RETAIL RATE FORECASTS

Retail Rates Start an Upward Trend

HIGHLIGHTS

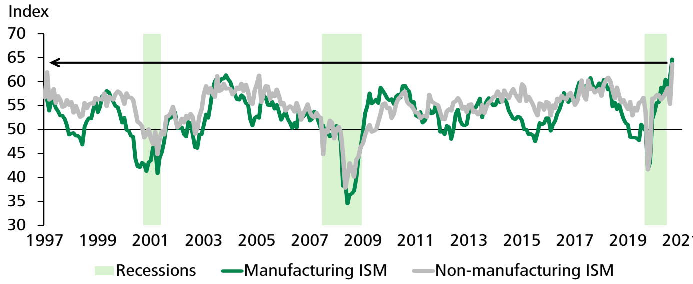
- The Federal Reserve (Fed) and the Bank of Canada (BoC) are under greater pressure to reduce their quantitative easing.
- Canada's economic recovery should withstand the third wave of COVID-19.
- This third wave undermines the loonie's rebound potential.
- A first quarter favourable to stock markets.

- **U.S. growth could be an engine for the global economy.** The recovery following the winter wave of COVID-19 is well underway in the United States, and the rebound could continue to pick up. Employment jumped in March, as the ISM indexes broke the records set in recent years (graph 1). In addition to having a hefty fiscal stimulus program, the United States is also one of the countries whose vaccination campaign is furthest along, which, for the time being, appears to be preventing the resurgence of cases observed elsewhere. While the planet faces a third major wave of the pandemic, the rebound in the U.S. economy could provide significant support for growth.

- **The Fed is under greater pressure to reduce its quantitative easing.** The improved economic outlook has led inflation expectations and bond yields higher in recent months. Although it acknowledged this improvement in its new economic forecasts, the Fed refrained from announcing a potential reduction in the pace of its asset purchases. At the March 17 meeting, it reiterated that it would like to see a concrete improvement in economic indicators before announcing a policy change.

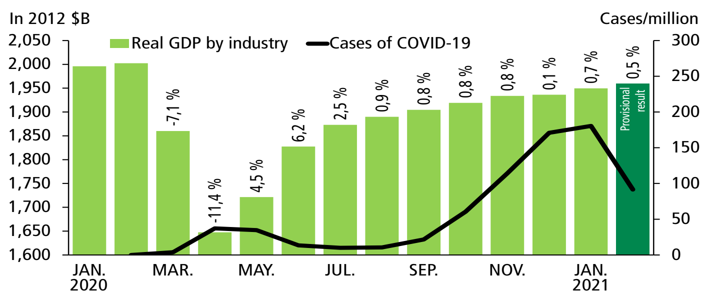
- **Canada's economic recovery should withstand the third wave.** The effects of the second wave of COVID-19 on the Canadian economy were fairly limited overall. The job losses posted in December and January had already been almost fully recouped before another strong gain in March, while real GDP by industry did not see a single month of decline (graph 2). It is worth noting that the housing sector is a major source of

GRAPH 1
The U.S. ISM indexes reached peaks in March*



* Manufacturing ISM: last peak in 1983; non-manufacturing ISM: highest level compiled.
Sources: Institute for Supply Management and Desjardins, Economic Studies

GRAPH 2
Canada's GDP did not decline despite the second wave of COVID-19



Sources: World Health Organization, Statistics Canada and Desjardins, Economic Studies

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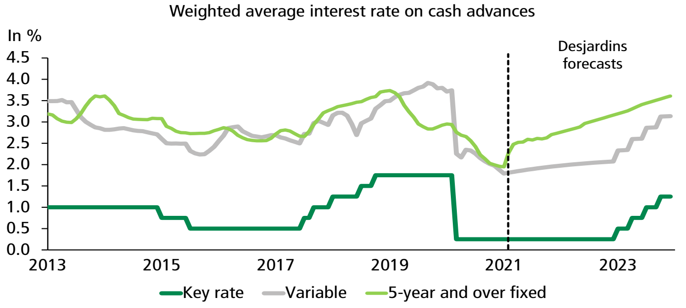
strength for the Canadian economy. Housing starts, resales and property prices have been exceptionally lively despite the pandemic. Although the renewed spread of COVID-19 brings with its new closures, job losses could be smaller this time around. The vaccination campaign, which is rolling out well, could also shorten this new wave.

- **The BoC seems more inclined to adjust asset purchases.** The BoC strayed little from its message at the March 10 meeting. However, it did acknowledge the resilience of Canada's economy and showed openness to adjusting the pace of its asset purchases as it gains confidence in the strength of the recovery. Very good recent economic data could mean that such an adjustment could take place soon.

