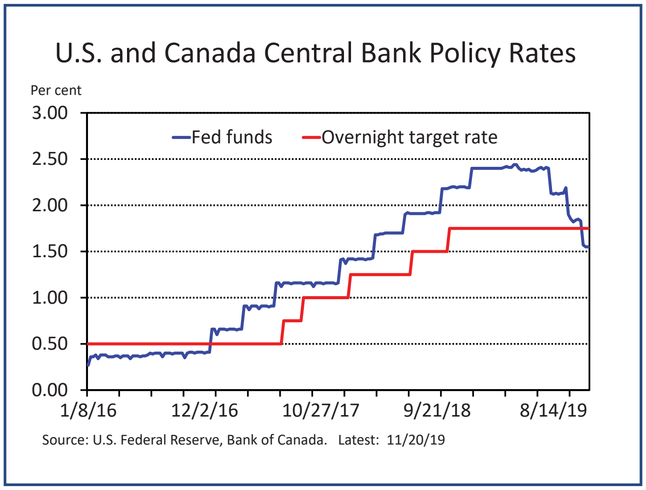
Interest Rate Forecast

Highlights

- Key trade decisions looming
- Sub-par economic growth
- Bank of Canada on hold in December
- Lower rate likely in 2020



The economic and rate outlook is policy dependent, with political factors as important as economic factors, at least in the short-term. The on and off U.S.-China trade deal moves market sentiment and markets causing considerable swings in equity prices, bond yields, and economic prospects. A no-deal Brexit could be added to this political policy uncertainty mix, affecting markets.

If a phase one U.S.-China trade deal is signed and includes a rollback of existing tariffs and postponement of the Dec. 15 tariffs, markets will celebrate by sending equities, bond yields, and commodity prices higher. However, there are risks to this scenario. Should the trade deal fall through, or be delayed into 2020, trade policy uncertainty will remain elevated, resulting in a worse outcome.

One piece of good news was that prospective tariffs on imports of autos from Europe and elsewhere were dropped, or more specifically, not imposed by the legislated deadline of Nov. 14. The U.S. President could still impose those tariffs under different legislation, which seems unlikely, but then again unlikely often occurs under his watch.

The latest gauges on the economy contained a sprinkling of good news. The preliminary, or flash, PMIs (Purchasing Managers' Index) for the U.S. turned up in the headline index with output in the manufacturing and service sectors higher in November. Offsetting this were weak Flash PMIs for Japan and the Eurozone in November. It is notable that global manufacturing PMI has improved every month since July.

Economic growth continues at a sub-par pace and it is unlikely that it will pick up materially in the near-term. Assuming no further escalation in trade tensions and a phase one deal combined with recent monetary and fiscal stimulus measures points to growth momentum nearing a bottom. When the inflection point will occur is uncertain, but if the working assumption plays out, a global growth pickup by mid-2020 is realistic.

Bear in mind that this pickup would come on the heels of a more than two-year period of slowing and subpar growth rates which opened a considerable amount of economic slack or excess capacity. The growth rebuilding phase would leave the economy in this state for some time depending on the strength of the growth resurgence. Current low interest rates and accommodative monetary policy would prevail through 2020 and probably into 2021 before consideration to resuming rate normalization emerges.

This business cycle expansion phase is different from any seen in the post-war era. To have monetary policy easing at this juncture of the cycle is unprecedented and reflects the politically-driven policy changes impacting trade, beginning with the imposition of import duties by the U.S. on solar panels and washing machines, followed by duties on steel and aluminum to the many trade disruptions that exist today. Brexit is another politically motivated issue contributing to economic uncertainty and underperformance. Absent these political disruptions, interest rates would be higher and heading to normal levels.

Canada's economy is slowing from the temporary bounce in the second quarter of this year. Key indicators have mostly turned softer or negative in the latest month. Third quarter 2019 real Gross Domestic

Canada: Key economic data releases

Indicator	Prior month	Latest month
Industry GDP, % change	0.2	0.2
Employment, % change	0.3	0
Unemployment rate, %	5.5	5.5
Hours worked, % change	-0.3	0.1
Real international goods exports, % change	-0.3	-1.5
Real international goods trade balance, $b	0.2	0.3
Real manufacturing sales, % change	0.6	-0.7
Real retail sales, % change	0.3	-0.1
Real wholesale sales, % change	0.7	1.7
Non-residential building permits, % change	-14.9	-6.6
Housing starts, units, % change	-2.2	-8.7
MLS residential sales, % change	1.3	0
Total CPI, % change y/y	1.9	1.9
Core CPI1., % change y/y	2	2.1

Source: Statistics Canada, CMHC, CREA. Month-to-month changes except CPI year/year. 1. Average of three measures.

Product (GDP) is tracking well below two per cent annualized growth. The Bank of Canada's forecast calls for 1.3 per cent while this forecast has it at 1.0 per cent. The impact of the GM strike will weigh on this outcome. Fourth quarter 2019 real GDP growth is similarly put at 1.3 per cent by the Bank and this forecast has it remaining at 1.0 per cent as well.

