

ECONOMIC VIEWPOINT



A Look Back at 2017: The True Beginning of the Post-Financial Crisis Era

A Few Economic and Financial Highlights

It is now time to assess the year 2017. Here are the main aspects that caught our attention.

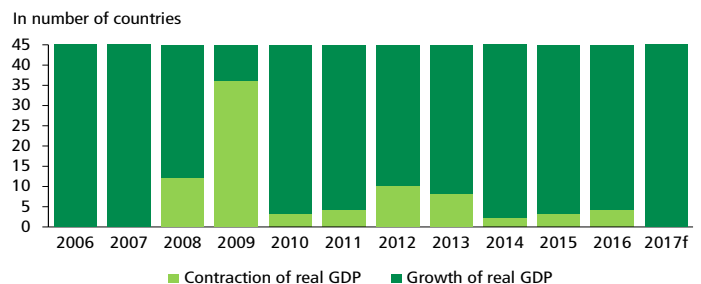
The pace of economic growth generally accelerated in 2017. A 3.5% rise in global real GDP is estimated for the year compared to 3.1% in 2016. According to the Organisation for Economic Co-operation and Development (OECD), none of the world's biggest economies (45 countries) will have experienced an annual contraction this year, the first time since 2007 (graph 1).

The United Kingdom is the only G7 country where the economy has slowed since 2016. The Brexit referendum results continued to haunt Britain's economic and political situation in 2017. Discussions with the European Union regarding Brexit have been particularly difficult. Hoping to reinforce her political legitimacy, Prime Minister Theresa May instead found herself leading a minority government the day after an early general election held on June 8.

President Donald Trump was unable to implement his main electoral promises in 2017. It was only at the very end of the year that the Republican majority presented its tax reform to Congress. Very little was said about possible investments in infrastructure. Overall, 2017 was a good year for the U.S. economy, although the first quarter again proved to be disappointing. Household and business confidence increased, and the job market improved once again.

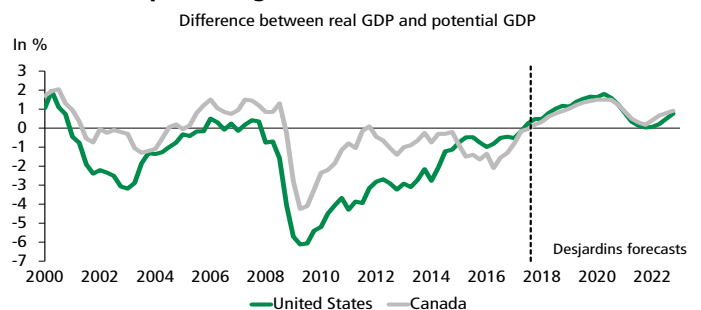
The current economic cycle lasted one year longer in the United States and is soon expected to rank second in terms of longevity since data started to be compiled. A new phase was initiated with the closing gap between real and potential GDP in Canada and the United States (graph 2). At this stage,

GRAPH 1
For the first time in ten years, no country's real GDP shrank in 2017



f. Organisation for Economic Co-operation and Development (OECD) forecasts
Sources: OECD and Desjardins, Economic Studies

GRAPH 2
Start of a phase where the U.S. and Canada's economy will exceed their potential growth



Sources: Datastream, Bank of Canada, Congressional Budget Office and Desjardins, Economic Studies

François Dupuis, Vice-President and Chief Economist • Carine Bergevin-Chammah, Economist • Hélène Bégin, Senior Economist
Mathieu D'Anjou, Senior Economist • Benoit P. Durocher, Senior Economist • Francis Généreux, Senior Economist • Hendrix Vachon, Senior Economist
Desjardins, Economic Studies: 514-281-2336 or 1 866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

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inflationary pressures should start to become more evident due to the increasing scarcity of excess production capacity and workers.

