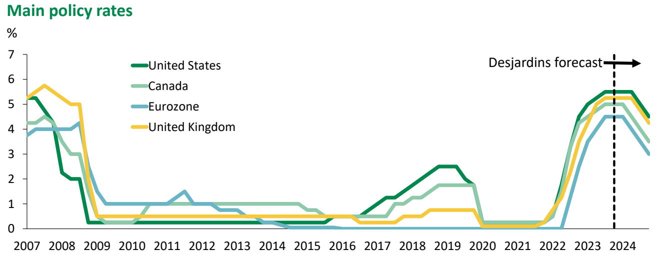
ECONOMIC VIEWPOINT

What To Watch in 2024

Gearing Up for a Tense Year

We expect interest rates to come down in 2024, providing relief to borrowers. Bond yields have already started to fall, and the trend is likely to continue as the major central banks start cutting their policy interest rates (graph 1). In Canada, rate cuts could start this spring if inflation improves enough. **We'll also be keeping an eye on changes in risk and term premia because they also affect the retail rates offered to savers and borrowers.** Our forecasts already account for some premia going up, but more significant increases could curb cuts to retail rates. Another area we'll be watching is quantitative tightening, as many central banks are shrinking their balance sheet. In addition to draining excess liquidity from the financial system, quantitative tightening could limit the downward movement of certain interest rates.

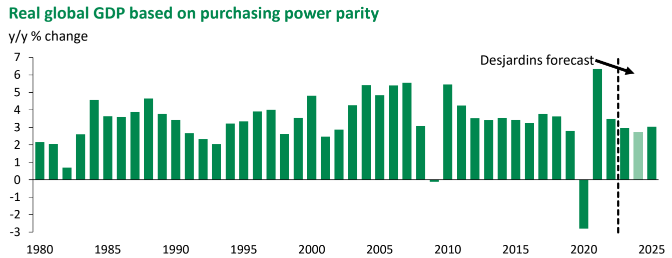
Graph 1
We Expect Several Rate Cuts



Datastream and Desjardins Economic Studies

Several countries are already grappling with stagnating economies and could slip into a recession. So far, the slowdowns haven't been too bad and nothing dramatic is expected in the first half of 2024. But once a downward spiral begins, **the risk of more significant economic contractions goes up**. Additionally, there isn't much that central banks and governments can do in the short term if inflation and interest rates remain elevated. However, we expect global economic weakness to remain moderate (graph 2), with real GDP growth

Graph 2
The 2024 Global Economic Slowdown Will Be Fairly Moderate



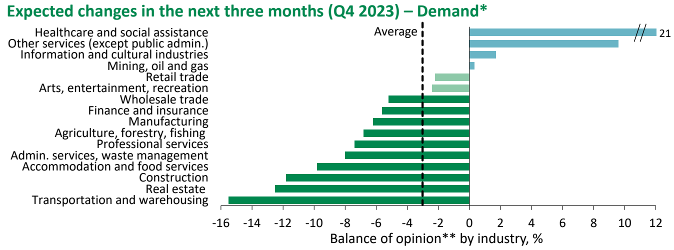
Global Bank, International Monetary Fund, Consensus Forecast and Desjardins Economic Studies

improving in late 2024. **The Canadian economy is likely to experience a short and shallow recession in the first half of 2024.** We expect household consumption and residential investment to fall as interest-rate-sensitive households continue to renew their mortgages at higher rates. A slowing US economy will also take some of the wind out of the sails of Canadian exports. **Quebec's economic results for late 2023 and early 2024 will be negatively impacted by the strikes in the education and health care sectors.** Following a mild recession in 2023, the Quebec economy should return to positive territory, especially in the second half of 2024.

