the tone of the relationship with China, but a Trump administration would be unlikely to roll back Biden's signature economic policies. In Canada, housing remains top of mind, with the upward trend in listings in certain cities signalling potential further depreciation in housing values. This could add another layer of financial difficulty for stretched homeowners who bought when prices were at their peak. And just about everywhere, disruption risks remain elevated. These can stem from a variety of factors, including weather events, labour strikes, geopolitical conflicts, financial market volatility and public health concerns. On those fronts, nothing indicates that 2024 will offer a respite from the tumult experienced in 2023.

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Jimmy Jean, Vice-President, Chief Economist and Strategist • Randall Bartlett, Senior Director of Canadian Economics
 Benoit P. Durocher, Director and Principal Economist • Royce Mendes, Managing Director and Head of Macro Strategy
 Hélène Bégin, Principal Economist • Tiago Figueiredo, Associate – Macro Strategy • Francis Généreux, Principal Economist
 Lorenzo Tessier-Moreau, Principal Economist • Hendrix Vachon, Principal Economist

Desjardins Economic Studies: 514-281-2336 or 1-866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

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RISKS INHERENT IN OUR SCENARIOS

Inflation is coming down, though it remains above target in many countries. The odds of additional interest rate hikes have dropped significantly, but they're not zero. Further progress on inflation could take longer, and other inflationary shocks aren't out of the question. There's also a good deal of uncertainty surrounding the effect of high interest rates on economic growth. GDP has stalled in Canada, but not in the US. We could see sustained headwinds in the coming quarters. As mortgages taken out at low interest rates during the pandemic come up for renewal, many Canadian borrowers will feel the squeeze. And if the global economy gets stuck in a major rut, Canada could see its exports fall and terms of trade deteriorate dramatically. Higher unemployment and interest rates could also mean a bigger housing market correction in Canada. Then there's the risk of banking sector turmoil that could make matters worse by further tightening credit conditions. This could lead to more bankruptcies and sharper price corrections in several asset classes. The spectre of another government shutdown in the US and the spread of labour unrest to other industries could also destabilize the economy. From a currency perspective, if the global economy falls off a cliff, the greenback will likely surge. This could exacerbate vulnerabilities and spark foreign debt crises in more fragile countries. The situation in China remains worrisome as well. Worsening geopolitical tensions could also spell instability for the global economy, financial markets and commodity prices, particularly as the Israeli–Palestinian conflict escalates. And finally, we can't rule out the possibility of more volatility from extreme weather events that are adding to today's already uncertain macroeconomic environment.

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

%	WEIGHT*	REAL GDP GROWTH			INFLATION RATE		
		2023f	2024f	2025f	2023f	2024f	2025f
Advanced economies	38.7	1.5	1.1	1.8	4.6	2.5	2.2
United States	15.7	2.4	1.4	1.9	4.1	2.6	2.5
Canada	1.4	1.1	0.1	2.0	3.8	2.3	2.0
<i>Quebec</i>	0.3	-0.1	0.1	1.5	4.5	2.8	2.0
Japan	3.6	1.7	0.6	0.9	3.2	2.2	1.4
United Kingdom	2.3	0.5	0.5	1.6	7.4	2.9	2.3
Eurozone	11.9	0.5	0.6	1.7	5.6	2.2	1.9
<i>Germany</i>	3.3	-0.1	0.4	1.5	6.1	2.4	2.1
<i>France</i>	2.3	0.9	0.7	1.6	5.0	2.4	1.9
<i>Italy</i>	1.9	0.7	0.5	1.6	6.0	2.2	1.8
Other countries	4.2	1.1	1.5	2.2	4.6	2.5	2.2
<i>Australia</i>	1.0	1.7	1.3	2.4	5.6	3.2	2.7
Emerging and developing economies	61.3	3.8	3.7	3.8	8.6	6.2	4.9
North Asia	26.9	5.6	4.9	4.6	3.2	2.9	3.0
<i>China</i>	18.5	5.5	4.4	4.1	0.6	1.6	1.9
<i>India</i>	7.2	6.3	6.2	6.5	5.6	4.6	4.6
South Asia	5.2	4.1	4.5	4.5	3.5	2.7	2.7
Latin America	5.7	2.5	1.5	2.6	5.1	3.7	3.6
<i>Mexico</i>	1.7	2.9	1.8	2.4	4.7	3.8	3.7
<i>Brazil</i>	2.3	3.2	1.0	2.7	4.8	3.8	3.9
Eastern Europe	8.2	2.1	2.3	2.7	19.4	15.2	9.1
<i>Russia</i>	3.2	1.9	1.5	1.5	6.2	4.8	4.7
Other countries	15.3	2.2	2.8	2.7	19.0	12.2	10.0
<i>South Africa</i>	0.6	0.7	1.3	1.2	5.8	4.8	5.1
World	100.0	3.0	2.7	3.0	7.1	4.8	3.9

f: forecast; PPP: Purchasing Power Parities, exchange rate that equates the costs of a broad basket of goods and services across countries; * 2022.

Sources: World Bank, Consensus Forecasts and Desjardins Economic Studies

FINANCIAL FORECASTS

Most central banks are done raising key interest rates, and cuts could begin as early as next spring. It will not be necessary for inflation to return to its target before these first cuts. As the picture improves in terms of consumer price growth, real interest rates will increase and become more restrictive for the economy. It will then become justified to reduce them, especially if the job market and the economy moderate as we expect. By the end of 2024, we forecast six 25 basis point cuts for the Canadian overnight rate. The American equivalent could be reduced a little less, while the US economy should remain in better shape than the Canadian economy. Further rate cuts should follow in 2025, but these could be more gradual. Central banks will then be walking on thin ice to avoid reviving inflation at the same time as the economy recovers. Ultimately, we do not expect interest rates to return to their pre-pandemic levels. The deterioration in economic data in several countries is expected to weigh on equity markets into early 2024. The prices of oil and several commodities could fall further in the short term. However, rebounds in the stock markets and commodities are expected when interest rate cuts materialize and the economy regains strength. Many currencies will follow a similar trend, including the Canadian dollar. Despite lower key interest rates in Canada, the loonie should appreciate later in 2024 amid higher commodity prices and improved investor risk appetite.

