

Retail Rate Forecasts

March 20, 2009

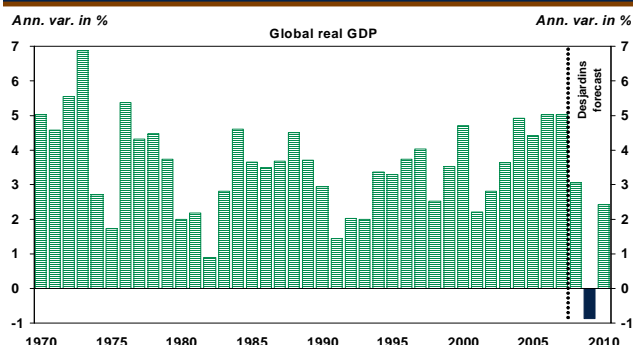
Retail rates fall to historic lows

HIGHLIGHTS

- Financial uncertainty and the global recession sent stock markets tumbling again in February.
- After slashing key rates to almost zero, the Bank of Canada is contemplating other measures.
- Retail rates continue to fall.
- The loonie is still under pressure.
- A lasting stock market recovery seems unlikely in the short term.

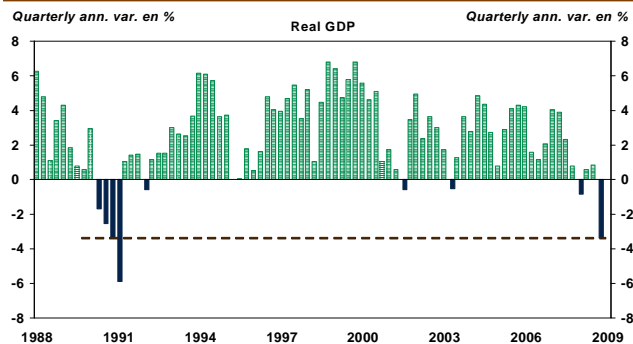
- **The international economic and financial context remains bleak.** The global recession is here and it looks like real global GDP will fall in 2009 for the first time since World War II (graph 1). Despite government efforts, major international financial institutions remain fragile and fears of bankruptcy and nationalization launched a new wave of panic on the markets in early 2009.
- **The Canadian economy's deterioration is particularly striking.** Canadian GDP slipped 3.4% in the last quarter of 2008 while domestic demand, which used to drive growth in the country, tumbled 4.9% (graph 2). According to the latest statistics, the labour and housing market continued to slide at the beginning of the year. The contraction of the Canadian economy could last longer and be more painful than previously anticipated.
- **The Bank of Canada (BoC) cut its key rate to merely 0.50% in March.** While not ruling out the possibility of another rate cut, the BoC is well aware that such a move would be marginally useful at best.
- **The BoC should keep its key rate near zero for the next few quarters** and try to support the economy and financial system using non-traditional tools, such as extending credit directly. We cannot rule out zero rates and a true quantitative policy, (printing money) if these new tools prove inadequate. Recently the Bank of England and the Federal Reserve have resorted to such measures of last resort.
- **The deterioration in public finances has caused bond yields to rise slightly.** Fears regarding U.S. debt financing are having an adverse effect on the bond market. Despite the favourable environment for low-risk securities, Canadian and U.S. bond yields have increased in the past few months (graph 3). The Fed's quantitative policies have caused rates to go back down, however.