The Canadian economy has yet to feel the full weight of the interest rate hiking cycle that started in March 2022. While the impact on residential investment and the broader housing market was swift, purchases of consumer durables such as autos have fared better than many expected. We don't think this will last into 2024, as pandemic-era demand fades into the rearview mirror. This weakness should be reflected in retail and wholesale trade as well. Discretionary spending on travel, entertainment and hospitality slowed considerably through 2023, and this trend should only intensify this year as households are increasingly confronted with higher mortgage payments (graph 3 on page 2). Looking to business investment, lower oil prices relative to the last couple of years should keep a lid on oil and gas production and investment, while elevated

Graph 3
Most Sectors Expect a Slow Start

Expected changes in the next three months (Q4 2023) – Demand*



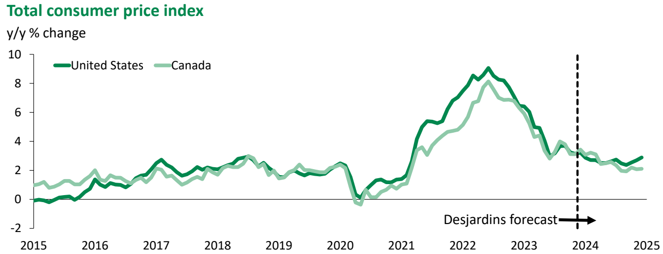
* Demand for goods and services offered by your business. ** Percentage of respondents who answered "increase" less percent who answered "decrease."
Statistics Canada and Desjardins Economic Studies

interest rates, input costs and uncertainty will act as a headwind to both investment in non-residential buildings and construction more broadly. And with the US and broader global economy likely to slow, demand for Canadian manufactured and non-manufactured exports should follow suit.

Tremendous strides have been made in the fight against inflation since price growth peaked in 2022. This trend is expected to continue in 2024. Some countries, particularly in Europe, have already seen their consumer price index variations return to near central bank targets. China is even experiencing negative inflation. These gains have largely been driven by falling energy prices, as well as markedly lower pressure on the price of goods in general. However, inflation is proving stickier on the services side. This is what's happening in the United States. If service and wage inflation don't come down further, it will be hard to meet the 2% target in 2024, though the gap should narrow nonetheless. Similarly, inflation in Canada is expected to continue to trend lower through 2024. However, unlike in many other advanced economies, **inflation is projected to reach the Bank of Canada's 2% inflation target by the end of the year** (graph 4). This is despite shelter inflation remaining elevated. It should therefore be the result of a meaningful cooling in energy, food and non-shelter core price growth. Softening wage pressures should manifest in 2024, reflecting the job market cooldown with a lag. However, like other central banks, the Bank of Canada will hope to see some positive progress on

Graph 4
Inflation Is Expected to Come Down Further in 2024

Total consumer price index



Statistics Canada, Bureau of Labor Statistics and Desjardins Economic Studies

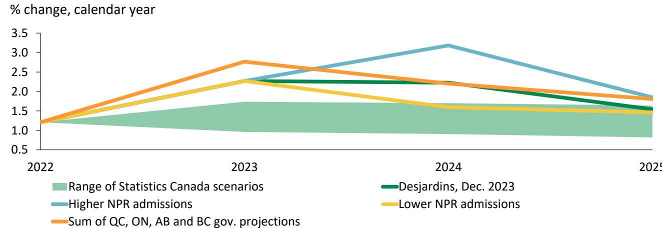
wages, which remained sticky in late 2023. Lack of progress would complicate the BoC's job, though mostly from an optics perspective. Wages remain a lagging indicator, and so long as job vacancies trend lower and the unemployment rate higher, the BoC should trust that workers' bargaining power will eventually diminish.

We think **Canada's housing markets will trend higher following a soft spring season**. Our latest forecasts assume weak or falling first-quarter price growth in many centres amid still-high borrowing costs and stalling economic momentum. That would build on the underwhelming fall 2023 real estate season experienced in many cities. Rate cuts in mid-2024 should support a rebound in economic growth and sales activity, though still-limited affordability—particularly in high-priced Ontario and BC markets—will likely prevent significant gains. Moreover, those who bought homes at lower rates face potentially large mortgage payment increases at renewal.

We think Canadian population growth will be strong again this year, even as non-permanent resident (NPR) admissions weaken alongside hiring. But there's a risk that NPR arrivals hold firm (graph 5), limiting affordability improvements. Housing starts are also worth monitoring, particularly if they fall significantly despite government efforts to boost the supply of affordable housing. While a number of projects have been announced as part of the federal government's Housing Accelerator Fund, this supply will probably only hit the market in the years ahead.

