April 22, 2021

Upside Risks Dominate

- **The effects of the vicious third wave of the pandemic on the economy are being overtaken by continued resilience and positive surprises to indicators.**
- **Risks remain tilted to the upside, owing largely to President Biden's attempts to raise government spending even further.**
- **The Bank of Canada is likely to raise interest rates in 2022-Q3, well ahead of the Fed owing to higher inflation and markedly better labour market outcomes in Canada. The Fed is expected to move in 2023-Q1. Both central banks will raise interest rates by 25 bps a quarter once they start hiking.**

Despite very worrisome developments on the pandemic front in recent weeks in many countries, incoming economic data continue to suggest outcomes are surpassing expectations. This is particularly true in the United States and Canada. In the former for example, March retail sales were exceptionally strong on account of stimulus cheques. In Canada, the March labour market readings were very robust with employment now only 1.5% off pre-pandemic levels, and housing construction particularly strong. There is no doubt, however, that tightened mobility restrictions will have an impact on countries that have imposed them.

In Canada, the strength of incoming data, solid growth prospects in the US, and higher commodity prices are leading us to raise our forecast for 2021 to 6.4% (from 6.2%) and to 4.1% in 2022 (from 4.0%). This upward revision is tempered by the economic impacts of the third COVID wave, which we now believe will shave 3 percentage points from 2021-Q2 growth, leaving growth at 2.9% in that quarter. Canadian output is likely to return to pre-COVID levels during the summer. The speed of this recovery is nothing short of exceptional given that many forecasters (including us) had earlier called for an early- to mid-2022 return to pre-pandemic activity. The K-shaped recovery is still very much at play as the pandemic continues to weigh on COVID-affected sectors of the economy, while almost every other sector is doing substantially better.

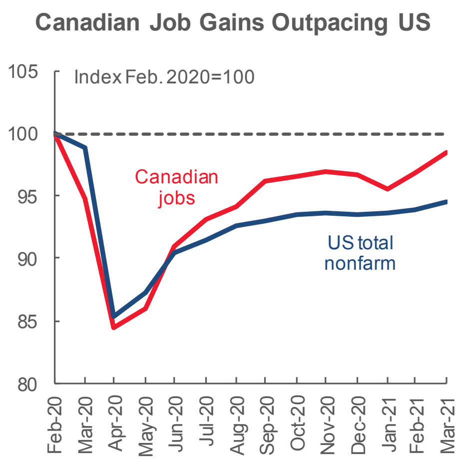
As in Canada, the US economy continues to recover strongly. We have raised our forecast to 6.6% (from 6.3%) in 2021 but reduced it slightly to 4.3% (from 4.4%) in 2022. Our revision mostly reflects the strength of incoming data though we are also currently including about half of President Biden's infrastructure plan. As a result, the risks to our forecast are tilted to the upside given the likelihood that significantly more fiscal spending occurs in the next few years (more infrastructure and other planned announcements).

Though growth outcomes are expected to be roughly similar in both countries this year, labour market dynamics are significantly better in Canada (chart 1). US employment remains 5.5% below pre-pandemic levels while Canada is only 1.5% away. The participation rate is only 0.3 percentage points lower in Canada than it was in February 2020, while it is 1.8 percentage points lower in the US. The labour force is already above pre-pandemic levels in Canada but remains over two percentage points below in the US.

CONTACTS

Jean-François Perrault, SVP & Chief Economist
416.866.4214
Scotiabank Economics
jean-francois.perrault@scotiabank.com

Chart 1



Sources: Scotiabank Economics, Statistics Canada, BLS.

These differential labour market outcomes matter from a monetary policy perspective. While core inflation measures are close to the Bank of Canada's target, core PCE inflation in the US is further away. For the Fed, the dual mandate means they need to incorporate labour market under-performance in their policy stance as well. As a result, we believe the BoC will raise rates well ahead of the Fed, as early as 2022-Q3. We expect the Fed will need to raise rates early in 2023, even though that timeline is quite accelerated relative to current communications from Fed officials. We do not believe that a later tightening by the Fed will pose a challenge for the BoC.

As noted above, risks to the forecast appear tilted to the upside given the likelihood of further fiscal measures in the US. This is despite a vicious phase of the pandemic and tighter-than-expected containment measures in many countries. From an economic perspective, it has been very reassuring to observe the economy's resilience in the face of the virus' evolution despite the very heavy human cost of the pandemic. We anticipate this divergence in economic and public health outcomes will last.