Graph 1 – Global economy shrinks for the first time



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

Graph 2 – Canadian real GDP takes biggest hit since the first quarter of 1991



Sources: Statistics Canada and Desjardins, Economic Studies

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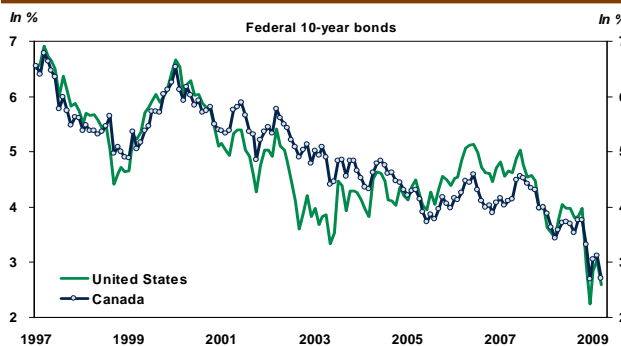
NOTE TO READERS: The letters **K**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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- **Retail rates continued to fall.** Short-term rates have especially benefitted from the fact that Canadian key rates are at all-time lows. The one-year mortgage rate dropped from 5.00% in January to 4.45% (graph 4). Five-year mortgage rates dropped to 5.55%, a new low. It seems that Canadian policymakers' efforts have reassured Canadian banks and maintained the supply of credit, at least to credit-worthy borrowers.
- **Mortgage rates not likely to go up.** Given the protracted economic slowdown and the fact that key rates will stay close to zero for many quarters, it doesn't look like retail rates will go up any time soon. In fact, we think rates will come down again over the next few months. In addition, extremely low variable and fixed mortgage rates are prompting many borrowers to rethink their mortgage options. We recently published a study¹ on the mortgage market which concluded that fixed five-year mortgages are currently a very interesting option.

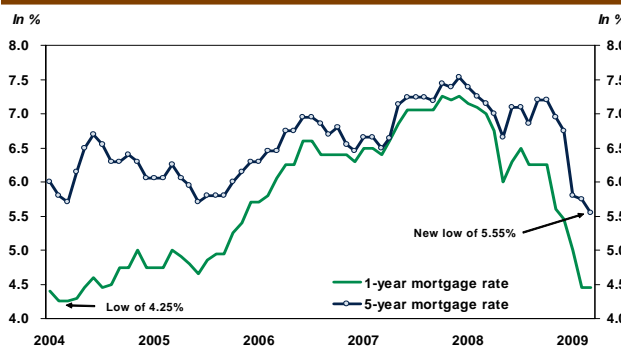
¹ See *Economic Viewpoint* "The financial crisis has led to changes in the Canadian mortgage market", dated March 4, 2009.

Graph 3 – Despite the upsurge, bond yields remain low



Sources: Datastream and Desjardins, Economic Studies

Graph 4 – Mortgage rates fell back near or below their historic low



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								
Sep. 2008	3.25	4.75	6.25	6.70	7.20	2.25	2.85	3.20
October 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
January 2009	1.25	3.00	5.00	5.75	5.80	1.15	1.90	2.20
Feb. 2009	1.25	3.00	4.45	5.50	5.75	1.00	1.90	2.20
Mar. 20, 2009	0.75	2.50	4.45	4.95	5.55	0.50	1.80	2.20
Forecasts – End of quarter								
2009: Q1	0.75	2.50	4.10–4.45	4.45–4.95	5.30–5.55	0.25–0.50	1.65–1.80	1.95–2.20
2009: Q2	0.25–0.75	2.00–2.50	3.95–4.45	4.35–4.85	5.05–5.55	0.20–0.50	1.45–1.80	1.75–2.20
2009: Q3	0.25–0.75	2.00–2.50	3.85–4.35	4.25–4.75	5.05–5.55	0.20–0.50	1.35–1.80	1.65–2.15
2009: Q4	0.25–0.75	2.00–2.50	3.85–4.35	4.25–4.75	5.15–5.65	0.20–0.50	1.30–1.80	1.65–2.15
2010: Q1	0.25–0.75	2.00–2.50	3.95–4.45	4.40–4.90	5.30–5.80	0.25–0.75	1.40–1.90	1.75–2.25
2010: Q2	0.25–0.75	2.00–2.50	4.10–4.60	4.60–5.10	5.50–6.00	0.30–0.80	1.50–2.00	1.80–2.30
2010: Q3	0.25–0.75	2.00–2.50	4.10–4.60	4.70–5.20	5.55–6.05	0.35–0.85	1.60–2.10	1.85–2.35
2010: Q4	0.75–1.25	2.50–3.00	4.20–4.70	4.90–5.40	5.75–6.25	0.45–0.95	1.70–2.20	2.05–2.55

