ECONOMIC VIEWPOINT

What To Watch in 2025

Growing Fault Lines

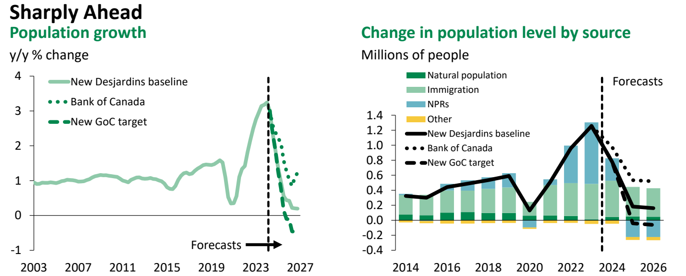
2025 will likely be marked by what Donald Trump will do now that he's headed to the Oval Office for a second term. If the past few weeks are anything to go by, the 47th president and certain members of his inner circle, like Elon Musk, are determined to **overturn the global economic and geopolitical order**. Recent attacks on the sovereignty of Canada, Greenland (and therefore Denmark) and Panama all give reason to fear the worst. The US has been the main guarantor of geopolitical stability since World War II. What would happen if it abandons this role, unilaterally breaks international treaties and conventions, and withdraws from supranational organizations? The resulting rise in instability could worsen economic conditions, hobble markets and investments, and multiply political and economic crises.

Two of the biggest questions are **how big will the scope of Trump's promised protectionist trade policy be, and how quickly will it be implemented?** A number of hypotheses were advanced during and since the election. The rapid implementation of very high tariffs would hit the global economy hard, especially if businesses inside and outside the United States don't have enough time to adjust course. If the new Trump administration takes its time (as his previous administration did in 2017–2018) and the tariffs are more targeted or less severe than expected, the consequences won't be quite so harsh.

If the US applies import tariffs on Canadian goods, it would cause the Canadian economy to slow materially once it's introduced. But until then, Canadian exports could be very strong as US companies look to build up inventories, providing a tailwind to growth. Anecdotes and trade data suggest this is happening. However, given the uncertainty around the timing, level and breadth of tariffs on imports from Canada, this tailwind to growth may not blow for long. We expect some goods, such as energy, to be exempted from levies at the border, but we won't know for sure until after President Trump's inauguration. If energy is exempt from tariffs, Ontario and Quebec will be among the most exposed provinces to US tariffs.

Another headwind on the horizon for Canada is **slower population growth**, as population gains have propelled the economy forward over the past couple of years (graph 1). Lower immigration targets and plans to reduce the number of temporary residents should cause headline real GDP growth to be lower, but real GDP per capita should arrest its decline and begin rising once again. In Quebec, given the weaker-than-average rate of natural increase in the province, new immigration policies may lead to overall population stagnation and potentially a demographic decline in more rural economic regions, many of which have unemployment rates that were still under 4% late last year.

Graph 1
The Canadian Population Boom Has Boosted Demand but May Slow Sharply Ahead

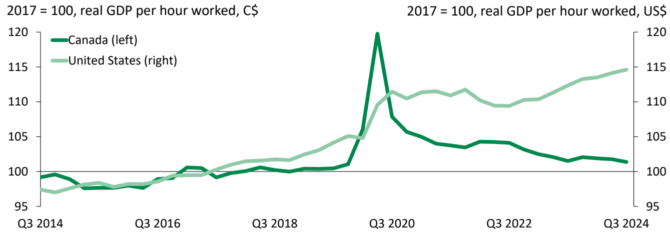


NPRs: Non-permanent residents; GoC: Government of Canada
Note: Annual population is presented on a calendar-year basis.
Government of Canada, Statistics Canada, Bank of Canada and Desjardins Economic Studies

Along with rising real GDP per capita, slower population growth should reverse the trend decline in **labour productivity** that Canada has been contending with since emerging from the pandemic (graph 2 on page 2). This should help to boost real wage gains. However, Canada's productivity problems go well beyond population growth. To meaningfully spur productivity growth in Canada, policymakers should focus on encouraging Canadian companies to adopt new technologies, such as artificial intelligence, and to scale up.

Graph 2
Since the Pandemic, Canadian Productivity Has Significantly Trailed US Productivity

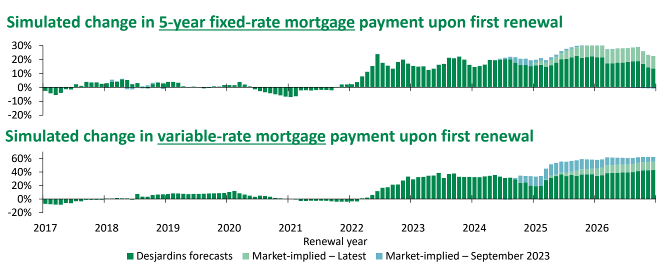
Canada and US business sector labour productivity



Statistics Canada, Bureau of Labor Statistics and Desjardins Economic Studies

To make it a full hat trick of headwinds, many Canadian households that took out **mortgages** in 2020 will see them renewed at higher interest rates in 2025. According to our research, monthly payments could increase by as much as 40%, depending on the type of mortgage (graph 3). This extra mortgage service cost could lead to reduced consumption, compounding the weakness in the consumer sector stemming from slower population growth. Further interest rate cuts by the Bank of Canada this year should help to further mitigate the drag coming from household budgets squeezed by higher mortgage payments.

