

ECONOMIC & FINANCIAL OUTLOOK

Progress on Inflation Sets the Stage for 50-Basis-Point Cuts in Canada and the United States

By Jimmy Jean, Vice-President, Chief Economist and Strategist

The global economy is facing a multitude of crosscurrents that can be expected to keep shaping market expectations and economic forecasts in the months ahead. China's economic woes have been underscored by its bond yields sinking to record lows, in spite of its central bank selling bonds to curb the decline. Weaker prices for Chinese exports have supported the country's trade, but the Chinese economy remains held back by the fallout from the ongoing deleveraging in its property sector and resulting negative wealth effect. Intensifying protectionist measures from the West will pose additional challenges for exports going forward. Europe has seen some modest growth, despite still restrictive financing conditions, partly thanks to major sporting events this summer. The ECB should nonetheless keep proceeding relatively cautiously with its policy normalization given persistent wage pressures and services inflation.

In contrast, a sense of urgency has started to take hold among North American central banks. Having begun easing later than others, the Federal Reserve is in catch-up mode with a 50-basis-point cut at its September 18 decision. The Bank of Canada started cutting a quarter earlier, rightfully ignoring exaggerated policy divergence fears. This is because the Fed and the BoC's motivations are slightly different: while the Fed is catching up, the BoC is seeking to shield its economy from significant headwinds in the coming year, particularly the abrupt slowdown in population growth and the burden of mortgage renewals.

Despite these differences, the US and Canadian economies share a common trend: cooling job markets. For now, the slowdown appears orderly. Rising unemployment is primarily being driven by demographic growth, while layoffs remain near cyclical lows. Hiring has slowed, but this was expected given the drop in job openings. Both economies posted respectable growth in the first half of the year, and we project continued, albeit modest, growth moving forward, unlikely to trigger recession-style layoffs.

Two important factors will nonetheless strongly influence this outlook. The first is the outcome of the US election. By virtue of its heavy reliance on universal tariffs, Trump's agenda would have net-negative effects on growth and would push up inflation in the US and possibly abroad. The second is how central banks navigate rate normalization in an environment where their decisions will reflect the difficult tradeoffs between risks to growth and inflation.

In Canada, this challenge is compounded by the government's evolving immigration policies and their implementation. The Bank of Canada's most recent forecast projects strong population growth over the next two years, implying skepticism about the government's ability to fully achieve its goals. But the Bank of Canada's forecasts have been too optimistic lately. Should the government unveil a more detailed and convincing execution plan when it updates its immigration targets this fall,

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the economic outlook may need to be downgraded further. This could open the door to a more aggressive rate cut trajectory in Canada than markets are pricing in at the moment. While clarity is awaited on this issue, we think risk management considerations should still nudge the Bank of Canada to cut rates by 50 basis points next month.

RISKS INHERENT IN OUR SCENARIOS

Although inflation has come down, it remains above target in most countries. In Canada, labour disputes could multiply, temporarily disrupting the economy and putting even more upward pressure on wages and inflation. Except for the Bank of Japan, central banks most likely won't start hiking rates again. There's also a great deal of uncertainty over the lagged effect of higher interest rates on economic growth. It's therefore quite possible that some central banks may be forced to cut rates faster. As more and more homeowners are renewing mortgages at higher rates, far too many Canadian borrowers could have trouble making payments and listings could rise sharply. Tenants are increasingly under pressure as well. And that's before we even consider the possibility of a spike in layoffs, which would increase unemployment and worsen the impact on the housing market and credit in general. The US presidential election in November could also be a game-changer. A close outcome could provoke social instability. And a second Trump term in the White House may create uncertainty, especially regarding international trade and the independence of the Federal Reserve. Irrespective of who wins, fiscal deterioration in the United States (and elsewhere) could prompt credit rating downgrades and possibly push long-term interest rates higher. Worsening economic and geopolitical tensions could also spell instability for the global economy, financial markets and commodity prices.

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	2.6	2.2
United States	15.7	2.5	2.6	2.0	4.1	2.9	2.3
Canada	1.4	1.2	1.1	1.8	3.9	2.4	2.1
<i>Quebec</i>	0.3	0.2	1.2	1.7	4.5	2.4	2.0
Japan	3.6	1.7	-0.1	1.2	3.3	2.5	2.1
United Kingdom	2.3	0.1	1.1	1.3	7.4	2.6	2.3
Eurozone	11.9	0.5	0.9	1.4	5.5	2.4	2.0
<i>Germany</i>	3.3	-0.1	0.0	1.0	6.0	2.4	2.0
<i>France</i>	2.3	1.1	1.2	1.3	4.9	2.3	1.8
<i>Italy</i>	1.9	1.0	0.8	1.2	5.7	1.2	1.8
Other countries	4.2	1.3	1.7	2.1	4.7	2.7	2.1
<i>Australia</i>	1.0	2.0	1.3	2.3	5.6	3.4	2.8
Emerging and developing economies	61.3	4.0	3.9	3.9	8.7	7.5	4.7
North Asia	26.9	5.8	5.3	4.8	2.9	2.2	2.4
<i>China</i>	18.5	5.2	4.8	4.1	0.2	0.5	1.3
<i>India</i>	7.2	8.2	7.0	6.6	5.7	4.5	4.6
South Asia	5.2	4.0	4.4	4.3	3.4	2.4	2.5
Latin America	11.5	2.4	2.3	2.0	5.2	4.3	3.5
<i>Mexico</i>	1.7	3.2	1.8	1.6	5.6	4.6	3.6
<i>Brazil</i>	2.3	2.9	2.8	2.0	4.2	4.2	3.8
Eastern Europe	8.2	3.2	3.2	2.7	19.5	18.4	9.0
<i>Russia</i>	3.2	3.6	3.4	1.7	5.9	6.9	4.6
Other countries	9.5	2.2	2.5	3.4	19.9	17.2	10.4
<i>South Africa</i>	0.6	0.7	1.0	1.9	6.1	4.9	4.5
World	100.0	3.1	3.1	3.1	7.1	5.7	3.8

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

World Bank, Consensus Forecasts and Desjardins Economic Studies

FINANCIAL FORECASTS

Even though the Bank of Canada (BoC) has cut its policy rate three times in a row, the target remains above the neutral rate, which means it's still restrictive. As inflation continues to moderate, we expect to see more rate cuts in Canada. The BoC should even announce a 50-basis-point cut at its next meeting given a more fragile economy. The Federal Reserve also opted for a 50-basis-point cut at its September meeting in response to progress on inflation and risks of further deterioration in the employment market.

