Quarterly Economic Forecast

The Art Of The Deal Makes A Late Appearance

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Summary

- We ended 2018 with a report discussing the many event risks that required political solutions in 2019, from U.S.-China trade tensions, to USMCA, to Brexit. We close 2019 with movement on all three fronts, but not nearly as much as is needed to remove global and business uncertainty and kick-start the investment cycle. But, beggars can't be choosers.
- Some de-risking in market sentiment is a net positive, but now the ultimate test will be the extent in which it is transmitted into economic outcomes. The wheels were set in motion this year with trade disruptions that not only lingered far longer than expected, but also proved more detrimental to global economic momentum. This led to a series of downgrades, with world real GDP now tracking the slowest pace in a decade at 2.8%. For 2020, we anticipate a modest improvement to 3.0%.
- With interest rates nearing effective lower limits in regions like Europe and Japan, the push is on for more fiscal stimulus. This can turn into a wildcard that generates better economic outcomes in 2020, but based on fiscal plans announced so far, the boost to 2020 global GDP appears similar to that of this year (+0.4 ppts).
- Regionally, the U.S. will continue to lead the G7 in economic growth by a good margin, and recent progress on negotiations with China offer upside potential to near-term exports. However, the absence of a broader trade deal that offers clear line of sight and assurances on the business backdrop is likely to still restrain investment. Plus, trade policy uncertainty will persist with other nations, particularly Europe which is a larger trading partner to the U.S. than China.
- The threat of U.S. auto tariffs on the EU and Japan remains in place, but we are counting on no material tariff escalation to major trading partners during a re-election campaign that could cost jobs in key battleground states.
- Putting aside trade tensions and casting our eyes to other economies, many face idiosyncratic domestic challenges. This is particularly true for emerging markets that face knock-on impacts from a slowing Chinese economy, political unrest, and the risk that nervous investors divert capital at the first sign of trouble.

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U.S. Economy: Fed Pivot Shores Up Demand

- At a high level, the American economy has performed close to our expectations in 2019. Growth is on track to slow from 2.9% in 2018 to 2.3% this year. However, beneath the surface, the composition of growth is different from what we expected a year ago in two areas.
  - First, the global slowdown and elevated uncertainty stopped business spending in its tracks by mid-year and turned down manufacturing activity.
  - Second, the Federal Reserve needed to respond by pivoting to cutting rates (a total of 75 basis points). This succeeded in normalizing the yield curve slope, but we anticipate a relatively flat curve will persist in the absence of compelling evidence of stronger inflationary or economic pressures.
- The good news is that the almighty consumer has responded to the lower rates in textbook fashion by increasing demand for interest-sensitive durables as well as home sales. Continued strength in job markets has also generated a positive impulse for household income and spending growth.
- Provided that inflation remains close to the Fed's 2% target (as we expect), the central bank is likely to move to the sidelines and patiently observe the interaction of past rate cuts on the economy as well as developments on the global and trade fronts.

Canada: Back To Its Old Ways

- The export-led surge in Canadian economic activity in the second quarter faded as quickly as it developed. The pace of expansion in the third quarter fell back to 1.3% annualized, a subdued rate that we anticipate will be repeated in the final quarter.
- Still, a stronger than thought economic performance in the first half of the year leaves the economy on track to deliver a trend-like 1.7% turnout for this year as a whole. This marks a 0.2 percentage point upgrade from our last estimate, due to upward revisions to history from Statistics Canada.
- Canada's showing over the next few years is likely to be in line with 2019. Underneath this moderate headline is an economy that remains on two tracks. Labour markets have been strong, but households remain cautious around their spending plans. Housing activity is trending higher, but prospects for other types of investment remain challenging.

Table 1: Economic & Financial Forecasts

	2019F	2020F	2021F
Real GDP (annual % change)			
Canada	1.7	1.6	1.8
U.S.	2.3	2.0	1.9
Canada (rates, %)			
Overnight Target Rate	1.75	1.50	1.50
2-yr Govt. Bond Yield	1.70	1.45	1.65
10-yr Govt. Bond Yield	1.65	1.65	1.90
U.S. (rates, %)			
Fed Funds Target Rate	1.75	1.75	2.25
2-yr Govt. Bond Yield	1.65	1.90	2.30
10-yr Govt. Bond Yield	1.90	2.20	2.60
WTI ($US/bbl)	56	59	60
Exchange Rate (USD per CAD)	0.76	0.76	0.77

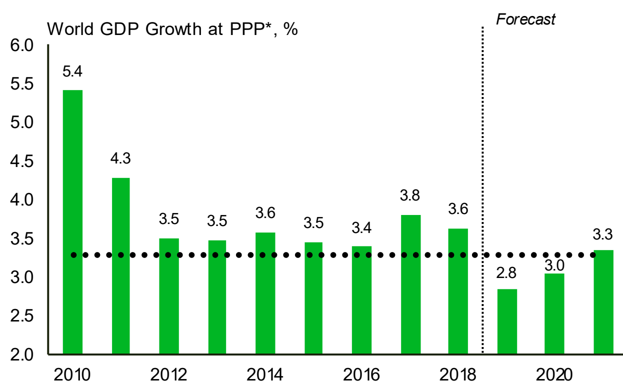
F: Forecast by TD Economics, December 2019; Forecasts for exchange rate and yields are end-of-period. Source: Bloomberg, Bank of Canada, U.S. Federal Reserve.

- Domestically, stretched balance sheets will play off against rising incomes, including government tax measures. Balance sheet repair is expected to win out in line with recent trends, holding spending growth to a sub-trend pace. Improving housing activity points to an upside risk to this outlook.
- The Bank of Canada remains wedded to holding rates stable, which has resulted in the highest policy rate among its peers and a more persistent inverted yield curve that has only very recently corrected at the 10-year to 3-month spread.
  - At its December 4th rate decision, the central bank was more upbeat about the recent economic data, but once again highlighted downside risks to growth from abroad. They are mindful of the potential risk further monetary easing can present to household leverage, given signs of strengthening housing demand.
- We still see the risks tilted towards an insurance rate cut this spring. Beyond the potential for global downside risks to materialize, a possible trigger for an easing could be a desire to offset negative impacts on household finances emanating from rising global bond yields.
- Impeded by ongoing elevated global uncertainty, the Canadian dollar is expected to stay in its recent narrow range of 74-76 US cents.