Graph 5
Demographics Present Significant Upside Potential for Canada's Housing Markets This Year

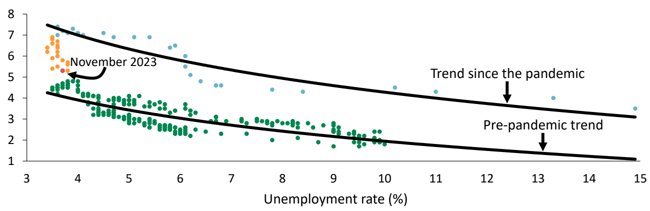
Canadian population growth projections



NPR: Non-permanent resident
Statistics Canada and Desjardins Economic Studies

Until now, labour markets have been largely insulated by the economic slowdown observed in a number of countries. The major advanced economies have been facing a labour shortage since the pandemic, and as a result businesses are reluctant to let workers go. This is the case in the US, where the number of job openings is falling toward pre-pandemic levels and unemployment hasn't gone up (graph 6 on page 3). But eventually the hiring spree should slow and, when it does, inflation should cool a little more. We'll be keeping an eye on

Graph 6
Can Job Openings Continue to Fall without Causing a Spike in Unemployment?
United States – Beveridge curve (relationship between job openings and unemployment)



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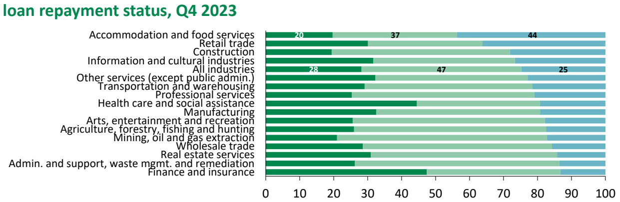
both job vacancies and wages. **Canada's unique position as a high immigration nation is likely to continue in 2024. Even though we expect a deceleration in the pace of NPR admissions, it should still be sufficient for population growth to exceed the pace of hiring.** As a result, even as we see a broadly stable level of employment on the year, the unemployment rate should continue its climb, reaching around 7.0%.

75% of the businesses that received a CEBA loan have paid it back or plan to pay it back in full by December 2026, but the numbers are more concerning in certain sectors (graph 7). In the accommodation and food services sector, 69% of all businesses took out a CEBA loan. Now 44% of these borrowers say they can't or may not be able to repay their loans by December 2026. Since there's a substantial incentive for businesses to pay off their loans in full by January 18, 2024, it stands to reason that any businesses postponing repayment are facing serious financial hardship. **Some businesses may declare bankruptcy, resulting in layoffs. Insolvency is up across the country and has surpassed 2019 levels.** In Quebec, the number of insolvencies increased 44% in 2023 (January to October) compared to the same period in 2022. There's a risk that this trend could continue in the sectors hardest hit by the economic slowdown (accommodation and food services, retail and construction).

Graph 7
Businesses in the Accommodation and Food Services and Retail Sectors Will Have a Harder Time Repaying CEBA Loans
CEBA loan repayment status, Q4 2023

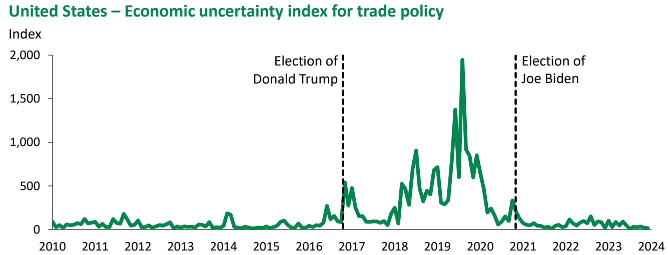


Statistics Canada

After a highly unusual period, we should see a normalization of monetary policy, inflation and economic growth in 2024. If so, we may see more fundamental factors influence stock market returns. Inflation won't pad corporate profits like it did before. As a result, the focus will shift back to economic growth and consumer demand in particular. And since the economic slowdown will support the bond market, it could also hurt the stock markets.