A jumbo rate cut shouldn't be taken as a panic move, but as a normal response in an environment where inflation is no longer a real threat. We think financial markets would react favourably to bigger cuts by central banks. Investors would probably regain their appetite for equities, but potential overvaluation would remain a risk that needs to be monitored. Commodities may win back some recently lost ground, although the sluggish Chinese economy would likely still cause concern. This should in turn limit the upside for the Canadian dollar, but we believe the loonie would nevertheless be lifted by the optimism prevailing on financial markets and an overall pullback in the US dollar. Spreads between Canadian and US interest rates are expected to narrow somewhat in 2025.

Table 2
Summary of Financial Forecasts

End of period in % (unless otherwise indicated)	2023		2024				2025			
	Q3	Q4	Q1	Q2	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	3.25	3.00
Canada	5.00	5.00	5.00	4.75	4.25	3.50	3.00	2.75	2.50	2.25
Eurozone	4.00	4.00	4.00	3.75	3.50	3.25	2.75	2.50	2.25	2.00
United Kingdom	5.25	5.25	5.25	5.25	5.00	4.75	4.25	3.75	3.50	3.25
Federal bonds										
<u>United States</u>										
2-year	5.14	4.33	4.70	4.77	3.60	3.50	3.35	3.25	3.15	3.10
5-year	4.64	3.86	4.23	4.36	3.45	3.35	3.25	3.20	3.15	3.15
10-year	4.57	3.87	4.21	4.37	3.70	3.60	3.55	3.55	3.50	3.40
30-year	4.70	4.02	4.35	4.54	4.00	3.90	3.90	3.85	3.80	3.70
<u>Canada</u>										
2-year	4.87	3.88	4.17	3.99	2.85	2.85	2.75	2.65	2.60	2.55
5-year	4.25	3.17	3.51	3.51	2.70	2.65	2.55	2.55	2.55	2.60
10-year	4.03	3.10	3.45	3.50	2.85	2.85	2.80	2.80	2.80	2.75
30-year	3.81	3.02	3.34	3.39	3.05	3.05	3.05	3.00	3.00	2.95
Currency market										
Canadian dollar (USD/CAD)	1.36	1.32	1.35	1.37	1.36	1.36	1.35	1.34	1.33	1.33
Canadian dollar (CAD/USD)	0.74	0.75	0.74	0.73	0.74	0.74	0.74	0.75	0.75	0.75
Euro (EUR/USD)	1.06	1.10	1.08	1.07	1.11	1.12	1.12	1.13	1.13	1.14
British pound (GBP/USD)	1.22	1.27	1.26	1.26	1.32	1.33	1.32	1.32	1.33	1.33
Yen (USD/JPY)	149	141	151	161	142	140	138	136	134	132
Stock markets (level and growth)*										
United States – S&P 500	4,770		Target: 5,650 (+18.5%)				Target: 5,850 (+3.5%)			
Canada – S&P/TSX	20,958		Target: 24,000 (+14.5%)				Target: 25,200 (+5.0%)			
Commodities (annual average)										
WTI oil (US\$/barrel)	78 (72*)		78(76*)				79 (80*)			
Gold (US\$/ounce)	1,940 (2,030*)		2,300 (2,200*)				2,000 (1,900*)			

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

Datastream and Desjardins Economic Studies

Overseas

Slow but Steady Growth

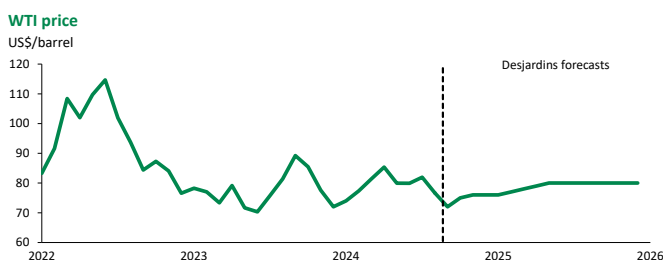
FORECASTS

Global economic growth remains quite modest, helping inflation ease further and prompting the major central banks to continue their newly minted monetary easing cycles. Growth is expected to remain relatively slow in the eurozone, and Germany—where real GDP contracted again in the second quarter—is of particular concern. In the United Kingdom, economic momentum seemed to be improving, but we’re expecting the new government to tighten the purse strings, which could slow growth in the coming year. However, like the eurozone, the UK economy will benefit from a continued gradual decline in interest rates. Meanwhile, China’s economy is struggling to recover, as the country’s stimulus measures have not been as effective as hoped. Global real GDP growth is expected to come in at 3.1% in 2024 and 2025.

After the challenges of 2023, most advanced economies posted improved economic growth in the first half of 2024. That said, real GDP gains remain quite modest, and the economic climate is still fragile. Even the drop in inflation—especially for core indexes excluding food and energy—seems to have stalled in several countries. The global economy is also not immune to geopolitical tension. Take shipping costs for example, which started to rise again in the spring and have remained high ever since. There’s also little prospect of peace in Ukraine and Gaza. Despite this geopolitical tension, oil prices have plummeted. West Texas Intermediate (WTI) fell from US\$82 per barrel in early August to US\$65 per barrel in mid-September (graph 1), on the back of revised expectations for petroleum product consumption over the next few quarters. Furthermore, the anticipated increase in production is likely to put the global oil market back in a surplus position and drag down prices. That said, lower interest rates will probably help prop up oil prices, and we expect WTI to rebound to around US\$75 per barrel at the end of the year. The Organization of the Petroleum Exporting Countries and its partners’ (OPEC+) plan to delay its increase in oil output likely won’t have much impact on prices, given that the cartel hasn’t been sticking to its output targets and has been overproducing for eight consecutive months now.

