

Green Friday

A Publication of BMO Capital Markets Economic Research · Douglas Porter, CFA, Chief Economist, BMO Financial Group

Markets continue to readily look beyond the prospect of a dark winter for many economies to a much brighter 2021. Even amid still-rising virus case counts and widening restrictions in many areas, as well as clearer signs that confidence is buckling, **global equities** reached an all-time high this week. The MSCI World Index is now up more than 10% y/y, and has roared back by over 57% from its March low. In North America, the TSX moved into positive terrain for 2020, and was working on an impressive 7-day winning streak on Friday. Meanwhile, the venerable Dow topped the 30,000 mark for the first time, while the S&P 500 and Nasdaq also scaled record heights, with the latter almost 40% above year-ago levels. News that Janet Yellen will be the next Treasury Secretary was greeted by open arms, adding to the positive financial market vibes.

The upbeat market tone was not confined to stocks, as **oil** hit its best level (over \$45) since the pandemic began, in advance of next week's key OPEC confab. While crude is still well down from a year ago, that's simply not the case for almost all other major commodities, as resource prices have mounted arguably an even more impressive snap-back than stocks in the face of the deep damage to global growth this year. For example, the **Bank of Canada's non-energy commodity price index** is now up 12% y/y, with all four major components above year-ago levels. Economically-sensitive **copper** prices are on a roll, with the red metal now up 23% y/y, and the copper/gold price ratio now back to levels prevailing at the start of the year. However, the seemingly sober **bond market** continues to see the glass as half-empty, with yields barely budging in recent weeks. For example, even with the S&P 500 on course for an astonishing 11% surge in November, 10-year Treasury yields have actually dipped 3 bps since the start of the month.

Bonds are being held more closely in check by relentless central bank purchases, strong forward guidance, relatively stable inflation expectations, and the cold reality of near-term economic challenges almost everywhere. For example, due to new restrictions and shutdowns, **we have cut our Q4 GDP forecast for Canada** to 0.6% (from 2.3% recently, and as high as 8% pre-second wave), after what's expected to be a 47.5% burst in Q3 (data due on Tuesday). While recent data have pointed to better-than-expected momentum in the early fall—including decent gains in October wholesale and manufacturing sales reported this week—we now expect a hefty drop in activity for December. Even so, we maintain our above-consensus view on 2021 growth prospects at +5.5% for Canada, with the positive vaccine news globally even lending some upside risk to that call. As well, we expect fiscal policy to continue to be highly supportive in coming months, with Ottawa's budget update on Monday likely to roll out new measures for hard-hit sectors.

It's a slightly different backdrop for the U.S. economy. At the same time that we were shaving our Canadian estimate for Q4, **we were busily upgrading our view on growth stateside**. U.S. Q4 GDP is now expected to rise at a sturdy 5% clip, albeit

ECONOMIC RESEARCH
economics.bmo.com

Douglas Porter, CFA, Chief Economist
douglas.porter@bmo.com

cooling to around 1% in Q1 (amid the ongoing uncertainty around fiscal policy). On balance, we remain comfortable with our call for +4% GDP in 2021, which is only a smidge above the current consensus (which may well be rising as we speak on the positive vaccine outlook).

Where the U.S. economy really stands out from some of its other OECD counterparts, however, is how it fared in 2020 overall. At this point, it now looks like U.S. GDP contracted by 3.5% for all of this year. No doubt, that's a heavy hit, and the worst year for growth in the post-war era (the prior record low was a drop of 2.5% in 2009). But, it's also by far the mildest drop in the G7, and likely to represent a somewhat smaller GDP drop than seen in even widely heralded Australia and New Zealand. In the G7, the next step down are Japan, Germany and Canada, which are all now expected to drop about 5.5% or slightly worse in 2020. And then it's another huge step down to the other three major European economies, where activity will be down about 9%, with the U.K. likely the weakest with a massive 11% setback this year.

A fair question is **how did the U.S. economy manage to avoid an even deeper drop**, when it had such a negative experience with the virus? After all, the nation was also dealing with election uncertainty, civil unrest, and a relatively large service sector (especially compared with, say, Japan and Germany). Part of the answer is that U.S. fiscal policy was extremely supportive and at an early stage of the pandemic. The same can be said for monetary policy, and U.S. interest rates had more room to fall.

But **Canada's policy response was every bit as strong** and, yet, there was still a **big divergence** in the full-year economic outcomes in two economies with broadly similar growth potential. The heavy presence of tech in the U.S. economy was a big positive, while the hard hit to the energy sector from the spring collapse in oil prices was a relative negative for Canada. That still leaves the nagging sense that the **lighter restrictions stateside** may have played a role in averting a deeper downturn, but with much worse health outcomes. However, we will see how the economies perform on a relative basis in the months ahead—we expect the widest divergences to narrow markedly in the coming year.

The mountain of savings built up by both households and businesses earlier this year remains, well, mountainous. To cite but one current example, the U.S. personal savings rate remained sky-high in October at 13.6% even as disposable incomes fell 0.8% in the month. True, that's well down from the record heights of above 30% at the peak of the shutdowns in April. But this means that—even now—spending by U.S. households is much farther below income levels than normal. While spending on goods has more than fully rebounded, outlays on services remain constrained, so overall consumption is down 0.6% y/y. Meantime, disposable incomes are still up more than 6% y/y, about 3 pts higher than the pre-pandemic pace, even with waning fiscal support.

Monthly data on Canadian income and overall spending are not available (in fact, we don't yet even have Q3 data), but we fully expect that trends are broadly similar to the U.S. picture. Deposits at chartered banks (personal and non-personal) have soared 17% y/y, or about 10 pts faster than pre-virus trends. That growth pick-up represents

roughly \$200 billion in extra deposits than what would have normally been expected, or a sizable chunk of the deterioration in government finances this year.

We would assert that this build-up in deposits and savings is not so much by choice or due to caution, but more a result of circumstances. Consumers are simply constrained in what they can buy and are, in fact, spending with alacrity where they can spend—witness the rapid rebound in retail outlays overall and the housing market. As the economy is more fully able to re-open—hopefully within the next year—watch for the savings rate to nearly normalize, without any prodding from policy whatsoever.

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