WELLS FARGO

International Commentary — February 2, 2021

Canadian Economy Holding Up, but COVID a Lingering Concern

Summary

- The Bank of Canada held its policy rate at 0.50% at its January monetary policy meeting, and maintained its quantitative easing program at its current pace of asset purchases. The central bank noted some caution about near-term growth prospects, and now projects a contraction in Q1 GDP growth. However, as progress is made on the vaccine rollout, in addition to fiscal stimulus and higher commodity prices, policymakers expect economic activity to rebound over the longer-term.
- Despite an increase in COVID infections and the reintroduction of lockdown measures, the longer-term economic outlook appears to be encouraging, and we look for a recovery to gather momentum from the second half of 2021.
- We remain relatively positive on the Canadian dollar's prospects and look for the currency to strengthen against the greenback over the medium to longer-term. We target a USD/CAD exchange rate of CAD1.2200 by the middle of next year.

Economist(s)

Jen Licis
Economic Analyst | Wells Fargo Securities, LLC
jennifer.licis@wellsfargo.com | 704-410-1309

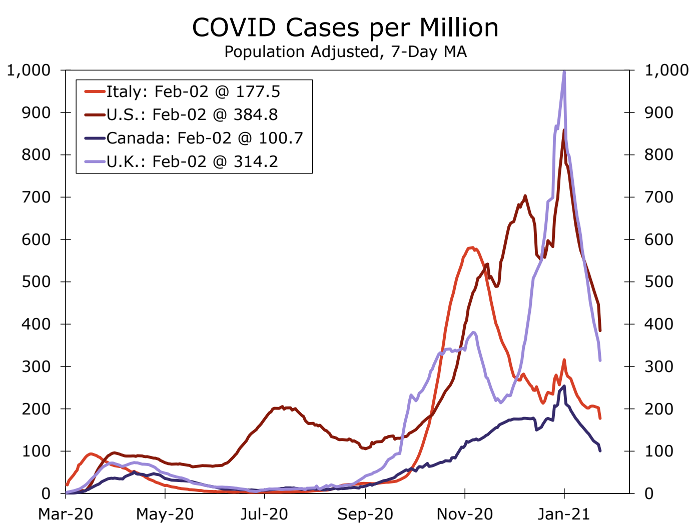
Nick Bennenbroek
International Economist | Wells Fargo Securities, LLC
nicholas.bennenbroek@wellsfargo.com | 212-214-5636

Bank of Canada Holds Steady in January

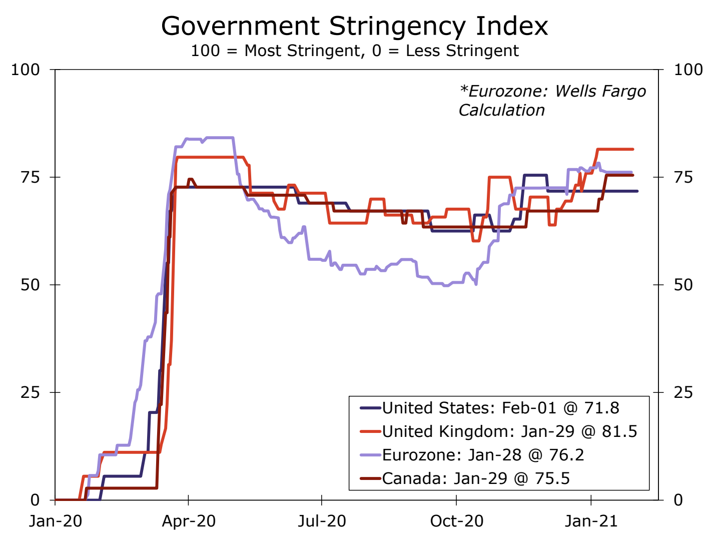
At its January policy meeting, the Bank of Canada (BoC) held its policy interest rate at 0.25%, as widely expected, and maintained its quantitative easing (QE) program at the current pace of around C$4B of government bonds per week. However, the central bank did note that as confidence in the recovery improves, the pace of QE purchases could be adjusted as required, potentially hinting at an eventual tapering of asset purchases. In the accompanying statement, policymakers also acknowledged some caution about the near-term economic outlook, as more restrictive COVID containment measures amid the second wave of the virus are likely to weigh on economic activity. Although the economy held up better than anticipated going into the last quarter of 2020, the central bank now looks for GDP to contract in Q1-2021, declining at an annualized rate of 2.5%. Over the medium-to-longer term, however, the central bank expects to see a bounce back in activity, and revised its 2022 GDP growth forecast to 4.8%, up from 3.7% in its previous forecast.

