RETAIL RATE FORECASTS

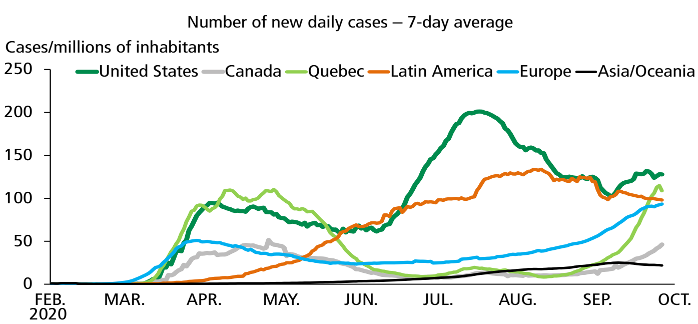
Retail Rates at All-Time Lows

HIGHLIGHTS

- The spike in COVID-19 cases is threatening the global economic recovery.
- The Canadian economy will continue to receive significant monetary and fiscal support.
- Uncertainty takes a toll on the loonie.
- The outlook remains fairly positive for stocks.

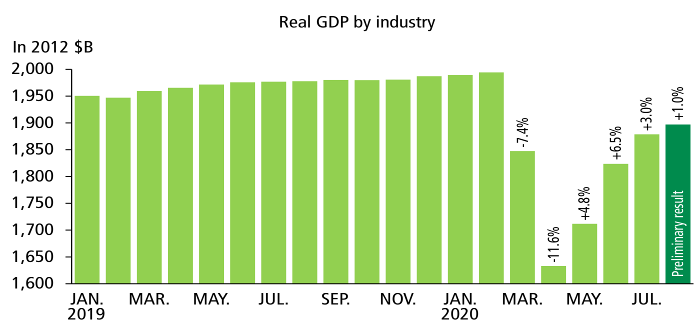
- **The global economic recovery will be slow and difficult.** Although the world's major economies have reopened in most of their activities in the third quarter, the COVID-19 pandemic continues to take a major toll on growth and the outlook. After a phase of strong rebound, the economy will experience a much slower and more difficult recovery in the coming months. The rise in COVID-19 cases in many regions of the world will require new lockdown measures (graph 1). Although the measures will be shorter-term and more targeted, they will hamper growth and cause uncertainty to persist.
- **The Federal Reserve** (Fed) **is willing to tolerate higher inflation to ensure a successful recovery**. Since cutting rates in March, the Fed has reiterated that the target federal funds rate will stay at its effective lower bound until the economy has fully recovered, and that it will use all the tools at its disposal, including large-scale asset purchases, to support the economy. The Fed also announced it would adjust its monetary policy to tolerate inflation temporarily above its 2% target, with the goal of achieving that rate on average, in the long term.
- **Canada's economic recovery is losing steam.** Strong rebounds in real GDP by industry in Canada in May and June (+4.8% and +6.5%, respectively) gave way to less spectacular growth in July (+3.0%). The preliminary estimate released by Statistics Canada for August indicates that growth will continue to slow down, to about 1% (graph 2). The resurgence

GRAPH 1
New cases are on the rise in many regions of the world



Sources: World Health Organization, Institut national de santé publique du Québec and Desjardins, Economic Studies

GRAPH 2
Canada's economic recovery is easing



Sources: Statistics Canada and Desjardins, Economic Studies

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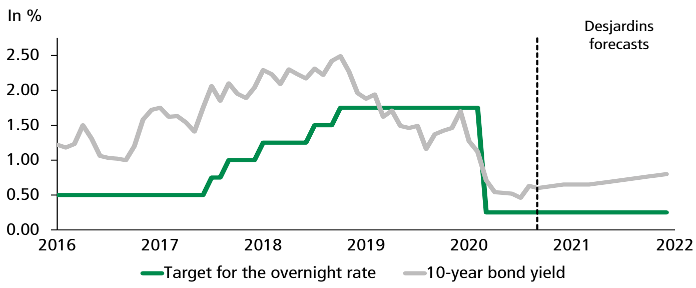
of COVID-19 cases in September and the announcement of new lockdown measures in Quebec could also cause a drop in real GDP in October. If this second wave of infections is not controlled, it could hurt growth more in the fourth quarter, particularly since a number of government assistance programs will be tapering off.

- **The Canadian economy will continue to receive significant monetary and fiscal support.** Like the Fed, the Bank of Canada has reiterated its commitment to stand pat on key rates and to continue to buy assets as needed until the economic recovery is firmly underway. These measures will keep bond yields low and enable the various levels of government to continue spending aimed at supporting households and businesses impacted by the pandemic. This was also the intention announced by the Canadian government in the Speech of the Throne on September 23. Despite a projected deficit of nearly 15% of GDP for 2020, major spending will continue in 2021 to support the recovery.

