AUTORITÉ DES MARCHÉS FINANCIERS

Economic and Financial Review

June 14, 2024

Office of the Chief Economist

Table of contents

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Legal deposit – Bibliothèque et Archives nationales du Québec, 2024
ISSN 2561-7109

Highlights

- In the world's major economies, restrictive monetary policies appear to be yielding results. The process of disinflation is well underway but is becoming more challenging as inflation nears central bank targets.
- The Bank of Canada and the European Central Bank have begun to lower their key policy rates owing to the continuing decline in inflation and the very gradual economic recovery in Canada and the euro area.
- In the United States, the economy remains resilient despite some signs of a slowdown, and progress in reducing inflation is more modest. As a result, the Federal Reserve will wait until the fall to ease its monetary policy.
- In Canada, inflation is back within the Bank of Canada's target range of 1% to 3%. In June, the central bank cut its key policy rate by 25 basis points, to 4.75%.
- The Québec economy has shown encouraging signs of recovery since the beginning of the year. Consumer spending is holding fast owing, in part, to strong wage growth.
- Stock markets have performed well since the start of the year, bolstered by the resilience of the global economy and expectations of more flexible monetary policies.
- On the bond markets, yields have been trending upward since the start of the year, reflecting persistent inflationary pressures. Investors have lowered their expectations of future monetary policy easing.

	Real GDP			**Inflation**			**Unemployment**		
% y/y	2023	2024e	2025f	2023	2024e	2025f	2023	2024e	2025f
United States	2.5	2.4	1.8	4.1	3.2	2.4	3.6	3.9	4.1
Euro area	0.5	0.7	1.4	5.5	2.4	2.1	6.6	6.6	6.5
Canada	1.3	1.0	1.8	3.9	2.5	2.1	5.4	6.3	6.3
Québec	0.1	0.7	1.5	4.5	2.6	2.2	4.5	5.4	5.6

Sources: Bloomberg and AMF

Economy

World

Since the start of the year, the global economy has remained resilient amid high interest rates and geopolitical tensions. The process of disinflation is well underway but is becoming more challenging as inflation nears central bank targets.

The major economies are beginning to diverge. Whereas the European and Canadian economies are undergoing a gradual recovery, with inflation continuing to fall, the U.S. economy, while still strong, is showing signs of slowing, with still-persistent inflation.

Some European central banks and the Bank of Canada have already begun to lower their key policy rates, while the Federal Reserve will keep them unchanged for a longer period of time.

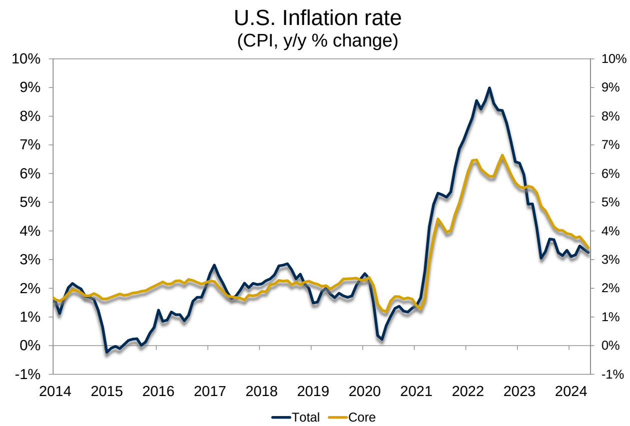
After exceeding expectations in 2023, the U.S. economy is beginning to moderate. Annualized GDP growth was just 1.3% during the first quarter, compared with 3.4% in the previous quarter, owing mainly to softening consumer spending and exports.

Nevertheless, the labour market remains tight. The pace of job creation has been solid since the start of the year, with an average of almost 250,000 new jobs being created every month. In May, the jobless rate was 4%.

Inflation remains a challenge, although it is far below the June 2022 peak of 9.1%. Prices rose 3.3% in May, mainly owing to price increases in the services sector. Core inflation, which excludes the more volatile items of food and energy, stood at 3.4%.

