

Economic and Financial Review

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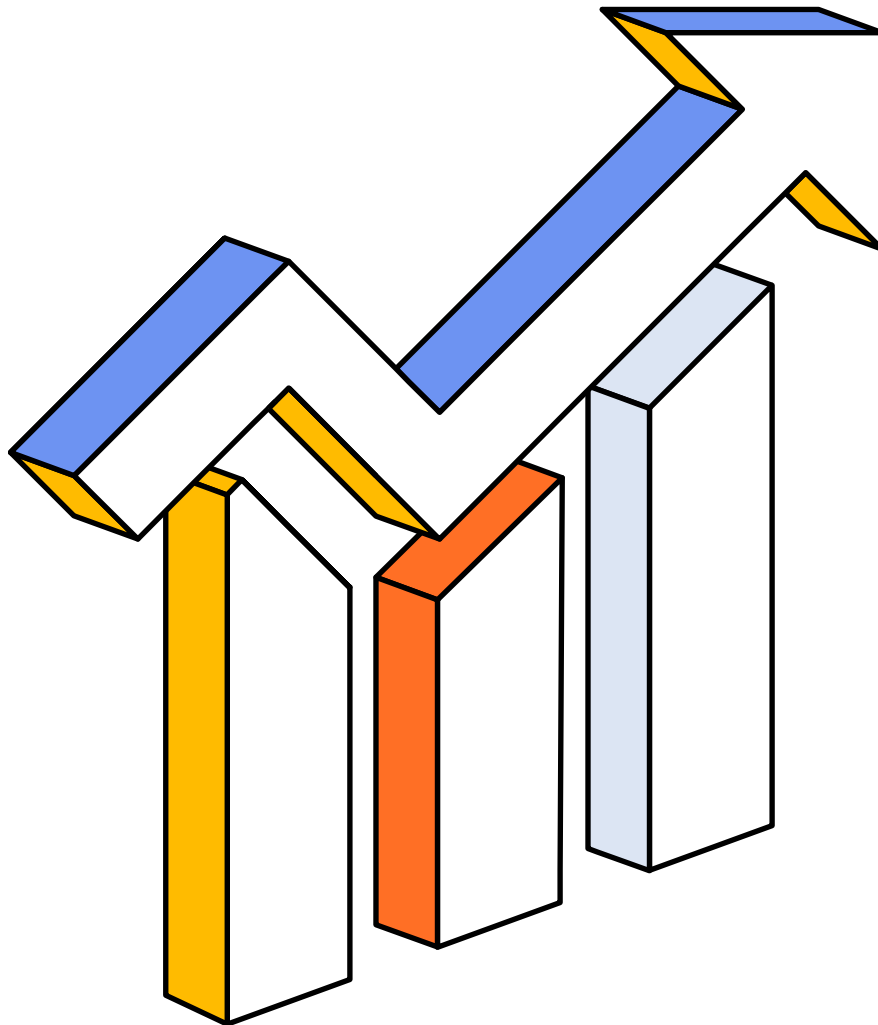


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Highlights

- As soon as Donald Trump returned to power, his new administration quickly launched an all-out trade war, imposing sweeping tariffs on all the United States' trading partners, adversaries and allies alike.
- The tariffs brought chaos and uncertainty to the economy and markets, driving down business and consumer confidence and increasing the risk of stagflation. Unpredictability is adversely affecting business conditions and causing companies to put off hiring and investment decisions or relocate production to the United States.
- The U.S. economy continues to be resilient despite GDP declining in the first quarter owing to a substantial negative contribution from net exports. Companies ramped up imports in order to build up inventories before prohibitive tariffs came into effect.
- In Canada, trade tensions with the United States are weighing on consumer and business confidence and dragging down the economy. Canada has so far avoided the highest tariffs but is still subject to steel, aluminum and automobile tariffs as well as tariffs related to fentanyl trafficking and illegal migration.
- Since the start of the year, the financial markets have been highly volatile in the face of uncertainty stemming from the trade war and the growing risk of stagflation. For the first time in many years, U.S. indexes fared worse overall than other main indexes, particularly European indexes.