- **Bond yields should remain stable.** Although the central banks don't specify targets for longer-term bond yields, their significant asset purchases are helping to keep yields stable and low (graph 3). The expansion of asset-buying programs to corporate bonds has also limited hikes in financing costs for the private sector. Against this backdrop, major fluctuations in interest rates on bonds and retail rates seem unlikely. However, a major rise in the risk of default or inflation expectations could change that outlook.

GRAPH 3
Interest rates will remain low for the long term in Canada



Sources: Datastream 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)								
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 2020	0.50	2.45	3.19	3.89	4.94	0.75	1.05	1.30
July 2020	0.50	2.45	3.09	3.89	4.94	0.55	0.90	1.15
August 2020	0.50	2.45	3.09	3.74	4.74	0.50	0.70	0.95
September 2020	0.50	2.45	2.89	3.54	4.74	0.50	0.70	0.95
Oct. 5, 2020	0.50	2.45	2.89	3.54	4.74	0.50	0.70	0.95
Forecasts								
End of quarter								
2020: Q4	0.50–0.75	2.45–2.70	2.50–3.10	2.90–3.70	4.10–4.90	0.15–0.90	0.30–1.05	0.45–1.20
2021: Q1	0.50–0.75	2.45–2.70	2.10–3.10	2.80–3.80	4.00–5.00	0.05–0.95	0.20–1.10	0.35–1.25
2021: Q2	0.50–0.75	2.45–2.70	2.00–3.20	2.70–3.90	3.90–5.10	0.05–1.00	0.10–1.15	0.25–1.30
2021: Q3	0.25–1.00	2.20–2.95	1.85–3.35	2.55–4.05	3.75–5.25	0.05–1.15	0.05–1.30	0.20–1.45
End of year								
2021	0.25–1.25	2.20–3.20	1.85–3.35	2.55–4.05	3.75–5.25	0.05–1.15	0.05–1.30	0.20–1.45
2022	0.25–1.25	2.20–3.20	1.75–3.45	2.45–4.15	3.65–5.35	0.05–1.15	0.05–1.30	0.20–1.45
2023	0.25–1.50	2.20–3.45	1.65–3.55	2.40–4.30	3.75–5.65	0.05–1.15	0.05–1.55	0.40–1.90

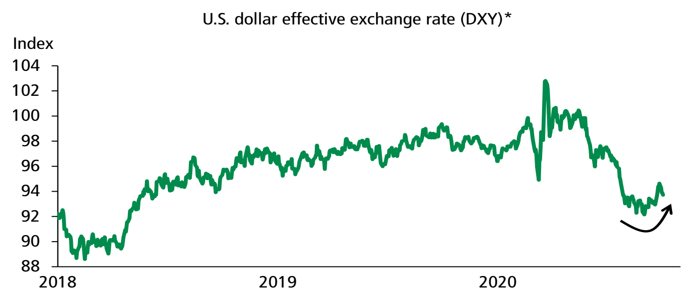
[1] Non-redeemable (annual); NOTE: Forecasts are represented using an asymmetric range reflecting the perceived probability of deviation from the base scenario. The mean of the range does not represent the forecast associated with the base scenario.
Source: Desjardins, Economic Studies

Exchange Rate

Uncertainty Takes a Toll on the Loonie

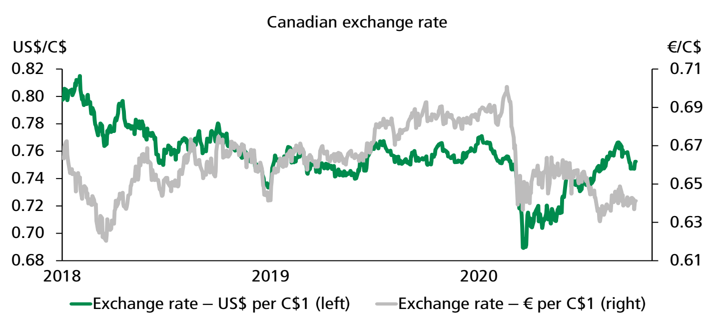
- Given the climate of greater uncertainty, the U.S. dollar is benefitting from its safe haven effect. Nevertheless, it's far below the levels seen in the spring (graph 4). This is consistent with the fact that the degree of uncertainty is lower than it was at the start of the pandemic. The greenback's rebound has also likely been reined in by the fact that the Federal Reserve appears hampered by its intention to tolerate higher inflation in order to stimulate employment.
- Under these circumstances, the Canadian dollar momentarily fell below the psychological barrier of US$0.75 (graph 5). At the start of September, it was close to US$0.77, a peak not seen since January. The loonie's recent depreciation against the U.S. dollar is similar to that of other currencies, including the euro. The Canadian dollar held fairly close to €0.64 in September. That's still well below the €0.68 to €0.69 seen at the start of the year.
- The pound sterling has gotten a little more attention recently as the Brexit issue is back in the news. The pound's value fluctuated in tandem with progress on the negotiations with the rest of Europe, which are expected to yield a final agreement in October. The pound approached US$1.34 in August, then fell to nearly US$1.27 before climbing back above US$1.29 in the last few days.
- **Forecasts:** Uncertainty could remain higher throughout the fall than it was over the summer. The U.S. dollar should continue to have an advantage over most currencies. However, further gains could be fairly small failing a sharp erosion in the economic situation and signs that the pandemic could worsen considerably. The Canadian dollar should end the year below the US$0.75 mark and appreciate slightly in 2021.