Progress in the fight against inflation has been slow and inconsistent for the past several months. As a result, the Federal Reserve has had to keep its key policy rate higher for a longer period of time than initially anticipated in order to keep price increases under control.

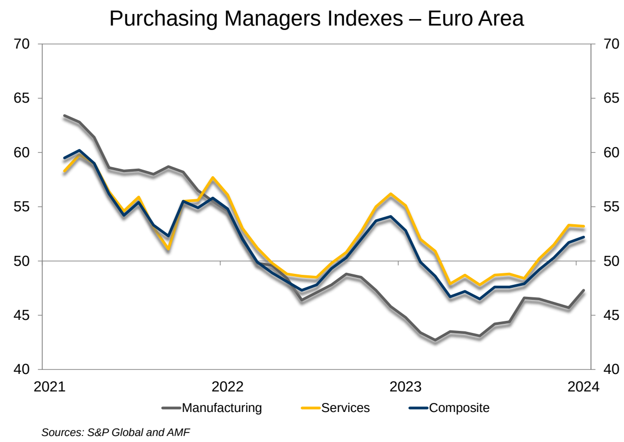
In fact, the Fed left the key policy rate unchanged at 5.25%-5.50% in June, the highest level in 23 years. U.S. monetary policymakers are concerned about the trajectory of inflation and expect to make no more than two rate cuts between now and the end of the year.



Sources: U.S. Bureau of Labor Statistics and AMF

Since the beginning of the year, the euro area economy has been regaining momentum. After a technical recession in the second half of 2023, GDP has started to rise again, posting annualized quarterly growth of 1.3% in the first quarter.

This recovery looks set to continue, according to the latest economic indicators. The composite purchasing managers' index rose above 50 and continues to climb, pointing to economic expansion. For the time being, growth is concentrated in the services sector, while manufacturing, despite some improvement, remains in contraction territory.



Inflation fell to 2.6% in May, down from its October 2022 peak of 10.6%, nearing the European Central Bank's (ECB) 2% target. Core inflation stood at 2.9%. With this rapid decrease in inflation and the economy still in gradual recovery, the ECB was able to go ahead with a first rate cut in June. However, the central bank was non-committal about what would happen next, pointing out that wage inflation remains high and total inflation would continue to be above the 2% target beyond 2024.

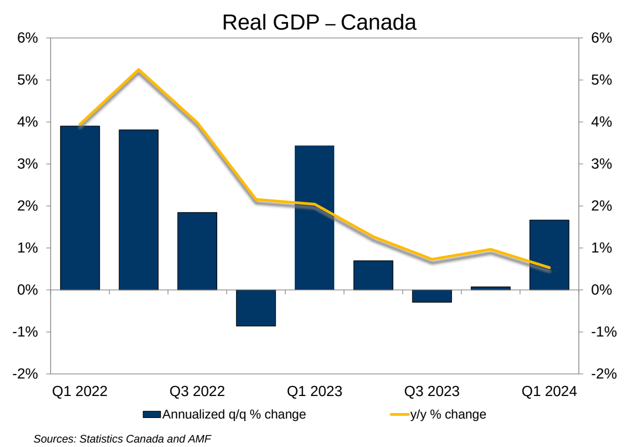
The situation is similar in the United Kingdom, where the economy is also in gradual recovery following a technical recession in 2023. Inflation, which stood at 2.3% in April, is approaching the target, and the Bank of England may lower its key policy rate in the summer.

After last year's slower-than-expected post-pandemic recovery, China's economy surprised on the upside, posting annual growth of 5.3% in the first quarter of 2024. Some of the support measures put in place by the authorities seem to have paid off, leading most international financial institutions to revise their economic forecasts upward. China is now expected to achieve the government's target of approximately 5% growth.

But the country is not out of the woods yet. In recent years, economic growth has been undermined by a real estate debt crisis that has pushed several property developers into bankruptcy. Local government over-indebtedness, slowing consumer spending and persistent deflation are also weighing on growth. Lastly, trade tensions with the United States are escalating. The Biden administration has maintained the tariffs imposed during the Trump administration and levied new ones since the start of 2024 on such things as electric vehicles and other clean technologies, microprocessors and artificial intelligence.