| | Real GDP | | | Inflation | | | Unemployment Rate | | |
|----------------------|----------|-------|-------|-----------|-------|-------|-------------------|-------|-------|
| % change | 2024 | 2025f | 2026f | 2024 | 2025f | 2026f | 2024 | 2025f | 2026f |
| United States | 2.8 | 1.4 | 1.5 | 3.0 | 3.2 | 2.8 | 4.0 | 4.4 | 4.5 |
| Euro area | 0.9 | 0.8 | 1.1 | 2.4 | 2.1 | 1.9 | 6.4 | 6.4 | 6.4 |
| Canada | 1.5 | 1.2 | 1.0 | 2.4 | 2.2 | 2.1 | 6.4 | 6.8 | 6.8 |
| Québec | 1.4 | 0.7 | 0.7 | 2.3 | 2.0 | 2.1 | 5.4 | 6.2 | 6.2 |

f: forecast

Sources: Bloomberg and AMF

World

As soon as Donald Trump returned to power, his new administration quickly launched an all-out trade war, imposing sweeping tariffs on all U.S. trading partners, adversaries and allies alike. Washington imposed steel and aluminum and automobile tariffs, a universal 10% tariff and higher reciprocal tariffs (later suspended for 90 days). Tariff escalation between the United States and China, the world's two largest economies, went on for more than a month, with tariffs in excess of 100% being imposed by both sides, and was not diffused until the month of May. Other tariffs on goods such as pharmaceuticals, semiconductors, lumber and copper are being considered.

Canada and Mexico have so far avoided the most extreme reciprocal tariffs but are still subject to steel, aluminum and automobile tariffs as well as tariffs related to fentanyl trafficking and illegal migration. To date, only China and Canada have taken retaliatory action, with other countries preferring to give negotiations a chance before pushing back.

The tariffs brought chaos and uncertainty to the economy and markets, driving down business and consumer confidence and increasing the risk of stagflation. Faced with volatile markets and pressure from business leaders, the White House was forced to pause certain tariffs and grant exemptions to mitigate their impact on the electronics and automotive sectors, among others. The United States is now attempting to negotiate favourable trade agreements with dozens of countries in a 90-day period. An example of such an agreement was reached with the United Kingdom in early May.

The persistent threat of punitive, sectoral, reciprocal and universal tariffs is weighing on the Canadian and global economies. The resulting unpredictability is adversely affecting business conditions and prompting businesses to put off hiring and investment decisions or relocate production to the United States. Uncertainty is also

making Canada less attractive to foreign investors, with access to the U.S. markets no longer entirely guaranteed.

The target that Canada must reach to avoid tariffs has turned out to be highly subjective and moving. American demands could end up extending beyond fentanyl trafficking and illegal migration to include military spending, supply management (dairy products, eggs, poultry), the digital service tax, access to the banking sector, and water, among others. The United States may continue to wield the threat of tariffs until, and even after, the Canada-United States-Mexico Agreement is renegotiated.



As a result of the trade war, U.S. GDP was down 0.3% in the first quarter. Companies ramped up their imports to build up their inventories before prohibitive tariffs came into effect. Statistical distortions are masking the resilience of the U.S. economy, with consumer spending and investment holding relatively firm. The labour market also remains strong, with 177,000 jobs created in April and the jobless rate remaining steady at 4.2%.

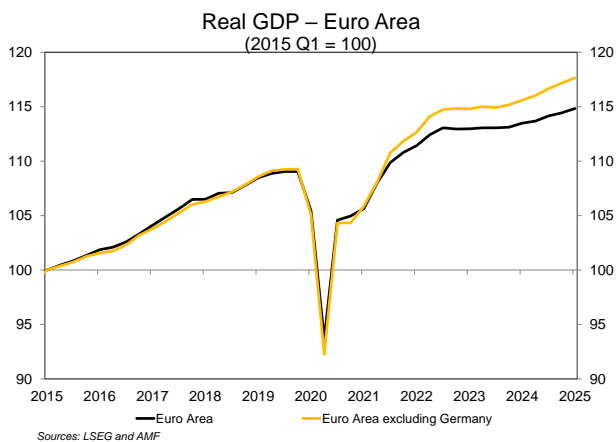
The Federal Reserve has kept its key policy rate within a range of 4.25%-4.50%, unchanged since the beginning of the year. Although the effects of the trade war are starting to be felt, economic growth has not slowed enough yet to warrant monetary easing.

The U.S. economy is creating jobs at a solid pace, unemployment is down and inflation, at 2.3% in April, remains above the 2% target. The

Fed indicated that the risk of unemployment and inflation rising again has increased owing to higher tariffs.