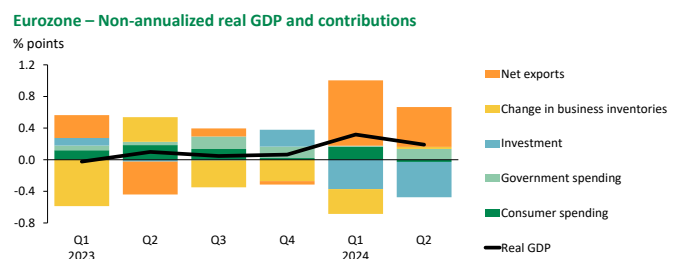
Eurozone real GDP grew a non-annualized 0.2% in the second quarter of 2024, after rising 0.3% in the first quarter. Real consumer spending has dipped, while business investment has dropped more sharply (graph 2), partly due to the delayed impact of high interest rates. But it’s primarily a reflection of a German economy that’s struggling, whereas its neighbours are already experiencing better growth after the challenges of last year. German industrial production has dropped 9.1% since the first quarter of 2023, and the situation in the automotive sector is broadly negative (graph 3). At just 42.4 in August,

Graph 1
Abundant Supply and Weak Demand Have Caused Oil Prices to Fall



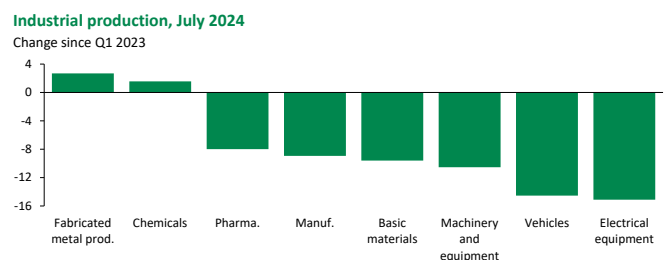
WTI: West Texas Intermediate
Datastream, International Energy Agency and Desjardins Economic Studies

Graph 2
Growth Is Holding Strong Despite Declining Investment



Eurostat and Desjardins Economic Studies

Graph 3
German Industry Remains Sluggish



Federal Statistical Office and Desjardins Economic Studies

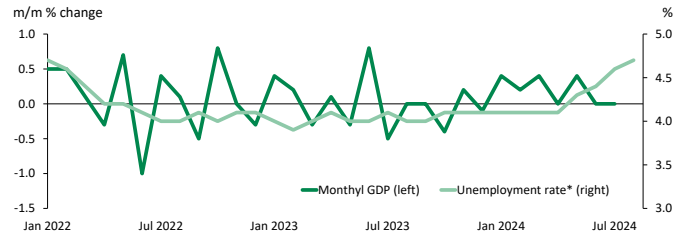
Germany’s Manufacturing PMI isn’t suggesting an improvement any time soon. That said, we expect other major eurozone economies to continue to grow moderately, helped by the monetary easing initiated by the European Central Bank.

The UK economy seems to be at a turning point. Real GDP growth has been relatively strong recently, with non-annualized gains of 0.7% in Q1 and 0.6% in Q2. While this is the best half-year performance since 2017 aside from the post-pandemic rebound, the economy now seems to be losing steam. Monthly GDP was flat in June and July, and the unemployment rate is rising (graph 4). The Labour government’s October budget may be quite austere, which could curb economic growth over the coming year. That said, we expect to see an acceleration in investments in certain sectors, especially renewable energy. Inflation has slowed substantially, prompting the Bank of England to begin cutting interest rates in August. We’re anticipating another 25-basis-point cut in the fall and further gradual easing next year, which will help underpin economic growth.

Japan has succeeded in overcoming its recent challenges. Second-quarter non-annualized real GDP growth came in at 0.7%, after negative or flat prints in each of the last three quarters (graph 5). The third-quarter indicators released to date show mixed results. Core inflation has slowed, but the Bank of Japan is likely to continue tightening monetary policy.

China’s economic woes continue. The slowdown primarily affected the real estate sector at the start of the year but now seems to be more broad-based. Both industrial production and retail sales have shown signs of slowing in recent months (graph 6). Although the central government has implemented a wide range of stimulus measures to boost the housing market and consumer spending, they’re not having the desired impact. Of particular concern is the US\$70B plan to have local governments buy up unsold properties, which has made little headway so far. The recent drop in financing rates also hasn’t produced the expected results. Economic activity over the next few quarters is likely to mirror the previous ones, and we expect real GDP to grow by 4.8% in 2024.

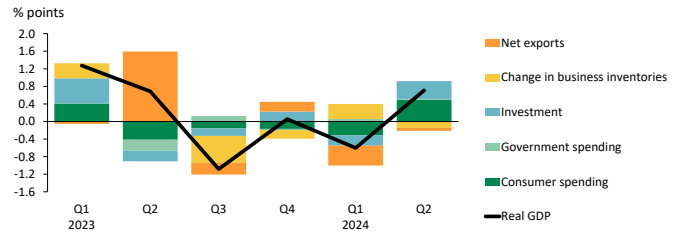
Graph 4
Economic Growth in the UK Has Slowed Recently, and the Labour Market Is Deteriorating



* Based on the number of unemployment benefits claimants. Office for National Statistics and Desjardins Economic Studies

Graph 5
After Several Challenging Quarters, the Economy Improved in Q2

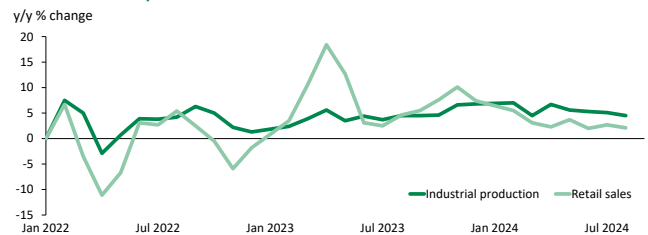
Japan – Non-annualized real GDP and contributions



Cabinet Office and Desjardins Economic Studies

Graph 6
The Economic Slowdown Seems to Be Becoming More Broad-Based

China – Industrial production and retail sales



National Bureau of Statistics of China and Desjardins Economic Studies

United States

Slightly Slower Growth Will Prompt the Federal Reserve to Keep Cutting Rates

FORECASTS

The US economy posted another solid increase in the second quarter of 2024. Since then, data releases have been more mixed overall, and have even come in below expectations. This is especially true for the job market. Although real GDP growth may have begun moderating in the third quarter, we don't expect a major economic reversal, just slightly below-potential growth. This should help rein in wage growth and inflation. The Federal Reserve (Fed) has started relaxing its monetary policy and is expected to keep doing so at future meetings.