COVID Cases Increasing in Canada, but Less Noticeably Than Its Peers

The resurgence in COVID cases and resulting lockdown restrictions are likely to be a drag on economic activity in the near-term. Recently, Ontario, Canada's most populous province, imposed a stay-at-home order starting January 14, which requires residents to remain at home except for permitted purposes or activities. In addition, Ontario also put in place additional public health measures which include outdoor organized public and social gatherings to be limited to five people, all non-essential retail stores must open no earlier than 7AM and close no later than 8PM, while non-essential construction was further restricted.Quebec also imposed strict lockdown measures in an effort to slow the spread of infection, with nearly all territories on Maximum Alert until February 8, while other provinces have restrictions as well. Although virus cases accelerated and the new COVID variant was identified in Ontario, in relation to its peers such as the United States (80,202 cases per million) or United Kingdom (57,717 cases per million), the rise in cases has been much lower in Canada, with about 20,968 COVID cases per million residents. Interestingly, the University of Oxford's Government Stringency Index shows that Canada has more relaxed restrictions than the United Kingdom and the Eurozone, even with the recent increase in lockdown measures, but the country's measures are more stringent than the United States'. In our view, it is possible the strict lockdown measures in many Canadian provinces may be quite short-lived and thus only a short-term negative on economic activity.



Source: Bloomberg LP and Wells Fargo Securities

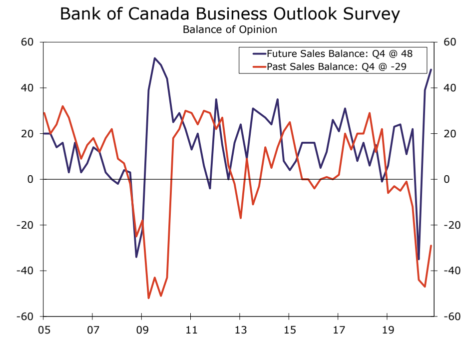


Source: Bloomberg LP, University of Oxford and Wells Fargo Securities

That said, the Canadian labor market, has not been immune to the effects of rising COVID cases and associated lockdown measures. Employment fell by 52,700 in December, the first decline since April, while the unemployment rate edged up to 8.8%. Nevertheless, some details were less discouraging as full-time employment increased by 42,700. The labor market is not out of the woods yet however as the January jobs report, which is due at the end of this week, is expected to show another fall in employment. Acknowledging that employment still below pre-pandemic levels, we nonetheless expect any setbacks in employment to be only a short-term phenomenon.

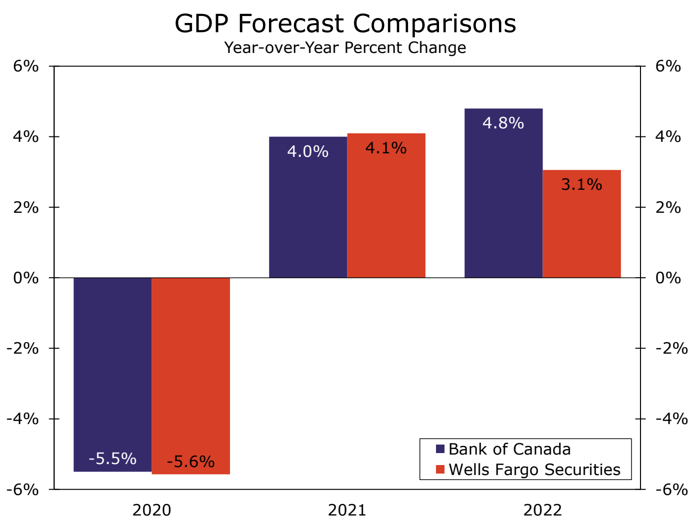
Canada's Longer Term Economic Outlook Remains Encouraging Overall

Although the prospects for the near-term are a bit uncertain, the medium-to-longer term outlook for the Canadian economy remains encouraging. There have been some signs that the economy has been resilient to the rising number of COVID cases, as economic growth near the end of 2020 beat market expectations. November GDP increased 0.7% month-over-month, posting a seventh monthly gain, due in part to a solid rise in the mining, quarrying, oil & gas sector. Retail sales have also held up better than expected, rising 1.2% month-over-month in November. However, the preliminary figures for December suggest that sales declined 2.6%, following seven months of consecutive increases. In addition, the BoC's Winter Business Outlook survey signaled improved business sentiment. Businesses reported that their current sales were below pre-pandemic levels, but growth of future sales were hopeful. We note, however, the survey was conducted before further COVID restrictions were put into place. Therefore, it is possible that the actual uptick in sales might not be as positive as respondents' expectations.