TABLE 2
Summary of financial forecasts

END OF PERIOD IN % (UNLESS OTHERWISE INDICATED)	2023		2024				2025			
	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key interest rate										
United States	5.50	5.50	5.50	5.50	5.00	4.50	4.00	3.50	3.00	3.00
Canada	5.00	5.00	5.00	4.50	4.00	3.50	3.00	2.50	2.25	2.25
Eurozone	4.50	4.50	4.50	4.00	3.50	3.00	2.75	2.50	2.25	2.25
United Kingdom	5.25	5.25	5.25	5.25	4.75	4.25	3.75	3.25	3.00	2.75
Federal bonds										
<u>United States</u>										
2-year	5.14	4.70	4.35	4.05	3.70	3.40	3.20	3.00	3.00	3.00
5-year	4.64	4.30	4.10	3.80	3.50	3.25	3.10	3.10	3.10	3.10
10-year	4.57	4.35	4.20	4.00	3.75	3.55	3.40	3.30	3.30	3.30
30-year	4.70	4.50	4.35	4.15	3.90	3.65	3.50	3.35	3.35	3.35
<u>Canada</u>										
2-year	4.87	4.15	3.80	3.30	2.95	2.70	2.50	2.35	2.30	2.30
5-year	4.25	3.55	3.35	3.05	2.75	2.65	2.60	2.55	2.50	2.50
10-year	4.03	3.45	3.30	3.10	2.90	2.80	2.75	2.70	2.65	2.65
30-year	3.81	3.30	3.20	3.05	2.85	2.80	2.75	2.70	2.70	2.75
Currency market										
Canadian dollar (USD/CAD)	1.36	1.37	1.38	1.37	1.35	1.33	1.32	1.32	1.32	1.33
Canadian dollar (CAD/USD)	0.74	0.73	0.73	0.73	0.74	0.75	0.76	0.76	0.76	0.75
Euro (EUR/USD)	1.06	1.07	1.07	1.08	1.10	1.12	1.13	1.14	1.15	1.16
British pound (GBP/USD)	1.22	1.25	1.25	1.27	1.28	1.30	1.32	1.33	1.34	1.35
Yen (USD/JPY)	149	145	142	138	133	130	128	127	126	125
Stock markets (level and growth)*										
United States – S&P 500	4,450 (+15.9%)		Target: 4,450 (0%)				Target: 4,740 (+6.5%)			
Canada – S&P/TSX	19,750 (+1.9%)		Target: 20,000 (+1.3%)				Target: 21,360 (+6.8%)			
Commodities (annual average)										
WTI oil (US\$/barrel)	78 (73*)		82 (85*)				83 (82*)			
Gold (US\$/ounce)	1,920 (1,900*)		1,730 (1,720*)				1,710 (1,700*)			

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

Overseas

Major Economies Will Continue to See Flat Growth

FORECASTS

Real GDP declined in most major advanced economies in the third quarter, reflecting weak or stagnant economic activity due to higher interest rates. These economies—especially the eurozone and United Kingdom—should continue to post slight contractions or very modest growth in the coming quarters. This will help bring inflation down further. We even expect interest rate cuts in the spring in the eurozone and over the summer in the UK, helping the economy pick up late next year. Growth in China will likely remain relatively slow despite the government’s efforts. Global real GDP is expected to come in at 3.0% in 2023, 2.7% in 2024 and 3.0% in 2025.

The global economy buckled in 2023 under the weight of higher interest rates and the steep cost of living. While all G7 economies expanded in the first quarter, only the US (+5.2% annualized) and Italy (+0.4% annualized) saw positive real GDP growth in the third quarter. A big Q4 rebound is unlikely, meaning annual global GDP growth will probably slow from 3.4% in 2022 to 3.0% in 2023.

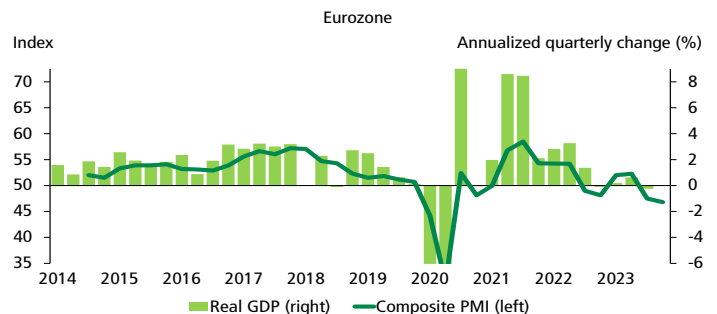
This global slowdown has sent most commodity prices lower. Even oil prices are down despite another round of production cuts announced by the Organization of the Petroleum Exporting Countries and its partners (OPEC+) (graph 1). The market has little confidence that OPEC+ will meet its new production targets, as many oil producers, especially those in Africa, are likely to ignore them. Metal and energy product prices are expected to fall for a few more months, but should rebound as demand picks up in the second half of 2024 and into 2025.

The eurozone economy contracted in the third quarter, with real GDP shrinking an annualized 0.5%. While fairly modest, this decline reflects the current climate and the short-term outlook. It therefore appears the eurozone is experiencing stagnant growth rather than an actual recession. This is also borne out by the

PMIs (graph 2) and the main consumer and business confidence indexes. But Germany is at a higher risk, as ifo large business confidence indexes suggest economic activity is more likely to contract (graph 3).

