ECONOMIC VIEWPOINT

Tough Times Ahead: A Look at Long-Term Challenges Already Being Felt

By Jimmy Jean, Vice-President, Chief Economist and Strategist, Marc-Antoine Dumont, Senior Economist, Hendrix Vachon, Principal Economist, and Francis Généreux, Principal Economist

Generally, we tend to focus our forecasting efforts on the current year and the next few years. But as we are on the cusp of a period of major upheaval—which is already happening to some extent—we should look a little further down the road. This Economic Viewpoint sums up our current thinking about the next few decades. Making precise forecasts isn't easy, because uncertainty increases the further ahead we look. But it lays the groundwork for future trends and major developments that could characterize the next few decades in economic terms.

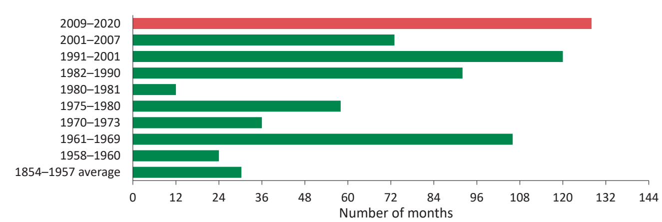
Start Strong to Reach High!

Before talking about long-term challenges, it's important to look at the current situation, because it could very well influence the coming years and certain choices that will have a lasting impact. The biggest challenge in the short term is restoring price stability. Once central banks feel that they are on track to achieve this, many will be able to cut interest rates, which should boost economic growth. However, the supply–demand balance is likely to remain precarious, and inflation could spike again. As such, the ideal scenario for the next few quarters isn't strong growth, but rather a gradual acceleration scenario that will limit the risk of an inflation uptick. If central banks had to raise their key interest rates again only a few quarters after cutting, investor and consumer confidence could be severely shaken. The economy would have to be held back again to rein in inflation. Many companies might postpone investment projects as a result, limiting economic growth potential in the longer term. The government's financial situation would remain unstable for longer. Tough decisions—some with potentially long-term effects—might be needed.

Duration of Economic Cycles

It's difficult to predict how economic cycles will evolve and how strong growth will be. Historically, in the 19th and first half of the 20th century, cycles were shorter, lasting only a few years. More recently, as economies have become more driven by services, cycles are lasting longer (graph 1). We saw a record 10-year expansion in the United States in the 2010s. Recent economic cycles have generally been characterized by fairly stable inflation close to central bank targets and have been extended due to relatively low interest rates. If the current battle against inflation is successful, and lower inflation expectations are able to bring price growth levels to heel, the current cycle could last several more years. Of course, other factors, including technological and financial innovations, new or updated regulations—particularly in the financial sector to avoid bubbles forming and bursting—, productivity gains, the geopolitical

Graph 1
Recent Economic Cycles Have Been Longer, Especially the One That Ended with the Pandemic
Duration of expansion phases in US economic cycles

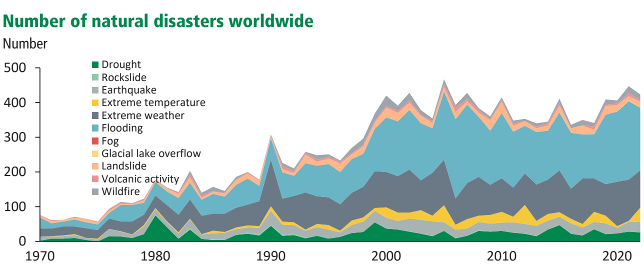


National Bureau of Economic Research and Desjardins Economic Studies environment and the management of public finances, can influence economic trends and the scope and duration of cycles. An investment boom—which is likely coming—could also support long-term growth.

