

ECONOMIC & FINANCIAL OUTLOOK

Businesses and Consumers Won't Get Much Relief until Interest Rates Fall Further

By Benoit P. Durocher, Director and Principal Economist

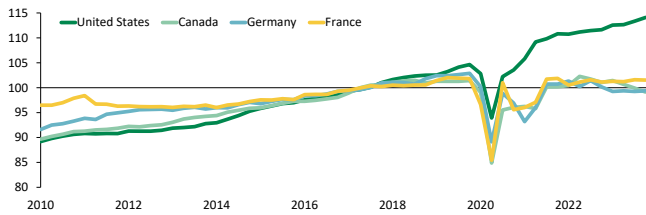
Well, it happened. After watching interest rates spike, consumers are finally catching a break, with some central banks recently starting their rate cutting cycle. Among advanced economies, Canada, the eurozone, Switzerland and Sweden have begun to loosen monetary policy. The Bank of Canada (BoC) lowered its target for the overnight rate from 5.00% to 4.75% on June 5. But despite this initial cut, Canadian monetary policy remains very restrictive, and additional reductions will be needed to gradually bring rates closer to neutral (about 2.75%). If inflation continues to come down in Canada, we expect three more cuts by the end of the year, followed by further loosening in 2025 and 2026. We see the BoC's target for the overnight rate eventually falling to about 2.25% by early 2026.

In the US, the Federal Reserve (Fed) will have to wait longer before starting to cut rates. Demand there has been more resilient, and there's still some upward pressure on inflation. For example, per capita consumer spending growth is stronger than in most other industrialized countries (graph 1). This is likely due in large part to mortgage terms, which are longer in the United States than in countries like Canada and the United Kingdom. It's also why interest rate hikes don't have as much of an immediate impact in the US. Investment continues to rise as well, especially in the manufacturing sector (graph 2), as some US companies have started to reshore production—particularly chip manufacturing—to reduce their dependence on volatile global trade. We therefore expect the Fed to wait until

Graph 1
Per Capita Consumption Is Much Higher in the US than in Other Major Advanced Economies

Real final consumption expenditure per capita*

2017 = 100



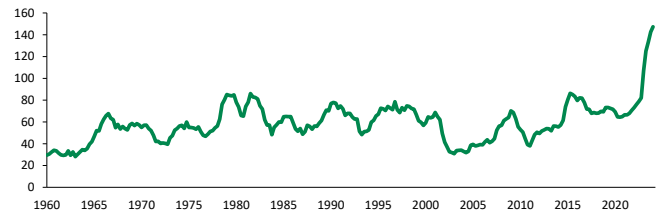
* Including non-profit institutions serving households.

Organisation for Economic Co-operation and Development and Desjardins Economic Studies

Graph 2
Investment in US Manufacturing Construction Has Surged

United States – Real investment in non-residential manufacturing construction

Billions of 2017 US\$



Bureau of Economic Analysis and Desjardins Economic Studies

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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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its November meeting immediately following the presidential election to announce its first interest rate cut.

It remains to be seen how far the BoC will diverge from the Fed on monetary policy. The fear is that the Canadian dollar will plummet, potentially pushing up import prices and putting renewed upward pressure on inflation. But our estimates suggest the BoC has some room to pursue its own monetary policy. On the one hand, interest rate spreads aren't the only factor driving the CAD exchange rate, and our forecasts see the Canadian dollar depreciating just slightly over the coming months. On the other hand, import prices don't show up in consumer prices right away, and consumer prices won't move much if the exchange rate doesn't.

Lower interest rates will impact businesses and consumers around the world to varying degrees over the coming quarters. Our forecasts for Canada and Quebec haven't changed much, and we're still expecting economic growth to pick up in 2024. But the booming population, which has been a major driver of Canada's economic growth in recent quarters, is expected to slow as new caps on non-permanent resident admissions take effect this fall. This could offset some of the positive effects of lower interest rates and result in new labour shortages in some sectors.

RISKS INHERENT IN OUR SCENARIOS

Inflation has come down, though it remains above target in most countries and other inflationary shocks aren't out of the question. The odds of additional interest rate hikes are low, but rates could remain elevated for some time if inflation fails to settle down. There's also a great deal of uncertainty surrounding the lagged effect of higher interest rates on economic growth. As mortgages continue to be renewed at higher rates, many Canadian borrowers could feel the squeeze. Tenants are increasingly under pressure as well. Higher unemployment could also lead to challenges for the housing market and credit in general. The US presidential election in November could be an inflection point that adds even more uncertainty, especially around international trade. Fiscal deterioration in the United States and elsewhere could prompt credit rating downgrades and possibly push long-term interest rates higher. Worsening geopolitical tensions like the election of populist, protectionist leaders or governments could also spell instability for the global economy, financial markets and commodity prices. From a currency perspective, if the global economy deteriorates, many investors may park their assets in US dollars, sending the greenback even higher. Further widening of interest rate spreads with the United States would have the same effect. If currencies slide against the greenback, it could have a destabilizing effect on many economies.

