Economic Outlook

Fourth Quarter 2020

Winter Hibernation

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SEI recently released its fourth-quarter Economic Outlook. A summary of the conclusions is provided below:

- COVID-19 remains a significant public health concern and continues to impact the Canadian and global economies. The successful production and delivery of vaccines will be the two most important factors that determine the pace of economic recovery in 2021.
- Canada's stringent lockdowns have helped keep infection rates lower than in the U.S. and other hard-hit countries—but at an economic cost. Its inflation-adjusted gross-domestic product tumbled in the second quarter to 12.1% below its year-ago level; although it improved in the third quarter to 5.2% below the year-ago level[1].
- The Canadian federal deficit for the fiscal year ended March 31 is estimated to total more than C$380 billion—or 17.5% of GDP (about C$275 billion of which represents its COVID-19 response plan)[2]. The deficit is anticipated to shrink to 5.1% of GDP in fiscal year 2022 and to 2.1% in 2023, depending upon the speed at which the economy returns to more normal conditions[2].
- Bank of Canada's (BOC) bond-buying program has offset the expected government-debt issuance associated with the pandemic response plan, which would otherwise have placed pressure upon financial markets. The BOC said it will keep its overnight policy rate pegged at 0.25% through 2021 and 2022, after having lowered it from 0.75% in March.
- Canadian BBB bond yield spreads were 77 basis points wider than their U.S. counterparts at the end of 2020, about 30 basis points more than the three-year average. Canadian equities, meanwhile (as measured by the MSCI Canada Index), have failed to keep up with the U.S. stock market (as measured by the MSCI USA Index) since the end of the global financial crisis[3].
- Economic activity in the U.S. has continued to improve from April's low and is now 2.5% below its year-ago level[4] (implying that the economy is still operating almost 5% below capacity).
- The U.S. economic rebound was driven by three factors. First, a large portion of the U.S. population has been able to continue working and shopping virtually. Second, manufacturing and construction experienced strong recoveries. Third, income-support programs and emergency lending facilities were successful in preventing a downward self-reinforcing spiral in consumption and employment.
- There is fear that U.S. business activity could be throttled by additional lockdown orders during the first quarter. However, investors are looking beyond the valley. The promise of vaccines being widely available in the U.S. and other developed countries has encouraged a risk-on, pro-cyclical posture in financial markets.
- While we have seen some evidence of a "Great Rotation" from growth to value and cyclical investing, we believe it is too early to tell if this is the beginning of a major secular shift in equity investment themes.
- If the world economy enjoys a durable cyclical recovery in 2021, the U.S. dollar should continue to fall. This would also bolster the rally in commodity prices. Commodities of all sorts have been rallying sharply since the spring.

A full-length paper is available if you wish to learn more about these timely topics.

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[1] Statistics Canada
[2] Fall Economic Statement 2020, "Supporting Canadians and Fighting COVID-19," https://www.budget.gc.ca/fes-eea/2020/home-accueil-en.html.
[3] FactSet
[4] U.S. Bureau of Economic Analysis

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