International	2010–19	2019	2020	2021f	2022f	2010–19	2019	2020	2021f	2022f
	Real GDP (annual % change)					Consumer Prices (y/y % change, year-end)				
World (based on purchasing power parity)	3.7	2.8	-3.3	6.1	4.5					
Canada	2.2	1.9	-5.4	6.4	4.1	1.7	2.1	0.8	2.6	2.2
United States	2.3	2.2	-3.5	6.6	4.3	1.7	2.0	1.2	2.2	2.6
Mexico	2.7	0.0	-8.2	4.9	2.1	4.0	2.8	3.2	4.3	3.6
United Kingdom	1.8	1.4	-9.8	5.2	4.9	2.1	1.3	0.6	1.4	1.9
Eurozone	1.4	1.3	-6.7	4.2	3.9	1.3	1.3	-0.3	1.2	1.3
Germany	2.0	0.6	-5.3	3.5	3.9	1.3	1.5	-0.3	1.8	1.4
France	1.4	1.5	-8.2	5.8	3.8	1.2	1.5	0.0	1.3	1.1
China	7.7	6.0	2.3	8.3	5.9	2.7	4.5	0.2	2.0	2.6
India	7.0	4.7	-7.1	9.3	7.0	6.8	7.4	4.6	4.7	5.3
Japan	1.3	0.3	-4.9	3.0	1.2	0.6	0.8	-1.2	0.8	1.0
South Korea	3.3	2.0	-1.0	3.1	2.8	1.7	0.7	0.5	1.8	2.0
Australia	2.6	1.9	-2.4	4.0	2.2	2.1	1.8	0.9	1.8	2.1
Thailand	3.6	2.3	-6.1	4.2	3.8	1.5	0.9	-0.3	0.8	1.7
Brazil	1.5	1.4	-4.1	4.1	2.8	5.9	4.3	4.5	5.3	4.2
Colombia	3.7	3.3	-6.8	5.0	4.0	3.9	3.8	1.6	3.1	3.0
Peru	4.5	2.1	-11.1	8.7	4.0	2.9	1.9	2.0	2.6	2.3
Chile	3.3	1.0	-5.8	7.5	3.5	3.2	3.0	3.0	3.0	3.0
Argentina	1.4	-2.1	-9.9	4.0	3.1	26.1	53.8	36.1	48.0	37.1

Commodities	2010–19	2019	2020	2021f	2022f
	(annual average)				
WTI Oil (USD/bbl)	74	57	39	59	62
Brent Oil (USD/bbl)	82	64	43	62	65
WCS - WTI Discount (USD/bbl)	-18	-14	-12	-13	-15
Nymex Natural Gas (USD/mmbtu)	3.39	2.53	2.02	2.85	2.70
Copper (USD/lb)	3.10	2.73	2.80	3.80	4.00
Zinc (USD/lb)	1.02	1.16	1.03	1.25	1.20
Nickel (USD/lb)	7.00	6.31	6.25	7.50	7.25
Iron Ore (USD/tonne)	101	93	109	142	100
Metallurgical Coal (USD/tonne)	179	185	127	125	140
Gold, (USD/oz)	1,342	1,393	1,771	1,837	1,850
Silver, (USD/oz)	21.64	16.21	20.48	28.31	32.00