Global Outlook: Slower for Longer

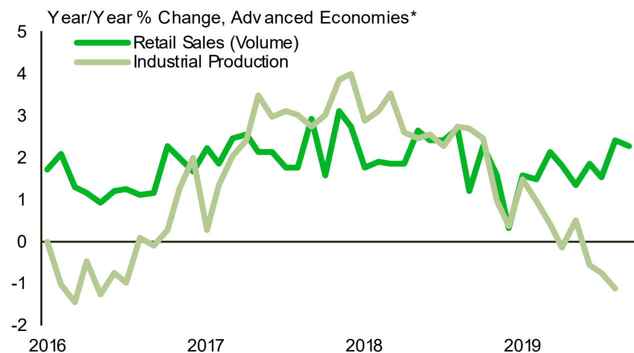
- 2019 global growth of 2.8% will mark the weakest rate in a decade. Unfortunately, there is little optimism for a strong rebound in 2020. We see only a modest lift to 3.0% next year, which would still mark a below-trend global pace (Chart 1).
- The forecast reflects weaker-than-expected performances in Europe and Asia through the end of this year, with little momentum to kickoff 2020.
    - The global manufacturing slump has intensified in recent months, officially landing on U.S. shores. Automobile manufacturing remains ground zero for the downturn.
    - In contrast, tight global labour markets have supported healthy wage gains, helping consumers largely shrug off the woes of the manufacturing sector (Chart 2). But, layoffs in manufacturing industries will test the resilience of the household sector – the keystone to the economic recovery.
- Although some trade-related economic uncertainty has abated in recent weeks, sustainability is key. Also, this impact will play second fiddle to the cyclical downturn in manufacturing and idiosyncratic shocks that have impacted several emerging market economies.
    - The announcement of a Phase 1 trade deal between the U.S. and China has removed the threat of more tariffs coming into play, but the devil is in the details. At the time of writing, official communication was elusive on providing specific timetables for tariff roll backs and trade details between the two countries. Nevertheless, the détente in trade tensions is a net positive to market sentiment and marks a de-risking of the global backdrop. This assumes the U.S. does not pivot to Europe on aggressive tariff action.
    - In the event that negative trade action takes place with Europe, it could mark the tipping point for Europe into a recession and once again undermine the stability of the global economy (including the U.S.) via the sentiment channel.
- Aside from trade, other downside risks linger, dampening growth and are likely to contribute to bouts of financial market volatility. These include geopolitical hotspots (Hong Kong, Iran, North Korea, Venezuela) and more recently popular protests in Bolivia, Chile, Lebanon and France.
- With below-trend growth persisting in a number of regions, there is little cushion to offset unanticipated shocks. In the G7, the risk of a further deterioration in economic activity is highest for the Euro Area (Germany and Italy) and the UK. In emerging markets, the risk is highest in Mexico and Brazil. Policymakers have reacted by cutting interest rates and committing to various fiscal packages, but economic growth is at risk of getting worse before improving.

Chart 1: Low Odds of a Big Jump in Global Growth



* Purchasing Power Parity. Source: IMF, Forecasts by TD Economics as at December 2019

Chart 2: Consumer Demand Remains Resilient

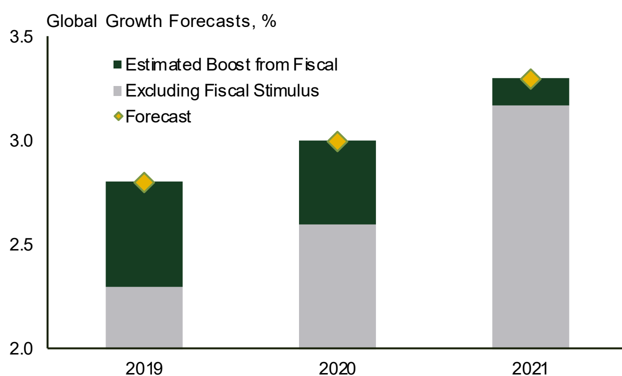


*Canada, U.S., Euro Area, UK and Japan, weighted by their respective relative PPP shares as of 2018. Source: BLS, FRB, Statistics Canada, Statistics Japan, Eurostat, IMF, TD Economics. Last Obs.: 19Q3.

Europe and Japan Weighing Most on G7 Growth

- The downturn in the European manufacturing sector has intensified and spread beyond Germany and Italy. As a result, Euro Area growth has slumped to a below-trend pace, with growth being kept afloat by a resilient consumer.

- In response, the ECB has delivered some stimulus by cutting the deposit rate by 10 basis points (to -0.5%) and restarted asset purchases equating to about €60bn per quarter. In addition, budgets announced this fall by member nations should help boost growth by about 0.2-0.3 percentage points next year (Chart 3). Nevertheless, this may still prove inadequate to prevent the Euro Area from slipping into a deeper economic downturn, especially if external demand falters further.
- After running hot in the first half of the year, Japan's economy has since weakened with the fourth quarter set to contract, as consumer spending adjusts to a rise in the value-added tax rate. Fiscal spending amounting to US $239bn has been announced as a means to support demand currently and after the 2020 Summer Olympics, the largest such fiscal package since 2016. Nevertheless, growth next year is likely to decelerate from this year's 1.2% pace.
- In the UK, parliament has agreed to a withdrawal agreement with the EU, but a conclusion to the Brexit saga remains elusive. The strong Conservative majority election victory last week should ensure that PM Boris Johnson's withdrawal agreement passes parliament by the January 31st deadline. Still, even with an agreement to leave in hand, the future trading relationship between the UK and the EU will still need to be redefined. As a result, the associated prolonged period of uncertainty should continue to weigh on the economy, keeping growth at or below 1% next year.



EMs Hampered by Domestic Concerns

- Emerging Market Economies (EMEs) remain challenged on a number of fronts. Although the low inflation environment has enabled policymakers to react by injecting stimulus (lower policy rates, increased fiscal spending), idiosyncratic challenges and the potential for an escalation in trade tensions threaten their outlook.
  - Latin America is mired in an economic downturn, with crises in Argentina and Venezuela weighing on the outlook for the wider region.
  - Both India and China are struggling to boost economic activity. India is working its way through a bank credit crunch, while China's structural economic slowdown continues, exacerbated by U.S. tariffs.
  - Even east Asian economies, some of which have benefitted from the trade diversion due to U.S.-China trade tensions, have been caught in the global manufacturing slowdown.
- Chinese demand seasonally slows every winter, but higher frequency indicators suggest that the economy has slowed more than expected in the past few months. In response, policymakers have begun to more aggressively cut the price of bank credit, and local government fiscal expenditures are expected to ramp up in the months ahead. Encouragingly, manufacturing and services industry sentiment is improving, signalling that past stimulus efforts may be starting to bear fruit. In addition, the much vaunted "Phase 1" trade deal and ongoing trade talks with the U.S. should further inject more confidence in Chinese firms and households, providing upside risk on economic activity. Overall, we have marked down our outlook for Chinese economic growth to 5.9% in 2020, a tenth of a point weaker than our previous forecast and the slowest pace since 1990 (3.9%).
- The outlook for China is contingent on authorities being able to manage ongoing financial stability concerns. Corporate defaults have been on the rise, and banking authorities have been diligent in bailing out troubled banks. Managing these risks while addressing U.S. trade-related issues will be key to successfully steering the economy to a soft landing.

U.S. Outlook

- The U.S. economy has performed very close to expectations for 2019. We had forecast real GDP growth would slow from 2.9% in 2018 to 2.3% in 2019. With three quarters of actual data, 2019 is on track to hit our forecast.
- However, as global growth slowed over the year, and trade uncertainty escalated, the Federal Reserve pivoted from raising interest rates, to cutting by 75 basis points.
- As a result, the composition of economic growth looks different than what we expected a year ago (Chart 4). Notably, consumer spending has held up well thanks to lower rates. But business investment has disappointed as uncertainty increased, and trade and inventories proved more volatile.
- Since last quarter's forecast, market-based recession risk probabilities have fallen. In the wake of three Fed rate cuts, the yield curve is no longer inverted, and financial markets have calmed from the heightened worries in late summer. Inflation also remains well contained, and there are few signs of overheating in the labor market. To add to the positive developments, the year is also closing with reduced trade tensions with China and the USMCA deal inching closer to ratification. We expect the Fed to remain in a holding pattern, but stand ready to act should the outlook unexpectedly sour.