Real GDP advanced by an annualized 3.0% in the second quarter of 2024. This was a clear improvement on the 1.4% posted early this year, but it's slightly below the 4.1% average gain for the second half of last year (graph 7). Stronger consumer spending helped rev up final domestic demand between the first (+2.4%) and second quarters (+2.9%). These numbers may be revised when the annual update of the National Economic Accounts is published in late September.

Despite the negative impact of Hurricane Beryl in early July, real consumer spending kicked off the third quarter with a monthly gain of 0.4% for that same month, driven partly by a rebound in motor vehicle sales. Beryl had a bigger impact on housing starts, industrial production and hours worked than on personal consumption. Rapidly falling gas prices have boosted consumer confidence in recent months.

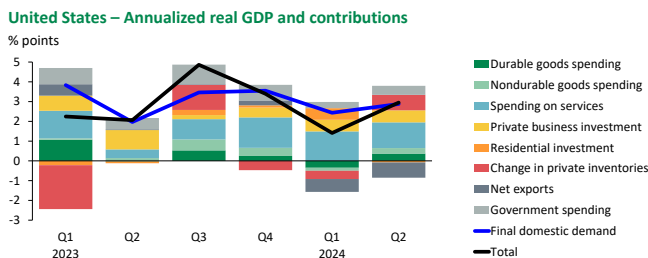
Relatively speaking, consumers are feeling more confident despite growing concern about the strength of the labour market. July's 4.3% rise in unemployment, in addition to the previously reported news that just 114,000 jobs (later revised down to 89,000) were created that same month, made a big impression. According to the U.S. Bureau of Labor Statistics' preliminary estimate of the annual benchmark revision of its establishment survey, employment counts will likely be revised

sharply downward, amplifying fears of a major downturn in the labour market. The August print, which showed unemployment falling slightly to 4.2% and 142,000 jobs created, somewhat eased concerns. Initial unemployment claims held steady while gross layoffs slowed (graph 8). This suggests that while the labour market may be starting to creak, it nevertheless doesn't look like it will collapse. But we need to keep a close eye on the situation. For the time being, we expect slowing net hires and mild upticks in unemployment, but not enough to believe a recession is imminent.

In addition to consumer spending, one reason for the US economy's relatively buoyant growth has been resilient business investment, which has boosted productivity. But the ISM indexes, especially for manufacturing, have shown some weakness of late, while there could be a slowdown in nonresidential construction, following the surge from the Inflation Reduction Act. This is expected to exert some drag on the economy, although that should be partly offset by interest rate cuts. Lower interest rates should help prop up residential construction over the next quarters.

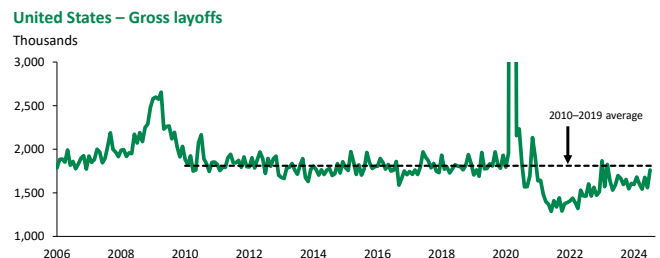
The past two years have been marked by rampant inflation and a tight labour market. But both of these have started to fade. Headline inflation plummeted from a peak of 9.1% in the

Graph 7
Real GDP Growth Remained Strong in Q2 2024



Bureau of Economic Analysis and Desjardins Economic Studies

Graph 8
The Number of Layoffs Has Increased but Remains Modest



Bureau of Labor Statistics and Desjardins Economic Studies

summer of 2022 to just 2.5% in August. More muted price gains have helped boost real household income in an environment where wages are still growing fairly rapidly. Inflation should keep gradually drifting toward the 2% target, giving the Fed the flexibility it needs to continue with the monetary easing that it just started. This will allow Fed officials to focus more on increased slack in the job market and the risks of an economic downturn.

Of course, there's another factor that could significantly affect the trajectory of the US economy: the outcome of the November 5 election. Both presidential candidates are promising to extend at least some of the 2017–2018 tax cuts that are slated to expire at the end of 2025. Trump wants to extend the whole package of cuts while slashing corporate taxes even more. Harris plans to extend the tax cuts for taxpayers earning less than \$400,000 while significantly expanding the tax credit for families and workers. She also wants to increase home construction and assist first-time homebuyers. But Trump's plans for immigration and trade could have the biggest impact on the economy over the next few years. We'll soon be publishing a more in-depth analysis of the issues in the presidential election and the expected impact of the Republican and Democratic platforms.

