Retail Rate Forecasts

Desjardins Economic Studies
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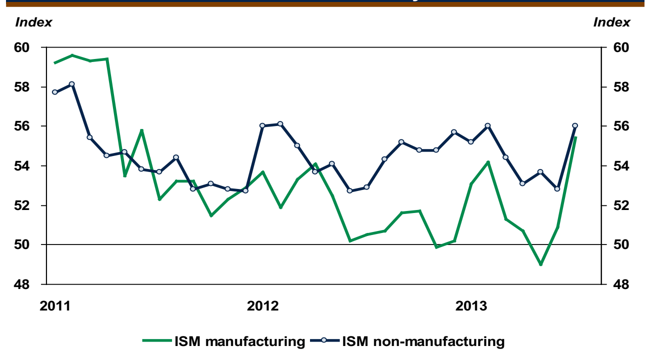
# Growth seems poised to pick up in industrialized nations

## HIGHLIGHTS

- After modest growth in the first half of the year, a number of advanced economies are sending more promising signals.
- The Canadian real estate sector is resilient.
- Bond yields have shot up in the last few months, but retail rates remain low.
- The Canadian dollar should come back up.
- U.S. stocks more resilient than expected.

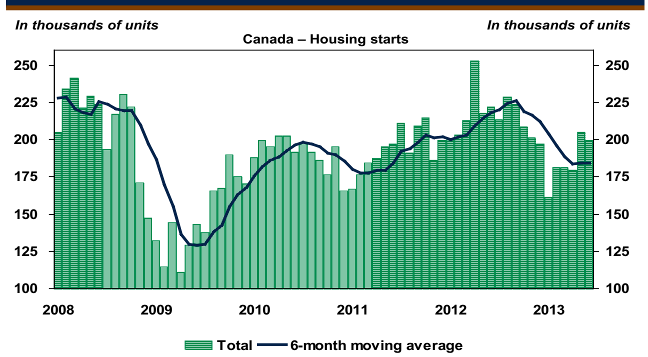
- **Advanced nations' growth is heading for acceleration.** Global economic growth remained modest in the initial months of 2013, with a continuing recession in the euro zone and a U.S. economy reined in by restrictive fiscal policy and trouble in the manufacturing sector. However, the confidence and activity indexes have picked up lately, pointing to livelier growth, especially in the United Kingdom and United States (graph 1). The situation is not as encouraging for emerging nations, including China, whose annual real GDP growth slowed to an annualized 7.5% last spring.
- **Canada's economy is doing fairly well.** Overall, the latest Canadian figures are fairly encouraging: retail sales jumped 1.9% in May and real GDP grew 0.2% that month. However, the biggest surprise was delivered by the housing market, with housing starts (graph 2), home resales and prices rebounding over the last few months. The most likely scenario remains nonetheless a soft landing by Canada's real estate market. The flooding in southern Alberta and construction strike in Quebec could affect Canadian summer data.
- **The Bank of Canada (BoC) continues to signal a long status quo.** The BoC's new Governor, Stephen Poloz, made his arrival felt in July by amending the wording of the forward-looking statement on future monetary policy. However, the BoC's fundamental message is essentially the same. It still expects the monetary policy to remain appropriate for some time. As the economy, inflation and consumers' financial situation slowly return to normal, gradual normalization of the key rate will be appropriate.

