Private Investment Management (Discretionary)

Wealth Management
Dominion Securities

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Dear client

Low interest rates lasting decades?

The present financial newsletter looks, among other things, at the possible evolution of interest rates for the next few years or decades.

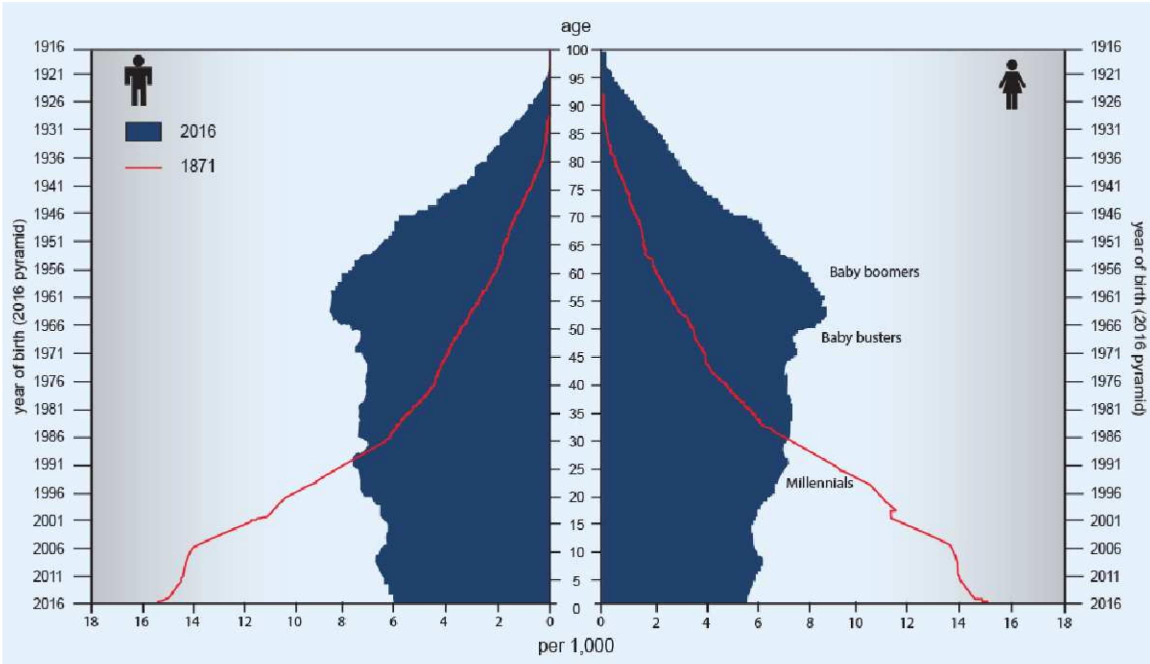
We can argue that a significant proportion of retirees (people 65 and over) have a lower income then the income they earned while working. This group is less likely able to maintain its pre-retirement spending habits.

We can assume that physical and mental healh problems affect people more as they age. Health issues can restrict the level of activity, consumption and outings, putting a stop their level of expenditure.

Therefore, it is plausible to pretend that in a developed country such as Canada, where technological and medical progress extend people's longevity, global consumption could decrease due to an overall aging population.

You will find below a first graph which illustrates the transformation of the age pyramid for 145 years, for the years 1871 and 2016.

Graph # 1



Source : Statistics Canada, population census, 1871 and 2016.

The red line represents the composition by age group in 1871. We can observe that the vast majority of the population was under 50 years of age. The shape of the curve ressembles a pyramid with a large base of young individuals and a small proportion of elderly people at the top of the pyramid.

The shaded area in blue représents 2016's age group composition. In 2016, the biggest concentration of people is situated at the baby-boomers' and baby-busters level, all aged between 45 and 65 years old. We can also observe that people of 70 plus years old have much more weight in 2016 compared to 1871.

If you want to learn more about this statistic, I invite you to consult the following link: https://www150.statcan.gc.ca/n1/daily-quotidien/170503/g-a001-eng.htm

So why focus on an age group composition? In order to explain the pressure exerted by the age group pyramid on inflation and, by extension, on interest rates.

We can assume that a lower consumption restricts the power of companies/corporations to raise too much the price of producst and services given a slower growing demand (consumption).

Graph # 2

How to Use the Calculator

Enter any dollar amount, and the years you wish to compare, then click the **Calculate** button.

YEARS MUST BE IN THE RANGE 1914 - 2020. COMMAS AND SPACES CAN BE USED IN THE DOLLAR AMOUNT.