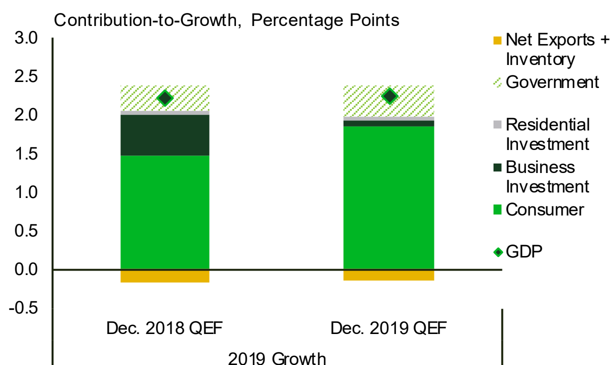
Temporary Factors to Flatter 2020 Growth

- We expect U.S. growth to modestly edge down to 2.0% in 2020, with a few temporary factors flattering the near-quarter headline. First, the six-week strike at GM subtracted from growth in the fourth quarter of 2019. As production ramps back up, it could add as much as 0.5 percentage points to annualized growth in the first quarter of 2020. Second, the production slowdown at Boeing due to the grounded 737 Max has also been weighing on investment through 2019. If regulators clear the plane to fly early in 2020, the ramp-up in production will also add to growth. These two factors combined could add 0.1-0.15 percentage points to GDP growth for 2020 as a whole.
- In addition, activity related to the 2020 decennial census will lift government spending largely in the second quarter of 2020. We have included this impact in our forecast for some time.
- There is a new wild card in the forecast related to the very recent announcement of a Phase 1 trade deal between the U.S. and China. At the time of writing, details were lacking, as was a mutually agreed-upon date for formal implementation. The end result could lead to a level-shift up in U.S. exports for a particular quarter or two, further flattering the GDP growth profile. However, this needs to be in consideration on whether a corresponding increase in U.S. imports would offer a partial counterbalance.

Resilient Labor Market Makes Impressive Gains

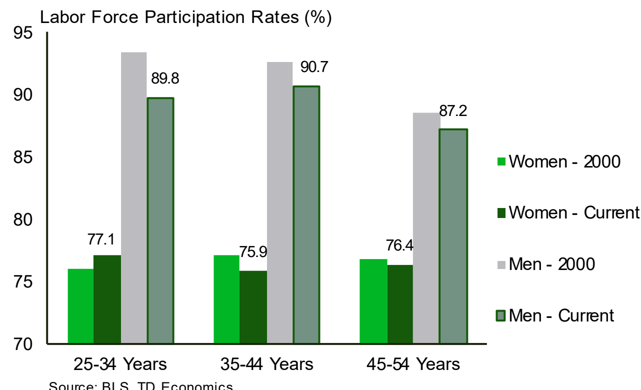
- Perhaps the most encouraging trend in the U.S. economy is the sustained improvement in labor force participation among core-aged Americans. This has occurred despite heightened business uncertainty and slower economic

Chart 4: US Growth Meets Expectations, But Makeup is Very Different



Source: Bureau of Economic Analysis, TD Economics

Chart 5: Women Make Biggest Gains in Labor Force Participation



Source: BLS, TD Economics

growth. Participation rates for women have made rapid gains, and young women's (aged 25-34) participation rate has reached an all-time high (although a significant gap remains versus men of the same age). In contrast, participation rates remain depressed for certain groups, primarily younger males (Chart 5). Despite these challenges, the share of core-aged individuals working full-time is nearing a record, which offers a key support to income growth going forward.

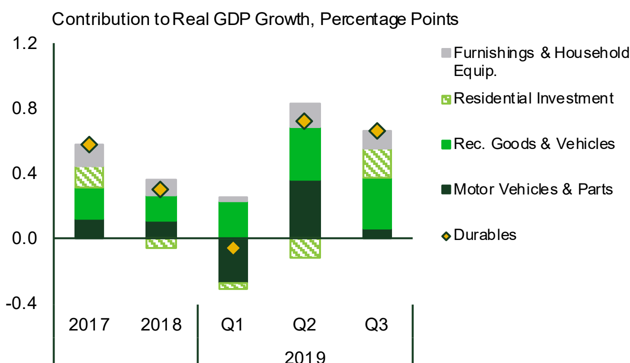
- Depending on the measure, wage gains have been between 3-4% over the past year, below the pace seen in hot labor markets in previous expansions. The Fed has also pointed out that looking at wages, it is hard to call the labor market hot. Adding to this more lukewarm picture is the modest downturn in job openings that has occurred through the year. While all regions exhibit a slowdown, the epicenter of this softness is the manufacturing-heavy Midwest.

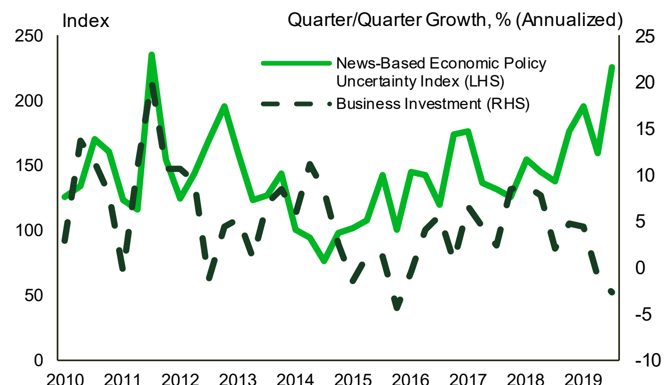
Lower Rates Boost Consumer and Housing

- The consumer remains the linchpin of U.S. growth. Solid job, wage and income gains explain the persistence in elevated consumer confidence. Household spending has also received a notable boost from one factor that was not anticipated at the start of this year: lower interest rates. Purchases on interest-sensitive durable goods have picked up noticeably through the middle of 2019 (Chart 6).
- Just as important, lower borrowing rates have driven an improvement in the housing market. Existing home sales are volatile on a month-to month basis, but zooming out, sales have been trending upwards through 2019 after a notable downturn in the latter half of last year. The 100-basis point drop in the 30-year conventional mortgage rate since November 2018 has helped boost demand for homes, although tight inventories are a constraint on sales and have pushed prices higher.
- New home construction has also picked up after a period of weakness, particularly for single-family homes. Combined with stronger activity in the resale market, residential investment grew for the first time in seven quarters in the third quarter. Monthly housing indicators are also pointing to another solid outturn in the fourth quarter.
- The revival in the housing market will drive up housing-related purchases. Even so, consumer spending is on track to slow from a red-hot pace through the middle of 2019, to roughly 2.3% in the fourth quarter. It should hold near 2.5% through 2020, which is an upgrade from our previous forecast in a nod to strengthening household fundamentals. However, since another leg lower in borrowing rates seems unlikely, the impulse to consumers and housing will gradually fade. Consumption growth should move more in line with income growth.

Uncertainty Chills Business Spending

- The other side of the coin to brisk consumer spending is the utter stall in business investment in 2019. Business spending fell in the second and third quarters and





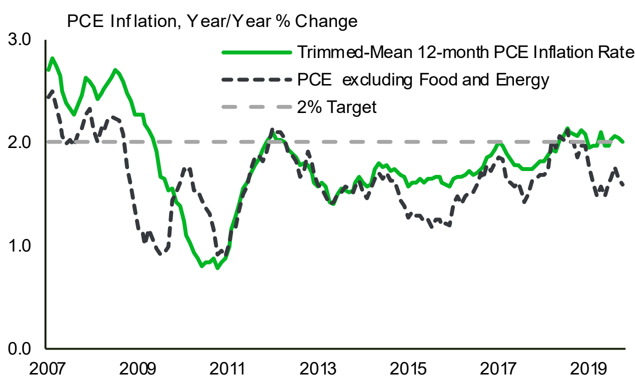
is only expected to grow by 1% in the fourth. This is far weaker than the pace we had expected a year ago.

