RETAIL RATE FORECASTS

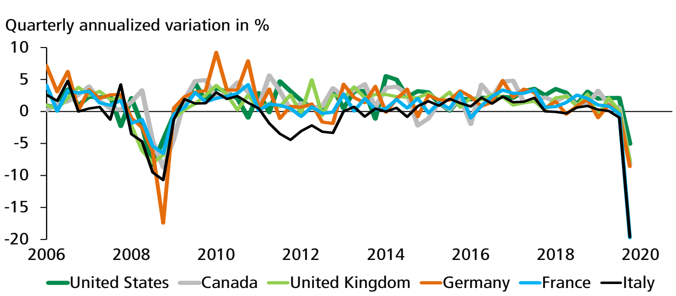
Low Interest Rates Are Here to Stay for a Long Time

HIGHLIGHTS

- The lockdown lifting is reason for cautious optimism concerning the recovery.
- The Bank of Canada's new governor, Tiff Macklem, will stay the course during these turbulent times.
- Did the Canadian dollar appreciate too quickly?
- Will the stock market continue to win over the skeptics?

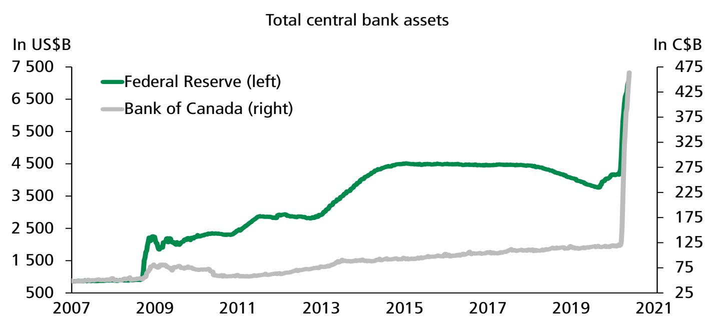
- **The lockdown lifting is reason for cautious optimism concerning the recovery.** After shutting down for weeks, many economies around the world are starting to gradually pick up activity. For now, partial openings do not seem to be causing a major resurgence of the contagion. The successful lifting of the lockdown is of utmost importance at this point, as the latest economic figures begin to reveal the full extent of the current contraction (graph 1).
- **Asset purchases will keep expanding central bank balance sheets for a long time.** With the Federal Reserve's (Fed) key rate at its effective lower bound and very low inflation, all indications are that massive asset purchases will continue in the coming months. This will increase the Fed's balance sheet, which is already reaching an unprecedented level, even more (graph 2). Furthermore, the April 29 meeting minutes revealed that the members of the Fed's open market committee were deeply concerned about the state of the economy, a potential second wave of infection and the possible repercussions on the financial system. While the Fed will clearly not hesitate to accelerate and expand its asset purchases as needed, negative interest rates will not be an option.
- **Recent figures show the full extent of the damage to the Canadian economy.** Even though the forced

GRAPH 1
Real GDP fell in the first quarter in several countries



Sources: Datastream and Desjardins, Economic Studies

GRAPH 2
The size of central bank balance sheets is growing very quickly



Sources: Datastream, Bank of Canada and Desjardins, Economic Studies

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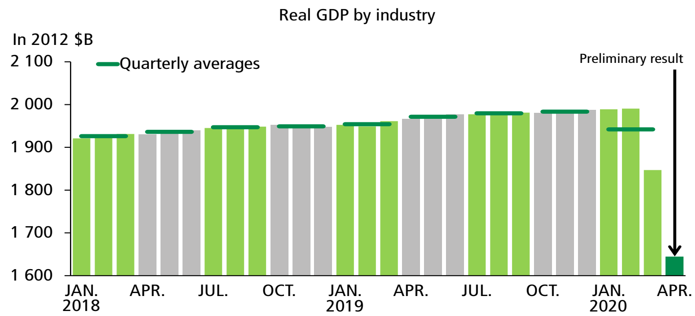
closures and distancing measures only began in mid-March in Canada, the impact on growth was already being felt in the first quarter, with GDP plunging 8.2% at an annualized rate. The contraction will be even worse in April according to the preliminary data (graph 3) as the Canadian economy lost nearly two million jobs. However, with some sectors reopening, and the first monthly gain for employment in May, there is hope that the worst is now behind us. Yet, the recovery remains extremely vulnerable to a second wave of the infection.