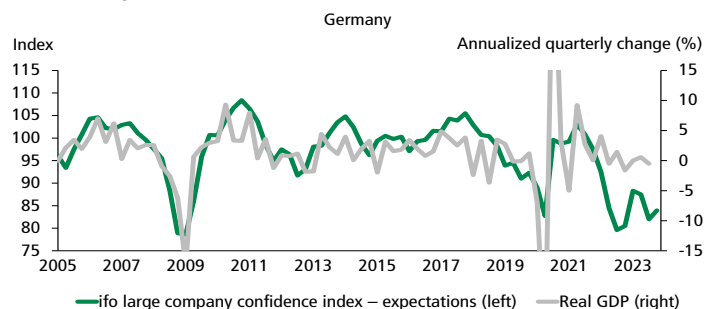
The eurozone’s economic slowdown is largely the result of the European Central Bank’s (ECB) rate hikes, which have brought

GRAPH 2
The Composite PMI Suggests Eurozone Real GDP Will Continue to Fall Moderately



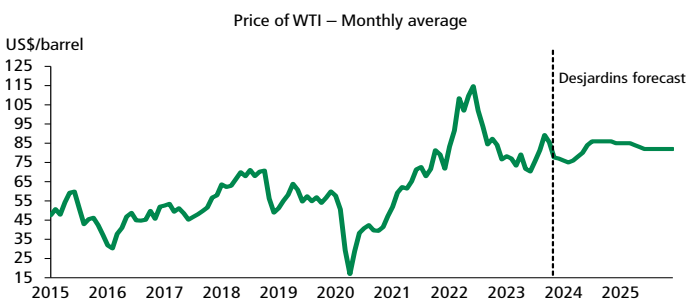
Sources: S&P Global, Eurostat and Desjardins Economic Studies

GRAPH 3
The ifo Index Shows a High Risk of a Sharp Economic Contraction in Germany



Sources: ifo Institute for Economic Research, Federal Statistical Office and Desjardins Economic Studies

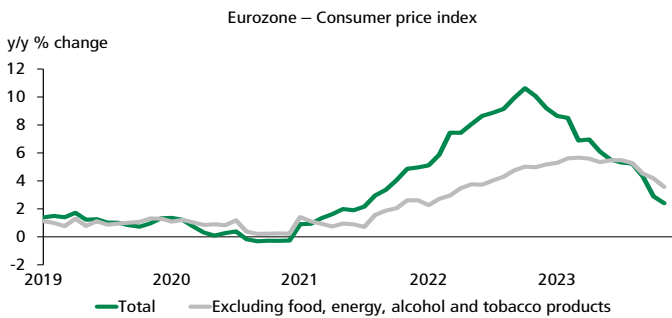
GRAPH 1
The OPEC+ Production Cut Sent Oil Prices Lower



OPEC+: Organization of the Petroleum Exporting Countries and its partners; WTI: West Texas Intermediate
Sources: Datastream and Desjardins Economic Studies

inflation down sharply. Over the past year, the annual change in the consumer price index has plummeted from a high of 10.6% to just 2.4% in November. This is due primarily to a drop in energy prices, which spiked last year over supply fears sparked by the war in Ukraine. But we're also seeing progress on core inflation, which strips out food and energy. It came in at 3.6% in November in the eurozone (graph 4). With inflation coming down and economic stagnation on the horizon, the ECB will likely start cutting interest rates in the spring.

GRAPH 4
Eurozone Inflation Has Already Come Down Sharply

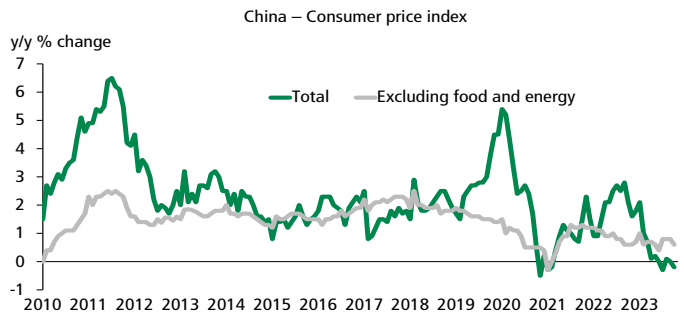


Sources: Eurostat and Desjardins Economic Studies

It's a similar story in the United Kingdom. There too, real GDP contracted in the third quarter, and more weak growth or declines are expected in the coming quarters. Inflation has been a bit stickier in the UK, so the Bank of England will probably wait until summer before cutting interest rates. In Japan, economic activity fell in the third quarter after surging in the spring. Look for weak real GDP growth in the coming quarters.

China's economy was expected to come roaring back in 2023 after the country lifted its zero-COVID policy, but the rebound early this year quickly faded. Housing market problems, high local government debt and pandemic fallout on Chinese consumption have all hobbled growth. As a result of these factors and the challenging global economic environment, inflation came down and even fell into negative territory on two occasions (graph 5). This stands in stark contrast to what we've seen in most other major economies. The central government's stepped-up stimulus measures have been somewhat successful. China posted a stronger-than-expected 1.3% quarterly jump in real GDP in the third quarter. These measures aren't addressing the underlying issues, however. They're designed to generate short-term rather than long-term economic gains. And even those gains may have been short-lived, as data from October and November suggest weak real GDP growth in the fourth quarter. We therefore expect growth to come in at 5.5% in 2023, 4.4% in 2024 and 4.1% in 2025.

GRAPH 5
Chinese Inflation Slipped into Negative Territory



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

United States

After Surging in the Third Quarter, US Economic Growth Is Poised to Slow

FORECASTS

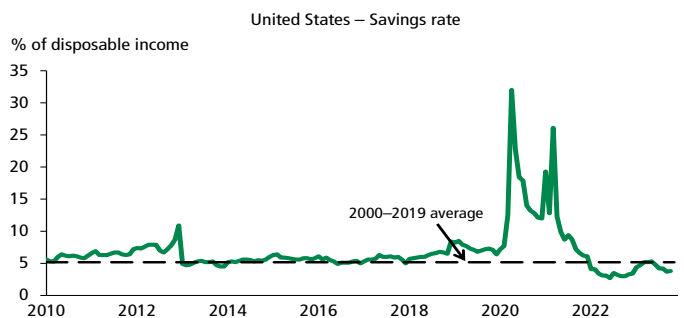
US real GDP grew a whopping 5.2% annualized in the third quarter on the back of stronger real consumption. But real consumption should slow in the coming quarters as consumers feel the pinch of high interest rates. We should therefore see a pullback in hiring, inflation and real GDP growth, prompting the Federal Reserve to start cutting interest rates next year. Look for real GDP to expand 2.4% in 2023, 1.4% in 2024 and 1.9% in 2025.

The 5.2% annualized jump in real GDP in Q3 2023 was impressive but not all that surprising. It's the fastest pace of growth since the fourth quarter of 2021, and it's particularly stunning given still-high inflation and sky-high interest rates. This bounce in real GDP was largely the result of real consumption (graph 6), which picked up despite relatively low consumer confidence. That's one reason we think it's too good to last. We expect the economy to slow, but don't think a US recession is all that likely anymore.

