

Two Steps Forward, One Step Back

- Incoming data suggest a sharp rebound is underway in many countries though failure to control the spread in the virus in the US suggests the recovery in the second half of the year will be more muted.
- Despite a V-shaped recovery in growth rates which should see strong growth for the remainder of the year and into 2021, the recovery will be long and painful for many sectors and individuals. A return to pre-COVID levels of economic activity is several quarters away.
- Disinflationary pressures will be significant, as inflation responds with a lag to the decline in output. Policy rates in most industrialized countries are likely to remain at current levels through the end of 2022.

Though COVID-19 cases continue to rise globally, success in controlling the virus in some countries has allowed a relaxation of public health measures that have been so economically harmful. **Across the industrialized economies for instance, economic indicators seem to confirm that a V-shaped recovery of growth rates is fully underway (chart 1).** Those countries are in the easy phase of the recovery as spectacular growth rates flow from the re-opening process. To a varying degree, indicators of household or business activity suggest that a significant amount of COVID-related losses in output have been reversed. Markets have obviously been welcoming of these developments, but it is easy to overlook the fact that some of these losses will persist and that there are questions about the sustainability of the recovery once much of the re-opening process is complete. Levels of economic activity are expected to remain well-below those observed pre-COVID in many countries for quite a while. In Canada, for instance, we currently expect it will take until early 2022 to return to late 2019 levels of economic activity.

In countries where virus control has proven to be more challenging, such as some Latin American nations, the rebound is not yet underway despite policy efforts to attenuate the impact of the pandemic that are, for the most part, substantial. **The dramatic increase in COVID cases seen in the United States—and to a lesser degree the evident ease with which the virus can re-establish itself as seen in many other parts of the world—are a stark reminder that the sharp rebound in economic activity observed at the moment across countries is acutely vulnerable to virus-related developments.** So important are these downside risks that our forecasts for Canada and the US in 2020, for example, have remained roughly unchanged even though second quarter data and early third quarter data have generally been stronger than our expectations as we scale back the extent and speed of the rebound for the remainder of the year.

Compounding the health risks are policy risks in the United States. It is clear President Trump is embarking on a more confrontational path across several areas. **Of most immediate concern, a premature withdrawal of policy support—such as may occur if the supplemental unemployment insurance payments were to be scaled back—risks damaging what is not yet a self-sustaining recovery.** For the moment, we assume those benefits will be

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Chart 1



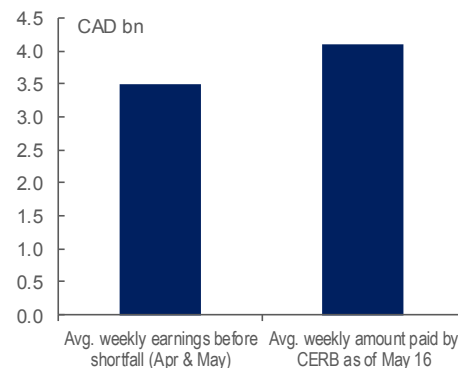
extended as-is for as long as needed, but if that were to change, as seems possible this week, we would reduce our US forecast accordingly.

From a Canadian perspective, incoming data are clearly indicative of a very sharp improvement in economic activity even as many sectors are still struggling. This is most evident in the household spending data, with retail sales having returned to pre-COVID levels, though the composition of those sales is clearly very different as some sub-sectors (general merchandise and food stores) are significantly above pre-virus levels, while a number of others remain well-below February levels. Auto sales have rebounded powerfully, a combination of pent-up demand, but also reflecting greater interest in purchasing cars post-COVID. This is no doubt linked to surveys showing less desire to take public transit. Developments on the consumer spending side likely reflect an impressive resilience in household finances despite a sharp increase in unemployment. This likely flows from the emergency income support from the government (chart 2), reduced childcare expenses, the various deferral programs offered by financial institutions, the strength of house prices, and the very strong rebound in equity markets observed.