A "basket" of goods and services

...that cost:	$	100.00	in	1914
...would cost:	$	2,226.67	in	2019

Clear Calculate

Per cent change:	2,126.67
Number of Years:	105
Average Annual Rate of Inflation (%) / Decline in the Value of Money:	3.00

By using the following link: https://www.bankofcanada.ca/rates/related/inflation-calculator, we are able to retrace the inflation's calculation between two periods. The inflation from 1914 to 2019 was on average 3.00% per year.

However, in the last 20 years, the annual inflation rate was only 1.90% per year. See graph # 3 below:

Graph # 3

How to Use the Calculator

Enter any dollar amount, and the years you wish to compare, then click the **Calculate** button.

YEARS MUST BE IN THE RANGE 1914 - 2020. COMMAS AND SPACES CAN BE USED IN THE DOLLAR AMOUNT.

A "basket" of goods and services

...that cost:	$	100.00	in	1999
...would cost:	$	146.01	in	2019

Clear Calculate

Per cent change:	46.01
Number of Years:	20
Average Annual Rate of Inflation (%) / Decline in the Value of Money:	1.91

Various factors can explain the fall in inflation over the past 20 years.

. Among others, we can assume that the declinig birth rate in developed countries has reduced population growth, affecting inflation growth as well.

. Productivity gains linked to an increased use of technologies have allowed to maintain a competitve and stable price structure. We have recently read in an article that the use of technology and productivity gains have possibly reduced the annual inflation rate by 0.50%.

. The increase in production from emerging countries, producing at lower cost, has allowed and still continues to exert pressure on prices.

The role of the Bank of Canada

The Bank of Canada is the country's central bank. Its main role, as defined in the Bank of Canada Act, is to "foster Canada's economic and financial prosperity". The Bank of Canada oversees four main areas of responsibility, the first of which is to control monetary policy: The Bank exerts influence on the amount of money in circulation in the economy and uses its monetary policy framework to keep inflation low and stable. From the following link: https://www.bankofcanada.ca/about

The Bank of Canada targets an annual inflation rate ranging between 2% to 3% in the medium term.

Given the factors mentioned above, the inflation has been under control for a long time, which explain why central banks, including the Bank of Canada, have been able to lower interest rates for many years without the fear of seeing inflation rise too high.

As long as inflation remains under control (less than 3%), the Bank of Canada can afford to keep interest rates low, which favors consumption, which in turn, drives the economy.

Photo : lightwise / 123RF

“I believe rates will continue to decrease and stay in the lower range for a few decades.” These words were pronounced by Ghislain Maillet, district vice president at Fidelity.

“With the current debt level, it is unimaginable to think that the rates could increase drastically”, he believes.

“When rates are low, any alternative to bonds, any guaranteed product that pays interest will be expensive: real estate, some stocks, etc.” he claimed.

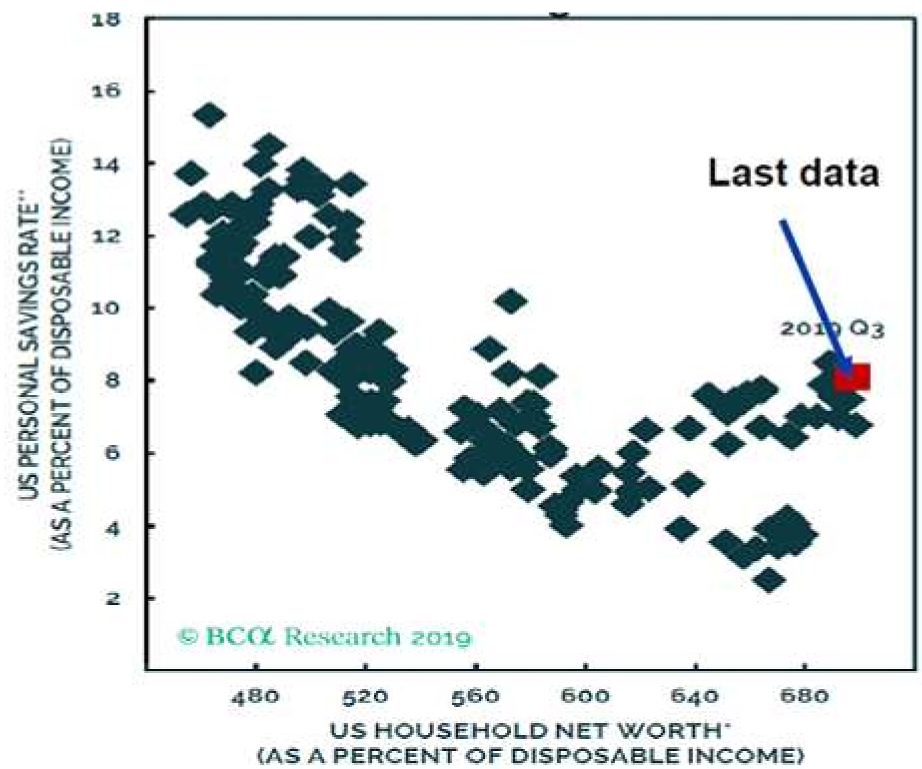
Elements for another 2008 (significant drop in stock markets) are not met according to Fidelity and us. Among other things, regulations imposed by the United States following the financial crisis prevents banks from taking as much risk as they did then, according to him. It is to be expected that if the economy grows weaker, Canadian and US banks will further lower interest rates (even if it means temporarily tolerating higher inflation than the 2% to 3% target, in the long-term) to stimulate borrowing, investment and, consequently, consumption, allowing the economic expansion to continue.

