

Retail Rate Forecasts

August 4, 2009

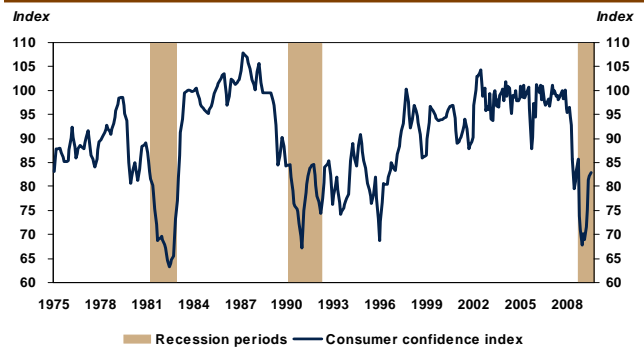
The hopes of economic recovery grow stronger

HIGHLIGHTS

- The economic and financial environment is still improving.
- The Bank of Canada believes that the recovery is beginning in Canada, but does not anticipate raising its key rates soon.
- Retail rates have been stable since mid-June and we don't expect major movements before the end of the year.
- Everything is currently favouring the loonie, but further appreciation could jeopardize the recovery.
- After a short-lived correction, the stock indexes started back on an up trend.

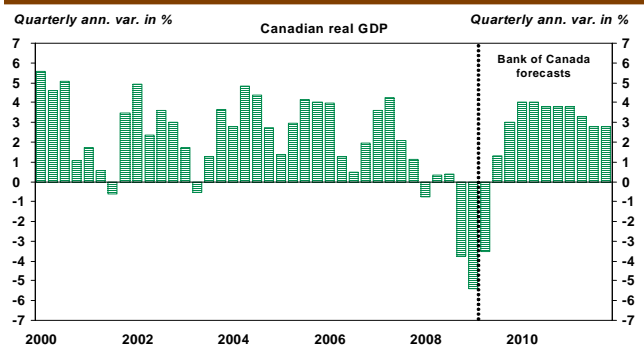
- **The economic recovery appears to be materializing.** In the beginning of July, some disappointing economic statistics, including further substantial job losses in the United States, tempered the hopes of a V-shaped recovery. However, overall, the leading indicators have been improving steadily around the world, suggesting that the recession is coming to an end (graph 1).
- **After a few weeks of doubt, optimism is back in the markets.** A number of firms, including some major U.S. banks, have posted better-than-forecast earnings for the second quarter. This bolstered investor confidence and gave the stock market rebound, started last March, a second wind.
- **The Bank of Canada (BoC) is upbeat.** According to the BoC's new forecast, the Canadian economy will return to growth in the third quarter and then see a relatively lively recovery (graph 2), buoyed by domestic demand. After contracting by 2.3% in 2009, the BoC expects Canada's real GDP to advance by 3.0% in 2010 and 3.5% in 2011.
- **The BoC still intends to keep its key rate at 0.25% until mid-2010.** The BoC believes that the recovery is nascent and that stimulative policies are still critical. Moreover, given the economy's substantial surplus supply, inflation could remain below the 2% target until mid-2011.
- **The recovery could be slower than the BoC anticipates.** We are seeing some signs of economic recovery: consumer and business confidence has shot up in the last few months, financial conditions have improved, commodity prices have turned around, and the impact of monetary easing and fiscal measures should intensify. However, we continue to believe that there are still many uncertainties and, moreover, that it

Graph 1 – Canadian consumer confidence has rebounded



Sources: Conference Board of Canada and Desjardins, Economic Studies

Graph 2 – The Bank of Canada is calling for a relatively strong recovery



Sources: Statistics Canada, 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