The euro area posted annualized growth of 1.4% in the first quarter of 2025, compared with 1.0% in the last quarter of 2024. However, this acceleration occurred before U.S. tariffs on Europe were announced in April and therefore could be short-lived.

For the past few years, Germany has been a damper on euro area growth. Indeed, Europe's manufacturing powerhouse and largest economy has posted slower growth than the other 19 members of the euro area.



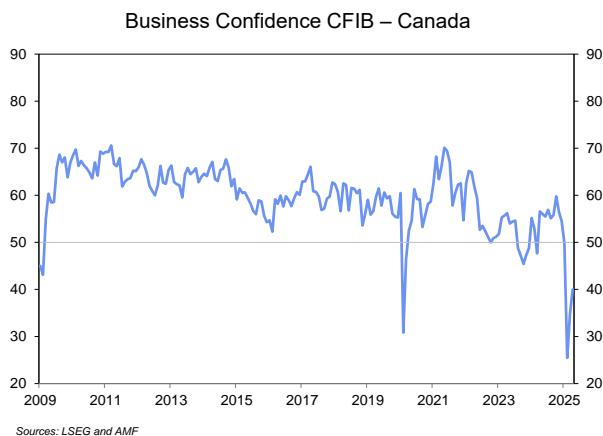
The European Central Bank has lowered its key policy rate three times since the beginning of the year, setting it at 2.25% in April. Inflation stood at 2.2% in April, close to the CEB's 2% target, and the economic growth outlook remains moderate. In March, the central bank trimmed its growth forecasts to 0.9% for 2025.

Lastly, China maintained an annual growth rate of 5.4% in the first quarter. On the front lines of the trade war with the United States, the country nonetheless lowered the reserve requirement ratio for banks and injected liquidity into the banking sector to support its economy. In addition to grappling with U.S. tariffs, the world's second largest economy is struggling with weak domestic demand and an extended real estate sector crisis.

China has also sought to diversify trading partners in order to reduce its dependence on the United States and appears to have succeeded in doing so. Chinese exports registered very strong year-over-year growth of 8.1% in April, with declining trade with the United States being more than offset by increasing trade with South-east Asia and Europe.

Canada

In Canada, the uncertainty arising from the United States-conducted trade war is weighing on consumer and business confidence and dragging down the economy. Consumption, residential real estate and business spending are starting to feel the whiplash.



Trade tensions are also impeding recovery of the labour market and businesses are signaling that they intend to hire fewer people. Moreover, the labour market has slowed this year and has even declined slightly in the past three months.

It was expected that GDP growth in the first quarter would be boosted by net exports as a result of U.S. customers frontloading their orders owing to concerns about the impact of tariffs on the prices on products imported from Canada. However, this frontloading of orders is merely shifting economic activity from one period to another and will shave a few points off economic growth in the following quarters.

Demand for housing has already weakened since the beginning of the year, despite looser borrowing conditions. Home sales are down and housing prices are declining everywhere, except Québec.

Residential activity is very sensitive to fluctuations in economic conditions, employment and interest rates. Should the Canadian economy slow significantly, this segment of domestic demand would be among those most affected.

Inflation stood at 1.7% in April. Recent variations in the CPI are due to the one-time effects of the end of the GST break granted by the Trudeau government and the scrapping of the carbon tax. Eventually, tariffs and supply chain disruptions will push up certain prices.

The magnitude of such upward pressures on inflation will depend on developments in the trade war, the tariffs imposed and the ability of businesses to adapt to the new environment. It will also depend on the extent to which price increases are passed on to consumers. Since the economy is still in a position of excess supply, businesses may be forced to absorb a portion of the cost increases and squeeze profit margins.

There is a very good chance that this trade war will plunge the Canadian economy into a recession. However, the economic outlook is facing an unusual degree of uncertainty owing to the U.S. administration's continual, unpredictable reversals on trade policy.

This highly unpredictable environment is complicating the work of decision makers at the Bank of Canada because it is difficult to predict how much U.S. tariffs and possible retaliatory measures will depress economic activity and push up consumer prices.

Québec

After slowing in 2023, Québec's economy picked up in 2024, posting GDP growth of 1.4%. Economic growth was expected to continue this year, driven by lower interest rates and the relatively sound financial health of consumers.

However, momentum may be dampened by the trade war with the United States and the resulting climate of uncertainty. This reversal will negatively impact business investment and hiring and presents a major risk for Québec's economy.