- All categories of spending are down from their 2018 pace, with investment in structures (includes oil and gas) falling at a double-digit pace in the second and third quarters. The uncertainty that has been created by tariff policy has weighed on business sentiment and held back investment (Chart 7). In our recent report, we estimate that over and above any tariff-induced price effects, uncertainty shaved a total of 20-40bps off growth since the first quarter of 2018.
- Investment should solidify in the coming quarters, but we don't expect a return to its robust pace of 2017-2018 as slower global and domestic economic growth limit the need for capacity expansion. The Phase 1 trade deal is unlikely to materially alter this perception for businesses.
- An ongoing inventory drawdown is also expected to weigh on growth for a couple of quarters following a build-up in manufacturing and wholesale inventories in the latter half of 2018 and early 2019. This is in part related to businesses adjusting stocks in advance of tariffs, but also due to the disruptions at Boeing and GM preparing for strike action. The subsequent drawdown will continue to weigh on growth over the next few quarters.

Benign Inflation Gives Fed Room to Breathe

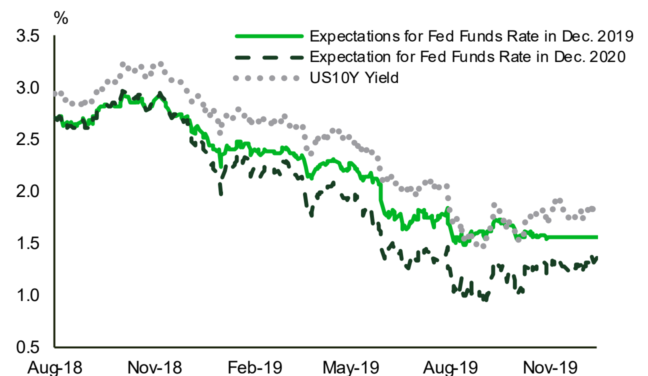
- Despite tariffs and low unemployment, the Fed's preferred inflation measure has not sustained the 2% target this cycle. Other measures of underlying inflation trends, which strip out the most volatile price changes rather than just food and energy, are running closer to 2% (Chart 8). However, there are few signs that inflation is about to break higher or lower.

Chart 8: Inflation is Still Benign



Source: Dallas Fed, Haver Analytics & TD Economics

Chart 9: Treasury Yields Following the Fed



Source: Bloomberg LP, TD Economics

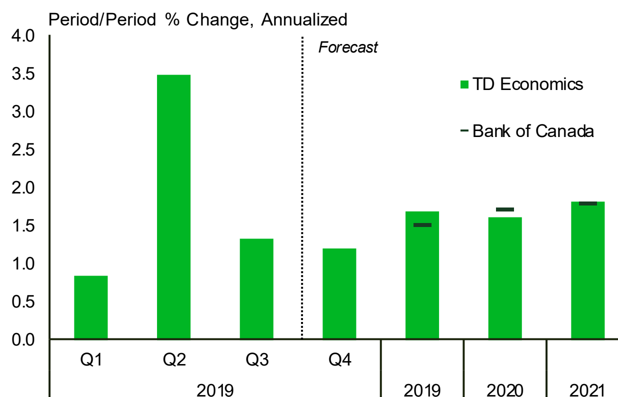
- As a result, after cutting rates 75 basis points in 2019, the Federal Reserve can remain patient to see how the domestic and global backdrop unfold before adjusting the fed funds rate further.
  - The Fed's rate cuts have helped to reverse the yield curve inversion that had been in place since the spring. Due to the resulting reset in market expectations, the 10-year Treasury yield is about 30 basis points higher from its low in September (Chart 9). Recession probability readings, which showed a greater than 50% chance of recession by the middle of 2020, have now fallen to approximately 20-30%.
  - With smaller interest rate differentials versus many of the other major global economies and a reduction in recession risks, the U.S. dollar has fallen nearly 2% from its peak in early September. This move was largely against Emerging Market currencies, reflecting expectations of a trade deal between China and the U.S. Now that it has lurched closer to reality, the broad trade-weighted dollar should sustain a flat-to-lower pattern in the coming quarters.

Canadian Outlook

- Here we go again. As widely expected, the Canadian economy's barn-burning second quarter growth was doused in the third quarter, with activity increasing a modest 1.3% (annualized). However, beneath the headline lay a surprisingly strong 3.2% gain in final domestic demand.
- The GDP report brought Statistics Canada's annual revisions, which also delivered positive surprises. Business investment has been stronger of late than initially reported, as have household incomes. The latter means that the household saving rate is higher than previously thought.
- A similar modest pace of growth is likely to be recorded in the fourth quarter of 2019, partly owing to labour-related disruptions in the auto and transportation sectors. Including their 'knock-on' effects, we expect these temporary factors to drag down growth by about 0.3 p.p. in the quarter.
- Looking further ahead, there have been some positive international developments of late, notably the U.S.-China 'phase one' deal and CUSMA nearing the finish line. However, soft global growth coupled with still-lingering trade uncertainty is unlikely to offer fertile ground for exports and investment, while the factors that have been constraining consumer spending will remain in place. On the latter, however, there is a greater possibility for upside surprises. Notably, wage gains have been getting hotter and the rebound in home sales may feed through to lagged household-related purchases in the New Year. Federal tax changes should also support spending. We've slightly upgraded our outlook for consumer spending given these factors. However, when it comes to a meaningful acceleration of spending, for now, we maintain a 'believe it when you see it' approach.
- Looking through the noise, Canada's economy is trending around its economic potential expansion rate of around 1.7%. We see no near-term catalysts to change this one way or the other (Chart 10). Regional growth divergences remain an important element of the outlook, as discussed in our Provincial Economic Forecast, also released today.
- The Bank of Canada has refrained from delivering precautionary rate cuts this year as it assesses the balance between external risks and domestic resilience, particularly in household borrowing. We still see the balance of risks tilted toward easing and have incorporated one 25 bp rate cut in 2020. One potential trigger for the cut could be an up-trend in global bond yields that dampens the domestic spending outlook. Still, we cannot dismiss the possibility that the current setting of monetary policy may be Canada's new normal to address the high-leverage cycle.

Some Help For Cautious Households From Re-elected Liberals

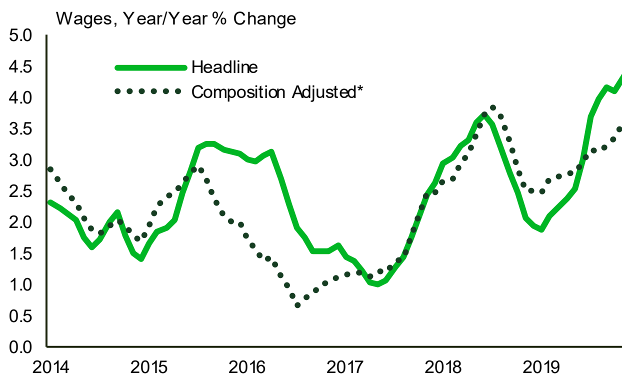
- PM Trudeau campaigned on a platform heavy on tax adjustments, most significantly an increase in the basic personal amount (roughly speaking, the amount of income one can earn before paying income tax). The December 5th speech from the throne reinforced this priority, alongside promised measures to support housing activity. Post-speech actions mean that the tax change will be in effect for the 2020 tax year.
- We expect these changes to be moderately growth-positive, adding about 5-10 bps per year to economic growth over 2020 and 2021. The modest impact relative to the size of government spending is due to an economy operating close to its potential (meaning a smaller fiscal multiplier), and cautious household behaviour of late. Notably, the household savings rate climbed more than a percentage point between the first and third quarters of the year.