Decarbonizing the Planet Will Require Major Investment

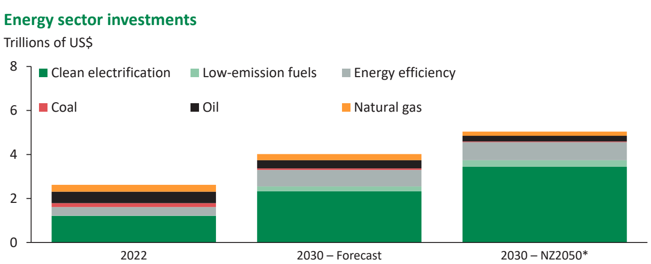
Global warming is on track to average 2.9°C by 2100, well above the 1.5°C to 2.0°C target set out in the Paris Agreement on climate change. The harmful effects of climate change are already visible, with the number of natural disasters increasing by 450% since 1970 (graph 2). However, physical risks are only half of the story. The transition risks associated with environmental policies and changes in demand also have the potential to significantly impact the economy. To decarbonize the economy, we'll need to make major investments in critical minerals, supply chains, energy production, transport electrification and infrastructure (including in mass transit) over the next few years. According to the IMF, "The path to net zero by 2050 requires low-carbon investments to rise from $900 billion in 2020 to $5 trillion annually by 2030." For clean energy alone, the International Energy Agency estimates that investments will likely have to almost triple to achieve net zero (graph 3). Although the energy transition comes with physical and transition risks, it will also provide economic opportunities, many of which could help create prosperity in Indigenous and other communities that have been marginalized in the past.

Graph 2
The Number of Natural Disasters Has Already Increased Significantly



Our World in Data and Desjardins Economic Studies

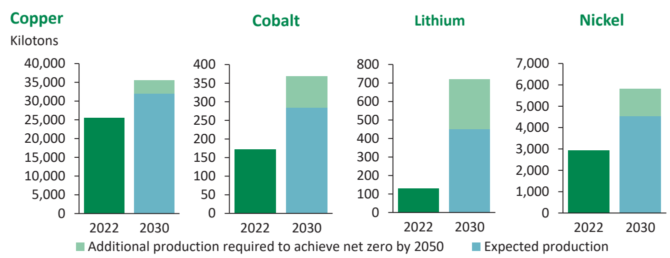
Graph 3
More Investments Are Needed in Clean Energy



*NZ2050: Scenario to achieve net zero by 2050
International Energy Agency and Desjardins Economic Studies

To achieve carbon neutrality, 30 million tons of critical minerals will be required by 2030. Mining production has already started reacting to this greater expected need, and new projects are on the rise in Quebec and across Canada. However, future projects remain insufficiently developed to meet anticipated needs, particularly for copper, cobalt, lithium and nickel (graph 4). According to the International Energy Agency, to achieve the net zero target by 2050, mining investment will need to increase by 30% more than what is already planned. In Quebec, investment in exploration has surged 70% since 2020 in anticipation of upcoming needs. If the province reaches its full mining potential, it could help generate a real economic boom, but it will come with its share of environmental issues and labour market pressure. Significant investment will also be required in the metal recycling sector, which will mitigate the pressure on the mining sector in the longer term.

Graph 4
Critical Mineral Production Must Increase to Meet Net-Zero Targets

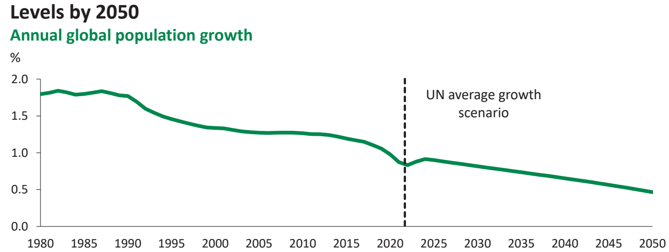


International Energy Agency and Desjardins Economic Studies

Demographics Are Becoming Less Conducive to Growth

Population growth means more consumers and more workers, which supports economic activity. However, the United Nations (UN) is projecting reduced demographic growth. This trend is already apparent, and global population growth could fall to half its current level by 2050 (graph 5). Growth of the population ages 15 to 64, which makes up the bulk of the workforce, is also expected to slow more sharply in many countries. These projections could be revised lower if the birth rate continues to decline.

