ECONOMIC VIEWPOINT

A Look Back at 2021

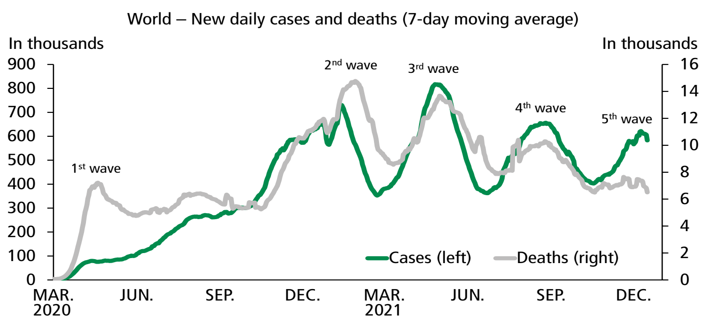
Vaccination Boosted the Economy, but Inflation Sprung up Much More than Expected

The year 2021 is drawing to a close. Here are the main economic and financial points that caught our attention. An upcoming *Economic Viewpoint* will discuss what to watch for in 2022 and what might affect our forecasts.

The COVID-19 pandemic continued to be a major theme in 2021. At the time of writing, the toll of the pandemic was 267.0 million infected and 5.3 million dead, according to official data (graph 1). While we hoped that the worst was behind us, the emergence of the Delta variant during the winter forced governments around the world to reintroduce restrictive public health measures. However, the human and economic impacts began to diverge between countries with this wave, as the virus was stopped by vaccinated portions of the population. The long-awaited large-scale rollout of vaccines had begun in the winter. According to the most recent data, 55% of the global population has received at least one dose, but advanced countries are well ahead. Despite a rockier start in Canada, the vaccination campaign quickly picked up speed and, today, the country is among the places with the highest vaccination rates, with about 76% of the population fully vaccinated. A significant decrease in the number of deaths was therefore noted in Canada during the 2021 waves compared to the previous ones.

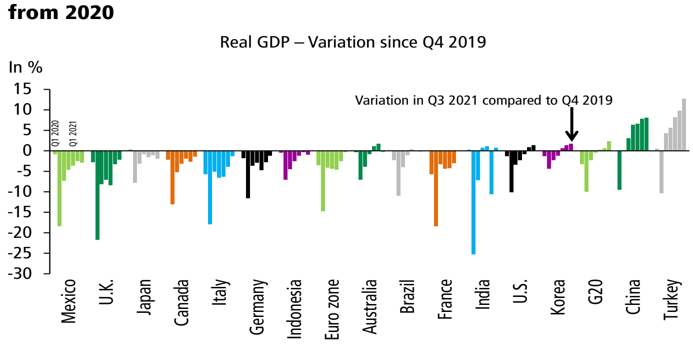
On the economic front, 2021 was a year of **recovery in goods and services production**. Aided tremendously by China, the G20 real GDP had in the first quarter of 2021 already surpassed the level it was at in late 2019 (graph 2). In the United States, this full recovery was achieved in the second quarter of 2021. Canada's real GDP in the third quarter was still 1.4% short of what it was at the end of 2019. However, the recovery is uneven among the provinces, as Quebec's real GDP has already surpassed its pre-pandemic level. There are also significant discrepancies between goods sectors, where the recovery was very fast (boosted by consumption that was significantly higher than the pre-pandemic trend), and services sectors (affected to a

GRAPH 1
The pandemic is losing steam



Sources: World Health Organization and Desjardins, Economic Studies

GRAPH 2
Many countries have already recouped their real GDP losses from 2020



Sources: Organisation for Economic Co-operation and Development and Desjardins, Economic Studies

Jimmy Jean, Vice-President, Chief Economist and Strategist • Mathieu D'Anjou, Director and Deputy Chief Economist • Hélène Bégin, Senior Economist
Marc-Antoine Dumont, 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

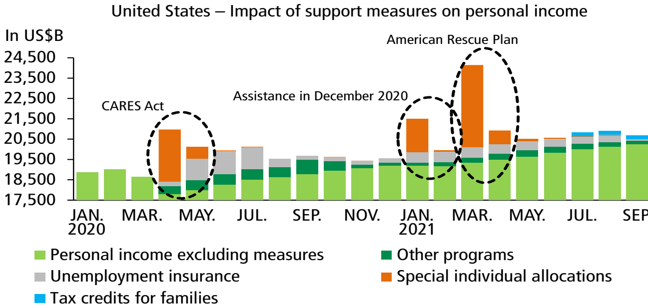
greater extent by public health measures), with a full recovery yet to come in many regions.