Graph 3
The Impact of Higher Mortgage Rates at Renewal Is Just Getting Started

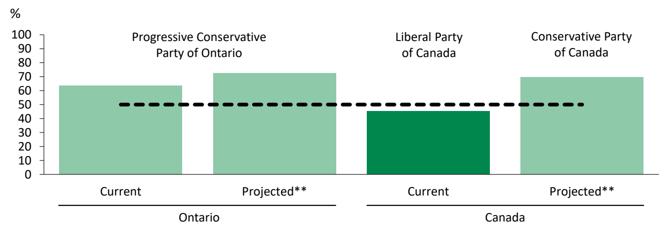


Bank of Canada and Desjardins Economic Studies

One of the few bright spots for growth in 2025 is the boost Canadians will get from the GST/HST holiday that started in mid-December. But the holiday will end in mid-February, leaving the economic impact short-lived. And with parliament now prorogued until March 24, other proposed federal transfers are unlikely to see the light of day. **Speculation about a spring election** abounds, but the fixed election date of October 2025 is the only certainty Canadians have currently as to when the writ will be drawn up. However, until a federal election is out of the way, it is difficult to see how the Government of Canada will contend effectively with a second Trump presidency. Currently, the Conservative Party of Canada leads in polls by a large margin and would win a majority government if an election were to be held today (graph 4). The same is true for Ontario, where there is wide speculation that the Progressive Conservatives will call an election as early as this spring—more than a year ahead of schedule. With polls pointing to an even larger majority if an election were to be held today, the Government of Ontario also intends to send transfers to households in early 2025 and has been very vocal in its opposition to the prospect of US tariffs on Canadian exports.

Graph 4
Elections Are Widely Expected Federally and in Ontario in 2025

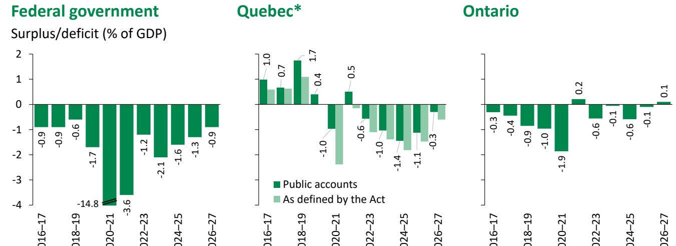
Current and projected post-election seat share*



* Seat projections from 338Canada are used for the possible upcoming Ontario and federal government elections;
** As of January 9, 2025.
338Canada and Desjardins Economic Studies

Although Quebec isn't due for another provincial election until fall 2026, the **Quebec government is legally required to include in its next budget a plan to eliminate its $11 billion deficit** ($8.8 billion if we exclude deposits in the Generations Fund) by 2029–2030. Although the deficit is still manageable, returning to black ink will not be so straightforward. Given uncompetitive income tax rates and an aging population that may stagnate over the coming years, options to tackle the fiscal challenge are limited. In addition, the latest fiscal update didn't factor in a potential trade war or the current uncertainty over the capital gains inclusion rate. In short, even in the best of cases, the Quebec government will be forced to make unpopular decisions to comply with budget legislation, which will weaken economic growth (graph 5). Both the federal and Ontario governments will also work towards balancing their

Graph 5
Budget-Balancing Efforts Will Hold Back Economic Growth



* Must achieve a balanced budget, as defined by the Balanced Budget Act, by 2029–2030; deficits recorded in the public accounts are shown so that we can compare Quebec's deficit with those of Ontario and the federal government.
Public Accounts of Canada and Desjardins Economic Studies

budgets. However, the federal government is not bound by legislative time constraints, and Ontario's deficit is less significant relative to its economy.

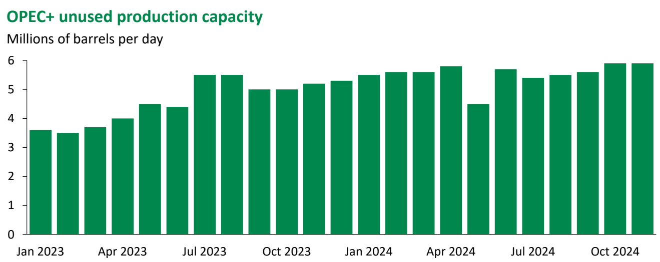
Internationally, Trump has pledged to **end the war in Ukraine** and stop sending military aid within six months of his return to the White House. If his administration succeeds, many of the sanctions against Russia could be lifted quickly. Ending this conflict could ease geopolitical tension and lower oil and gold prices.

As for the energy transition, Trump 2.0 could **significantly affect decarbonization efforts and environmental, social and governance (ESG) policies**. The president-elect has expressed skepticism about climate policy and may try to gut environmental regulations implemented by the previous administration. This may involve withdrawing from the Paris Agreement and reducing tax credits for renewable energy. This could slow progress towards decarbonization and ramp up uncertainty about the environmental regulatory framework. This kind of framework is a critical factor if the world is to achieve a successful energy transition without any painful repercussions like heightened inflation.