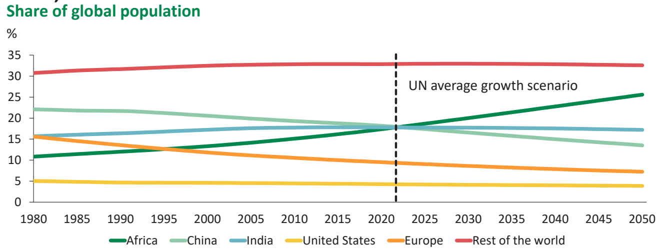
Graph 5
Global Population Growth Is Slowing and Could Be Only Half of Current Levels by 2050



United Nations and Desjardins Economic Studies

According to UN forecasts, Africa is expected to account for a quarter of the world's population by 2050, setting the stage for a shift in the global order (graph 6). This will make the continent a much bigger player in trade and international market development. Of the 20 economies that the IMF expects to post the strongest growth in 2024, more than half are in Africa. Meanwhile, China's demographic weight will decrease and India's should stabilize. However, India is likely to remain the world's most populous country for decades and should therefore play a more significant role on the international stage.

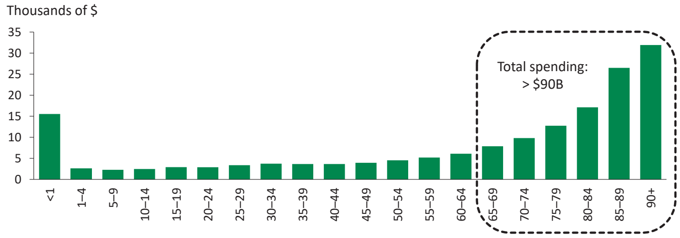
Graph 6
Africa Could Account for a Quarter of the World's Population by 2050, and China's Share Will Fall
Share of global population



United Nations and Desjardins Economic Studies

Closer to home, the main demographic issue will be the aging population. Healthcare costs are expected to increase as the baby boomer generation ages. Their final years will be the most expensive, as health care costs spike for people ages 85 and over (graph 7). Government finances—especially in advanced economies—will come under strain. The 2030s and 2040s are likely to be particularly challenging. There will be a lot of pressure to find new sources of income, review the services basket or make efficiency gains to care for more people to avoid costs skyrocketing. A shift toward home care could help here.

Graph 7
Healthcare Spending Increases Considerably with Age
Total healthcare spending per capita, 2021



Canadian Institute for Health Information and Desjardins Economic Studies

Demographic changes could also affect housing. If population growth eases over the long term, it could improve affordability for future generations. Even though many baby boomers want to stay in their home for as long as possible, many are likely to move to housing that is better suited to their changing needs, and ownership will eventually change hands. This would free up houses and large apartments for young families. However, housing adapted for seniors who are losing their independence and require greater care would likely become scarcer.

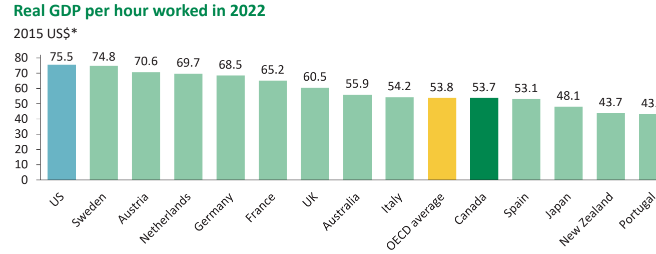
Immigration should mitigate the effects of an aging population in several advanced economies. Slower global population growth could lead to reduced migration, but advanced economies are likely to remain attractive for decades to come. This will be a major source of workers and economic and social enrichment for these countries and will also help contend with rising health care spending. If population growth were maintained at a somewhat strong pace, the risk of a residential property price correction would also be lower. However, as we've seen recently in Canada, high immigration can also put too much pressure on housing and other services. It's important to strike and maintain a fair balance over the long term, while creating conditions that maximize immigrants' economic and social contributions.

Increasing Productivity Would Go a Long Way

To offset a slowdown in population growth, some countries may bridge the gap by boosting productivity. This would help maintain solid economic growth and provide additional leeway to meet the needs of an aging population, invest in decarbonization and fight climate change. Productivity would also help drive growth without additional inflationary pressure. Canada and the United States are neighbours, but their productivity trends have diverged considerably recently. The situation in Canada—which is also lagging other advanced economies—needs to be resolved (graph 8).