- **Bank of Canada (BoC) changes governor but not direction.** On June 3, the BoC cut back on some market operations after an improvement in financial conditions. Although financial institutions' access to short-term liquidity does not seem to be a concern anymore, supporting the economy and the credit market is of prime importance to the BoC as shown by its intention to continue large-scale asset buying until the economic recovery is firmly underway. The arrival of Tiff Macklem as BoC's new governor should not change the outlook in this regard.

- **Calm returns to the bond markets.** Long-term Canadian bond yields ended May almost unchanged from the previous month. There was little in the way of change on the U.S. market, too. Note that central bank asset buying is supporting demand and helping to narrow credit spreads. This context should encourage financial institutions to keep expanding credit, which may translate into lower retail interest rates.

GRAPH 3
The Canadian economy is expected to contract even further in April



Sources: Statistics Canada and Desjardins, Economic Studies

TABLE 1
Forecasts: Retail rate

IN %	DISCOUNT RATE	PRIME RATE	MORTGAGE RATE 1 year	MORTGAGE RATE 3 years	MORTGAGE RATE 5 years	TERM SAVINGS[1] 1 year	TERM SAVINGS[1] 3 years	TERM SAVINGS[1] 5 years
Realized (end of month)								
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 2020	0.50	2.45	3.49	3.99	4.99	0.85	1.05	1.30
May 2020	0.50	2.45	3.29	3.89	4.94	0.75	1.05	1.30
June 5, 2020	0.50	2.45	3.29	3.89	4.94	0.75	1.05	1.30
Forecasts								
End of quarter								
2020: Q2	0.25–0.50	2.20–2.45	2.70–3.90	3.30–4.50	4.35–5.55	0.15–1.35	0.45–1.65	0.70–1.90
2020: Q3	0.25–0.75	2.20–2.70	2.35–3.55	3.00–4.20	4.05–5.25	0.00–1.20	0.30–1.50	0.65–1.85
2020: Q4	0.25–0.75	2.20–2.70	2.15–3.35	2.65–3.85	3.70–4.90	0.00–1.10	0.15–1.35	0.45–1.65
2021: Q1	0.25–1.00	2.20–2.95	2.00–3.20	2.35–3.55	3.50–4.70	0.00–1.05	0.00–1.15	0.30–1.50
End of year								
2021	0.25–1.25	2.20–3.20	1.85–3.35	2.20–3.70	3.35–4.85	0.00–1.20	0.00–1.30	0.05–1.55
2022	0.25–1.25	2.20–3.20	1.85–3.35	2.20–3.70	3.45–4.95	0.00–1.20	0.00–1.30	0.05–1.55
2023	0.50–2.00	2.45–3.95	2.35–3.85	2.65–4.15	4.00–5.50	0.05–1.40	0.30–1.80	0.55–2.05

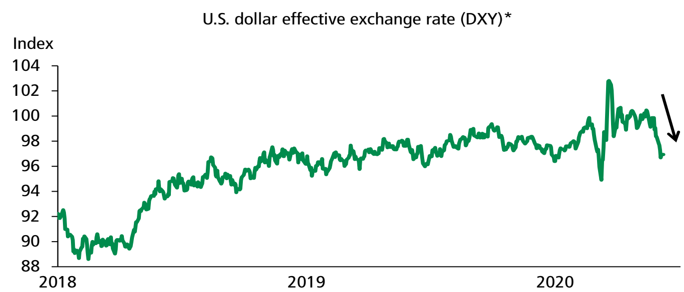
[1] Non-redeemable (annual); NOTE: Forecasts are represented using an asymmetric range reflecting the perceived probability of deviation from the base scenario. The mean of the range does not represent the forecast associated with the base scenario.
Source: Desjardins, Economic Studies

Exchange Rate

Did the Canadian Dollar Appreciate Too Quickly?