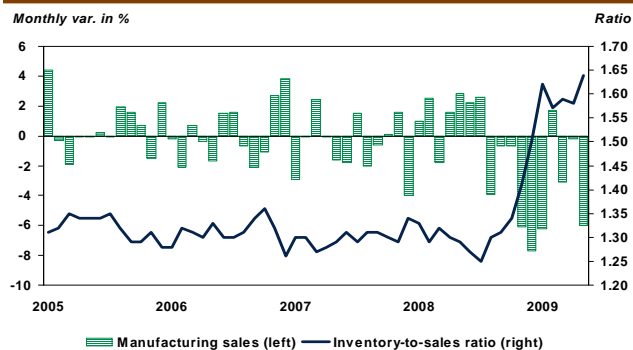
NOTE TO READERS: The letters **K**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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.

will take several more quarters for the deep adjustments underway in the global and Canadian economies, related to the recession and structural problems, to conclude (graph 3).

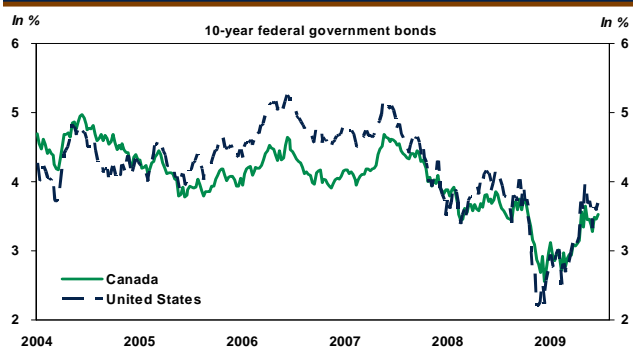
- **Bond rates pulled back temporarily.** Bond rates' rapid rise ended in mid-June as investors' overflowing optimism gave way to some doubts. In Canada, the 10-year rate went from 3.65% to under 3.30% around mid-July. However, the recent resurgence in market optimism has taken rates up by a few dozen basis points in the last few weeks (graph 4).
- **Retail rates are steady.** After raising some of their rates in early June, Canadian institutions have not made any other major changes to the retail rates. The posted 1-year mortgage rate is at a 3.75% low, while the rate for a 5-year term is 5.85%.
- **Our retail rate scenarios have not changed much.** Keeping key rates at their lower bound for several more months and relatively stable bond rates should limit movement in retail rates until the end of the year. However, the recovery will prompt rates to rise substantially in 2010.

Graph 3 – Canadian manufacturers face continued difficulties



Sources: Statistics Canada and Desjardins, Economic Studies

Graph 4 – The ascent of bond rates paused



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								
Feb. 2009	1.25	3.00	4.45	5.50	5.75	1.00	1.90	2.20
March 2009	0.75	2.50	4.45	4.95	5.55	0.50	1.80	2.20
April 2009	0.50	2.25	3.95	4.15	5.25	0.40	1.60	2.00
May 2009	0.50	2.25	3.95	4.15	5.25	0.40	1.60	1.90
June 2009	0.50	2.25	3.75	4.65	5.85	0.40	1.60	2.00
July 2009	0.50	2.25	3.75	4.65	5.85	0.40	1.60	2.00
August 3, 2009	0.50	2.25	3.75	4.65	5.85	0.40	1.60	2.00
Forecasts – End of quarter								
2009: Q3	0.50	2.25	3.50–4.00	4.40–4.90	5.60–6.10	0.15–0.65	1.35–1.85	1.75–2.25
2009: Q4	0.50	2.25	3.50–4.00	4.45–4.95	5.65–6.15	0.15–0.65	1.35–1.85	1.75–2.25
2010: Q1	0.50–0.75	2.25–2.50	3.55–4.05	4.55–5.05	5.85–6.35	0.20–0.70	1.45–1.95	2.05–2.55
2010: Q2	0.50–1.00	2.25–2.75	3.70–4.20	5.00–5.50	6.30–6.80	0.35–0.85	1.85–2.35	2.55–3.05
2010: Q3	0.50–1.00	2.25–2.75	3.95–4.45	5.40–5.90	6.55–7.05	0.65–1.15	2.25–2.75	2.80–3.30
2010: Q4	1.00–1.50	2.75–3.25	4.25–4.75	5.70–6.20	6.60–7.10	1.05–1.55	2.50–3.00	2.90–3.40