Table 3
United States: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2024				2025		Annual average			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	2022	2023	2024f	2025f
Real GDP (2017 US\$)	1.4	3.0	2.0	1.9	1.9	2.0	1.9	2.5	2.6	2.0
Personal consumption expenditures	1.5	2.9	3.5	1.7	1.9	1.8	2.5	2.2	2.5	2.1
Residential construction	16.0	-2.0	-5.4	4.6	7.6	5.2	-9.0	-10.6	4.2	3.5
Business fixed investment	4.4	4.6	1.2	2.9	2.8	3.2	5.2	4.5	3.6	3.0
Inventory change (2017 US\$B)	28.6	69.0	50.0	45.0	35.0	30.0	128.1	43.7	48.1	28.7
Public expenditures	1.8	2.7	2.0	1.7	1.9	1.9	-0.9	4.1	3.1	2.0
Exports	1.6	1.6	2.5	2.0	1.5	1.7	7.0	2.6	2.1	1.8
Imports	6.1	7.0	4.0	2.0	2.4	2.2	8.6	-1.7	3.9	2.8
Final domestic demand	2.4	2.9	2.6	2.0	2.2	2.2	1.7	2.3	2.8	2.3
Other indicators										
Nominal GDP	4.5	5.5	4.7	4.1	4.4	4.2	9.1	6.3	5.2	4.4
Real disposable personal income	1.3	1.0	3.2	2.4	0.6	2.5	-6.0	4.1	1.5	2.0
Employment ¹	2.0	1.5	1.0	1.0	0.8	0.8	4.3	2.3	1.6	0.8
Unemployment rate (%)	3.8	4.0	4.2	4.3	4.3	4.2	3.6	3.6	4.1	4.2
Housing starts ² (thousands of units)	1,407	1,340	1,321	1,403	1,422	1,440	1,552	1,421	1,368	1,447
Corporate profits* ³	6.4	8.0	5.5	2.5	5.0	4.2	9.8	1.5	5.5	4.2
Personal savings rate (%)	3.8	3.3	3.2	3.4	3.1	3.3	3.3	3.6	3.4	3.3
Total inflation rate*	3.2	3.2	2.6	2.5	2.5	2.2	8.0	4.1	2.9	2.3
Core inflation rate* ⁴	3.8	3.4	3.2	3.1	2.7	2.5	6.2	4.8	3.4	2.6
Current account balance (US\$B)	-951	-1,038	-1,057	-1,061	-1,073	-1,081	-1,012	-905	-1,027	-1,086

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

Rates are Coming Down but Headwinds Abound for Canada's Economy

FORECASTS

Canada's economic engine continues to sputter. Growth has slowed while the unemployment rate has edged steadily higher. Although inflation is coming down toward 2% and the Bank of Canada (BoC) has started cutting interest rates, higher costs will continue to strain household budgets. This is likely to curb spending over the next couple of years, particularly when combined with the need to save to contend with impending mortgage renewals. Planned reductions in newcomers to Canada should restrain economic activity as well. But possibly the most pressing concern over the outlook is the uncertainty around the US presidential election. While we've assumed the status quo will continue in the forecast presented here, a second Trump presidency could hit Canadians where it hurts—in the trade balance. Fortunately, the BoC has ample room to bring cut rates further and faster than we currently expect if the circumstances warrant it.

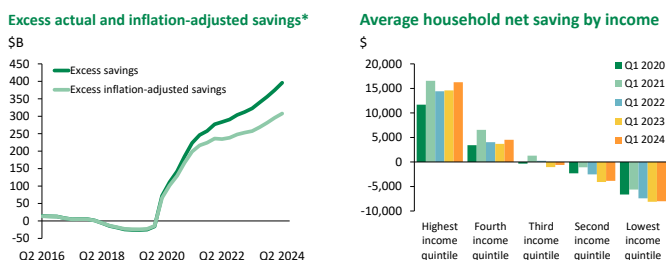
For many Canadians, there is an unshakeable feeling that all is not well with the Canadian economy. [Growth stalled in June and is expected to do the same in July](#). At around 1.0% annualized, Q3 2024 real GDP growth is tracking well below the Bank of Canada's forecast of 2.8%. At the same time, the [unemployment rate](#) is inching higher, albeit largely among younger workers and newcomers to Canada. Inflation may be coming down, but the Consumer Price Index (CPI) in August was 19% above its end-of-2019 level, and prices are only expected to keep rising. [Interest rates are falling as well](#), although many Canadian households are likely to see their monthly mortgage payments rise at renewal. Together, higher prices and interest rates will put increasing strain on the finances of Canadians, especially among lower-income households (see [our in-depth analysis](#) on the topic). Still elevated wage growth should help, but [our research](#) suggests this has been increasingly concentrated in the public sector. And while aggregate savings in the economy have remained elevated, they've largely been squirreled away by the most affluent households (graph 9).

With these headwinds to contend with, we expect Canadians to be unusually tight-fisted over the next couple of years.

Consumer spending should slow markedly. Home renovations could be reined in as well. More downbeat consumer activity will be further exacerbated by the federal government's planned reduction in non-permanent residents (NPRs). There may be fewer immigrants than currently planned as well. The weakness in household consumption and residential investment will put downward pressure on headline real GDP growth, which we believe will come in well below the Bank of Canada's most recent forecast (graph 10). This despite our expectation that the ongoing slide in real GDP per capita and productivity should start to reverse as fewer newcomers arrive in Canada.

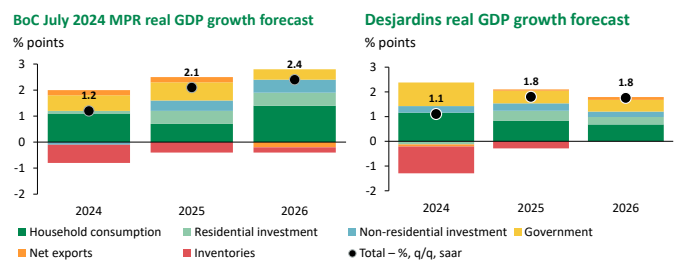
If these headwinds—still high prices, a wall of mortgage renewals, and slower population growth—weren't enough, arguably the biggest risk to the outlook for the Canadian economy is the outcome of the upcoming US presidential election. We've assumed the status quo continues in our base case. We have little reason to think that trade policy in a Harris-Walz administration with a divided Congress would deviate much from the past four years. However, a second Trump presidency could pose risks to this outlook, particularly in the event of a Republican sweep. At a minimum it could lead

Graph 9
Savings Continue to Rise, but the Gains Are Uneven Across Households



* The underlying trend is based on the 5-year cumulative average growth rate from Q4 2014 to Q4 2019. Statistics Canada and Desjardins Economic Studies

Graph 10
Consumption and Housing Could Be Weaker than the BoC Expects



BoC: Bank of Canada; MPR: Monetary Policy Report
Bank of Canada, Statistics Canada and Desjardins Economic Studies

to fewer Canadian exports to the US because of the broad-based application of tariffs. Other policies related to things like energy and immigration should have more mixed impacts on Canada's economy. The one silver lining is that Canadian exports may get a boost in the final quarter of 2024 as US businesses look to take advantage of a more positive trade regime before the Oval Office changes hands in early 2025. But it may be all downhill from there. We will detail our analysis in forthcoming Economic Viewpoints.