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

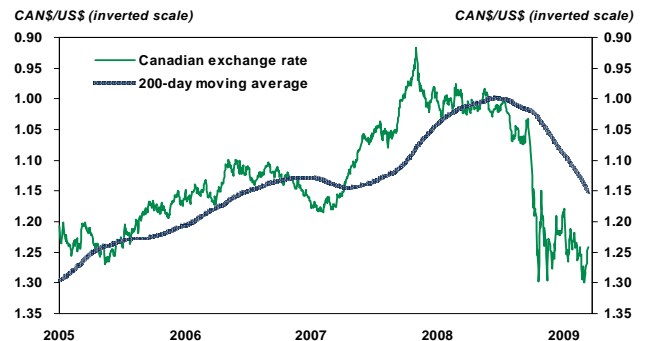
Source: Desjardins, Economic Studies

CANADIAN DOLLAR

The loonie will remain under pressure in the short term

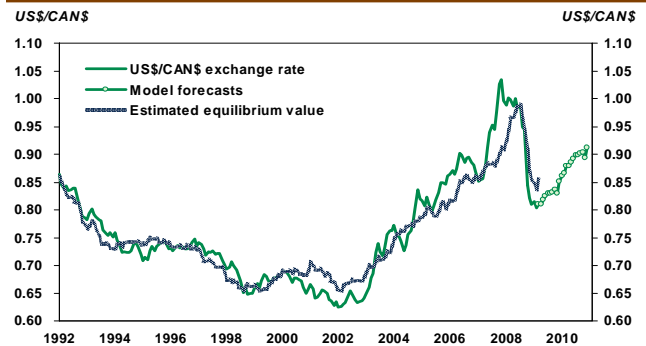
- After staying afloat early this year, in March, the loonie tested late 2008's triple low (graph 5) on a new wave of financial strains. However, the fall of the greenback after the decision to monetize the U.S. debt sent the loonie back up.
- Overall, the economy's fundamentals are unfavourable to the loonie. Of course, oil prices have consolidated in a range focused around US\$40/barrel, suggesting that the USD/CAD pair will have trouble achieving a sustainable break above CA\$1.30. However, the short-term economic situation is rapidly worsening and Canada's relative position is deteriorating. Job losses have accelerated sharply and everything suggests that the job market will be feeling the effects of the recession into the second half of 2009. Under these circumstances, the jobless rate could close in on 9%, which would maintain consumers' current pessimism. Parallel to that, foreign trade is still eroding.
- Over the longer term, once the financial upheaval has dissipated, any improvement in the economic situation or expectation of recovery could result in a substantial rebound in commodity prices. Our econometric models are very clear. As energy and non-energy commodity prices are dominant factors in our model for the Canadian exchange rate, this could put the loonie back on track for sustained growth as of the second half of the year (graph 6).
- **Forecast:** The Canadian dollar will remain close to its low over the next few months while the greenback will continue to benefit from investors' risk aversion. The loonie will start gaining strength before the end of 2009, benefiting from, among other things, the gradual increase in commodity prices.

Graph 5 – Canadian dollar and trend



Sources: Datastream and Desjardins, Economic Studies

Graph 6 – The loonie should benefit from the expected increase in commodity prices



Sources: Datastream 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
US\$/CAN\$	0.9407	0.8204	0.7900	0.8000	0.8600	0.8800	0.9000	0.9200	0.9500	1.0000
CAN\$/US\$	1.0630	1.2189	1.2658	1.2500	1.1628	1.1364	1.1111	1.0870	1.0526	1.0000
CAN\$/euro	1.4931	1.6943	1.6709	1.5750	1.4884	1.4773	1.4722	1.4761	1.4642	1.4240
US\$/euro	1.4047	1.3901	1.3200	1.2600	1.2800	1.3000	1.3250	1.3580	1.3910	1.4240
US\$/£	1.7825	1.4378	1.4500	1.4500	1.5500	1.6000	1.6500	1.7000	1.7500	1.8000