GRAPH 4
The U.S. dollar appreciated in September



* 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 dipped below US$0.75 again



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	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f
US$/CAN$	0.7552	0.7699	0.7112	0.7366	0.7507	0.7400	0.7500	0.7600	0.7650	0.7700
CAN$/US$	1.3241	1.2988	1.4062	1.3576	1.3321	1.3514	1.3333	1.3158	1.3072	1.2987
CAN$/€	1.4435	1.4579	1.5429	1.5248	1.5621	1.5676	1.5600	1.5526	1.5556	1.5584
US$/€	1.0902	1.1225	1.0973	1.1232	1.1727	1.1600	1.1700	1.1800	1.1900	1.2000
US$/£	1.2323	1.3248	1.2400	1.2356	1.2928	1.2700	1.2800	1.3000	1.3200	1.3400

f: forecasts
Sources: Datastream and Desjardins, Economic Studies

Asset Classes Return

Despite the Lingering Uncertainty, the Outlook Remains Fairly Positive for Stocks

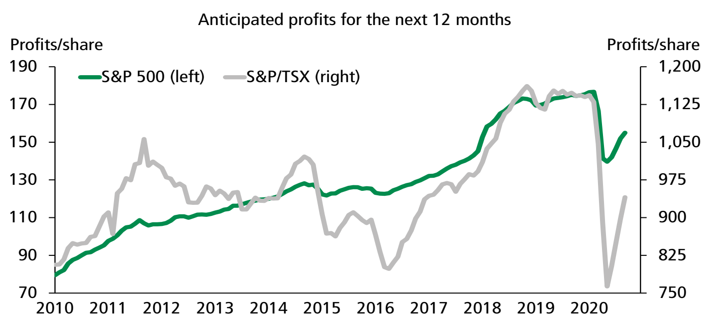
- **The start of the summer was highly profitable for investors.** The stock markets' fierce rebound continued in July and August. Evidence of a swift post-lockdown recovery in economic activity contributed to this strong performance, as did the central banks' commitment to support the economic recovery over the long term. Profit expectations have risen in recent months (graph 6) as the direst economic depression scenarios have been ruled out. Following in the NASDAQ's footsteps, the S&P 500 thus hit an all-time high in August. The Canadian stock market also saw a rapid rise, although the S&P/TSX stayed below pre-pandemic levels (graph 7).

- **Uncertainty returned in September.** After five months of strong growth, the stock markets' upward momentum, particularly for tech stocks, looked fragile. High levels of profit-taking pushed the indexes back down in early September. The inability of U.S. politicians to agree on a new stimulus plan and the approaching presidential election, the results of which could be contested, have also justified more caution among investors. As a second wave appears to have taken hold in Canada and several European countries, and even reached the White House, the surge in COVID-19 cases have also contributed to the renewed volatility.

- **Central banks have confirmed their expansionist bias.** Beyond public health and economic issues, the financial markets' solid performance is being buoyed by central banks. Both the Federal Reserve (Fed) and the Bank of Canada (BoC) have promised to keep key rates at their effective lower bound until the economy has fully recovered, which could take several years. The Fed even said that it was officially adopting average inflation targeting, signalling that it would tolerate inflation of above 2% following the current period of low inflation. Both the Fed and the BoC are also continuing with their large-scale bond purchases, which has helped keep bond yields very low along the entire curve. By ensuring that the markets run smoothly, even during a crisis, and injecting liquidity, the central banks are also favouring riskier assets, such as corporate bonds (graph 8) and equities.

