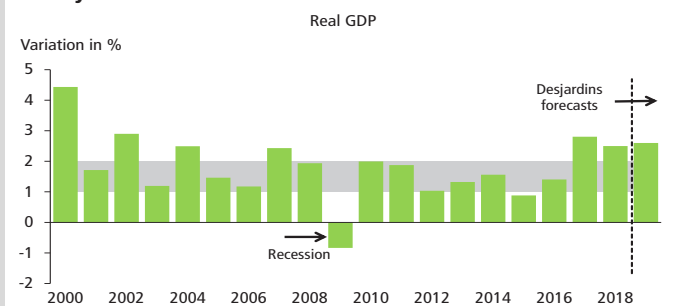


ECONOMIC VIEWPOINT

Quebec's Economy Soars: Several Factors Explain the Current Resilience

After the 2008–2009 recession, Quebec's economy grew rather modestly. The rise in real GDP was fluctuating around 1.5% annually and had even dropped below 1% during the 2015 slowdown. Therefore, it seemed impossible to beat the 2% mark given the lower growth in potential GDP than in the past. Household and business confidence reflected an unfavourable climate in many respects. Cautious consumers and businesses, a moribund real estate market, Quebec's precarious public finances and Montreal's sluggishness all contributed in one way or another to slowing the economy. Then, all of these factors did an about-face, and the situation quickly improved. Real GDP suddenly shot up three years ago and is now advancing at more than 2.5% (graph 1). Aside from the global economy accelerating as of mid-2016, with positive repercussions for Quebec, several other factors are behind this renewed strength.

GRAPH 1
Quebec has been experiencing an economic boom over the last three years

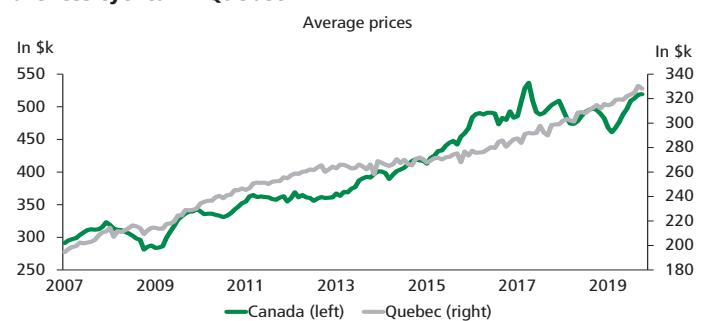


Sources: Institut de la statistique du Québec and Desjardins, Economic Studies

1. A More Stable Real Estate Market than in Canada

- ▶ Historically, the real estate markets in Montreal and Quebec as a whole were always less cyclical than many Canadian markets, especially Toronto and Vancouver.
- ▶ During the 2008–2009 recession, property prices hardly declined in Quebec but fell significantly in the country (graph 2).
- ▶ The 15% tax on foreign investors introduced in August 2016 in Vancouver and April 2017 in Toronto immediately caused these markets to undergo a correction. Sales and prices plunged, which helped to turn down the heat a little. Vancouver then raised the tax to 20% on non-resident purchases.
- ▶ Some foreign buyers headed to Montreal, especially those from China, but not enough to cause prices to escalate. The annual price increase in Montreal is now roughly 5% (graph 3 on page 2), but it's largely due to local buyer demand because

GRAPH 2
Residential real estate prices are fluctuating more in Canada and are less cyclical in Quebec



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

of the highly favourable economic situation and labour market.

