RETAIL RATE FORECASTS

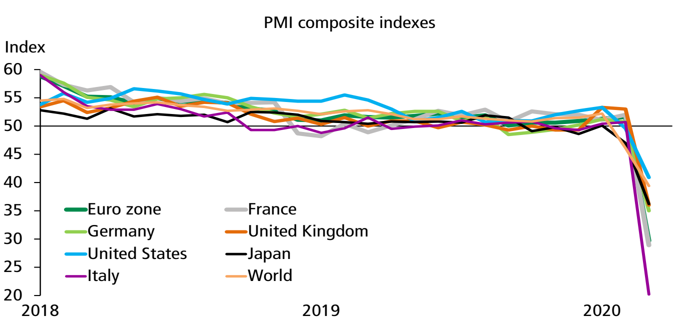
Central Banks and Governments Are Taking Unprecedented Actions to Support an Economy on Hold

HIGHLIGHTS

- The global economy is on hold to deal with the COVID-19 pandemic.
- The plunge in oil prices adds to Canada's economic woes.
- The prevailing uncertainty remains favourable for the U.S. dollar.
- Is the dramatic stock market correction over?

- **The global economy is on hold to deal with the COVID-19 pandemic.** On March 11, the World Health Organization (WHO) declared a global pandemic in light of the explosive spread of COVID-19. A stream of countries have since announced strict containment and social distancing measures. There is no doubt that the restrictions put in place will cause the fastest global economic contraction in modern history. For the time being, little data exists to determine the impact of such measures, but the Purchasing Managers' Indexes (PMI), which are generally linked to GDP growth, point towards sudden declines all over the world (graph 1).

GRAPH 1
PMI indexes plummeted around the world



Sources: IHS/Markit, Datastream and Desjardins, Economic Studies

- **Forceful response by the Federal Reserve (Fed) and U.S. government.** In less than a month, the Fed slashed the target for the federal funds rate by 150 basis points, bringing it down to its effective lower bound. The Fed also announced a plethora of unconventional measures, increasing its asset purchases and amending regulations to support the credit market. The U.S. government also announced a massive stimulus plan worth more than US$2,000B for both individuals and businesses. The authorities' response is every bit as unprecedented as the health and economic crisis caused by COVID-19.

- **The plunge in oil prices adds to Canada's economic woes.** Canada's March employment numbers are startling, with a monthly loss of more than 1 million jobs (graph 2 on page 2), and there is every indication that the situation might worsen still. As the Canadian economy faces this major economic shock, it must also deal with exceptionally low oil prices. The value of a barrel of WCS (Western Canada Select), the benchmark index for oil from Western Canada, hit US$4 at the beginning of April. Oil-exporting provinces could therefore be hit twice as hard by the current crisis.

- **Quantitative easing is making its way in Canada.** The Bank of Canada (BoC) followed the example of the Fed by lowering its key rate from 1.75% to 0.25% in less than a month in March and by initiating asset purchases that will

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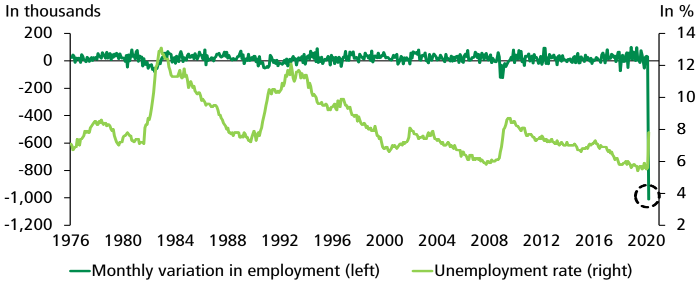
GRAPH 2
A historic deterioration of Canada's labour market in March

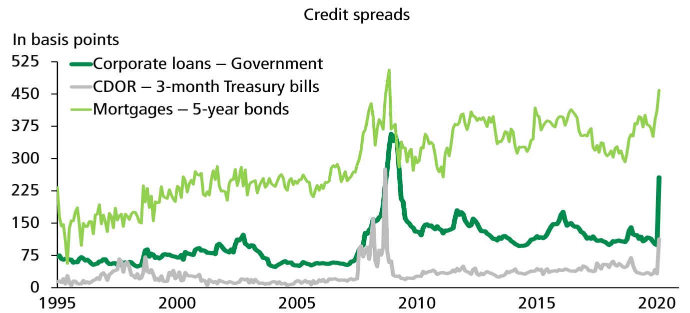


Sources: Statistics Canada and Desjardins, Economic Studies

increase the size of its balance sheet, a first in Canada. These actions were accompanied by a massive federal support program for individuals and businesses affected by COVID-19. The BoC has since strengthened its actions by further enlarging its asset purchase program at its April 15 meeting.