Despite the rebound in some market-based measures of inflation expectations, inflation appears likely to remain well below central banks' targets in countries where those exist. The Canadian example is indicative of developments globally. The shock to the level of output is so large that, even if we accept that much of it results in lower supply, the output gap will widen sharply, putting downward pressure on inflation. Of course, the relation between output gaps or other measures of economic activity and inflation, is captured in the Phillips Curve and there is some debate as to how well that relation is holding up. In Canada, our estimated Phillips Curve has held up quite well in recent years, as has that for the US, though that curve has never worked as well as it has in Canada. As there is a lag between a deterioration of the cyclical position of the economy and inflation (around a year in our model), the fact that various measures of trend inflation remain around 2% in Canada should not be interpreted as proof that inflation will remain at target, or even rise from current levels. Core inflation is only expected to return to the Bank of Canada's target by the end of 2022.

Given our assessment of disinflationary pressures, policy rates in industrialized economies should remain at current levels for an extended period of time. Rates will not rise for many quarters. In the US, Chairman Powell indicated that the Fed has not even begun to think that they should begin thinking about higher policy rates. In Canada, the Bank of Canada has returned to Carney-era forward guidance by categorically committing to maintain its policy rate at current levels until inflation is sustainably at its target. If our forecast is accurate, that wouldn't be until 2023. Moreover, if additional policy support is required, both central banks have indicated that they would not consider negative interest rates, but rather consider means to lower interest rates further up the curve, possibly by following Australia's experience in yield curve control.

Chart 2

Weekly Earnings Shortfall vs Average Weekly CERB Payment


Sources: Scotiabank Economics, Finance Canada, Statistics Canada.

International	2010–18	2018	2019	2020f	2021f	2010–18	2018	2019	2020f	2021f
		Real GDP (annual % change)					Consumer Prices (y/y % change, year-end)			
World (based on purchasing power parity)	3.8	3.8	3.0	-3.2	5.4					
Canada	2.2	2.0	1.7	-6.6	5.4	1.7	2.0	2.1	0.2	2.1
United States	2.3	3.0	2.2	-4.7	5.4	1.7	2.2	2.0	0.6	2.4
Mexico	3.0	2.1	-0.3	-9.1	3.1	4.1	4.8	2.8	3.7	3.9
United Kingdom	1.9	1.3	1.5	-9.4	6.1	2.2	2.1	1.3	0.7	1.4
Eurozone	1.4	1.9	1.3	-8.3	5.2	1.3	1.5	1.3	0.5	1.0
Germany	2.1	1.5	0.6	-6.3	5.3	1.3	1.6	1.5	0.5	1.3
France	1.4	1.7	1.5	-9.7	6.0	1.1	1.6	1.5	0.4	1.1
China	7.9	6.8	6.1	2.1	8.5	2.5	1.8	4.5	1.7	2.5
India	7.2	6.8	4.8	-5.2	8.3	7.3	2.1	7.4	4.0	4.3
Japan	1.4	0.3	0.7	-4.2	2.0	0.6	0.3	0.8	-0.6	0.5
South Korea	3.5	2.9	2.0	-1.6	3.1	1.8	1.3	0.7	0.1	1.7
Australia	2.7	2.7	1.8	-3.6	2.7	2.1	1.8	1.8	0.4	1.6
Thailand	3.8	4.1	2.4	-6.0	4.2	1.5	0.4	0.9	-0.8	1.5
Brazil	1.4	1.3	1.1	-5.7	2.9	6.0	3.8	3.8	3.1	5.2
Colombia	3.8	2.5	3.3	-7.5	5.0	3.9	3.2	3.2	1.9	3.1
Peru	4.8	4.0	2.2	-11.5	8.7	3.0	2.2	1.9	1.1	1.5
Chile	3.6	4.0	1.1	-6.0	4.4	3.2	2.6	3.0	2.2	3.0
Argentina	1.8	-2.5	-2.1	-8.1	5.8	23.0	47.6	53.8	26.7	42.5
Commodities		(annual average)								
WTI Oil (USD/bbl)	74	65	57	37	44					
Brent Oil (USD/bbl)	82	72	64	41	46					
WCS - WTI Discount (USD/bbl)	-18	-26	-14	-14	-15					
Nymex Natural Gas (USD/mmbtu)	3.39	3.07	2.53	1.93	2.50					
Copper (USD/lb)	3.10	2.96	2.72	2.50	2.75					
Zinc (USD/lb)	1.02	1.33	1.16	0.92	1.00					
Nickel (USD/lb)	7.00	5.95	6.32	5.70	6.00					
Aluminium (USD/lb)	0.89	0.96	0.81	0.90	0.90					
Iron Ore (USD/tonne)	101	70	94	87	70					
Metallurgical Coal (USD/tonne)	179	207	184	130	140					
Gold, (USD/oz)	1,342	1,268	1,393	1,650	1,700					
Silver, (USD/oz)	21.64	15.71	16.21	16.50	18.00					