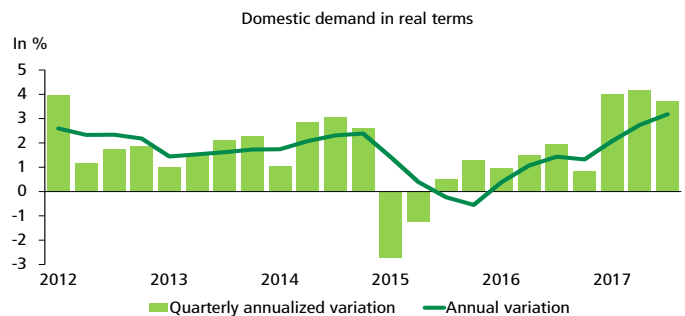
A challenging year for free trade. In January, President Donald Trump pulled the United States out of the Trans-Pacific Partnership (TPP), which was to establish a free-trade agreement among 11 countries, including Canada. The remaining members are now attempting to salvage it. North American Free Trade Agreement (NAFTA) is also at risk. The negotiations appear to be at a standstill, while the deadline to reach an agreement was set for the end of March 2018. Nonetheless, the Canada–European Union Comprehensive Economic and Trade Agreement (CETA) came into effect last September, thus opening a new era of trade between the two regions.

In Canada, 2017 was marked by exceptional growth in domestic demand (graph 3). Household consumption spending was very strong, while the job market made significant gains throughout the year, which helped to maintain a relatively high level of confidence. Generally speaking, residential investment also continued to improve significantly. The tax breaks introduced in 2016 certainly contributed to the economy's strong growth in 2017. That being said, the rate of inflation has remained relatively low (graph 4) as the delayed impact of the excess capacity of recent years was still being felt.

In Quebec, economic growth quickly rose to roughly 2.5% in 2017, its best performance in approximately 15 years. Households' contribution was sustained by the improved job market. The unemployment rate even reached 5.4% in November (graph 5), the lowest monthly rate in more than 40 years. The labour shortage has led to an increase in wages of approximately 2.5%. At roughly 1%, the rate of inflation has remained low for the fifth year in a row. The Quebec government, which recorded budget surpluses of \$4.6B in the last two years, announced additional tax reductions of \$1.1B for individuals which would be applied retroactively to January 1st, 2017.

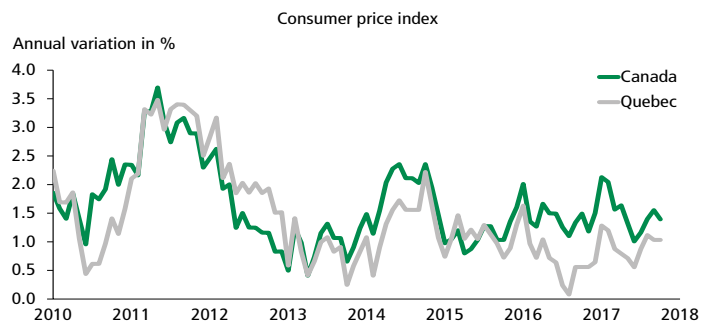
In 2017, British Columbia remained number one in terms of economic growth in Canada. Alberta and Saskatchewan were back on the path to growth in 2017 as the oil industry stabilized. Ontario's economic growth remained strong during the year despite several temporary setbacks, such as the adjustment of the housing market to the restrictive measures announced in the spring for the Toronto area, as well as the slump in the automotive industry during the summer.

GRAPH 3
Canadian domestic demand sped up in 2017



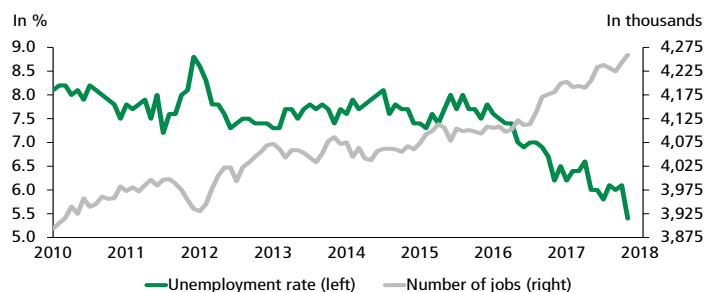
Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 4
Inflation rate remained fairly low in Canada, especially in Quebec



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 5
Healthy improvement in Quebec's unemployment rate and jobs



Sources: Statistics Canada and Desjardins, Economic Studies

Another excellent year for investors. Improved economic conditions and an upsurge in business earnings led stock markets to rise sharply in 2017 (graph 6). After the spectacular gains of 2016, the Canadian stock market experienced more challenges, but an increase in commodity prices helped it finish the year on a high note. The continuation of very low long-term bond yields helped stock markets perform well and enabled the Canadian bond market to record a positive return.