- **Retail rates did not follow bond yields.** Although the BoC lowered its key rate by 150 basis points and bond yields plummeted in March, this movement was not fully reflected in retail rates. The high uncertainty and increased risk limited transactions on the institutional financing market, which widened yield spreads between risk-free bonds and loans available to financial institutions (graph 3). All the evidence suggests that the magnitude of these financial tensions prompted the BoC to expand its asset buying program. These actions reduced the cost of funds for financial institutions, which should pave the way for lower retail rates in the weeks and months to come.

GRAPH 3
Credit spreads widened to levels reminiscent of the 2008 crisis at the end of March



CDOR: Canadian Dollar Offered Rate, short-term rates on loans between financial institutions
Sources: Datastream and Desjardins, Economic Studies

TABLE 1
Forecasts: Retail rate

IN %	DISCOUNT RATE	PRIME RATE	MORTGAGE RATE			TERM SAVINGS[1]		
			1 year	3 years	5 years	1 year	3 years	5 years
Realized (end of month)								
October 2019	2.00	3.95	3.69	4.34	5.19	1.40	1.60	2.00
November 2019	2.00	3.95	3.69	4.34	5.19	1.40	1.60	2.00
December 2019	2.00	3.95	3.69	4.34	5.19	1.40	1.60	2.00
January 2020	2.00	3.95	3.69	4.34	5.19	1.40	1.60	2.00
February 2020	2.00	3.95	3.69	4.34	5.19	1.40	1.60	1.80
March 2020	0.50	2.45	3.49	3.99	4.99	0.85	1.05	1.30
April 15, 2020	0.50	2.45	3.49	3.99	4.99	0.85	1.05	1.30
Forecasts								
End of quarter								
2020: Q2	0.25–0.50	2.20–2.45	2.40–3.60	2.95–4.15	3.95–5.15	0.00–1.15	0.45–1.65	0.65–1.85
2020: Q3	0.25–0.75	2.20–2.70	2.30–3.50	2.60–3.80	3.75–4.95	0.00–1.10	0.25–1.45	0.50–1.70
2020: Q4	0.25–0.75	2.20–2.70	2.25–3.45	2.55–3.75	3.75–4.95	0.00–1.00	0.20–1.40	0.45–1.65
2021: Q1	0.25–1.00	2.20–2.95	2.20–3.40	2.50–3.70	3.65–4.85	0.00–0.95	0.15–1.35	0.40–1.60
End of year								
2021	0.00–1.25	1.95–3.20	2.00–3.50	2.30–3.80	3.45–4.95	0.00–1.05	0.00–1.50	0.20–1.70
2022	0.25–1.75	2.20–3.70	2.05–3.55	2.30–3.80	3.65–5.15	0.00–1.10	0.00–1.50	0.20–1.70
2023	0.75–2.25	2.70–4.20	2.50–4.00	2.70–4.20	4.05–5.55	0.05–1.55	0.35–1.85	0.60–2.10

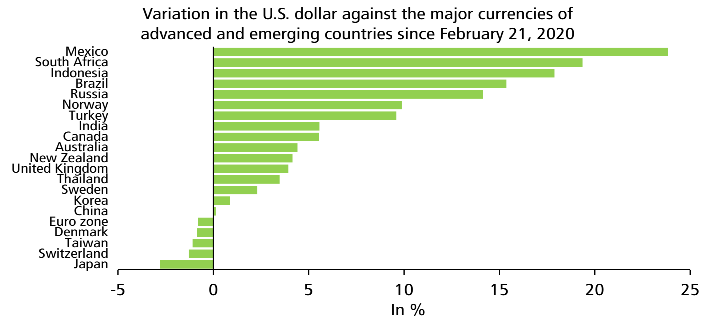
[1] Non-redeemable (annual); NOTE: Forecasts are represented using an asymmetric range reflecting the perceived probability of deviation from the base scenario. The mean of the range does not represent the forecast associated with the base scenario.
Source: Desjardins, Economic Studies

