Eve of Destruction… or Reconstruction?

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After bravely holding up remarkably well in the face of some serious headwinds through the early fall, **financial markets seemed to lose their nerve this week**. The combination of rapidly rising virus cases globally and the rapidly approaching U.S. election sent stocks skittering, oil to a four-month low, and commodity currencies into retreat. Still, while it was a challenging week for risk-related assets, the major equity measures are still shy of full correction terrain and firmly above 200-day moving averages. Providing some underlying support is the view that renewed restrictions amid the second wave of the virus are likely to be much less crippling to the economy than in the spring. And, this week's heavy slate of indicators provided ample evidence that growth can rebound quickly when restrictions are lifted.

Curiously, and potentially importantly, **bond yields did not partake** in the risk-off move this week. The 10-year Treasury yield was on track to rise slightly on the week even as the S&P 500 fell roughly 6% and WTI prices dropped more than 10%. It was a similar picture in Canada, with 10s nudging up a tick, despite a mid-week rally. The latter was inspired by an adjustment in the Bank of Canada's QE program; while it plans on tapering weekly GoC purchases to $4 billion (still over $200 billion per year, for the record), the buying will now be more heavily concentrated on the long end. Even with the Maple version of Operation Twist, the Canadian curve only flattened by a few bps on the week, which saw very little net movement overall in light of the big moves in other markets.

One factor that may be holding bond yields aloft is the **possibility of much more aggressive stimulus spending**, depending on what unfolds in Tuesday's U.S. election. No doubt, most are preparing for all potential outcomes—especially after the 2016 misfire—but betting markets and pundits are cautiously leaning to a two-thirds probability of a Democratic sweep. That result would eventually usher in the largest spending package, and send bond supply soaring. Markets may also be mindful of the sustained pop in yields which followed the **2016 result**, when 10s jumped almost 20 bps the day after the election and were up a towering 70 bps within five weeks. Of course, there's also the **2000 episode**, where the contested election led to an 85-bp plunge in yields before the end of the year.

Another factor holding yields aloft has been the **steady drum-beat of better-than-expected economic results** from around the world. True, these figures are looking into the bygone days of late summer, when economies were reopening. However, some are so surprisingly strong that they indicate the underlying economy can cope better than widely appreciated with the virus. Perhaps the most obvious example of that was the spike in Q3 GDP in the Euro Area. Growth came in more than 3 percentage points above consensus in the quarter, and that's before the magic of annual rates. After a deep dive in the first half of the year, growth powered ahead 12.7% in Q3, or at a 61.1% annual rate. That's almost double the strong 33.1% annualized pace in the

U.S., and well above Canada's expected 47% rise. The Euro spike left GDP in the region down a manageable 4.3% y/y, a lighter drop than that in Canada (-4.5%) and not far from the U.S. (-2.9%). Even with a possible late-year stumble amid the new restrictions—notably in France and Germany—the hole isn't nearly as deep as many expected for Europe heading into 2021.

The flurry of crucial economic data will continue next week, albeit heavily overshadowed by the U.S. election. Almost lost amid the hubbub, the FOMC meets next Thursday, Ontario reveals a budget that same day, the October employment reports for both the U.S. and Canada are due on Friday, and we'll get key readings from the ISM and on auto sales early in the week. The slew of data will provide the first good reading on how the North American economy fared during the second wave and some renewed rollbacks. Based on the notable drop in U.S. jobless claims in the month, but also a pronounced lull in real-time measures, **early indications are that growth kept its head above water in October, but only just**.

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Beyond this month, where is the economy headed next? We take a deeper look at that crucial issue in this week's Focus Feature. Here are some takeaways:

The solid Q3 GDP results so far show that underlying economies were not fundamentally damaged by the lockdowns—those sectors that were able to reopen bounced back—largely thanks to the massive degree of government income support. And while the run-up in virus cases casts a cloud, note that the two largest economies in the world are unlikely to roll back openings—China doesn't need to, and the U.S. doesn't want to.

Even with the mega U.S. election wildcard, ultimately we are big believers that politics play a distant secondary role in the economic outlook. The election will only shift the needle on growth by a few ticks—provided we have a clear, or at least semi-clear, result by Wednesday morning. For now, we are **looking at a 4% rebound in the U.S. economy in 2021**, even with a lull around the turn of the year. There's even some upside risk to that call, on the possibility of a big stimulus package, offset by the resurgence of the virus.

For **Canada**, the U.S. election holds many important implications, from trade, to stimulus spending, to energy, to pipelines; but, again, as long as it's a clear result, the election is of tertiary importance to the domestic macro outlook. We have trimmed our above-consensus call for Canadian GDP growth next year, but remain higher than most at 5.5% (the BoC, for one, is at 4.2%), on the view that activity will rebound forcefully again as restrictions are lifted—as was so clearly shown during this summer.

For **the global economy** more broadly, we had assumed that, even before the recent second wave, growth would cool markedly after the initial Q3 burst in activity. At the very least, we will see some real moderation in coming months, with even a small pullback for a spell in some economies possible. However, we believe that the North American economy will avoid a full-on double dip (or W shape), even if the road is about to get much bumpier. For global growth overall, we remain comfortable calling for a 5.5% snapback after this year's historic 4% setback.

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