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

North America	2010–19	2019	2020	2021f	2022f	2010–19	2019	2020	2021f	2022f
	Canada (annual % change, unless noted)					United States (annual % change, unless noted)				
Real GDP	2.2	1.9	-5.4	6.4	4.1	2.3	2.2	-3.5	6.6	4.3
Consumer spending	2.5	1.7	-6.1	5.1	3.0	2.4	2.4	-3.9	7.1	4.1
Residential investment	2.5	-0.2	3.8	19.1	4.9	4.4	-1.7	6.1	14.9	3.6
Business investment*	2.6	0.5	-11.5	3.6	5.0	5.0	2.9	-4.0	9.0	5.3
Government	1.2	1.7	-0.3	2.9	2.6	0.0	2.3	1.1	2.8	4.0
Exports	3.4	1.3	-9.8	12.3	6.6	3.8	-0.1	-12.9	10.1	7.3
Imports	3.7	0.4	-11.3	10.3	4.6	4.5	1.1	-9.3	15.6	5.6
Inventories, contribution to annual GDP growth	0.1	0.2	-1.6	0.6	0.2	0.2	0.0	-0.7	0.6	0.0
Nominal GDP	4.0	3.6	-4.6	9.8	6.8	4.0	4.0	-2.3	8.7	7.1
GDP deflator	1.7	1.7	0.8	3.2	2.6	1.7	1.8	1.2	2.0	2.7
Consumer price index (CPI)	1.7	1.9	0.7	2.3	2.2	1.8	1.8	1.3	2.4	2.5
Core inflation rate**	2.7	1.9	1.8	1.9	2.1	1.6	1.7	1.4	1.9	2.3
Pre-tax corporate profits	6.3	0.6	-6.1	14.4	5.5	5.2	0.3	-5.8	10.6	4.9
Employment	1.3	2.2	-5.1	4.5	3.5	1.5	1.3	-5.7	2.3	2.9
Unemployment rate (%)	6.9	5.7	9.6	7.3	5.5	6.2	3.7	8.1	5.3	3.7
Current account balance (CAD, USD bn)	-57.0	-47.4	-42.7	-3.4	5.7	-411	-480	-647	-772	-779
Merchandise trade balance (CAD, USD bn)	-13.1	-15.4	-36.7	-12.0	1.8	-764	-864	-916	-1072	-1121
Federal budget balance (FY, CAD, USD bn) ***	-20.9	-39.4	-354.2	-154.7	-59.7	-830	-984	-3,132	-3,393	-1,508
percent of GDP	-1.2	-1.8	-16.1	-6.4	-2.3	-4.8	-4.6	-15.0	-14.9	-6.2
Housing starts (000s, mn)	201	209	219	257	215	0.99	1.30	1.40	1.56	1.50
Motor vehicle sales (000s, mn)	1,819	1,916	1,570	1,812	1,920	15.7	16.9	14.4	16.9	17.4
Industrial production	2.4	-0.2	-8.3	6.4	4.0	2.1	0.9	-6.7	6.0	3.3
	Mexico (annual % change)									
Real GDP	2.7	0.0	-8.2	4.9	2.1					
Consumer price index (year-end)	4.0	2.8	3.2	4.3	3.6					
Current account balance (USD bn)	-19.8	-4.4	22.8	-20.7	-23.9					
Merchandise trade balance (USD bn)	-5.6	5.4	30.2	-9.8	-19.8					

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 the August 2020 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				2022			
Canada	Q4	Q1	Q2	Q3	Q4	Q1e	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Real GDP (q/q ann. % change)	0.4	-7.5	-38.5	40.6	9.6	6.3	2.9	8.5	4.8	3.7	2.9	2.6	3.2
Real GDP (y/y % change)	1.7	-0.3	-12.7	-5.3	-3.2	0.2	14.0	6.8	5.6	5.0	5.0	3.5	3.1
Consumer prices (y/y % change)	2.1	1.8	0.0	0.3	0.8	1.4	2.7	2.5	2.6	2.2	2.1	2.2	2.2
Avg. of new core CPIs (y/y % change)	2.0	1.9	1.7	1.7	1.8	1.8	1.9	2.0	2.0	2.0	2.1	2.2	2.2
Unemployment Rate (%)	5.7	6.4	13.1	10.1	8.8	8.4	7.7	6.9	6.3	5.8	5.5	5.3	5.2
United States													
Real GDP (q/q ann. % change)	2.4	-5.0	-31.4	33.4	4.3	6.0	7.8	9.8	6.4	3.4	1.7	1.8	1.6
Real GDP (y/y % change)	2.3	0.3	-9.0	-2.8	-2.4	0.3	12.3	7.0	7.5	6.8	5.3	3.3	2.1
Consumer prices (y/y % change)	2.0	2.1	0.4	1.3	1.2	1.9	3.3	2.2	2.2	2.3	2.4	2.5	2.6
Total PCE deflator (y/y % change)	1.5	1.7	0.6	1.2	1.2	1.6	2.5	2.0	2.1	2.2	2.3	2.4	2.4
Core PCE deflator (y/y % change)	1.6	1.8	1.0	1.4	1.4	1.5	1.9	2.0	2.1	2.2	2.3	2.3	2.3
Unemployment Rate (%)	3.6	3.8	13.1	8.8	6.8	6.2	5.4	4.9	4.5	4.1	3.8	3.5	3.4