Exchange Rate

The Prevailing Uncertainty Remains Favourable for the U.S. Dollar

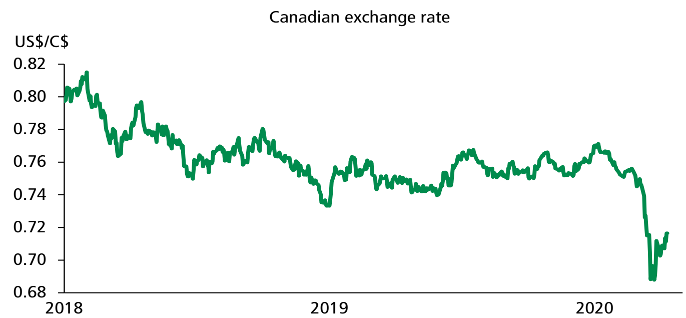
- Significant exchange rate movements have been observed since late February. The U.S. dollar benefited overall because of its role as a natural safe haven (graph 4). Emerging country currencies suffered the steepest declines. Some advanced country currencies, meanwhile, managed to appreciate. This was notably the case of the euro, which climbed to US$1.14 in the first week of March. This appreciation coincided with the reduction in interest rate spreads between Europe and the United States. U.S. bond yields slid further as a result of the increased potential of monetary easing by the Federal Reserve. The euro has since weakened and is trading at around US$1.09.
- The Canadian dollar was more resistant to the first wave of anxiety early in the year that penalized a number of commodity-linked currencies. Its depreciation was more evident in the last week of February and the first three weeks of March, temporarily falling below US$0.69. Since the last week of March, the loonie has managed to recover some of the ground it had lost earlier. It is now trading at around US$0.71 (graph 5).
- **Main Elements to Watch For:** Financial markets have had to digest a lot of new information since the end of February. The next few weeks will likely bring fewer new developments, which should reduce exchange rate volatility. However, it will take until economic activity begins showing signs of recovery for the degree of prevailing uncertainty to decrease significantly and for the U.S. dollar to resume its lasting downward trend against multiple currencies. The Canadian dollar could end the year at around US$0.74.

GRAPH 4
The U.S. dollar appreciated against multiple currencies



Sources: Datastream and Desjardins, Economic Studies

GRAPH 5
The Canadian dollar rebounded from a low below US$0.69 in the third week of March



Sources: Datastream and Desjardins, Economic Studies

Impacts on the Canadian dollar	Short-term	Long-term
Risk aversion	→	↗
Commodity prices	→	↗
Interest rate spreads	→	→

TABLE 2
Forecasts: Currency

	2019		2020				2021			
END OF PERIOD	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
US$/CAN$	0.7552	0.7699	0.7112	0.7100	0.7250	0.7400	0.7450	0.7500	0.7500	0.7600
CAN$/US$	1.3241	1.2988	1.4062	1.4085	1.3793	1.3514	1.3423	1.3333	1.3333	1.3158
CAN$/€	1.4435	1.4579	1.5429	1.5352	1.5034	1.4865	1.4899	1.4800	1.4933	1.4868
US$/€	1.0902	1.1225	1.0973	1.0900	1.0900	1.1000	1.1100	1.1100	1.1200	1.1300
US$/£	1.2323	1.3248	1.2400	1.2500	1.2600	1.2500	1.2500	1.2500	1.2700	1.3000

f: forecasts
Sources: Datastream and Desjardins, Economic Studies

Asset Classes Return

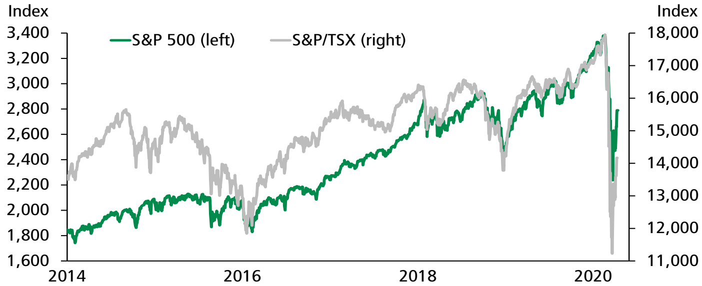
Is the Dramatic Stock Market Correction Over?