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

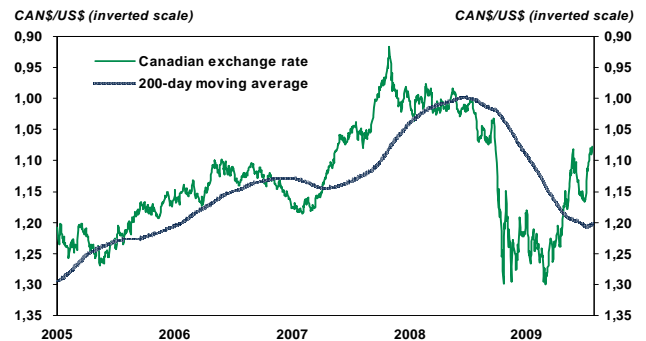
Source: Desjardins, Economic Studies

CANADIAN DOLLAR

The strong loonie jeopardizes the recovery

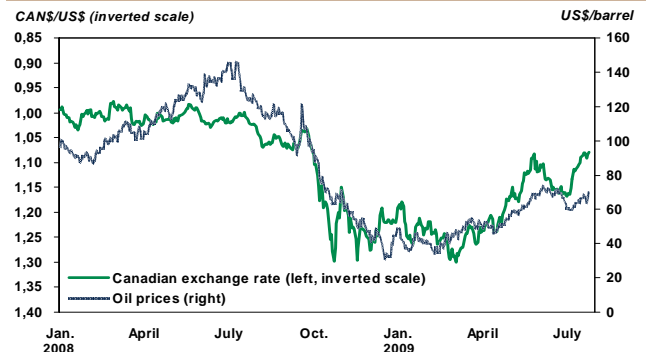
- The loonie has undergone substantial fluctuations in the last few months. After a spectacular surge that lasted from March until early June, the loonie depreciated by about 9% in June and early July, when market optimism was temporarily shaken (graph 5). Oil's tumble to less than US\$60/barrel magnified the loonie's pullback (graph 6).
- However, the trend reversed in mid-July. Another wind of optimism blew through the international financial markets following better-than-forecast corporate results in the United States. Investors then started to once again favour risky assets, such as stock and commodities, over safe-haven securities. The U.S. dollar then tumbled, especially against commodity currencies such as the loonie.
- The Canadian dollar's comeback, with the USD/CAD pair recently hitting 1.0750, a low that dates back to last October, also appears to have been magnified by the optimism shown by the Bank of Canada (BoC). Although the BoC still intends to keep its key rates at the lower bound until mid-2010, some think that monetary firming could start in Canada before it does in other industrialized countries.
- Most factors currently seem to favour the loonie. However, in our view, this cannot last very long. The BoC's recovery scenario assumes that the Canadian dollar is under US\$0.90. If the dollar keeps rising, it could smother the recovery and all hopes of seeing Canadian key rates come back up will evaporate. Similarly, if oil prices shoot up, this could put the brakes on the global recovery and make commodity prices and the loonie fall.
- Forecasts:** The loonie should not be able to settle above US\$0.95 on a lasting basis before the end of 2009. A real return to parity is still expected in the second half of 2010.

Graph 5 – Canadian dollar and trend



Sources: Datastream and Desjardins, Economic Studies

Graph 6 – The loonie's rise is not solely due to a comeback of oil 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	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
US\$/CAN\$	0.9407	0.8204	0.7918	0.8600	0.9000	0.9300	0.9300	0.9500	1.0000	1.0000
CAN\$/US\$	1.0630	1.2189	1.2630	1.1628	1.1111	1.0753	1.0753	1.0526	1.0000	1.0000
CAN\$/€	1.4931	1.6943	1.6769	1.6309	1.6000	1.5269	1.5054	1.4737	1.3800	1.3600
US\$/€	1.4047	1.3901	1.3277	1.4027	1.4400	1.4200	1.4000	1.4000	1.3800	1.3600
US\$/£	1.7825	1.4378	1.4334	1.6469	1.6500	1.6500	1.6500	1.6500	1.7000	1.7500

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

f: forecasts

ASSET CLASSES RETURN

The stock market correction was mild

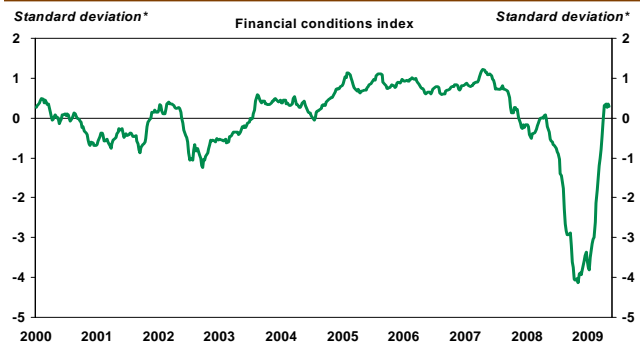
- The markets pulled back briefly before going back on the rise.** In mid-June, we thought a market correction was likely after the spectacular rebound seen in the previous months. That is what happened, when the major North American indexes pulled back by about 10% from mid-June to mid-July. The movement was short-lived, however, and the indexes rebounded in the last few weeks, reaching their highest point since last fall (graph 7).
- Financial conditions continue to improve.** Initially, the stock market rally that started in March was based on a tangible drop in financial strain. Conditions have kept improving recently, with corporate financing premiums coming down again and the capital markets operating more and more normally. In Canada, a Bank of Canada (BoC) index now shows that, overall, financial conditions are even slightly better than normal (graph 8).
- Profit outlooks start improving.** U.S. corporate results which, overall, beat expectations for the second quarter are also supporting the market rebound. The improved performance of financial institutions is especially encouraging. The gradual comeback of earnings and hopes of an economic recovery have prompted analysts to start upgrading their U.S. profit forecasts (graph 9), a development that is very good for stock.
- The risk of another correction remains.** The stock market outlook remains good over a medium and long horizon (see the June 19, 2009 *Economic Viewpoint*). The last few months have however shown that the markets remain very volatile and that there is still a relatively sizeable risk of another temporary correction in the near term. It could be triggered by such things as economic statistics that confirm that the economic recovery will be weak.
- Soft demand will limit the rise of oil prices.** In the last few weeks, commodities have followed a similar path to the stock markets. Oil prices dropped below US\$60/barrel in mid-July and then recently came back near US\$70. Beyond the fluctuations caused by the financial markets, global oil demand is still very soft and will have a hard time justifying much higher prices before the end of this year.
- Too early for monetary firming.** Despite the looming end to the recession, everything suggests that key rates will stay at their floors for several more months. In the United States, the Federal Reserve is being very cautious regarding the recovery, still preferring to refer to a stabilization. In Canada, the BoC is more upbeat, but it is stressing the need to maintain stimulative policies to support the recovery. Monetary firming should not begin on either side of the border until the second half of 2010 (graph 10). However, if the recovery materializes and inflation begins to rise more quickly than forecast, the door could slowly open to monetary policy firming a little earlier.

