ECONOMIC VIEWPOINT

#1 BEST OVERALL FORECASTER - CANADA

A Look Back at 2018: Strong Economic Growth despite Increased Volatility

Now is the time to assess the year 2018. Here are the main aspects that caught our attention.

Despite recent concerns, the global economy fared very well in 2018. The annual growth of global real GDP should reach 3.8% for the year, its highest increase since 2011.

Protectionism loomed heavily over 2018. The first salvos came from the United States, which launched higher tariffs on washing machines and solar panels, followed by steel and aluminum. The European Union, Canada, Mexico, China and other countries subsequently retaliated. Then the United States targeted China, imposing new tariffs of US$50B on Chinese products, followed by an additional US$200B. Trade tensions were reflected in slower international trade (graph 1) and greater investor edginess.

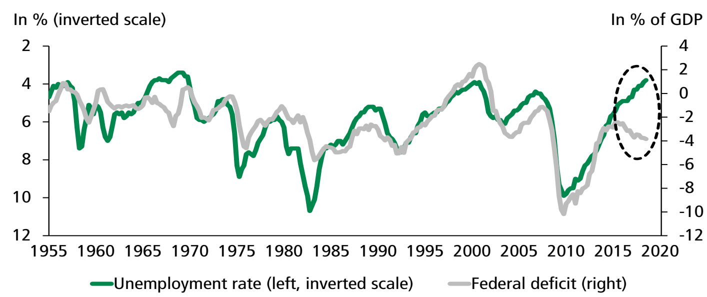
After a good year in 2017, the euro zone's GDP slowed in 2018. The German and Italian GDP even fell in Q3. Household and business confidence indexes declined throughout the year and social tensions escalated, especially in France. Things were no better in the United Kingdom, where **the Brexit issue continues to dominate economic news**. As 2018 comes to a close and March 29, 2019 draws ever nearer, nothing has been settled in an issue where nothing has been easy for almost two years.

2018 turned out great for the U.S. economy. The annual growth of real GDP should reach 2.9%, making this the best progression of the current cycle, along with 2015. The unemployment rate fell to 3.7% for the first time since 1969. Household and business confidence remained strong throughout the year. This good economic climate was bolstered by the tax cuts enacted by Congress and the Trump administration, although the budget cost of that policy jacked up the federal deficit in 2018 (graph 2).

GRAPH 1
International trade slowed in 2018

Sources: CPB - Netherlands Bureau for Economic Policy Analysis and Desjardins, Economic Studies

GRAPH 2
U.S. public finances continued to slump despite strong economic growth



Sources: U.S. Treasury, Bureau of Labor Statistics 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.

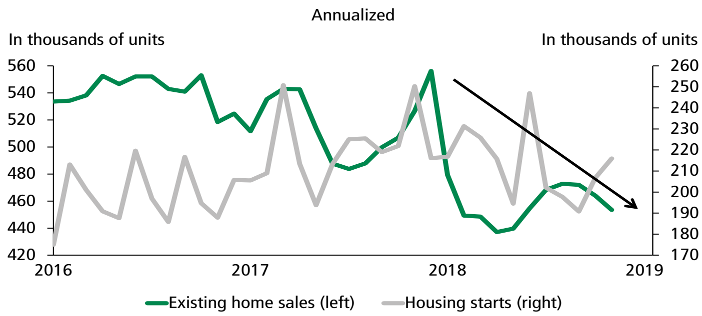
In Canada, 2018 started with a new guideline from the Office of the Superintendent of Financial Institutions (OSFI) aimed at reining in mortgage credit. Combined with other recent restrictive measures and the gradual rise in interest rates, that new initiative resulted in **a net housing market slowdown** in several regions of Canada (graph 3). **In Quebec, however, real estate remained relatively robust** due to favourable conditions, especially with regard to the labour market. The Greater Montreal market even reached the point of overheating in the fall, as the number of buyers exceeded the supply of properties for sale.

After several months of uncertainty, Canada, the United States and Mexico arrived at an agreement last September to replace the North American Free Trade Agreement (NAFTA) with a new trade agreement: the Canada–United States–Mexico Agreement (CUSMA). Even though the ratification process will continue through 2019, anxieties about international trade have moderated considerably.

With the increase in energy production in recent years, **2018 has been afflicted by a serious crude oil transportation problem in Canada**. As a result, investments in the energy sector experienced difficulties throughout the year, which affected the oil producing provinces. **The drop in gasoline prices that started in mid-2018 lowered inflation throughout the country** (graph 4), which was good for provinces like Quebec that import most of their oil. Quebec has stand out for some months, with one of the lowest inflation rate in the country.

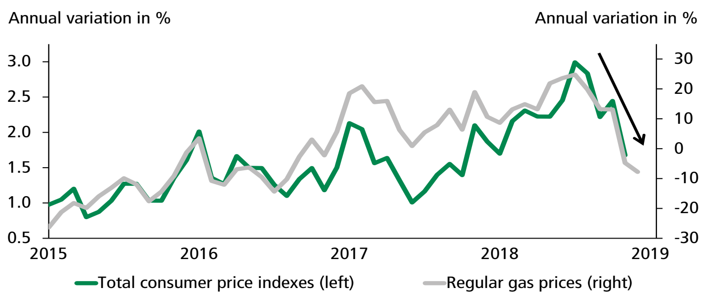
The Canadian labour market smashed two records in November: it boasted the lowest unemployment rate (5.6%) since 1976 and the strongest job creation (+94,100 new hires) in a single month. As the working population ages, those figures highlight the labour shortage problems that appear in certain regions and sectors. Quebec is one of the hardest hit provinces, as evidenced by the high job vacancy rate (graph 5).

GRAPH 3
Slowdown in Canada's housing market since the start of 2018



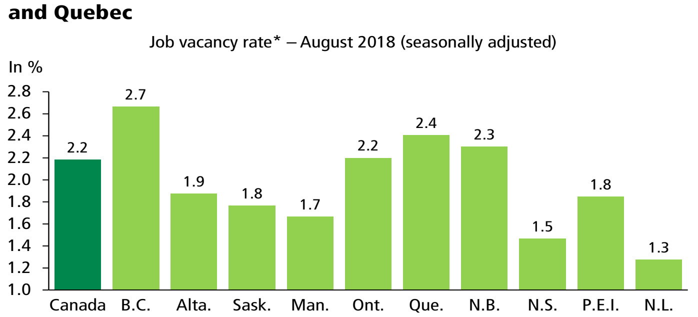
Sources: Canadian Real Estate Association, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

GRAPH 4
The recent drop in gas prices has calmed inflationary tensions in Canada



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 5
Labour shortages are especially prevalent in British Columbia and Quebec



* Number of vacant positions expressed as a percentage of the total amount of occupied and vacant positions.
Sources: Statistics Canada and Desjardins, Economic Studies

Greater volatility has hurt markets. While 2018 got off to a flying start, with the S&P 500 climbing more than 7% during the first weeks of January, fears of rising interest rates quickly pushed the indexes back down. Volatility remained high throughout the year, with trade tensions and growing doubts as to the health of the global economy feeding investor anxiety. A second correction at the end of the year plunged most stock indexes below their 2017 closing levels (graph 6).