Graph 8
Canada's Productivity Is Low Relative to Comparable Countries

Real GDP per hour worked in 2022



*Adjusted for purchasing power parity
Organisation for Economic Co-operation and Development (OECD) and Desjardins Economic Studies

However, there's no silver bullet. It will require a combination of greater investment, innovation, new technologies, skilled labour, entrepreneurial spirit, risk appetite and a favourable regulatory and tax framework. We can also take advantage of sectors of activity that are already performing well. Facilitating labour transfers to more in-demand and more productive sectors would help increase average productivity.

Sometimes the emergence of a major new technology—think steam engines, electricity or the development of telecommunications, especially the Internet—causes productivity to spike. People are noticing artificial intelligence's (AI) potential for major productivity gains. AI is developing at a dizzying pace and is already affecting the way many businesses operate. Productivity gains may take time to materialize across the economy, but they should ramp up over time. Like other disruptive technologies that have appeared in recent decades, AI will also affect investment needs and the labour market. According to an IMF study, 60% of workers in advanced economies hold jobs with high AI exposure. Unlike previous technologies that disrupted the job market, AI will likely impact more highly educated knowledge workers. What's more, AI and the changes it's ushering in will create new jobs we can't even imagine today. How fast AI spreads across economies and countries and new jobs in the sector appear, as well as its social acceptability and the scope of the regulations that will ultimately be needed to control it, are still to be determined. Major needs in fields including health care, energy and construction will also provide opportunities for job reclassification. Governments will need to help people in these fields through the transition with training and temporary income support.

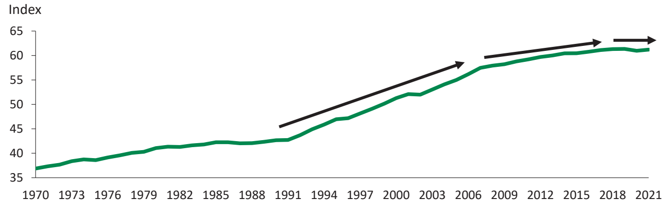
Toward a Less Globalized Economy?

Globalization has taken a hit in recent years due to a series of headwinds including the Trump administration's protectionist stance in the United States, followed by the pandemic—which shone a light on the fragility of supply chains—and growing geopolitical tension resulting in new trade barriers. There's now political will in the West to reshore certain industries or choose trading partners more carefully to ensure more reliable supply in the event of various shocks. The new battery and electric vehicle sector isn't immune to this trend, especially given its significant economic growth prospects. Meanwhile calls to tax products from countries that don't apply the same environmental rules are getting louder in some countries, especially in Europe.

That said, the gap between political will and economic reality can be wide. Globalization indexes, such as those prepared by the KOF Swiss Economic Institute, show that the pace of globalization has moderated, but it's still early to say that we're in a genuine period of deglobalization (graph 9). Looking only at the volume of goods and services traded, we can see that growth has slowed from the peak years of globalization (1990s to 2007), but trade hasn't decreased (graph 10).

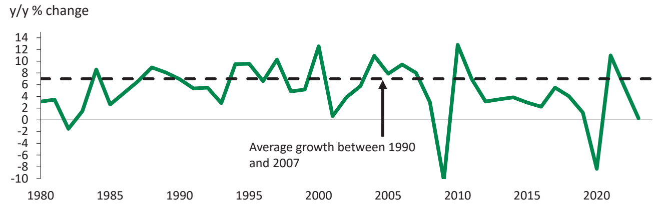
Economically speaking, broad-based deglobalization wouldn't be desirable. One compromise could be greater regionalization of trade, or a scenario where trade is concentrated between allies

Graph 9
Since 2018, Globalization Hasn't Progressed Much, but Deglobalization Hasn't Occurred Either
Globalization index



KOF Swiss Economic Institute and Desjardins Economic Studies

Graph 10
The Volume of Goods and Services Traded Continues to Grow, but Less Quickly
Volume of goods and services traded