- ▶ In January 2018, the new federal rules that extended to uninsured loans, i.e., stress tests, mostly affected the more

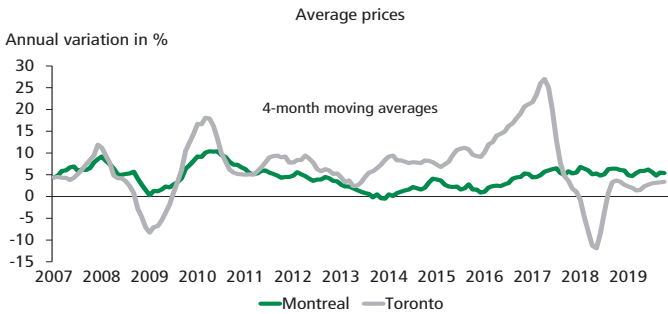
François Dupuis, Vice-President and Chief Economist • Mathieu D'Anjou, Deputy Chief Economist • Hélène Bégin, Senior Economist

Desjardins, Economic Studies: 418-835-2450 or 1 866-835-8444, ext. 5562450 • desjardins.economics@desjardins.com • desjardins.com/economics

NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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GRAPH 3
Existing property prices: Montreal is far from the Toronto rollercoaster



Sources: Canadian Real Estate Association, Quebec Professional Association of Real Estate Brokers through the Centris system, and Desjardins, Economic Studies

expensive markets around the country, especially Vancouver and Toronto.

- ▶ The number of transactions and average prices plummeted, but the adjustment period appears to be over, and the market is regaining strength.
- ▶ According to the Canada Mortgage and Housing Corporation (CMHC), Montreal’s market is not overvalued like Vancouver’s and Toronto’s a few years ago.
- ▶ The surge continues in both Montreal and Quebec as a whole. The situation is far from being out of all proportion as was the case elsewhere in the country before the correction.

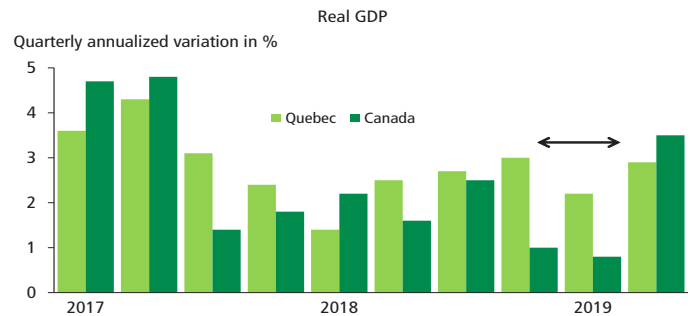
THE TAKEAWAY

- ▶ The fact that the residential real estate market is usually less cyclical in Quebec than elsewhere in Canada has been shown to be a factor in the resilience evident during the current period of economic growth.
- ▶ Still, Montreal’s residential real estate market has crossed the line that defines overheating. This makes it vulnerable to a possible correction, especially if foreign buyers were to be taxed.

2. The Oil Patch’s Troubles Have Had Little Impact on Quebec’s Economic Growth

- ▶ Aside from stronger residential real estate cycles in other parts of the country, Canada’s economy is feeling the effects of the oil industry’s ups and downs.
- ▶ The struggles in this sector explain in part the weak growth in real GDP in Canada in late 2018 and early 2019, which remained around 1% for two consecutive quarters (graph 4).
- ▶ During this time, Quebec maintained a solid cruising speed, with real GDP up roughly 2.5% for several quarters in a row.

GRAPH 4
Economic growth more stable in Quebec: Canada suffered from the convulsions of the real estate market and oil sector



Sources: Institut de la statistique du Québec, Statistics Canada and Desjardins, Economic Studies

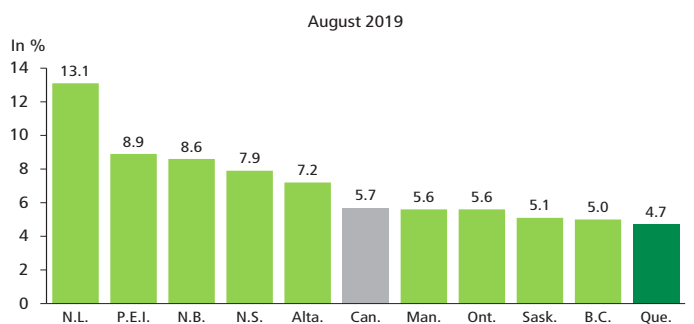
THE TAKEAWAY

- ▶ The resilience of Quebec’s economy is due in part to a high degree of industrial diversification, which reduces its dependence on a specific industry. This upside will continue to limit sudden changes in the pace of growth.
- ▶ Quebec is not immune to the possibility of a sudden and marked economic slowdown.