Mr. Ghislain Maillet estimates that that the current bull cycle will continue for several more years, which is the result of a strong American economy and a healthy consumer.

Graph # 4

Savings rate and wealth level of American households

Source: BCA, December 31, 2019



Graph #4 shows, that in the third quarter of 2019, American households allocated +/- 8% of their disposable income to savings. This percentage is high on a historical basis and suggests that the consumer is able to continue to consume, fueling economic growth.

Graph # 5

USA: Michigan Consumer Confidence Survey

Source: IA Economy, Bloomberg, January 16, 2020

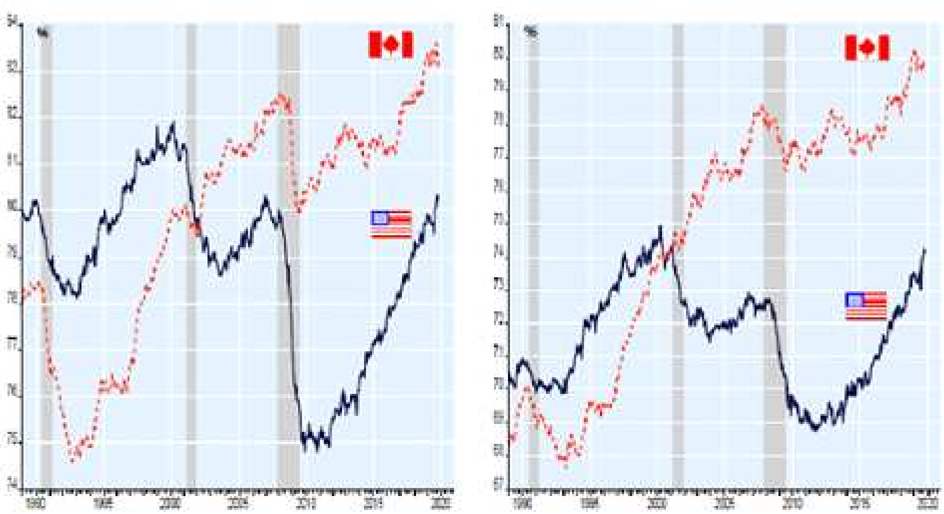
American consumers' level of confidence is currently at its highest. In summary, the American consumer feels good (confident), has a financial cushion and saves in a way where he will continue to fuel the US economic growth.

Graph # 6

Employment / population ratio of 25 to 54 year olds

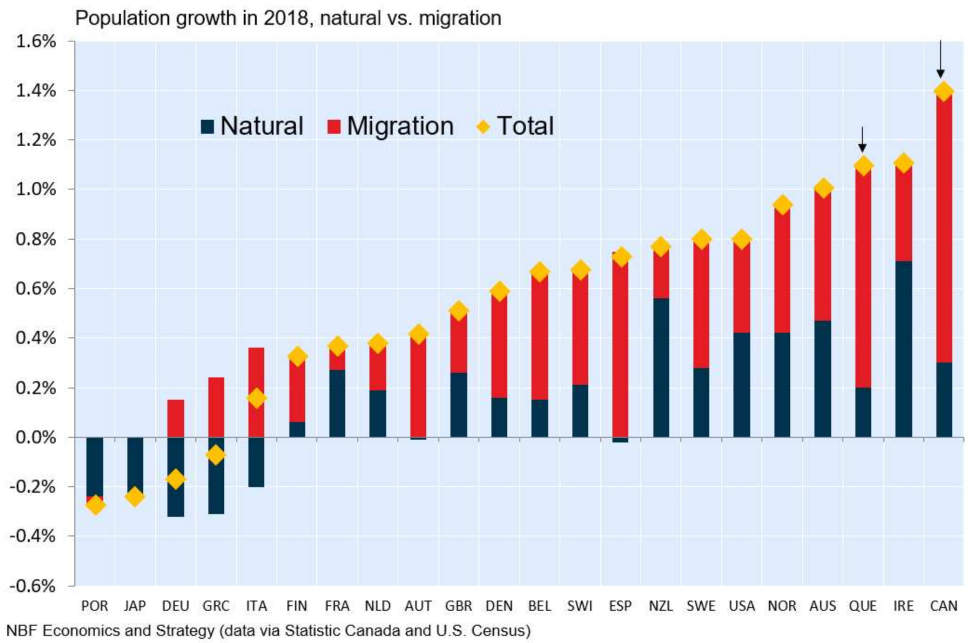
Employment / population ratio of women aged 25 to 54

