RETAIL RATE FORECASTS

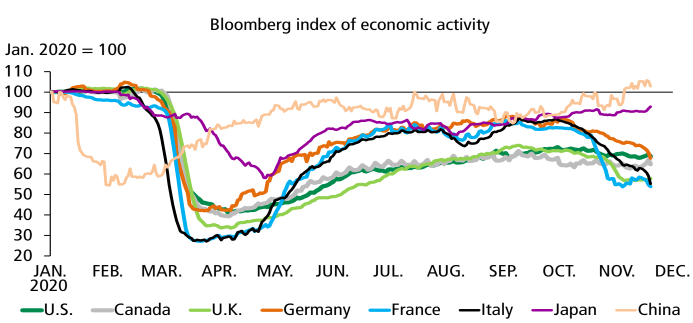
Little Interest Rate Movement Expected

HIGHLIGHTS

- The second COVID-19 wave is lashing the West.
- The Bank of Canada expects a status quo of its key rate until 2023.
- Hopes for a quick vaccination give the stock markets new energy.
- Market optimism favours the Canadian dollar.

- **The second COVID-19 wave is lashing the West.** The return of the cold weather seems to coincide with a major surge of COVID-19 cases in Europe and North America. Many countries are dealing with much higher infection rates than last spring, forcing them to impose new restrictive measures on their populations. While the restrictions are much more targeted than they were in spring, some high-frequency indicators are already starting to suggest that economic activity is slowing in many countries (graph 1). The recent developments surrounding vaccines, however, permit some optimism for the future. Growth could be stronger in 2021, when immunity allows the restrictions to be lifted.

GRAPH 1
Indicators suggest a slowdown in Europe



Sources: Bloomberg and Desjardins, Economic Studies

- **Joe Biden's victory paves the way for greater fiscal support.** President Joe Biden's arrival at the White House in January means we can expect an increase in U.S. government spending and measures to support households and businesses affected by the pandemic. While monetary policy remains highly stimulating, the nomination of former Federal Reserve Chair Janet Yellen as Treasury Secretary also suggests we could see more coordination between monetary and fiscal policy responses.
- **Canada's economic data was good before the effects of the second wave.** In recent months, the economic numbers have delivered some nice surprises in Canada. Retail sales recovered quickly after last spring's shock, and were still showing good growth in September. Employment also bounced back over the summer, and was still rising in October despite the new public health measures imposed in Quebec and Ontario (graph 2 on page 2). Even if the third quarter GDP growth rate was lower than expected, it still came in at annualised rate of 40,5 %. The rapid surge in new COVID-19 cases in several other provinces, however, suggests some tougher months this winter.
- **The Bank of Canada** (BoC) **expects a status quo of its key rate until 2023.** At its October 28 meeting, the BoC once again reiterated its support for the economy. Unsurprisingly, the key rate stayed at its lower bound, and asset purchases will continue, even though the BoC has slowed the pace of purchases and will henceforth favor securities with longer maturities. The BoC took the opportunity to downgrade its

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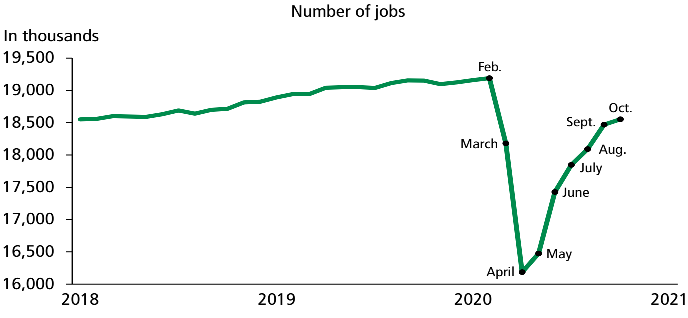
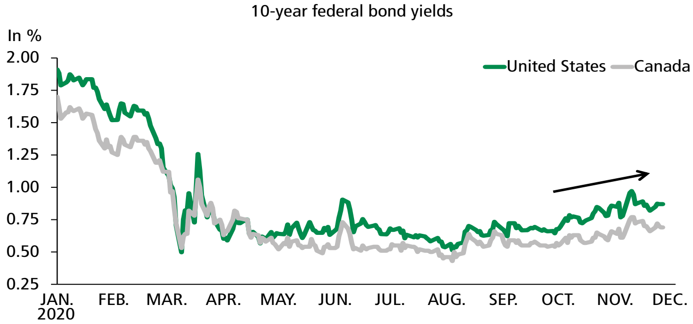
NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

GRAPH 2
Employment is still rebounding in Canada despite the new restrictions



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 3
The recent rise in bond yields is limited



Sources: Datastream and Desjardins, Economic Studies

assessment of the GDP's potential growth rate and the neutral interest rate. In this context, it does not expect to increase its key rate before 2023.

