Uncertainty Rules

A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group

ECONOMIC RESEARCH
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Assuming President-elect Joe Biden is inaugurated on January 20 (following legal challenges from the Trump administration and potential recounts) and the Republicans hold onto the Senate (following two runoff votes in Georgia on January 5), **we are unlikely to change our U.S. economic call of 4.0% growth in 2021**. A divided Congress will likely result in a smaller stimulus deal of up to $1 trillion of support measures for the unemployed, hard-hit businesses, and states struggling to balance their budgets. In the event the Democrats sweep Congress, we would need to upgrade our forecast to account for upwards of $2 trillion of stimulus (or 10% of GDP) and a "Blue Wave" of spending on infrastructure, education, housing, health and child care, and environmental actions. Conversely, if Congress remains gridlocked on a fiscal deal, we would likely need to reduce our forecast. In particular, allowing the extended unemployment insurance programs (that currently assist over 13 million people) to expire at year-end would impede the recovery, though possibly not derail it due to the massive amount of savings built up by households in response to earlier programs. For **Canada**, a Biden win could mean calmer trade relations, but possibly no Keystone XL pipeline, hurting Alberta.

Beyond the election, the **economy's biggest threat is the coronavirus**, with caseloads surging to record levels in both countries. Governments are trying to suppress the virus with restrictions more on social interaction than business activity to limit the damage to livelihoods. A ray of light is that several front-running **vaccines** might be available by the turn of the year. Depending on their effectiveness, safety and speed of rollout, they could pave the way back to normality. Before that, however, we will need to learn how to control the pandemic (as much of Asia has already done) without resorting to broad shutdowns, which now threaten to tip Europe back into recession.

So far, both economies are showing **more resilience to the virus than expected**, though several industries remain on virtual life-support. Due to massive income-support programs that have more than offset wage losses, consumers are leading the way. Savings built up during the shutdowns and stoked by government transfers are fueling purchases, with money not spent on travel and dining getting diverted to goods. U.S. consumer spending rebounded 41% annualized in Q3, cutting the earlier loss to 3.3%. Retail sales have been V-shaped in Canada as well, driven by autos, furnishings and recreation. Housing markets show few signs of slowing even as pent-up demand wanes, with prices posting double-digit gains across Southwestern Ontario, Ottawa and Montreal. Taking advantage of record-low borrowing costs and the ability to work in less expensive regions, teleworkers are leaving apartments and condos for more spacious properties away from big cities. Canadian housing starts look to exceed last year's level, something no builder could have imagined in the spring.

Key Messages

The U.S. election outcome may not alter our outlook if it results in a split Congress and moderate fiscal relief bill, though surging virus caseloads very well could.

Apart from several hard-hit services industries that remain in distress, the U.S. and Canadian economies are coping better with the virus than many analysts expected, largely because of massive policy support.

But record daily infections have led to targeted restrictions in some regions, resulting in a moderate downward revision to our Canadian growth outlook. A possible return to broader shutdowns remains the biggest threat to the recovery.

While lagging households, business spending is also improving. U.S. equipment investment rose sharply last quarter, offsetting weak commercial construction. The **33% annualized bounce in Q3 GDP** cut the U.S. economy's earlier plunge from 10.1% to 3.5%, now a smaller hole than in the Great Recession. This was despite rising infections and partial restrictions in the summer. Meantime, strong monthly GDP gains **point to a 47% rebound in Canadian Q3 growth**, as COVID cases eased this summer.

Strong gains in consumer spending in September and work hours in October led to an upward revision to our **Q4 U.S. growth call to 4.0% annualized.** The ISM manufacturing index also hit a 2-year high in October, with factories benefiting from the shift away from services to goods. Even with the economy losing momentum due to ebbing pent-up demand and surging infections, real GDP looks to contract a lesser 3.5% in 2020 versus 4.0% previously thought. This would still be the worst annual result since 1946, though likely the best in the G7 and better than the 5 1/2% slide the consensus was calling for in May. As noted earlier, we **still expect a 4.0% rebound in 2021**, albeit with downside risks stemming from the pandemic and political uncertainty.