One of the factors that supported economic recovery in the United States was U.S. federal government assistance, which includes the American Rescue Plan introduced in March 2021 by the **new Biden administration**. This program, totalling US$1,844B, provided a boost to U.S. households disposable income (graph 3), particularly through direct help and new extra unemployment benefits. President Joe Biden, who took office on January 20, 2021, also sought to put in place new longer-term support for the U.S. economy through his Build Back Better Agenda, which includes a bipartisan agreement on infrastructure (already passed by Congress) and a social investment and climate action program that has yet to be approved in the Senate. There is also the sense that the tone and priorities of the White House have changed significantly between the Trump and Biden eras, even though a certain protectionist bias remains.

The labour market recovery continued across the board in 2021 (graph 4). In Canada, particularly in Ontario, jobs returned to their pre-pandemic numbers in September, whereas in Quebec, the recovery was complete in November. The rebound is uneven, however, and some sectors are still experiencing significant delays. In November, the unemployment rate practically dropped back down across Canada to what it was before the pandemic. Quebec is expected to stand out with the country's lowest unemployment rate for the 2021 average. Under the circumstances, the labour shortage problems that existed before the pandemic became a headache again in 2021. In the United States, the job market recovery is a little further behind. In November, the market was still 3,912,000 jobs short of its pre-pandemic level, whereas the jobless rate had a 0.7 percentage point gap to close.

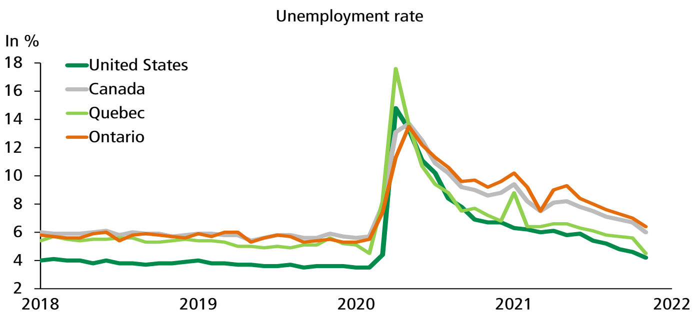
The global economic recovery in recent quarters ran into **bottlenecks that have disrupted a number of sectors**. These supply constraints stem mainly from pandemic-related disruptions, such as the complete or partial closure of plants, labour shortages and freight transport problems, all of which impeded the fluidity of supply chains (graph 5). The motor vehicle sector continues to be particularly hard hit by these constraints, especially in terms of the availability of electronic parts. Motor vehicle assembly has slowed in most part of the world despite high demand. The imbalances have also been exacerbated by a substantial increase in energy and raw material costs. The weather has played a role as well, with severe storms and frigid temperatures last winter in the southern United States and, more recently, flooding in British Columbia.

GRAPH 3
U.S. federal government assistance gave a big boost to household income



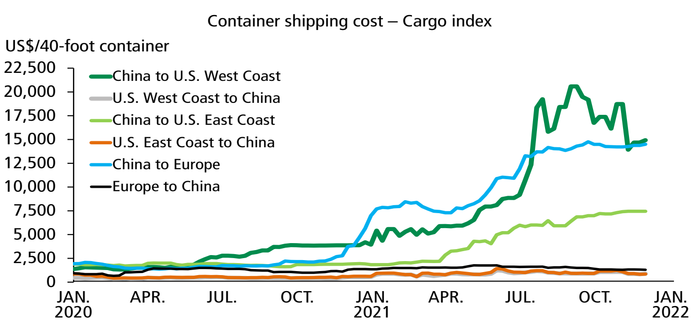
Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

GRAPH 4
The job market continued to improve in 2021



Sources: U.S. Bureau of Labor Statistics, Statistics Canada and Desjardins, Economic Studies