Table 1
Global GDP Growth (Adjusted for PPP) and Inflation Rates

%	Weight*	Real GDP growth			Inflation rate		
		2023	2024f	2025f	2023	2024f	2025f
Advanced economies	38.7	1.6	1.6	1.8	4.6	2.8	2.2
United States	15.7	2.5	2.4	2.0	4.1	3.1	2.4
Canada	1.4	1.2	1.0	1.8	3.9	2.5	2.1
<i>Quebec</i>	<i>0.3</i>	<i>0.0</i>	<i>0.7</i>	<i>1.5</i>	<i>4.5</i>	<i>2.7</i>	<i>2.3</i>
Japan	3.6	1.8	-0.1	1.1	3.3	2.5	1.9
United Kingdom	2.3	0.1	0.9	1.3	7.4	2.5	2.2
Eurozone	11.9	0.6	0.9	1.6	5.5	2.3	1.9
<i>Germany</i>	<i>3.3</i>	<i>0.0</i>	<i>0.3</i>	<i>1.3</i>	<i>6.0</i>	<i>2.4</i>	<i>2.0</i>
<i>France</i>	<i>2.3</i>	<i>1.1</i>	<i>1.1</i>	<i>1.5</i>	<i>4.9</i>	<i>2.5</i>	<i>1.8</i>
<i>Italy</i>	<i>1.9</i>	<i>1.0</i>	<i>1.0</i>	<i>1.3</i>	<i>5.7</i>	<i>1.5</i>	<i>1.8</i>
Other countries	4.2	1.3	1.8	2.2	4.7	2.7	2.1
<i>Australia</i>	<i>1.0</i>	<i>2.0</i>	<i>1.5</i>	<i>2.5</i>	<i>5.6</i>	<i>3.3</i>	<i>2.8</i>
Emerging and developing economies	61.3	4.0	4.0	3.9	8.7	7.4	4.7
North Asia	26.9	5.8	5.4	4.8	2.9	2.3	2.6
<i>China</i>	<i>18.5</i>	<i>5.2</i>	<i>5.0</i>	<i>4.1</i>	<i>0.2</i>	<i>0.6</i>	<i>1.5</i>
<i>India</i>	<i>7.2</i>	<i>8.2</i>	<i>6.8</i>	<i>6.6</i>	<i>5.7</i>	<i>4.5</i>	<i>4.6</i>
South Asia	5.2	4.0	4.5	4.3	3.4	2.4	2.6
Latin America	11.5	2.4	2.0	2.3	5.2	4.0	3.5
<i>Mexico</i>	<i>1.7</i>	<i>3.2</i>	<i>2.2</i>	<i>2.3</i>	<i>5.6</i>	<i>4.1</i>	<i>3.6</i>
<i>Brazil</i>	<i>2.3</i>	<i>2.9</i>	<i>1.9</i>	<i>2.1</i>	<i>4.2</i>	<i>3.9</i>	<i>3.8</i>
Eastern Europe	8.2	3.1	2.7	2.7	19.5	17.3	9.0
<i>Russia</i>	<i>3.2</i>	<i>3.6</i>	<i>2.6</i>	<i>1.5</i>	<i>5.9</i>	<i>5.3</i>	<i>4.6</i>
Other countries	9.5	2.2	2.7	3.4	19.9	17.5	10.1
<i>South Africa</i>	<i>0.6</i>	<i>0.7</i>	<i>1.2</i>	<i>1.9</i>	<i>6.1</i>	<i>5.0</i>	<i>4.6</i>
World	100.0	3.1	3.1	3.1	7.1	5.7	3.8

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

World Bank, Consensus Forecasts and Desjardins Economic Studies

FINANCIAL FORECASTS

The Bank of Canada announced its initial rate cut in June. With inflation continuing to cool in Canada, a second cut seems likely in July. All told, Canadian policy rates are expected to come down 100 basis points in 2024 and 150 basis points in 2025. Bond yields are also down recently, keeping the yield curve strongly inverted and longer-term interest rates attractive. In the US, where inflation has been stickier, the Fed will probably wait to make its first cut in November when it meets right after the presidential election. It's expected to cut again in December and follow that up with additional reductions in 2025 to gradually bring the federal funds rate closer to neutral, where it wouldn't restrict economic growth.

The Canadian dollar could lose some more ground in the short term in response to diverging monetary policy between Canada and the United States. We could see the loonie briefly approach CAN\$1.40/US\$ this summer, especially as little support is expected from commodity prices in the immediate term. Investor risk appetite may also moderate after the strong performance by the stock market during the first half of the year.

Table 2
Summary of Financial Forecasts

End of period in % (unless otherwise indicated)	2023		2024				2025			
	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key interest rate										
United States	5.50	5.50	5.50	5.50	5.50	5.00	4.75	4.50	4.00	3.75
Canada	5.00	5.00	5.00	4.75	4.50	4.00	3.50	3.25	2.75	2.50
Eurozone	4.50	4.50	4.50	4.25	4.00	3.75	3.50	3.25	3.00	2.75
United Kingdom	5.25	5.25	5.25	5.25	5.00	4.50	4.25	4.00	3.50	3.25
Federal bonds										
<u>United States</u>										
2-year	5.14	4.33	4.70	4.70	4.40	4.00	3.75	3.50	3.35	3.20
5-year	4.64	3.86	4.23	4.30	4.15	3.95	3.80	3.55	3.40	3.30
10-year	4.57	3.87	4.21	4.30	4.10	3.95	3.85	3.60	3.45	3.40
30-year	4.70	4.02	4.35	4.45	4.25	4.10	3.95	3.70	3.55	3.45
<u>Canada</u>										
2-year	4.87	3.88	4.17	3.90	3.60	3.20	2.95	2.75	2.70	2.55
5-year	4.25	3.17	3.51	3.40	3.30	3.10	3.05	2.85	2.80	2.70
10-year	4.03	3.10	3.45	3.40	3.25	3.15	3.15	2.90	2.85	2.75
30-year	3.81	3.02	3.34	3.30	3.15	3.10	3.10	2.85	2.85	2.75
Currency market										
Canadian dollar (USD/CAD)	1.36	1.32	1.35	1.38	1.38	1.37	1.37	1.36	1.35	1.34
Canadian dollar (CAD/USD)	0.74	0.75	0.74	0.73	0.73	0.73	0.73	0.74	0.74	0.75
Euro (EUR/USD)	1.06	1.10	1.08	1.07	1.08	1.10	1.11	1.11	1.12	1.12
British pound (GBP/USD)	1.22	1.27	1.26	1.27	1.28	1.29	1.30	1.30	1.31	1.32
Yen (USD/JPY)	149	141	151	157	153	148	145	142	137	134
Stock markets (level and growth)*										
United States – S&P 500	4,770			Target: 5,575 (+16.9%)			Target: 5,770 (+3.5%)			
Canada – S&P/TSX	20,958			Target: 22,300 (+6.4%)			Target: 23,300 (+4.5%)			
Commodities (annual average)										
WTI oil (US\$/barrel)	78 (72*)			80 (84*)			83 (82*)			
Gold (US\$/ounce)	1,940 (2,030*)			2,190 (2,100*)			1,950 (1,900*)			

f: forecast; WTI: West Texas Intermediate; * End of year.