A second wave of the virus is now rolling across Canada, resulting in new restrictions on indoor dining, bars and personal-care services in several provinces. Consequently, we **lowered our Q4 growth forecast to 2.3% and our 2021 call to 5.5%** (from the long-standing 6.0%). However, next year's outlook will be supported by **GM's surprising announcement to reopen the Oshawa plant** in 14 months and rehire 2,300 workers. While the provinces appear more willing to restrict activity than their U.S. counterparts, the Federal government is more responsive to cushioning the blow, already extending income-support programs for workers into next summer and revamping the under-used commercial rent-relief program. The IMF ranks Canada tops in providing fiscal support, followed by the U.S. and Australia. Of course, the spending measures--upwards of $240 billion or over 10% of GDP--have also drilled a large hole in the budget that could exceed 16% of GDP this year. Still, the government shows no sign of turning down the fiscal taps until the crisis is well behind us.

With the economy recovering, labour markets are healing. U.S. nonfarm payrolls are now down 6.6% since February, recovering 54% of the initial 22 million layoffs. The unemployment rate of 6.9% is less than half of April's post-war high (14.7%), but still nearly double February's half-century low (3.5%). Elevated permanent layoffs (3.7 million) suggest further progress will take longer, especially if the participation rate rises quickly (so far, child-care responsibilities have forced many people out of the workforce). Canada has made faster progress in recovering its job losses than the U.S. (according to one survey), reclaiming about 80% of the earlier 3 million job cuts. Unlike most U.S. states, provinces can run budget deficits, and have used this flexibility to increase hiring in education and health care. While the decline in the jobless rate from 13.7% in May to 8.9% in October has been slowed by a near complete rebound in the participation rate, the latter has positive implications for income and spending.

With fewer temporary layoffs on deck, jobless rates will fall more slowly in coming years. As a result, neither the **Fed** nor the **Bank of Canada** is expected to raise policy rates until 2024. The **Canadian dollar** is expected to strengthen modestly toward $1.30 by late next year, benefiting from firmer oil and commodity prices as global demand improves.