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

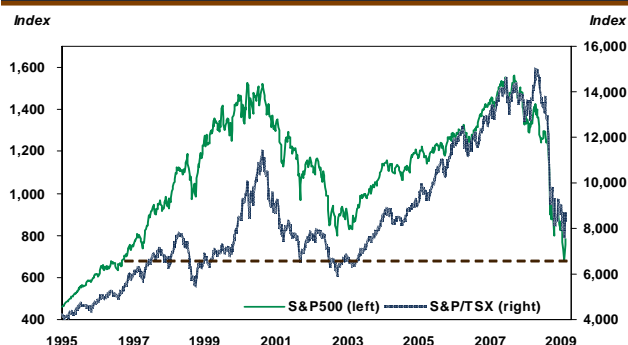
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ASSET CLASSES RETURN

Another difficult year for the U.S. stock market

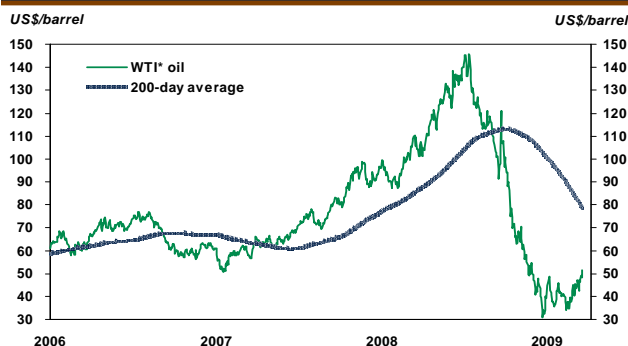
- Year kicks off with another market correction.** As we feared, the market surge at the end of 2008 was not the beginning of a bull market. The decline in the indexes turned into a collapse in February after the U.S. presented a financial stability plan that was short on details and provided for no immediate aid. Fears of bank nationalization and bankruptcies gripped the markets around the world, sending them plunging to their lowest level in years, if not decades (graph 7).
- The new market recovery is still tenuous.** After falling for several weeks, the North American indexes gained about 15% in the past few days. Just like at the end of 2008, this increase has all the makings of a technical recovery but no one is sure whether the correction is over. Despite this recent gain, American indexes are still close to 15% below their level of the beginning of 2009 while the Canadian stock market is still down 5%.
- Stabilization of commodity prices.** After a sharp correction in the second half of 2008, commodity prices have generally stabilized since the beginning of the year. The reaction of producers, who have reduced their output and investments, has partially offset weak global demand. Oil prices have recently risen above US\$50 a barrel (graph 8). However, in light of the protracted global recession, prices are not likely to go up strongly between now and the end of the year.
- Central banks will keep their rates close to zero for a long time.** Most central banks have already cut their key rates to zero or thereabouts. The Fed and the Bank of Canada (BoC) have announced that they will not raise their rates for many months. In our view, given the absence of inflationary risks, monetary tightening should not begin before late 2010.
- Federal bond yields likely to remain at their current level for a long time.** The financial and economic context will remain favourable for very low bond yields for the next quarters (graph 9). Strong risk aversion and increased household savings will support demand for federal bonds. The possibilities of deflation will also benefit fixed-income securities. However, large issues of U.S. government bonds will continue to concern investors and could limit the decline of bond yields (graph 10).
- Quantitative policies could benefit the bond market.** Now that key rates are practically zero, central banks are focusing on non-traditional ways to turn the economy around. In light of the improved bank credit situation, the BoC seems intent on granting credit to businesses more directly. The end result could be narrowed yield spreads and gains for fixed income investors. Bond acquisitions by central banks will also push down interest rates.

