

Retail Rate Forecasts

January 22, 2009

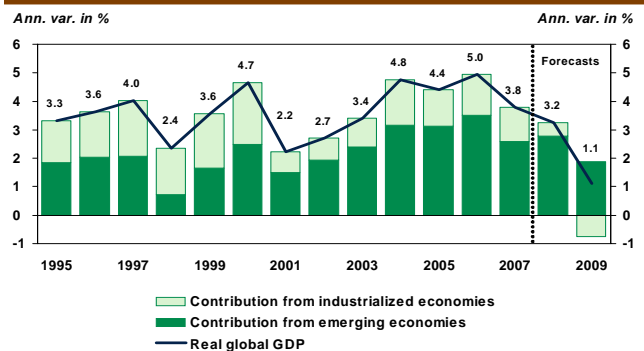
Interest rates continue to pull back

HIGHLIGHTS

- A global recession is being confirmed with ongoing disappointment from the economic statistics.
- Key rates are nearing zero and will remain very low for a very long time.
- Retail rates have dropped once again.
- The Canadian dollar could test its November low.
- The year-end stock market rally does not augur an immediate return to a bull market.

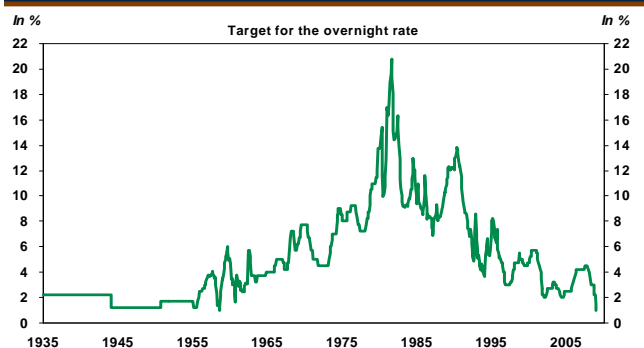
- **The economic outlook grows gloomier still.** The economic statistics remained disappointing in the last few weeks. A worldwide recession is being confirmed for 2009, with global growth likely to be only 1.1% (graph 1). Like almost all of the industrialized nations, the economies of the United States, Canada, Québec and Ontario will not be able to avoid contracting this year.
- **Economic stimulus measures proliferate.** Monetary and government authorities are doing everything in their power to limit the recession's scope and length. After taking their key rates close to zero, some of the major central banks, including the Federal Reserve, are increasingly turning toward direct injections of liquidity and purchasing financial securities to try to kick start the credit market and economic activity. Around the globe, governments are also announcing massive economic stimulus plans in addition to the efforts that have already been made to ensure the stability of financial institutions.
- **The Bank of Canada (BoC) cut its key rates by 50 basis points in January, to an historic low of 1 % (graph 2).** The BoC expects Canada's economy to contract until mid-2009, leading to a 1.2% pullback in Canada's real GDP this year.
- **Key rate cuts are not over.** Even though the BoC is being optimistic, anticipating a strong economic recovery in 2010, we think it will have to go further with monetary easing. Inflation is already forecast to temporarily move into negative territory in the first half of 2009, and the risks to Canada's economy are still clearly tilted to the downside. An additional 50 basis point cut should thus be ordered in March, to limit the recession's severity in Canada.

Graph 1 – The global recession is being confirmed



Sources: International Monetary Fund, Consensus Forecasts and Desjardins, Economic Studies

Graph 2 – The BoC has lowered its key rate to the lowest point ever recorded



Sources: Bank of Canada and Desjardins, Economic Studies

François Dupuis
Vice-President and Chief Economist

Yves St-Maurice
Director and Deputy Chief Economist

Mathieu D'Anjou
Senior Economist

Martin Lefebvre
Senior Economist

Hendrix Vachon
Economist

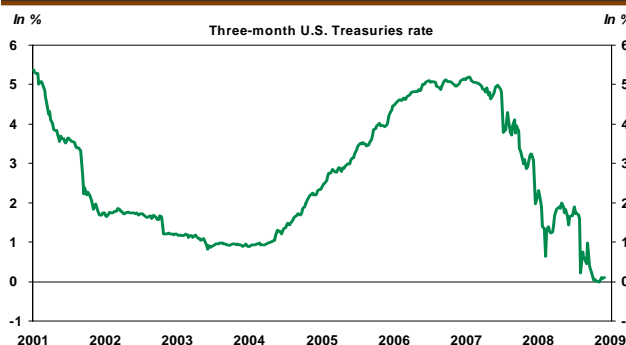
514-281-2336 or 1 866 866-7000, ext. 2336
E-mail: desjardins.economics@desjardins.com