Graph 1 – July's sharp rise in ISM indexes is encouraging for the U.S. economy




Sources: Institute for Supply Management and Desjardins, Economic Studies

Graph 2 – The downtrend in Canadian housing starts is fading




Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

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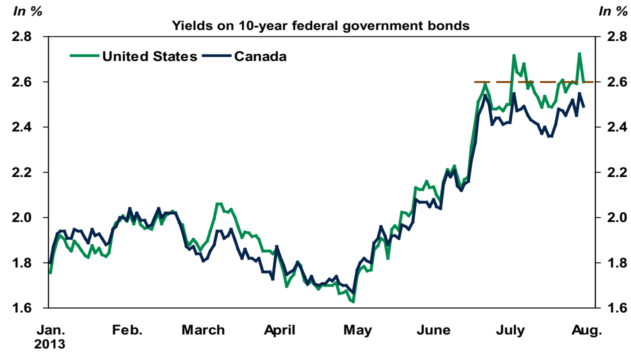
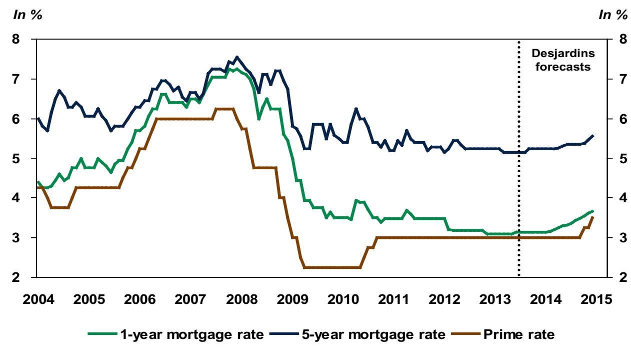
- **The Federal Reserve (Fed) strives to soothe investors.** Confirmation that U.S. monetary authorities were contemplating cutting back on their financial security purchases worried investors in May and June. However, since then, Fed leaders have several times signalled that the monetary policy would remain highly expansionary for several quarters to come. While the Fed could start to taper its securities purchases this fall, U.S. key rates should remain at their floor until late 2015.
- **Long-term bond yields are still much higher than they were in spring.** The reassuring remarks from Fed leaders soothed the financial markets, and the U.S. stock market jumped to another historic high. Bond yields remain much higher than they were several months ago (graph 3), however, with investors no longer ready to accept yields that are below inflation.
- **The climb by retail rates promises to be limited.** The surge in bond yields prompted some upticks in retail rates. The 3-year mortgage rate is up 20 basis points since the end of May. We could see some additional slight increases in the next few months. Retail rates should remain very low for a few more quarters, however (graph 4).

**Graph 3 – Bond yields have stabilized at much higher levels than last spring**




Sources: Datastream and Desjardins, Economic Studies

**Graph 4 – Canadian retail rates should remain 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** | | | | | | | | |
| February 2013 | 1.25 | 3.00 | 3.09 | 3.70 | 5.24 | 0.90 | 1.25 | 1.75 |
| March 2013 | 1.25 | 3.00 | 3.09 | 3.55 | 5.14 | 0.90 | 1.25 | 1.75 |
| April 2013 | 1.25 | 3.00 | 3.09 | 3.55 | 5.14 | 0.90 | 1.25 | 1.75 |
| May 2013 | 1.25 | 3.00 | 3.09 | 3.55 | 5.14 | 0.90 | 1.25 | 1.75 |
| June 2013 | 1.25 | 3.00 | 3.14 | 3.65 | 5.14 | 0.90 | 1.25 | 1.75 |
| July 2013 | 1.25 | 3.00 | 3.14 | 3.75 | 5.14 | 0.90 | 1.25 | 1.75 |
| Aug. 6, 2013 | 1.25 | 3.00 | 3.14 | 3.75 | 5.14 | 0.90 | 1.25 | 1.75 |
| **Forecasts** | | | | | | | | |
| End of quarter | | | | | | | | |
| 2013: Q2 | 1.25 | 3.00 | 3.00–3.40 | 3.50–4.00 | 5.00–5.50 | 0.65–1.15 | 1.05–1.55 | 1.55–2.05 |
| 2013: Q3 | 1.25 | 3.00 | 3.00–3.40 | 3.50–4.00 | 5.00–5.50 | 0.70–1.20 | 1.10–1.60 | 1.60–2.10 |
| 2013: Q4 | 1.00–1.50 | 2.75–3.25 | 2.95–3.45 | 3.60–4.10 | 5.00–5.50 | 0.75–1.25 | 1.10–1.60 | 1.60–2.10 |
| 2014: Q1 | 1.00–1.50 | 2.75–3.25 | 3.10–3.60 | 3.90–4.40 | 5.10–5.60 | 0.80–1.30 | 1.15–1.65 | 1.75–2.25 |
| End of year | | | | | | | | |
| 2014 | 1.50–2.00 | 3.25–3.75 | 3.40–3.90 | 4.25–4.75 | 5.30–5.80 | 1.10–1.60 | 1.50–2.00 | 2.15–2.65 |
| 2015 | 2.00–2.50 | 3.75–4.25 | 4.25–4.75 | 5.25–5.75 | 6.00–6.50 | 1.50–2.00 | 2.25–2.75 | 2.70–3.20 |
| 2016 | 2.75–3.75 | 4.50–5.50 | 4.80–5.80 | 5.60–6.40 | 6.25–7.05 | 1.65–2.65 | 2.60–3.40 | 3.00–3.80 |