3. A Tighter Labour Market

- ▶ In August, Quebec’s unemployment rate fell to 4.7%, a level even lower than that of the other provinces (graph 5), for the first time since the beginning of monthly statistics in 1976.

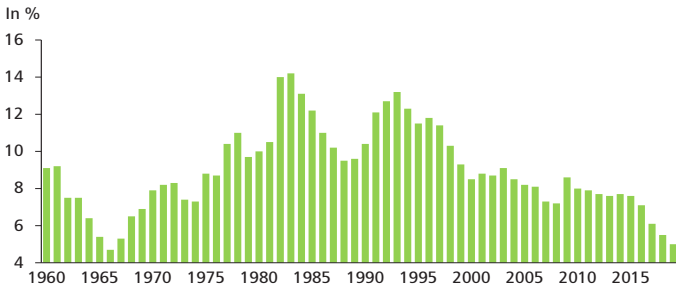
GRAPH 5
Quebec’s unemployment rate: The lowest in the country



Sources: Statistics Canada and Desjardins, Economic Studies

- ▶ The unemployment rate for 2019 will be at 5% for the first time since the mid-1960s (graph 6 on page 2).
- ▶ The strong growth of Quebec’s economy over the last few years, which stimulated job creation, contributed to the rapid decline in unemployment.

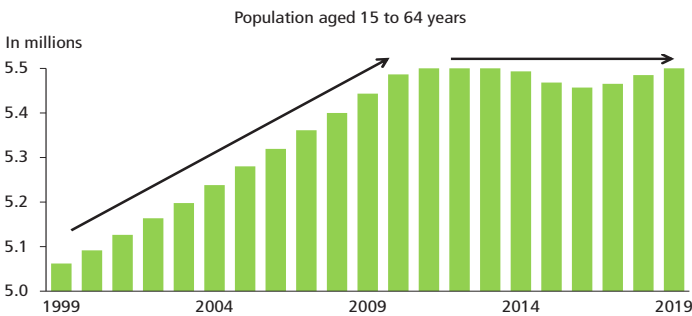
GRAPH 6
Quebec's unemployment is at its lowest rate since the 1960s



Sources: Statistics Canada and Desjardins, Economic Studies

- ▶ Quebec's demographic trends, distinguished by a markedly aging population compared to the country overall, is helping to massively reduce the unemployment rate.
- ▶ The working age population, i.e., those aged 15 to 64 years, has tended to stabilize in recent years (graph 7), whereas it continues to grow throughout Canada and in Ontario. Therefore, the downward pressure on Quebec's unemployment rate is greater.

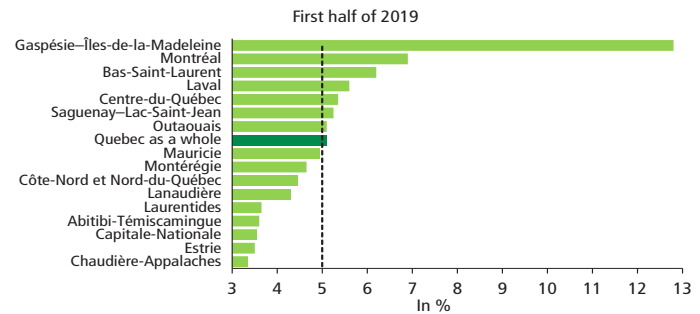
GRAPH 7
Quebec's demographic trends affect the number of potential workers



Sources: Statistics Canada and Desjardins, Economic Studies

- ▶ The aging population and the generational imbalance is causing a labour shortage throughout Quebec's regions and various sectors. There are not enough young people to fill the gap left by retirees.
- ▶ The regional disparities have largely faded in just a few years. Many regions are posting an unemployment rate below 5% (graph 8), a phenomenon that reflects the overall improvement in Quebec's economy and the demographic trends.