Sources: Scotiabank Economics, Statistics Canada, BEA, BLS, IMF, Bloomberg.

North America	2010-18	2018	2019	2020f	2021f	2010-18	2018	2019	2020f	2021f
	Canada					United States				
	(annual % change, unless noted)					(annual % change, unless noted)				
Real GDP	2.2	2.0	1.7	-6.6	5.4	2.3	3.0	2.2	-4.7	5.4
Consumer spending	2.6	2.1	1.6	-6.4	4.9	2.4	2.7	2.4	-5.4	5.4
Residential investment	2.7	-1.5	-0.5	-3.9	7.0	5.0	-0.6	-1.7	1.6	5.3
Business investment*	2.4	1.8	-0.4	-7.4	10.6	5.2	6.9	2.9	-3.1	10.7
Government	1.2	3.4	1.8	-0.1	2.8	-0.3	1.8	2.3	2.4	3.0
Exports	3.6	3.1	1.3	-12.1	6.6	4.2	3.0	-0.1	-15.2	6.6
Imports	3.9	2.6	0.6	-9.7	7.4	4.8	4.1	1.1	-13.5	7.8
Nominal GDP	3.9	3.9	3.6	-6.3	7.3	4.0	5.5	4.0	-3.7	6.7
GDP deflator	1.7	1.8	1.9	0.2	1.8	1.7	2.4	1.8	1.0	1.2
Consumer price index (CPI)	1.7	2.3	1.9	0.7	1.6	1.8	2.4	1.8	0.9	1.8
Core inflation rate**	1.9	1.9	2.0	1.6	1.4	1.6	2.0	1.7	1.1	1.6
Pre-tax corporate profits	5.8	2.5	-0.1	-23.2	8.0	5.5	6.1	0.3	-21.3	1.7
Employment	1.2	1.3	2.1	-5.9	6.0	1.4	1.6	1.4	-5.9	4.5
Unemployment rate (%)	7.0	5.8	5.7	9.9	6.9	6.5	3.9	3.7	9.5	7.0
Current account balance (CAD, USD bn)	-58.4	-55.5	-47.0	-59.9	-63.9	-403	-450	-480	-475	-534
Merchandise trade balance (CAD, USD bn)	-13.0	-22.1	-18.4	-32.5	-40.2	-753	-880	-864	-822	-932
Federal budget balance (FY, CAD, USD bn) ***	-18.9	-14.0	-22.0	-343.0	-125.0	-813	-779	-960	-3,700	-2,100
percent of GDP	-1.0	-0.7	-1.0	-15.9	-5.4	-4.6	-3.8	-4.5	-17.9	-9.5
Housing starts (000s, mn)	200	213	209	190	178	0.96	1.25	1.30	1.27	1.38
Motor vehicle sales (000s, mn)	1,810	1,984	1,862	1,568	1,783	15.5	17.2	16.9	14.1	15.8
Industrial production	2.7	3.1	-0.8	-5.8	4.0	2.2	4.0	0.9	-8.9	4.8
	Mexico									
	(annual % change)									
Real GDP	3.0	2.1	-0.3	-9.1	3.1					
Consumer price index (year-end)	4.1	4.8	2.8	3.7	3.9					
Current account balance (USD bn)	-21.2	-23.0	-4.3	-15.4	-16.9					
Merchandise trade balance (USD bn)	-6.8	-13.6	5.4	-4.7	4.1					