- **Retail rates resume an upward trend.** The upward movement in bond yields beat expectations in February and March as a result of a surge in inflation expectations. This sudden steepening affected in particular the 5-year bond and over, raising financing costs for financial institutions. The retail rates actually offered, especially fixed mortgage rates, have resumed an upward trend, even though posted rates have not budged. Variable rates are, however, expected to remain low, at least until key rate increases are announced, which could wait until the beginning of 2023 (graph 3).

GRAPH 3
5-year and over fixed mortgage rates will rise, while the variable rate will remain steady



Sources: Bank of 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)								
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
December 2020	0.50	2.45	2.89	3.54	4.74	0.45	0.65	0.90
January 2021	0.50	2.45	2.89	3.54	4.74	0.40	0.60	0.85
February 2021	0.50	2.45	2.79	3.49	4.74	0.40	0.60	0.85
March 2021	0.50	2.45	2.79	3.49	4.74	0.40	0.60	1.05
April 14, 2021	0.50	2.45	2.79	3.49	4.74	0.40	0.60	1.05
Forecasts								
End of quarter								
2021: Q2	0.50	2.45	2.65–3.10	3.35–3.80	4.60–5.05	0.35–0.60	0.55–0.80	1.00–1.25
2021: Q3	0.50–0.75	2.45–2.70	2.50–3.20	3.20–3.90	4.45–5.15	0.20–0.70	0.40–0.90	0.85–1.35
2021: Q4	0.25–0.75	2.20–2.70	2.40–3.35	3.10–4.05	4.50–5.45	0.00–0.95	0.20–1.15	0.65–1.60
2022: Q1	0.25–1.00	2.20–2.95	2.35–3.45	3.05–4.15	4.45–5.55	0.00–1.05	0.15–1.25	0.75–1.85
End of year								
2022	0.25–1.25	2.20–3.20	2.25–3.70	2.95–4.40	4.55–6.00	0.00–1.30	0.35–1.80	0.95–2.40
2023	0.75–2.25	2.70–4.20	2.40–4.40	3.20–5.20	4.50–6.50	0.10–2.10	0.50–2.50	0.85–2.85
2024	1.25–3.25	3.20–5.20	2.90–5.30	3.30–5.70	4.60–7.00	0.35–2.75	0.75–3.15	0.95–3.35

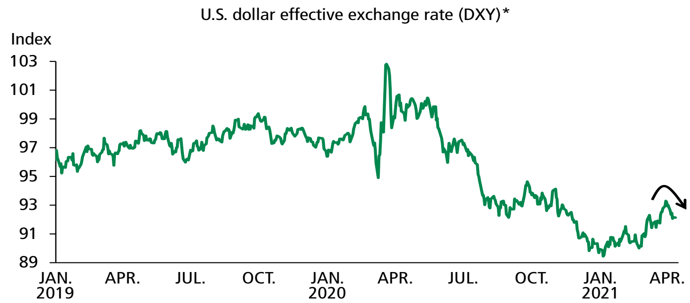
[1] Non-redeemable (annual); NOTE: Forecasts are represented using an asymmetric range reflecting the perceived probability of deviation from the base scenario. The mean of the range does not represent the forecast associated with the base scenario.
Source: Desjardins, Economic Studies