In fact, we've seen some encouraging signs for consumers recently. Consumer confidence improved slightly in December as gasoline prices have come down sharply in recent weeks, mortgage rates are falling (though still elevated), and stocks have been rallying since late October. That said, consumers are still struggling. While the tight labour market has driven up incomes, it's expected to soften. At the same time, consumers are keeping up their spending by saving less, which doesn't bode well for the medium term (graph 7). And credit is slowing amid higher interest rates and tighter lending conditions. New car sales have stalled in recent months despite improving dealer inventories. Bottom line? We expect real consumption to slow or flatline in the coming quarters. This will likely mean weaker real GDP growth in the first half of 2024.

GRAPH 7

The US Has a Relatively Low Household Savings Rate



Sources: Datastream and Desjardins Economic Studies

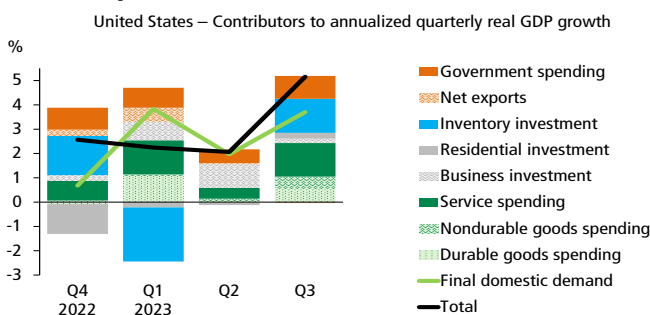
The US labour market has been remarkably resilient, but the tide appears to be turning on this front as well. Consumer confidence surveys are increasingly sending mixed messages about how easy it is to find a job. Unemployment has climbed in recent months (only to retreat slightly in November), but there's no clear sign of an economic downturn. Weekly unemployment claims have been up and down, but the number of applicants has been rising steadily (graph 8 on page 7). This suggests that while layoffs remain few and far between, it's increasingly difficult for the unemployed to find a new job. We also expect hiring to slow in the coming months without a drop in net employment.

There are other signs of weaker GDP growth ahead as well. Over the summer, the Biden policy-driven surge in nonresidential construction started to peter out. Meanwhile residential investment posted its first quarterly advance since early 2021, but likely fell back as mortgage rates surged in late October to their highest levels since 2000. Rates have since come down, but not enough to significantly boost mortgage demand. And weak economic growth elsewhere around the world suggests exports won't be a big contributor to US real GDP growth.

We therefore expect US economic growth to slow in the coming quarters, which should help bring inflation to heel.

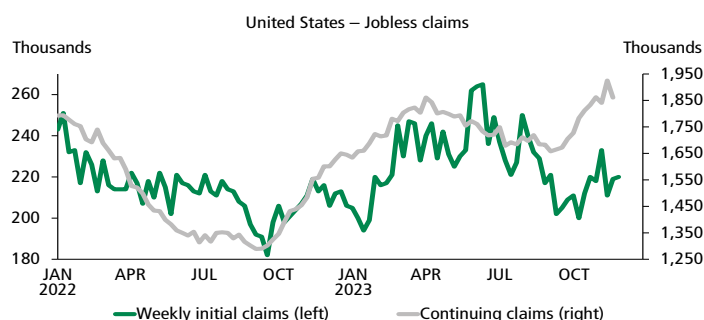
GRAPH 6

Stronger Consumption Contributed to US Real GDP Growth in the Third Quarter



Sources: Bureau of Economic Analysis and Desjardins Economic Studies

GRAPH 8
The Number of Unemployment Insurance Recipients Is Up



Sources: Employment and Training Administration and Desjardins Economic Studies

Consumer price growth is already down sharply on a year-over-year basis, falling from its June 2022 peak of 9.1% to “just” 3.2% in October. This slowdown should continue, especially if the labour market continues to soften. If that happens, expect the Fed to end its interest rate hold and start cutting rates in the third quarter of next year. But it will likely do so gradually, meaning monetary policy will remain relatively restrictive in 2024 and 2025, especially in real terms (on an inflation-adjusted basis).

TABLE 3
United States: Major economic indicators

QUARTERLY ANNUALIZED % CHANGE (UNLESS OTHERWISE INDICATED)	2023		2024				ANNUAL AVERAGE			
	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	2022	2023f	2024f	2025f
Real GDP (2012 US\$)	5.2	1.1	0.6	0.1	1.6	2.0	1.9	2.4	1.4	1.9
Personal consumption expenditures	3.6	2.2	0.9	-0.1	1.4	1.8	2.5	2.2	1.4	1.7
Residential construction	6.2	-2.0	-0.6	1.9	3.8	4.7	-9.0	-10.9	1.2	2.7
Business fixed investment	1.3	2.0	-0.1	-0.1	1.4	1.9	5.2	4.3	1.2	1.9
Inventory change (US\$B)	83.9	50.0	40.0	40.0	40.0	45.0	128.1	44.0	41.2	50.0
Public expenditures	5.5	2.5	1.0	0.9	0.9	0.9	-0.9	3.9	1.9	1.6
Exports	6.0	3.0	-1.6	-1.0	0.0	1.5	7.0	2.6	0.2	1.4
Imports	5.2	4.0	-1.7	0.0	-0.8	0.2	8.6	-1.5	0.4	0.8
Final domestic demand	3.7	1.9	0.7	0.2	1.4	1.8	1.7	2.2	1.4	1.8
Other indicators										
Nominal GDP	8.9	4.0	3.2	2.0	4.0	4.4	9.1	6.3	4.0	2.8
Real disposable personal income	0.1	2.5	0.1	0.6	0.5	1.7	-6.0	4.1	1.0	1.9
Employment ¹	1.6	1.4	0.8	0.2	0.4	0.7	4.3	2.3	0.9	0.6
Unemployment rate (%)	3.7	3.8	4.1	4.2	4.2	4.1	3.7	3.7	4.1	4.0
Housing starts ² (thousands of units)	1,367	1,368	1,367	1,382	1,410	1,435	1,551	1,393	1,399	1,478
Corporate profits ³	-0.7	0.7	3.3	3.1	0.2	1.0	9.8	0.4	1.9	2.9
Personal savings rate (%)	4.0	4.1	3.9	4.1	3.9	3.9	3.3	3.6	3.9	4.1
Total inflation rate [*]	3.6	3.2	2.7	2.5	2.5	2.7	8.0	4.1	2.6	2.5
Core inflation rate ^{*4}	4.4	3.9	3.5	3.0	2.9	2.7	6.1	4.8	3.0	2.4
Current account balance (US\$B)	-855	-872	-867	-876	-867	-856	-972	-858	-866	-854