- The other side of the announcement, related to housing and yet to be formally legislated, comes as the sector has been on an upswing, exceeding expectations of late. Resale activity is up nearly 20% from its February low, with prices coming along for the ride (up more than 14% on the same basis). Activity has been broadly-based across most key markets. Supported by strong population growth, low borrowing costs, and healthy income gains, the outlook for the housing sector remains healthy. As it has been for some time, more supply is needed to address affordability concerns in key markets.

Labour Market-Spending Disconnect Still at Play

- Even as the pace of hiring has come off of late, the trend in Canadian labour markets remains solid. Net employment is up a healthy 292.9k year-on-year through November, solidly ahead of the post-crisis trend. Over the past few years, gains have come largely from service-related sectors that have so far been spared the brunt of trade-related uncertainty.
- More recently, employment has been shifting to relatively higher paying positions, helping to boost wage gains above the 4% mark. Even absent this shift, wages would be trending at a solid 3+% (Chart 11).
- And yet, even as labour markets have stayed healthy, consumer spending has disappointed. Total consumer spending may have ticked up a notch in the third quarter, but the year-on-year trend remained at just 1.4% while retail sales volumes continue to trend sideways. It is telling that the 1.4% y/y trend in consumption volumes falls a bit short of population growth.



- As discussed in a recent report, the reason for this disconnect is a hangover of sorts from past excesses. Auto sales are above population fundamentals, and adjustments in housing markets over the past few years have slowed the gains in housing wealth relative to the heydays of 2012-2017.
- More fundamentally, household finances remain stretched. The debt service ratio has been trending steadily higher, as have consumer insolvencies.
- Ultimately, while we've upgraded the consumer spending outlook modestly to reflect recent developments, our view remains one of caution. Our roughly 1.7% trend pace of consumer expenditures is a good notch below the 2.4% post-crisis average. We see this forecast as consistent with the recent behavior of households to repair their balance sheets.

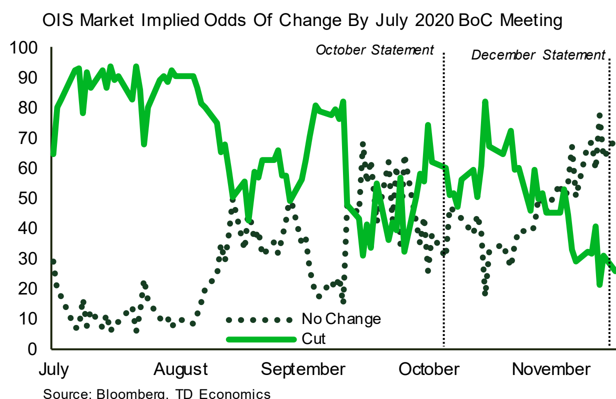
Investment Mired in Uncertainty

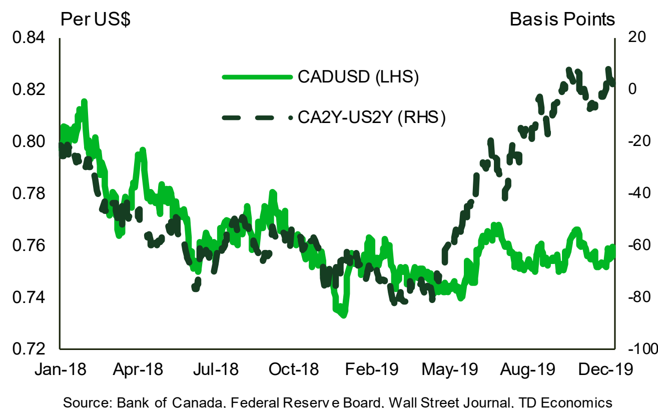
- Turning to investment, the (revised) trend of late has been better than expected. In its latest GDP release, Statistics Canada transformed six quarters of contractions in structures investment into just four (ending last year), marking the level of activity up nearly 6% in the process. This change was attributed to better than initially reported spending in the energy sector broadly defined, including the sizeable LNG Canada project in British Columbia.
- The key question is the durability of capital spending. Firm sentiment remains soft and the outlook for the energy sector remains highly uncertain. In terms of machinery and equipment spending, much of the gains of late have come from the more volatile categories, notably transportation equipment. Spending on industrial machinery continues to struggle to gain traction.
- Discouragingly, the trend in imports of capital goods has been disappointing, with the domestic picture no better. Shipments of machinery, electrical equipment, and other key areas have flatlined. As a result, inventories remain elevated among manufacturers and capital equipment wholesalers. There appears to be little near-term appetite for a sustained increase in capital spending.

- Indeed, from a fundamentals point of view, low interest rates, as well as accelerated capital depreciation and other tax breaks have done little to change the investment story. This suggests that until there is more clarity on the external backdrop we can only expect a sub-par pace of investment spending.
- We have undoubtedly received a bit more clarity of late: The U.S. and China appear to have reached a 'phase one' trade deal that includes a modest rolling-back of tariffs, and the 'new NAFTA' has almost reached the finish line. But with phase two of U.S.-China negotiations soon to be underway and other regions entering the U.S. trade war cross hairs, it appears that uncertainty will be with us for some time to come, limiting the upside to trade and investment.
- As mentioned, one bright spot continues to be LNG Canada's Kitimat project. However, recent reports suggest that the bulk of investment activity is likely to occur later than anticipated, shifting some investment spending past 2020.

Bank of Canada Sets A High Bar To Easing

- In contrast to its advanced economy peers, the Bank of Canada has kept policy rates stable. It now has one of the highest policy rates of any developed economy. The statement accompanying the December 4th decision to hold the overnight rate at 1.75% highlighted the improvement in domestic and international economic data, but also reiterated that external headwinds will remain a challenge for the Canadian economy.





- Market odds of a rate cut by mid-2020 have bounced around between 1 in 3 and 1 in 2 (Chart 12) and it is admittedly a close call. Arguing in favour of holding rates steady, inflation is right where the Bank wants it, wage growth is healthy, and mortgage growth is reaccelerating. The Governing Council remains concerned about refueling a housing/debt binge. Arguing in favour of cuts, global growth appears unlikely to improve much, trade uncertainty is likely to continue and financial conditions have begun to tighten – the 5-year yield is up nearly 50bps from its August low. Further advances could send the already-elevated debt service ratio even higher and threaten even modest consumer spending growth.
- With the current policy setting by the Bank of Canada now higher than that of the Fed, interest rate differentials between short-term Canada and U.S. government bond yields are tight. The spread between the Canada and U.S. 2-year yields now sits at -0.06%, up from -0.85% in March 2019. Typically, this would mean an appreciation of the Canadian dollar against the greenback (Chart 13). Instead, lower commodity prices and heightened global uncertainty has kept the loonie trading in a tight 74 to 76 US cent range. Should the trade environment and sentiment towards global growth improve, the loonie could test the 80 US cent level. This would be an unwelcome tightening in financial conditions at this point in the Canadian business cycle if it's not met with much stronger external demand for exports.