Graph 7 – The stock market rebound paused for a few weeks



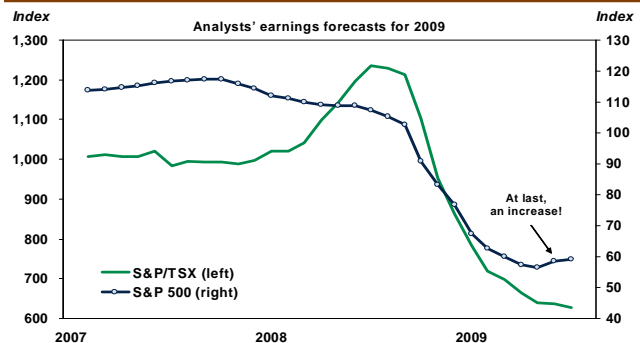
Sources: Datastream and Desjardins, Economic Studies

Graph 8 – Canada's financial conditions show spectacular improvement



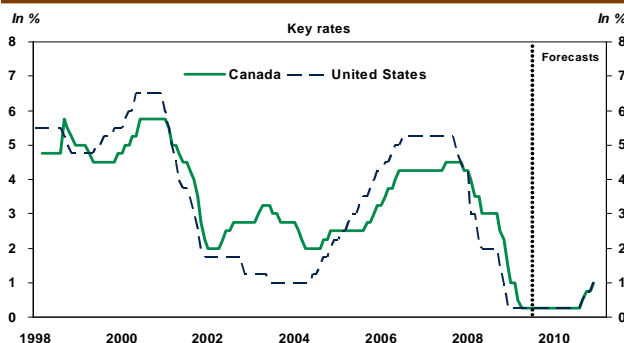
* From the average.
Sources: Bank of Canada and Desjardins, Economic Studies

Graph 9 – Profit forecasts are finally starting to be upgraded in the United States

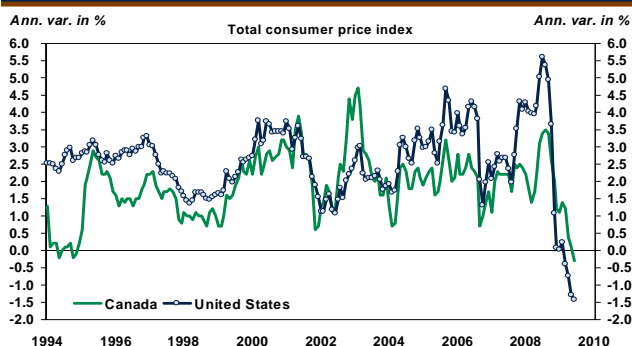


Sources: Institutional Brokers Estimate System and Desjardins, Economic Studies

- **Bond rates should stay close to current levels until the end of the year.** Key rates close to zero and no inflation pressure, with the annual change in prices currently negative on both sides of the border (graph 11), should rein in the rise of bond rates in the months to come. However, governments' huge financing needs and gradual improvement of the economic and financial environment also make a sharp drop in rates unlikely.
- **Overall, our forecast returns for the asset classes are upheld.** Although we cannot rule out further temporary pullbacks, the stock market up trend should last over the medium range. The North American indexes would thus end the year slightly above current levels, recording further substantial appreciation in 2010. The situation is not as good for the bond market, where returns will be limited by the comeback of interest rates, especially next year.

Graph 10 – Key rates will be kept close to zero for several more months


Sources: Datastream and Desjardins, Economic Studies

Graph 11 – The inflation rate is currently negative in Canada and the United States


Sources: Statistics Canada and Desjardins, Economic Studies

**Table 3
Asset classes return**

	Cash	Bonds	Canadian stocks	U.S. stocks	International stocks	Exchange rate
End of year	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: 0.35 0.2 to 0.5	target: 4.0 2.0 to 5.5	target: 22.0 10.0 to 30.0	target: 12.0 0.0 to 20.0	target: 17.0 5.0 to 25.0	target: -11.8 (US\$0.93) -13.6 to 2.6
2010f range	target: 0.75 0.5 to 1.0	target: 2.0 0.0 to 4.0	target: 13.0 5.0 to 20.0	target: 16.0 5.0 to 25.0	target: 18.0 5.0 to 25.0	target: -7.0 (US\$1.00) -15.4 to 3.3

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

Sources: Datastream and Desjardins, Economic Studies