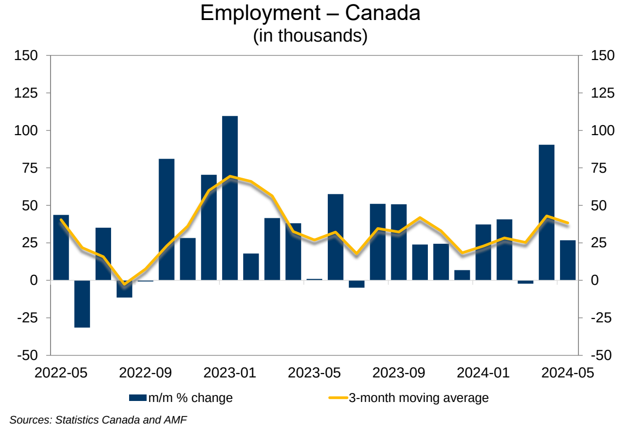
Canada

The Canadian economy has showed signs of recovery in the first half of 2024 following last year's substantial slowdown in consumer spending and contraction in investment spending.



The economy strengthened at the start of the year, with GDP posting annualized growth of 1.7% in the first quarter. While this represents very modest growth, it is a marked improvement over last year's stagnation. Activity was bolstered, in part, by an acceleration in consumer spending, an increase in government spending and a recovery in investment.

In the labour market, the slowdown in employment over the past year led to a significant rise in the unemployment rate, which climbed more than one percentage point year over year, from 5.1% to 6.2%. Job creation has remained relatively stable in recent months, but the level of job creation is not sufficient to stabilize the unemployment rate.



Progress in reducing inflation in the last few months has slowed. Nonetheless, at 2.7% in May, the inflation rate was back inside the Bank of Canada's target range of 1% to 3%. The various measures of core inflation are also showing a slow but steady improvement.

Economic growth that has been below long-term potential for the past year has generated excess capacity in the economy. The reduced pressures on global supply will encourage a return to price stability. However, rapidly rising unit labour costs, driven by strong wage growth and low productivity, represent a major challenge and a potential roadblock to a durable decline in inflation.

The Bank of Canada had held the key policy rate at 5% since July 2023, the highest level since 2001. However, reduced inflation led monetary authorities to cut the key policy rate by 25 basis points to 4.75%. Bank of Canada officials have suggested that it is reasonable to expect further cuts in the months ahead.

The cuts expected this year will be gradual and no doubt modest. Even so, the key policy rate is very likely to come down faster in Canada than in the United States. If a substantial gap appears between the Canadian and U.S. rates, it could cause the Canadian dollar to fall in value.

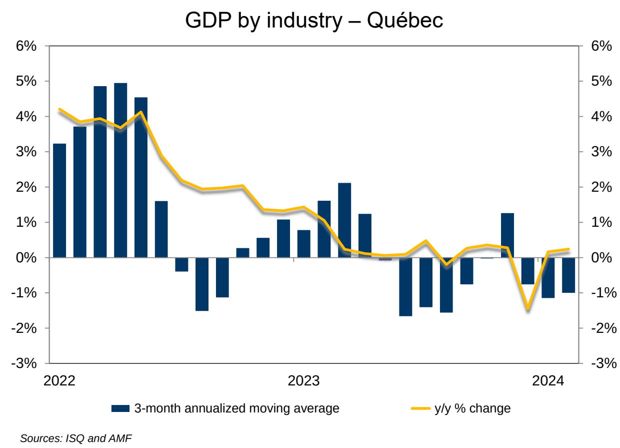
In the best-case scenario, we can expect the Canadian economy to stabilize in 2024. The export sector will sustain growth, while domestic demand will continue to adjust to a higher interest rate environment than in previous years. The second half of 2024 will offer a more favourable economic environment for business and job creation, however.

