Economic Viewpoint
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Medium-term issues and forecasts

This expansion cycle will not last forever

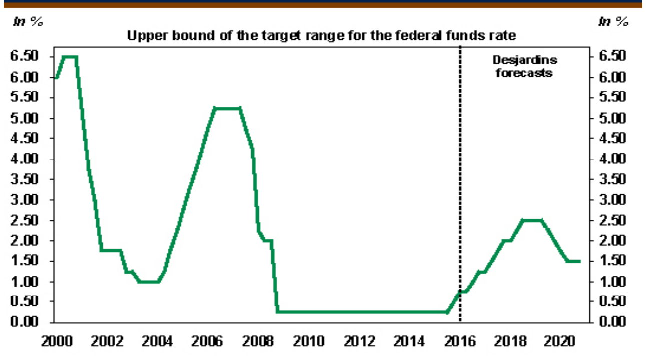
World economic activity should accelerate in the next few years and a number of central banks will fall into step with the Federal Reserve (Fed) in terms of monetary firming. After dropping for several years, bond yields should start to trend up again; this could curb some stock market growth. From now until 2020, the likelihood that the current economic expansion cycle will end will increase. In 2019, it will have been 10 years since the last U.S. recession, making for a fairly long cycle. Incorporating an economic slowdown towards the end of the medium-term projection scenario therefore seems prudent. The slowdown could come from a new slump by U.S. demand, which would have impacts on the rest of the global economy. This scenario means that interest rates would start dropping again around 2019.

INTERNATIONAL ISSUES

While the situation has improved in the United States and Europe, global economic growth has slowed in recent years due to some weakness in the major emerging markets, including China. The anticipated commodity price rebound will help numerous emerging countries recover, but the situation could remain difficult in China. Aside from situational effects that could persist beyond the next two years, China must alter its growth model. The shift to a model that is closer to that used by advanced economies, more focused on consumption and domestic demand, should limit growth while allowing it to be more mature. Note also that the demographic outlook is not very good for Chinese economic growth. Under these circumstances, India's economy should outperform China's in the area of medium-term growth. To do so, the Indian government will have to pay special attention to the improvement of public infrastructure and encourage private investment.

In the United States, economic growth by 2018 should be fairly similar to current figures, with real GDP growth around 2.5%. It will be a little faster than the 2.2% potential growth estimated by the Congressional Budget Office. At the same time, the monetary firming launched by the Fed at the end of 2015 will go forward slowly until mid-2018 (graph 1). The Fed could then be tempted to take a long break to allow its balance sheet to shrink. Also, a U.S. economic slowdown around 2019 would encourage the Fed to be cautious and eventually convince it to lower its interest rates. All in all, key interest rates should hit a cyclical peak at around 2.50% in 2018, which is lower than the long-term equilibrium rate of 3.50% recently estimated by Fed leaders. If the Fed had launched monetary firming earlier, the chances of rising to 3.50% would have been greater, but the fragility of the U.S. economy over this decade made that impossible.

Graph 1 – The U.S. federal funds rate will top out at 2.50%



Sources: Datastream and Desjardins, Economic Studies

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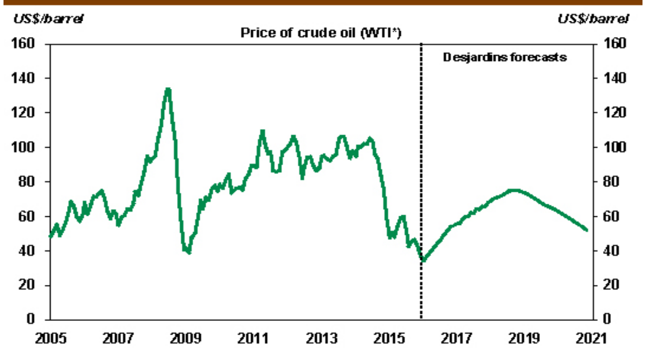
CANADIAN ISSUES

Although oil prices are expected to rise gradually in the years to come (graph 2), everything suggests they will stay below the breakeven point for numerous expansion projects in Canada's oil sector. Under the circumstances, the Canadian economy cannot count on a substantial rise by energy sector investment to support growth in the coming years. However, some adjustments will persist during the transition period. Among other things, the Canadian dollar should stay fairly low, allowing the manufacturing sector to make a bigger contribution to real GDP growth. The service sectors should also have a greater weight in Canadian output, continuing the trend seen for many years now.

Graph 2 – The climb by oil prices will be slow and gradual



* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Demographic projections indicate that growth by the population aged 25 to 34, those responsible for the creation of most new households, will slow substantially in the years to come. This should translate into slower activity in the housing market. Homebuilding and existing home sales are still very high in Ontario, so that province could be especially affected by the slowdown. Over the next few years, however, Ontario should be able to maintain economic growth just above the national average thanks to the contribution from its manufacturing sector. The automotive industry seems to be in good position here, but new investments will be required to support growth.

Quebec's economy is expected to post a slight cyclical rebound in 2016 and 2017 thanks to a push from business investment and public infrastructure spending. Real GDP growth will stay below 2%, however, as a number of structural factors will put the brakes on economic growth. The main factors are the shaky financial situation facing Quebec households and the provincial government, as well as unfavourable demographic trends. These weaknesses will have a limiting impact on the economy and employment over the medium range. Accordingly, potential GDP growth will converge between 1.0% and 1.5% by 2020.

Our medium-term forecasts for the Canadian economy factor in the impacts of a slowdown in the United States. Canada's interest rate hike period therefore promises to be fairly short. We expect the target for the overnight rate to crest at 2.00% in 2018.