GRAPH 5
Shipping costs from China have exploded



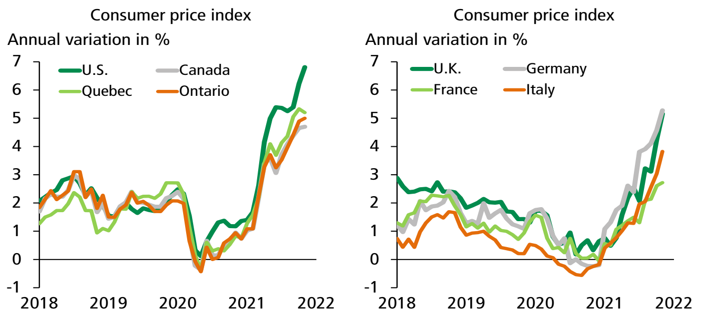
Sources: Bloomberg and Desjardins, Economic Studies

Inflation spiked in 2021 in many regions of the globe, particularly in the United States and Canada (including Quebec and Ontario) (graph 6). For example, the annual variation in the consumer price index increased from 0.7% in December 2020 to 4.7% in November 2021 for Canada as a whole. This is largely due to pandemic-related disruptions, with imbalances between supply and demand for many goods and services. First, the gradual return to normal has resulted in a sharp increase in demand. Second, supply problems and some shortages, including labour, have hampered the available supply. Other factors have also had a major impact. Oil prices continued to climb for much of the year, which also contributed to the increase in annual consumer price growth. Residential real estate prices also rose during the year, especially in Canada, driving up some housing-related price components.

There was **a lot of action in the residential market** in 2021. Housing starts hit a record high at the beginning of the year, but have dropped since then due to soaring construction costs, shortages of some materials and unusual supplier deliveries. The supply of new and existing properties has therefore been insufficient to meet buyer demand. This has intensified the overheating, price acceleration and overvaluation in a number of the country's markets. The degree of the residential real estate market's vulnerability therefore changed from moderate to high in Canada, particularly in Montreal, Ottawa and Toronto. Bidding wars and multiple offer scenarios were plentiful in the spring in some markets. Average prices rose sharply again, about 20% in Quebec and Canada in 2021, pushing them to new heights (graph 7). However, prices in Quebec stabilized for a few months. Prices began to go up again at the end of 2021, as buyers rushed to beat the expected key interest rate hike.

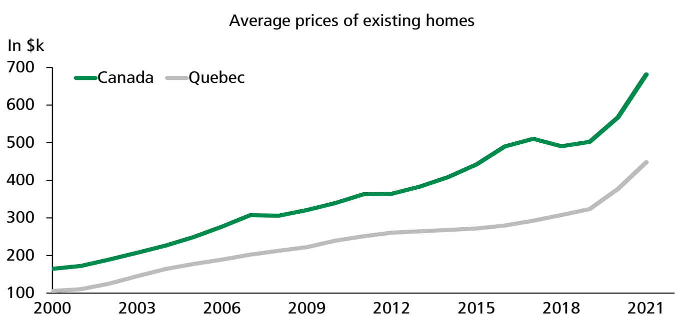
An outstanding year for North American stock markets wraps up. In mid-December, the S&P 500 and the S&P/TSX were up respectively by about 25% and 20% from the start of 2021. Aside from a few short profit taking periods as a result of COVID-19 waves, the emergence of new variants or concerns over inflation or the Chinese real estate sector, the stock markets posted a strong uptrend throughout 2021 (graph 8), continuing the spectacular rebound that had begun soon after the initial shock caused by the pandemic at the end of the first quarter of 2020. The surge in the value of some tech and meme stocks and of cryptoassets could raise fears of speculative excesses stemming, among other things, from unprecedented actions taken by central banks to prop up financial markets. However, the substantial gains of North American indexes were also based on the robust economic recovery and on the excellent performance of large companies whose earnings bounced back quickly to new record highs.