Forecasts

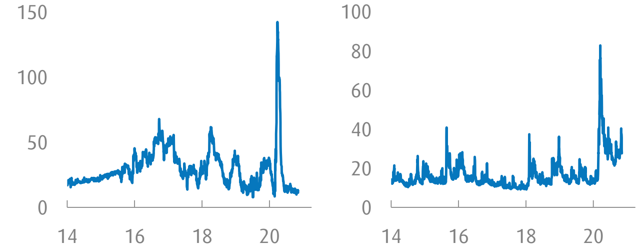
	2020				2021				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2019	2020	2021
CANADA											
Real GDP (q/q % chng : a.r.)	-8.2	-38.7	47.0	2.3	4.2	6.5	6.0	5.0	1.7	-5.6	5.5
Consumer Spending	-12.4	-43.0	67.2	5.2	3.4	6.9	6.7	5.8	1.6	-6.1	7.2
Business Investment (non-res.)	-2.7	-56.7	56.6	6.9	5.0	6.7	7.7	7.1	0.4	-10.5	5.3
Consumer Price Index (y/y % chng)	1.8	0.0	0.3	0.3	0.6	1.9	1.6	1.7	1.9	0.7	1.4
Unemployment Rate (percent)	6.3	13.0	10.0	8.7	7.9	7.7	7.4	7.1	5.7	9.5	7.5
Housing Starts (000s : a.r.)	209	191	239	210	210	206	202	202	209	212	205
Current Account Balance ($blns : a.r.)	-52.9	-34.5	-40.8	-39.8	-41.5	-41.8	-41.7	-42.9	-47.0	-42.0	-42.0
Interest Rates (average for the quarter : %)											
Overnight Rate	1.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.75	0.50	0.25
3-month Treasury Bill	1.29	0.22	0.16	0.10	0.10	0.10	0.10	0.10	1.65	0.45	0.10
10-year Bond	1.20	0.59	0.55	0.65	0.70	0.75	0.80	0.85	1.59	0.75	0.80
Canada-U.S. Interest Rate Spreads (average for the quarter : bps)											
90-day	16	8	5	0	0	0	0	0	-45	7	0
10-year	-18	-10	-10	-18	-17	-16	-15	-14	-56	-14	-15
UNITED STATES											
Real GDP (q/q % chng : a.r.)	-5.0	-31.4	33.1	4.0	2.8	4.0	3.7	3.3	2.2	-3.5	4.0
Consumer Spending	-6.9	-33.2	40.7	6.0	3.0	4.0	4.0	3.7	2.4	-3.7	5.1
Business Investment (non-res.)	-6.7	-27.2	20.3	1.4	3.2	4.4	3.4	2.4	2.9	-4.9	2.7
Consumer Price Index (y/y % chng)	2.1	0.4	1.3	1.2	1.3	2.7	2.0	2.0	1.8	1.2	2.0
Unemployment Rate (percent)	3.8	13.0	8.8	6.8	6.4	6.1	5.8	5.5	3.7	8.1	6.0
Housing Starts (mlns : a.r.)	1.48	1.08	1.43	1.41	1.34	1.34	1.34	1.35	1.30	1.35	1.34
Current Account Balance ($blns : a.r.)	-446	-682	-833	-858	-875	-883	-895	-905	-480	-705	-890
Interest Rates (average for the quarter : %)											
Fed Funds Target Rate	1.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	2.13	0.38	0.13
3-month Treasury Bill	1.13	0.14	0.11	0.10	0.10	0.10	0.10	0.10	2.10	0.35	0.10
10-year Note	1.38	0.69	0.65	0.80	0.90	0.90	0.95	1.00	2.14	0.90	0.95
EXCHANGE RATES (average for the quarter)											
US¢/C$	74.4	72.2	75.1	75.7	75.9	76.2	76.5	76.8	75.4	74.4	76.4
C$/US$	1.34	1.39	1.33	1.32	1.32	1.31	1.31	1.30	1.33	1.35	1.31
¥/US$	109	108	106	105	105	106	106	107	109	107	106
US$/Euro	1.10	1.10	1.17	1.16	1.16	1.18	1.20	1.21	1.12	1.13	1.19
US$/£	1.28	1.24	1.29	1.29	1.30	1.31	1.32	1.33	1.28	1.28	1.31

Blocked areas mark BMO Capital Markets forecasts

Chart 1
Risk Aversion Jumps

United States (as of November 5, 2020)

Ted Spread[1] **VIX**[2]

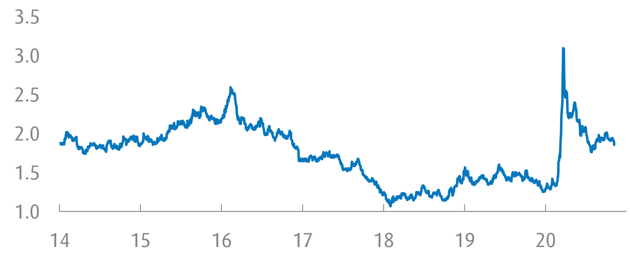


[1] 3-mnth Eurodollar minus 3-mnth T-bills (bps); [2] CBOE market volatility index
Sources: BMO Economics, Haver Analytics

Chart 2
Credit Spreads Widen

United States (ppts : as of November 5, 2020)

Corporate Bond Spreads[1]

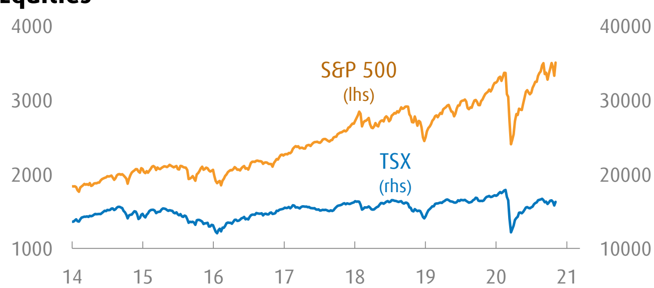


[1] 15-year BoA Merrill Lynch AA Corporate Yield less 10-year Treasury Yield
Sources: BMO Economics, Haver Analytics