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

Sources: Datastream and Desjardins Economic Studies

Canada

As the Canadian Economy Slows, the Bank of Canada Prepares to Take Its Foot off the Brake

FORECASTS

The release of GDP data for the third quarter of 2023 threw economists for quite a loop. But now that the dust has settled, maybe the most notable aspect of these changes is how small an impact they had on our economic forecast for Canada. We continue to expect a mild recession in the first half of 2024. This economic slack is what the Bank of Canada has been hoping for to help cool the economy and take pressure off price growth. However, even as rates come down, they will remain higher than those Canadians contended with prior to the pandemic.

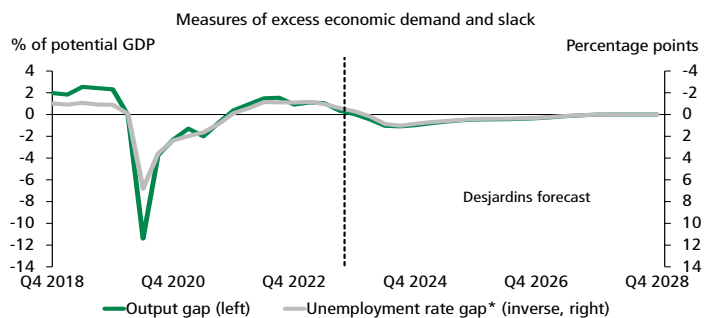
The release of national accounts data for the third quarter of 2023 threw economists for quite a loop. Not only did Q3 real GDP growth come in well below expectations (-1.1% annualized versus +0.1%), but the prior quarter was revised up dramatically (to +1.4% from -0.2% previously). Numbers for the previous three years were also re-estimated, while the reference year for real GDP was rebased. These revisions boosted real GDP per capita relative to prior estimates, although didn't reverse the downward trend since Q3 2022. Together, the changes created some challenges in quickly understanding what the Q3 data meant for the economic outlook.

But now that the dust has settled, among the most notable aspects of the revisions is how small an impact they had on our economic forecast for Canada. For real GDP, we expect a modest reacceleration in growth to end 2023, followed by a short and shallow recession in the first half of 2024. The weakness is expected to be broad-based. Consumption, business investment and residential investment are all anticipated to contract at the start of 2024, as high interest rates and inflation weigh on economic activity and sentiment.

The impending recession is expected to push Canada's unemployment rate higher. The pace of hiring has already begun to lag population growth, and this gulf is likely to widen further as the economy slows. This despite the torrid pace of population growth expected to cool somewhat in the coming years. Consequently, the unemployment rate should rise above its long-run trend (graph 9). Similarly, the expected decline in real GDP will cause the output gap to move into negative territory, where we expect it to remain over the duration of the outlook.

This economic slack is what the Bank of Canada has been hoping for to help cool the economy and take pressure off price growth. And indeed, it looks to be getting its wish. We expect inflation to gradually trend lower through 2024 as monetary policy remains restrictive, eventually hitting the Bank's 2% target on a sustainable basis around the end of the year. But the Bank won't

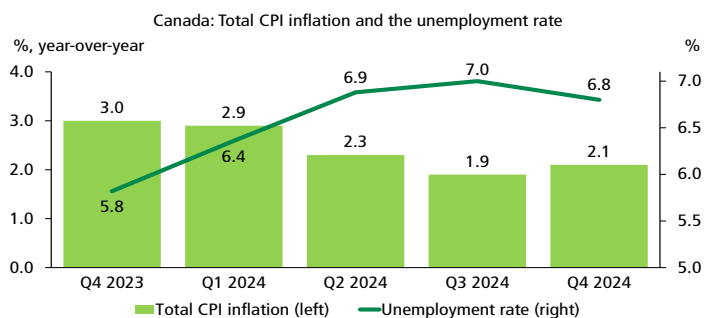
GRAPH 9
More Economic Slack Is Anticipated for the Foreseeable Future



*The unemployment rate gap is the difference between the unemployment rate and its long-run trend. Sources: Statistics Canada and Desjardins Economic Studies

wait that long to begin cutting rates. As our Macro Strategy team pointed out in a [recent note](#), "[c]entral bankers will likely need to see the unemployment rate around 6.5% AND inflation at or below 3% to begin cutting rates." We believe both criteria will be satisfied around the end of Q1 2024 (graph 10), prompting the Bank of Canada to begin cutting the overnight policy rate

GRAPH 10
The Conditions Will Soon Be Ripe for Rate Cuts



Sources: Statistics Canada and Desjardins Economic Studies

in Q2 of next year. We look for six rate cuts in 2024. Monetary policy easing should continue steadily into 2025.

However, even as rates come down, they will remain higher than those Canadians contended with prior to the pandemic. Indeed, we expect the Bank's policy rate to stabilize in the long term at a level closer to that observed from 2002 through 2005 than in the decade that preceded the COVID-19 pandemic. That means that homeowners will continue to renew their mortgages at higher rates than they faced at their last renewal or when more recent mortgages were originated. This is especially true for households that took out mortgages in 2020 and 2021. Higher rates will be particularly acute for those households with fixed-payment variable rate mortgages, many of whom added to their principal as interest rates rose instead of making higher monthly or lump-sum payments. We anticipate this additional financial burden to limit the extent of the recovery resulting from falling interest rates.