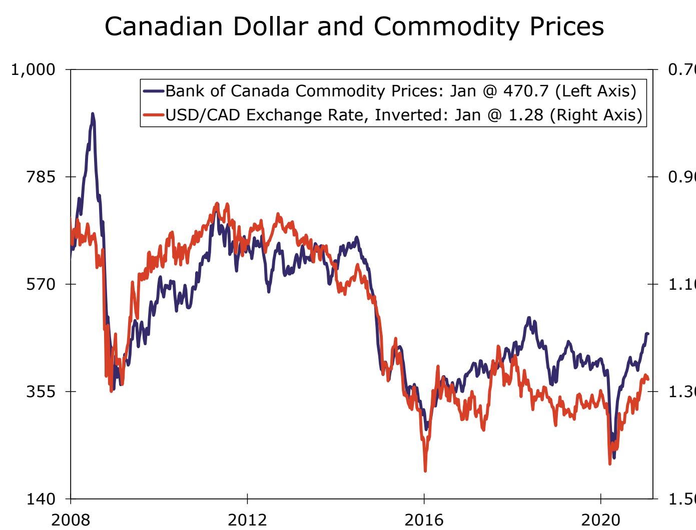


Source: Bank of Canada, Bloomberg LP and Wells Fargo Securities

Aggressive fiscal stimulus from the Canadian government has also helped to offset the negative effects from the pandemic and should continue to support the country's recovery. The government announced in its 2020 Fall Economic Statement potential plans to spend between an extra C$70B and C$100B over the next three years, which would equate to around a cumulative 4.3% of GDP, or spending of around 1.4% of GDP per year. The statement also included the budgetary impact of the government's COVID fiscal response, estimated at C$275B for the 2020 fiscal year (about 12.5% of GDP) and C$51B for the 2021 fiscal year (about 2% of GDP), signaling that income support measures by the government have been aggressive. Given that the Canadian government is only gradually phasing out its fiscal support measures, and the central bank is only modestly tapering its bond purchases, we believe that the influences of economic policies are likely to remain an overall positive influence for the Canadian economy and currency over the medium-term.



Source: Bank of Canada and Wells Fargo Securities



Source: Datastream and Wells Fargo Securities

Overall, we expect the Canadian economic recovery to gather some momentum over the medium- and longer term as progress is made on the vaccine front and oil prices remain supportive, while government stimulus measures should also underpin the economic expansion. In addition, as the global economy recovers and the negative effects from COVID dissipate, foreign demand should strengthen, benefiting Canadian export growth. Looking ahead, we continue to look for the Canadian economy and currency to strengthen, and look for real GDP to rebound 4.1% for full-year 2021, slightly more optimistic than the BoC's 4% rise. As for 2022, we forecast growth to moderate to 3.1%, while the BoC expects economic activity to increase nearly 5%, suggesting some upside risk to our medium-term forecast.

Given these developments, we remain constructive on the Canadian dollar's prospects, and expect the currency to gain over time. As the global economy strengthens, oil prices and global equities should continue to rise, which should also support the currency, and we target a USD/CAD exchange rate of CAD1.2200 by the middle of 2022. That said, we see the risks as tilted toward an even faster pace of appreciation given the resilience of the Canadian economy so far, and the fact that the near-term economic slowdown could be brief.

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

The 2021 Annual Economic Outlook: Aftershocks and Divergence in the Post-Pandemic Economy is available at wellsfargo.com/economicoutlook

Via The Bloomberg Professional Services at WFRE

And for those with permission at www.wellsfargoresearch.com

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	International Economist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

Required Disclosures

This report is produced by the Economics Group of Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes this report directly and through affiliates including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Europe S.A., Wells Fargo Securities Canada, Ltd., Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodity Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodity Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this report.

The information in this report has been obtained or derived from sources believed by Wells Fargo Securities, LLC to be reliable, but Wells Fargo Securities, LLC does not guarantee its accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or upon any opinions set forth herein. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial product or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company.

Important Information for Non-U.S. Recipients

For recipients in the United Kingdom, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 (“the Act”), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU (“MiFID2”). The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. For recipients in the EEA, this report is distributed by WFSIL or Wells Fargo Securities Europe S.A. (“WFSE”). WFSE is a French incorporated investment firm authorized and regulated by the Autorité de contrôle prudentiel et de résolution and the Autorité des marchés financiers. WFSE does not deal with retail clients as defined in the Directive 2014/65/EU (“MiFID2”). This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED - MAY LOSE VALUE - NO BANK GUARANTEE