

ECONOMIC VIEWPOINT

The Economic Slowdown Is Set to Hit Industry Where It's Already Hurting

By Joëlle Noreau, Principal Economist and, Florence Jean-Jacobs, Principal Economist

An economic slowdown is underway in Quebec. It's hard to say how long it will last, but all signs point to weak—possibly even negative—growth for the rest of 2022 and the first half of 2023. It's shaping up to be a difficult road ahead for businesses. With that in mind, we assessed the risks at play and what they mean for the industry outlook. The takeaway: different sectors will be affected to varying degrees.

#1: Sectors still recovering from the pandemic will face new challenges

To paint a clearer picture, we've grouped the major economic sectors into categories. The first category includes sectors that face increased vulnerability due to a set of three factors: (1) they were already hard hit by the pandemic; (2) they're still in recovery mode; and (3) they're particularly sensitive to reductions in discretionary spending, as consumers tend to tighten their purse strings during economic slowdowns. Making the situation even more difficult is that these businesses are especially affected by labour shortages. They include accommodation and food services, arts, entertainment and recreation, contact-intensive services (barbers/hairdressers, estheticians, mechanics, etc.), and retail sales. Additionally, having already exhausted their borrowing capacity over the past two and a half years, they have very little breathing room. The next few quarters will be quite challenging, as illustrated in table on page 2.

#2: The global economic slowdown will be especially hard on the manufacturing, transportation and warehousing, and wholesale trade sectors

Our second category includes sectors that were dealt a heavy blow by the pandemic and are now facing big challenges. On top of a labour shortage, the general slowdown of the global economy and drop-off in international trade are putting pressure on their business. Excluding historically-stable food production, manufacturing is the most impacted, with knock-on effects to transportation and warehousing, and wholesale trade. The transportation and warehousing sector looks to be particularly

vulnerable to higher interest rates and the cost of borrowing coming out of the pandemic. A downturn in the pace of residential and commercial construction will also contribute to a drop in demand for materials and their transportation.

#3: Construction and its ancillary industries will see fallout from the real estate correction

Some industries will be directly impacted by the effects of higher interest rates and the resulting slowdown in the real estate sector, which we're already starting to see. That's the case for both residential and commercial real estate services. Quebec's housing market is seeing declines in home prices, sales and housing starts. On the commercial side, hybrid work arrangements and rising interest rates have slowed growth in office and retail spaces in urban centres. An unfavourable economic outlook means retail leasing will continue to cool. As for office leasing, companies' expansion plans have been put on hold and demand is already waning.

Joining them are sectors that will suffer fallout from lower real estate spending, such as construction, and residential construction in particular—a sector already struggling with a labour shortage and high cost of materials.

Industries that depend on residential construction will also be impacted by the slowdown in housing starts and renovation demand: wood products, plastics (flooring, pipes, siding, foam, etc.) and furniture manufacturing and sales.

Desjardins, Economic Studies: 418-835-2450 or 1 866-835-8444, ext. 5562450 • desjardins.economics@desjardins.com • desjardins.com/economics

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Industrial and commercial construction will also experience a downturn, leading to a drop in demand for non-metallic mineral product manufacturing.

#4: Rising interest rates and geopolitical uncertainty are putting pressure on the agriculture sector

Quebec's GDP in the agriculture sector is higher than it was pre-pandemic, and it's an industry that's generally resilient to economic slowdowns. However, it's facing three considerable challenges at the moment: (1) higher borrowing costs due to interest rate rises, the top concern of agricultural businesses according to Statistics Canada's most recent Canadian Survey on Business Conditions; (2) uncertainty caused by the war in Ukraine about the availability and prices of inputs; and (3) stress from energy prices.

Furthermore, a reduced pace of manufacturing on both sides of the border and a construction slump will lead to a slowdown in electric power generation and distribution.

What sectors are faring well?

Table shows how vulnerable the above-mentioned sectors are. But other sectors that are less sensitive to features of the current downturn (higher interest rates, real estate contraction, reduction in discretionary spending, dependence on exports) are in a better position to ride out the coming months. These sectors include: professional services; health care services; mining, quarrying, and oil and gas extraction; and finance and insurance. Some

subsectors, such as food processing and retailers of essential products (grocery stores and pharmacies), tend to fare better during slowdowns.

Conclusion

It should come as no surprise that most sectors will be affected by the economic slowdown. Businesses that managed to survive the pandemic may now be forced to close their doors, unable to shoulder the additional burden of an economic downturn. Remember, for those in the most vulnerable sectors, it's now been almost three straight years of setbacks.

TABLE

Quebec: Different industries will be impacted to varying degrees by the economic slowdown

	OVERALL IMPACT	CHALLENGES							
		Cost of borrowing/ higher interest rates	Profits and margins	Insolvencies (number and trend)	Labour shortage	Reduced discretionary spending	Input costs	Real estate correction	Export dependencies
Industries									
Accommodation, food services, arts, entertainment and recreation	●	●	●	●	●	●	●	●	●
Transportation and warehousing	●	●	●	●	●	●	●	●	●
Other services (personal care services, repair and maintenance, etc.)	●	●	●	●	●	●	●	●	●
Construction	●	●	●	●	●	●	●	●	●
Retail trade	●	●	●	●	●	●	●	●	●
Manufacturing	●	●	●	●	●	●	●	●	●
Wholesale trade	●	●	●	●	●	●	●	●	●
Agriculture, forestry, fishing and hunting	●	●	●	●	●	●	●	●	●
Real estate services	●	●	●	●	●	●	●	●	●
Electric power generation and distribution	●	●	●	●	●	●	●	●	●
Administrative services, waste management, etc.	●	●	●	●	●	●	●	●	●
Information and cultural industries	●	●	●	●	●	●	●	●	●
Health care, social assistance and educational services	●	●	●	●	●	●	●	●	●
Professional services	●	●	●	●	●	●	●	●	●
Finance and insurance	●	●	●	●	●	●	●	●	●
Mining, quarrying, and oil and gas extraction	●	●	●	●	●	●	●	●	●
Legend ● Struggling ● Negative outlook ● To monitor ● Above-average outlook									

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Note: Data on insolvencies is based on the Canadian results of Industry Canada's Insolvency Statistics in Canada, and data on profits and margins is from Statistics Canada's Quarterly Survey of Financial Statements.
Sources: Statistics Canada, Industry Canada and Desjardins, Economic Studies