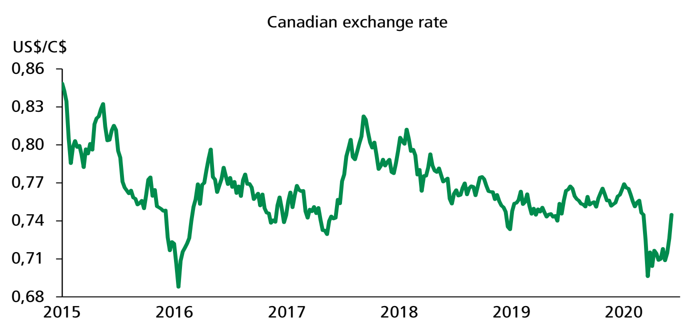
- The U.S. dollar has been tending to depreciate against many currencies since mid-May (graph 4). This is in keeping with the renewed optimism on the financial markets and the decreased demand for safe havens. The worsening political and trade tensions between China and the United States do not seem to be enough to provide fresh impetus to the greenback.
- Like most of the major currencies, the Canadian dollar appreciated against the U.S. dollar, recently trading over US$0.74. This is a clear improvement from the US$0.69 low reached in March (graph 5). Currencies like the Canadian dollar that are linked to commodities tend to depreciate sharply during times of upheaval but rebound when optimism returns. Nonetheless, the loonie remains below pre-pandemic crisis levels. It is also the case against the euro. The Canadian dollar remains near €0.66, although it was close to €0.69 at the beginning of the year. The euro is now worth US$1.13.
- **Forecasts:** The lifting of the lockdown seems to be working, and the global economy is showing signs of coming back to life. However, it will probably take a few months before we will be able to assess the strength and sustainability of the economic recovery. Any disappointment could stop the growing optimism on the markets and help the greenback. In addition, the worsening political and trade tensions between China and the United States will have to be closely monitored. The forecasts for the Canadian dollar were revised up, but we still believe that the loonie should end the second quarter near US$0.73. Despite the lockdown lifting currently underway, part of the economic recovery looks as if it will take a long time. Cautious optimism is still appropriate.

GRAPH 4
The U.S. dollar has clearly been trending down since mid-May



* Based on a basket of currencies that includes the Canadian dollar, euro, pound, yen, Swiss franc and Swedish krona.
Sources: Datastream and Desjardins, Economic Studies

GRAPH 5
The Canadian dollar regained much of the ground lost earlier



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	0.7300	0.7300	0.7350	0.7400	0.7450	0.7500	0.7500
CAN$/US$	1.3241	1.2988	1.4062	1.3699	1.3699	1.3605	1.3514	1.3423	1.3333	1.3333
CAN$/€	1.4435	1.4579	1.5429	1.5342	1.5205	1.5102	1.5135	1.5034	1.5067	1.5067
US$/€	1.0902	1.1225	1.0973	1.1200	1.1100	1.1100	1.1200	1.1200	1.1300	1.1300
US$/£	1.2323	1.3248	1.2400	1.2500	1.2400	1.2400	1.2400	1.2500	1.2600	1.2800

f: forecasts
Sources: Datastream and Desjardins, Economic Studies

Asset Classes Return

Will the Stock Market Continue to Win Over the Skeptics?

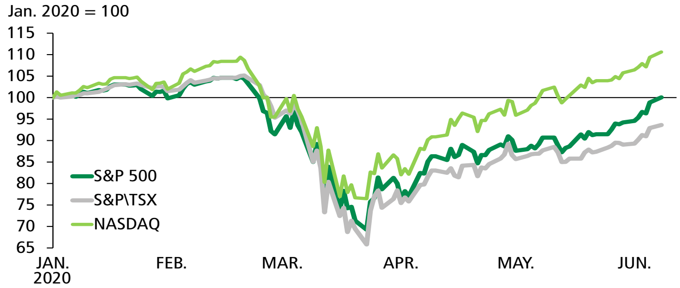
- **Stock markets keep advancing.** In mid-April, we noted that the unprecedented measures implemented by central banks had already led the stock markets to rebound sharply from their lows in March. This upward trend has generally continued in recent weeks as investors greet the start of lockdown lifting positively in the economies that had been put on hold to fight COVID-19. Technology stocks are doing particularly well, and the NASDAQ is even up significantly since the beginning of 2020 (graph 6). This keen interest in technology stocks is also benefiting the S&P 500 compared to other indexes, including the S&P\TSX in Canada.

- **Reduced economic activity is affecting earnings.** The rapid stock market rebound can be surprising as all signs point to the global economy recording its worst contraction this year since the depression of the 1930s. Even if the current health crisis is very different from a traditional recession and the gradual lifting of the lockdown measures is revealing signs of activity and hiring bouncing back to a certain extent, the profitability of certain businesses will be seriously affected, and some bankruptcies are unavoidable. As a result, analysts are continuing to revise their profit forecasts down (graph 7), and some sectors may suffer long-term sequels.

- **Central bank actions could justify higher stock market valuations.** The stock indexes' quick rebound thus does not seem to be justified by the hope that corporate earnings will quickly return to the levels recorded before the current crisis. At a time when central banks, especially the Fed, are committed to continuing to do everything they can to ensure that financial markets function properly and injecting massive amounts of liquidity, we can see why many investors would nonetheless turn to stocks. In our opinion, these central bank actions, which suggest that bond yields will remain very low in the coming years, would justify a lower expected return for investors on their stock market investment and, as a result, higher price-earnings ratios than in the past (graph 8).