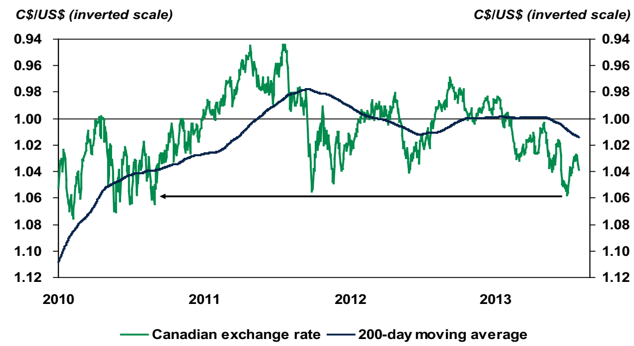
Note: Forecasts are expressed as ranges. (1) End of quarter forecasts; (2) Non-redeemable (annual).
Source: Desjardins, Economic Studies

# CANADIAN DOLLAR

## The Canadian dollar will come back up

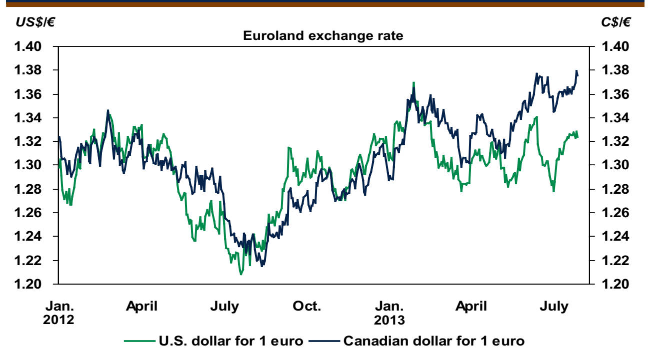
- The Canadian dollar hit a 21-month low in early July, at US$0.9428. The weakness was primarily due to a U.S. dollar that had strengthened in anticipation of less accommodative U.S. monetary policy. Fears surrounding emerging nations' growth and commodity demand also impacted the Canadian dollar negatively.
- The trend reversed in the last few weeks, and the loonie is once again trading at around US$0.96 (graph 5). A better understanding of the Federal Reserve's (Fed) stance pulled the greenback down. The Canadian dollar also got a boost from a few better-than-anticipated economic statistics and from high oil prices. Fears regarding commodity demand remain high overall, however, especially as Chinese growth continues to disappoint.
- The euro has also been trending up against the U.S. dollar in the last few weeks, going from less than US$1.28 at the start of July to US$1.33 recently. The weakening greenback and the release of encouraging data on an upcoming end to the euro zone's recession were the main factors boosting the common currency. The euro was more stable against the Canadian dollar. The exchange rate held at around C$1.36–1.37/€ (graph 6).
- **Forecasts:** The Canadian dollar is not expected to get back to parity against the greenback until the start of 2014. The prospect of Canadian monetary firming in the fall of 2014 and anticipated easing of the concerns about global commodity demand will help the loonie rise. However, changes to the Fed's stance could prompt further periods of elevated volatility. The tough economic and political context and the possibility of additional monetary easing in the euro zone should keep the euro from moving substantially above US$1.30 in the coming months. The euro should go down slightly against the Canadian dollar.