Sources: Scotiabank Economics, Statistics Canada, CMHC, BEA, BLS, Bloomberg. *For Canada it includes capital expenditures by businesses and non-profit institutions.
 ** US: core PCE deflator; Canada: average of 3 core measures published by the BoC. *** In order to align with US reporting, as of this issue of Scotiabank's Forecast Tables, Canadian Federal and Provincial Budget Balances for FY2020/21 are noted in calendar year 2020, FY2021/22 in calendar year 2021.

Quarterly Forecasts	2019	2020				2021			
Canada	Q4	Q1	Q2e	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Real GDP (q/q ann. % change)	0.6	-8.2	-40.0	33.5	12.6	6.2	2.0	4.3	5.5
Real GDP (y/y % change)	1.5	-0.9	-13.5	-7.3	-4.6	-1.1	13.0	6.2	4.5
Consumer prices (y/y % change)	2.1	1.8	0.0	0.8	0.2	0.5	2.1	1.9	2.1
Avg. of new core CPIs (y/y % change)	2.0	1.9	1.7	1.5	1.2	1.3	1.3	1.4	1.5
Unemployment Rate (%)	5.7	6.3	13.0	11.5	9.1	7.6	7.1	6.7	6.2
United States									
Real GDP (q/q ann. % change)	2.4	-5.0	-32.9	21.3	10.0	8.3	5.2	4.3	2.9
Real GDP (y/y % change)	2.3	0.3	-9.5	-5.7	-4.0	-0.8	11.0	6.9	5.1
Consumer prices (y/y % change)	2.0	2.1	0.4	0.5	0.6	1.3	1.7	2.0	2.4
Total PCE deflator (y/y % change)	1.5	1.7	0.6	0.6	0.4	1.1	1.5	1.8	2.2
Core PCE deflator (y/y % change)	1.6	1.8	0.9	0.8	0.8	1.2	1.5	1.7	1.8
Unemployment Rate (%)	3.5	3.8	13.0	11.2	9.8	8.6	7.3	6.4	5.9

Sources: Scotiabank Economics, Statistics Canada, BEA, BLS, Bloomberg.