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Overseas

Europe's Economy Is Starting to Look Up

FORECASTS

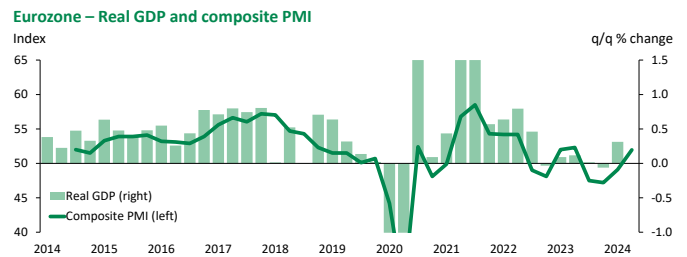
Many countries, especially in Europe, saw a return to growth in early 2024, following a year of economic stagnation. That said, the situation remains fragile and the economic indicators don't point to a strong uptick in activity. GDP is expected to continue edging up in the main advanced economies, but only at a moderate pace. Cooling inflation and falling interest rates should pave the way for more sustained growth over time. Meanwhile, China's economy is showing further signs of improvement, though it's still being held back by the troubled property sector. Global real GDP growth is expected to come in at 3.1% in 2024 and 2025.

Several countries saw their economies pick up in early 2024 compared to 2023, but international trade has nonetheless continued to stagnate. Shipping rates have also started rising again in the past few weeks (graph 3), much like they did at the beginning of the year when attacks in the Red Sea pushed costs higher. Oil consumption, especially in advanced economies, has been somewhat disappointing in recent months, feeding concerns that demand for gasoline could be weaker than expected this summer. At the same time, the oil supply is expected to keep rising, especially since the Organization of the Petroleum Exporting Countries and its partners (OPEC+) have announced plans to increase production. As a result, crude oil prices have fallen. This is one more factor helping bring down inflation around the world. That said, we expect the price of West Texas Intermediate (WTI) to trend back upward and close the year at around US\$84 per barrel.

Eurozone real GDP grew a non-annualized 0.3% in the first quarter of 2024. While modest, this gain is a step in the right direction as it follows five quarters of flat or slightly negative growth. The hope is that it marks the beginning of more enduring growth. The PMIs released so far this spring suggest that we could see another improvement in real GDP in the second quarter (graph 4). However, eurozone economic indicators are sending mixed signals. After a few months of gains, industrial production fell in April, and retail sales

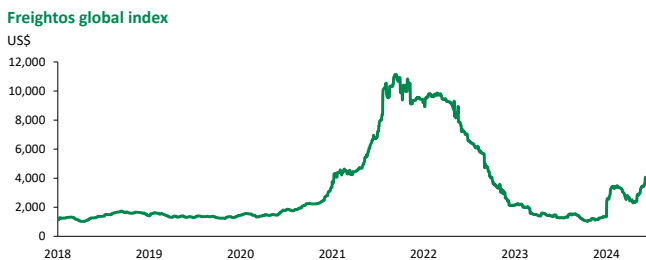
stagnated. Consumer confidence also remains relatively low. And yet the eurozone economy is still expected to improve throughout 2024 and 2025. The rebound will be partially dependent on the European Central Bank (ECB) following its June key rate cut with further easing. But the ECB will likely take a gradual approach since progress on inflation seems to be slowing and wage increases continue to threaten price stability (graph 5). The situation is further complicated by the political uncertainty stirred by the EU Parliament election results and the announcement of a snap election in France.

Graph 4
The Eurozone Economy Should Continue to Expand



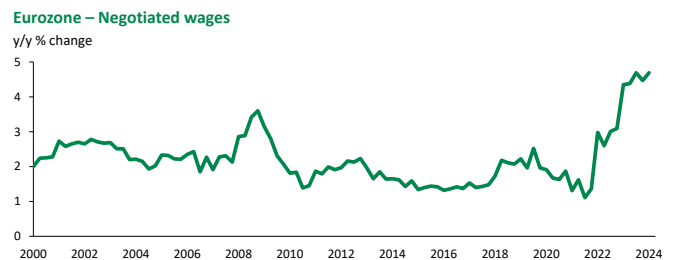
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Graph 3
Container Shipping Rates Are on the Rise Again



Freightos, Datastream and Desjardins Economic Studies

Graph 5
Wage Growth Remains Strong in the Eurozone



European Central Bank and Desjardins Economic Studies

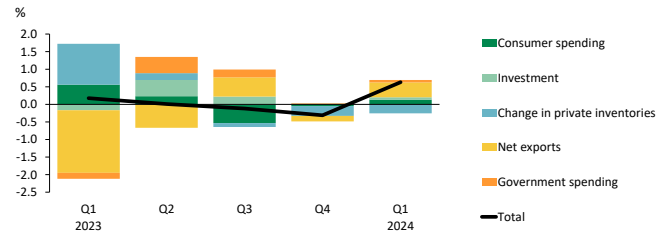
Politics are also a major issue in the United Kingdom. If the polls are right, the July 4 general election should deliver a landslide win for the Labour Party, ending 14 years of Conservative rule under five different prime ministers. Keir Starmer's party is campaigning on what is a rather cautious wealth creation platform. They promise to deliver economic stability to support business planning, increase infrastructure investments to accelerate the clean energy transition, and speed up residential construction. The UK has seen its economy struggle over the past few years, but even there indicators perked up in early 2024, with real GDP increasing 0.6% over the previous quarter. While this was the strongest surge recorded since the fourth quarter of 2021, the improvement was primarily driven by net exports, as domestic demand remained shaky (graph 6). In addition, monthly real GDP failed to grow in April and the labour market seems to have deteriorated in recent months. We nonetheless expect the United Kingdom to continue posting moderate growth in the coming quarters. UK inflation has slowed dramatically and was down to 2.0% in May. The Bank of England is expected to follow other major central banks by embarking on a rate cutting cycle sometime this summer.

In contrast to other advanced economies, Japan seems to be sinking deeper into a recession. The country's real GDP has contracted for two of the last three quarters, with sharp declines in household spending (graph 7). The second-quarter indicators released to date show mixed results. Even though inflation has slowed, the Bank of Japan may continue gradually tightening its monetary policy. It stands in stark contrast with other major central banks with a key interest rate that remains close to 0%.

China recorded solid real GDP growth with a 1.6% non-annualized gain in the first quarter of 2024. However, its overall economic performance has been very uneven. Manufacturing is the only sector that has shown steady growth since the beginning of the year. Year-on-year industrial output growth jumped from 4.5% in March to 6.7% in April before slightly slowing down to 5.6% in May. But there are still no signs of improvement in China's property market, which was a key driver behind economic growth in recent decades. Average home prices have been falling for 10 consecutive months (graph 8). That said, it looks as though recent measures introduced by the central government will finally address the structural problems that are bogging down the economy. While it will take time for the property sector to return to growth, we could see the situation start to stabilize. Against this backdrop, we're anticipating real GDP growth of 5.0% in 2024, moderating to 4.1% in 2025.