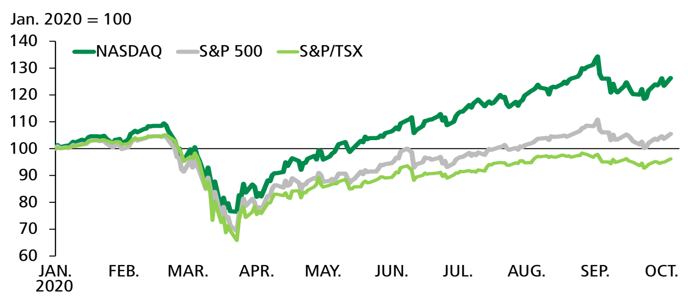
- **The crisis is creating winners and losers.** Despite a difficult September, stock markets are still posting an impressive performance in a climate in which the global economy is going through the most severe contraction since World War II. However, investors have quickly realized that the COVID-19 crisis has little in common with a usual recession. The unprecedented actions of governments and central banks have helped avoid the vicious circle often seen during a recession: a plunge in confidence, employment and income

GRAPH 6
After a sharp nosedive, profit expectations have climbed back up



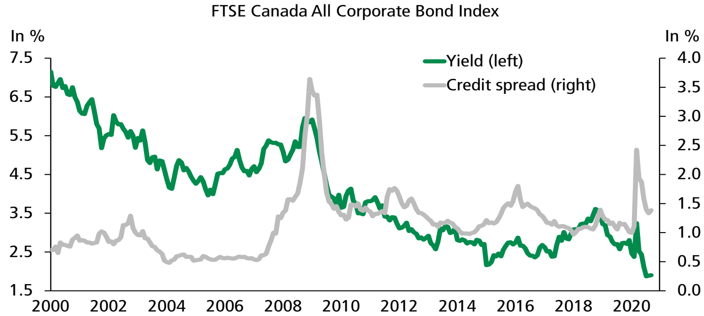
Sources: I/B/E/S, Datastream and Desjardins, Economic Studies

GRAPH 7
The stock markets' rebound is impressive despite a difficult September



Sources: Datastream and Desjardins, Economic Studies

GRAPH 8
Canadian corporate bond yields have also dropped since the beginning of 2020

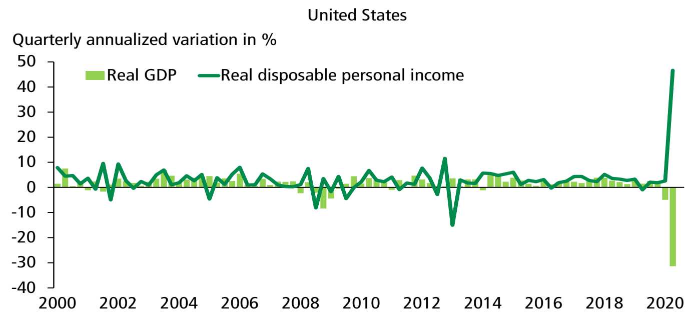


Sources: Datastream and Desjardins, Economic Studies

(graph 9), financial strains and widespread bankruptcy. Since incomes and household demand appear solid, it makes sense to see businesses that aren't directly affected by the pandemic perform well. Conversely, the situation is still extremely difficult for businesses that cannot operate easily with social distancing in place.

- **The stock markets may continue to do well next year.** Volatility could remain high in the short term as the public health situation is changing quickly. However, on the whole, we are maintaining our targets for the end 2020. The resilience of a large part of the economy is encouraging, and the vigilance of governments and the central banks limits the likelihood of lasting mayhem on financial markets in the short term. Thanks to the resilience of the stock markets and the sharp drop in bond yields, 2020 should close with solid gains for investors. Now that key rates are at their effective lower bound in North America and credit spreads have returned near normal levels, however, the potential for additional gains on the bond market is extremely low. As a result, it looks like returns for this asset class will be limited in 2021. In a context of extremely low rates and ample liquidity, and as the gradual economic recovery is expected to continue, stock markets appear better positioned to rack up significant gains next year.

GRAPH 9
Thanks to government assistance, the economy's collapse was accompanied by a surge in household income



Sources: Bureau of Economic Analysis 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: 0.90	target: 9.0	target: 1.0	target: 7.0	target: -3.0	target: 4.0 (US$0.74)
range	0.75 to 1.00	7.0 to 11.0	-6.0 to 6.0	0.0 to 12.0	-10.0 to 3.0	0.0 to 6.9
2021f	target: 0.25	target: 1.0	target: 10.0	target: 7.0	target: 8.0	target: -3.9 (US$0.77)
range	0.00 to 0.50	-3.0 to 5.0	2.0 to 16.0	-2.0 to 14.0	0.0 to 15.0	-2.5 to 5.5

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