Graph 7 – U.S. stock market fell back to its 1996 level



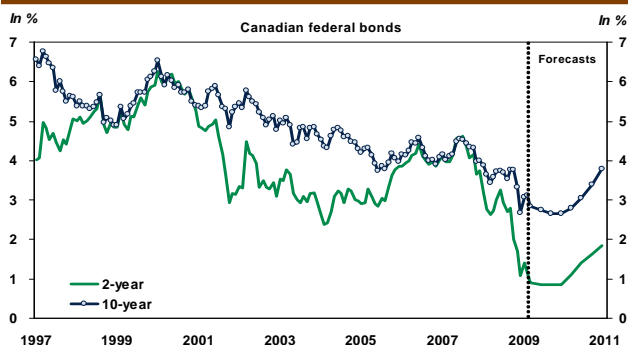
Sources: Datastream and Desjardins, Economic Studies

Graph 8 – Oil prices stabilizing



* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

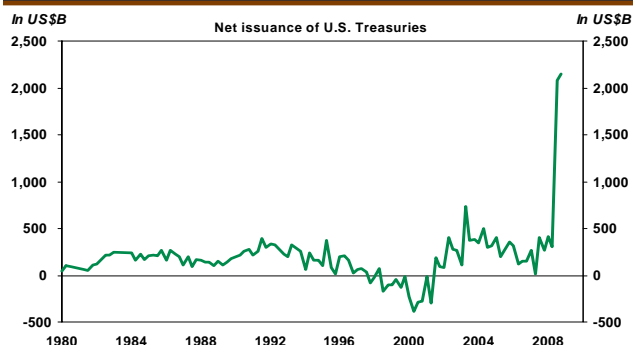
Graph 9 – Canadian bond yields will stay close to their current levels for a long time



Sources: Datastream and Desjardins, Economic Studies

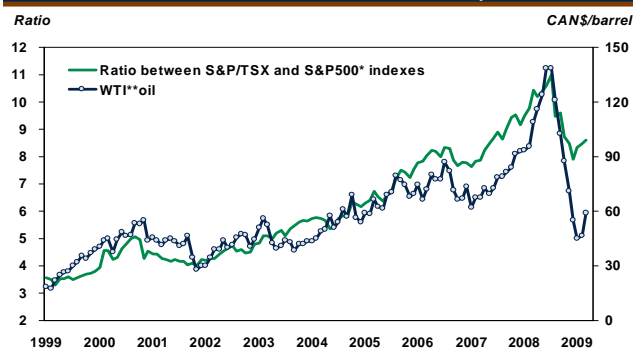
- **Investors still face a few tough months.** As major international financial institutions remain fragile, and business profits continue to shrink, there's little chance that the bull market will make a real comeback before the fall. Until then, we can expect the markets to be highly volatile and recent lows could be tested again. As such, we have revised our 2009 forecast for U.S. equities to close to zero.
- **The Canadian equity market seems more attractive.** Thanks to a more solid financial sector and the stabilization of commodity prices, Canadian stocks have been faring better than their U.S. counterparts since the beginning of the year (graph 11). Taking the dollar's movement into account, the Canadian market should keep its edge until the end of 2009, and the S&P/TSX could finish the year with gains of about 10%.

Graph 10 – The issuance of U.S. Treasuries has increased



Sources: Federal Reserve and Desjardins, Economic Studies

Graph 11 – Crude prices largely explain the Canadian and U.S. stock markets' relative performance

* In Canadian dollars; ** West Texas Intermediate.
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: 0.5 0.3 to 0.7	target: 4.5 2.5 to 6.5	target: 10.0 -5.0 to 15.0	target: 3.0 -10.0 to 10.0	target: 2.0 -12.0 to 12.0	target: -6.8 (US\$0.88) -13.6 to 2.6

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

Sources: Datastream and Desjardins, Economic Studies