Interest Rate Outlook

	2019				2020				2021			
	Q1	Q2	Q3	Q4*	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Canada												
Overnight Target Rate	1.75	1.75	1.75	1.75	1.75	1.50	1.50	1.50	1.50	1.50	1.50	1.50
3-mth T-Bill Rate	1.67	1.66	1.65	1.65	1.53	1.40	1.40	1.40	1.40	1.40	1.40	1.40
2-yr Govt. Bond Yield	1.55	1.47	1.58	1.70	1.50	1.40	1.43	1.45	1.50	1.55	1.60	1.65
5-yr Govt. Bond Yield	1.52	1.39	1.40	1.64	1.55	1.50	1.55	1.60	1.65	1.70	1.75	1.80
10-yr Govt. Bond Yield	1.62	1.46	1.37	1.64	1.55	1.50	1.55	1.65	1.75	1.80	1.85	1.90
30-yr Govt. Bond Yield	1.89	1.68	1.53	1.73	1.65	1.60	1.70	1.80	1.90	2.00	2.10	2.15
10-yr-2-yr Govt Spread	0.07	-0.01	-0.21	-0.06	0.05	-0.06	0.12	0.20	0.25	0.25	0.25	0.25
U.S.												
Fed Funds Target Rate	2.50	2.50	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.25
3-mth T-Bill Rate	2.35	2.08	1.84	1.53	1.55	1.55	1.55	1.55	1.55	1.68	1.93	2.17
2-yr Govt. Bond Yield	2.27	1.75	1.63	1.64	1.70	1.75	1.80	1.90	2.00	2.10	2.20	2.30
5-yr Govt. Bond Yield	2.23	1.76	1.55	1.71	1.75	1.80	1.90	2.00	2.10	2.20	2.30	2.40
10-yr Govt. Bond Yield	2.41	2.00	1.68	1.88	1.95	2.00	2.10	2.20	2.30	2.40	2.50	2.60
30-yr Govt. Bond Yield	2.81	2.52	2.12	2.30	2.35	2.40	2.50	2.60	2.70	2.75	2.80	2.85
10-yr-2-yr Govt Spread	0.14	0.25	0.05	0.24	0.25	0.24	0.30	0.30	0.30	0.30	0.30	0.30
Canada-U.S. Spreads												
Can - U.S. T-Bill Spread	-0.68	-0.42	-0.19	0.12	-0.02	0.12	-0.15	-0.15	-0.15	-0.28	-0.53	-0.77
Can - U.S. 10-Year Bond Spread	-0.79	-0.54	-0.31	-0.24	-0.40	-0.24	-0.55	-0.55	-0.55	-0.60	-0.65	-0.70

F: Forecast by TD Economics as at December 2019. All forecasts are end-of-period.
Source: Bloomberg, Bank of Canada, Federal Reserve, TD Economics. *Spot rates as at December 16, 2019 with the exception of policy rates.

Foreign Exchange Outlook

Currency	Exchange rate	2019				2020				2021			
		Q1	Q2	Q3	Q4*	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Exchange rate to U.S. dollar													
Euro	USD per EUR	1.12	1.14	1.09	1.11	1.09	1.09	1.10	1.11	1.12	1.13	1.14	1.15
UK pound	USD per GBP	1.30	1.27	1.23	1.33	1.31	1.30	1.30	1.31	1.32	1.33	1.34	1.35
Japanese yen	JPY per USD	111	108	108	110	108	107	107	106	106	105	105	104
Chinese renminbi	CNY per USD	6.71	6.87	7.15	6.99	6.95	6.90	6.85	6.80	6.80	6.80	6.80	6.80
Exchange rate to Canadian dollar													
U.S. dollar	USD per CAD	0.75	0.76	0.76	0.76	0.75	0.75	0.75	0.76	0.76	0.77	0.77	0.77
Euro	CAD per EUR	1.50	1.49	1.44	1.47	1.45	1.46	1.46	1.47	1.47	1.47	1.48	1.50
UK pound	CAD per GBP	1.74	1.66	1.63	1.76	1.74	1.74	1.73	1.73	1.73	1.73	1.74	1.76
Japanese yen	JPY per CAD	82.8	82.4	81.6	83.3	81.2	79.9	80.1	80.3	80.5	80.8	80.4	80.2
Chinese renminbi	CNY per CAD	5.03	5.25	5.40	5.31	5.23	5.15	5.15	5.15	5.19	5.23	5.23	5.23

F: Forecast by TD Economics as at December 2019. All forecasts are end-of-period.
Source: Bloomberg, Bank of Canada, Federal Reserve, TD Economics. * Spot rates as at December 16, 2019.

Commodity Price Outlook

	2019				2020				2021			
	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Crude Oil (WTI, $US/bbl)	55	60	56	56	55	56	58	59	59	60	60	60
Natural Gas ($US/MMBtu)	2.92	2.56	2.38	2.40	2.45	2.45	2.45	2.50	2.51	2.53	2.54	2.55
Gold ($US/troy oz.)	1303	1307	1474	1480	1500	1500	1500	1450	1450	1450	1450	1450
Silver ($US/troy oz.)	15.58	14.91	17.02	17.22	17.60	17.60	17.60	17.00	17.00	17.00	17.00	17.00
Copper (cents/lb)	282	278	263	263	265	280	285	289	277	274	276	281
Nickel ($US/lb)	5.60	5.56	7.05	6.85	7.60	7.48	7.48	7.48	8.05	8.62	8.85	8.85
Aluminum (cents/lb)	84	81	80	79	81	79	78	78	78	78	76	77
Wheat ($US/bu)	7.08	6.36	6.14	6.75	6.80	6.85	6.90	6.95	6.99	7.02	7.06	7.09

F: Forecast by TD Economics as at December 2019. All forecasts are period averages.
Source: Bloomberg, TD Economics, USDA (Haver).