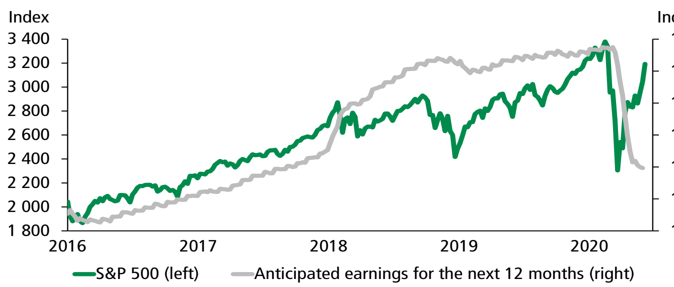
- **The oil price recovery is impressive, too.** The transportation sector felt the full impact of halting the global economy, which caused oil consumption to decline dramatically. The concern over inadequate storage capacity and the imminent expiry of a major futures contract even caused the price of WTI (West Texas Intermediate) oil to temporarily dive into negative territory on April 20. Still, after this dramatic drop, oil prices climbed quickly in recent weeks to return near US$40 per barrel. Faced with falling demand and prices, oil producers sharply cut output (graph 9 on page 5), raising hopes that the global market would rebalance

GRAPH 6
The stock market recovery is impressive



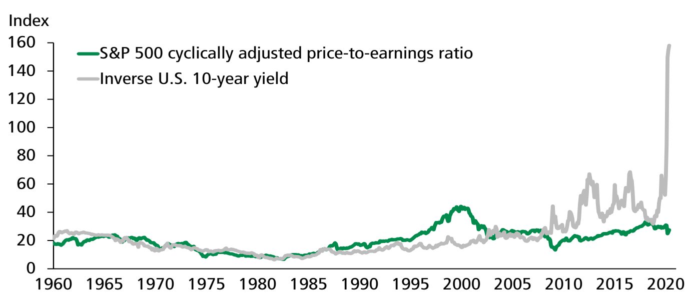
Sources: Datastream and Desjardins, Economic Studies

GRAPH 7
The earnings outlook is down significantly



Sources: Datastream and Desjardins, Economic Studies

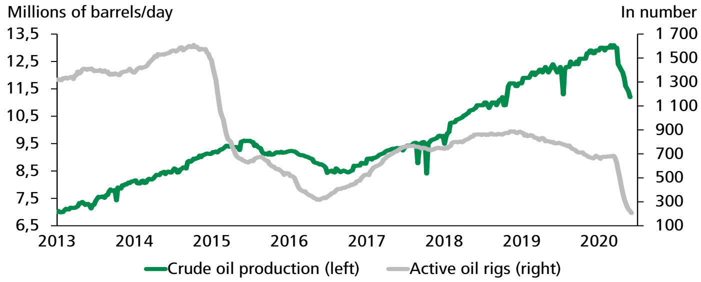
GRAPH 8
Should the return on stocks be the same as in the past even though bond yields have melted?



Sources: Robert J. Shiller, Yale University, Datastream and Desjardins, Economic Studies somewhat. Still, further price gains would be difficult to sustain, since it could lead some producers to increase production too quickly, while demand is expected to remain limited for many months to come.

- **Investors can thank the central banks.** By and large, asset classes are doing reasonably well in the unprecedented situation currently facing the global economy. Stock market declines are quickly reversing while the Canadian bond market advanced about 5% since the beginning of the year. Admittedly, these relatively good results are due in large part to central banks. Aside from dramatically lowering interest rates, they are underpinning the demand for all financial assets by injecting massive amounts of liquidity and even directly buying some riskier assets. The coming months could prove to be more difficult for risky assets, which now seem ready for a period of consolidation. Additionally, uncertainty about how the pandemic will evolve remains high, and the geopolitical, trade and social tensions could prompt investors to take profits. Nonetheless, as everything points to central banks continuing to provide support, we revised our stock targets up for the end of 2020, especially regarding the United States.

GRAPH 9
U.S. oil production and drilling reacted quickly to the drop in prices



Sources: Baker Hughes, Energy Information Administration and Desjardins, Economic Studies

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: -1.0	target: 3.5	target: -4.0	target: 4.8 (US$0.735)
range	0.55 to 1.00	2.0 to 7.0	-10.0 to 8.0	-5.0 to 10.0	-12.0 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