ECONOMICS DIGEST
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Canadian current trends update

▲ Canadian GDP rose 0.3% in April (expectations +0.1%).
▲ Employment slipped 2k in June – but was still up 421k from a year ago.
▲ Retail sales declined 0.1% in May.
▲ Total house starts increased to 246k from 197k in May.
▲ The trade balance unexpectedly swung to a surplus in May.
▲ Headline CPI fell back to 2.0% from 2.4% in May.

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Financial markets...

An ounce (or two) of prevention

The central bank tide continued to turn over the past month with policymakers lowering rates (RBA), signaling near-term cuts (Fed, ECB) or simply sounding more dovish (BoC, BoE). The common thread is rising trade tensions and slowing global growth, which is already having a notable impact on some economies (particularly in Asia and Europe) and generating a good deal of uncertainty in others. While June’s G-20 meetings turned down the temperature on the US-China trade dispute, recent tariff increases remain in place. And simmering US trade tensions with the EU and Japan have curbed enthusiasm about broader de-escalation.

Adding to the uncertain global backdrop, policymakers are growing frustrated with their inability to hit inflation targets. The ECB stands out most in this regard with core inflation stuck around 1% and inflation expectations worryingly low. The central bank has shifted back to an easing bias, and we now see its deposit rate being lowered over the second half of the year. US inflation is closer to the Fed’s objective but has been below 2% for much of the last decade. With inflation pressures remaining “muted,” the Fed has the flexibility to introduce a bit of accommodation. We now expect fed funds will be lowered in July and September to offset the negative impact of trade tensions and slowing global growth. The BoC and BoE have had more success on inflation over the last year, contributing to a more neutral policy stance for now. But we expect trade issues at home and abroad will have both central banks lowering rates modestly in the next six months.

Central bank actions and intentions have boosted both equity and bond markets—a sign that investors think monetary policy support will be sufficient to offset trade headwinds. They seem to share Fed Chair Powell’s view that an ounce of prevention is worth a pound of cure.
Canada’s energy slowdown continues to ease

Despite rising global headwinds, recent Canadian data have been broadly positive and there is growing evidence of the economy emerging from its Q4/18-Q1/19 slowdown. April GDP was up 0.3%, handily beating expectations for a second consecutive month. Unlike in March, growth was concentrated in the energy sector, which was a major drag on activity over the winter. Some of the increase is likely to be temporary—oil companies ramped up production rather than undertaking usual maintenance, so we should see some give-back in the coming months—but rising drilling activity and further easing in production restrictions suggest the energy sector’s recovery is becoming entrenched.

Canada’s non-energy economy continues to chug along. Housing hasn’t exactly turned from headwind to tailwind like the energy sector, but recent stabilization is encouraging. Consumer spending is also emerging from a winter slump with retail sales up an annualized 3% in the last three months. Other services sectors like wholesale trade, hospitality, and tech continue to expand at a solid rate. Manufacturing has shown some signs of weakness, though not to the extent seen in other economies. While exports jumped higher in May, the increase isn’t likely to be sustained—manufacturing sentiment has fallen sharply amid rising trade tensions and slowing global industrial production. Overall, however, Q2 GDP growth is tracking a 2.2% annualized pace with healthy contributions from both energy and non-energy industries.

Business Outlook Survey better than expected (feared) in Q2

Business confidence fell sharply in Q1; rising trade tensions and a decline in manufacturing sentiment had us concerned about a further slip in Q2. But the BoC’s latest Business Outlook Survey was stronger than expected with overall sentiment moving back above its longer-term average (though only slightly). The future sales indicator posted a solid increase, with foreign sales likely to see modest growth even as firms expect global trade headwinds and uncertainty will restrain exports. In fact, concerns about global trade tensions were less prevalent than expected—among factors restraining sales, capacity pressures and domestic regulation ranked higher than trade policy. With domestic demand remaining supportive, hiring and investment intentions remained slightly above longer-term levels. Overall, the Q2 BOS was about as good as the BoC could have hoped for given global developments during the May survey period.

BoC sounding more concerned about global risks

With a run of positive economic data and a less worrying Business Outlook Survey in hand, we thought the Bank of Canada would come out with a neutral tone again in July. They did maintain a neutral bias—saying current accommodation remains appropriate—but sounded more concerned about global developments than in May. Whereas the last policy statement put an improving domestic economy front and centre, July’s led with rising trade tensions and a deteriorating global outlook. The BoC lowered its global growth forecast this year and next, and said escalating trade conflicts are the biggest downside risk to the outlook globally and in Canada. And while marking up its Q2 growth forecast, Governing Council pointed out that some of the increase will be from temporary factors, and growth is expected to moderate somewhat in Q3. GDP growth was revised lower for 2020, largely due to less contribution from business investment and exports, but is still expected to average around 2%.

Overall, the BoC thinks trade conflicts and uncertainty will reduce the level of GDP by up to 2% by the end of 2021. Given that sizeable headwind, it’s no surprise policymakers were sounding more cautious in July. For now, though, the BoC looks set to diverge from the Fed, holding rates steady while the US central bank cuts. Firmer core inflation in Canada (close to 2% for the last year) and an already more-accommodative stance give the BoC some leeway in that regard. But its latest comments suggest further deterioration in the global outlook, or an increase in trade tensions, would see the BoC joining its global peers in lowering rates. We have penciled in a 25 basis point rate cut in early-2020 that should help take some pressure off the Canadian dollar, which has increased 2.5 cents in the last six weeks thanks to the Fed’s dovish shift.
Special reports...

**A stable market isn’t a bad thing**

- **Home resale market stays in a holding pattern in June**: Overall resale activity in Canada was essentially flat compared to May (down marginally by 0.2%) and June 2018 (up just 0.3%). This provided further evidence that the market has passed its cyclical bottom.

- **National benchmark price taking a vacation**: It’s been tracking very close to year-ago levels for the past six months. In June it was down 0.3% y/y, slightly less than the 0.6% y/y decline recorded in May.

- **Two (or three) steps forward, one step back in Western Canada**: Vancouver, Victoria, Calgary and Edmonton rolled back part of previous months’ sales increases. June levels were generally weak but well above recent cyclical lows, however. Downward price pressure intensified in Vancouver but let up slightly in Calgary and Edmonton.

- **Most markets in Central Canada still doing well**: Montreal saw further gains in resales and prices, and Toronto’s slow recovery remained on track. Activity fell in Ottawa though the level was still strong and prices continued to accelerate.

- **A pleasing sight for policy-makers**: The last two months have painted the picture Canadian policy-makers want to see—generally soft but stable conditions in previously overheated markets, with prices continuing to correct in Vancouver where affordability remains a big issue.

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