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

	2019	2020				2021				2022			
Central Bank Rates	Q4	Q1	Q2	Q3	Q4	Q1	Q2f	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	0.25	0.25	0.50	0.75
US Federal Reserve (upper bound)	1.75	0.25	0.25	0.25	0.25	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	4.25	4.25	4.00	4.00	3.75	3.75	4.00	4.50	4.75	5.00
Central Bank of Brazil	4.50	3.75	2.25	2.00	2.00	2.75	4.25	5.50	6.00	6.50	7.00	7.00	7.00
Bank of the Republic of Colombia	4.25	3.75	2.75	1.75	1.75	1.75	1.75	2.00	2.50	3.00	3.50	4.00	4.00
Central Reserve Bank of Peru	2.25	1.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50
Central Bank of Chile	1.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50
Central Bank of Argentina	55.00	38.00	38.00	38.00	38.00	38.00	40.00	44.00	48.00	50.00	50.00	50.00	50.00
Europe													
European Central Bank MRO Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	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	-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	0.10	0.10	0.10	0.10
Asia/Oceania													
Reserve Bank of Australia	0.75	0.25	0.25	0.25	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Bank of Japan	-0.10	-0.10	-0.10	-0.10	-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	3.85	3.85	3.85	3.85
Reserve Bank of India	5.15	4.40	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.25	4.50	4.75	5.00
Bank of Korea	1.25	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
Bank of Thailand	1.25	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
Currencies and Interest Rates													
Americas						(end of period)							
Canadian dollar (USDCAD)	1.30	1.41	1.36	1.33	1.27	1.26	1.26	1.23	1.23	1.24	1.24	1.25	1.25
Canadian dollar (CADUSD)	0.77	0.71	0.74	0.75	0.79	0.80	0.79	0.81	0.81	0.81	0.81	0.80	0.80
Mexican peso (USDMXN)	18.93	23.67	22.99	22.11	19.91	20.43	21.20	21.53	21.62	21.32	22.07	22.45	22.87
Brazilian real (USDBRL)	4.02	5.21	5.47	5.61	5.19	5.63	5.07	4.78	4.61	4.50	4.28	4.19	4.17
Colombian peso (USDCOP)	3287	4065	3758	3828	3428	3663	3465	3458	3450	3438	3425	3413	3400
Peruvian sol (USDPEN)	3.31	3.43	3.54	3.60	3.62	3.74	3.63	3.58	3.55	3.54	3.52	3.51	3.50
Chilean peso (USDCLP)	753	854	821	784	711	719	720	720	720	720	720	710	700
Argentine Peso (USDARS)	59.87	64.40	70.46	76.18	84.15	91.99	95.80	99.70	106.10	108.30	107.20	105.00	101.40
Europe													
Euro (EURUSD)	1.12	1.10	1.12	1.17	1.22	1.17	1.20	1.22	1.23	1.25	1.25	1.24	1.24
UK pound (GBPUSD)	1.33	1.24	1.24	1.29	1.37	1.38	1.43	1.47	1.48	1.49	1.49	1.50	1.50
Asia/Oceania													
Japanese yen (USDJPY)	109	108	108	105	103	111	108	107	106	105	108	110	110
Australian dollar (AUDUSD)	0.70	0.61	0.69	0.72	0.77	0.76	0.78	0.80	0.80	0.79	0.79	0.78	0.78
Chinese yuan (USDCNY)	6.96	7.08	7.01	6.79	6.53	6.55	6.60	6.40	6.40	6.50	6.50	6.60	6.60
Indian rupee (USDINR)	71.4	75.5	75.5	73.8	73.1	73.1	74.0	72.0	72.0	73.0	73.0	74.0	74.0
South Korean won (USDKRW)	1,156	1,219	1,203	1,170	1,086	1,132	1,160	1,120	1,120	1,140	1,140	1,160	1,160
Thai baht (USDTHB)	30.0	32.8	30.9	31.7	30.0	31.3	31.0	30.2	30.2	30.6	30.6	31.0	31.0
Canada (Yields, %)													
3-month T-bill	1.66	0.21	0.20	0.12	0.07	0.09	0.10	0.15	0.15	0.20	0.35	0.60	0.90
2-year Canada	1.69	0.42	0.29	0.25	0.20	0.22	0.40	0.55	0.75	0.90	1.20	1.40	1.65
5-year Canada	1.68	0.58	0.36	0.35	0.39	0.99	1.05	1.25	1.45	1.55	1.60	1.70	1.80
10-year Canada	1.70	0.69	0.53	0.56	0.68	1.56	1.60	1.70	1.80	1.85	1.90	1.95	2.00
30-year Canada	1.76	1.30	0.99	1.11	1.21	1.98	2.05	2.05	2.10	2.10	2.15	2.15	2.15
United States (Yields, %)													
3-month T-bill	1.51	0.05	0.14	0.09	0.08	0.01	0.05	0.10	0.10	0.10	0.10	0.10	0.15
2-year Treasury	1.57	0.25	0.15	0.13	0.12	0.16	0.20	0.40	0.55	0.70	0.90	1.10	1.25
5-year Treasury	1.69	0.38	0.29	0.28	0.36	0.94	0.90	1.15	1.30	1.35	1.45	1.55	1.70
10-year Treasury	1.92	0.67	0.66	0.68	0.91	1.74	1.70	1.85	2.10	2.15	2.20	2.25	2.30
30-year Treasury	2.39	1.32	1.41	1.46	1.64	2.41	2.35	2.45	2.50	2.50	2.55	2.60	2.60

Sources: Scotiabank Economics, Bloomberg.