- **The rise in bond yields could be slow and uncertain.** In the United States and Canada, yields on long-term bonds edged up in recent weeks (graph 3), driven by the improving growth outlooks and the expected increase in U.S. government spending. The upward movements were, however, fairly limited when compared with historical variations. Given that the central banks will keep making large bond purchases, we are unlikely to see yields increase substantially unless the economy improves quickly. Bond yields should therefore remain close to where they are now, which will also keep retail rates stable.

TABLE 1
Forecasts: Retail rate

	DISCOUNT RATE	PRIME RATE	MORTGAGE RATE			TERM SAVINGS[1]		
IN %			1 year	3 years	5 years	1 year	3 years	5 years
Realized (end of month)								
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
October 2020	0.50	2.45	2.89	3.54	4.74	0.50	0.70	0.95
November 2020	0.50	2.45	2.89	3.54	4.74	0.45	0.65	0.90
Dec. 2, 2020	0.50	2.45	2.89	3.54	4.74	0.45	0.65	0.90
Forecasts								
End of quarter								
2020: Q4	0,50	2,45	2.70–3.10	3.35–3.75	4.55–4.95	0.25–0.65	0.45–0.85	0.70–1.10
2021: Q1	0.50–0.75	2.45–2.70	2.25–3.05	2.90–3.70	4.10–4.90	0.05–0.80	0.30–1.05	0.60–1.35
2021: Q2	0.50–0.75	2.45–2.70	2.15–3.15	2.80–3.80	4.00–5.00	0.00–0.90	0.25–1.15	0.55–1.45
2021: Q3	0.25–1.00	2.20–2.95	2.05–3.25	2.70–3.90	3.90–5.10	0.00–0.95	0.15–1.20	0.45–1.50
End of year								
2021	0.25–1.25	2.20–3.20	1.90–3.40	2.55–4.05	3.75–5.25	0.00–1.10	0.10–1.35	0.40–1.65
2022	0.25–1.25	2.20–3.20	1.80–3.50	2.45–4.15	3.65–5.35	0.00–1.10	0.10–1.35	0.40–1.65
2023	0.25–1.50	2.20–3.45	1.70–3.60	2.40–4.30	3.75–5.65	0.00–1.10	0.10–1.60	0.30–1.80

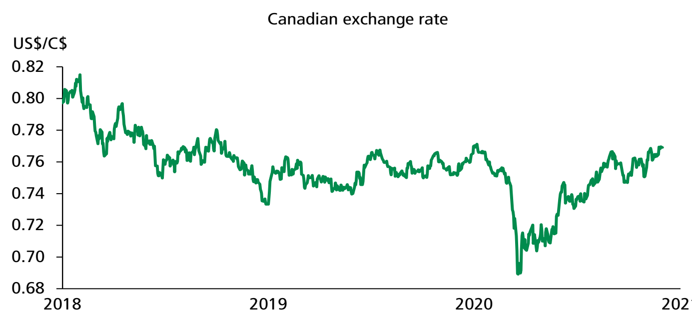
[1] Non-redeemable (annual); NOTE: Forecasts are represented using an asymmetric range reflecting the perceived probability of deviation from the base scenario. The mean of the range does not represent the forecast associated with the base scenario.
Source: Desjardins, Economic Studies

Exchange Rate

Market Optimism Favours the Canadian Dollar

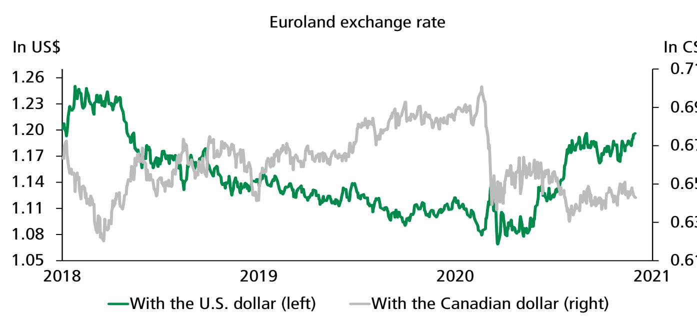
- The surge in optimism in financial markets resulted in dropping demand for the U.S. dollar. The greenback also seems to be penalized by pandemic's less favourable trend in the United States and the ongoing highly accommodating tone taken by the Federal Reserve.
- The Canadian dollar is now trading at close to US$0.77 (graph 4), an exchange rate comparable to the rate prevailing prior to the pandemic. Like many currencies, the Canadian dollar is benefiting from the optimism in the financial markets. However, the loonie is posting a more mixed performance against the other major currencies. For example, at less than C$0.65/€, its exchange rate against the euro is still well below where it was at the start of 2020.
- At US$1.19, the euro is at a two-and-a-half-year peak (graph 5). The euro's performance may seem astonishing, as the pandemic pummelled Europe, with major consequences for the economy. However, the recent trend for COVID-19 cases has been more encouraging. This increases the chances of an economic rebound in the coming months. The euro is also still benefiting from weaker long-term inflation expectations and the European Central Bank has less wiggle room to further ease its monetary policy.
- **Forecasts:** We have adjusted our exchange rate forecasts slightly upward to reflect the recent surge in optimism. That said, current levels still seem a little high against the backdrop of the economic and public health issues that continue to loom. The arrival of vaccines does not solve everything. The winter could be difficult, and we could see some declines in value for the major currencies. They could start to appreciate again on a more sustainable basis toward next spring.