All told, while Canada's economy isn't in a recession and we think one is unlikely before the end of the year (see [our recent discussion](#) of why that's the case), there are substantial challenges ahead. Indeed, while rates are coming down, headwinds abound for the Canadian economy. Fortunately, the Bank of Canada has ample room to cut rates further and faster than we currently expect if the circumstances warrant it.

Table 4
Canada: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2024				2025		Annual average			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	2022	2023	2024f	2025f
Real GDP (2017 \$)	1.8	2.1	1.0	1.8	2.0	2.0	3.8	1.2	1.1	1.8
Final consumption expenditure [of which:]	3.6	2.1	2.8	1.4	1.8	1.7	4.5	1.7	2.3	1.8
<i>Household consumption expenditure</i>	3.6	0.6	2.7	1.4	1.8	1.7	5.1	1.7	2.1	1.7
<i>Government consumption expenditure</i>	3.3	6.0	3.1	1.6	2.1	1.9	3.2	1.6	2.6	2.3
Gross fixed capital formation [of which:]	1.3	3.5	-1.0	2.2	2.8	3.6	-2.4	-3.2	-0.4	2.5
<i>Residential structures</i>	-0.1	-7.3	-1.3	2.3	4.3	4.5	-12.1	-10.3	-1.0	2.8
<i>Non-residential structures</i>	3.7	2.0	-3.3	-1.5	3.3	3.2	6.7	2.6	-3.3	1.3
<i>Machinery and equipment</i>	0.0	28.8	-9.6	6.3	0.1	6.6	-0.3	-6.4	-0.4	3.3
<i>Intellectual property products</i>	7.6	1.1	2.3	3.0	2.1	1.2	6.0	0.3	2.3	1.9
<i>Government gross fixed capital formation</i>	-1.7	11.0	7.8	4.4	2.7	2.5	4.2	5.4	3.4	4.1
Investment in inventories (2017 \$B)	25.4	25.7	25.4	25.1	24.6	24.1	55.3	38.9	25.4	23.2
Exports	2.0	-1.8	-2.9	2.4	2.6	2.9	3.2	5.4	0.3	1.7
Imports	0.1	-0.5	-0.4	1.5	2.7	2.9	7.6	0.9	0.5	1.9
Final domestic demand	3.1	2.4	2.0	1.6	2.1	2.2	2.8	0.5	1.7	2.0
Other indicators										
Nominal GDP	0.3	7.1	1.1	2.1	3.8	2.9	11.8	2.8	3.8	3.0
Real disposable personal income	5.0	1.9	2.4	1.8	-0.3	5.9	-0.1	1.9	3.4	2.3
Employment	1.5	2.4	0.5	1.6	2.2	1.9	4.0	2.4	1.7	1.7
Unemployment rate (%)	5.9	6.3	6.6	6.8	6.7	6.7	5.3	5.4	6.4	6.6
Housing starts ¹ (thousands of units)	245	250	250	237	228	227	262	242	246	230
Corporate profits* ²	-8.0	2.2	-0.6	-2.5	15.9	12.5	14.7	-17.4	-2.3	12.1
Personal savings rate (%)	6.7	7.2	7.1	7.1	6.5	7.4	5.4	5.5	7.0	7.4
Total inflation rate*	2.8	2.7	2.1	1.8	2.4	1.9	6.8	3.9	2.4	2.1
Core inflation rate* ³	2.9	2.8	2.5	2.0	2.5	2.2	5.0	3.9	2.6	2.2
Current account balance (\$B)	-5.4	-8.5	-7.7	-8.3	-9.0	-9.3	-10.3	-21.0	-29.9	-37.8

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

Quebec

The Speedy Economic Recovery Will Give Way to More Moderate Growth

FORECASTS

Quebec's economy roared back to life in early 2024 after weathering a period of decline, with real GDP erasing all its previous losses by the spring. In the wake of this economic bounceback, growth is expected to ease over the next few quarters to a pace of approximately 1.5%. The labour market is likely to worsen for another few months amid the financial challenges many businesses are facing. In the short term, we anticipate that the unemployment rate will top 6% before falling back below 5% by the end of 2025. Continued growth, controlled inflation and a series of interest rate cuts will be reflected in demand for workers next year.

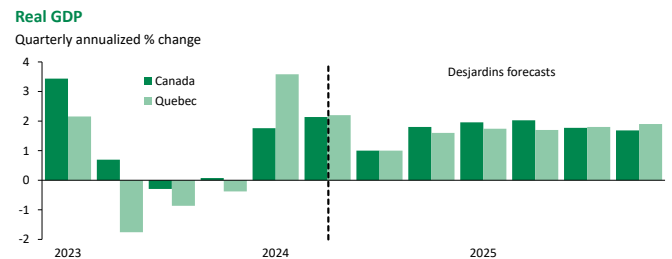
While the economy has come a long way since the beginning of 2024 (graph 11), the labour market continues to be hampered by the weakness of some businesses and a higher number of [bankruptcies](#). Smaller businesses have had a much harder time dealing with the challenges of recent years—especially the pandemic, rising costs, and significantly higher debt as a result of temporary government support. Businesses in more precarious situations have hit the brakes on hiring, which has put a dent in the province's employment growth.

Monthly volatility aside, payrolls have stabilized since the beginning of 2024 (graph 12). However, the [unemployment rate](#) climbed from 4.5% in January to 5.7% this summer. Record population growth—primarily due to the arrival of foreign students and workers—is pushing up unemployment. The stricter rules already in place for admitting international candidates to English-speaking universities and the federal and provincial governments' desire to limit the number of new non-permanent residents should slow the growth of the working-age population. Combined with Quebec's return to economic growth, which will support a more broad-based recovery in hiring within a few months, the unemployment rate should dip below 5% by the end of next year.

Growth in after-tax income remains steady despite the temporary labour market weakness. Hourly wages also picked up again in early 2024 after new collective agreements in the education sector were adjusted. Other wage increases are expected—including for Quebec's public service employees and nurses—that will depend on the outcome of negotiations. Significant wage increases are also being granted in the private sector to offset the high inflation rates of recent years. However, inflation has slowed and even dropped to 1.5% in August. For now, incomes are rising faster than consumer spending, keeping the household savings rate close to 15%.