Québec

The Québec economy idled in 2023. Only consumer spending and net exports kept it afloat. Business investment, residential construction and government spending sagged during the year. Labour disputes in the public sector also depressed economic activity at the end of 2023.

However, since the beginning of the year, encouraging signs of recovery have begun to appear. GDP posted monthly growth of 0.2% in February, following a 2% increase in January.

With manufacturing and construction still struggling, most of this growth is being driven by the services sector.



The current recovery is expected to be sustained by higher business capital spending. Meanwhile, the construction sector is expected to be bolstered by the recovery of the real estate market and the housing shortage in many areas of Québec.

The anticipated interest rate cuts will also provide some oxygen and sustain the ongoing recovery in the construction sector. However, no one is expecting a surge in housing starts. The recent trend has been subdued.

Consumer spending has held fast, despite the economic slowdown and two years of interest rate hikes. Robust wage growth, the influx of foreign workers and, more broadly, strong population growth have sustained spending on goods and services.

The labour market has slowed since last year, but this is not translating into net job losses. In fact, employment has remained virtually unchanged since September 2023, and the unemployment rate stood at 5.1% in May.

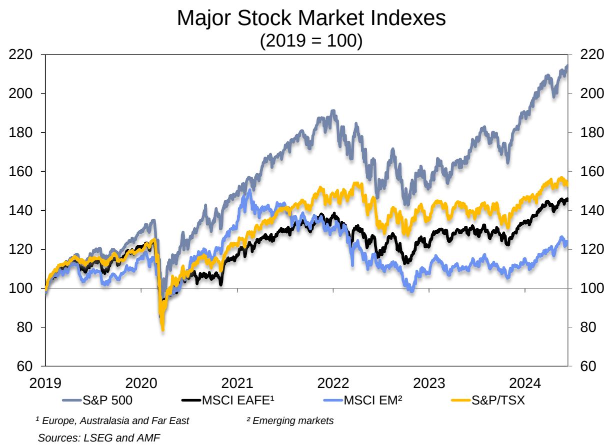
In this context, consumption should remain relatively buoyant over the coming months owing, in part, to the expected upturn in the labour market and despite tighter financial conditions.

The economic picture is therefore expected to brighten in 2024 and 2025. The improvement will be sustained by falling inflation and interest rates, and a slightly rosier labour market. The economic recovery will nevertheless be very gradual and fairly modest this year, reflecting expected monetary easing.

Financial markets

Stock markets have performed well since the start of the year, bolstered by the resilience of the global economy and expectations of looser monetary policies.

Since the 2022 declines, following the launch of the monetary tightening campaigns, the major stock market indices have posted significant gains. After rising almost 20% in 2023, the MSCI All Country World Index has returned around 11% since the start of 2024, reaching new highs.

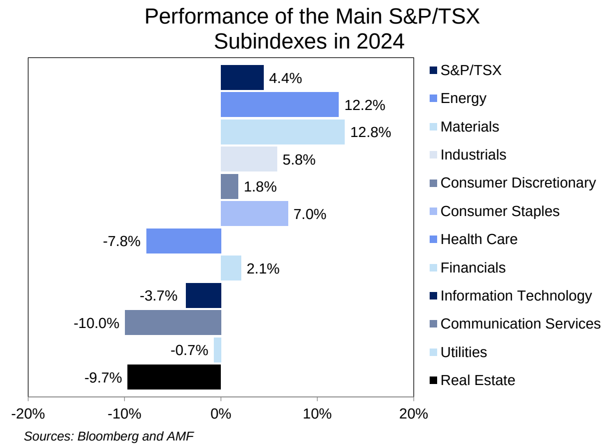


Once again, the U.S. markets performed well. The S&P 500 has risen about 13% so far this year, driven, in particular, by the excellent performance of technology stocks. The Tech Giants have continued to propel U.S. indices to new peaks, including the NASDAQ, which has returned approximately 16% since the start of the year.

With the solid performance of the U.S. economy, corporate earnings in most sectors have posted sizeable increases since the start of the year. Elsewhere in the world, with improved economic conditions in Europe, the European stock markets have also fared well.

