Canadian current trends update

▲ GDP activity in October bounced back 0.3%, more than reversing the disappointing 0.1% decline reported in September.

▲ Employment was up 94k in November, the third consecutive monthly increase.

▲ Retail sales increased 0.3% in nominal terms in October, but overall sale volumes were flat in the month.

▲ Canadian housing starts rose to 216k in November

▲ Canada’s trade deficit widened to $1.2 billion in October

▲ Consumer price growth slowed in November with a drop in the headline year-over-year CPI rate to 1.7%

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Financial markets...

wHOa wHOa wHOa!

Equities have been on a roller coaster ride for the last two months, while global growth concerns, market jitters and less hawkish central bankers have pushed bond yields sharply lower since early-November. Those same growth concerns, along with rising supply, have weighed heavily on oil prices. Two key international meetings over the last week held the prospect of some reprieve. First, a Trump-Xi dinner at the G20 summit raised hopes that the US and China might negotiate a truce in their escalating trade war, which has become a key risk to the global outlook. A US pledge to delay a scheduled tariff increase in exchange for concessions from China initially cheered investors, though sentiment soured with the realization that the two countries were far apart on what was actually agreed upon. US tariff hikes appear to have been postponed for 90 days while the two superpowers work toward an agreement. Another round of tariff threats from Trump provided an inauspicious start to the process and prompted a renewed selloff in equity markets.

After the G20 meeting, it was OPEC’s December 6-7 gathering that drew attention. Producers (including Russia) agreed to cut output by 1.2 million barrels per day in an effort to better balance the global oil market. The cut was seen as substantial enough to send oil prices to a two-week high. The move will be welcomed in Canada, where the Alberta government has grown increasingly frustrated by falling oil prices—particularly for domestic crude. They were in no mood to wait for OPEC, announcing their own mandatory supply cut of 325 thousand barrels per day that will kick in next year. The decision pushed Canadian heavy oil prices to two-month highs, even before OPEC’s decision pushed global benchmarks higher.
Canadian domestic spending fell flat in Q3...

Canada’s economy grew at a 2% annualized pace in Q3, matching market expectations and coming in slightly ahead of the Bank of Canada’s forecast. But that was where the good news ended. Domestic spending was flat quarter-over-quarter for the first time in more than two years as consumer spending growth slowed further and the residential sector remained a drag on activity. More troubling was a pullback in business investment following more than a year of consistent gains. Less contribution from households is to be expected given rising rates and regulatory changes. But the pullback in business investment flies in the face of the BoC’s Business Outlook Survey pointing to stronger capital spending. There have been some positive developments for the investment outlook since Q3—less trade uncertainty (at least within North America) and government incentives to encourage capital spending. But at the same time, lower oil prices challenge the energy sector capex outlook. On balance, the much-hoped-for rotation toward stronger business investment and exports looks a bit less certain than it did a few months ago.

...and growth isn’t likely to pick up in the near-term...

After a number of good news stories for Canada—including an updated trade deal with the US and Mexico and a major LNG export facility getting the green light—the tide seems to have turned lately. Most significantly, lower oil prices have dealt a blow to Alberta’s economic outlook. After climbing above US$75/barrel in early-October, the WTI benchmark price has fallen sharply, hitting $50 toward the end of November. The impact on Canada’s oil sector has been exacerbated by steep discounts on Canadian heavy oil. Elevated inventories and lack of export capacity saw WCS oil trading for less than $20 through much of November. And unlike during past periods of steep discounts on heavy oil, Canadian light and synthetic oil prices have also been impacted. The Alberta government, facing sharply lower royalty revenues, responded with the dramatic step of mandating production cuts. Producers will have to lower output by 325 thousand barrels per day starting in January. Those curtailments will be pared back when inventories reach more normal levels, and should end altogether late next year.

While WCS prices rallied on the news, production cuts will likely reduce Canadian GDP growth by 0.1-0.2% next year. Much of that drag will show up in the first quarter, setting up for a slow start to 2019. And it looks like that will follow a soft end to this year. We have trimmed our current quarter growth forecast on the back of less momentum (September GDP fell 0.1%) and the negative impact of postal strikes and lower oil prices (including production curtailments that were announced prior to the Alberta government’s mandated cuts). As a result, we look for average growth of just over 1% in Q4/18 and Q1/19—about half the pace seen through the first three quarters of 2018.

...making a January rate hike unlikely

The Bank of Canada held rates steady in December with a predictably dovish tone that contrasted sharply with October’s hawkish hike. Lower oil prices were front and centre with the statement noting energy sector activity will likely be “materially weaker” than expected. The bank also noted signs of less growth momentum heading into Q4, hinting at a markdown to their current GDP forecast of 2.3%. And given downward revisions to historical growth, they raised the possibility that the economy might have a bit more room for non-inflationary growth than previously thought. The statement did contain some balancing comments. Policymakers attributed Q3’s weak business investment to trade uncertainty and remained optimistic on the non-energy capex outlook given US-MCA, accelerated depreciation and capacity constraints. And once again there was mention of two-sided risks around trade policy, even if there are signs that trade tensions are “weighing more heavily” on the global economy. But those mitigating factors weren’t enough to keep the Canadian dollar from selling off sharply after the statement.

The BoC maintained their tightening bias, still indicating rates will eventually need to rise to a neutral range (2.5-3.5% by their estimate). But their list of factors that will determine the pace of rate hikes has grown longer to include oil price developments, business investment and the economy’s capacity limits. Even if we get some progress on those issues between now and January (for instance, higher oil prices and a strong Q4 Business Outlook Survey), it looks like the bank will be marking down their growth and inflation forecasts at their next meeting. Given their data dependent mantra, it’s hard to see Governing Council raising rates at the same time. We think they’ll hit the pause button until Q2 when they have a better idea of how the economy is adapting to another oil price downturn. They’ll likely be hoping for more clarity on the global trade backdrop by then as well. While it looks like rate hikes will come a bit later than expected, our forecast continues to call for two rate increases next year, which would bring the overnight rate to 2.25% by year end.
Special reports...

Slow November for Canada’s housing market

- **Sales stutter across the country**: Nearly two-thirds of local markets recorded a month-to-month decline in home resales in November. This translated into a third-consecutive drop of 2.3% overall in Canada.

- **The stress test and higher interest rates still a big deal**: Both buyers and sellers remained somewhat downbeat in the face of the earlier tightening of mortgage qualification rules and elevated homeownership costs in key markets.

- **Home prices soften in western Canada**: Benchmark prices continue to trend lower in many western markets, including Vancouver, Calgary, Edmonton and Regina. Prices are rising modestly at best in the central and eastern regions of the country. The aggregate benchmark for Canada was up 2.0% year-over-year in November, marking a slight deceleration from 2.3% in the previous two months.

- **Demand and supply generally remain in balance**: But market conditions now favour buyers in Vancouver. A dearth of properties for sale put sellers in command in Montreal and Ottawa.

- **Market dreariness is here to stay for a while**: We see little that could revive the market’s spark in the near term. We expect further interest rate hikes from the Bank of Canada in 2019, which will keep demand cool. Our outlook calls for only marginal gains in both resales and prices overall in Canada over the coming year.

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