- **Complacency suddenly gave way to panic.** Not to worried about the coronavirus epidemic in China, the S&P 500 index closed at an all-time high of 3,386 points on February 19. This complacency gave way to real panic when cases of infection began to surge in Europe and North America, prompting authorities to introduce draconian isolation measures. Stock markets took a dramatic tumble in response to a virtually unheard-of demand shock that will have major adverse impacts on economic activity and corporate earnings. In the space of about a month, the main North American indexes dropped more than 30% (graph 6). The longest bull run in history for the U.S. stock market, which had begun in March 2009, thus came to an abrupt end.

- **Central banks seem to have managed to avert a financial crisis.** The spike in anxiety over the COVID-19 pandemic and the stock market nosedive caused major tensions on financial markets. Credit spreads on corporate bonds skyrocketed (graph 7) and signs of poor market functioning and liquidity shortages even emerged, reminding many of the 2008 financial crisis. Determined to prevent a financial crisis from exacerbating the economic shock caused by COVID-19, central banks took decisive action to keep markets running smoothly. In addition to slashing their key rates by 150 basis points in March, the Federal Reserve and the Bank of Canada stepped up bond buying programs to support the supply of credit and liquidity. These central bank actions, coupled with governments' intensive efforts to help households and businesses affected by the crisis, appear to have reassured investors. Combined with some signs that the epidemic curve is flattening, this helped the S&P 500 and S&P/TSX indexes to rebound by about 25% from their closing values on March 23, officially putting an end to the bear market.

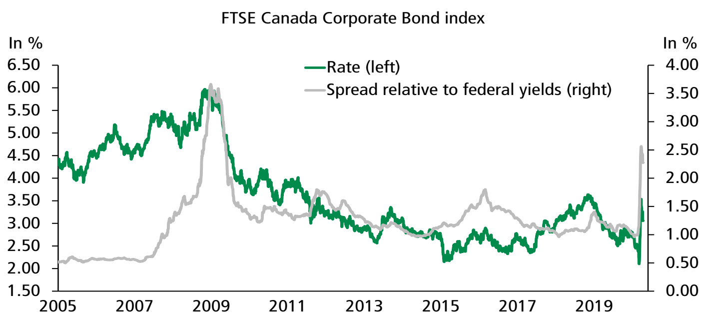
- **Oil demand is severely affected.** The decline in air transportation and the implementation of isolation measures in most economies are having a striking impact on demand for petroleum products. The International Energy Agency estimates that the global demand for oil in the first half of 2020 will drop by about 15 mbd (million barrels per day) compared to the same period last year (graph 8). The dispute between Saudi Arabia and Russia, which raised fears of a surge in global production, amplified the fall in the price of the black gold. A new agreement between the major producers was finally reached recently, which should mean close to a 10 mbd reduction in the global supply. These production cuts will not be sufficient to avoid an increase in world oil inventories in the short term, but they do offer hope

GRAPH 6
After peaking in mid-February, stock markets took a nosedive



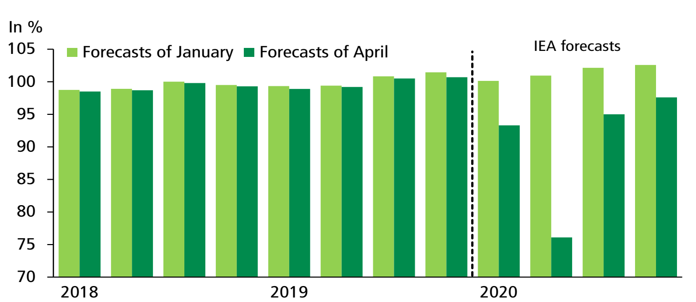
Sources: Datastream and Desjardins, Economic Studies