Graph 6
UK Real GDP Was Up in the First Quarter

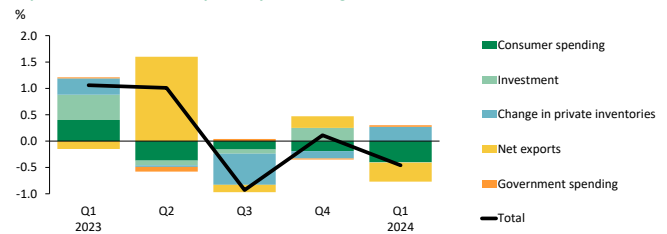
United Kingdom – Contributions to quarterly real GDP growth



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Graph 7
Japanese Real GDP Contracted Again

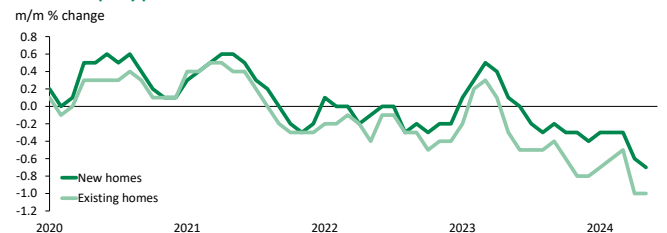
Japan – Contributions to quarterly real GDP growth



Cabinet Office and Desjardins Economic Studies

Graph 8
Property Prices Continue to Fall in China

China – Property prices



National Bureau of Statistics of China and Desjardins Economic Studies

United States

Consumption Growth Will Likely Slow until Interest Rates Start Coming Down

FORECASTS

The US economy slowed in the first quarter of 2024 after posting blockbuster growth in the second half of 2023, though domestic demand remains strong. We expect annualized real GDP growth to come in around 2% in the coming quarters. Inflation will continue to come down slowly over the next few months, but should cool enough for the Fed to finally start lowering interest rates late in the year. As the labour market gradually rebalances as job openings fall, wage growth and inflation should also slow.

Real GDP growth was strong in the second half of 2023 but eased in early 2024. After rising 4.9% in the third quarter of last year and 3.4% in the fourth quarter, real GDP grew just 1.3% on an annualized basis in Q1. This masked a healthy 2.5% increase in final domestic demand, however (graph 9). The slowdown was mainly due to a drop in net exports (and a 7.7% spike in real imports) and a smaller change in business inventories. Meanwhile domestic demand was supported by solid growth of 3.9% in services consumption (the strongest reading since Q3 2021), along with a surge in residential construction (+15.4%) and intellectual property investment (+7.9%).

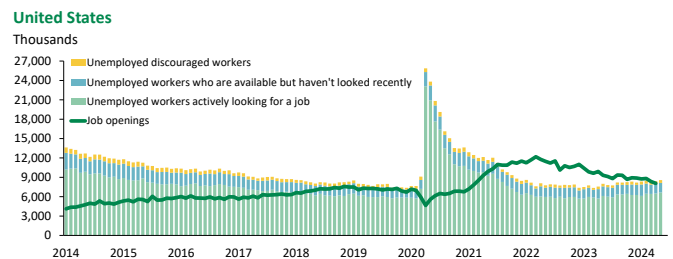
Strong domestic demand growth also translated to brisk hiring. According to the establishment survey, the US has created 1,239,000 jobs so far this year—a remarkable feat given the length of time interest rates have been at elevated levels. Other indicators suggest the labour market is gradually coming into better balance. Job openings are at their lowest level since February 2021, and there are now fewer job openings than there are officially unemployed and discouraged workers (graph 10). Meanwhile the household survey shows much slower job creation, and unemployment claims are up in recent weeks. We expect hiring to slow in the coming months, which should help wage and price growth to eventually come down as well.

Despite the resilient job market, consumer sentiment is weak. Even the drop in gasoline prices in recent weeks hasn't moved

the needle as expected. The University of Michigan consumer sentiment index actually fell in June (graph 11). The uncertainty surrounding the presidential election seems to be hurting confidence. While real consumption growth is expected to come in around 2% in the second quarter, consumer spending growth could ease in the coming quarters. It looks like the excess savings built up during the pandemic has run out, and [consumer credit growth has slowed](#). Higher-for-longer interest rates in the US won't help the situation.

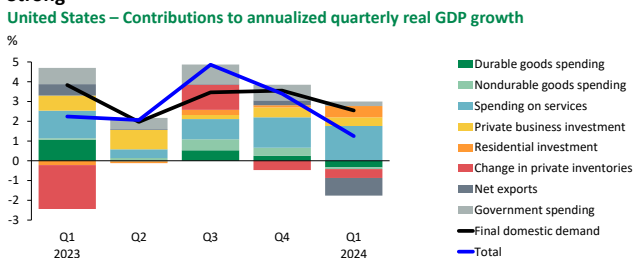
Meanwhile business investment is expected to grow modestly in the coming quarters. Last year's spike in manufacturing

Graph 10
The Labour Market Is Gradually Coming into Better Balance



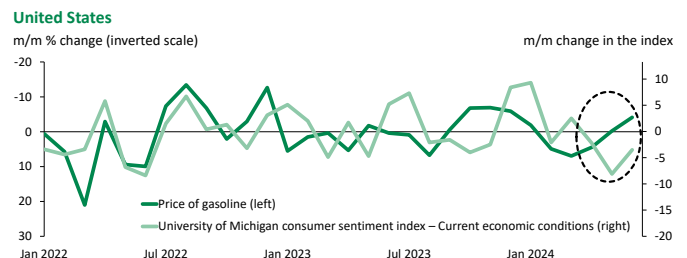
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Graph 9
GDP Growth Slowed in Early 2024, but Domestic Demand Remained Strong



Bureau of Economic Analysis and Desjardins Economic Studies

Graph 11
Consumer Confidence Is Down despite Lower Gasoline Prices



U.S. Energy Information Administration, University of Michigan and Desjardins Economic Studies

construction hasn't yet translated to higher investment in equipment, but the increase in industrial production in May is encouraging and we could see sustained growth later in the cycle. The Q1 jump in residential construction (+15.4% annualized) will likely be short-lived. That said, we expect a positive contribution from business inventories in Q2 after they shaved nearly half a percentage point off GDP growth in each of the previous two quarters.