International Monetary Fund and Desjardins Economic Studies

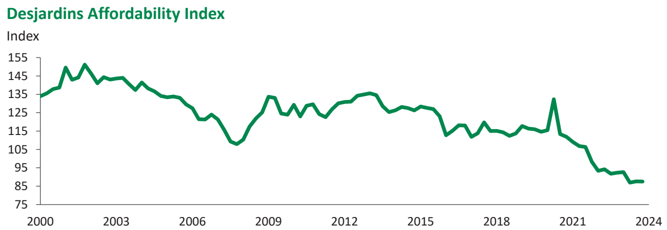
or friendly countries, with similar visions of democracy, social development and environmental protection. There are clearly undeniable advantages to trade that we shouldn't lose sight of. Globalization increases competition and provides access to cheaper products, which helps keep inflation low. For smaller economies, access to international markets also makes it easier for local businesses to grow. By expanding, these businesses can take advantage of economies of scale, increase their efficiency and generate productivity gains for the entire local economy.

Inequality Is Rising

Unfortunately, economic inequality remains a key global issue, and huge inter- and intra-country disparities persist. The main inter-country income disparities have narrowed since the 1990s thanks to globalization, the rise of emerging economies and development efforts in poorer regions. As such, deglobalization could harm the populations of some emerging economies if it materializes. Within advanced economies, income growth has been more uneven, as gains from globalization and adoption of new technologies haven't been shared evenly. The inequalities that remain are fuelling a tense geopolitical climate and have propelled a surge in migration in recent years. Climate change issues and widespread adoption of AI could drive increased inequality in the coming years and decades if governments don't put in place sufficient social security safety nets, such as helping negatively impacted workers requalify for other types of employment.

Roadblocks to housing and home ownership could lead to significant inequalities. Canada, which was long recognized as relatively affordable, has seen its situation deteriorate considerably in recent years (graph 11). Re-establishing an acceptable level of affordability will be no small task. In the fall of 2023, Canada Mortgage and Housing Corporation estimated that an additional 3.5 million housing units beyond the current uptrend would be needed by 2030 to restore affordability. This implies almost tripling the pace of construction immediately, which seems particularly challenging amid increasing investment and labour needs in several other sectors. In April, the Parliamentary Budget Officer used a less ambitious affordability target and estimated that 1.3 million additional units would need to be completed by 2030 to eliminate the housing gap in Canada. That's still a considerable number.

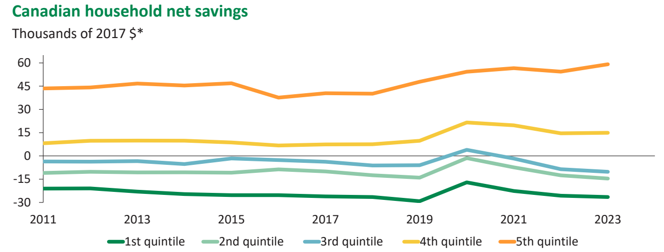
Graph 11
Affordability Has Declined Dramatically in Canada, Especially in Recent Years



Desjardins Economic Studies

Unless affordability improves rapidly, home ownership—a major asset for previous generations—may be out of reach for many young people, who will struggle to make up the shortfall by investing more of their savings in the financial markets. Rents have also surged, putting a strain on many household budgets and making saving much more difficult for many people. The gap between the savings rate of the rich and the less well-off has widened in Canada in recent years (graph 12). That said, young people have the advantage of a more dynamic job market than their predecessors, which offers great opportunities for advancement. In the future, some imbalances between generations and social classes could be addressed with taxation. For example, governments could become more willing to increase wealth taxes to finance public services and investments, including housing subsidies.

Graph 12
Only the Highest-Income Households Are Managing to Save More



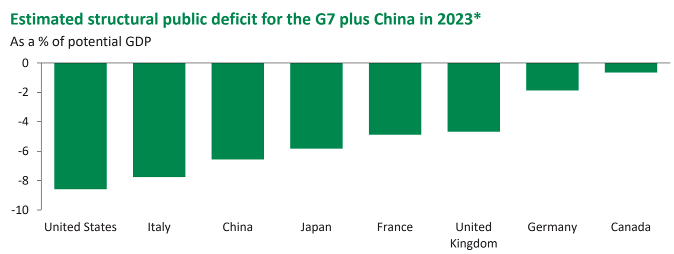
*Adjusted using the household consumption expenditure deflator.
Statistics Canada and Desjardins Economic Studies

The Debt Burden Can't Keep Going Up

Government debt levels surged during the pandemic, but inflation has helped bring down debt when compared to the size of the economy. However, the public debt burden remains higher than it was before the pandemic. As for consumers and businesses in advanced economies, their average debt burden is now slightly lower than it was in early 2020 (graph 13).