	2019		2020			2021			
Central Bank Rates	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Americas	(% , end of period)								
Bank of Canada	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
US Federal Reserve (upper bound)	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Bank of Mexico	7.25	6.50	5.00	4.75	4.75	4.75	4.75	4.75	4.75
Central Bank of Brazil	4.50	3.75	2.25	1.75	1.75	1.75	2.25	3.25	4.25
Bank of the Republic of Colombia	4.25	3.75	2.50	2.00	2.00	2.00	2.00	2.50	3.00
Central Reserve Bank of Peru	2.25	1.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
Central Bank of Chile	1.75	0.50	0.50	0.25	0.25	0.25	0.25	0.25	0.25
Central Bank of Argentina	55.00	38.00	38.00	38.00	38.00	38.00	38.00	38.00	40.00
Europe									
European Central Bank MRO Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
European Central Bank Deposit Rate	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Bank of England	0.75	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Asia/Oceania									
Reserve Bank of Australia	0.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Bank of Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
People's Bank of China	4.15	4.05	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Reserve Bank of India	5.15	4.40	4.00	3.75	3.50	3.50	3.50	3.50	3.75
Bank of Korea	1.25	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Bank of Thailand	1.25	0.75	0.50	0.25	0.25	0.25	0.25	0.25	0.25
Currencies and Interest Rates									
Americas	(end of period)								
Canadian dollar (USDCAD)	1.30	1.41	1.36	1.34	1.32	1.30	1.30	1.28	1.28
Canadian dollar (CADUSD)	0.77	0.71	0.74	0.75	0.76	0.77	0.77	0.78	0.78
Mexican peso (USDMXN)	18.93	21.97	23.00	23.52	24.33	24.46	24.29	24.17	24.23
Brazilian real (USDBRL)	4.02	5.20	5.46	5.31	5.26	4.88	4.96	5.07	5.03
Colombian peso (USDCOP)	3287	4065	3758	3709	3654	3473	3465	3458	3450
Peruvian sol (USDPEN)	3.31	3.44	3.54	3.47	3.45	3.47	3.52	3.46	3.40
Chilean peso (USDCLP)	753	852	822	740	750	740	740	730	720
Argentine Peso (USDARS)	59.87	64.40	70.46	77.30	82.70	85.60	87.50	90.20	94.60
Europe									
Euro (EURUSD)	1.12	1.10	1.09	1.18	1.18	1.20	1.20	1.21	1.21
UK pound (GBPUSD)	1.33	1.24	1.25	1.28	1.29	1.30	1.31	1.32	1.33
Asia/Oceania									
Japanese yen (USDJPY)	109	108	108	105	105	104	104	102	102
Australian dollar (AUDUSD)	0.70	0.61	0.69	0.71	0.71	0.73	0.73	0.75	0.75
Chinese yuan (USDCNY)	6.96	7.08	7.01	7.05	7.05	7.00	7.00	6.90	6.90
Indian rupee (USDINR)	71.4	75.5	75.5	74.0	74.0	73.0	73.0	72.0	72.0
South Korean won (USDKRW)	1,156	1,219	1,203	1,220	1,220	1,200	1,200	1,180	1,180
Thai baht (USDTHB)	30.0	32.8	30.9	31.5	31.5	31.0	31.0	30.0	30.0
Canada (Yields, %)									
3-month T-bill	1.66	0.21	0.20	0.15	0.15	0.15	0.15	0.15	0.15
2-year Canada	1.69	0.42	0.29	0.25	0.25	0.35	0.45	0.55	0.65
5-year Canada	1.68	0.58	0.36	0.30	0.45	0.60	0.80	1.00	1.20
10-year Canada	1.70	0.69	0.53	0.50	0.60	0.75	1.00	1.20	1.45
30-year Canada	1.76	1.30	0.99	0.95	1.15	1.30	1.45	1.55	1.65
United States (Yields, %)									
3-month T-bill	1.51	0.05	0.14	0.10	0.10	0.10	0.10	0.10	0.10
2-year Treasury	1.57	0.25	0.15	0.15	0.15	0.25	0.35	0.45	0.55
5-year Treasury	1.69	0.38	0.29	0.20	0.35	0.50	0.70	0.95	1.10
10-year Treasury	1.92	0.67	0.66	0.60	0.70	0.85	1.10	1.30	1.60
30-year Treasury	2.39	1.32	1.41	1.25	1.40	1.55	1.70	1.85	2.00

Sources: Scotiabank Economics, Bloomberg.