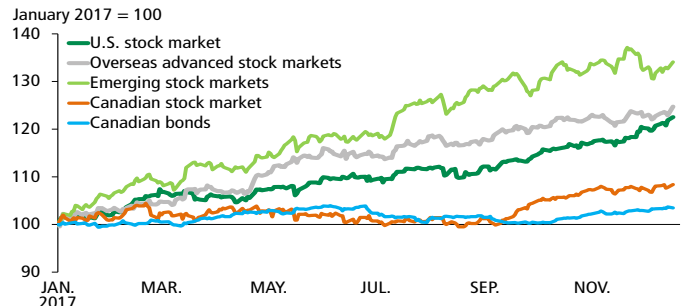
Good years are generally accompanied by moments of excess. This year, the value of the bitcoin, one of the many cryptocurrencies that exist, increased from approximately US\$1,000 to more than US\$18,000, for a gain of 1700%. However, this was not the best year in terms of growth. In 2013, the bitcoin gained more than 9000% in value (graph 7). It is difficult not to talk about a speculative bubble, especially since the use of this cryptocurrency in everyday life remains extremely marginal, approaching more the one of a security.

Gradual monetary tightening has become the name of the game. Monetary tightening in the United States has continued unabated in 2017. In addition to increasing the federal funds rate by 0.75%, the Federal Reserve started to gradually reduce its bond holdings. The Bank of Canada (BoC) and the Bank of England also began to raise their key rates. However, steady low inflation allows central banks to proceed with a very gradual normalization of their monetary policies.

Long-term bond yields have remained low. After surging in late 2016, long-term bond yields in North America did not show a clear trend this year. This can be explained in large part by low inflation and a highly accommodating monetary policy, especially in the euro zone and Japan. While short-term bond yields demonstrated a clearer upward trend, the yield curve flattened considerably.

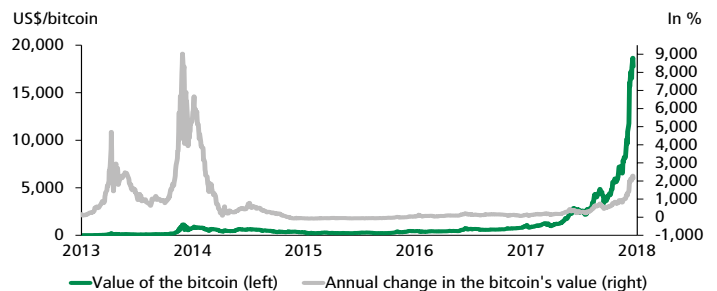
The currency market remained very volatile this year. The U.S. dollar took off at the beginning of the year, sustained by Donald Trump's promises to stimulate the economy, before it quickly ran out of steam. The Canadian dollar benefited from the rise in oil prices, but even more so from the two consecutive key rate increases ordered by the BoC over the summer (graph 8). Although the European Central Bank remained in easing mode, the euro benefited from a healthier economy and anticipations of an eventual withdrawal of monetary stimulus.

GRAPH 6
Another great year for asset classes, especially foreign ones



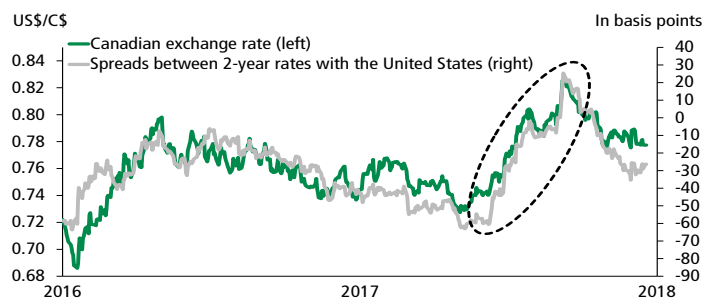
Sources: Datastream and Desjardins, Economic Studies

GRAPH 7
Bitcoin's value hit a new record, but the annual change has been greater in the past



Sources: Bloomberg and Desjardins, Economic Studies

GRAPH 8
The loonie benefited from the favourable change in interest rates over the summer



Sources: Datastream and Desjardins, Economic Studies