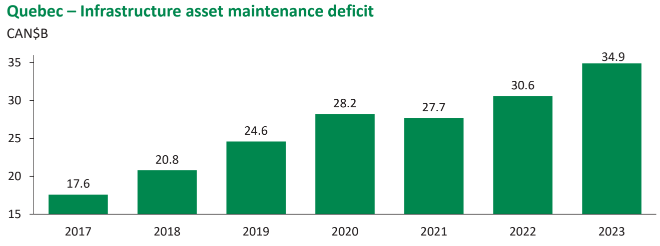
In the long term, we wouldn't want to see public debt expanding faster than the economy, especially if interest rates remain higher than the prevailing average levels during the last decade. According to the latest estimates by the International Monetary Fund, structural public deficits are still particularly high in the United States, Italy, China and Japan (graph 14). These and other countries will likely have to make considerable efforts to get their public finances in order. This could be particularly difficult given the aging population and increased government support for initiatives to combat climate change. In some places, such as Quebec, significant catch-up on infrastructure upgrades is also required (graph 15 on page 6). The countries with the highest productivity (and therefore that generate the most wealth) per capita will be the best positioned to shore up their public finances without resorting to painful spending cuts or tax increases. Higher income taxes would be more difficult to justify

Graph 14
Several Countries Have High Structural Public Deficits



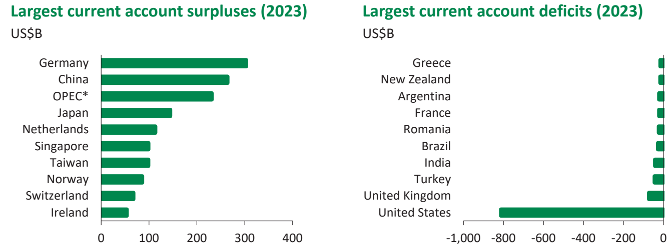
*For all levels of government.
International Monetary Fund and Desjardins Economic Studies

Graph 15
The Increase in the Asset Maintenance Deficit Is Concerning



Quebec Infrastructure Plan and Desjardins Economic Studies

Graph 16
Who Would Finance a Deterioration of Current Account Balances Due to Increased Investment and Government Spending?



*Members of the Organization of Petroleum Exporting Countries.
International Monetary Fund and Desjardins Economic Studies

amid a labour shortage. Wealth taxes and new tariffs could be considered, but a green tax policy could be a better option, which would also help drive the transition to a greener economy. That said, although the structural deficit doesn't need to be eliminated to stabilize the debt level, it mustn't exceed potential economic growth plus inflation.

Rising Pressure on the Global Capital Markets

What do housing construction, public deficits, investments in the energy transition and infrastructure upgrades have in common? They all require financing, which isn't limitless. Capital markets will likely be in high demand if all current investment objectives are maintained or increased. Savings will probably have to ramp up to meet new financial needs. As a result, neutral interest rates may also need to rise to give households incentive to save more. This could also encourage people and some businesses to borrow a little less, leaving more financial resources available for projects that are more profitable and more desirable for society, as well as for government funding for important projects that may be less financially profitable.

