Canadian current trends update

▲ Canadian GDP edged down 0.1% in February following a solid 0.3% gain in January.

▲ Headline employment was up 107k in April – the largest increase in more than 40 years.

▲ Retail sales rose 1.1% in March, boosted by a price-led 6% increase in sales at gasoline stations.

▲ Housing starts jumped to 235,000 annualized units in April, continuing to pick up from a multi-year low of 167,000 in February.

▲ Canada’s trade deficit edged lower for a third straight month in March but was still elevated at $3.2 billion.

▲ Headline inflation ticked up to 2.0% year-over-year in April from 1.9% in March.

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Financial markets...

Searching for signs of spring

Global equity markets performed well in April—and hit record highs in Canada and the US—before stocks were sent lower this week on fresh tariff threats (and ultimately actions) from the Trump administration that seemed to dash hopes of a US-China deal. While trade tensions clearly remain a risk, some green shoots in the latest economic data helped reduce fears of a further global slowdown. US GDP growth surprised to the upside in Q1, and while details of the report were less than stellar, we’ve seen indications of a pickup in domestic demand heading into Q2. Euro area GDP also came in a bit stronger than expected, and the UK economy grew at a solid pace even as Brexit uncertainty intensified in the first quarter. Canadian data have yet to fully thaw after a winter slowdown, but much of the loss of momentum still reflects transitory factors. We expect growth will start to pick up in Q2.

While economic activity seems to be warming up, central banks aren’t ready to shed their extra layers. The Fed remained firmly in neutral in May, balancing an easing in some key risks with a surprising slowdown in inflation. The Bank of Canada dropped their tightening bias given the economy’s longer-than-expected “detour” away from full capacity. And despite rumours of potential hawkish dissent, the Bank of England remained unanimous in voting to leave current stimulus in place. The ECB is keeping their foot on the accelerator, while the Reserve Bank of New Zealand opted for more stimulus, lowering their policy rate for the first time since 2016. Low inflation and accommodative central banks are keeping longer-term government bond yields close to recent lows—and back in negative territory in Germany. The Canadian and US yield curves remain very flat, though the recession talk that accompanied March’s brief curve inversion has quieted down.
Still no “all clear” from Canadian GDP figures

Canadian GDP fell 0.1% in February, the fourth decline in the last six months. That’s the worst stretch we’ve seen since the first half of 2016. As was the case back then, much of the recent slowdown reflects issues in the energy sector, which we expect will exert less downward pressure as 2019 progresses. February was a slightly different story as the oil and gas sector provided less of a headwind but weather appeared to weigh on economic activity. Rail transportation issues and a slowdown in home sales combined to shave 0.1 ppt off monthly growth, and we think other industries might have been less obviously impacted by wintry weather, which led to a drop in hours worked in February. The combination of a slowdown in the energy sector and some transitory weather-related disruptions is expected to limit Q1 GDP growth to just 0.7% annualized—only a minor improvement on the previous quarter’s 0.4% increase.

The question is how much of a pickup in growth we can expect as those factors fade. Developments in the household sector will be key. The recent easing in financial conditions might be behind some interest-rate sensitive purchases—auto sales, for example, have picked up early this year after slowing through much of 2018. But it remains the case that Canadians’ debt servicing costs have climbed over the last year. On average, households have to dedicate nearly one percentage point more of their disposable incomes to debt payments than they did before the Bank of Canada began raising interest rates. That is likely to keep overall consumer spending growing at a relatively modest pace. On the housing side, we’re seeing east-west divergence with the Vancouver and Prairie markets remaining under downward pressure, while activity has stabilized in Toronto and remains solid in markets like Ottawa and Montreal. And after some weather disruptions, homebuilding activity remains strong. On balance, we think the drag on GDP from consumers and housing seen over the second half of last year won’t be repeated, but the household sector is unlikely to punch above its weight going forward.

Job growth powers ahead despite GDP weakness

In sharp contrast to the slowdown in GDP figures, Canadian job growth continues at an impressive pace. The economy added 426,000 positions over the last 12 months, the best run rate in more than a decade. The surge in hiring is being helped by strong population growth and rising labour force participation, though the unemployment rate has still managed to push cycle (and multi-decade) lows. Wage growth remains the fly in the ointment, growing at a slower pace than low unemployment would suggest. The diverging trends in GDP and employment hint at one factor that might be holding back wage growth—weak productivity. Business sector productivity, a key driver of long-run wage growth, was flat in 2018.

BoC lowers 2019 growth forecast, drops tightening bias

The Bank of Canada officially shifted into neutral in April, noting the current degree of monetary policy accommodation is warranted. The change in guidance coincides with a softer global growth outlook and sharp downward revision to the bank’s 2019 Canadian growth forecast (now 1.2% vs. 1.7% in January and 2.1% last October). The latest markdown reflects a more significant slowing in housing and business investment than previously assumed, as well as less fiscal support in Ontario. The BoC does, however, expect growth will pick up later this year, returning to a pace around 2% in 2020-21. While dropping an explicit tightening bias, Governor Poloz did indicate that the bank might eventually get back to raising rates if its forecasts are validated. But even in that case, it looks like further rate hikes would be limited—the bank lowered its assumption for the neutral policy rate to 2.25-3.25% in April, only modestly above the current 1.75% overnight rate. With underlying inflation remaining steady around 2% and monetary policy fairly close to neutral, we think the bar is high for another rate increase. But at the same time we don’t think the outlook calls for easing, despite market pricing continuing to lean in that direction.

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April’s good news: the bottom has been reached for Canada’s housing market

- **Home resales increased in Canada for the second-straight month in April**: The 3.6% month-over-month advance isn’t an ‘all-clear’ signal for the market but strongly suggests that the cyclical bottom has been reached. Activity climbed above year-ago levels for the first time since December 2017.

- **Prices stabilizing**: The Canada-wide benchmark price was essentially flat year-over-year, down marginally by 0.3%. This was a smaller decline than in March (-0.5%).

- **Local market picture remains highly fragmented but April brought more encouraging news**: Activity picked up in Alberta and Saskatchewan and there were strong indications that the Toronto-area market finally turned a corner.

- **However, the Vancouver-area market isn’t out of the woods yet**: Resales fell for a sixth consecutive month and prices are still sliding (the benchmark is down 8.7% since the June 2018 peak). A recovery seems far off at this stage.

- **April won’t set off a broad-based rally**: The back-to-back resale increases in March and April were mostly about the unwinding of the poor weather effect this winter. Not much more should be expected in the coming months as buyers continue to deal with affordability issues in key markets and policy actions.

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