GRAPH 8
Quebec's labour market has improved overall: Unemployment rate is below 5% in many regions



Sources: Institut de la statistique du Québec and Desjardins, Economic Studies

- ▶ The labour shortage has caused wages to soar since 2017. The annual increase that was hovering around 1% before is now nearing 3%.

THE TAKEAWAY

- ▶ The labour market's significant improvement, especially an unemployment rate that fell faster than elsewhere in the country, also proved to be a factor in the resilience of Quebec's economy.
- ▶ Given that the demographic trends have firmly taken hold, the unemployment rate will remain low. In the event of a major economic slowdown, the provincial unemployment rate may go up a little but without returning to more than 8%.

4. A More Favourable Picture in the Regions

- ▶ The cycle of expansion of the U.S. and the world's economies has stimulated most of Quebec's regions.
- ▶ Many saw their unemployment rates drop below the 5% mark for the very first time. Major regional disparities faded, especially due to demographic reasons.
- ▶ In recent years, Montreal resumed its role as an engine of growth in the province, which has had a positive effect on Quebec's regions.

THE TAKEAWAY

- ▶ The improved economy and tighter labour market throughout Quebec's regions are making the province less vulnerable to the economy's possible deterioration.

5. Montreal's Resurgence

- ▶ The change in municipal leadership in November 2013 brought a new energy to Montreal.

- ▶ This dynamic approach provided Montreal with a clear direction, and a general sense of optimism returned.
- ▶ Montreal's strength is becoming increasingly obvious thanks to a number of infrastructure and transit projects.
- ▶ The change in the way Montreal is perceived is having an impact on government, the general population, the business world, and investors.
- ▶ The renewed interest in the Montreal real estate market is evident in the influx of capital and the number of construction projects, especially in the core. Commercial, industrial and multi-residential buildings are highly sought-after by local and international buyers.
- ▶ Montreal's higher ranking among several leading industries and internationally is causing an influx of foreign students and highly specialized workers to the research and high-tech sectors, especially artificial intelligence.

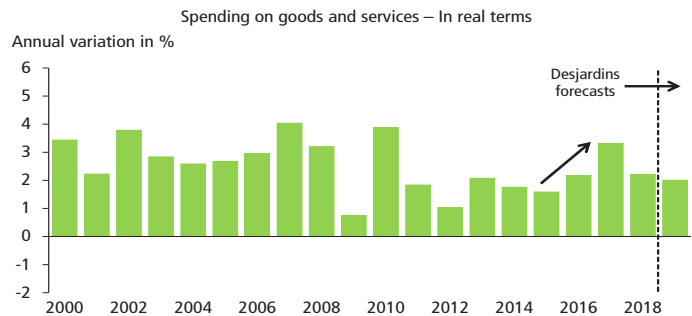
THE TAKEAWAY

- ▶ Montreal's resurgence has provided a positive boost to Quebec's economy.
- ▶ The fact that the regions of Quebec, including Montreal, are doing well is strengthening the foundations underpinning Quebec's current economic cycle and helping to prolong the resilience period.

6. A Very Positive Situation for Consumers

- ▶ The tighter labour market is helping consumers remain on solid ground in all regions of Quebec, thereby making them less vulnerable to the possible deterioration of the economy.
- ▶ Montreal's economic strength and significant demographic weight are positive for consumer spending in Quebec and having a ripple effect on the regions.
- ▶ Employment income is rising rapidly thanks to job creation and the low unemployment rate, which is lifting wages. Stimulates consumer spending.
- ▶ Since 2016, the reduced federal and provincial tax burden on individuals has also been raising household income. Among the various measures, the introduction of the federal child tax benefit, the elimination of the Quebec government's health tax, and small tax reductions overall have given households more room to manoeuvre.
- ▶ Retail sales and consumption have been advancing at a solid pace in Quebec since 2016 after five lean years (graph 9).