Exchange Rate

The Third Wave of COVID-19 Undermines the Loonie's Rebound Potential

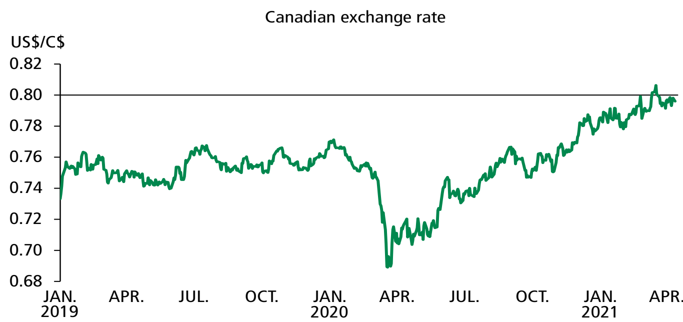
- The third wave of COVID-19 that has swept through many countries in recent weeks increased currency market volatility. The U.S. dollar tended to appreciate until the end of March, especially since the United States was largely unaffected by the rise in COVID-19 cases. Since the beginning of April, however, the trend seems to want to return to depreciation for the greenback (graph 4). This is likely due to the fact that investors are fairly optimistic about the coming months, counting on the continued vaccination campaign and the lifting of the public health measures recently put in place in a number of countries.
- Canada was hit by the third wave somewhat later than Europe, and the recently announced public health measures in several provinces seem to be limiting the Canadian dollar's capacity to climb back up to the US$0.80 mark (graph 5). The euro fared better recently, returning to around US$1.19 and C$1.50. Elsewhere in Europe, the pound sterling seems to be struggling more because of uncertainty surrounding the implementation of the Brexit deal. In particular, fresh tensions erupted in Northern Ireland.
- **Forecasts:** The U.S. dollar is expected to continue to depreciate slightly in the coming quarters. The U.S. economy should definitely do well, but a number of other countries will follow in its wake soon. The expected moderation in the progression of bond yields in the United States should also limit the greenback's rebound potential this year. Canada's continued vaccination rollout and a gradual lifting of public health measures will help bring the Canadian dollar back up to US$0.80 by early summer. Gains are expected to be rather small from then onwards.

GRAPH 4
The U.S. dollar has been underperforming since early April



* 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 is holding below US$0.80



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

	2020		2021				2022			
END OF PERIOD	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
US$/CAN$	0.7507	0.7853	0.7962	0.8050	0.8100	0.8100	0.8100	0.8100	0.8050	0.8000
CAN$/US$	1.3321	1.2734	1.2560	1.2422	1.2346	1.2346	1.2346	1.2346	1.2422	1.2500
CAN$/€	1.5621	1.5580	1.4762	1.4907	1.4938	1.5062	1.5062	1.4938	1.4907	1.4875
US$/€	1.1727	1.2236	1.1753	1.2000	1.2100	1.2200	1.2200	1.2100	1.2000	1.1900
US$/£	1.2928	1.3670	1.3797	1.3900	1.4100	1.4300	1.4300	1.4300	1.4400	1.4400

f: forecasts
Sources: Datastream and Desjardins, Economic Studies

Asset Classes Return

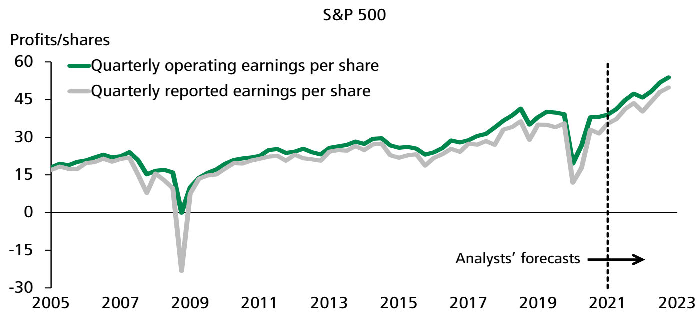
A First Quarter Favourable to Stock Markets

- **The improved economic outlook favours the stock markets.** The North American economies were very resilient amid the second wave of COVID‑19, while many industries, including residential real estate and commodities, experienced exceptional growth. The acceleration of vaccination programs and the U.S. government's generous aid plans also point to strong economic growth in the coming quarters. Business earnings should therefore continue to climb and reach new heights once the sectors hardest hit by social distancing measures resume their activities (graph 6). Against this backdrop, stock markets have continued to pull in significant gains since the start of 2021, despite the rise in bond yields. Buoyed by rising oil prices, the S&P/TSX did particularly well, with a total return, including dividends, of more than 8% in the first quarter (graph 7).

- **A much more difficult start to the year for bonds.** The marked improvement in the economic outlook and government and monetary authorities' commitment to keep highly stimulative policies for a long time to come have also put significant upward pressure on bond yields. Until the end of January, the rise was mainly affecting long-term yields and essentially reflecting higher inflation expectations. We are now seeing a more generalized increase in bond yields, as investors start to expect faster monetary policy normalization. The Canadian 5-year yield therefore rose from 0.39% at the end of 2020 to close to 1%. Although credit spreads are still narrow, such a fast increase in bond yields dragged the FTSE Canada Universe Bond index down 5% in the first quarter.