The Provinces	(annual % change except where noted)										
Real GDP	CA	NL	PE	NS	NB	QC	ON	MB	SK	AB	BC
2010–18	2.2	0.5	2.0	0.9	0.6	1.7	2.2	2.2	2.5	2.8	2.8
2018	2.0	-3.5	2.6	1.5	0.8	2.5	2.2	1.3	1.3	1.6	2.6
2019*	1.7	4.0	4.5	2.1	1.0	2.7	1.6	1.0	-0.8	-0.6	2.8
2020f	-6.6	-6.8	-5.2	-5.5	-5.7	-6.7	-6.4	-5.1	-6.8	-8.9	-5.3
2021f	5.4	5.0	5.2	5.4	5.3	5.2	5.3	5.5	5.7	5.9	5.4
Nominal GDP											
2010–18	3.9	3.2	3.9	2.7	2.8	3.7	4.1	4.0	3.3	3.8	4.5
2018	3.9	1.7	4.2	3.3	3.2	4.8	3.7	2.2	1.4	3.8	4.5
2019e	3.6	5.9	6.6	4.0	2.8	4.3	3.9	2.8	0.8	1.0	4.9
2020f	-6.3	-8.9	-4.5	-4.9	-5.1	-6.0	-5.6	-4.0	-8.1	-10.8	-4.8
2021f	7.3	7.4	7.1	7.1	7.2	6.9	7.0	7.3	7.9	8.5	7.0
Employment											
2010–18	1.2	0.5	1.2	0.2	-0.2	1.1	1.3	0.8	0.9	1.5	1.4
2018	1.3	0.5	3.0	1.5	0.3	0.9	1.6	0.6	0.4	1.9	1.1
2019e	2.1	0.6	2.7	2.2	0.8	1.8	2.9	0.9	1.8	0.5	2.6
2020f	-5.9	-7.5	-2.7	-5.3	-4.1	-6.2	-5.8	-4.4	-5.8	-7.3	-6.9
2021f	6.0	4.7	6.9	6.0	6.0	6.1	5.9	6.2	6.0	6.0	6.3
Unemployment Rate (%)											
2010–18	7.0	13.3	10.8	8.8	9.3	7.4	7.3	5.5	5.2	6.1	6.4
2018	5.8	13.8	9.4	7.6	8.0	5.5	5.6	6.0	6.1	6.6	4.7
2019e	5.7	11.9	8.8	7.2	8.0	5.1	5.6	5.3	5.4	6.9	4.7
2020f	9.9	15.2	10.9	10.8	10.7	10.0	10.0	8.6	9.7	11.5	9.4
2021f	6.9	12.9	7.6	7.9	7.6	6.9	7.1	5.2	6.6	8.4	6.2
Housing Starts (units, 000s)											
2010–18	200	2.4	0.8	4.1	2.7	44	70	6.5	6.4	31	33
2018	213	1.1	1.1	4.8	2.3	47	79	7.4	3.6	26	41
2019e	209	0.9	1.5	4.7	2.9	48	69	6.9	2.4	27	45
2020f	190	0.8	1.0	3.8	2.3	49	70	6.0	2.4	22	32
2021f	178	0.8	1.3	3.9	2.5	43	65	5.7	2.1	25	29
Motor Vehicle Sales (units, 000s)											
2010–18	1,810	33	7	51	41	430	711	55	53	236	193
2018	1,984	28	8	51	38	449	853	67	47	226	217
2019e	1,862	34	7	52	40	442	767	51	44	218	207
2020f	1,568	28	7	45	34	370	645	44	36	175	184
2021f	1,783	30	7	51	38	422	735	50	40	197	213
Budget Balances, (CAD mn)											
2019	-22,000	-1,456	-4	41	98	1,900	-9,184	-325	-319	-7,540	203
2020f**	-343,000	-2,147	-173	-853	-299	0	-20,500	-325	-2,426	-20,000	-12,524
2021f***	-125,000	--	--	--	--	--	--	--	--	--	--

* Based on preliminary GDP by industry estimates for all provinces but Quebec and Ontario. ** NL budget balance in 2020 is net of one-time revenue boost via *Atlantic Accord*.

*** In order to align with US reporting, as of this issue of Scotiabank's Forecast Tables, Canadian Federal and Provincial Budget Balances for FY2020/21 are noted in calendar year 2020, FY2021/22 in calendar year 2021. Sources: Scotiabank Economics, Statistics Canada, CMHC, Budget documents; Quebec budget balance figures are after Generations Fund and Stabilization Reserve transfers.

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