TABLE 4
Canada: Major economic indicators

QUARTERLY ANNUALIZED % CHANGE (UNLESS OTHERWISE INDICATED)	2023		2024				ANNUAL AVERAGE			
	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	2022	2023f	2024f	2025f
Real GDP (2012 \$)	-1.1	0.4	-0.3	-0.7	1.5	2.1	3.8	1.1	0.1	2.0
Final consumption expenditure [of which:]	2.1	2.0	0.8	0.4	1.3	1.7	4.5	2.1	1.2	1.7
Household consumption expenditure	0.1	1.6	-0.2	-0.4	1.0	1.7	5.1	2.1	0.4	1.6
Government consumption expenditure	7.3	2.8	3.5	2.6	2.3	2.0	3.2	1.8	3.3	2.0
Gross fixed capital formation [of which:]	-1.3	1.1	-0.9	-1.2	2.4	3.0	-2.4	-2.3	0.3	2.7
Residential structures	8.3	-2.1	-2.4	-1.3	2.1	2.8	-12.1	-10.0	-0.1	3.3
Non-residential structures	-7.7	6.4	-1.8	-3.6	2.7	3.1	6.7	5.6	0.2	2.1
Machinery and equipment	-14.4	-3.0	-1.7	-3.4	3.3	5.6	-0.3	-5.6	-1.8	3.9
Intellectual property products	-1.4	1.3	2.1	2.0	2.0	2.0	6.0	1.6	1.3	2.0
Government gross fixed capital formation	2.4	3.8	2.7	2.5	2.4	2.3	4.2	4.4	2.5	2.1
Investment in inventories (2012 \$B)	25.4	19.1	17.7	16.9	15.9	15.2	55.3	26.9	16.4	15.4
Exports	-5.1	-3.7	-1.4	-2.1	2.1	2.8	3.2	4.3	-1.4	2.9
Imports	-0.6	-3.6	-0.3	-0.4	1.6	2.0	7.6	0.7	-0.3	2.6
Final domestic demand	1.3	1.8	0.4	0.0	1.6	2.1	2.8	1.1	1.0	2.0
Other indicators										
Nominal GDP	6.4	1.7	0.1	0.6	3.6	3.6	11.8	2.3	2.1	3.1
Personal savings rate (%)	0.9	-1.1	-1.7	3.3	4.2	-1.1	-0.1	0.9	0.5	2.7
Employment	1.5	1.9	-0.1	-0.9	1.0	2.1	4.0	2.4	0.7	2.0
Unemployment rate (%)	5.5	5.8	6.2	6.9	7.0	6.8	5.3	5.4	6.7	6.5
Housing starts ¹ (thousands of units)	259	250	220	220	220	225	262	245	221	238
Corporate profits* ²	-22.4	-11.5	-0.2	8.2	9.9	9.9	14.7	-18.6	6.9	6.9
Personal savings rate (%)	5.1	4.3	3.8	4.5	5.2	4.5	5.4	4.6	4.5	5.3
Total inflation rate*	3.7	3.0	2.9	2.3	1.9	2.1	6.8	3.8	2.3	2.0
Core inflation rate* ³	3.4	3.3	3.5	2.9	2.6	2.5	5.0	3.8	2.9	2.0
Current account balance (\$B)	-3.2	-3.8	-6.3	-6.8	-6.9	-7.5	-10.3	-21.2	-27.4	-41.2

f: forecast; * annual change; ¹ annualized basis; ² before taxes; ³ excluding food and energy.
Sources: Datastream and Desjardins Economic Studies

Quebec

Quebec Is Likely Already in a Recession

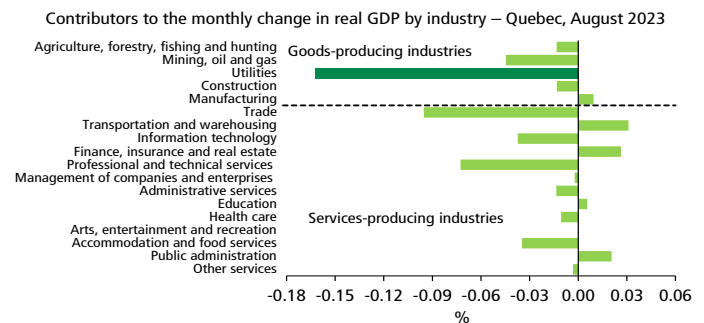
FORECASTS

It looks like Quebec’s second-quarter drop in real GDP extended into the third and fourth quarters, setting the stage for a mild recession. Overall, economic conditions will remain soft until at least Q2 2024, but we could see real GDP bounce back into positive territory in the first quarter if striking education and health care workers return to the job. Although the quarterly numbers have been more volatile than expected, the annual figures have been tracking our latest forecast pretty closely. That means Quebec could end both 2023 and 2024 with essentially flat annual real GDP growth—further evidence that its economy has stalled.

Quebec’s economy has been losing steam since the second quarter (graph 11), and it doesn’t look like the third quarter was any better. Real GDP by industry contracted 0.4% in August, coming in well below expectations. Not only did electricity exports fall sharply due to poor weather, but many other sectors posted large declines as well, including residential construction, trade, accommodation and food services, and information and culture (graph 12). Quebec consumers are clearly feeling the pinch of higher interest rates and the loss of purchasing power due to high inflation.

By our estimates, real GDP by industry would need to have grown at least 0.6% in September for third quarter GDP to come in positive. It’s not impossible, but it’s very unlikely given the current climate. That means Quebec’s real GDP probably contracted slightly in the third quarter. If it did, Quebec would be in a technical recession,¹ as real GDP fell an annualized 1.9% in the second quarter. But take that with a grain of salt, as we expect to see sizeable revisions to the data in the coming weeks.

GRAPH 12
Lower Electricity Production Was a Big Drag On Quebec’s Real GDP in August



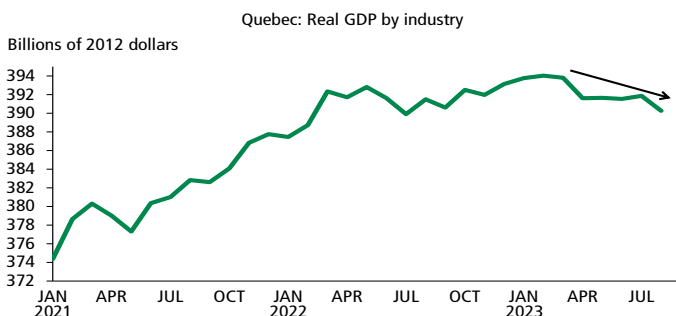
Sources: Institut de la statistique du Québec and Desjardins Economic Studies

Quebec’s real GDP slide likely continued into the fourth quarter. Overall, economic conditions will remain difficult as the effects of interest rate hikes continue to work their way through the economy. Additionally, strikes by education and health care workers in November and December will drag down real GDP in those sectors and the entire provincial economy.