Canadian Economic Outlook																		
Period-Over-Period Annualized Per Cent Change Unless Otherwise Indicated																		
	2019				2020				2021				Annual Average			4th Qtr/4th Qtr		
	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	19F	20F	21F	19F	20F	21F
Real GDP	0.8	3.5	1.3	1.2	1.6	1.5	1.8	1.8	1.8	1.8	1.8	1.8	1.7	1.6	1.8	1.7	1.6	1.8
Consumer Expenditure	2.5	0.5	1.6	1.7	1.7	1.8	1.7	1.6	1.6	1.7	1.6	1.6	1.6	1.6	1.7	1.5	1.7	1.6
Durable Goods	5.0	-1.7	1.8	1.6	1.2	1.2	1.2	1.4	1.7	1.9	1.8	1.8	0.9	1.2	1.6	1.7	1.3	1.8
Business Investment	11.1	-5.1	9.0	3.7	2.2	2.5	2.9	3.2	3.9	4.7	4.5	4.3	0.4	3.0	3.8	4.5	2.7	4.4
Non-Res. Structures	4.2	4.4	11.1	3.6	1.9	2.2	2.7	3.1	3.6	4.1	3.9	3.7	1.2	3.7	3.4	5.8	2.5	3.8
Equipment & IPP*	18.1	-13.9	6.7	3.8	2.6	2.9	3.0	3.2	4.1	5.4	5.2	4.9	-0.5	2.3	4.2	3.0	2.9	4.9
Residential Investment	-2.7	5.5	13.3	5.0	3.7	3.6	3.4	3.3	3.1	3.0	2.8	2.5	-0.4	5.1	3.1	5.1	3.5	2.9
Govt. Expenditure	3.3	0.9	1.8	1.2	1.1	0.8	0.8	0.9	0.9	1.0	1.0	1.2	1.8	1.1	0.9	1.8	0.9	1.0
Final Domestic Demand	3.3	0.3	3.2	2.0	1.8	1.8	1.7	1.7	1.8	1.9	1.9	1.9	1.4	1.9	1.8	2.2	1.7	1.9
Exports	-3.3	12.9	-1.5	1.0	2.0	2.1	2.2	2.2	2.4	2.5	2.9	3.1	2.0	2.0	2.4	2.1	2.1	2.7
Imports	8.1	-3.5	0.1	0.4	2.1	2.1	2.2	2.3	2.7	3.1	3.3	3.3	0.5	1.2	2.7	1.2	2.2	3.1
Change in Non-farm Inventories (2012 $Bn)	17.7	10.7	-0.6	-3.5	-2.0	-3.5	-3.3	-2.8	-2.3	-2.3	-2.3	-2.3	6.1	-2.9	-2.3	--	--	--
Final Sales	2.1	1.8	4.9	3.1	2.0	2.1	1.7	1.6	1.7	1.9	1.9	1.9	1.6	2.5	1.8	3.0	1.8	1.9
International Current Account Balance ($Bn)	-67.3	-27.0	-39.4	-40.3	-42.3	-43.6	-45.2	-46.7	-48.1	-49.9	-51.5	-52.8	-43.5	-44.4	-50.6	--	--	--
% of GDP	-3.0	-1.2	-1.7	-1.7	-1.8	-1.8	-1.9	-1.9	-2.0	-2.0	-2.1	-2.1	-1.9	-1.9	-2.0	--	--	--
Pre-tax Corp. Profits	9.2	36.0	-18.9	2.7	1.5	2.3	3.0	4.1	4.2	4.4	3.9	3.8	-0.2	1.2	3.9	5.4	2.7	4.1
% of GDP	12.3	13.0	12.3	12.3	12.2	12.2	12.1	12.2	12.2	12.2	12.2	12.2	12.4	12.2	12.2	--	--	--
GDP Deflator (y/y)	1.1	1.9	1.4	2.9	2.2	1.6	2.0	1.9	2.0	2.0	2.0	2.0	1.8	1.9	2.0	2.9	1.9	2.0
Nominal GDP	5.6	8.1	1.6	3.5	3.3	3.5	3.7	3.9	3.9	3.8	3.8	3.8	3.6	3.6	3.8	4.7	3.6	3.8
Labour Force	3.3	1.9	1.6	1.0	1.0	0.9	0.8	0.8	0.8	0.8	0.8	0.7	1.9	1.1	0.8	2.0	0.9	0.8
Employment	2.9	3.0	1.2	0.3	0.6	0.8	0.8	0.8	0.8	0.9	0.8	0.8	2.1	0.8	0.8	1.8	0.8	0.8
Change in Empl. ('000s)	133	138	56	16	31	37	39	40	41	42	40	39	386	162	160	342	147	162
Unemployment Rate (%)	5.8	5.5	5.6	5.8	5.9	5.9	5.9	5.9	5.9	5.8	5.8	5.8	5.7	5.9	5.8	--	--	--
Personal Disp. Income	4.4	7.3	3.8	5.3	4.2	4.2	3.9	3.7	3.7	3.6	3.5	3.5	4.6	4.5	3.7	5.2	4.0	3.6
Pers. Savings Rate (%)	2.1	3.0	3.2	3.6	3.7	3.8	3.7	3.7	3.7	3.6	3.6	3.5	3.0	3.7	3.6	--	--	--
Cons. Price Index (y/y)	1.6	2.2	1.9	2.2	2.2	1.8	1.8	1.8	1.9	2.0	2.0	2.0	2.0	1.9	2.0	2.2	1.8	2.0
CPIX (y/y)**	1.5	1.9	2.0	2.0	2.0	2.0	1.9	1.9	1.9	2.0	2.0	2.0	1.8	2.0	2.0	2.0	1.9	2.0
BoC Inflation (y/y)***	1.9	2.0	2.1	2.0	2.0	2.0	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Housing Starts ('000s)	187	224	223	202	208	205	205	206	208	211	212	210	209	206	210	--	--	--
Home Prices (y/y)	-4.0	1.7	3.8	6.9	13.6	9.5	4.9	4.0	3.6	3.4	3.0	2.5	2.1	7.8	3.1	6.9	4.0	2.5
Real GDP / worker (y/y)	-0.4	-0.4	-0.6	-0.1	0.6	0.7	0.9	0.9	0.9	0.9	0.9	0.9	-0.4	0.8	0.9	-0.1	0.9	0.9

F: Forecast by TD Economics as at December 2019.

Home price measure shown is the CREA Composite Sale Price.

* Intellectual Property Products. ** CPIX: CPI excluding the 8 most volatile components. *** BoC Inflation: simple average of CPI-trim, CPI-median, and CPI-common.

Source: Statistics Canada, Bank of Canada, Canada Mortgage and Housing Corporation, Haver Analytics, TD Economics.