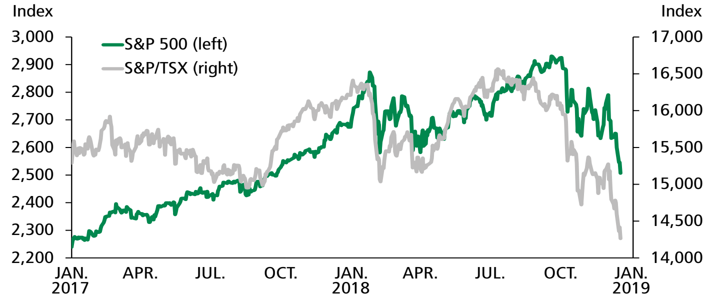
Oil prices were on a roller-coaster ride in 2018. Production cuts by members of the Organization of the Petroleum Exporting Countries (OPEC) and renewed sanctions against Iran led to fears of a shortage. The situation quickly reversed as the United States, Russia and Saudi Arabia boosted outputs. The volatility was reflected in the WTI (West Texas Intermediate) barrel price, which dropped from US$75 to US$50 in just over a month. The WCS (Western Canadian Select) barrel price experienced more difficulties, as its spread with the WTI temporarily reached a record at US$50 (graph 7).

After a difficult first quarter, the U.S. dollar was once again on the rise against most other currencies. Economic growth improved in the United States, but decreased elsewhere, including Europe and several emerging countries. That shored up investor risk aversion and boosted the demand for the U.S. dollar as a safe-haven currency. The protectionist measures applied by the United States also contributed to the appreciation of the U.S. dollar.

Key rates climbed faster throughout North America. The generally favourable economic environment and rising inflation spurred several central banks to continue normalizing their monetary policies in 2018. The European Central Bank stopped buying financial assets in December 2018, while the Bank of England raised its key rates by 0.25%. In North America, key rate hikes even accelerated, with the Federal Reserve making four 0.25% hikes compared to three in Canada. However, investor anxiety curtailed the uptick in longer-term bond yields (graph 8).

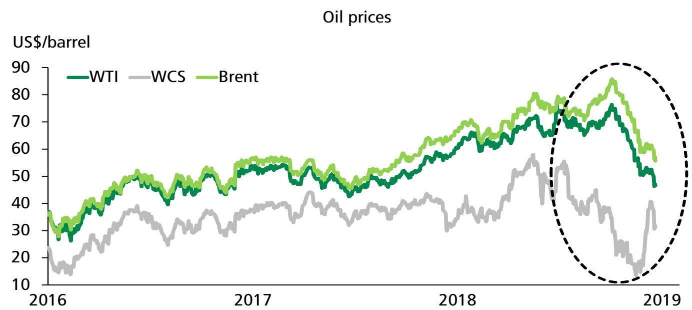
All in all, it was a tough year for Canadian assets. Low returns on bond and stock markets were amplified by the depreciation of the Canadian dollar, which is now hovering around US$0.75. Low oil prices, unfavourable interest rate spreads and a stronger greenback all contributed to the loonie's tumble.

GRAPH 6
Stock markets underwent two corrections in 2018



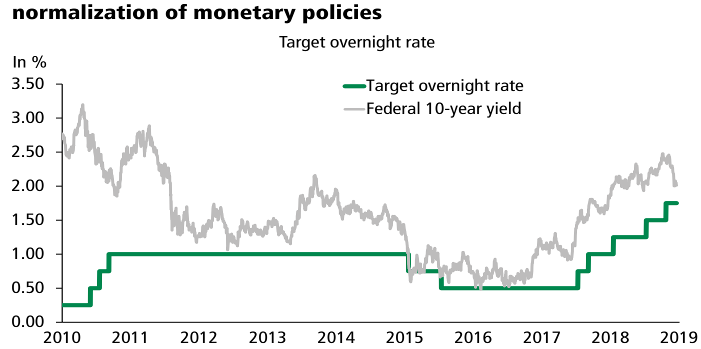
Sources: Datastream and Desjardins, Economic Studies

GRAPH 7
The spread between Canadian and U.S. oil prices reached a US$50 peak in October



WTI : West Texas Intermediate; WCS : Western Canadian Select
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

GRAPH 8
Long-term yields increased only slightly despite the ongoing normalization of monetary policies



Sources: Datastream and Desjardins, Economic Studies