Chart 3
Equities Like Election Results

(indices : as of November 6, 2020)

Equities



Sources: BMO Economics, Haver Analytics

Chart 4
Loonie Holding Firm

(US¢ : as of November 6, 2020)

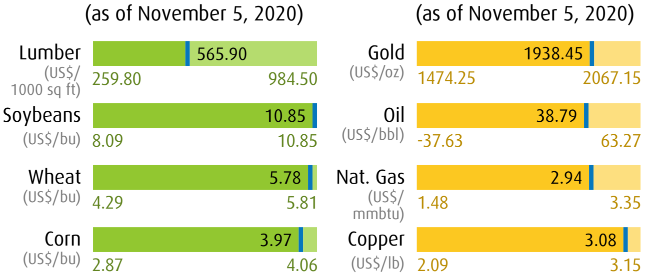
Canadian Dollar

Sources: BMO Economics, Haver Analytics

Chart 5
Natural Gas Flares Higher

Commodity price range since start of 2020

Materials & Foodstuffs (as of November 5, 2020) **Metals & Energy** (as of November 5, 2020)



Sources: BMO Economics, Haver Analytics
Line indicates current value

Chart 6
Oil Steadies

(US$/bbl : as of November 6, 2020)

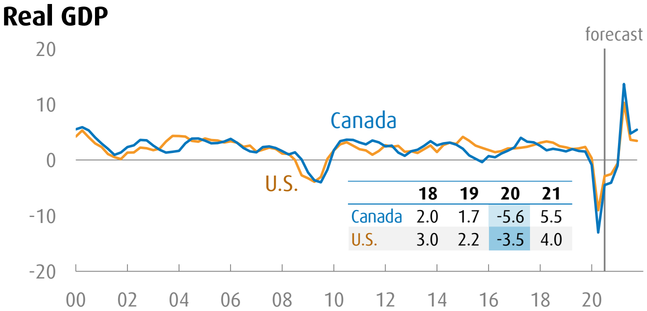
WTI Crude Oil Price

Sources: BMO Economics, Haver Analytics

Chart 7
From Shutdown to Reopening

(y/y % chng)

Real GDP



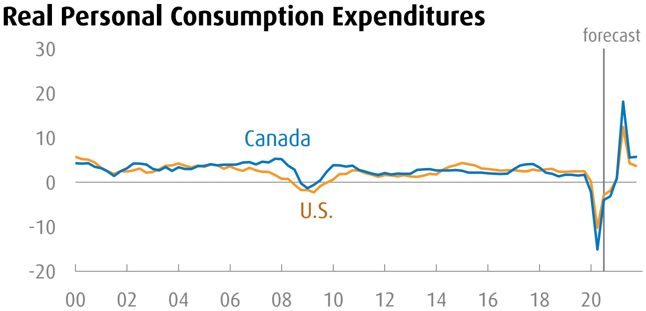
	18	19	20	21
Canada	2.0	1.7	-5.6	5.5
U.S.	3.0	2.2	-3.5	4.0

Sources: BMO Economics, Haver Analytics

Chart 8
Consumers Leading Recovery

(y/y % chng)

Real Personal Consumption Expenditures

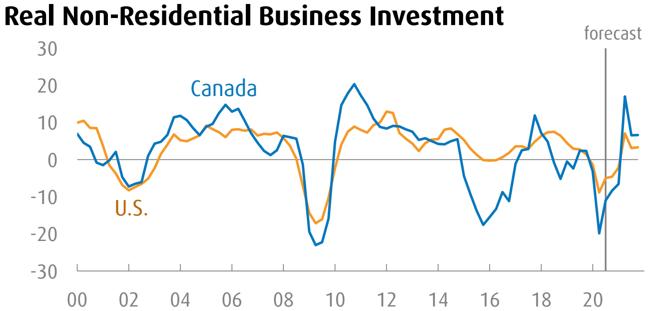


Sources: BMO Economics, Haver Analytics

Chart 9
Investment Lagging

(y/y % chng)

