

## Highlights

- Financial markets tank on pandemic and oil price war shocks
- Economic fallout underway, worst lies ahead
- More rate cuts coming

**Note:** *This forecast is based on data through March 12, 2020. The Bank of Canada cut its target overnight rate at an unscheduled meeting by 50 bps to  $\frac{3}{4}$  of a per cent on March 13, 2020. This is in advance of Central 1 Economics' call for a 50 bps cut on April 15.*

Events have outpaced the last forecast and require revisions to the rate outlook. The combination of COVID-19 turning into a global pandemic and the emergence of an oil price war between Saudi Arabia and Russia sent financial markets into a sudden freefall. Central bank emergency rate cuts, plunging bond yields and tanking equity markets caused considerable angst among economic and market agents. The outlook is for more central bank rate cuts, a weaker economy and a lower rate environment through 2021 than previously forecast.

The global economy is showing signs of distress due to supply chain disruptions and fall in demand from the COVID-19 outbreak. China's manufacturing activity contracted sharply this February, and with lesser contractions in Japan, Germany, France, Italy, Taiwan, and South Korea, global manufacturing declined at the fastest pace since the 2008-09 financial crisis. COVID-19 is having an impact on the service sector with China, once again, leading the global decline during February.

While the spread of the COVID-19 outbreak looks to be fading in China, it has picked up momentum in Western Europe, and the U.S., among other countries. The World Health Organization (WHO) declared COVID-19 as a global pandemic. At last count, 118 countries reported cases of the coronavirus. Travel restrictions, event cancellations, and reduced public interactions are the order of the day.

The oil price war sent markets on another leg down. Oil prices dropped about 30 per cent practically overnight when Saudi Arabia announced that it would increase oil production and reduce prices in response to the breakdown in negotiations with Russia and other OPEC+ members. In response, Russia threatened to increase its oil production by this April 1. Further talks at OPEC+ meetings are scheduled for May or June but in the meantime these lower oil prices will remain. And, when an agreement to tackle reduced oil demand is reached, oil prices are likely to return to prewar levels at around fifty US dollars.

Economic growth forecasts for 2020 are being revised down in most, if not all, countries. Before the oil price war, the OECD revised its 2020 global economic growth forecast down to 2.4 per cent from 2.9 per cent last November. A post oil price war forecast would probably be lower. The temporary nature of the coronavirus and its impacts implies that economic activity will pick up when demand revives. Some businesses will resume normal operation and restock inventory as the supply chain gears up. This is likely to occur sometime in the second half of 2020, but it is a forecast uncertainty.

Similarly, 2021 growth forecasts are higher than in 2020 in most countries. Much of this is due to the resumption of normal activity and to stimulus measures aimed at boosting economic growth. Monetary easing will be followed by fiscal and regulatory measures. The latter take time to develop and enact while the former is more immediate. Central bankers, led by the Fed, implemented emergency rate cuts in early March.

Canada's economy was already feeling the negative impacts of strikes, bad weather, rail blockades, and lower commodity prices only to be hit by the coronavirus outbreak and the oil price war. These latter two events are more serious individually, and in combination, than the other negatives. This prompted the Bank of Canada (BoC) to make an emergency rate cut of 50 basis points (bps) prior to the oil price war. Another rate cut of 50 bps is expected at the BoC's next meeting in April mainly in response to the large drop in oil prices.

Economic growth for 2020 is cut to 1.0 per cent with growth in the first half approaching zero and possibly

Economic Forecast - Canada								
	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2018	2019	2020	2021
Real GDP, % annualized	1.1	0.3	0.5	-1.0	2.0	1.6	0.6	1.7
Unemployment Rate, %	5.5	5.7	5.6	5.9	5.8	5.7	6.0	5.7
Core CPI, % y/y	2.0	2.1	2.0	1.9	1.9	2.0	1.7	2.1

Source: Statistics Canada, Central 1. Shaded areas are forecasts.

lower. An outright recession is not foreseen, though it cannot be ruled out if the pandemic and low oil prices extend well beyond the first half of 2020. A drop in real Gross Domestic Product (GDP) during the second quarter of 2020 is expected. A pickup in interest rate sensitive sectors, such as housing, should offset some of those economic losses as will some additional fiscal stimulus. This below-potential growth forecast widens the output and makes another rate cut a certainty.