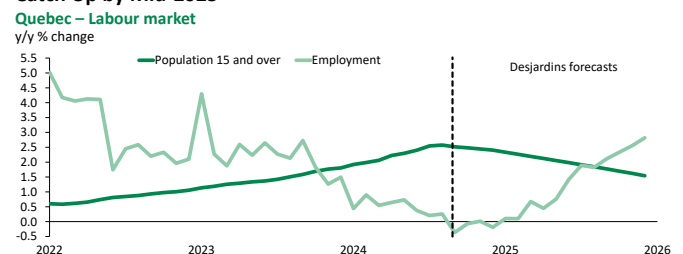
Residential construction and existing home sales recovered in early 2024, but there's currently more houses and condominiums available. This has kept selling prices relatively stable over the past few months, although higher than last year on average.

Graph 11
Post-Bounceback, Quebec's Economic Growth Will Align with Canada's



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

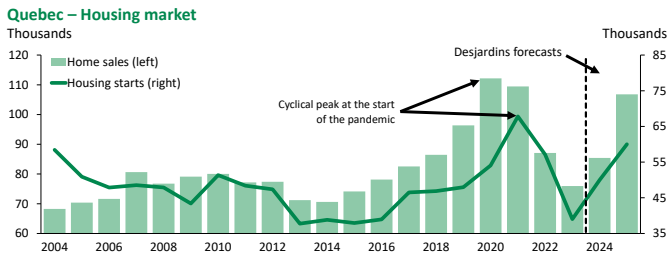
Graph 12
Population Growth Is Expected to Slow Slightly, but Employment Will Catch Up by Mid-2025



Statistics Canada and Desjardins Economic Studies

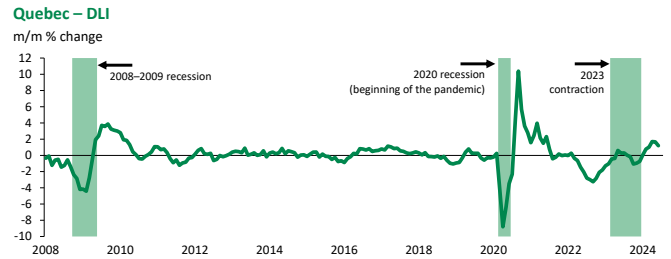
Purpose-built rental housing starts began to recover long before interest rate cuts were initiated, particularly in cities and municipalities that relaxed regulations or offered financial incentives to kickstart new projects. Construction should continue to ramp up in the coming quarters as borrowing costs decrease. We expect housing starts in Quebec to increase by close to 25% this year and another 20% next year (graph 13 on page 12). This year, the housing market was behind Quebec's return to economic growth, while the [Desjardins Leading Index](#) confirms that the province's economy is likely to keep expanding (graph 14 on page 12).

Graph 13
Residential Real Estate Activity Will Continue to Climb but Will Remain Well Below Its Recent Peak



Canada Mortgage and Housing Corporation, Canadian Real Estate Association and Desjardins Economic Studies

Graph 14
The DLI Is Positive: The Economic Outlook Is Favourable



DLI: Desjardins Leading Index
 Desjardins Economic Studies

Table 5
Quebec: Major Economic Indicators

Annual average % change (unless otherwise indicated)	2021	2022	2023	2024f	2025f
Real GDP (2017 \$)	6.7	2.5	0.2	1.2	1.7
Final consumption expenditure [of which:]	6.0	4.1	1.1	1.9	1.7
Household consumption expenditure	5.5	4.9	2.0	2.2	2.0
Government consumption expenditure	7.3	2.2	-1.1	1.3	1.5
Gross fixed capital formation [of which:]	11.1	-2.7	-7.7	1.9	9.0
Residential structures	13.7	-11.7	-17.1	5.0	20.7
Non-residential structures	5.1	6.1	-0.3	-0.2	2.8
Machinery and equipment	22.6	-4.9	-6.6	2.1	3.2
Intellectual property products	12.0	2.3	1.4	4.5	2.8
Government gross fixed capital formation	4.5	7.4	-3.3	-2.1	4.0
Investment in inventories (2017 \$M)	-462	11,097	9,262	2,238	-1,584
Exports	5.6	0.5	2.8	-0.2	1.7
Imports	8.4	6.0	0.0	1.5	2.9
Final domestic demand	7.1	2.5	-0.8	1.9	3.2
Other indicators					
Nominal GDP	11.6	8.4	3.7	4.5	3.5
Real disposable personal income	1.1	3.0	1.2	2.6	1.0
Weekly earnings	2.9	4.1	3.6	3.4	2.2
Employment	4.3	3.0	2.4	0.3	1.4
Unemployment rate (%)	6.1	4.3	4.5	5.4	5.7
Personal savings rate (%)	14.8	12.6	12.0	12.6	11.5
Retail sales	14.4	8.5	3.7	0.5	5.0
Housing starts ¹ (thousands of units)	67.8	57.1	38.9	50.0	60.0
Total inflation rate	3.8	6.7	4.5	2.4	2.0

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

A Great Deal Needs to Be Done, but There Aren't Enough Resources to Do It

Overall, there are plenty of reasons to be optimistic about the longer-term perspective. The economy will likely get a boost from the substantial amount of investment required, especially to address the energy transition. In Canada, housing starts are also expected to gradually pick up in response to high demand. Similarly, a wide variety of infrastructure investments will be needed. The challenge will be to meet all these needs using the resources available. If economies grow too fast, they can easily overheat. In this kind of situation, inflation is an ever-present risk that may lead to several interest rate hikes. The solution to this problem would be higher productivity, but that seems unlikely for now.

Delaying the Energy Transition Isn't the Same as Giving Up

An increasing number of businesses have postponed investments in the energy transition, disappointing many. But society needs to make the transition, so we find it hard to believe it won't happen. There's still reason to believe companies will ramp up transition-related investment, which will affect the mining, manufacturing, infrastructure and clean energy sectors. Setting up new production chains and integrating new, still-developing technologies will take time. The increase in investment will also be contingent on long-term economic growth potential, which is determined by the availability of factors of production, including labour. Economic growth potential for Canada and the US is estimated at around 2%.