GRAPH 7
Canadian credit spreads jumped to their highest level since the 2008 crisis



Sources: Datastream and Desjardins, Economic Studies

GRAPH 8
The world's oil demand will be much weaker than initially expected in 2020

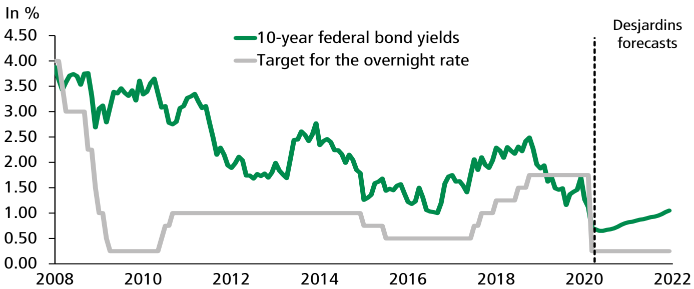


IEA: International Energy Agency
Sources: IEA and Desjardins, Economic Studies

that the market will rebalance itself faster and the price will gradually creep back up once the containment measures are lifted.

- **Bond yields will stay very low.** Bond markets played their safe haven role, and the FTSE Canada Universe Bond index has posted a gain of over 4% since the start of 2020. This gain is mostly due to government securities, as corporate bonds were penalized by wider credit spreads. While North American key rates should hold at their effective lower bound for several quarters and central banks will continue to buy bonds for some time, U.S. and Canadian bond yields are expected to stay very low (graph 9), even if economic activity were to rebound in the second half of 2020. A gradual narrowing in credit spreads could help the bond market still make slight gains by the end of the year.

GRAPH 9
Interest rates will remain low in the coming quarters



Sources: Datastream and Desjardins, Economic Studies

- **It will be difficult for stock markets to continue their recent run in the short term.** The authorities' decisive moves to limit the fallout from the epidemic and avert a financial crisis justify a certain uptick in stock markets. However, these efforts will not prevent a sharp contraction in economic activity and corporate earnings in the short term. Even though activity is expected to rebound in the second half of 2020, it would be wrong to believe that all the adverse effects of the crisis will be quickly wiped out. Moreover, the risk of a longer pandemic or further financial tensions is still high, which should limit stock market gains in the short term. The North American stock markets could nevertheless end the year slightly above current levels if our scenarios of a gradual pickup in economic activity in the coming months materialize.

TABLE 3
Asset classes percentage return

	CASH	BONDS	CANADIAN STOCKS	U.S. STOCKS	INTERNATIONAL STOCKS	EXCHANGE RATE
END OF YEAR IN % (EXCEPT IF INDICATED)	3-month T-Bill	Bond index[1]	S&P/TSX index[2]	S&P 500 index (US$)[2]	MSCI EAFE index (US$)[2]	C$/US$ (variation in %)[3]
2009	0.6	5.4	35.1	26.5	32.5	-13.7
2010	0.5	6.7	17.6	15.1	8.2	-5.2
2011	1.0	9.7	-8.7	2.1	-11.7	2.3
2012	1.0	3.6	7.2	16.0	17.9	-2.7
2013	1.0	-1.2	13.0	32.4	23.3	7.1
2014	0.9	8.8	10.6	13.7	-4.5	9.4
2015	0.6	3.5	-8.3	1.4	-0.4	19.1
2016	0.5	1.7	21.1	12.0	1.5	-2.9
2017	0.6	2.5	9.1	21.8	25.6	-6.4
2018	1.4	1.4	-8.9	-4.4	-13.4	8.4
2019	1.6	6.9	22.9	31.5	22.7	-4.8
2020f	target: 0.80	target: 5.0	target: -7.0	target: -9.0	target: -14.0	target: 4.0 (US$0.74)
range	0.55 to 1.00	3.0 to 7.0	-18.0 to 2.0	-20.0 to 3.0	-24.0 to -5.0	1.3 to 10.0

f: forecasts; [1] FTSE Canada Universe Bond Index; [2] Dividends included; [3] Negative = appreciation, positive = depreciation.
Sources: Datastream and Desjardins, Economic Studies