Shrinking overall demand for goods and services could lead to some investment projects being postponed or cancelled. Businesses may also decide to relocate some of their operations to avoid the impact of tariffs on their U.S. order book.

Like Ontario, Québec will be hit harder by the tariffs than Canada as a whole owing to tariff differentiation, the intensity of trade with the United States and the export mix.

The labour market's recovery, which began in the summer of 2024, has been idling for several months. In April, the unemployment rate stood at 6.0%, up from an average of 5.3% in 2024 and 4.4% in 2023.



Sources: LSEG and AMF

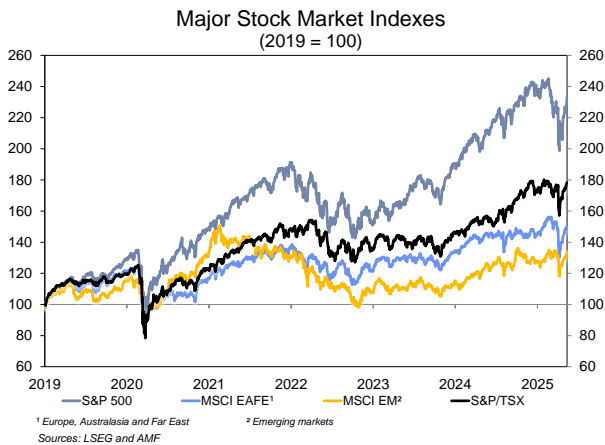
The Government of Québec is projecting a deficit of \$13.6 billion for 2025-2026. It is also projecting that deficits will gradually be reduced by the end of the decade, until the budget is close to balanced. It plans to achieve this

through more moderate spending growth, among other things. Consequently, the contribution of government spending to GDP growth is expected to shrink in the coming years and to have a more modest effect on economic growth.

Financial markets

Since the start of the year, the financial markets have been highly volatile in the face of uncertainty stemming from the trade war and the growing risk of stagflation. Stock markets were up at the start of the year, but then quickly posted losses following the Trump administration's tariff announcements, particularly those on April 2 concerning reciprocal tariffs.

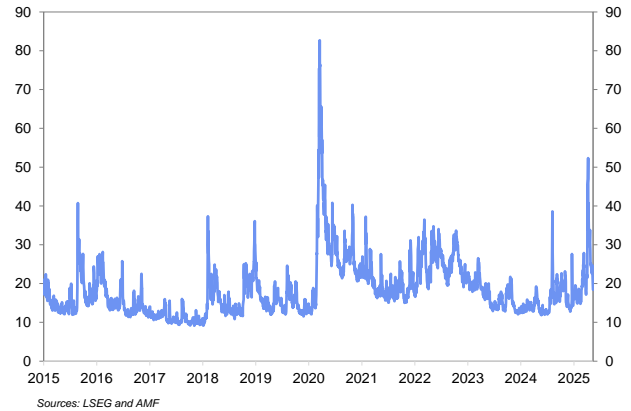
The year ended with the MSCI All Country World Index posting a slight gain of approximately 1% since the start of the year. Uncertainty related to the trade war also resulted in significant foreign exchange rate, bond yield and raw material price volatility.



In the United States, the S&P 500 is down about 1% this year. For the first time in years, U.S. indexes fared worse overall than the other major indexes, particularly those in Europe. U.S. stock markets were hit particularly hard by the imposition of (quickly suspended) reciprocal tariffs. In the days following the tariff announcement, U.S. indexes were in free fall and volatility reached highs not seen since the COVID-19 shock in 2020.

From peak to trough, the S&P 500 fell 19%, and the NASDAQ, 24%, only to almost fully recover after a pause on reciprocal tariffs was announced and tensions between the United States and China abated.

S&P 500 Index Volatility (VIX)



The Canadian stock markets outperformed their U.S. counterparts year over year, with the S&P/TSX up a slight 3%. The Canadian index was boosted by the significant increase in gold prices, reflecting gold's status as a reliable safe haven. This increase buoyed the Materials sector, which accounts for approximately 14% of the S&P/TSX's capitalization. TSX-listed Québec companies exhibited mixed performance amid trade tensions. The Morningstar National Bank Québec Index has declined 1% since the start of the year, pulled down by the Industrials sector.

Overall, major stock markets elsewhere in the world also outperformed the U.S. indexes. Major indexes outside the U.S. started the year with significantly lower valuations and appear to have been less impacted by uncertainty related to the trade war.