We're calling for real GDP growth of around 2% for the next few quarters. That would be slightly below the current potential growth estimate and keep inflation moving closer to the Fed target. But the Fed won't finally start cutting rates until its November meeting right after the presidential election.

Table 3
United States: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2023		2024				Annual average			
	Q3	Q4	Q1	Q2f	Q3f	Q4f	2022	2023	2024f	2025f
Real GDP (2017 US\$)	4.9	3.4	1.3	1.9	1.6	2.0	1.9	2.5	2.4	2.0
Personal consumption expenditures	3.1	3.3	2.0	2.0	1.6	1.7	2.5	2.2	2.2	1.9
Residential construction	6.7	2.8	15.4	-4.7	0.9	5.7	-9.0	-10.6	4.4	2.2
Business fixed investment	1.4	3.7	3.3	3.5	3.2	3.5	5.2	4.5	3.4	3.5
Inventory change (2017 US\$B)	77.8	54.9	27.8	60.0	50.0	40.0	128.1	43.7	44.4	26.2
Public expenditures	5.8	4.6	1.3	2.5	2.3	2.1	-0.9	4.1	3.0	2.2
Exports	5.4	5.1	1.2	-0.1	1.5	1.5	7.0	2.6	1.5	1.4
Imports	4.2	2.2	7.7	6.0	2.0	1.5	8.6	-1.7	3.8	2.0
Final domestic demand	3.5	3.6	2.5	2.1	1.9	2.1	1.7	2.3	2.6	2.2
Other indicators										
Nominal GDP	8.3	5.1	4.3	4.8	4.3	4.1	9.1	6.3	5.0	4.3
Real disposable personal income	0.5	0.9	1.9	1.6	1.6	1.1	-6.0	4.1	1.5	1.8
Employment ¹	1.7	1.6	2.0	1.8	1.2	0.8	4.3	2.3	1.7	0.9
Unemployment rate (%)	3.7	3.7	3.8	4.0	4.2	4.3	3.6	3.6	4.1	4.1
Housing starts ² (thousands of units)	1,380	1,481	1,407	1,340	1,410	1,428	1,552	1,421	1,396	1,469
Corporate profits* ³	-0.6	5.1	7.2	7.5	4.5	1.0	9.8	1.5	5.0	3.0
Personal savings rate (%)	4.3	3.7	3.8	3.6	3.6	3.5	3.3	3.6	3.6	3.5
Total inflation rate*	3.6	3.2	3.2	3.2	2.9	3.0	8.0	4.1	3.1	2.4
Core inflation rate* ⁴	4.4	4.0	3.8	3.5	3.4	3.2	6.2	4.8	3.5	2.5
Current account balance (US\$B)	-883	-887	-942	-1,002	-1,011	-1,014	-1,012	-905	-992	-1,027

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

Canada

As Rate Cuts Begin, Headwinds Abound

FORECASTS

With the Bank of Canada (BoC) having kicked off rate cuts in June, many Canadians are no doubt taking Governor Tiff Macklem's advice to "just enjoy the moment for a bit." But even as interest rates are likely to move lower over the next couple of years as inflation slows, there will be offsetting headwinds to growth. These include a wave of mortgage renewals in 2025 and 2026 at much higher interest rates than when households last locked in rates during the pandemic. At the same time, population growth will slow as the federal government caps the number of newcomers to Canada.

At its June rate announcement, the BoC finally gave Canadians reason to celebrate. With a 25-basis point cut in the overnight policy rate, the central bank has embarked on what we expected to be a gradual but sustained path of lower interest rates (graph 12). Indeed, Governor Tiff Macklem was clear that, if inflation continues to ease, "it is reasonable to expect further cuts to our policy interest rate." And as other major central banks are anticipated to follow suit before the end of the year, lower rates overall should spur economic growth and improve sentiment both here and abroad.

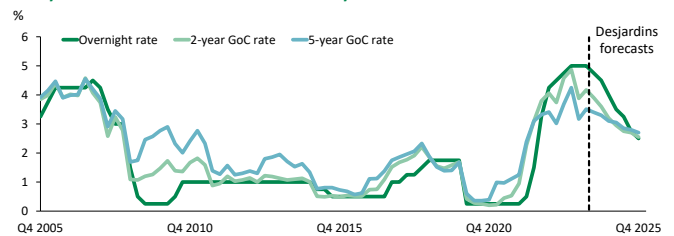
But take a peek under the hood of the Canadian economy and it quickly becomes apparent that the BoC has reasons to be concerned. Real GDP growth came in well below the BoC's forecast to start 2024, while being revised meaningfully lower at the end of last year. That means there is likely more slack in the Canadian economy than the BoC projected in the April 2024 Monetary Policy Report. And this despite surging population growth, which has ensured that Canada dodged a recession despite a sustained decline in real GDP per capita. Meanwhile, near-term measures of core inflation universally dropped very sharply in the first four months of this year, with the weakness concentrated in non-shelter components of the Consumer Price Index (graph 13). While this gave the BoC the confidence it needed to begin cutting rates in June, the pace at which inflation has slowed so far this year came as a surprise to both the central bank and markets. Signs of economic weakness are further compounded by surging business insolvencies at the start of 2024 and still very weak business and consumer confidence.

Going forward, it's tough to see the Canadian economy breaking out of its funk. While lower interest rates will provide a tailwind to growth, monetary policy will remain restrictive. Indeed, we don't expect the overnight policy rate to fall below its long-run neutral level until the end of 2025 at the earliest. And as households renew their mortgages at higher rates, particularly those that bought homes in 2020 and 2021, higher debt service costs will mean fewer funds available to spend. We expect household consumption and residential investment will be