GRAPH 6
Inflation skyrocketed in many places around the world



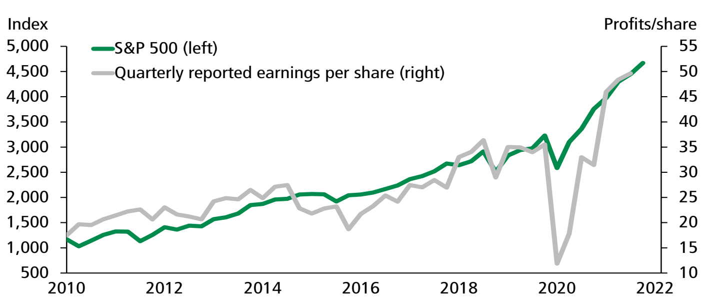
Sources: Datastream and Desjardins, Economic Studies

GRAPH 7
Home prices spiked in 2021



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 8
Stock markets and corporate profits reached new heights

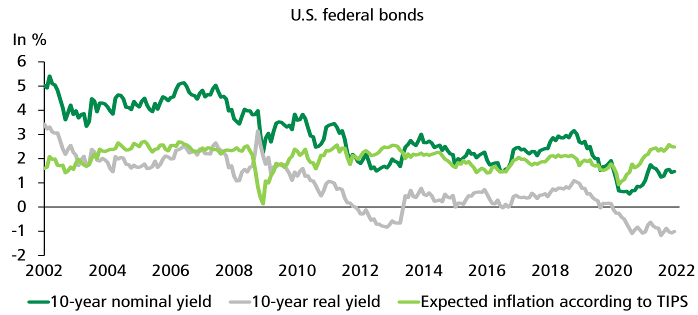


Sources: S&P Dow Jones Indices, Datastream and Desjardins, Economic Studies

Interest rates have started to rise. The year 2021 has been less favourable to bonds, as the strong economic recovery and rising inflation were coupled with somewhat rising bond yields, particularly at the beginning and end of the year. Central banks, which were prepared for a slow economic recovery without inflation like the one that followed the 2008–2009 financial crisis, had to adjust their position in light of the skyrocketing inflation and the quick return of labour shortages. The Bank of Canada (BoC) therefore ended its quantitative policy at the end of October and the Federal Reserve is rapidly reducing its asset purchases. In both cases, the central banks are now signalling that key rate hikes should begin fairly early in 2022. It must be noted that the increase in bond yields in 2021 essentially reflects the rise in the compensation for inflation, whereas real yields have remained very negative (graph 9), a situation that is becoming increasingly difficult to justify.

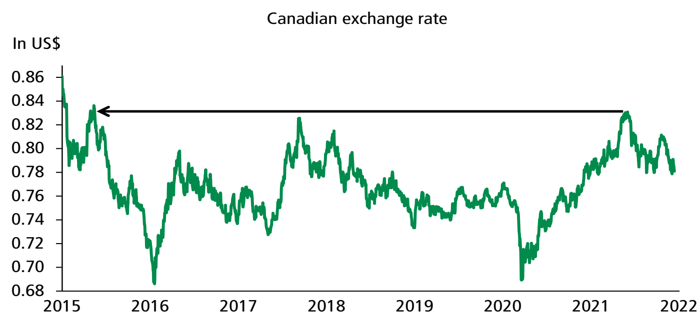
The year has been rather bumpy for many currencies, including the Canadian dollar. Economic difficulties at the beginning of the year due to the pandemic caused a temporary depreciation in most currencies against the U.S. dollar. Then, the acceleration of the vaccination campaign and greater optimism on financial markets had the opposite effect on exchange rates. The Canadian dollar profited especially in the spring, when oil and raw material prices also posted strong growth. The fact that the BoC was one of the first central banks to reduce its asset purchases provided a further boost to the loonie, which also quickly benefited from interest rate hike expectations. At the beginning of June, the loonie reached a six-year high above US$0.83 (graph 10). The trend for the Canadian currency was a downward one after that. The U.S. dollar, in turn, began to benefit from monetary tightening expectations. Investor optimism also waned with the arrival of the Omicron variant. The drop in oil prices was another negative factor for the loonie in the last part of the year.

GRAPH 9
Real interest rates remained very negative



TIPS: Treasury Inflation Protected Securities
Sources: Datastream and Desjardins, Economic Studies

GRAPH 10
The Canadian dollar hit a six-year high



Sources: Datastream and Desjardins, Economic Studies