Meanwhile, bond yields fluctuated. Yields for U.S. government bonds, considered the safest asset in the world, surged on news of reciprocal tariffs, reaching 4.50% in mid-April for 10-year bonds, while the U.S. dollar continued the decline that started from the beginning of the year.

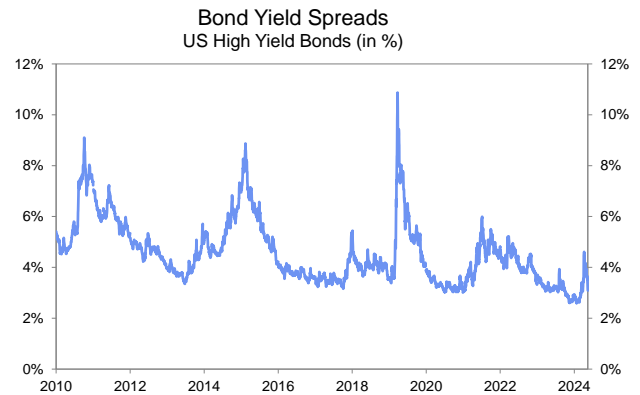
U.S. bond yields generally decline during periods of financial stress owing to increased investor demand for safe assets. The rise in U.S. bond yields was due to higher inflation expectations, greater demand for liquidity, and the reallocation of portfolios away from the United States.

Some concerns have also begun to surface regarding the status of U.S. government bonds as the ultimate safe haven, although that status seems unlikely to change in the foreseeable future. Recently, U.S. bond yields declined slightly, reflecting a slight de-escalation of the trade war.

Canadian bond yields have not moved significantly since the start of the year. They remain well below U.S. bond yields, reflecting the relative weakness of the Canadian economy. Government of Canada 10-year yields are at around 3.20%, well below their U.S. counterparts. The Bank of Canada cut its policy rate far more drastically than its U.S. counterpart. Since the peak observed in 2024, it has lowered its policy rate 225 basis points, to 2.75%, compared with a range of 4.25% to 4.50% for the Fed.

In Québec, S&P Global downgraded the Government of Québec's credit rating from AA- to A+, citing persistent operating deficits, which could put upward pressure on the province's borrowing costs.

Growing fears of a recession have also been weighing on the corporate bond market, with high-yield U.S. corporate bond spreads widening significantly since the start of the year.



Sources: Federal Reserve Economic Data (FRED) and AMF

The ongoing trade war will continue to generate a high degree of uncertainty in financial markets. The actions of the U.S. administration are very unpredictable, and the expected economic slowdown will dampen investor confidence. Market volatility is expected to continue in the coming quarters.

Bear markets: From peak to trough to peak again

Last April, the S&P 500 narrowly avoided a bear market (i.e., when closing prices drop at least 20% from peak to trough). How did recent Canadian and U.S. bear markets play out? What lessons can be learned from them?

The S&P/TSX and S&P 500 bear markets differ in magnitude, duration and cause, but historically they share a common pattern: they climb back again and reach new heights. Below is a snapshot of S&P 500 index and S&P/TSX index bear markets since 1969.

| Recent S&P/TSX Bear Markets | | | | |
|--|--|---|--------------------------------------|--|
| Event (bear market) | Decline (from previous peak to trough) | Period from start of decline to return to initial level | Performance in year following trough | Performance during the stock market recovery |
| Vietnam War (May 1969 to May 1970) | -29% | 3 years | 25% | 68% over 3 years |
| Oil Embargo (October 1973 to December 1974) | -37% | 5 years | 14% | 182% over 6 years |
| 2nd oil shock and the fight against inflation (November 1980 to July 1982) | -44% | 2 years | 84% | 205% over 5 years |
| October 1987 Crash - Black Monday (August to October 1987) | -31% | 6 years | 20% | 176% over 10 years |
| Failure of the LTCM hedge fund and the emerging markets crisis (April to October 1998) | -32% | 2 years | 32% | 113% over 2 years |
| Dot-com bubble (September 2000 to October 2002) | -50% | 5 years | 33% | 165% over 6 years |
| Housing bubble and financial crisis (June 2008 to March 2009) | -50% | 6 years | 58% | 107% over 5.5 years |
| Oil price plunge (September 2014 to January 2016) | -24% | 2.5 years | 30% | 52% over 4 years |
| Public health crisis (COVID-19) (February to March 2020) | -37% | 1 year | 68% | n/a |
| AVERAGE: | -36% | 4 years | 43% | 128% over 5 years |

