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ONE-TO-ONE INSIGHTS

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2020 – WHAT TO EXPECT

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Will 2020 be a recessionary year? After all, the current economic expansion is the longest ever, and the yield curve is nearly inverted—a situation that, in some cases in the past, signaled an upcoming recession. This is an important call for policymakers and markets.

2020 Global Economic Outlook – watch video:

Mid-cycle vs. late-cycle easing

It's true that in the past, the yield curve was a leading recessionary indicator—but not always. Note that in both 1995 and 1998, the yield curve was inverted, and nothing happened. The reason for the false signal was that in both cases, the U.S. Federal Reserve (Fed) cut interest rates, and by doing so, was able to prevent/postpone a recession. In economic jargon we call this a mid-cycle easing.

Fast forward to the current situation, and the Fed has already cut rates by 75 basis points. So the key question is, to what extent is this a mid-cycle easing, akin to what we saw in 1995 and 1998? Or is it a late-cycle easing, as seen in 2001 and 2008, which was too late to prevent a recession? Our call is that, based on the trajectories of many economic variables, today's environment is more consistent with a mid-cycle easing. This should play a role in preventing recessionary forces from taking over next year.

The U.S. economy in 2020

Monetary policy will not be the only force helping the U.S. economy in 2020. The Trump administration received the green light from Congress to increase fiscal spending in 2020. That spending will be an important contributor to economic growth next year, probably by as much as 0.3%. Monetary and fiscal stimulus will buy the president some time to allow the reduction in the trade tension between China and the U.S. to add to economic growth through increased business investment.

Outlook for Canada

Recent communication from the Bank of Canada (BoC) has been more optimistic about the economic landscape, pointing to early signs of stabilization in the global economy, and stronger than expected business investment. The bank also pointed to the vanishing output gap, and hinted about the potential impact of accelerating wage inflation on consumption. Even fiscal policy was mentioned as a potential positive, and reading between the lines of the bank's comments on the "very strong" housing market in Q3 suggests low appetite to fuel that market with additional cuts. Furthermore, in a speech, deputy governor Timothy Lane declared independence from the Fed, suggesting that the bank can chart its own path.

2020 outlook conclusions

Accordingly, we suspect that the Fed is now happily on hold, as the economy is starting to positively react to previous rate cuts. The BoC is also in no rush to touch interest rates any time soon. It's possible that rates will be cut at least once in 2020, if the recent labour market weakness continues. Another reason for the BoC to keep rates low(er) is the value of the Canadian dollar. A stronger loonie versus other major currencies has led to a situation where we lost a share of exports to the U.S. to countries such as China, Japan, Germany and Mexico. A lower Canadian dollar might help to reverse that trajectory.

Overall, we do not expect 2020 to be an extremely strong year. However, with enough tailwinds coming from monetary and fiscal policies as well as reductions in trade tension, both economies can manage to grow at around 1.5% next year—nothing to write home about, but better than a recession.

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