Below-potential growth in the third and fourth quarters of 2019 will be the basis for the Bank of Canada to undertake its version of insurance cuts in 2020. The Bank is unlikely to stop at one quarter-point cut and a second similar-sized cut is expected to follow soon after the first. Timing of the first cut could be as soon as the January meeting in 2020 if the U.S.-China phase one trade deal collapses or there is no roll back of tariffs. Weak data on Canada's economy could be another motivation to move in January.

The latter is expected to be sufficient to prompt the Bank to take out insurance at the March 2020 meeting. An inter-MPR (Monetary Policy Report) meeting cut is not common but has occurred when the economic circumstances warrant a move.

The market for three-month Canadian Bankers' Acceptance futures is pricing in one quarter-point cut by April 2020. Prior to the October 30, 2019 rate announcement, the C.D. Howe Institute's Monetary Policy Council (MPC) recommended that the Bank of Canada lower its overnight target rate to 1.50 per cent by April 2020 from 1.75 per cent. However, forecasters and markets can be wrong for the right reasons due to political manoeuvers altering the economic landscape. An inverted bond yield curve in Canada remains in effect until the second quarter-point cut in this forecast. A gradual steepening will play out during the growth acceleration stage expected after mid-2020. Assuming only natural economic forces are at play, the next phase of rate normalization by central banks will begin in 2021.

Many assumptions go into a forecast and each one has the potential to throw the forecast off-track. As the saying goes: "forecasting is difficult, especially if it is about the future".

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ECONOMIC FORECAST - CANADA

	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2018	2019	2020	2021
Real GDP, % annualized	0.5	3.7	1	1	1.9	1.5	1.6	1.7
Unemployment Rate, %	5.8	5.5	5.5	5.6	5.8	5.6	5.5	5.3
Core CPI, % y/y	1.9	1.9	2	1.9	1.9	1.9	1.9	1.8

Source: Statistics Canada, Central 1 Credit Union.

Target Overnight Rate Forecast	
Meeting Date	**(Per cent)**
Oct. 30, 2019	1.75 (a)
Dec. 4	1.75
Jan. 22, 2020	1.75
Mar. 4	1.50
Apr. 15	1.25
June 3	1.25
July 15	1.25
Sep. 9	1.25
Oct. 28	1.25
Dec. 9	1.25
Jan. 2021	1.25
Mar.	1.25
Apr.	1.25
Jun.	1.50
Jul.	1.50
Sep.	1.50

Source: Bank of Canada, Central 1 Credit Union. (a) actual

Interest Rate Forecast									
	2019 Q3 a	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3
Target Overnight Rate	1.75	1.75	1.65	1.25	1.25	1.25	1.25	1.30	1.50
Prime Rate	3.95	3.95	3.85	3.45	3.45	3.45	3.45	3.50	3.70
1-mo. T-Bill	1.65	1.65	1.55	1.20	1.15	1.15	1.15	1.20	1.40
3-mo. T-Bill	1.64	1.65	1.60	1.25	1.25	1.25	1.25	1.30	1.50
6-mo. T-Bill	1.66	1.65	1.60	1.30	1.25	1.30	1.30	1.35	1.55
1-year T-Bill	1.65	1.70	1.60	1.30	1.30	1.35	1.35	1.40	1.65
2-year GoC Bond	1.48	1.55	1.50	1.30	1.30	1.35	1.40	1.45	1.70
3-year GoC Bond	1.43	1.55	1.45	1.30	1.30	1.35	1.45	1.50	1.75
5-year GoC Bond	1.36	1.45	1.40	1.30	1.30	1.40	1.50	1.65	1.85
10-year GoC Bond	1.36	1.45	1.40	1.30	1.35	1.45	1.55	1.70	1.90

Source: Bank of Canada, Central 1 Credit Union. Note: Quarterly average based on daily data. a = actual, all others forecast.

Mortgage Rate Forecast

	2019 Q3 a	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3
1-year Mortgage	3.64	3.65	3.65	3.45	3.35	3.35	3.35	3.45	3.65
3-year Mortgage	4.16	3.95	3.95	3.75	3.65	3.65	3.75	3.75	4.00
5-year Mortgage	5.21	5.19	5.10	4.90	4.90	4.90	4.90	5.05	5.20

Source: Bank of Canada, Central 1 Credit Union. Note: Quarterly average based on weekly data. a = actual, all others forecast. Posted fixed term rates from Bank of Canada rates based on typical rate (mode) at six major banks.

Deposit Rate Forecast

	2019 Q3 a	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3
1-year GIC	1.35	1.35	1.35	1.20	1.10	1.10	1.10	1.10	1.20
3-year GIC	1.80	1.80	1.80	1.50	1.50	1.50	1.50	1.50	1.65
5-year GIC	1.97	2.00	2.00	1.80	1.80	1.80	1.80	1.95	1.95

Source: Bank of Canada, Central 1 Credit Union. Note: Quarterly average based on weekly data. a = actual, all others forecast. Non-redeemable semi-annual rates from Bank of Canada based on typical rate (mode) at six major banks.