Real Non-Residential Business Investment

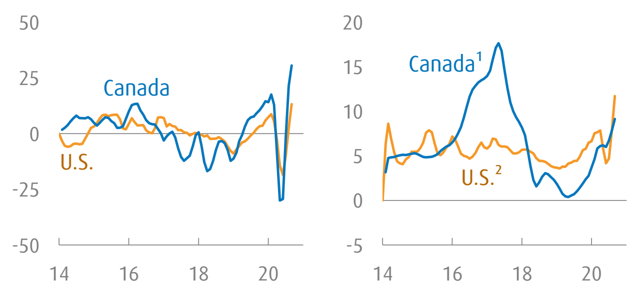


Sources: BMO Economics, Haver Analytics

Chart 10
Housing Resilient

Existing Homes (y/y % chng : 3-mnth m.a.)

Sales **Prices**

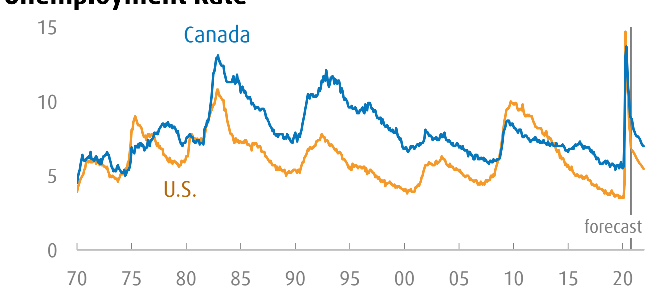


Sources: BMO Economics, Haver Analytics [1] MLS HPI; [2] NAR Median Sales Price

Chart 11
Jobless Rate Improving

(percent)

Unemployment Rate

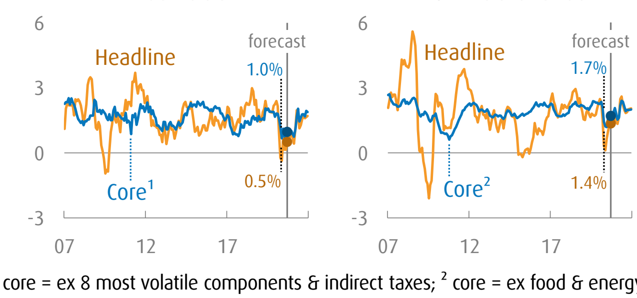


Sources: BMO Economics, Haver Analytics

Chart 12
Inflation Bottoms

Consumer Price Index (y/y % chng)

Canada **United States**

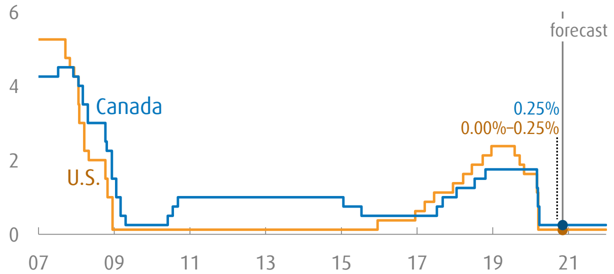


[1] core = ex 8 most volatile components & indirect taxes; [2] core = ex food & energy
Sources: BMO Economics, Haver Analytics

Chart 13
Policy Rates Going Nowhere

(% : as of : November 6, 2020)

Overnight Rate

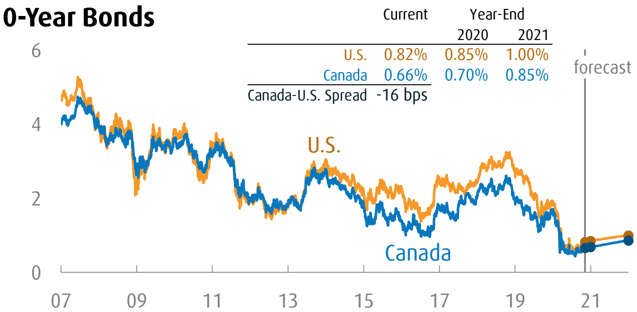


Sources: BMO Economics, Haver Analytics

Chart 14
Low for Much Longer

(% : as of November 6, 2020)

10-Year Bonds



Sources: BMO Economics, Haver Analytics

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