A record number of countries will be going to the polls in 2024, to choose the governments for the United Kingdom, India, Mexico, Taiwan and the European Parliament. Of course, all eyes will be turned to the US presidential election, which is set for November 5. **The results of the likely rematch between Joe Biden and Donald Trump will be decisive for the US economy.** However, we'll also be watching the run-up to the November election, particularly because of the unusual legal troubles surrounding Mr. Trump's eligibility. If he returns to the White House, US protectionism is likely to escalate once again, along with political uncertainty on many fronts, including the economy, taxation, the environment, international trade (graph 8) and diplomatic relations. Things will be more stable if Biden is re-elected, but his age will continue to fuel speculation. Regardless of who wins, chances are slim that the US will manage to reduce its massive public deficit. Will there be another rating downgrade? We'll be watching for that, too.

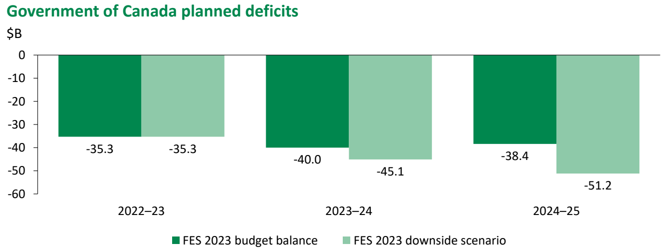
Graph 8
Donald Trump's Return to the White House Could Lead to Increased Uncertainty, Especially in Trade Policy
United States – Economic uncertainty index for trade policy



Baker, Bloom and Davis, Datastream and Desjardins Economic Studies

Unlike in the US, a federal election in Canada in 2024 is far from certain. The Conservative Party of Canada opened up a significant polling lead in the second half of last year. But the Supply and Confidence Agreement between the governing Liberal Party of Canada and the New Democratic Party means a federal election may be put off until 2025. As such, there isn't likely to be much pressure on the federal government to meaningfully reduce expected deficits (graph 9 on page 4) by curbing spending. Arguably, a year that is likely to feature a recession makes 2024 an inauspicious time to shift towards austerity. Nevertheless, the government has pledged to offer clear details on several of its proposed initiatives designed

Graph 9
The Federal Government Plans to Run Sustained Deficits



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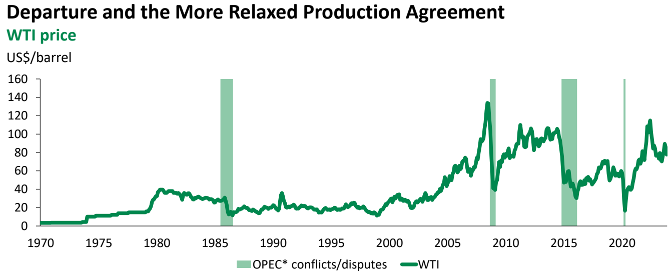
to stimulate growth and accelerate the energy transition simultaneously. For example, the enactment of legislation for clean technology manufacturing and clean hydrogen tax credits was scheduled for early this year. This was planned to be followed by the implementation of additional tax credits, such as for clean electricity, later in the year. Adhering to this timeline will be vital for Canada's industrial policy to be competitive against the US Inflation Reduction Act, which is currently drawing investments globally. At the provincial level, elections are due to be held in New Brunswick, Saskatchewan and British Columbia in 2024. (See our analysis of the federal and provincial fiscal plans published in late 2023 for more information.)

Geopolitical issues may continue to disrupt the economy in 2024. War continues to rage in Ukraine, and support from Europe and the US is waning. This could help Russia and upset the balance of power. The Israel–Hamas conflict threatens to extend beyond the borders of the Palestinian territories and inflame the entire region. Maritime trade disruptions are already occurring. Other political issues that could drag down the global economy and financial markets include tensions surrounding Taiwan and immigration in Europe. On the commodities side, there are renewed fears of friction within OPEC+ following Angola's recent departure from the organization and the more relaxed production agreement reached in November 2023 (graph 10). As a result of these factors, as well as concerns that demand may dip due to the global economic slowdown, **oil prices may remain highly volatile**. Demand for industrial metals remains soft due to the economic slowdown in China, but the central government's stimulus measures could spark a fast recovery. For grain, supply and demand are expected to be more balanced than in 2023, which should help stabilize prices. However, the risk of escalating conflicts could spark volatility for fertilizers and grains. Finally, precious metals could benefit from the economic and financial uncertainty. This would help to limit the anticipated price falls.