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

IMPORTANT: This document is based on public information, obtained from sources that are deemed to be reliable. Desjardins Group in no way guarantees that the information is complete or accurate. The document is provided solely for information purposes and does not constitute an offer or solicitation for purchase or sale. The document may under no circumstances be construed as a commitment by Desjardins Group, which takes no responsibility for the consequences of any decision made based on the information herein. The prices and rates shown are for information purposes only as they may change at any time based on market conditions. Past returns are no guarantee of future performance, and Desjardins Group does not hereby purport to provide any investment advice. The opinions and forecasts contained herein are, unless otherwise indicated, those of the document's authors and do not represent the official position of Desjardins Group. Copyright © 2009, Desjardins Group. All rights reserved.

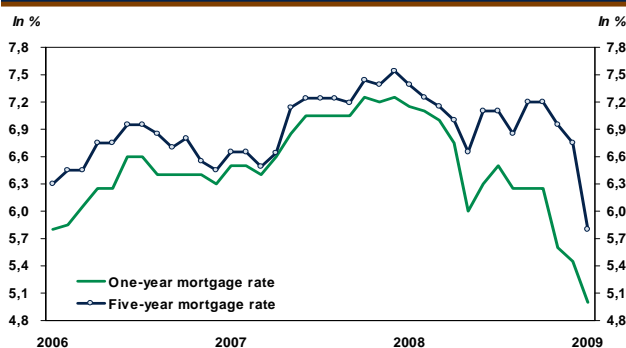
- **Bond rates continued to decline.** Resurfacing fears of deflation (that is, a widespread decline in consumer prices), once again increased the appeal of government bonds. Recently, investors even agreed to buy U.S. Treasuries that offered no yield (graph 3). Rates on Canadian bonds have thus declined to lows that date back several decades.
- **Further substantial drops in mortgage rates in January.** Despite extreme financial strain, retail rates fell substantially in 2008 and in early 2009. The one-year mortgage rate thus went from 7.25% at the end of 2007 to 5.00 % now, while the five-year rate went from 7.55% to 5.80% (graph 4). Monetary stimulus and the tumble in bond rates are therefore helping borrowers, even though financial institutions had to raise the premiums they demand to offset the increase in their financing costs. The rates paid on term savings have also plummeted.
- **Very low retail rates in 2009.** The economic and financial context suggests that retail rates could go down a little lower in the coming months. After that, a modest economic recovery and reduced turmoil in the financial markets should limit 2010's ascent of retail rates.

Graph 3 – Investors agree to finance the U.S. government almost free of charge



Sources: Datastream and Desjardins, Economic Studies

Graph 4 – Mortgage rates have pulled back substantially in recent months



Sources: Datastream and Desjardins, Economic Studies

Table 1
Forecasts : Retail rate

	Discount rate (1)	Prime rate (1)	Mortgage rate (1)			Term savings (1) (2)		
			1 year	3 years	5 years	1 year	3 years	5 years
Realized – End of month								
July 2008	3.25	4.75	6.50	7.00	7.10	2.25	2.85	3.20
August 2008	3.25	4.75	6.25	6.35	6.85	2.25	2.85	3.20
Sep. 2008	3.25	4.75	6.25	6.70	7.20	2.25	2.85	3.20
Oct. 2008	2.50	4.00	6.25	6.70	7.20	2.25	2.85	3.20
Nov. 2008	2.50	4.00	5.60	6.30	6.95	1.90	2.25	2.60
Dec. 2008	1.75	3.50	5.45	6.20	6.75	1.20	2.25	2.60
Jan. 22, 2009	1.25	3.00	5.00	5.75	5.80	1.20	2.25	2.60
Forecasts – End of quarter								
2009: Q1	0.50–1.00	2.25–2.75	4.60–5.00	5.40–5.75	5.45–5.80	0.70–1.20	1.80–2.25	2.05–2.55
2009: Q2	0.50–1.00	2.25–2.75	4.50–5.00	5.25–5.75	5.30–5.80	0.55–1.05	1.65–2.15	1.90–2.40
2009: Q3	0.50–1.00	2.25–2.75	4.50–5.00	5.25–5.75	5.30–5.80	0.50–1.00	1.45–1.95	1.75–2.25
2009: Q4	0.50–1.00	2.25–2.75	4.50–5.00	5.25–5.75	5.30–5.80	0.50–1.00	1.45–1.95	1.75–2.25
2010: Q1	0.50–1.00	2.25–2.75	4.50–5.00	5.35–5.85	5.45–5.95	0.50–1.00	1.45–1.95	1.75–2.25
2010: Q2	0.50–1.00	2.25–2.75	4.65–5.15	5.40–5.90	5.50–6.00	0.55–1.05	1.45–1.95	1.75–2.25
2010: Q3	1.00–1.50	2.75–3.25	4.85–5.35	5.45–5.95	5.65–6.15	0.75–1.25	1.45–1.95	1.95–2.45
2010: Q4	1.50–2.00	3.25–3.75	4.95–5.45	5.65–6.15	6.05–6.55	1.05–1.55	1.85–2.35	2.45–2.95

