# Main Event on Q4 Fight Card: Virus versus Vaccine

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The wave of news and events in the past few weeks can be neatly summarized thusly: The near-term outlook has weakened markedly while the medium-term outlook has brightened notably. The next few months will have to run the gauntlet of resurgent virus cases almost everywhere and deepened uncertainty on the U.S. fiscal support outlook. But looking beyond the potentially hard winter, **the substantially positive vaccine results hold out the promise of a return to a new-ish normal**, which may also be the case on the U.S. fiscal front. Financial markets have mostly keyed on the positive vaccine news, although U.S. equities largely fought to a draw this week after reaching record highs across the board on Monday. Still, the MSCI World Index is up roughly 10% just since the start of November, oil prices have made a nice recovery to above $41, and emerging market and commodity currencies have firmed versus a listing U.S. dollar.

Investors are looking across the possibility of a deep valley in coming weeks. The **IMF** weighed in, suggesting that while the global economy has rebounded faster and stronger than most expected, the **momentum is fading** amid rising virus cases and renewed restrictions. There is no debate on that point; the debate is the extent of the fade. The conventional wisdom is that **most economies are now better poised to deal with shutdowns**, and the logic runs like this:

- Any lockdowns won't be as widespread or as lengthy as in the spring.
- Both consumers and businesses are better prepared and better able to adapt to restriction measures. For example, many small businesses have greatly improved their on-line offerings.
- The businesses that are hardest hit by restrictions are already operating far below capacity, and may not weaken much further.
- Consumer confidence won't be shattered by shutdowns and the intense market turmoil seen during the spring.

However, **fiscal policy is not in a position to rapidly ride to the rescue** in many jurisdictions as it did in March. The post-election wrangling in the U.S. casts further doubt on a quick stimulus support package in the lame-duck session, even as Congressional leaders are negotiating again. While we believe an agreement will ultimately be reached, likely in the neighbourhood of $1 trillion, it most likely won't be in place for months. Meanwhile, the ballyhooed European Recovery Fund is at risk of being held up by Poland and Hungary. Canada is an outlier, with no fiscal ambiguity as Ottawa is prepared to "*do whatever it takes*" to support the economy in coming months.

**What does all of this imply for the outlook?** Beyond the fiscal question marks, the other big variable is the degree to which economies are actually locked down, and that's a moving and confusing target everywhere. Based on the measures announced to-date, **we estimate that Canada's Q4 GDP annualized growth rate will be**

**chopped by just under 6 percentage points below where it would have otherwise been**. That's a much, much milder cut than earlier this year, but the chapter is most probably not finished on restriction measures. The hit will probably be more intense in some other countries, as we look for outright declines in GDP for a variety of European economies—notably France, which is grappling with one of the most serious outbreaks and most serious shutdowns.

Of course, for Canada, there's the small issue that we don't even have the official Q3 GDP data yet (released on December 1). We expect output to snap back at a 47% annual rate in the quarter, but then to fade to around just a 2% pace in Q4. Fair question: How does that square with the comment above that restrictions will cut growth by almost 6 percentage points? Reasonable answer: We had initially assumed that the economy could grow by more than 8% in Q4, given the powerful momentum it carried into the fall season. That upbeat view is now out the window, and we have also cut our assumption for growth in the first quarter of next year to just over 2% as well. These modest figures **assume at least one month of decline** in activity late this year, with a rebound early in 2021. Even with the much more subdued outlook for the turn of the year, we are maintaining our above-consensus call for 2021 GDP growth of 5.5%, in part due to a more upbeat forecast for the back-half of next year.

It's a **roughly similar story for the U.S. outlook**, albeit with somewhat different undercurrents both on the fiscal front and on shutdown measures. We remain more upbeat on the Q4 outlook, with big gains in October industrial output and housing starts supporting our 4% call for the quarter. However, **we have chopped our Q1 call in half to a slim 1.5% clip**, with the possibility of more trims ahead depending on the fate of fiscal support. At the same time, though, we have also ramped up growth later next year, thus keeping the 2021 annual call steady at a 4.0% advance (after this year's expected 3.5% setback).

So, **on balance**, our forecast has seen a shuffling of the deck to more weakness in the near term and more strength in the further out quarters—in line with the opening remark to this piece. And the end result is **almost no change to our annual estimates** for 2020 and 2021. Note that the one financial market that has barely budged on balance since the start of the month—in keeping with our *"no net change in the forecast"*—is the government bond market. While there has been a lot of churning in yields recently, the 10-year Treasury yield is now back within a basis point of its 85 bp level the day before the U.S. election, and two-year yields are unchanged. For Canada, both 2s and 10s are up a modest 2 bps since the start of the month. The key takeaway message is that even amid the fireworks in equities and some other markets on the vaccine news, bonds are weighing that evenly against the clear near-term negative news. From an economist point of view, we simply can't disagree with the more cautious take from the fixed-income market.

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There was something almost reassuring from the market's reaction to this week's round of retail sales releases from many key economies. **U.S. retail sales** rose a mild 0.3% in October, and this was seen as a "disappointment", because it fell a couple ticks shy of expectations. **China's sales** were a tad below consensus at up 4.3% y/y, but that was countered by a solid 6.9% y/y rise in industrial production. On the other hand, both **Canada and the U.K. posted mildly better-than-expected retail figures** on Friday, with the latter up 1.2% in October (and +5.8% y/y), while the former was up 1.1% in September (and +4.6% y/y).

But the main point is that all of these figures are back to within a world we have seen before. That is, **they are essentially 'normal' again**. And that goes for a wide variety of economic indicators, which in many cases had experienced six sigma events in the spring and summer. After seeing post-war highs in joblessness for a few months, job losses (and gains) in the millions, double-digit changes in all kinds of indicators that normally don't even move by 1%, it's almost comforting to see metrics moving by less than a standard deviation again, not to mention single-digit unemployment rates.

Turning back to U.S. retail sales, let's rewind the clock to a few months ago. Way back in mid-June, the consensus for the May retail report was for a gain of 7.4%—in fact, it came in at a massive +17.7% (since revised up to 18.3%, so the spike was no fluke). The Treasury market saw a back-up of all of 4 bps on 10-year yields that day, on a miss of more than 10 percentage points in a highly important indicator. Hopefully, that 10-point mega-chasm puts the 0.2 micro-miss on the latest sales figure into some kind of perspective. Yet, note that the 10-year yields dipped 4 bps this Tuesday, the day of the retail report. True, a lot of factors are at play on any given day, but it says something that bond yields reacted in a symmetric fashion to these two wildly different retail results.

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