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Canadian current trends update

- ▲ GDP was flat in July following four months of gains
- ▲ The unemployment rate fell 0.2 ppts to 5.5%
- ▲ The headline sales increase of 0.4% in July was the first in three months
- ▲ Housing starts above consensus at 221,000 annualized units in September
- ▲ Trade deficit narrowed to 1B, in line with consensus
- ▲ CPI inflation held steady at 1.9% from a year ago

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Financial markets...

Sentiment slump

Just a few days in, October is already living up to its reputation as a bad month for equities. The S&P 500 fell by 3% in the first two days of the month, easily wiping out September's modest gain. The trigger was a string of disappointing manufacturing sentiment reports (most notably from the US and Germany) that reignited fears about the health of the global economy. Markets were already on edge after a month of rising geopolitical tensions. An attack in Saudi Arabia temporarily disrupted a sizeable chunk of global oil production, the US House of Representatives opened an impeachment inquiry against President Trump, embattled UK PM Boris Johnson continued to vow to leave the EU on October 31 (come what may), and months-long protests in Hong Kong escalated further.

Perhaps it's more surprising that a selloff didn't come sooner. We can thank central banks, which have acted as a security blanket for equity markets this year. Both the Fed and ECB lowered rates in September (with the latter announcing plans to restart QE) and a number of other advanced and emerging market central banks followed suit. In fact, it was the prospect of additional easing—spurred on by yet more negative economic data—that seemed to halt the latest decline in equities. Growing (but still not overwhelming) evidence that manufacturing malaise is spilling over into other sectors has markets betting on further rate cuts, and calls for fiscal stimulus aren't likely to die down. The best antidote, though, would be reversal of the protectionist trade policies that have weighed on industrial output, business sentiment, and the global flow of goods. US and Chinese negotiators will sit down to trade talks in the second week of October, before the next round of scheduled tariff hikes on tap for the 15th.



Canada's growth streak ends, but services output powers on

Canadian GDP was flat in July, ending a run of upside surprises that amounted to the best monthly growth streak in two years. Maintenance shutdowns in the oil and gas sector and a pullback in drilling activity weighed on growth in July. A further increase in Alberta's production caps gives the energy sector room to grow over the second half of the year, and July's transitory shutdowns should be reversed, but investment remains sluggish due to longer-term egress issues. The boost to global oil prices from supply disruptions in Saudi Arabia didn't last, leaving WTI in the lower half of the \$50-60 per barrel range that prevailed over the summer. Meanwhile, Canada's manufacturing sector continued to lose steam. That's not surprising given the global slowdown in industrial production growth. Further deterioration in manufacturing sentiment in countries like the US and Germany raises concerns about Canada's industrial outlook going forward, even as the domestic PMI improved in September.

Fortunately, Canada's services sector has continued to power ahead, recording above-trend gains in four of the last five months. Growth was broadly-based over that period, with particular strength in the wholesale and transport sectors (a bit surprising given a slowdown on the goods side) as well as finance and real estate (in line with an ongoing recovery in housing). Globally, the key question is whether weakness in the industrial sector is spilling over into the rest of the economy. There is some early evidence of that dynamic in Germany, where manufacturing is a larger share of the economy, but the Canadian services sector's recent performance suggests we're not there yet. Weakness in goods production will make it difficult to maintain above-2% growth—in line with the BoC's view that growth will be a bit slower over the second half of the year—but there is little to suggest the economy is gearing down more significantly.

Federal election to determine fiscal path ahead

The Department of Finance closed the books on fiscal year 2018/19 (which ended March 31) posting a \$14.0 billion deficit. That was slightly lower than projected as income tax receipts got a boost from strong employment growth. Last year's deficit was the smallest in three years but remains a far cry from the average budget shortfall of less than \$4 billion in the prior three years (including a nearly balanced budget in FY 2014/15). The government's projections show the deficit widening to nearly \$20 billion in both the current and upcoming fiscal years. That increase reflects higher debt servicing costs and the addition of a \$3 billion risk adjustment, so it isn't necessarily stimulative. Of course that fiscal path will change after the October 21 federal election, with parties offering voters a number of goodies that could provide a near-term fiscal boost. It's worth noting that none of the major parties is promising a swift return to balanced budgets—it looks like the federal government will continue to run deficits for the next few years, regardless of who is in power.

Global developments key to tone of upcoming BoC meeting

We were caught a bit off-guard by the Bank of Canada's neutral tone in early-September (so were investors, with the Canadian dollar gaining a cent in the days following the decision). But we still expect a more dovish tone from the central bank at its upcoming meeting on October 30. The BoC is paying "particular attention" to global developments, and relative to July when its forecasts were last refreshed we've seen more protectionism from the US, more uncertainty regarding Brexit, and (relatedly) gloomier manufacturing sentiment globally. So regardless of optimism around US-China trade talks or avoiding a no-deal Brexit, the BoC will be taking a more challenging global backdrop into account when it updates its forecasts. As always, how domestic companies are faring against that backdrop will be a key consideration. We'll get a better view on that in the October 22 Business Outlook Survey. Greater pessimism from Canadian firms would translate into a more cautious or dovish tone from the BoC. It's worth noting that the bank won't immediately incorporate any new fiscal measures following the October election (it tends to wait until the budget is passed) but any prospect of fiscal easing in the year ahead could be cause for patience.

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Special reports...

Market gains more altitude in September

- **Home resales climbed further above average in Canada:** Activity rose another 0.6% in September to 512,000 units (seasonally-adjusted and annualized). This was the highest level in 21 months and 6.6% above the 10-year average.
- **Sellers are increasingly in the driver's seat:** The sales-to-listings ratio (a gauge of demand-supply conditions) inched higher to 0.61 nationwide—a level usually associated with more pricing power for sellers—with Toronto and Vancouver firming up noticeably in recent months.
- **Home prices are heating up... modestly:** The national Home Price Index (HPI) further picked up its pace in September, rising 1.3% from a year ago (versus 0.9% in August). Price momentum has been increasing since June.
- **Vancouver's turnaround continues; upswing in Toronto, Ottawa and Montreal pause:** Vancouver recorded a strong resales gain for a third-straight month and showed further signs that prices have passed their cyclical bottom. Demand-supply conditions remained very tight in Ottawa and Montreal despite slight activity declines in September. Resales were little changed in the Toronto area but prices further accelerated their ascent. Things were a little soft in Calgary and Edmonton though not enough to alter the uptrend in place since March.
- **The market has turned the corner:** With Vancouver more clearly in recovery mode, the overall state of, and prospects for Canada's housing market appears to be quite solid. Low mortgage rates, solid labour markets and strong population growth will keep activity and prices on an upward trajectory.

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