The futures market for Three Month Bankers' Acceptances is pricing in a 50 bps rate cut by the BoC before July 2020. This forecast sees that occurring at their April 15, 2020 rate announcement. Further rate easing may be necessary should the more negative scenario play out. The Fed Funds futures market is pricing in another 100 bps reduction in the Fed's policy rate, which includes a 50 bps reduction at its March 17-18, 2020 meeting, bringing the policy rate to the 0.0 to 0.25 per cent range. If this plays out, the Fed's policy rate would equal the financial crisis low and assumes the worst outcome or that fiscal measures will be inadequate. Other Fed measures are possible including liquidity injections or expansion of quantitative easing.

Bond yields and treasury bill rates have plummeted during this market frenzy. Canada's government yield curve is less inverted as a result of short rates falling faster than long rates. Three-month T-bill rates are around 0.65 per cent, down from 1.60 per cent prior to the BoC rate cut, while the 10-year Government of Canada bond yield is around 0.65 per cent compared to 0.96 per cent before the rate cut. The market is telling the BoC to cut rates and it will not disappoint the market. A similar situation exists in the U.S.

Administered rates are coming down. Mortgage and deposit rates are under downward pressure with the large drop in rates and bond yields. Some movement is already occurring. For example, the special offers five-year closed mortgage rate is down to 2.99 per cent from 3.15 per cent three weeks ago. Posted

mortgage rates have changed by a lesser amount and by a minority of lenders. Deposit rates are down by more than mortgage rates. Non-redeemable GIC rates are about 20 bps lower than three weeks ago. This forecast has mortgage and deposit rates declining another 50 bps in the next two quarters.

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#### Target Overnight Rate Forecast

Meeting Date	(Per cent)
Mar. 4, 2020	1.25 (a)
Apr. 15	0.75
June 3	0.75
July 15	0.75
Sep. 9	0.75
Oct. 28	0.75
Dec. 9	0.75
Jan. 2021	0.75
Mar.	0.75
Apr.	0.75
Jun.	0.75
Jul.	1.00
Sep.	1.00
Oct.	1.25
Dec.	1.25

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

### Interest Rate Forecast

	2019 Q4 a	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4
Target Overnight Rate	1.75	1.50	0.85	0.75	0.75	0.75	0.75	1.00	1.25
Prime Rate	3.95	3.70	3.05	2.95	2.95	2.95	2.95	3.20	3.45
1-mo. T-Bill	1.67	1.30	0.65	0.65	0.65	0.70	0.75	0.95	1.20
3-mo. T-Bill	1.66	1.30	0.65	0.70	0.75	0.75	0.80	1.05	1.25
6-mo. T-Bill	1.69	1.30	0.65	0.70	0.75	0.80	0.85	1.10	1.30
1-year T-Bill	1.71	1.25	0.60	0.65	0.70	0.80	0.90	1.15	1.35
2-year GoC Bond	1.60	1.20	0.55	0.65	0.70	0.85	0.95	1.20	1.40
3-year GoC Bond	1.58	1.15	0.55	0.65	0.70	0.85	0.95	1.20	1.45
5-year GoC Bond	1.53	1.10	0.60	0.65	0.75	0.90	1.00	1.25	1.55
10-year GoC Bond	1.52	1.10	0.60	0.65	0.80	0.95	1.10	1.35	1.65

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

### Mortgage Rate Forecast

	2019 Q4 a	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4
1-year Mortgage	3.64	3.60	3.45	3.15	3.15	3.15	3.15	3.25	3.35
3-year Mortgage	3.94	3.90	3.60	3.40	3.40	3.40	3.50	3.65	3.80
5-year Mortgage	5.19	5.20	4.80	4.65	4.65	4.65	4.70	4.85	4.95

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 Q4 a	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4
1-year GIC	1.35	1.30	1.05	1.05	1.05	1.05	1.05	1.05	1.15
3-year GIC	1.80	1.75	1.35	1.35	1.35	1.35	1.40	1.50	1.60
5-year GIC	2.00	1.95	1.50	1.40	1.40	1.40	1.45	1.60	1.75

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.