Note: Forecasts are expressed as ranges. (1) End of quarter forecasts; (2) Non-redeemable (annual).

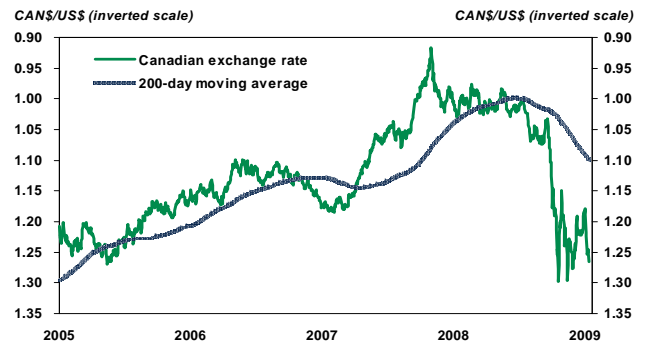
Source: Desjardins, Economic Studies

CANADIAN DOLLAR

The loonie could test its November low

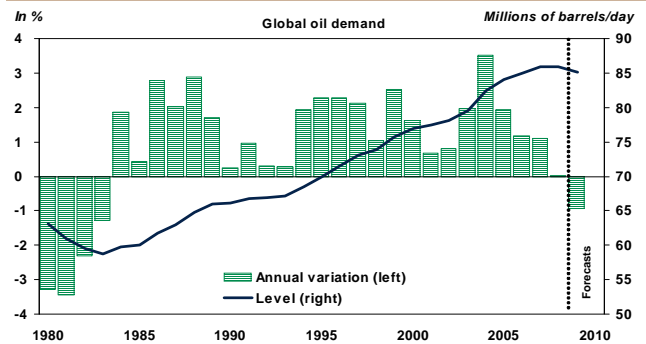
- Due to the greenback correction, and then the climb in oil prices, the loonie was able to keep its head above water at the end of December and in early January; now, the wind seems to be changing for Canada's dollar. After hitting a recent low under C\$1.18 on January 6, the USD/CAD is approaching quickly C\$1.30 (graph 5).
- Over the short term, for the loonie, the risks are still tilted to the downside. Given the evidence that the recession has begun, the Bank of Canada moved ahead with monetary easing, lowering its rate target to just 1.00% in January. The door is also open to further rate cuts. Monetary measures will likely be combined with a fiscal plan. The federal Finance Minister is now planning the biggest budget in Canada's history, with a deficit of almost C\$40B.
- And, although oil prices seem to be at excessively low levels, soft global demand for commodities and the growing risk of a severe global recession remain a heavy drag on crude prices. The Energy Information Administration now expects oil demand to decline by 0.9% in 2009 (graph 6).
- Over the longer range, however, the financial turmoil will largely have been resolved and, potentially, an increase in demand could translate into rapid increases in prices for natural resources. This could only be intensified by the many infrastructure economic recovery plans being put forward around the world.
- **Forecasts:** The pressure is still to the downside, and the greenback could easily come back to almost C\$1.30 shortly.

Graph 5 – Canadian dollar and trend



Sources: Datastream and Desjardins, Economic Studies

Graph 6 – Oil consumption is expected to drop sharply in 2009



Sources: Datastream, Energy Information Administration and Desjardins, Economic Studies

Determinants	Short-term	Long-term
Oil prices	↓	↑
Metals prices	↓	↑
Interest rates spreads (Canada - United States)	↓	↑

Table 2
Forecasts: currency

End of period	2008		2009				2010			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
CAN\$/US\$	0.9407	0.8204	0.7700	0.8000	0.8600	0.8800	0.9000	0.9200	0.9500	1.0000
US\$/CAN\$	1.0630	1.2189	1.2987	1.2500	1.1628	1.1364	1.1111	1.0870	1.0526	1.0000
CAN\$/euro	1.4931	1.6943	1.6234	1.5250	1.4535	1.4773	1.4722	1.4761	1.4642	1.4240
US\$/euro	1.4047	1.3901	1.2500	1.2200	1.2500	1.3000	1.3250	1.3580	1.3910	1.4240
US\$/£	1.7825	1.4378	1.4500	1.5000	1.5500	1.6000	1.6500	1.7000	1.7500	1.8000