In Canada, the S&P/TSX delivered a lower, but still positive, return of around 4%. Materials, which benefitted from rising gold prices, were especially strong, with 13% growth. Energy posted a significant increase of 12% on the strength of rising oil prices. The recent completion of the new Trans Mountain pipeline, which will give Canadian oil producers better access to world markets, is also worth noting.

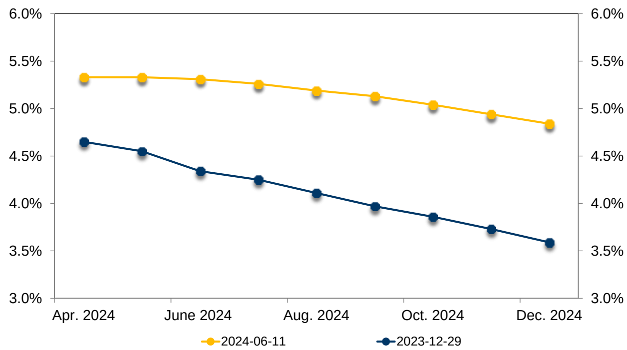
Finally, TSX-listed companies headquartered in Québec performed slightly better than the composite index as a whole.



On the bond markets, yields have been trending upward since the start of the year. U.S. 10-year yields have risen approximately 50 basis points since the start of the year and now stand at around 4.4%. The rise in bond yields reflects the solid performance of the U.S. economy and the persistence of inflationary pressures. In this context, investors have had to readjust their expectations of changes in monetary policy.

Investors now have much more modest expectations regarding monetary policy easing by the Federal Reserve than they did at the beginning of the year. According to the futures markets, investors were expecting six 25-basis-point cuts in 2024 at the start of the year, whereas now they are expecting no more than two. The first cut is expected in September at the earliest, according to the futures markets.

Market Expectations for Fed Funds Rate



Sources: LSEG and AMF

In Canada, investors have also lowered their expectations of future monetary policy easing. There is, however, a slight divergence in relation to the United States. The markets are expecting the Bank of Canada to cut rates by a total of 75 basis points, including the first decrease announced in June, by the end of 2024.

Otherwise, Canadian bond yields have moved largely in tandem with their U.S. counterparts since the start of the year. Canadian 10-year bond yields currently stand at 3.5%, some 90 basis points below U.S. 10-year yields, reflecting the greater fragility of the Canadian economy.

Finally, yield spreads on corporate bonds remain relatively narrow owing to the scenario increasingly favoured by investors of an economic soft landing.

Market Performance

		Level	% change				Last 12 months	
Stock Markets		**2024-06-11**	**1 month**	**3 months**	**6 months**	**1 year**	**Min.**	**Max.**
MSCI All Country World Index		964	1.58	4.22	14.12	19.47	765	964
MSCI EAFE[1]		1,527	-0.45	3.04	11.15	13.45	1,278	1,549
MSCI Emerging Markets		66,112	0.03	4.78	11.59	9.57	56,185	67,626
S&P 500		5,375	2.92	5.03	16.29	23.89	4,117	5,375
S&P/TSX		21,887	-1.89	0.54	7.72	9.87	18,737	22,468
Morningstar National Bank Québec Index		436	0.78	2.36	10.07	11.67	365	440
Bond Markets		**Level**					**Last 12 months**	
		2024-06-11	**-1 month**	**-3 months**	**-6 months**	**-1 year**	**Min.**	**Max.**
Québec	10-year	4.02	4.02	4.02	4.06	4.04	3.69	4.98
Canada	10-year	3.48	3.70	3.35	3.41	3.35	3.05	4.24
United States	10-year	4.41	4.50	4.10	4.23	3.74	3.71	4.99
Canada	BBB - 10-year Gov. spread	1.64	1.27	1.68	1.77	2.01	1.27	2.10
United States	BBB - 10-year Gov. spread	1.24	1.25	1.33	1.47	1.86	1.21	1.86

[1]Europe, Australasia and Far East

Sources: Bloomberg and AMF

NOTE