Furthermore, additional **natural disasters**, like the recent Los Angeles wildfires, could have severe and unexpected consequences. Aside from the immediate costs of reconstruction, they could disrupt supply chains, lower productivity and result in lost jobs, which would have a lasting impact on the local, national and global economies.

In a world that's already in the midst of an oil glut, any increase in production or decrease in demand could send **oil prices spiralling**. Among the things we're watching, a weaker-than-expected Chinese economy, a broader-than-expected trade war or a surge in US production under the new Trump administration could all significantly lower oil prices as well. And that doesn't even take into account the record unused production capacity of OPEC+. This is equivalent to 5% of global supply (graph 6) and could, on its own, flood the market if the cartel decides to open the pumps.

Graph 6
OPEC+ Has Record Unused Production Capacity

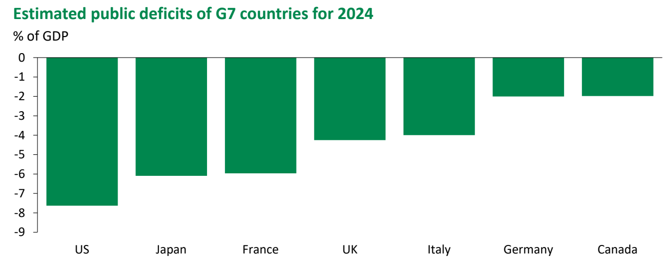


OPEC+: Organization of the Petroleum Exporting Countries and its partners
International Energy Agency and Desjardins Economic Studies

China's economy is undergoing a profound transformation as the central government works to resolve the property, liquidity, debt and confidence crisis that began in 2021. The key question is how it will execute. If stimulus measures prove insufficient or ineffective, any progress could be lost and **conditions in China could worsen**. Yet this may be an opportunity for Chinese authorities to finally address the structural issues affecting the economy, such as industrial policy and extravagant government spending.

Investor patience with sovereign bonds will keep being tested. Aside from monetary policy and economic trends, substantial public deficits could keep bond yields high in some higher-risk countries. Even though the US economy made strong gains in 2024, the public deficit exceeded 7% of GDP (graph 7). The deficits of Japan and France weren't that far behind. Financial conditions in a number of emerging countries could also deteriorate if investor risk appetite wanes. The US dollar's strength creates another challenge for these countries, as it increases the burden of their external debt.

Graph 7
Public Deficits Remain High as We Gear Up for a Tumultuous Year



International Monetary Fund and Desjardins Economic Studies

Which trade and immigration policies the incoming US administration chooses to pursue will have wide-ranging implications for the trajectory of the Canadian economy and, by extension, financial markets. Indeed, the **Bank of Canada** had hoped to slow the pace of rate cuts in 2025, but US trade policy will dictate whether that's possible. While our base case sees it cutting rates in a much more gradual fashion this year, the possibility of an earlier or more aggressive introduction of tariffs makes that a low-conviction call. On another note, the Bank of Canada's mandate with the government will be renewed at the end of the year. While a departure from the Bank's flexible 2% inflation-targeting framework would be surprising, we'll have to keep a close eye on its relations with the government should the Conservatives win the election. Pierre Poilievre has frequently criticized the work of Governor Tiff Macklem and his colleagues.

On the US side, central bankers have already shifted their focus towards upside risks to inflation. The market is now expecting the **Federal Reserve** to cut its policy rate by just 25 basis points by year-end. While the combination of trade, immigration and expansionary fiscal policies could prove to be inflationary, an episode like the one seen post-Covid remains a tail event. Market participants will be paying close attention to the Fed rhetoric around incoming inflation readings and developments on the policy agenda of the president-elect.

Along similar lines, the **Fed's independence** will be closely scrutinized as the year progresses. While the rhetoric from the president-elect has become less inflammatory more recently with regards to the Fed, the erosion of central bank independence is a risk worth monitoring, as it would have wide-reaching implications.

US equity markets outperformed global peers by a blistering 23 percentage points in 2024. That performance coincided with a record compression in breadth, with most of the gains in US large caps attributed to a handful of companies. This has been reflected in correlations, with the one-year implied correlation for US equities at the lowest levels on record. Historically, periods of compressed breadth have been associated with future equity drawdowns, but such a selloff would still require a catalyst. While monthly economic data remains a candidate, trade, immigration and fiscal policies could be another source of volatility in equity markets over the coming year. The performance of those few stocks that drove returns in 2024 will be vital to the overall market's performance in 2025.

Watch these four key factors for the **Canadian dollar**:
1) Canada's productivity growth lag vs. the US, 2) the mortgage renewal wall possibly leading to BoC rate cuts, 3) US tariffs, and 4) commodity prices. Most of them could lead to additional depreciation for the CAD beyond what is already priced in or forecast, but the extent depends largely on what actually happens with trade policy and political conditions internationally and in Canada.