GRAPH 4
The Canadian dollar near the US$0.77 again



Sources: Datastream and Desjardins, Economic Studies

GRAPH 5
The euro continues to do well



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	0.7650	0.7700	0.7700	0.7750	0.7800
CAN$/US$	1.3241	1.2988	1.4062	1.3576	1.3321	1.3072	1.2987	1.2987	1.2903	1.2821
CAN$/€	1.4435	1.4579	1.5429	1.5248	1.5621	1.5425	1.5325	1.5455	1.5484	1.5385
US$/€	1.0902	1.1225	1.0973	1.1232	1.1727	1.1800	1.1800	1.1900	1.2000	1.2000
US$/£	1.2323	1.3248	1.2400	1.2356	1.2928	1.3100	1.3000	1.3200	1.3400	1.3500

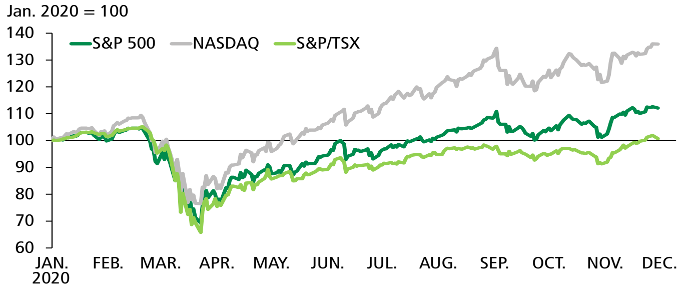
f: forecasts
Sources: Datastream and Desjardins, Economic Studies

Asset Classes Return

Hopes of a Quick Vaccination Give the Stock Markets New Energy

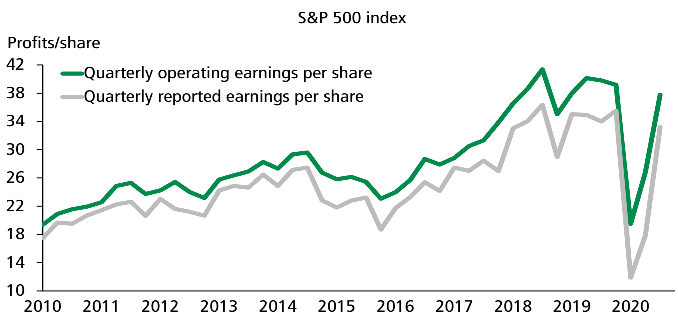
- **A pause of several months for the stock markets.** After posting a spectacular rebound at the end of last spring and over the summer, the stock indexes retreated in September and October. The surge in COVID-19 cases, which prompted numerous governments to reimplement some confinement measures, and the looming U.S. election justified some caution.
- **Optimism came back strong in November.** The results of the U.S. election were very well received by investors, who seem to have a favourable view of the likely combination of a Democratic president and a Republican senate. Moreover, fears of a lengthy challenge to the results and a major political and social crisis seem to be gradually dissipating. The stock market rebound picked up after very encouraging news regarding the development of COVID-19 vaccines. In the near term, everything suggests the public health situation will remain very difficult but, for the first time since the COVID-19 crisis started, hopes of getting back to some kind of normal within a few quarters seem realistic. November thus ended with major, widespread stock market gains and new peaks for the main U.S. indexes (graph 6). Even the S&P/TSX recently crossed back into positive territory for 2020 as a whole.
- **The rise in earnings and the stock markets could become more general if COVID-19 is defeated.** The surprising stock market performance, particularly in the United States, is partly due to the rapid rebound in corporate earnings since last spring's economic crisis. According to the preliminary results for the third quarter, the profits of S&P 500 companies are already very close to where they were before the crisis (graph 7). This rapid rebound is, among other things, based on technology corporations, and corporations that respond to consumer consumption. Other, more traditional industries, such as energy, transportation, and the industrial sector, continue to struggle, not to mention food services and recreation. All the gains the S&P 500 has made since the start of the year have thus been recorded by growth securities, whereas value securities have been lagging. However, the good news on vaccines recently played in favour of more traditional sectors, which could do some catching up next year if we really beat COVID-19.
- **The central banks will want to keep supporting the recovery.** The increase in COVID-19 cases and the return of some lockdown measures have strengthened central banks' resolve to support economic activity for some time to come. Even if the pandemic were to end quickly next year, it is hard to picture the Federal Reserve and Bank of Canada initiating monetary firming. Some increase in the medium- and