Less Consumption to Help Investment?

One way that investment could accelerate—while remaining within the limits imposed by economic growth potential—would be if consumer spending slows. This would free up some of the workers and resources that are currently involved in goods and services production, allowing them to be reallocated to investments. Furthermore, a decrease in spending will allow more savings, which can then be used to finance investment expansion. But that's easier said than done. Reducing spending growth requires consumers to make some sacrifices. Are we ready to do that?

Reducing government spending and deficits would also help create some room for investment to grow faster. But that's not really something we can count on given our aging populations, which require increasing amounts of government support, and the already significant repairs needed to existing infrastructure.

Residential Construction Needs to Ramp Up, Not Die Down

Residential construction is another sector where a slowdown would be problematic. This is especially true in Canada, where there's a huge shortage of housing. A lot of effort is currently

going into accelerating housing starts. We see housing starts picking up by 2028, but not enough to completely solve the housing crisis. As mentioned recently in [one of our studies](#), there are a number of constraints that are likely to limit growth in housing starts. Measures that would ease regulations to shorten delays before starting construction and minimize costs would be helpful. Effective measures to quickly increase the supply of construction workers are also needed.

Boosting Productivity Is More Important than Ever

Given the extent of these needs and the lack of resources to meet them, the pressure to improve productivity is high. Unfortunately, there's no easy way to do it. Productivity gains are driven by a variety of factors. A more effective allocation of labour and training programs to meet urgent needs in high-performance sectors could raise productivity. In addition, investments in new technologies like artificial intelligence and automation, as well as an improved regulatory framework, could also boost productivity. Our projections see productivity increasing, but given the lack of any noticeable progress in this area over the past few years, we're choosing to temper our optimism with a healthy dose of caution.

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	2.6	2.0	2.2	2.0	2.2	2.1	2.2
Total inflation rate (% change)	8.0	4.1	2.9	2.3	2.2	2.2	2.2	4.0	2.4
Unemployment rate	3.6	3.6	4.1	4.2	4.0	3.8	3.7	4.9	4.0
S&P 500 index (% change) ¹	-19.4	24.2	18.5	3.5	4.4	4.4	4.9	15.4	7.1
Federal funds rate	1.86	5.20	5.30	3.70	3.00	3.00	3.00	2.03	3.60
Prime rate	4.86	8.20	8.30	6.70	6.00	6.00	6.00	5.03	6.60
Treasury bills – 3-month	2.09	5.28	5.15	3.40	2.95	3.00	3.00	1.98	3.50
Federal bonds – 10-year	2.96	3.96	4.05	3.55	3.35	3.20	3.20	2.28	3.47
– 30-year	3.12	4.09	4.25	3.85	3.65	3.50	3.50	2.68	3.75
WTI oil (US\$/barrel)	95	78	78	79	80	80	78	67	79
Gold (US\$/ounce)	1,802	1,943	2,300	2,000	1,775	1,625	1,600	1,742	1,860
Canada									
Real GDP (% change)	3.8	1.2	1.1	1.8	1.8	2.1	2.0	2.3	1.8
Total inflation rate (% change)	6.8	3.9	2.4	2.1	2.0	1.9	2.0	3.3	2.1
Employment (% change)	4.0	2.4	1.7	1.7	1.6	1.8	1.9	1.6	1.7
Employment (thousands)	750	475	335	356	331	381	418	290	364
Unemployment rate	5.3	5.4	6.4	6.6	6.3	6.1	6.0	6.7	6.3
Housing starts (thousands of units)	217	271	246	230	246	256	260	240	248
S&P/TSX index (% change) ¹	-8.7	8.1	14.5	5.0	4.0	5.3	5.6	8.5	6.9
Exchange rate (US\$/C\$)	0.77	0.74	0.73	0.75	0.75	0.77	0.78	0.76	0.76
Overnight rate	1.95	4.74	4.55	2.70	2.25	2.50	2.75	1.85	2.95
Prime rate	4.14	6.94	6.75	4.90	4.45	4.70	4.95	4.05	5.15
Mortgage rate – 1-year	4.43	7.14	7.45	5.45	4.80	4.80	5.00	4.25	5.50
– 5-year	5.64	6.68	6.60	6.00	6.00	6.10	6.20	5.47	6.18
Treasury bills – 3-month	2.18	4.74	4.45	2.70	2.20	2.50	2.70	1.82	2.91
Federal bonds – 2-year	2.90	4.27	3.65	2.65	2.50	2.70	2.85	1.95	2.87
– 5-year	2.78	3.57	3.20	2.55	2.65	2.85	3.00	1.89	2.85
– 10-year	2.77	3.36	3.25	2.80	2.85	3.00	3.10	1.97	3.00
– 30-year	2.81	3.28	3.25	3.00	2.95	3.10	3.20	2.19	3.10
Yield spreads (Canada–United States)									
Treasury bills – 3-month	0.09	-0.54	-0.70	-0.70	-0.75	-0.50	-0.30	-0.15	-0.59
Federal bonds – 10-year	-0.19	-0.60	-0.80	-0.75	-0.50	-0.20	-0.10	-0.31	-0.47
– 30-year	-0.31	-0.81	-1.00	-0.85	-0.70	-0.40	-0.30	-0.49	-0.65
Quebec									
Real GDP (% change)	2.5	0.2	1.2	1.7	2.0	1.8	1.8	1.5	1.7
Total inflation rate (% change)	6.7	4.5	2.4	2.0	2.0	2.0	1.9	3.6	2.1
Employment (% change)	3.0	2.4	0.3	1.4	1.9	1.2	0.9	1.2	1.1
Employment (thousands)	130	105	13	64	88	54	43	58	53
Unemployment rate	4.3	4.5	5.4	5.7	4.8	4.2	3.8	5.8	4.8
Retail sales (% change)	8.5	3.7	0.5	5.0	4.2	4.0	4.0	5.6	3.5
Housing starts (thousands of units)	57	39	50	60	61	68	65	53	61

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