The Provinces	(annual % change except where noted)										
Real GDP	**CA**	**NL**	**PE**	**NS**	**NB**	**QC**	**ON**	**MB**	**SK**	**AB**	**BC**
2010–19	2.2	1.0	2.3	1.1	0.7	1.9	2.3	2.1	2.2	2.6	2.8
2019	1.9	4.0	5.1	2.4	1.2	2.7	2.1	0.6	-0.7	0.1	2.7
2020e	-5.4	-5.1	-3.6	-4.0	-3.2	-5.3	-5.8	-3.6	-5.1	-6.5	-4.8
2021f	6.4	3.7	5.1	5.6	5.3	6.7	6.4	5.3	5.7	6.4	6.4
2022f	4.1	1.5	3.3	3.5	3.4	4.1	4.3	3.5	3.6	4.3	4.4
Nominal GDP											
2010–19	4.0	3.5	4.3	2.9	2.8	3.8	4.1	3.8	3.3	3.7	4.5
2019	3.6	4.1	7.0	3.8	3.0	4.3	3.8	1.0	0.1	2.7	4.4
2020e	-4.6	-6.8	-1.7	-2.1	-1.3	-4.0	-4.9	-1.6	-7.4	-9.0	-2.4
2021f	9.8	8.9	7.4	8.1	7.6	9.4	9.6	7.5	10.5	12.5	9.3
2022f	6.8	4.6	5.7	5.8	5.8	6.7	6.8	6.0	7.0	7.9	6.7
Employment											
2010–19	1.3	0.6	1.5	0.3	0.0	1.2	1.4	0.9	0.8	1.2	2.0
2019	2.2	1.1	3.3	2.3	0.8	2.0	2.8	1.0	1.9	0.7	3.0
2020	-5.1	-5.7	-3.2	-4.7	-2.6	-4.8	-4.8	-3.7	-4.7	-6.6	-6.6
2021f	4.5	3.4	3.8	5.0	4.6	4.4	4.3	3.8	3.7	5.0	5.5
2022f	3.5	0.9	2.8	2.9	2.8	3.4	3.7	2.9	3.1	3.9	3.4
Unemployment Rate (%)											
2010–19	6.9	13.3	10.6	8.7	9.4	7.1	7.0	5.6	5.3	6.2	6.1
2019	5.7	12.3	8.7	7.4	8.1	5.1	5.6	5.3	5.6	7.0	4.7
2020	9.6	14.1	10.4	9.8	10.0	8.9	9.6	8.0	8.4	11.4	8.9
2021f	7.3	11.8	8.2	7.6	8.1	6.5	7.6	6.3	6.3	9.0	6.4
2022f	5.5	11.1	7.0	6.5	6.9	4.8	5.7	4.9	4.8	6.8	4.8
Housing Starts (units, 000s)											
2010–19	201	2.2	0.8	4.2	2.7	44	70	6.6	6.0	31	34
2019	209	0.9	1.5	4.7	2.9	48	69	6.9	2.4	27	45
2020	219	0.8	1.2	4.9	3.5	54	81	7.3	3.1	24	38
2021f	257	1.2	1.2	5.1	2.8	71	92	6.9	4.0	27	46
2022f	215	0.8	1.2	4.5	2.5	53	77	6.0	3.5	29	37
Motor Vehicle Sales (units, 000s)											
2010–19	1,819	33	7	51	41	432	715	55	53	237	194
2019	1,916	34	8	53	41	454	789	53	46	227	214
2020	1,570	28	7	44	34	376	612	46	40	186	180
2021f	1,812	31	8	50	38	435	707	52	45	213	205
2022f	1,920	32	8	53	40	474	772	54	48	230	221
Budget Balances, (CAD mn)											
2019*	-39,400	-1,383	22	3	49	4	-8,672	5	-319	-12,152	-321
2020	-354,200	-1,838	-120	-706	-13	-6,240	-38,468	-2,080	-1,865	-20,192	-8,144
2021f	-154,700		-112			-12,250	-33,100		-2,611	-18,221	
2022f	-59,700		-46			-8,500	-27,700		-1,685	-10,982	

* NL budget balance in 2019 is net of one-time revenue boost via *Atlantic Accord*.

Sources: Scotiabank Economics, Statistics Canada, CMHC, Budget documents; Quebec budget balance figures are after Generations Fund and Stabilization Reserve transfers.