As of this writing, it’s unclear how contract negotiations will play out, but the strikes should be resolved sometime in the coming weeks. If workers return to the job in early 2024, production in the education and health care sectors should bounce right back and contribute positively to quarterly real GDP growth. That could mean a return to positive growth in Q1 2024. A more modest increase in production should follow thereafter, while the effects of the gradual interest rate cuts expected next spring are felt.

The impacts of the recession are becoming more apparent in the labour market. Job vacancies have fallen (graph 13 on page 11), and hiring has slowed in recent months. Quebec’s unemployment rate jumped from a record low of 3.9% in January to 5.2% in November, and we expect it to keep edging up in the months to

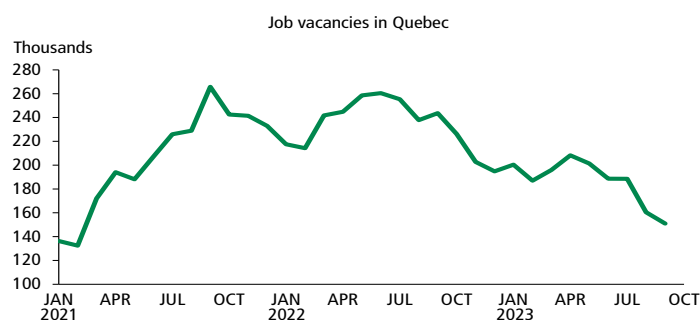
GRAPH 11
Quebec’s Economy Has Been Slowing since the Spring



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

¹ Defined as two consecutive quarters of negative real GDP growth.

GRAPH 13
The Labour Shortage Is Gradually Easing in Quebec



Sources: Statistics Canada and Desjardins Economic Studies

come. The labour market is gradually coming into better balance. We can see this in wages, which are rising much slower than they were at the start of the year.

TABLE 5
Quebec: Major economic indicators

ANNUAL AVERAGE % CHANGE (UNLESS OTHERWISE INDICATED)	2021	2022	2023f	2024f	2025f
Real GDP (2012 \$)	6.0	2.6	-0.1	0.1	1.5
Final consumption expenditure [of which:]	5.9	3.6	1.5	0.8	1.8
Household consumption expenditure	5.4	4.7	2.3	0.5	2.0
Government consumption expenditure	7.3	1.5	-0.5	1.4	1.5
Gross fixed capital formation [of which:]	7.2	-4.0	-8.4	-0.2	3.6
Residential structures	12.9	-11.5	-18.8	-1.6	4.4
Non-residential structures	-1.5	1.2	-1.2	-2.3	2.7
Machinery and equipment	20.3	1.0	-7.9	-2.0	2.3
Intellectual property products	7.1	-1.2	-0.7	0.5	3.0
Government gross fixed capital formation	-3.5	1.7	1.7	4.4	4.0
Investment in inventories (2012 \$M)	-431	6,442	-288	1,500	3,000
Exports	2.9	4.2	2.5	-0.2	2.9
Imports	6.8	6.5	0.0	0.7	4.6
Final domestic demand	6.2	1.9	-0.6	0.6	2.2
Other indicators					
Nominal GDP	11.8	9.6	2.7	2.1	3.3
Real disposable personal income	1.9	1.6	-0.9	1.2	2.0
Weekly earnings	2.9	4.1	3.5	2.3	2.0
Employment	4.3	3.0	2.4	0.4	2.0
Unemployment rate (%)	6.1	4.3	4.4	5.8	5.6
Personal savings rate (%)	14.6	11.4	7.4	6.7	6.4
Retail sales	14.4	8.5	3.6	2.6	4.0
Housing starts ¹ (thousands of units)	67.8	57.1	39.5	38.9	46.6
Total inflation rate	3.8	6.7	4.5	2.8	2.0

f: forecast; ¹ annualized basis.

Sources: Statistics Canada, Institut de la statistique du Québec, Canada Mortgage and Housing Corporation and Desjardins Economic Studies

Medium-Term Issues and Forecasts

The Next Economic Cycle Will See Some Major Structural Changes

The period of expansion we’re forecasting in the medium term is likely to be quite different from previous ones. Specifically, these are expected to be pivotal years in terms of spending and investing to combat climate change. Demographic trends will also be at turning points with population aging accelerating in many countries. Canada may see faster population growth, but its weak productivity gains mean that the country is unlikely to achieve better growth than the United States. Affordability of Canadian real estate will probably remain a key challenge, especially since we don’t expect interest rates to return to their pre-pandemic levels.

Energy Transition Efforts Are Expected to Ramp Up

International net zero and climate change targets are ambitious. Although they’re unlikely to be achieved within the desired timeframes, a [substantial increase](#) in spending and investment is needed to even come close, which should be a major source of economic growth.

For Canada, this will be an opportunity to diversify investment, offsetting the plateau and subsequent reduction in fossil fuel production. The mining sector could attract a significant portion of investment to meet the demand for raw materials needed for new, cleaner technologies (graph 14). The automotive industry is already investing heavily in its battery sector. The power generation industry is also taking action, with Hydro-Québec alone announcing more than C\$150 billion in investments by 2035.

Additional Pressure on Interest Rates

These projects will lead to greater demand for financing, which could impact interest rates. After falling in 2024 and 2025, interest rates should stabilize, but at higher levels than before the pandemic.

Demand for financing should also be bolstered by many highly indebted governments, if not by consumer and business debt in some countries. Quantitative tightening by central banks could also impact interest rates, as it reduces excess liquidity available to increase credit. We also need to consider rising geopolitical tension, which is hampering trade and curbing capital mobility.