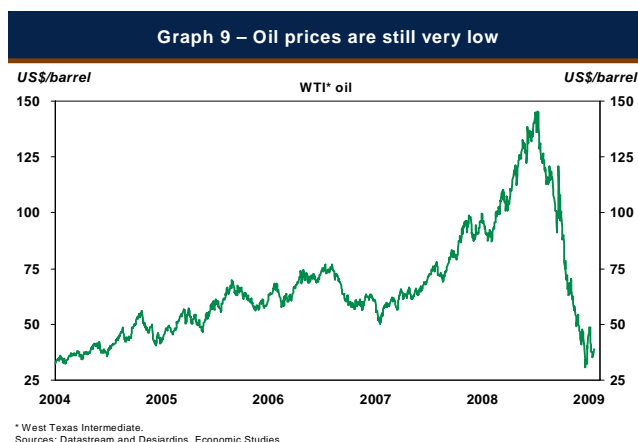
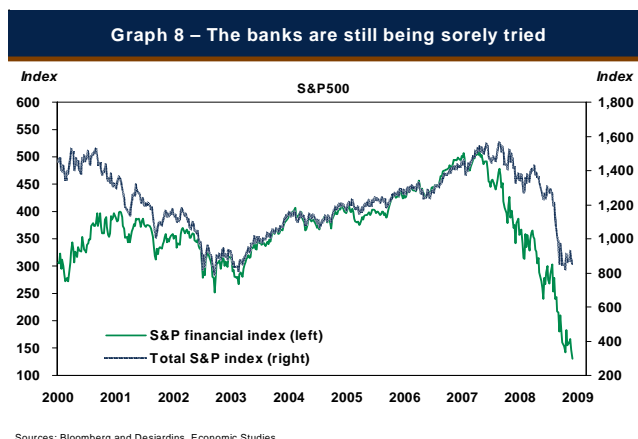
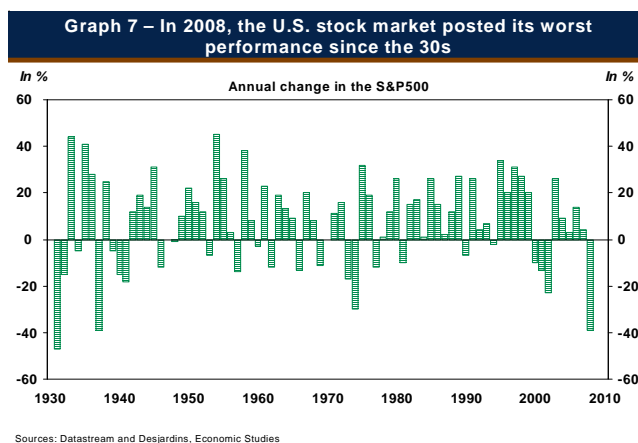
Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies

f: forecasts

ASSET CLASSES RETURN

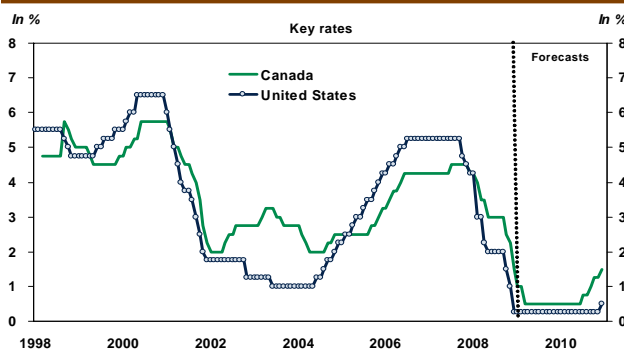
The economic situation will continue to affect risky assets in the short term