Global warming will continue to wreak havoc across the world. 2023 was the hottest year on record, and the year was marked by numerous natural disasters. Now, the UK's national weather service expects the global average temperature to rise even higher in 2024. **Physical infrastructure damage or destruction caused by extreme weather is a major economic risk.** Recent developments in the insurance market reflect this reality. In California, some insurers stopped issuing new home insurance policies in 2023 due to frequent wildfires. If this continues in 2024, it could make it harder to sell homes in problem areas and affect property prices.

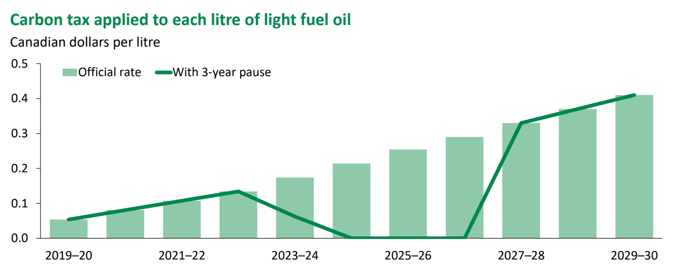
Decarbonization efforts are on the rise, along with related uncertainties. This could result in price adjustments. Businesses are concerned about the lack of clarity and predictability of transition measures. At the same time, rapid growth in energy transition projects around the world is leading to increased competition for key materials and labour, which could in turn drive up costs and contribute to persistent inflationary pressure in the economy. The flipside is that massive investments in decarbonization and infrastructure will actually benefit from the short-term economic slowdowns (or recessions, as the case may be) in 2024. This will allow global trade and industrial activity to stabilize, although geopolitical fragmentation may prevent a sharp upturn. **In Canada, much ink has been spilled discussing the effectiveness of carbon pricing.** While it is set to rise further to reach $80 per tonne next April, recent changes have put it under the microscope, notably the exemption of home heating fuel for three years (graph 11). At the same time, other policy changes have better leveled the playing field with the US's Inflation Reduction Act. These

Graph 10
There Are Renewed Fears of Friction within OPEC+ Following Angola's Departure and the More Relaxed Production Agreement



* OPEC became OPEC+ in 2016.
OPEC+: Organization of the Petroleum Exporting Countries and its partners; WTI: West Texas Intermediate
Datastream and Desjardins Economic Studies

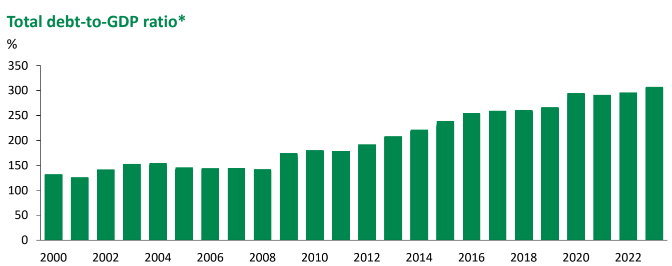
Graph 11
The Carbon Tax Cut Will Be Challenging to Reverse Later On



Government of Canada, Canada Revenue Agency and Desjardins Economic Studies include the introduction of contracts for differences—helping decarbonization-friendly firms to manage risk around carbon prices over the long term—and the still-to-be-enacted tax credits for low-carbon investments. Other jurisdictions like the European Union have also stepped up their environmental policies with the introduction of a carbon border tax in late 2023. (Tariffs will only be implemented in 2026.) This furthered the need to maintain the competitiveness of Canada's environmental regulatory framework.

Financial fragility and increased debt in emerging economies, along with high interest rates, present significant challenges to global economic growth. Some countries may face austerity to balance their budgets, while others may be unable to meet their financial obligations and default. This would send shocks through the financial markets and cause major index corrections. China's whopping debt is limiting its government's ability to act. Beijing is already dealing with a property market meltdown, high unemployment among younger adults, declining investments and low confidence among consumers and businesses (graph 12). Although Chinese authorities are expected to step up support in 2024, it's hard to know whether or not they'll be able to spur growth with stimulus measures while addressing the economy's underlying problems. In addition, **escalating tensions between China and the United States could prompt new protectionist measures, which would put a drag on global economic activity**.

Graph 12
China's Massive Debt Could Hold Back Its Real GDP Growth



* Excluding the financial sector.
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