**Graph 5 – The loonie is tending to appreciate after hitting a 21-month low in early July**




Sources: Datastream and Desjardins, Economic Studies

**Graph 6 – The euro recently stabilized against the Canadian dollar**




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**

| | 2012 | | 2013 | | | | 2014 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| End of period | Q3 | Q4 | Q1 | Q2 | Q3f | Q4f | Q1f | Q2f | Q3f | Q4f |
| US$/CAN$ | 1.0165 | 1.0079 | 0.9828 | 0.9506 | 0.9600 | 0.9800 | 0.9900 | 1.0000 | 1.0100 | 1.0200 |
| CAN$/US$ | 0.9838 | 0.9922 | 1.0175 | 1.0520 | 1.0417 | 1.0204 | 1.0101 | 1.0000 | 0.9901 | 0.9804 |
| CAN$/€ | 1.2657 | 1.3081 | 1.3065 | 1.3674 | 1.3646 | 1.3367 | 1.3333 | 1.3300 | 1.3168 | 1.3137 |
| US$/€ | 1.2865 | 1.3184 | 1.2841 | 1.2999 | 1.3100 | 1.3100 | 1.3200 | 1.3300 | 1.3300 | 1.3400 |
| US$/£ | 1.6148 | 1.6255 | 1.5185 | 1.5167 | 1.5300 | 1.5500 | 1.5700 | 1.5800 | 1.5900 | 1.6000 |

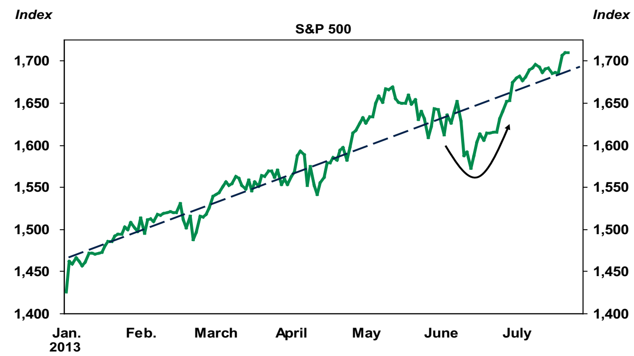
Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies f: forecasts