Not Such Good News for Affordability

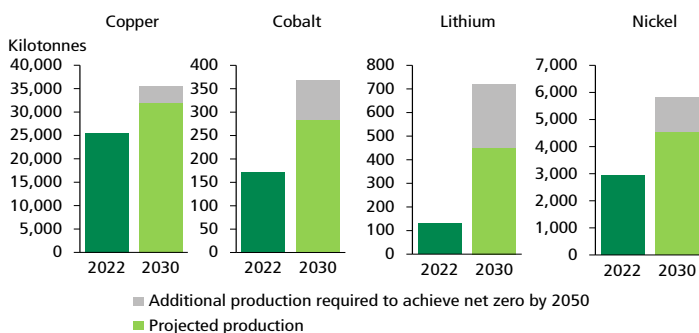
The interest rate outlook will limit the improvement in housing affordability, particularly in Canada where it’s a major challenge. Increasing housing supply enough to keep up with demand—which is being driven by rapid population growth—will be difficult, so rent and home prices are likely to remain high.

By 2027, most of the mortgages taken out at lower interest rates will have been renewed, forcing many households to adjust their budgets. Growth in consumption is expected to be lower than the average of previous decades.

Demographic Growth

Many countries are already living with the effects of an aging population. China will join the list and may even see its population start to shrink in the medium term, reducing economic growth. Canada is currently experiencing a rapid increase in population. Although this could moderate to about 1.5% per year, it would still be much higher than in the United States. This is good news for Canadian economic growth and should put real GDP gains at a similar level to the United States, where productivity gains contribute more to growth. However, the higher population will impact GDP per capita, which will continue to increase rapidly in the United States, but only slightly in Canada.

GRAPH 14
Mineral Production Must Increase to Meet Net-Zero Targets



Sources: International Energy Agency and Desjardins Economic Studies

TABLE 6
Major medium-term economic and financial indicators

% (UNLESS OTHERWISE INDICATED)	ANNUAL AVERAGE							AVERAGES	
	2022	2023f	2024f	2025f	2026f	2027f	2028f	2018–2022	2023–2028f
United States									
Real GDP (% change)	1.9	2.4	1.4	1.9	2.2	2.0	2.0	2.2	2.0
Total inflation rate (% change)	8.0	4.1	2.6	2.5	2.2	2.2	2.0	3.6	2.6
Unemployment rate	3.7	3.7	4.1	4.0	3.9	3.8	3.8	4.9	3.9
S&P 500 index (% change) ¹	-19.4	15.9	0.0	6.5	5.1	4.8	5.2	9.3	6.2
Federal funds rate	1.86	5.20	5.25	3.60	3.00	3.00	3.00	1.37	3.84
Prime rate	4.86	8.20	8.25	6.60	6.00	6.00	6.00	4.37	6.84
Treasury bills – 3-month	2.09	5.25	4.85	3.25	3.00	3.00	3.00	1.32	3.73
Federal bonds – 10-year	2.96	4.00	3.95	3.35	3.30	3.20	3.20	2.07	3.50
– 30-year	3.12	4.10	4.10	3.45	3.35	3.25	3.25	2.48	3.58
WTI oil (US\$/barrel)	95	78	82	82	80	78	78	65	80
Gold (US\$/ounce)	1,803	1,920	1,790	1,710	1,700	1,625	1,625	1,607	1,728
Canada									
Real GDP (% change)	3.8	1.1	0.1	2.0	1.9	2.0	1.9	1.6	1.5
Total inflation rate (% change)	6.8	3.8	2.3	2.0	2.1	2.0	2.0	3.0	2.4
Employment (% change)	4.0	2.4	0.7	2.0	2.2	2.3	2.0	1.4	1.9
Personal savings rate (%)	750	480	138	408	453	478	422	260	397
Unemployment rate	5.3	5.4	6.7	6.5	6.2	5.9	5.7	6.8	6.1
Housing starts (thousands of units)	217	271	221	238	242	234	232	234	240
S&P/TSX index (% change) ¹	-8.7	1.9	1.3	6.8	5.2	5.5	5.8	4.5	4.4
Exchange rate (USD/CAD)	0.77	0.74	0.74	0.76	0.75	0.77	0.77	0.77	0.75
Personal savings rate (%)	1.95	4.75	4.45	2.65	2.25	2.50	2.50	1.18	3.18
Prime rate	4.14	6.95	6.65	4.85	4.45	4.70	4.70	3.38	5.38
Mortgage rate – 1-year	4.43	7.10	6.90	5.30	5.15	5.15	5.10	3.52	5.78
– 5-year	5.64	6.70	7.00	6.45	6.35	6.50	6.55	5.18	6.59
Treasury bills – 3-month	2.18	4.75	4.15	2.45	2.20	2.50	2.50	1.15	3.09
Federal bonds – 2-year	2.90	4.30	3.35	2.40	2.45	2.65	2.70	1.49	2.98
– 5-year	2.78	3.60	3.05	2.55	2.60	2.90	2.95	1.60	2.94
– 10-year	2.77	3.40	3.10	2.70	2.75	3.05	3.10	1.75	3.02
– 30-year	2.81	3.30	3.05	2.75	2.80	2.95	3.00	2.01	2.98
<u>Yield spreads (Canada – United States)</u>									
Treasury bills – 3-month	0.09	-0.50	-0.70	-0.80	-0.80	-0.50	-0.50	-0.17	-0.63
Federal bonds – 10-year	-0.19	-0.60	-0.85	-0.65	-0.55	-0.15	-0.10	-0.32	-0.48
– 30-year	-0.31	-0.80	-1.05	-0.70	-0.55	-0.30	-0.25	-0.48	-0.61
Quebec									
Real GDP (% change)	2.6	-0.1	0.1	1.5	1.6	1.5	1.4	1.9	1.0
Total inflation rate (% change)	6.7	4.5	2.8	2.0	2.1	2.0	2.0	3.0	2.6
Employment (% change)	3.0	2.4	0.4	2.0	1.6	1.1	0.9	1.1	1.4
Employment (thousands)	130	106	16	89	76	53	44	49	64
Unemployment rate	4.3	4.4	5.8	5.6	4.8	4.2	3.8	6.0	4.8
Retail sales (% change)	8.5	3.6	2.6	4.0	4.2	4.0	3.9	5.7	3.7
Housing starts (thousands of units)	57	40	39	47	51	53	57	55	48

f: forecast; WTI: West Texas Intermediate; ¹ Changes are based on end-of-period data.

Sources: Datastream, Statistics Canada, Institut de la statistique du Québec, Canada Mortgage and Housing Corporation and Desjardins Economic Studies