Graph 12

The Bank of Canada Has Cut the Policy Rate, but It's Just the Beginning

Policy rate and Government of Canada bond yields

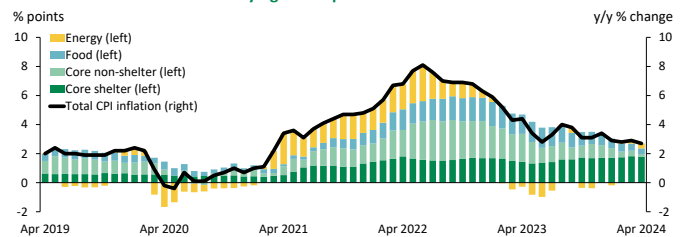


GoC: Government of Canada
Bank of Canada and Desjardins Economic Studies

Graph 13

Core Non-Shelter CPI Inflation Has Slowed Sharply in Early 2024

Total CPI inflation and its underlying decomposition*

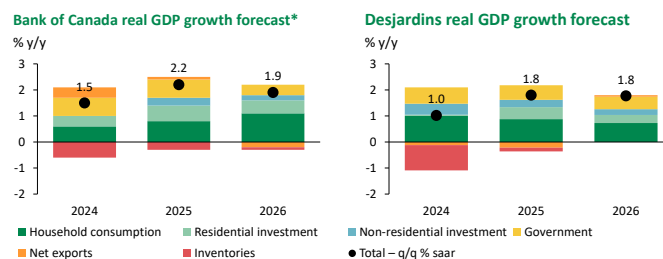


CPI: Consumer Price Index; * Calculated using fixed basket weights. Core CPI refers to the total CPI index excluding food and energy.
Statistics Canada and Desjardins Economic Studies

slower than they would be otherwise as a result. This weaker household spending profile will be compounded by the federal government's planned reduction in admissions of non-permanent residents (NPRs) in the coming years. Even if the Government of Canada reaches just half of its proposed target, which is to reduce the share of NPRs to 5% of the Canadian population after three years, the downshift in population growth will be substantial. While that will take pressure off the rental housing market, it will also mean lower overall consumption and residential investment. (See our [note](#) on the full impacts of the proposed NPR reductions.) Consequently, we think the economic

rebound in Canada will be more muted than in other countries, and certainly more downbeat than the Bank of Canada projected back in April (graph 14). However, the silver lining is that this more pronounced economic weakness will allow inflation to slow more quickly than it might otherwise, supporting still lower interest rates in the process.

Graph 14
We Expect Real GDP Growth to Fall Short of the Bank's Forecast



* The Bank of Canada's real GDP growth forecast is taken from the April 2024 Monetary Policy Report.
Bank of Canada and Desjardins Economic Studies

Table 4

Canada: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2023		2024				Annual average			
	Q3	Q4	Q1	Q2f	Q3f	Q4f	2022	2023	2024f	2025f
Real GDP (2017 \$)	-0.3	0.1	1.7	1.7	1.3	1.8	3.8	1.2	1.0	1.8
Final consumption expenditure [of which:]	1.4	1.6	2.9	1.7	1.6	1.7	4.5	1.7	1.9	1.7
Household consumption expenditure	0.1	3.2	3.0	1.4	1.1	1.5	5.1	1.7	1.9	1.6
Government consumption expenditure	4.7	-2.5	2.1	2.4	2.9	2.5	3.2	1.6	1.7	2.3
Gross fixed capital formation [of which:]	-3.9	-5.4	2.9	1.8	1.7	3.3	-2.4	-3.2	0.1	3.3
Residential structures	9.8	-2.3	1.3	-1.2	-0.5	2.8	-12.1	-10.3	0.7	4.0
Non-residential structures	-13.3	-14.7	1.9	6.1	3.5	4.1	6.7	2.6	-1.8	3.4
Machinery and equipment	-22.5	-11.3	6.4	0.5	2.1	3.5	-0.3	-6.4	-2.1	3.0
Intellectual property products	-2.3	1.9	8.2	4.9	2.9	2.9	6.0	0.3	3.2	2.2
Government gross fixed capital formation	2.0	3.4	2.1	1.6	3.5	3.9	4.2	5.4	2.1	3.3
Investment in inventories (2017 \$B)	41.3	39.5	30.0	36.4	30.4	29.0	55.3	38.9	31.4	28.0
Exports	-3.2	3.2	1.9	-3.3	2.7	2.5	3.2	5.4	0.7	2.3
Imports	-0.2	0.9	1.5	1.7	-0.5	2.4	7.6	0.9	1.3	2.7
Final domestic demand	0.2	0.0	2.9	1.8	1.7	2.1	2.8	0.5	1.5	2.2
Other indicators										
Nominal GDP	6.1	6.1	0.3	3.4	2.7	3.8	11.8	2.8	3.4	3.1
Real disposable personal income	6.3	2.4	5.2	4.8	1.0	0.0	-0.1	1.9	4.0	2.6
Employment	1.7	1.9	1.5	2.4	0.4	1.1	4.0	2.4	1.6	1.6
Unemployment rate (%)	5.5	5.8	5.9	6.2	6.5	6.6	5.3	5.4	6.3	6.4
Housing starts ¹ (thousands of units)	256	244	244	235	218	221	262	242	235	236
Corporate profits* ²	-20.5	-9.1	-6.3	0.1	-1.1	-0.2	14.7	-17.4	-1.9	11.2
Personal savings rate (%)	6.5	6.2	6.9	7.6	7.5	7.1	5.4	5.5	7.5	8.3
Total inflation rate*	3.7	3.2	2.8	2.6	2.2	2.2	6.8	3.9	2.5	2.1
Core inflation rate* ³	3.4	3.4	2.9	2.8	2.6	2.2	5.0	3.9	2.6	2.3
Current account balance (\$B)	-6.0	-4.5	-5.4	-5.5	-5.0	-5.8	-10.3	-21.0	-21.5	-32.8

f: forecast; * Annual change; ¹ Annualized basis; ² Before taxes; ³ Excluding food and energy.

Datastream and Desjardins Economic Studies

Quebec

Quebec's Economy Is on the Road to Recovery

FORECASTS

After a rough end to 2023 due to strikes in the healthcare and education sectors, Quebec's GDP now looks to be on the upswing. First-quarter results won't be released until the end of June, but they're expected to be very strong. It's even anticipated that real GDP shot up an annualized 3% or more compared with the fourth quarter of 2023. Quebec seems to have pulled itself out of the economic doldrums that lasted from spring 2023 through to the end of the year. During that time, the province recorded a cumulative decline in real GDP of roughly 2%. But the skies are finally starting to clear, with several signs of an economic upswing emerging in recent months. This comes as many Quebec households and businesses continue to struggle under the weight of high inflation and interest rates.

Not only did [real GDP](#) edge up for a second consecutive month in February with a 0.2% gain, but several other indicators also started improving. In addition, the [Desjardins Leading Index](#) (DLI) seems to be on a definitive upward trajectory, having pushed higher for three consecutive months (graph 15). Following a period of weakness, most components are recovering, which is a good sign for the Quebec economy as a whole.