- Investors benefited from a year-end rally.** 2008 closed on a slightly better note when a little rise in optimism drove the stock indexes up sharply at the end of December. After sliding below 7,650 points in November, the S&P/TSX index ended 2008 very close to 9,000 points. Despite this rise, Canada's stock market lost over 30% of its value in 2008. The stock market collapse affected the whole world and, last year, the S&P500 saw its biggest decline since the 30s' (graph 7). The decline in bond rates combined with a temporary easing in the financial strains also allowed Canada's bond market to end the year off well, taking its annual return to 6.4%.
- Market confidence is still very shaky.** In our opinion, the stock market spike at the end of 2008 should not be read as evidence that the market problems are over. Such rallies are normal in major stock market corrections, and the indexes have returned to a down trend since 2009 began. Even though the indexes' current levels already reflect a very grim scenario, the economic outlook and ongoing deterioration by corporate earnings, especially in the financial sector (graph 8), will be a heavy drag on the stock markets in the short run. We still expect the markets to fluctuate close to current levels over the next few months, and they could even test their November 2008 low.
- Pressure on commodity prices is still to the downside.** The deterioration in the global economic outlook is also being reflected in commodity prices, which have continued to slide in recent months. Oil prices are holding near US\$40/barrel (graph 9), even though the Organization of Petroleum Exporting Countries (OPEC) has announced a big production cut. Although prices for a number of commodities have now fallen to unsustainable levels that threaten future supply, soft demand should prevent a sharp surge in prices before the second half of 2009.
- Key rates will hold close to zero for a long time.** Key rates have now finished coming down in the United States and the end is in sight in Canada. However, the central banks still have work to do; more action will be needed to limit the impacts of the recession and support the financial system. Along with continuing to directly inject liquidity into the economy, Canadian and American monetary authorities will want to signal that they will keep key rates low for a long time to enhance the monetary policy's stimulating effect. Monetary firming should therefore not begin until mid-2010 (graph 10).
- Bond rates will also remain very low.** Key rates at almost zero, the recessionary environment and nonexistent inflation pressure are all factors that should keep bond rates very low over the next quarters (graph 11). Ongoing and substantial financial strains will also favour government securities in the next few months. The return potential, however, seems very low today for investors who opt for

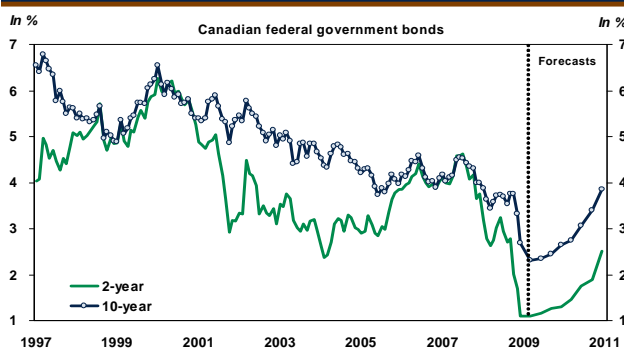


federal bonds. Larger gains could be recorded for other good quality bonds which, sooner or later, will benefit from the easing of financial strains.

- **The stock market should start a true ascent in the second half of 2009.** While the next few months could be tough for risky assets, the conditions should be met for a return to an up trend in the second half of the year. At that time, the many actions taken by authorities should start to stabilize the global economy and bring calm back to the financial markets. This will gradually revive investors' risk appetite. Like the economic recovery, the stock market rebound could be fairly modest in comparison with past episodes; it may take several years for the indexes to return to their historic peaks.

Graph 10 – Key rates will be kept at their lows for a long time


Sources: Datastream and Desjardins, Economic Studies

Graph 11 – Canadian bond rates will also remain very low


Sources: Datastream and Desjardins, Economic Studies

**Table 3
Asset classes return**

End of year	Cash	Bonds	Canadian stocks	U.S. stocks	International stocks	Exchange rate
	3-month T-Bill	Scotia Capital Bond Index	S&P/TSX Index*	S&P500 Index (US\$)*	MSCI EAFE Index (US\$)*	CAN\$/US\$ (var. in %)**
2000	5.50	10.20	7.40	-9.10	-14.00	3.80
2001	3.90	8.10	-12.60	-11.90	-21.20	6.50
2002	2.50	8.70	-12.40	-22.10	-15.70	-1.50
2003	2.90	6.70	26.70	28.70	39.20	-17.70
2004	2.20	7.10	14.50	10.90	20.70	-7.10
2005	2.70	6.50	24.10	4.90	14.00	-3.30
2006	4.00	4.10	17.30	15.80	26.90	0.20
2007	4.10	3.70	9.80	5.50	11.60	-14.40
2008	2.30	6.40	-33.00	-37.00	-43.10	22.10
2009f range	target: 0.75 0.5 to 1.0	target: 4.50 3.5 to 6.5	target: 14.00 0.0 to 20.0	target: 17.00 5.0 to 25.0	target: 20.00 0.0 to 30.0	target: -6.8 (US\$0.88) 10.0 to 20.0

f: forecasts; * Dividends included; ** Negative = appreciation and positive = depreciation.

Sources: Datastream and Desjardins, Economic Studies