Source: Economy and Strategy on-line via Statistics Canada and Datastream



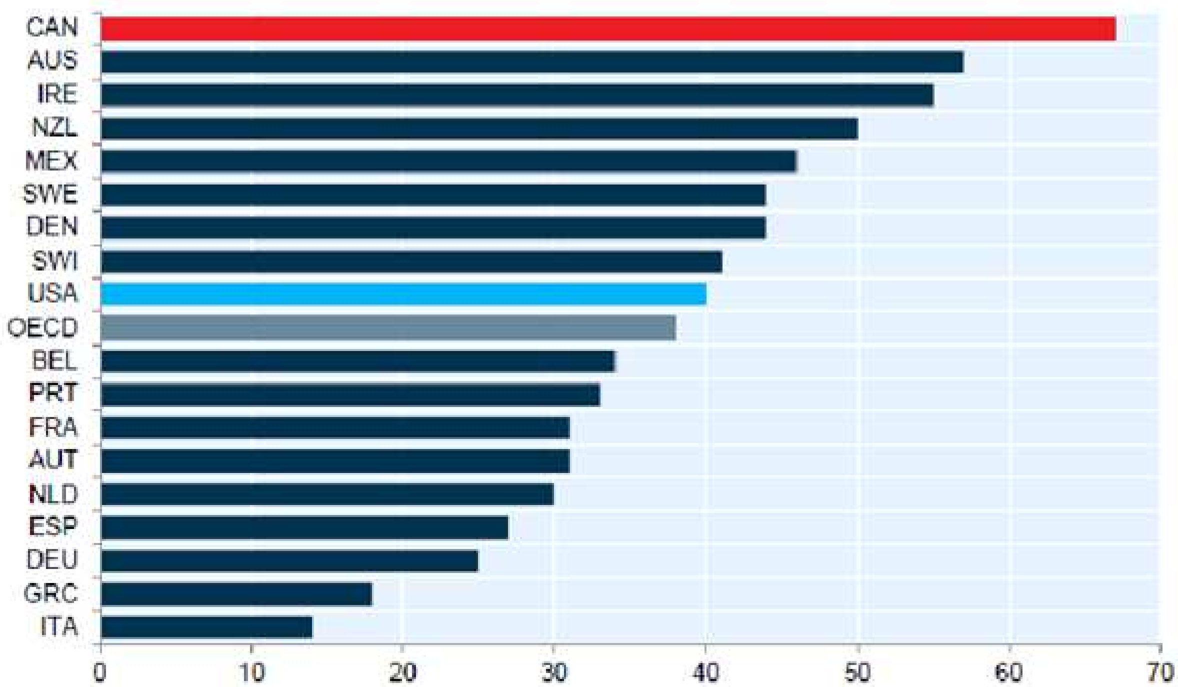
In Canada, the job market, for the population aged 25 to 54, is doing very well in terms of job prospects. The left graph shows that the employment ratio among 25 to 54 years old is above 83%, which is even higher than the US employment rate. The right graph shows women's employment rate (almost 80%) is, again, higher than the rates observed in the United States. Our Canadian family assistance policies (daycare subsidy, paid parental leave, etc.) are more generous than the ones existing in the US which perhaps partly explain this favorable gap for women's employment rate.

Graph # 7



Graph # 8

Percentage of immigrant population aged 25-64 with tertiary education (2017)



Source: NBF Economic and Strategy (OECD data) (December 31, 2019)

Graph #7 shows that Canada's population growth is the highest among the developed countries (OECD) in 2019, with a growth of 1.4%, mainly due to a positive factor of immigration. Mr. Clément Gignac, Senior Vice President and Chief Economist at IA Financial Group, recently mentioned, at a conference we attended, that Canada welcomes +/- 500,000 immigrants every year.

Graph # 8 indicates that Canada's immigrant population is better educated and able to enter the job market more quickly compared to other countries, including the US. It is plausible to believe that our immigrant eligibility criteria focus more on job skills.

In conclusion, the imposing level of government debts (among others) combined with a demographic curve that in some ways restricts consumption and continued productivity gains may imply that inflation will remain under control. As long as inflation remains under control, interest rates could remain low.

Therefore, for North America, given the current situation of full employment and the fact that consumers are optimistic and confident, the economy should continue to grow, albeit at a moderate pace.

Again, do not hesitate to contact us if necessary. We have all the resources to help you with financial planning.

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