A look at household spending shows there has been an increase in durable goods sales, which are sensitive to changing economic conditions and interest rates. Furniture, appliance and electronics sales have also been trending upward since the beginning of 2024, rising in tandem with the residential real estate market. Existing home sales and housing starts both bottomed out and have since been recovering. (See our [Spotlight on Housing](#) for more on this topic.) Vehicle sales continue to grow as supply improves for several makes and models, easing pent-up demand from years of unusually long delivery times.

Consumer confidence has rebounded somewhat recently and should continue to improve now that the Bank of Canada has started cutting interest rates. The jobs level has stabilized in recent months, but unemployment has continued to climb. After hitting a low of 3.9% in November 2022, the unemployment

rate has been gradually rising over the last few months, reaching 5.1% in May (graph 16).

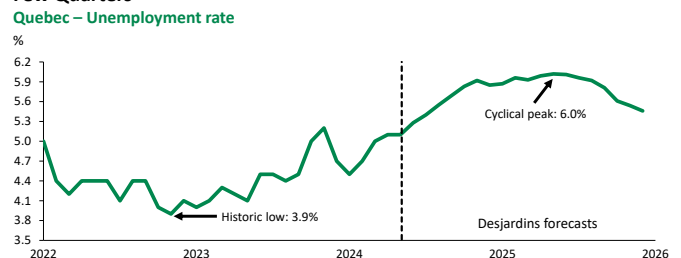
While the Quebec economy seems to be perking up following last year's slump, the labour market still seems to be suffering. Since the labour market tends to lag economic activity, we expect to see further deterioration over the next few months, with unemployment approaching 6% by the end of 2024 before it starts to ease later on next year. In the meantime, Quebec's economy should pick up speed and job numbers should eventually start rising again. Given that the pool of potential workers is very limited, there will continue to be a structural labour shortage for the next five years.

Quebec is currently experiencing a rapid rise in the working-age population, due in large part to immigration, which is pushing unemployment higher. According to the [Institut de la statistique du Québec](#), the province has posted record population growth. As a result, job vacancies have fallen significantly. But labour market conditions have also slackened across Canada, with the average duration of unemployment getting longer.

Graph 15
The DLI Is Strengthening: Quebec's Economy Will Continue to Recover



Graph 16
The Unemployment Rate Will Continue to Rise, Peaking at 6% in the Next Few Quarters



Even though job vacancies are falling, there continues to be [strong upward pressure on wages](#). After a brief pause, average hourly wages have been rising again in recent months, growing 5.1% year-over-year in May. This upward trend is being fuelled by high inflation, new collective agreements and a desire among businesses to retain employees. If they can afford to, companies are jockeying for workers so that they'll be ready to meet demand once it picks up.

SME confidence remains weak, despite improvements in recent months. Investment intentions remain low due to global geopolitical uncertainty, tight credit conditions caused by high interest rates and the fact that many businesses are struggling with lacklustre profits. Bankruptcies continue to rise and have now surpassed pre-pandemic levels.

Even though the Quebec economy is sending several positive signals, a lot of businesses and households are currently facing a difficult—or even critical—financial situation. But as Canadian interest rates come down this year and next, borrowers

should get some relief and Quebec's economic recovery should pick up speed.

Table 5
Quebec: Major Economic Indicators

Annual average % change (unless otherwise indicated)	2021	2022	2023	2024f	2025f
Real GDP (2017 \$)	6.7	2.5	0.0	0.7	1.5
Final consumption expenditure [of which:]	6.0	4.1	1.3	1.7	1.7
<i>Household consumption expenditure</i>	5.5	4.9	2.1	1.7	1.9
<i>Government consumption expenditure</i>	7.3	2.2	-0.7	1.4	1.5
Gross fixed capital formation [of which:]	11.1	-2.7	-7.8	1.9	3.3
<i>Residential structures</i>	13.7	-11.7	-17.5	7.3	3.9
<i>Non-residential structures</i>	5.1	6.1	-0.3	-0.5	2.8
<i>Machinery and equipment</i>	22.6	-4.9	-6.4	-3.8	2.3
<i>Intellectual property products</i>	12.0	2.3	1.4	0.9	2.8
<i>Government gross fixed capital formation</i>	4.5	7.4	-3.2	-0.6	4.0
Investment in inventories (2017 \$M)	-462	11,097	8,112	-1,065	-246
Exports	5.6	0.5	3.1	1.3	3.0
Imports	8.4	6.0	0.2	1.1	3.1
Final domestic demand	7.1	2.5	-0.6	1.7	2.0
Other indicators					
Nominal GDP	11.6	8.4	3.7	3.6	3.4
Real disposable personal income	1.9	1.6	4.0	6.5	3.3
Weekly earnings	2.9	4.1	3.6	4.0	3.1
Employment	4.3	3.0	2.4	0.9	2.1
Unemployment rate (%)	6.1	4.3	4.5	5.3	5.8
Personal savings rate (%)	14.8	12.6	12.1	10.8	8.8
Retail sales	14.4	8.5	3.6	1.7	4.5
Housing starts ¹ (thousands of units)	67.8	57.1	38.3	46.3	50.1
Total inflation rate	3.8	6.7	4.5	2.7	2.3

f: forecast; ¹ Annualized basis.

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

Medium-Term Issues and Forecasts

Wide-Ranging Needs Could Drive Investment

We recently published an [Economic Viewpoint](#) on the challenges that lie ahead for the next few decades. The note describes how major investments will be required for a wide range of reasons, such as supporting the clean energy transition and adapting to climate change. The Canada-wide housing shortage underscores the need to speed up residential construction. Emerging technologies like [artificial intelligence](#) could also lead to a wave of investment. Of course, this won't all happen over a five-year period, but we expect the investment boom to really take off in the medium term. While this is likely to fuel economic growth, it could also rekindle inflation if productivity gains aren't enough to boost potential GDP growth. To maintain balance between demand and supply, a few interest rate hikes could become necessary around 2028 following the cycle of cuts between now and early 2026.

Will We Do Enough to Support the Energy Transition?