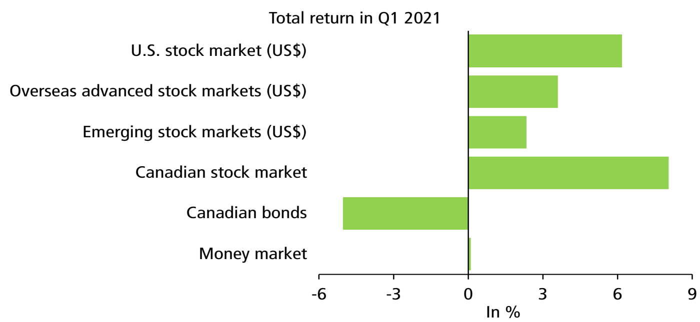
- **Fears of overheating could remain.** The speed of economic recovery in North America surprised all observers, and the outlook is very favourable with the U.S. ISM indexes, for example, having recently reached multi-year highs. This recovery is due primarily to very high demand from consumers, whose income was boosted by government support programs. In many sectors, supply has difficulty keeping up with demand, which has already resulted in a dramatic surge in some prices, including residential properties and commodities. U.S. businesses are also reporting generalized upward pressure on the price of their inputs and on their supplier deliveries (graph 8). In the past, we would have expected central banks to be concerned about such inflationary trends. This time around, however, the Federal Reserve (Fed) seems to be welcoming them and, for the time being, is refusing to consider a rapid reduction in its exceptional support measures.

GRAPH 6
The recovery in business earnings is impressive, and the outlook is favourable



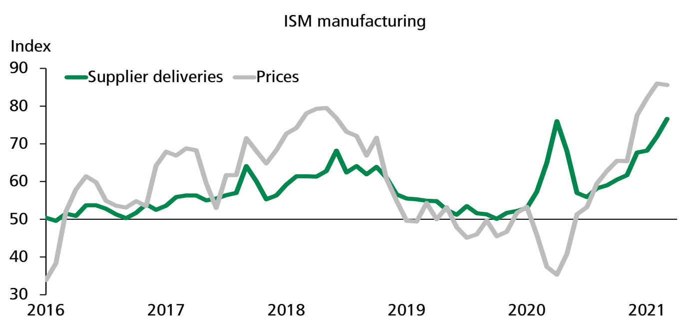
Sources: S&P Dow Jones Indices and Desjardins, Economic Studies

GRAPH 7
The Canadian stock market stood out in the first quarter, but the bond market saw steep losses



Sources: Datastream and Desjardins, Economic Studies

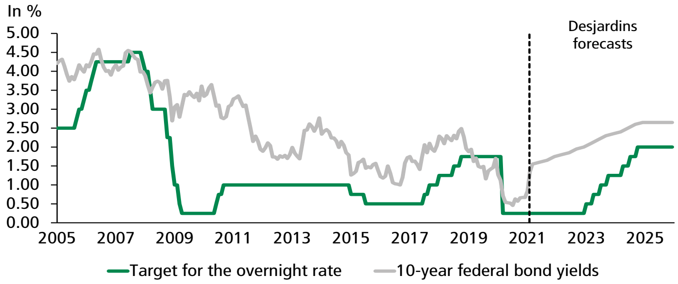
GRAPH 8
ISM manufacturing index components suggest procurement difficulties



Sources: Institute for Supply Management and Desjardins, Economic Studies

- **Key rates to rise slightly faster and higher.** The speed of the rise in bond yields in recent months took us by surprise, but it seems fully justified by the stronger growth and inflation outlook in North America. For now, central banks are maintaining a very cautious tone by stressing the labour market shortfall and the persistence of major health risks. However, the continued rollout of vaccination programs and the gradual reopening of economies should gradually reassure the Fed and the Bank of Canada, leading them to progressively reduce their bond purchases in the coming quarters. The first key rate increases are expected to come at the end of 2022 or at the beginning of 2023, and at a slightly faster pace than during the last round of monetary tightening (graph 9).
- **The outlook remains positive for stocks.** Despite worries about variants, the stepped-up vaccination campaigns still offer hope of a gradual reopening of the major economies in the coming quarters. This suggests that robust economic growth could continue to boost stock markets. We thus raised our targets for the main stock indexes. After the drastic adjustment of recent months, further bond yield increases are expected. They should, however, be much more gradual, greatly limiting losses for bond indexes. Given that the current situation is shrouded in vast uncertainty, the protective role played by bonds in a diversified portfolio shouldn't be neglected.

GRAPH 9
More favourable economic scenarios point to a slightly sharper rise in Canadian interest rates



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]
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
2020	0.9	8.7	5.6	18.4	8.3	-2.0
2021f	target: 0.10	target: -5.0	target: 17.0	target: 14.0	target: 10.0	target: -3.0 (US$0.81)
range	0.00 to 0.20	-8.0 to -2.0	8.0 to 25.0	5.0 to 22.0	2.0 to 20.0	-5.4 to 0.7

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