GRAPH 9
Consumption gains renewed strength in 2016 in Quebec

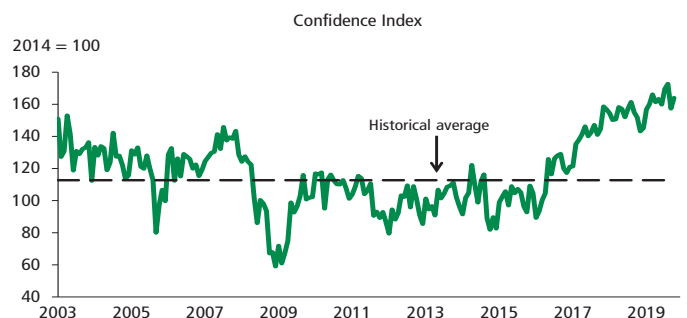


Sources: Statistics Canada and Desjardins, Economic Studies

THE TAKEAWAY

- ▶ The situation of households, which has improved through the labour market and the lower tax burden, is having a positive impact on consumer spending, which accounts for two thirds of the economy.
- ▶ The resilience of Quebec's economy is based in part on the more favourable situation for consumers.
- ▶ Moreover, Quebecers' confidence is up once again and has almost reached a historic peak (graph 10).

GRAPH 10
Quebecers' confidence is up since 2016

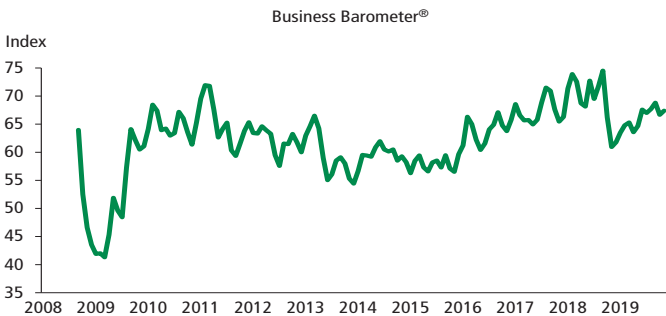


Sources: Conference Board of Canada and Desjardins, Economic Studies

7. The Upturn in Quebec's Public Finances

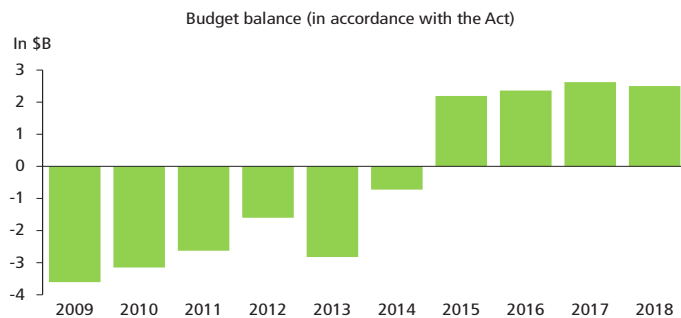
- ▶ People's and businesses' perception of the public finances is once again positive. Household and business confidence levels (graph 11 on page 5) have risen in part thanks to the improved public finances.
- ▶ The year 2015 marked the end of a long period of budgetary deficits for the Quebec government (graph 12 on page 5).

GRAPH 11
SME confidence start to improve in 2016, business climate is more positive



Sources: Canadian Federation of Independent Business and Desjardins, Economic Studies

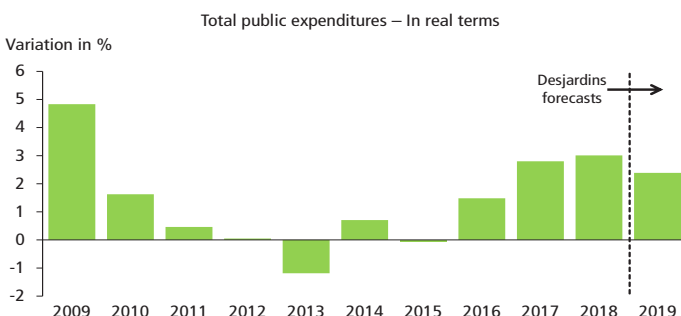
GRAPH 12
Quebec's budgetary deficits are a thing of the past