| Recent S&P 500 Bear Markets | | | | |
|--|--|---|--------------------------------------|--|
| Event (bear market) | Decline (from previous peak to trough) | Period from start of decline to return to initial level | Performance in year following trough | Performance during the stock market recovery |
| Vietnam War (November 1968 to May 1970) | -36% | 3 years | 44% | 74% over 3 years |
| Oil Embargo (January 1973 to October 1974) | -48% | 8 years | 38% | 125% over 6 years |
| 2nd oil shock and the fight against inflation (November 1980 to August 1982) | -27% | 2 years | 58% | 229% over 5 years |
| October 1987 Crash - Black Monday (August to December 1987) | -34% | 1 year | 21% | 582% over 12 years |
| Dot-com bubble (March 2000 to October 2002) | -49% | 7 years | 34% | 101% over 5 years |
| Housing bubble and financial crisis (October 2007 to March 2009) | -57% | 6 years | 69% | 401% over 11 years |
| Public health crisis (COVID-19) (February to March 2020) | -34% | 6 months | 75% | 114% over 2 years |
| Russia-Ukraine War (January to October 2022) | -25% | 2 years | 22% | n/a |
| AVERAGE: | -39% | 4 years | 45% | 196% over 6 years |

Daily closing prices were used to complete the table. Dividends paid were not taken into account. Doing so may have reduced the duration of the downturns and increased the returns indicated.

Sources: LSEG and AMF (Figures are as at May 1, 2025)

The following observations can be made based on the above data:

- After the S&P/TSX and the S&P 500 reach their lowest point, the bull market that follows lasts an average of 5 to 6 years.
- Since 1969, the indexes considered can take up to 8 years to return to their previous highs.

Like all stock markets, the S&P/TSX and the S&P 500 are unpredictable. They tend to move in the same direction but may diverge significantly. Their behaviour cannot be predicted, but one thing is for certain: historically, after reaching a low, they recover and reach new highs.

Market Performance

| Stock Markets | | | | | | | | |
|---------------|---|------------|----------|-----------|-----------|---------|----------------|--------|
| | | Level | | % change | | | Last 12 months | |
| | | 2025-05-12 | 1 month | 3 months | 6 months | 1 year | Min. | Max. |
| | MSCI All Country World Index | 1,041 | 9.59 | -2.37 | 0.03 | -1.49 | 900 | 1,081 |
| | MSCI EAFE¹ | 1,579 | 11.03 | -0.78 | 5.57 | 3.03 | 1,370 | 1,614 |
| | MSCI Emerging Markets | 71,551 | 8.68 | 1.93 | 3.96 | 2.67 | 63,205 | 72,137 |
| | S&P 500 | 5,844 | 8.97 | -3.43 | -2.34 | -3.42 | 4,983 | 6,144 |
| | S&P/TSX | 25,532 | 8.24 | -0.12 | 2.44 | 0.48 | 22,507 | 25,808 |
| | Morningstar National Bank Québec Index | 486 | 8.39 | 1.71 | -0.56 | -3.48 | 429 | 503 |
| Bond Markets | | | | | | | | |
| | | Level | | % change | | | Last 12 months | |
| | | 2025-05-12 | -1 month | -3 months | -6 months | -1 year | Min. | Max. |
| | Québec | | | | | | | |
| | 10-year | 3.87 | 3.95 | 3.76 | 3.88 | 3.72 | 3.44 | 4.12 |
| | Canada | | | | | | | |
| | 10-year | 3.21 | 3.26 | 3.18 | 3.27 | 3.14 | 2.83 | 3.54 |
| | United States | | | | | | | |
| | 10-year | 4.47 | 4.49 | 4.63 | 4.43 | 4.33 | 4.00 | 4.79 |
| | Canada | | | | | | | |
| | BBB - 10-year Gov. spread | 1.42 | 1.60 | 1.42 | 1.43 | 1.35 | 1.33 | 1.61 |
| | United States | | | | | | | |
| | BBB - 10-year Gov. spread | 1.24 | 1.37 | 1.07 | 1.06 | 1.04 | 1.01 | 1.44 |

¹Europe, Australasia and Far East
Sources: Bloomberg and AMF

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