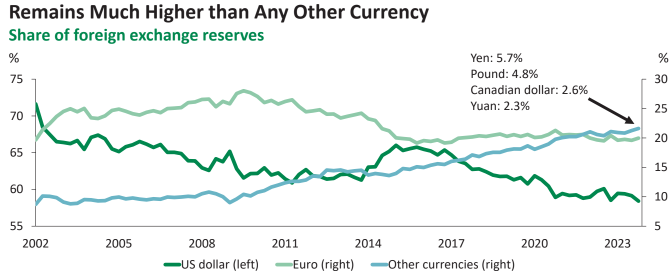
Countries with a savings shortfall could also rely on excess savings from other countries, which can be measured by current account balances. In 2023, Germany recorded the largest current account surplus at over US$300 billion. China had the second largest, followed by OPEC and Japan (graph 16). Over the next few decades, given the reduction in the use of fossil fuels, OPEC countries will likely have lower incomes and smaller savings surpluses, and may even post deficits. China's surplus is shrinking and therefore also appears to be at risk. It's also likely that many countries will see their financial needs rise as they have to deal with shared challenges, which will reduce the number of countries with surplus savings. This would make the scenario of higher neutral interest rates even more likely. In contrast, governments could reduce pressure on interest rates by limiting their deficits with higher tax receipts or cutting other expenses. Both will be difficult choices from a political standpoint.

On top of pressure from financing needs, capital markets could also face additional regulatory pressure. For example, to promote greener finance, rules will likely be implemented to better direct capital flows toward cleaner initiatives. As such, it will become more expensive to finance projects with more negative environmental impacts.

Will the US Dollar Be Dethroned, and Will There Be Changes to the International Financial System?

The US dollar is currently riding high on the back of a strong economy in the United States and expectations of higher-for-longer US interest rates. In the longer term, the role of the greenback is a little less certain. Among other things, its share of foreign exchange reserves appears to be trending down slightly (graph 17). However, despite this trend, the US dollar should continue to account for the lion's share, as no other currency seems to be able to take its place. The euro is currently the second-largest reserve currency, with a stable share around 20%.

Graph 17
The Weight of the US Dollar in Foreign Exchange Reserves Is Falling but Remains Much Higher than Any Other Currency



International Monetary Fund and Desjardins Economic Studies

One key quality of a dominant international currency is its high liquidity, and the size of the US economy and easy access to its well-developed capital markets have made the US dollar the candidate of choice. Most international commodities also continue to be denominated in US dollars. That said, greater geopolitical segmentation of the global economy could cause the greenback to lose some of its draw. For example, it may be used less by Russia and its allies and trading partners. A decrease in globalization and greater regionalization of trade could be a risk to the greenback, but it's likely to retain a clear advantage over other currencies for several more decades.

Why not use a cryptocurrency? First, no cryptocurrency is currently as liquid as the US dollar or many other major currencies. In addition, access to capital remains challenging with cryptocurrencies, which also don't enjoy the level of trust required for a genuine international currency due to insufficient regulation and monitoring. Some cryptocurrencies are also very energy-intensive and incompatible with the goal of a greener economy. Moreover, national currencies are generally regulated by a central bank based on targets related to inflation, employment and financial system stability. As such, the money supply can be more easily adjusted to account for economic and market fluctuations, which is a significant advantage.

Although inflation targets could eventually be revised upward—which remains a possibility, especially if the energy transition adds too much price pressure—how central banks and national currencies operate doesn't seem to be under scrutiny. However, it would come as no surprise if national currencies eventually became available in a new format, similar to some existing cryptocurrencies. This would be an alternative way to hold and trade currencies, in addition to the traditional paper format and demand deposits at financial institutions.

In Conclusion, the Future Will Be Busy, and We're Facing a Moment of Truth

Projects will be plentiful over the coming decades. Building more homes, transitioning to clean energy, adapting to climate change, dealing with an aging population and global uncertainty are all factors that will require vast amounts of investment and the ability to adapt our economies. This will put pressure on interest rates and government budgets. It may not always be easy to keep up with the urgent pace required. Hopefully, technological innovations will make work easier, just like steam engines, electricity and the Internet have already helped us make huge strides in terms of productivity. But beware of useless, unprofitable innovations. The international financial system, with the US dollar as the dominant currency, isn't perfect, but it's sure to remain well-suited to our future needs. However, rules should be added over time to better direct capital flows to greener projects. Right now, artificial intelligence may be the emerging innovation that could offer us the biggest gains, potentially initiating a new revolution that would free up resources for other economic uses. But the biggest surprises will probably be those we don't know about yet.