# ASSET CLASSES RETURN

## U.S. stocks more resilient than expected

- **The rally, which had seemed invincible since the start of the year, ran into its first difficulties in late spring.** Uncertainty surrounding the impact on economic growth of a potential drop in support from the Federal Reserve (Fed) prompted a decline of more than 5% in the S&P 500 between May 21 and June 24. July saw a quick turnaround, however. Once the Fed made every effort to explain that tapering did not constitute monetary tightening, and after the release of job creation figures that had been revised upward at the start of July, stock investors regained some confidence. The S&P 500 recouped all of the losses incurred in May and June, returning to its previous trend (graph 7). As of August 6, the stock market index was showing an impressive gain of nearly 20% since the start of the year.
- **The Canadian stock market looks up.** While the S&P/TSX's performance since the beginning of the year is nowhere near as spectacular (about flat on a year-to-date basis), some improvement has been seen lately, with a gain of 8.1% from the June 24 low to August 6. The recovery in the energy sector has been highly beneficial, going hand in hand with the rise by oil prices, as WTI (West Texas Intermediate) prices went up by around US$15 in July. For its part, the materials sector had started to improve in July, but the sharp drop by potash prices (graph 8) following the dissolution of a major Russian and Belorussian cartel led the sub-index to wipe out much of its gains at the end of the month. In contrast, the consumer staples sector, one of the strongest components of the S&P/TSX in 2013, accelerated sharply in July (graph 9), propelled in particular by Loblaw's acquisition of Shopper's Drug Mart. However, given this sector's small weight, the impact on the overall index was negligible.
- **Downside pressure on bonds eases slightly.** While the vagaries of the economic statistics created some occasional blips in July, the magnitude of the daily movements in bond yields diminished compared with May and June. At the start, the yield back up was largely due to the normalization of real rates; however, these began to stabilize in July, as inflation expectations firmed somewhat (graph 10) in response to the Fed's more dovish tone. All in all, instead of the net uptrend that characterized the end of spring, U.S. 10-year yields oscillated in a 2.45% to 2.70% band (2.35 to 2.55% for the Canadian yield). The next major level of 3.0% seems harder to reach, especially given that the revised job creation figures that came out in early August for the United States indicated slower growth than the previous month's figures. Weak inflation and fears that the upswing by mortgage rates will put the brakes on real estate recovery will likely mean that the Fed will maintain a cautious stance. Despite this, there is nothing to indicate beyond doubt that it will not move ahead with tapering next month: excluding employment, most recent activity indicators point to firming. Moreover, the latest U.S. bond auctions signal reduced investor appetite for an asset class that will be getting less

Graph 7 – The U.S. stock market was quick to recoup its late spring losses

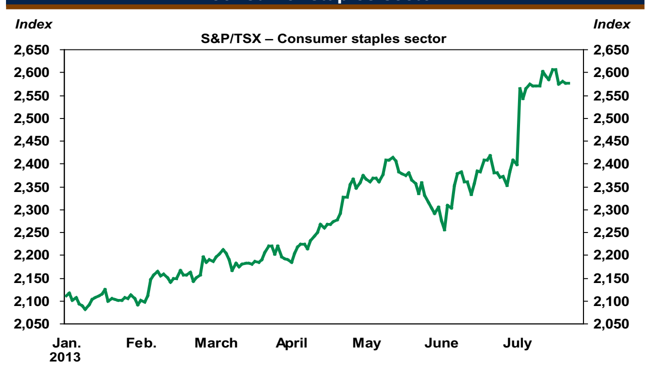



Sources: Datastream and Desjardins, Economic Studies

Graph 8 – July's sudden drop in potash prices comes on the back of a sustained downtrend


* Standard-grade muriate of potash from Saskatchewan.
Sources: Bloomberg and Desjardins, Economic Studies

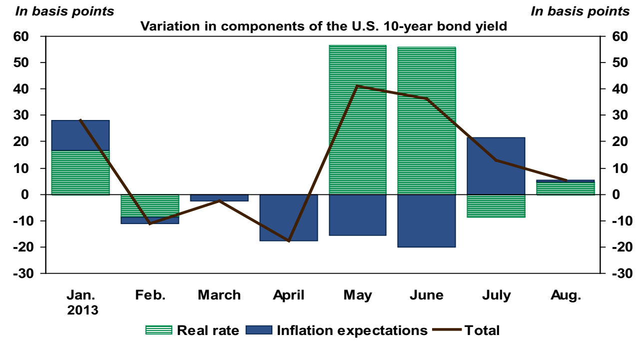
Graph 9 – Acquisitions have boosted the Canadian stock market's consumer staples sector




Sources: Datastream and Desjardins, Economic Studies support from the U.S. central bank's actions (graph 11). The convergence of these factors argues for a flat evolution in yields in the coming months, which will give way to a more sustained uptrend in early 2014.