U.S. Economic Outlook																		
Period-Over-Period Annualized Per Cent Change Unless Otherwise Indicated																		
	2019				**2020**				**2021**				**Annual Average**			**4th Qtr/4th Qtr**		
	Q1	**Q2**	**Q3**	**Q4F**	**Q1F**	**Q2F**	**Q3F**	**Q4F**	**Q1F**	**Q2F**	**Q3F**	**Q4F**	**19F**	**20F**	**21F**	**19F**	**20F**	**21F**
Real GDP	3.1	2.0	2.1	1.8	2.1	2.1	2.0	2.0	1.8	1.8	1.9	1.9	2.3	2.0	1.9	2.2	2.1	1.8
Consumer Expenditure	1.1	4.6	2.9	2.3	2.4	2.5	2.4	2.3	2.2	2.3	2.2	2.2	2.6	2.6	2.3	2.7	2.4	2.2
Durable Goods	0.3	13.0	8.3	3.5	2.9	3.7	3.4	2.9	2.4	3.0	2.7	2.9	4.9	4.5	2.9	6.2	3.2	2.7
Business Investment	4.4	-1.0	-2.7	1.1	2.1	3.0	3.0	3.0	3.0	3.0	3.0	3.0	2.3	1.4	3.0	0.4	2.8	3.0
Non-Res. Structures	4.0	-11.1	-12.0	-11.9	-2.5	-0.6	0.4	0.6	0.6	0.8	1.0	0.9	-4.8	-5.3	0.6	-8.0	-0.5	0.8
Equipment & IPP*	4.6	2.1	0.1	4.9	3.3	4.0	3.7	3.6	3.6	3.5	3.6	3.5	4.4	3.3	3.6	2.9	3.7	3.5
Residential Investment	-1.1	-2.9	5.1	3.5	5.1	2.4	1.2	0.8	0.9	0.9	1.0	1.1	-1.6	3.0	1.0	1.1	2.4	1.0
Govt. Expenditure	2.9	4.8	1.6	0.5	1.9	4.0	0.6	0.3	0.7	0.4	0.4	0.4	2.2	1.9	0.7	2.5	1.7	0.5
Final Domestic Demand	1.8	3.6	2.0	1.9	2.4	2.8	2.2	2.0	2.0	2.0	2.0	1.9	2.3	2.3	2.1	2.3	2.3	2.0
Exports	4.2	-5.7	0.9	-3.3	1.3	5.2	3.2	2.7	1.2	1.8	2.0	2.1	-0.3	1.0	2.2	-1.1	3.1	1.8
Imports	-1.5	0.0	1.5	-3.4	2.1	3.7	5.0	4.3	3.4	3.3	3.1	2.9	1.3	1.6	3.7	-0.9	3.8	3.2
Change in Private Inventories	116.0	69.4	79.8	65.8	59.6	21.2	27.9	39.7	44.0	46.8	51.3	54.9	82.7	37.1	49.3	--	--	--
Final Sales	2.6	3.0	2.0	2.1	2.3	2.9	1.9	1.8	1.7	1.8	1.8	1.8	2.2	2.3	1.8	2.4	2.2	1.8
International Current Account Balance ($Bn)	-545	-513	-506	-528	-558	-576	-614	-650	-683	-713	-736	-758	-523	-599	-723	--	--	--
% of GDP	-2.6	-2.4	-2.3	-2.4	-2.5	-2.6	-2.7	-2.9	-3.0	-3.1	-3.2	-3.2	-2.4	-2.7	-3.1	--	--	--
Pre-tax Corporate Profits including IVA&CCA	-14.3	16.0	0.9	9.4	-3.2	0.5	3.6	3.5	2.0	2.4	2.8	3.2	0.2	2.7	2.7	2.4	1.1	2.6
% of GDP	9.5	9.8	9.7	9.8	9.6	9.6	9.6	9.5	9.5	9.5	9.4	9.4	9.7	9.6	9.4	--	--	--
GDP Deflator (y/y)	2.0	1.8	1.7	1.7	2.0	1.9	1.9	2.0	2.0	2.1	2.1	2.1	1.8	1.9	2.1	1.7	2.0	2.1
Nominal GDP	3.9	4.7	3.8	3.5	4.3	4.0	4.1	4.1	3.9	4.0	4.1	4.1	4.1	4.0	4.0	4.0	4.1	4.0
Labor Force	0.5	-1.0	2.7	1.9	1.2	1.4	0.4	0.6	0.6	0.7	0.7	0.7	0.9	1.3	0.7	1.0	0.9	0.7
Employment	1.7	1.2	1.4	1.5	1.1	1.3	0.4	0.6	0.7	0.7	0.7	0.7	1.6	1.1	0.7	1.4	0.9	0.7
Change in Empl. ('000s)	617	438	511	565	398	512	169	215	286	276	260	251	2,336	1,709	1,060	2,131	1,294	1,073
Unemployment Rate (%)	3.9	3.6	3.6	3.6	3.6	3.6	3.7	3.7	3.7	3.7	3.7	3.8	3.7	3.7	3.7	--	--	--
Personal Disp. Income	4.9	3.9	4.4	2.5	4.2	3.3	3.6	3.7	4.4	4.0	4.1	4.1	4.4	3.6	4.0	3.9	3.7	4.1
Pers. Savings Rate (%)	8.5	7.8	7.9	7.5	7.5	7.2	7.0	6.9	6.9	6.8	6.8	6.7	7.9	7.2	6.8	--	--	--
Cons. Price Index (y/y)	1.6	1.8	1.8	2.0	2.3	2.1	2.3	2.2	2.2	2.3	2.2	2.2	1.8	2.2	2.2	2.0	2.2	2.2
Core CPI (y/y)	2.1	2.1	2.3	2.3	2.4	2.5	2.2	2.2	2.2	2.2	2.3	2.3	2.2	2.3	2.2	2.3	2.2	2.3
Core PCE Price Index (y/y)	1.6	1.6	1.7	1.6	1.9	1.9	1.9	2.0	1.9	2.0	2.0	2.1	1.6	1.9	2.0	1.6	2.0	2.1
Housing Starts (mns)	1.21	1.26	1.28	1.30	1.32	1.32	1.33	1.33	1.33	1.34	1.34	1.34	1.26	1.33	1.34	--	--	--
Real Output per hour (y/y)**	1.7	1.8	1.5	1.4	0.8	0.6	1.0	1.4	1.5	1.5	1.5	1.5	1.6	0.9	1.5	1.4	1.4	1.5

F: Forecast by TD Economics as at December 2019.

* Intellectual Property Products. ** Non-farm business sector.

Source: Bureau of Labor Statistics, Bureau of Economic Analysis, Census Bureau, TD Economics.

Economic Indicators: G7 & Europe				
		Forecast		
	2018	2019	2020	2021
Real GDP (annual per cent change)				
G7 (30.1%)*	2.0	1.7	1.4	1.5
U.S.	2.9	2.3	2.0	1.9
Japan	0.3	1.2	0.6	0.8
Euro Area	1.9	1.2	1.0	1.3
Germany	1.5	0.5	0.5	1.4
France	1.7	1.3	1.3	1.3
Italy	0.7	0.1	0.4	0.8
United Kingdom	1.4	1.3	0.9	1.5
Canada	2.0	1.7	1.6	1.8
Consumer Price Index (annual per cent change)				
G7	2.1	1.5	1.8	1.9
U.S.	2.4	1.8	2.2	2.2
Japan	1.0	0.6	1.3	1.1
Euro Area	1.8	1.1	1.0	1.4
Germany	1.9	1.3	1.3	1.6
France	2.1	1.3	1.3	1.6
Italy	1.2	0.7	0.9	1.4
United Kingdom	2.5	1.8	1.4	1.7
Canada	2.2	2.0	1.9	2.0
Unemployment Rate (per cent annual averages)				
U.S.	3.9	3.7	3.7	3.7
Japan	2.4	2.4	2.6	2.6
Euro Area	8.2	7.6	7.7	7.7
Germany	5.2	5.0	5.1	5.1
France	9.1	8.6	8.6	8.6
Italy	10.6	10.0	10.0	10.1
United Kingdom	4.0	3.8	3.9	3.9
Canada	5.8	5.7	5.9	5.8

*Share of 2018 world gross domestic product (GDP) at PPP.

Forecast as at December 2019.

Source: National statistics agencies, TD Economics.

Global Economic Outlook					
Annual Per Cent Change Unless Otherwise Indicated					
	2018 Share*		Forecast		
Real GDP	(%)	2018	2019	2020	2021
World	100.0	3.6	2.8	3.0	3.3
North America	18.5	2.8	2.0	1.9	1.9
United States	15.2	2.9	2.3	2.0	1.9
Canada	1.4	2.0	1.7	1.6	1.8
Mexico	1.9	2.1	0.1	1.5	2.1
European Union (EU-28)	16.3	2.0	1.4	1.2	1.5
Euro Area (EU-19)	11.4	1.9	1.2	1.0	1.3
Germany	3.2	1.5	0.5	0.5	1.4
France	2.2	1.7	1.3	1.3	1.3
Italy	1.8	0.7	0.1	0.4	0.8
United Kingdom	2.2	1.4	1.3	0.9	1.5
EU accession members	2.6	4.0	3.1	2.6	2.6
Asia	45.0	5.2	4.5	4.7	4.7
Japan	4.1	0.3	1.2	0.6	0.8
Asian NIC's	3.4	2.7	1.5	2.2	2.8
Hong Kong	0.4	3.0	-1.6	-1.9	2.9
Korea	1.7	2.7	1.9	2.9	3.0
Singapore	0.4	3.2	0.8	2.2	2.5
Taiwan	0.9	2.7	2.5	2.9	2.9
Russia	3.1	2.2	1.3	2.2	1.6
Australia & New Zealand	1.1	2.7	2.0	2.4	2.5
Developing Asia	33.2	6.4	5.6	5.7	5.8
ASEAN-5	5.5	5.3	4.8	4.7	5.0
China	18.7	6.5	6.2	5.9	5.7
India**	7.7	6.8	4.6	6.1	6.7
Central/South America	5.6	0.3	-0.2	1.2	2.2
Brazil	2.5	1.3	1.1	2.0	2.2
Other Developing	13.6	2.5	1.4	2.5	3.3
Other Advanced	1.1	2.6	1.5	1.9	2.0

*Share of world GDP on a purchasing-power-parity (PPP) basis.

Forecast as at December 2019. **Forecast for India refers to fiscal year.

Source: IMF, TD Economics.

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