Table 1
United States: medium-term major economic and financial indicators

	Annual average							*Average*	
In % (except if indicated)	2014	2015	2016f	2017f	2018f	2019f	2020f	2007-2014	2015-2020f
Real GDP (var. in %)	2,4	2,4	2,5	2,7	2,5	2,0	1,5	1,4	2,3
Total inflation rate (var. in %)	1,6	0,1	1,4	2,5	2,3	1,7	0,8	1,4	1,5
Unemployment rate	6,2	5,3	4,8	4,5	4,4	4,5	5,3	7,8	4,8
S&P 500 index (var. in %)*	11,4	-0,7	6,2	6,0	5,0	0,0	4,0	7,0	3,4
Federal funds rate	0,25	0,26	0,90	1,60	2,30	2,30	2,15	1,08	1,59
Prime rate	3,25	3,26	3,90	4,60	5,30	5,30	5,15	4,08	4,59
Treasury bills—3-month	0,03	0,05	0,60	1,35	2,15	2,10	1,90	0,80	1,36
Federal bonds—10-year	2,53	2,13	2,50	2,90	3,05	2,55	2,30	3,01	2,57
Federal bonds—30-year	3,34	2,84	3,10	3,35	3,40	2,95	2,75	3,88	3,07
WTI** oil (US$/barrel)	93	49	45	62	73	69	57	87	59
Gold (US$/ounce)	1 266	1 160	1 030	975	950	1 000	1 050	1 211	1 027

f: forecasts; * The variations are based on observation of the end of period; ** West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Table 2
Canada: medium-term major economic and financial indicators

In % (except if indicated)	2014	2015	2016f	2017f	2018f	2019f	2020f	2007-2014	2015-2020f
	Annual average							*Average*	
Real GDP (var. in %)	2,5	1,2	1,7	2,2	1,8	1,4	1,3	1,6	1,6
Total inflation rate (var. in %)	2,0	1,1	1,5	2,0	1,9	1,6	1,3	1,7	1,6
Employment (var. in %)	0,6	0,8	0,9	1,0	0,9	0,7	0,5	1,0	0,8
Employment (K)	111	144	160	180	166	122	87	176	143
Unemployment rate	6,9	6,9	7,0	6,8	6,4	6,1	6,2	7,2	6,6
Housing starts (K)	189	194	186	178	183	182	175	196	183
S&P/TSX* index (var. in %)	7,4	-11,1	4,9	7,0	7,0	2,0	0,0	3,4	1,6
Canadian dollar (US$/C$)	0,91	0,78	0,73	0,78	0,85	0,84	0,80	0,95	0,80
Overnight funds	1,00	0,65	0,50	0,65	1,65	1,80	1,95	1,55	1,20
Prime rate	3,00	2,79	2,70	2,85	3,85	4,00	4,15	3,49	3,39
Mortgage rate									
1-year	3,14	2,97	3,15	3,20	4,15	4,00	4,00	4,26	3,58
5-year	4,89	4,67	4,70	4,75	5,20	4,95	4,74	5,77	4,84
Treasury bills—3-month	0,91	0,53	0,50	0,75	1,75	1,70	1,50	1,39	1,12
Federal bonds									
2-year	1,06	0,55	0,70	1,25	2,00	1,80	1,55	1,79	1,31
5-year	1,58	0,86	1,00	1,65	2,35	2,00	1,75	2,33	1,60
10-year	2,23	1,53	1,65	2,15	2,55	2,10	1,90	2,94	1,98
30-year	2,77	2,20	2,30	2,65	2,90	2,50	2,30	3,42	2,48
Canada/U.S. rate spreads									
Treasury bills—3-month	0,88	0,48	-0,10	-0,60	-0,40	-0,40	-0,40	0,60	-0,24
Federal bonds—10-year	-0,30	-0,60	-0,85	-0,75	-0,50	-0,45	-0,40	-0,08	-0,59
Federal bonds—30-year	-0,57	-0,64	-0,80	-0,70	-0,50	-0,45	-0,45	-0,46	-0,59

f: forecasts; * The variations are based on observation of the end of period.
Sources: Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

Table 3
Quebec and Ontario: medium-term major economic indicators

Var. in % (except if indicated)	2014	2015	2016f	2017f	2018f	2019f	2020f	2007-2014	2015-2020f
	Annual average							*Average*	
Quebec									
Real GDP	1,5	1,3	1,5	1,7	1,3	1,1	0,9	1,4	1,3
Total inflation rate	1,4	1,1	1,6	2,1	2,0	1,7	1,5	2,3	1,7
Employment	0,0	0,9	0,9	0,6	0,4	0,2	0,1	1,0	0,5
Employment (K)	-1	37	35	25	15	10	5	40	21
Unemployment rate (%)	7,7	7,6	7,3	7,2	6,9	6,5	6,2	7,8	6,9
Retail sales	1,7	0,8	2,5	3,0	3,2	3,0	2,5	1,6	2,5
Housing starts (K)	39	37	36	37	35	33	30	45	35
Ontario									
Real GDP	2,7	1,9	2,3	2,6	2,0	1,5	1,2	1,1	1,9
Total inflation rate	2,4	1,2	1,6	2,1	1,8	1,7	1,3	1,8	1,6
Employment	0,8	0,7	1,2	1,1	1,0	0,8	0,4	0,8	0,9
Employment (K)	55	45	81	79	71	57	29	53	60
Unemployment rate (%)	7,3	6,8	6,7	6,6	6,3	6,0	6,1	7,7	6,4
Retail sales	5,0	4,4	4,8	4,9	4,5	4,0	3,5	2,9	4,4
Housing starts (K)	59	69	69	62	65	62	60	65	64

f: forecasts
Sources: Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies