Retail Rate Forecasts

Desjardins Economic Studies
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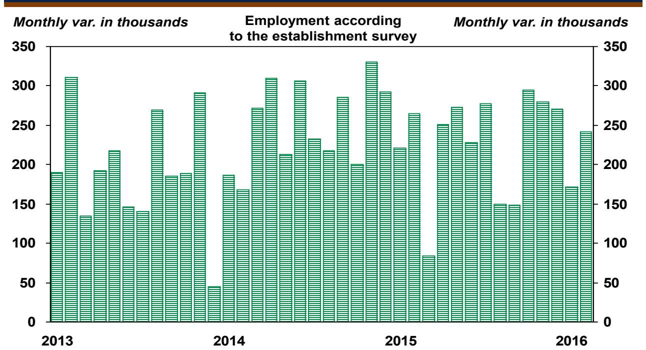
Optimism is on the upswing after an anxious start to the year

HIGHLIGHTS

- Reassuring economic signals in the United States and Canada.
- Oil prices on the rise.
- No change in sight for Canadian key rates.
- The Canadian dollar reaches the US$0.75 mark.
- Optimism returns to the markets.

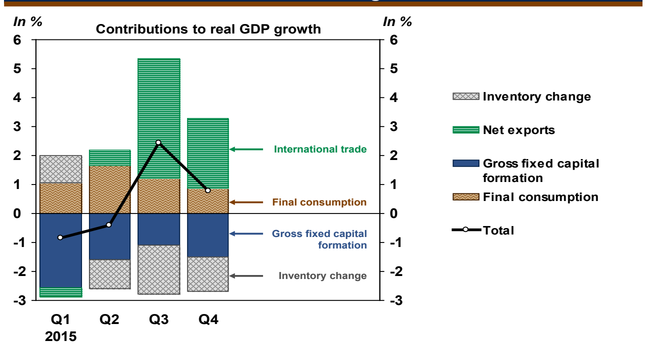
- **The U.S. economy's performance reassures.** Several statistics seem to show that the U.S. economy will see solid growth in Q1 2016. After moderating in January, job creation came back strong in February (graph 1). These results are in sharp contrast with the recession scenarios that fueled investor pessimism early in the year.
- **The European Central Bank (ECB) took further action in March.** In addition to trimming its key rates, the ECB opted to accelerate the pace of asset purchases and start acquiring corporate bonds. It also announced a new series of operations intended to inject liquidity into European banks at zero or negative rates. This measure shows that the ECB is very determined to support its banking system.
- **Commodity prices rise.** Like the stock indexes, commodity prices have rebounded in the last few weeks. WTI (West Texas Intermediate) oil prices, which had fallen to US$26 a barrel in mid-February, recently went over US$35. Beyond the speculation over an agreement between Russia and OPEC (Organization of Petroleum Exporting Countries) nations, the price rebound primarily seems to reflect renewed investor confidence and the drop in U.S. oil production.
- **Canada's economy is doing a little better than expected.** Although most analysts were expecting it to stagnate or even contract, Canada's economy grew an annualized 0.8% in the last quarter of 2015 (graph 2). The strong growth of monthly GDP and exports in recent months suggests that growth will beat 2.0% in the first quarter of 2016. However, the plunge in energy sector investment remains a major curb on the Canadian economy.

Graph 1 – Ongoing lively job creation in the United States



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

Graph 2 – International trade made another contribution to Canada's economic growth in Q4



Sources: Statistics Canada and Desjardins, Economic Studies

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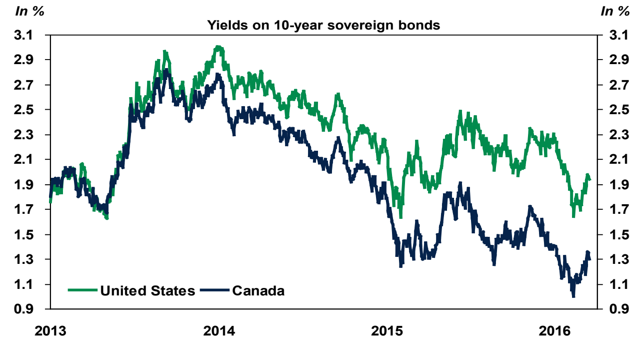
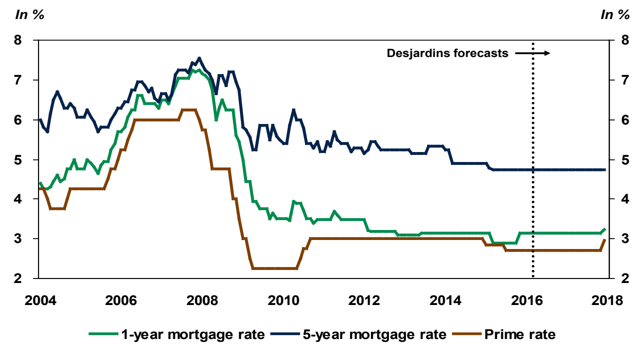
- **Nothing points to a change in Canadian key rates.** The recent upswing in oil prices and promising signs for North American economic growth seem to confirm that no further cuts to Canadian key rates will be needed. Moreover, the March 22 federal budget should include stimulus measures for Canada's economy.
- **Bond yields rise, but remain low.** North American bond yields have edged up recently after posting a spectacular plunge early in the year (graph 3). This partly reflects the change in monetary policy expectations on both sides of the border, with investors banking less on rate cuts in Canada and once again starting to think that the Federal Reserve could raise its key rates a few times in 2016.
- **We still expect retail rates to remain very stable.** Some Canadian financial institutions have taken certain retail rates up a little, especially on savings. We could see further slight adjustments to reflect changes in their financing costs. Overall, however, retail rates should stay very close to where they are now for several quarters (graph 4), with the ongoing low interest rate climate.

Graph 3 – Bond yields have wiped out some of the tumble of recent months



Sources: Datastream and Desjardins, Economic Studies

Graph 4 – Retail rates should stay close to current levels for some time



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								
Sept. 2015	0.75	2.70	2.89	3.39	4.74	0.85	1.05	1.50
Oct. 2015	0.75	2.70	2.89	3.39	4.74	0.85	1.05	1.50
Nov. 2015	0.75	2.70	3.14	3.39	4.74	0.85	1.05	1.50
Dec. 2015	0.75	2.70	3.14	3.39	4.74	0.85	1.05	1.50
January 2016	0.75	2.70	3.14	3.39	4.74	0.85	1.05	1.50
February 2016	0.75	2.70	3.14	3.39	4.74	0.85	1.05	1.50
March 16, 2016	0.75	2.70	3.14	3.39	4.74	0.85	1.15	1.50
Forecasts								
End of quarter								
2016: Q1	0.75	2.70	2.89–3.39	3.14–3.64	4.49–4.99	0.60–1.10	0.90–1.40	1.25–1.75
2016: Q2	0.50–0.75	2.45–2.70	2.89–3.39	3.14–3.64	4.49–4.99	0.60–1.10	0.90–1.40	1.25–1.75
2016: Q3	0.50–0.75	2.45–2.70	2.89–3.39	3.14–3.64	4.49–4.99	0.60–1.10	0.90–1.40	1.25–1.75
2016: Q4	0.50–1.00	2.45–2.95	2.89–3.39	3.14–3.64	4.49–4.99	0.60–1.10	0.90–1.40	1.25–1.75
End of year								
2017	0.50–1.50	2.45–3.45	2.85–3.65	3.50–4.30	4.49–5.15	0.60–1.30	0.80–1.55	1.25–1.95
2018	1.50–2.50	3.45–4.45	3.45–4.25	4.00–4.80	4.65–5.45	0.60–1.40	0.95–1.75	1.35–2.15
2019	1.25–2.25	3.20–4.20	3.15–3.95	3.60–4.40	4.49–5.15	0.60–1.25	0.80–1.50	1.25–1.90

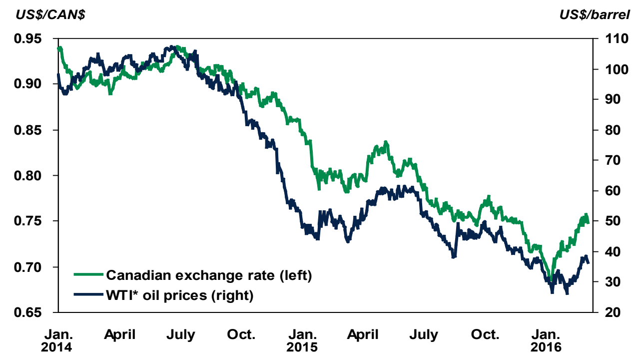
Note: Forecasts are expressed as ranges. (1) End of quarter forecasts; (2) Non-redeemable (annual).
Source: Desjardins, Economic Studies

CANADIAN DOLLAR

The Canadian dollar reaches the US$0.75 mark

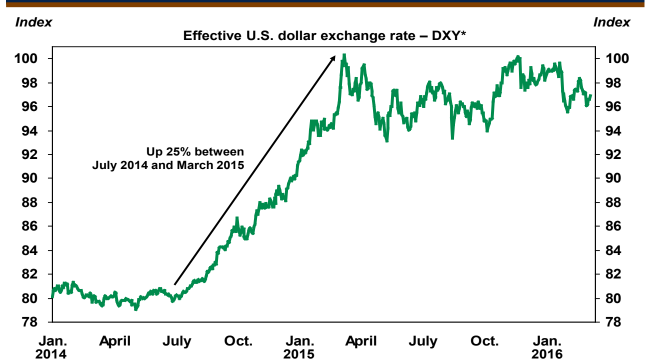
- The Canadian dollar's trend has been better since February and the loonie recently crossed the US$0.75 mark. One factor behind the upswing is the rebound in oil prices (graph 5). The loonie is also benefiting from some improved Canadian economic numbers. The perception that the Bank of Canada has been relatively optimistic at its last two monetary policy meetings is another factor that is tipping the balance. At the start of the year, the markets had been pricing in a strong probability of a Canadian interest rate cut in the near future, adding to the negative pressure on the loonie.
- In another vein, the Canadian dollar is rising at a time when the greenback is struggling to make further gains (graph 6). A year ago, the greenback had been capitalizing on expectations of monetary policy divergence given the looming U.S. interest rate increases. The markets now seem to be doubting the Federal Reserve's will or ability to raise interest rates gradually over the coming quarters. The Canadian dollar is not the only currency benefiting: the euro has gone back above US$1.10. The European Central Bank's additional action was not enough to take the common currency down. The same occurred with the yen, which rose despite the announcement of a negative interest rate policy in Japan.
- **Forecasts:** The Canadian dollar could lose a few cents in the near term. The oil price comeback remains fragile and a retreat would certainly penalize the loonie. The uptrend for crude prices should strengthen by year's end, which would allow the loonie to end the year on a positive note. However, the U.S. dollar should gain some strength in the months to come, as the markets could have to adjust their monetary firming expectations upward. This will limit the Canadian dollar's potential for gains. Given that it will not benefit from a rebound in oil prices, the euro will have more difficulty and should slide against the greenback and loonie.

Graph 5 – The Canadian dollar capitalizes on rebounding oil prices



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

Graph 6 – New gains are scarcer for the greenback in the last year



* Weighted U.S. dollar average against the euro, yen, pound, Canadian dollar, Swedish krona and Swiss franc.
Sources: Bloomberg and Desjardins, Economic Studies

Determinants	Short-term	Long-term
Oil prices	→	↗
Metals prices	→	↗
Interest rate spreads	↘	→

Table 2
Forecasts: currency

	2015		*2016*				*2017*			
End of period	**Q3**	**Q4**	**Q1f**	**Q2f**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**
US$/CAN$	0.7510	0.7225	0.7600	0.7400	0.7400	0.7500	0.7500	0.7500	0.7600	0.7800
CAN$/US$	1.3315	1.3841	1.3158	1.3514	1.3514	1.3333	1.3333	1.3333	1.3158	1.2821
CAN$/€	1.4863	1.5035	1.4737	1.4730	1.4459	1.4000	1.4133	1.4533	1.4474	1.4231
US$/€	1.1162	1.0863	1.1200	1.0900	1.0700	1.0500	1.0600	1.0900	1.1000	1.1100
US$/£	1.5148	1.4739	1.4200	1.4200	1.4400	1.4600	1.4900	1.5300	1.5300	1.5500

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

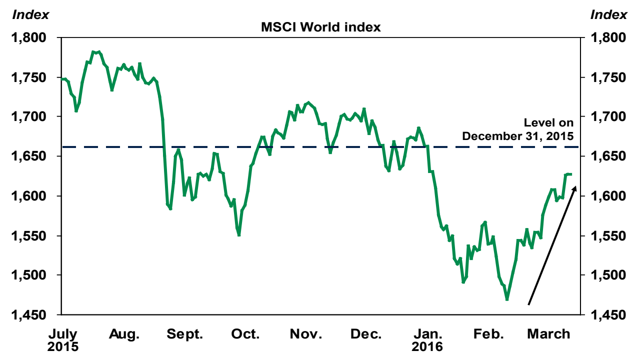
ASSET CLASSES RETURN

Optimism is back

- **The highly volatile climate in the stock markets early in the year gave way to some renewed confidence over the last weeks.** After plunging nearly 12% from January 1 to February 11, the MSCI World index has recouped nearly all of its losses (graph 7). European stock markets, which were at the core of the upheaval, have also recovered since mid-February, although the Euro Stoxx 600 index is still down about 6% from the start of the year. European bank stocks were hurt in the wake of concern about the soundness of some major banks. The Deutsche Bank was hit especially hard; in 2015, it had to suspend dividends due to its poor performance. Only after Deutsche Bank executives and the German finance minister repeatedly stressed that the institution was financially sound did a lull start to emerge. We are still trimming our target for international equity slightly, reflecting a climate that could remain shaky in Europe and Asia.
- **Note that the many concerns over global growth had helped fuel pessimism.** In January, the International Monetary Fund (IMF) had downgraded its growth outlook; the Organisation for Economic Co-operation and Development (OECD) followed suit in February. This, combined with a contraction in S&P 500 earnings in the last quarter, even raised suspicions about a recession. There was no solid foundation for such speculation, however, as we explained in a recent *Economic Viewpoint*.[1] The latest U.S. economic numbers have confounded the biggest sceptics, with Q1 2016 poised to see better growth than in the previous quarter. The S&P 500 has recorded a jump of more than 10% since February 11. It has now reclaimed the level of 2,000 points.
- **Rather than raging over whether the United States is about to go into recession, the debate is now focused on whether the Federal Reserve (Fed) will have enough confidence to raise key rates again by the summer.** Just last February, futures were pricing in a less than 5% chance of a key rate increase in June. The probability was recently close to 50% (graph 8). The greenback has halted its skyrocketing advance and the stabilization of oil prices is also good news for some sectors. Our return target for the U.S. stock market stays at 7.0%.
- **The S&P/TSX's performance is one of the year's nice surprises.** Whereas most global stock markets have recorded losses since January, Canada's stock market posts modestly positive growth (graph 9). The materials' sector is surging, gaining more than 20% since the start of the year. We must, however, remember that this performance is largely due to a spectacular rebound in gold

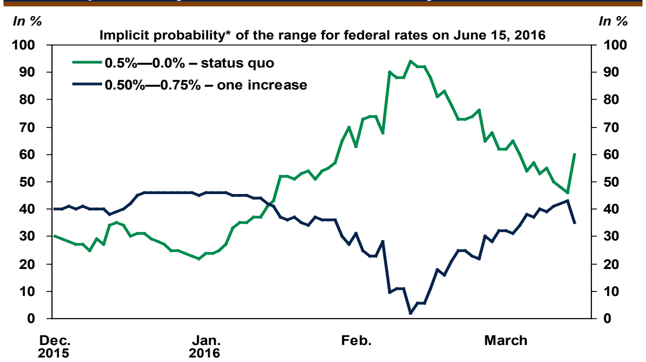
[1] Desjardins, Economic Studies, *Economic Viewpoint*, "Would an entry in bear market teritory be justified for the U.S. equity market?" February 23, 2016, www.desjardins.com/ressources/pdf/pv160223-e.pdf?resVer=1456229566000.

Graph 7 – Global stock markets have recouped much of their losses



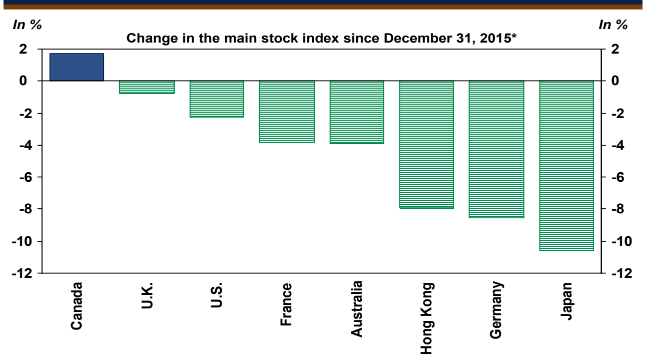
Sources: Bloomberg and Desjardins, Economic Studies

Graph 8 – Compared to February, markets are pricing in a higher probability that rates will be raised by this summer



* According to federal funds futures.
Sources: Bloomberg and Desjardins, Economic Studies

Graph 9 – Good start for the Canadian stock market this year



* On March 15, 2016.
Sources: Bloomberg and Desjardins, Economic Studies

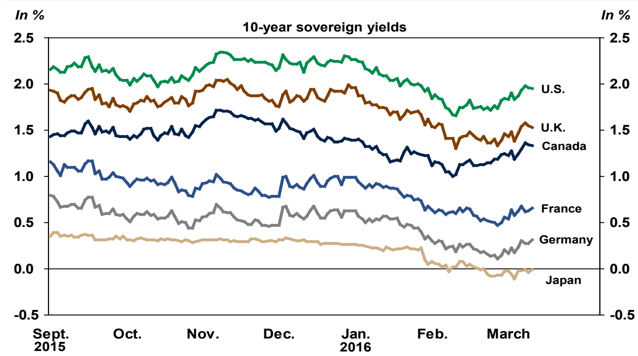
prices, which inflated the value of gold securities (graph 10). Gold's 18% rise is not based on very strong fundamentals; instead, it is a side-effect of market concerns, particularly about the impact of very aggressive monetary policy such as negative rates. This effect on the materials' sector could prove fleeting. Note, however, that the Canadian stock market's solid performance is not based on a single sector: it is fairly widespread. This notion, along with a better-than-anticipated start, prompt us to raise the return target to 6.0%.

- **For the bond markets, the drop in risk aversion is, of course, hitting the return on the asset class, contrasting with the situation that prevailed at the start of the year.** Although we think the Fed will raise its key rates in June, bond yields should climb very slowly, particularly in the long-term maturities. Very stimulating monetary policy internationally should limit the magnitude of the upward movement in North America yields (graph 11). We still expect a slightly positive return for the bond market.

Graph 10 – Gold's upswing is largely responsible for the boom in the materials sector

Sources: Bloomberg and Desjardins, Economic Studies

Graph 11 – Extremely low rates in Europe and Japan could restrain the uptrend in bond yields elsewhere



Sources: Bloomberg 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	Bond Index*	S&P/TSX Index**	S&P 500 Index (US$)**	MSCI EAFE Index (US$)**	C$/US$ (var. in %)***
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
2013	0.97	-1.2	13.0	32.4	23.3	7.1
2014	0.91	8.8	10.6	13.7	-4.5	9.4
2015	0.53	3.5	-8.3	1.4	-0.4	19.1
2016f	target: 0.50	target: 1.0	target: 6.0	target: 7.0	target: 3.0	target: -3.7 (US$0.75)
range	0.30 to 0.65	-2.0 to 4.0	-4.0 to 10.0	2.0 to 12.0	-8.0 to 10.0	-8.5 to 1.8

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