Study after study has concluded that a massive effort is needed if we want to successfully transition to clean energy and adapt to climate change. But it's hard to know where and when these investments will actually need to happen. If we were to base our predictions solely on good intentions and climate science, we'd expect investment levels to skyrocket over the next few years. Unfortunately, other factors need to be considered, such as the construction sector's capacity limits, the speed at which new technologies can be developed and implemented, and the pressure that capital markets could face if financing needs were to increase too quickly. Inflation could also rise sharply. For these reasons, our current prediction is that investments will increase fairly gradually over the next few years.

Some Economies Could Invest More than Others

Investment levels could vary from one economy to another. Things are looking good for an acceleration in investment in Quebec. For example, Hydro-Québec announced an ambitious [action plan](#) that involves investing up to \$185 billion by 2035. This considerable increase in the utility's investments could spark significant economic growth, likely making an appreciable difference by 2028. To achieve its goals, Hydro-Québec will need all of its suppliers to pitch in. As a result, many businesses may need to ramp up capacity. Having enough workers will also be an issue, and fast-track training programs are already being offered in many construction trades.

Other Investment Needs Abound

Housing is an obvious area where Canada needs to step up investment. But once again, there's a big difference between being willing and being able. Although various levels of government have announced measures aimed at getting homes

built faster, we don't expect a boom in residential construction in the short term. However, some constraints should ease over the medium term, allowing for housing starts to pick up.

Other sectors also have major investment needs. Aging infrastructure and public transit need to be addressed. The rise of artificial intelligence could also unleash a wave of business investment. The shift to electric transportation will require substantial levels of investment over several years to support activities that range from mining to EV battery recycling.

More Productivity Needed

Creative ways to balance growing needs with limited production capacity will be needed. While it won't be possible to hit all targets at once, increasing productivity would give more options. Better allocation of labour, combined with training programs designed to meet pressing needs, would help raise productivity. Investing in new technology like artificial intelligence and automation could also lead to productivity gains, as could streamlining regulation. Without further productivity gains, inflation could rise, or other parts of the economy will have to grow less quickly to compensate for an acceleration in investment.

Table 6
Major Medium-Term Economic and Financial Indicators

% (unless otherwise indicated)	Annual average							Averages	
	2022	2023	2024f	2025f	2026f	2027f	2028f	2019–2023	2024–2028f
United States									
Real GDP (% change)	1.9	2.5	2.4	2.0	2.2	2.0	2.2	2.1	2.2
Total inflation rate (% change)	8.0	4.1	3.1	2.4	2.2	2.2	2.2	4.0	2.4
Unemployment rate	3.6	3.6	4.1	4.1	3.9	3.8	3.8	4.9	3.9
S&P 500 index (% change) ¹	-19.4	24.2	16.9	3.5	4.5	4.5	4.8	15.4	6.8
Federal funds rate	1.86	5.20	5.45	4.45	3.35	3.00	3.00	2.03	3.85
Prime rate	4.86	8.20	8.45	7.45	6.35	6.00	6.00	5.03	6.85
Treasury bills – 3-month	2.09	5.28	5.25	4.05	3.10	3.00	3.00	1.98	3.68
Federal bonds – 10-year	2.96	3.96	4.20	3.65	3.30	3.20	3.20	2.28	3.51
– 30-year	3.12	4.09	4.35	3.75	3.35	3.25	3.25	2.68	3.59
WTI oil (US\$/barrel)	95	78	80	83	80	80	78	67	80
Gold (US\$/ounce)	1,802	1,943	2,190	1,950	1,775	1,625	1,625	1,742	1,833
Canada									
Real GDP (% change)	3.8	1.2	1.0	1.8	1.8	2.1	2.0	2.3	1.7
Total inflation rate (% change)	6.8	3.9	2.5	2.1	2.0	2.1	2.0	3.3	2.2
Employment (% change)	4.0	2.4	1.6	1.6	1.6	1.9	1.7	1.6	1.7
Employment (thousands)	750	475	326	331	342	409	369	290	355
Unemployment rate	5.3	5.4	6.3	6.4	6.3	6.1	6.0	6.7	6.2
Housing starts (thousands of units)	217	271	235	236	247	256	260	240	247
S&P/TSX index (% change) ¹	-8.7	8.1	6.4	4.5	4.0	5.3	5.6	8.5	5.2
Exchange rate (US\$/C\$)	0.77	0.74	0.73	0.74	0.76	0.77	0.78	0.76	0.75
Overnight rate	1.95	4.74	4.70	3.15	2.25	2.50	2.70	1.85	3.06
Prime rate	4.14	6.94	6.90	5.35	4.45	4.70	4.90	4.05	5.26
Mortgage rate – 1-year	4.43	7.14	7.40	5.50	4.85	4.85	4.95	4.25	5.51
– 5-year	5.64	6.68	6.80	6.40	6.20	6.20	6.25	5.47	6.37
Treasury bills – 3-month	2.18	4.74	4.60	2.95	2.25	2.50	2.70	1.82	3.00
Federal bonds – 2-year	2.90	4.27	3.85	2.80	2.50	2.70	2.85	1.95	2.94
– 5-year	2.78	3.57	3.40	2.90	2.70	2.85	3.00	1.89	2.97
– 10-year	2.77	3.36	3.40	2.95	2.75	3.00	3.10	1.97	3.04
– 30-year	2.81	3.28	3.30	2.95	2.75	2.95	2.95	2.19	2.98
Yield spreads (Canada–United States)									
Treasury bills – 3-month	0.09	-0.54	-0.65	-1.10	-0.85	-0.50	-0.30	-0.15	-0.68
Federal bonds – 10-year	-0.19	-0.60	-0.80	-0.70	-0.55	-0.20	-0.10	-0.31	-0.47
– 30-year	-0.31	-0.81	-1.05	-0.80	-0.60	-0.30	-0.30	-0.49	-0.61
Quebec									
Real GDP (% change)	2.5	0.0	0.7	1.5	1.8	1.6	1.6	1.5	1.5
Total inflation rate (% change)	6.7	4.5	2.7	2.3	2.0	2.0	1.9	3.6	2.2
Employment (% change)	3.0	2.4	0.9	2.1	1.7	1.2	0.9	1.2	1.3
Employment (thousands)	130	105	38	95	80	55	45	58	63
Unemployment rate	4.3	4.5	5.3	5.8	5.2	4.6	4.2	5.8	5.0
Retail sales (% change)	8.5	3.6	1.7	4.5	4.2	4.0	4.0	5.6	3.7
Housing starts (thousands of units)	57	38	46	50	61	68	65	53	58

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

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