GRAPH 6
After pausing, the stock markets regained momentum in November



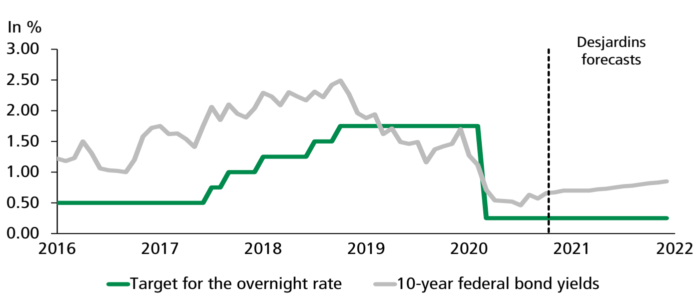
Sources: Datastream and Desjardins, Economic Studies

GRAPH 7
The U.S. corporate earnings rebound is impressive*



* After 96.1% of corporations had reported earnings for the third quarter of 2020.
Sources: S&P Dow Jones Indices and Desjardins, Economic Studies

GRAPH 8
Heading for slight steepening of the Canadian yield curve in 2021

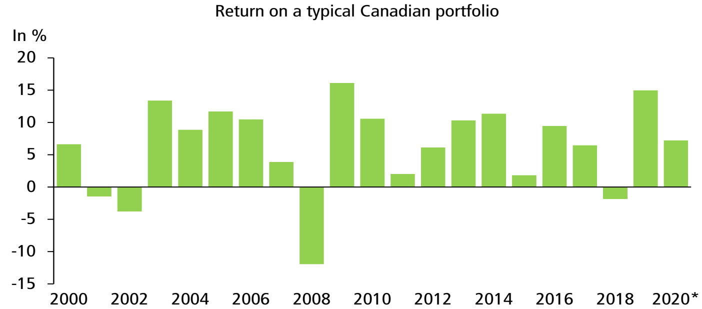


Sources: Datastream and Desjardins, Economic Studies

long-term yields is likely, however, reflecting the better economic outlook. For now, we are only anticipating a slight steepening of the Canadian curve (graph 8 on page 4).

- **Investors are doing well.** One basic feature of the COVID-19 crisis is that it simultaneously created winners and losers, like online commerce and air transportation. So far, investors are on the winning side. After 11 months, all the major asset classes are showing gains from the start of the year. A typical portfolio (35% Canadian equity, 15% U.S. equity, 45% Canadian bonds and 5% 3-month Treasury bills) yielded a return of 7.2%, about 1% above the average for the last 20 years (graph 9). Not bad in the context of a global pandemic and record economic contractions!
- **The stock markets could rise further in 2021.** The current surge in COVID-19 cases makes future movement of the markets highly uncertain over the near term. In the context of gradual vaccination that would allow the economic recovery that started last summer to resume, however, the outlook remains good for stock markets next year. More traditional sectors could do well, favouring the Canadian stock market, among others. With federal bond yields and credit spreads close to their historic lows, the potential for bond market gains seems quite limited, however.

GRAPH 9
Another good year for Canadian investors



* Total for the 11 first months of 2020.
Sources: Datastream 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: 0.85	target: 8.5	target: 3.5	target: 13.0	target: 3.0	target: 0.6 (US$0.765)
range	0.75 to 1.00	7.0 to 11.0	-3.0 to 8.0	8.0 to 18.0	-5.0 to 9.0	-0.65 to 1.98
2021f	target: 0.15	target: 1.0	target: 12.0	target: 10.0	target: 11.0	target: -1.9 (US$0.78)
range	0.00 to 0.30	-3.0 to 5.0	4.0 to 18.0	2.0 to 16.0	0.0 to 18.0	-3.8 to 1.3

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