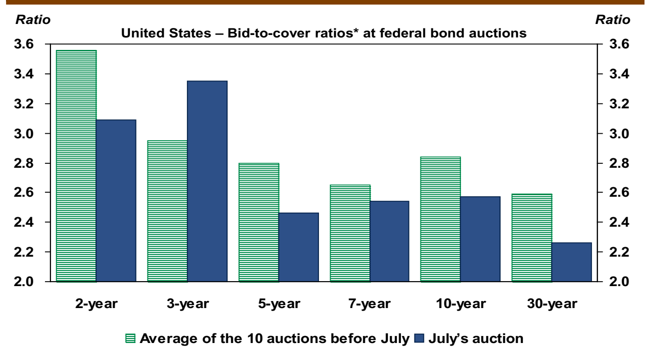
- **Return forecasts. We are raising our performance target for the U.S. stock market to 18%.** While recent growth has been very strong compared with analysts' profit expectations (which have also been trimmed), the fact is that U.S. stock markets came out of a major test at the end of last spring with their heads held high. This suggests more resilience than expected. With bonds that could face lesser investor interest, and consistent with our scenario for accelerating U.S. economic growth in the third quarter, the U.S. stock market could manage to protect much of its gains. Our target for the S&P/TSX remains unchanged, and we expect a wider performance gap in favour of the U.S. stock market. For bonds, we are reducing our return target to zero and downwardly shifting the range to reflect a stronger probability of negative returns.

**Graph 10 – The real rate stabilized and inflation expectations firmed up in July**




Sources: Datastream and Desjardins, Economic Studies

**Graph 11 – The reduced appetite for U.S. bonds is nearly reflected across the entire curve**




* Value of bids received divided by the issued amount.
Sources: U.S. Department of Treasury and Desjardins, Economic Studies

## Table 3
## Asset classes percentage return

| | *Cash* | *Bonds* | *Canadian stocks* | *U.S. stocks* | *International stocks* | *Exchange rate* |
|---|---|---|---|---|---|---|
| End of year | **3-month T-Bill** | **Dex Universe Bond Index** | **S&P/TSX Index*** | **S&P 500 Index (US$)*** | **MSCI EAFE Index (US$)*** | **C$/US$ (var. in %)**** |
| 2000 | 5.45 | 10.2 | 7.4 | -9.1 | -14.0 | 3.8 |
| 2001 | 3.88 | 8.1 | -12.6 | -11.9 | -21.2 | 6.5 |
| 2002 | 2.52 | 8.7 | -12.4 | -22.1 | -15.7 | -1.5 |
| 2003 | 2.87 | 6.7 | 26.7 | 28.7 | 39.2 | -17.7 |
| 2004 | 2.23 | 7.1 | 14.5 | 10.9 | 20.7 | -7.1 |
| 2005 | 2.70 | 6.5 | 24.1 | 4.9 | 14.0 | -3.3 |
| 2006 | 4.01 | 4.1 | 17.3 | 15.8 | 26.9 | 0.2 |
| 2007 | 4.14 | 3.7 | 9.8 | 5.5 | 11.6 | -14.4 |
| 2008 | 2.35 | 6.4 | -33.0 | -37.0 | -43.1 | 22.1 |
| 2009 | 0.34 | 5.4 | 35.1 | 26.5 | 32.5 | -13.7 |
| 2010 | 0.57 | 6.7 | 17.6 | 15.1 | 8.2 | -5.2 |
| 2011 | 0.92 | 9.7 | -8.7 | 2.1 | -11.7 | 2.3 |
| 2012 | 0.95 | 3.6 | 7.2 | 16.0 | 17.9 | -2.7 |
| 2013f | target: 1.00 | target: 0.0 | target: 6.0 | target: 18.0 | target: 8.0 | target: 2.8 (US$0.98) |
| range | 0.95 to 1.05 | -4.0 to 2.0 | 1.0 to 9.0 | 12.0 to 24.0 | 2.0 to 14.0 | 0.8 to 6.1 |

f: forecasts; * Dividends included; ** Negative = appreciation and positive = depreciation.
Sources: Datastream and Desjardins, Economic Studies