Sources: Ministère des Finances du Québec and Desjardins, Economic Studies

- ▶ Tighter spending controls, which involved cuts and some sacrifices by Quebecers, helped to get there (graph 13).
- ▶ Precautionary measures, such as the stabilization reserve and contingency reserves, helped too.
- ▶ Even if the weight of Quebec's gross debt is relatively high compared with that of the other provinces, at 46.1% of GDP

GRAPH 13
Current government and capital expenditures in Quebec are up as of 2016

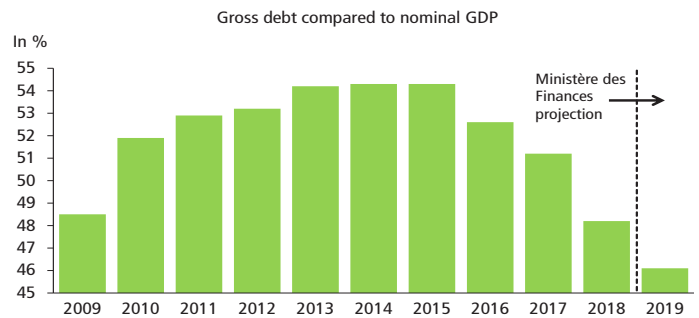


Sources: Institut de la statistique du Québec and Desjardins, Economic Studies

in March 2019, it's at its lowest level in more than 20 years (graph 14).

- ▶ The era of budgetary surpluses that has existed since 2015 is even facilitating the gradual repayment of the debt thanks to the Generations Fund.
- ▶ The room to manoeuvre made it possible to reinject money into the economy.
 - Reduced tax burden for individuals and businesses.
 - End of the State's spending restrictions.
 - More money in the Quebec infrastructure program.

GRAPH 14
The weight of Quebec's gross debt has fallen significantly in recent years



Sources: Ministère des Finances du Québec and Desjardins, Economic Studies

8. Investments in Infrastructure

- ▶ In recent years, the different levels of governments released significant sums of money for major road and transit infrastructure projects, especially in Montreal.
- ▶ The Turcot Interchange, the Champlain Bridge and the future Réseau express métropolitain (REM) funnelled a lot of investment into Quebec.
- ▶ The deterioration of roads, bridges and overpasses throughout the province required major sums of money to bring them back up to standard.

THE TAKEAWAY

- ▶ Massive infrastructure investments in Quebec accelerated economic growth.

IN SHORT

- ▶ A number of advantages have driven economic growth in Quebec since 2016 and prolonged its resilience.
- ▶ Less cyclical residential real estate in Quebec compared with elsewhere in Canada.
- ▶ A high degree of industrial diversification, which reduces the dependence on a specific industry, such as oil in some provinces.
- ▶ The major improvement in the labour market, especially the quicker drop in the unemployment rate compared with elsewhere in the country, thanks in part to the demographic trends specific to Quebec.
- ▶ The fact that the province's regions, including Montreal, are doing well is strengthening the foundations underpinning Quebec's current economic cycle.
- ▶ The situation of households, which has improved through the labour market and the lower tax burden, is having a positive impact on consumer spending, which accounts for two thirds of the economy.
- ▶ Consumer and business confidence levels are up again thanks in part to the improved public finances, which lifted the climate of uncertainty.
- ▶ Massive infrastructure investments accelerated the pace of economic growth in Quebec.

Conclusion

- ▶ Despite these positive factors, Quebec's economy is not immune to a possible slowdown. The slowing global economy, which is affecting both advanced and emerging countries, is already hitting China and the United States. The repercussions are being felt in Quebec thanks to the downtrend in exports and the hesitation by businesses to invest. Nonetheless, the fact that Quebec has several advantages should limit the damage to the economy.

Hélène Bégin, Senior Economist