Economic Viewpoint
Desjardins Economic Studies
www.desjardins.com/economics
June 25, 2015

Medium-term issues and forecasts

Central banks will remain cautious when raising their key rates

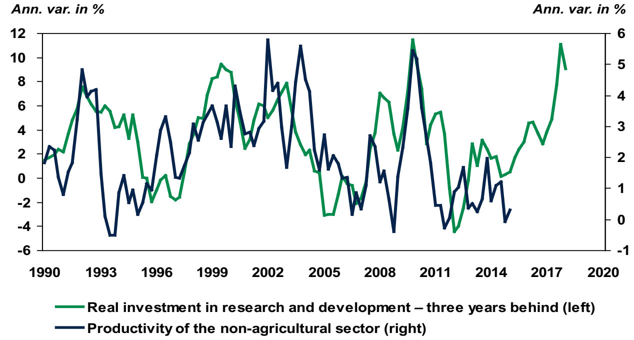
Soon, it will be time for the Federal Reserve to start raising its key interest rates, followed by other central banks in the coming years. Reduced excess production capacity and higher inflationary pressure will support their decision. The new cycle of monetary firming should be very different from previous ones, however. Rates will rise more gradually and, more specifically, will peak at a lower level. Several structural factors, such as demographics, will limit potential for economic growth, thereby impacting the central banks' decisions. The persistence of numerous risks, and a still quite volatile financial environment, will also prompt central banks to exercise caution.

INTERNATIONAL ISSUES

Similar to what we have seen since the end of the Great Recession of 2008–2009, global economic growth will continue to advance slowly. Demographic factors are among the main reasons for growth being less sustained than it was in the 1980s, 1990s or 2000s. This phenomenon is having a major impact on advanced economies, particularly in Europe, but also in certain key emerging countries, which are dealing with other inhibiting factors that reflect their increased maturity. As such, emerging countries will be hard pressed to repeat the very rapid growth they enjoyed at the end of the 1990s. With a growth target of 7%, Chinese real GDP should slowly close in on annual changes of around 6%. Similar to what Russia and Brazil are currently going through, the ups and downs of global economic, financial and geopolitical conditions will now have greater consequences on economic changes in emerging countries.

In the United States, we can count on strong economic growth in the next three years, and the Federal Reserve should continue to raise its key rates very gradually. GDP growth should remain relatively modest and, in the long term, potential GDP will not increase much more than 2%, according to Congressional Budget Office projections. However, we can be encouraged by the recent surge in research and development investment that, in the end, could trigger faster growth in productivity (graph 1), offsetting some of the negative effects weak demographic growth will have on potential GDP growth while limiting the need for high interest rates. However, the current growth cycle cannot last indefinitely, and there is risk of a new economic downturn by the end of the decade. This could lead to a halt in interest rate increases, even though they will be far below the levels seen in previous cycles.

Graph 1 – Growth in research and development investment should stimulate productivity in the United States



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

CANADIAN ISSUES

The potential for Canadian economic growth is estimated at 1.8% until 2017, and all signs point to it slipping lower after that (graph 2 on page 2). Based on Statistics Canada's demographic projections, annual growth in the working age population will continue to decline, falling to around 0.1% in 2026 (based on the average scenario). It bears reminding

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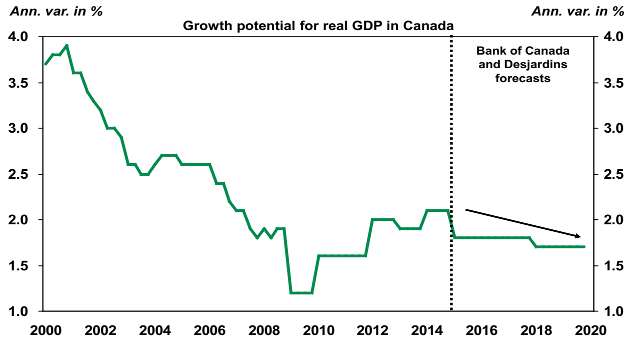
Graph 2 – Downward trend in potential growth should turn around in future years



Sources: Statistics Canada and Desjardins, Economic Studies

that annual growth in the working age population was around 1% in 2010. Under these conditions, it would be surprising for Canadian economic growth to significantly exceed the 2% mark in the next few years. On average, an annual gain in real GDP of 1.7% is therefore forecast for 2015 to 2019.

In light of the relatively modest outlook on growth, overall income in Canada will see more limited growth. This heightens worries about the high debt loads of Canadian households. The volume of Canadian debt could even prompt the Bank of Canada to cautiously proceed with monetary firming in the coming years, out of fear of exposing too many households to financial difficulties.

Boosted by a Canadian dollar remaining well below parity with the greenback, the manufacturing sector should continue to recover in the coming years, making a significant contribution to economic growth in Ontario and Quebec. With a strongly booming housing market in Ontario in recent years, there is a risk that some kind of correction will materialize in the medium term. The most likely scenario still involves a gradual normalization of the Ontario real estate market.

In Quebec, the fragile financial situation of households and unfavourable demographic trends will continue to be drag on the economy and employment. It will therefore be difficult for Quebec to see real GDP grow beyond 1.5% for the next years. Quebec will see the majority of its labour force, i.e. the population aged 15 to 64, begin to diminish in 2016. Consequently, potential GDP growth will slow to around 1.25% by 2019.

Precarious public finances in Quebec also risk affecting the economy for several years. The return to a balanced budget in 2015–2016 is only a first step, given the province's high debt. The provincial government must exercise strict control over its expenses in the short and medium terms, and continue making reforms, including some that could support the economy in the longer term.

Table 1
United States: medium-term major economic and financial indicators

	Annual average							Average	
In % (except if indicated)	2013	2014	2015f	2016f	2017f	2018f	2019f	2007-2014	2015-2019f
Real GDP (var. in %)	2.2	2.4	2.4	3.0	2.9	2.5	2.0	1.2	2.6
Total inflation rate (var. in %)	1.5	1.6	0.4	2.3	2.0	2.0	1.6	2.0	1.7
Unemployment rate	7.4	6.2	5.5	5.2	4.9	4.7	4.7	7.5	5.0
S&P 500 index (var. in %)*	29.6	11.4	6.9	5.9	5.0	5.0	0.0	7.0	4.6
Federal funds rate	0.25	0.25	0.35	1.10	1.85	2.50	2.80	1.08	1.72
Prime rate	3.25	3.25	3.35	4.10	4.85	5.50	5.80	4.08	4.72
Treasury bills—3-month	0.06	0.03	0.15	1.00	1.70	2.40	2.50	0.80	1.55
Federal bonds—10-year	2.34	2.53	2.25	2.65	3.15	3.40	2.90	3.01	2.87
Federal bonds—30-year	3.45	3.34	2.95	3.25	3.45	3.65	3.30	3.88	3.32
WTI** oil (US$/barrel)	98	93	54	68	80	80	70	87	70
Gold (US$/ounce)	1,411	1,266	1,190	1,100	1,050	1,000	1,050	1,211	1,078

f: forecasts; * The variations are based on observation of the end of period; ** West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Table 2
Canada: medium-term major economic and financial indicators

In % (except if indicated)	Annual average 2013	2014	2015f	2016f	2017f	2018f	2019f	Average 2007-2014	2015-2019f
Real GDP (var. in %)	2.0	2.4	1.5	2.2	2.0	1.7	1.3	1.6	1.7
Total inflation rate (var. in %)	0.9	2.0	1.0	1.9	2.0	1.8	1.7	1.7	1.7
Employment (var. in %)	1.5	0.6	0.8	0.9	1.0	0.8	0.6	1.2	0.8
Employment (K)	253	111	135	170	180	155	120	176	152
Unemployment rate	7.1	6.9	6.8	6.6	6.3	6.0	5.9	7.1	6.3
Housing starts (K)	188	189	182	180	190	180	175	200	182
S&P/TSX* index (var. in %)	9.6	7.4	5.2	7.8	8.0	6.0	0.0	3.4	5.4
Canadian dollar (US$/C$)	0.97	0.91	0.79	0.82	0.86	0.89	0.87	0.95	0.84
Overnight funds	1.00	1.00	0.75	0.75	1.25	1.95	2.05	1.55	1.35
Prime rate	3.00	3.00	2.85	2.85	3.35	4.05	4.15	3.49	3.45
Mortgage rate									
1-year	3.08	3.14	2.90	3.00	3.60	4.15	4.00	4.26	3.53
5-year	5.23	4.89	4.70	4.80	4.95	5.35	4.95	5.77	4.95
Treasury bills—3-month	0.97	0.91	0.65	0.80	1.30	2.00	1.90	1.39	1.33
Federal bonds									
2-year	1.11	1.06	0.70	1.15	1.65	2.25	1.95	1.79	1.54
5-year	1.63	1.58	1.10	1.70	2.10	2.55	2.10	2.33	1.91
10-year	2.26	2.23	1.70	2.10	2.60	2.85	2.25	2.94	2.30
30-year	2.83	2.77	2.30	2.60	2.85	3.05	2.65	3.42	2.69
Canada/U.S. rate spreads									
Treasury bills—3-month	0.91	0.88	0.50	-0.20	-0.40	-0.40	-0.60	0.60	-0.22
Federal bonds—10-year	-0.07	-0.30	-0.55	-0.55	-0.55	-0.55	-0.65	-0.08	-0.57
Federal bonds—30-year	-0.62	-0.57	-0.65	-0.65	-0.60	-0.60	-0.65	-0.46	-0.63

f: forecasts; * The variations are based on observation of the end of period.
Sources: Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

Table 3
Quebec and Ontario: medium-term major economic indicators

Var. in % (except if indicated)	Annual average 2013	2014	2015f	2016f	2017f	2018f	2019f	Average 2007-2014	2015-2019f
Quebec									
Real GDP	1.0	1.3	1.5	1.7	1.3	1.1	0.9	1.4	1.3
Total inflation rate	0.7	1.4	1.3	1.9	2.1	1.9	1.7	1.6	1.8
Employment	1.4	0.0	1.1	0.9	0.5	0.4	0.2	1.0	0.6
Employment (K)	48	-2	45	35	20	15	10	40	25
Unemployment rate (%)	7.6	7.7	7.3	7.0	6.8	6.5	6.2	7.8	6.8
Retail sales	2.5	1.7	1.3	3.5	3.4	2.9	2.5	2.9	2.7
Housing starts (K)	38	39	33	35	35	33	30	45	33
Ontario									
Real GDP	1.3	2.2	2.4	2.5	1.9	1.6	1.4	1.1	2.0
Total inflation rate	1.0	2.4	1.1	2.1	2.0	1.8	1.6	1.8	1.7
Employment	1.8	0.8	0.7	1.3	1.0	0.9	0.7	0.9	0.9
Employment (K)	96	54	50	93	70	65	50	61	66
Unemployment rate (%)	7.6	7.3	6.7	6.6	6.4	6.2	6.0	7.6	6.4
Retail sales	2.3	5.0	3.2	4.3	4.0	3.5	3.3	2.9	3.7
Housing starts (K)	61	59	68	65	65	65	60	65	65

f: forecasts
Sources: Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies