

## Canada Turns the Corner

**Douglas Porter, CFA**, Chief Economist • douglas.porter@bmo.com • 416-359-4887

**Benjamin Reitzes**, Senior Economist • benjamin.reitzes@bmo.com • 416-359-5628

After two tough years, the Canadian economy is turning the corner and looks poised to surprise the consensus and possibly the Bank of Canada to the high side in 2017. No doubt, there are plenty of global risks—and some closer to home—that could thwart the improving picture, but we believe the positives outweigh the potential negatives at this point. While a welcome relief after a steady stream of downside surprises in recent years, we doubt it will be enough to completely shift the BoC’s viewpoint at least until 2018.

What are the signs that Canada’s economy is breaking out of its lengthy funk?

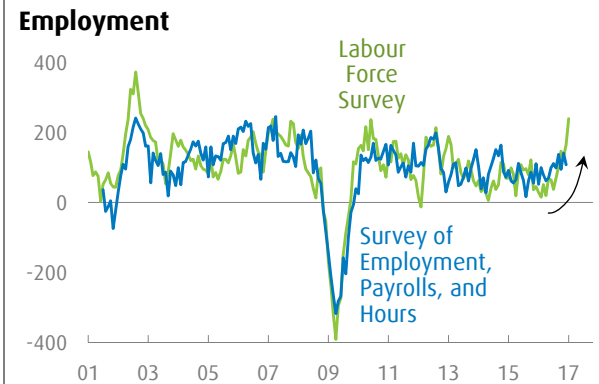
- **Employment** has just posted its strongest six-month run in 15 years, adding 239,000 net new jobs (*Chart 1*). While the gains have been heavily concentrated in part-time positions, and wages are slowing, full-time employment has been solid as well (1.9% a.r.) and the jobless rate is fading again.
- **Merchandise trade** has swung back into surplus after a two-year trip into the red. Real net exports will add heavily to Q4 GDP and are expected to match last year’s 0.7 ppt contribution again in 2017 (*Chart 2*).
- **Home and auto sales** hit all-time highs in 2016 and started this year on a solid footing as well.
- **Homebuilding** remains robust, with housing starts averaging more than 200,000 units over the past year and maintaining that strength in early 2017 (*Chart 3*).
- **Consumer spending and confidence** are solid. While this week’s December retail sales report looked soft on the surface, we would highlight ongoing seasonal adjustment issues on this front. The reality is that yearly retail volumes growth remains healthy.
- **Real GDP** has risen at more than a 3% annual rate since the middle of last year, and we suspect that a decent December gain of 0.2%-to-0.3% will maintain that pace (*Chart 4*).

What has triggered the turn in growth?

- **Oil and other commodity prices partially recovered**, helping finally stabilize business capital spending. Investment plunged almost 20% in real terms since oil prices cracked in mid-2014, alone chopping an average of more than 1.2 percentage points off GDP growth in each of the past two years. Alberta’s battered job market is showing signs of stabilizing, as is its housing market.

**Chart 1**  
**Employment Deployment**

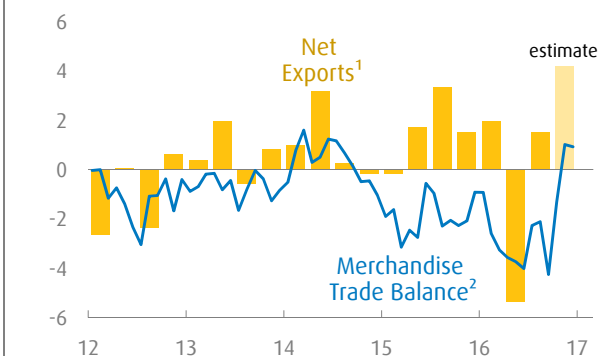
Canada (000s : s.a. : 6-mnth chng)



Sources: BMO Economics, Haver Analytics

**Chart 2**  
**Trade Turnaround... Tentatively**

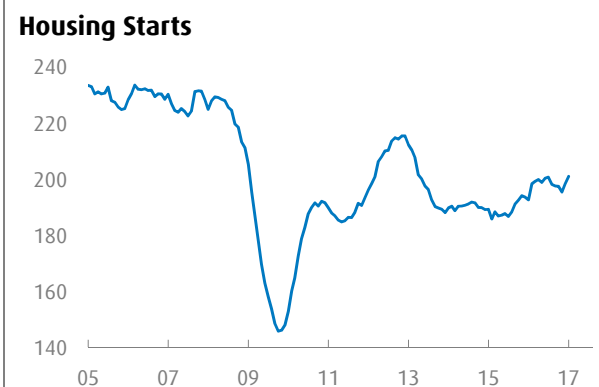
Canada



<sup>1</sup> (ppt contrib. to Real GDP ann. % chng) <sup>2</sup> (C\$ blns : BOP basis : s.a.)  
Sources: BMO Economics, Haver Analytics

**Chart 3**  
**Home Building: Strong Foundation**

Canada (000s : s.a.a.r. : 12-mnth m.a.)



Sources: BMO Economics, Haver Analytics

- **Fiscal policy** may finally be kicking in, providing a mild boost to growth. The official figures on infrastructure spending revealed next to no impact by 2016 Q3, but a more recent pick-up in construction jobs and GDP suggest activity is stirring.
- **Global growth** appears to have firmed recently, with the U.S. posting slightly better growth, China stabilizing and global PMIs improving.
- **Record equity markets and home prices** are likely providing a lift to confidence as well as a modest wealth effect for spending (*Chart 5*).

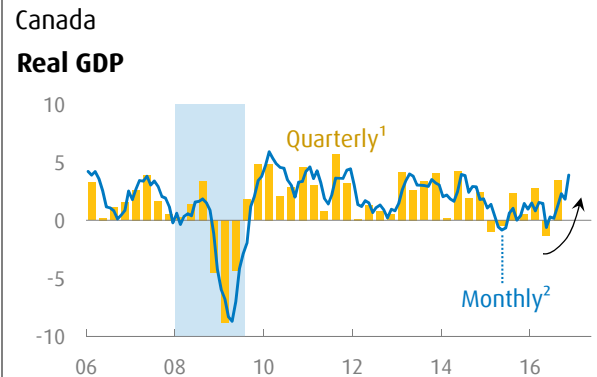
What could go wrong?

- **U.S. protectionist measures** are probably the most serious risk at this stage, although the tone has been much-improved in recent weeks. For Canada, a “tweak” to NAFTA is no great threat, and the market is apparently assigning low odds to a potential Border Adjustment Tax. Still, there are few certainties on the U.S. policy front at the moment.
- **A reversal in oil prices** could hammer sentiment in Alberta, just as there seemed to be some light in the tunnel for that hard-hit province.
- **Potential tax hikes** in this year’s Federal Budget could hit the rebound in consumer confidence.
- **The usual litany of global risks**—Brexit, China’s debt overhang, Greece—could be exacerbated by coming elections across Europe this year. The main risk appears to be in France, where Marine Le Pen is aiming for Frexit.

What are the market implications?

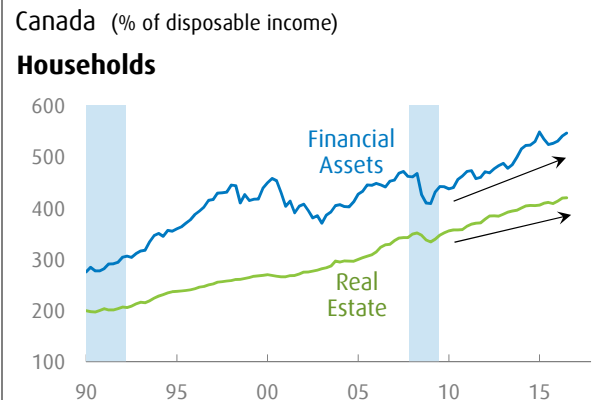
- **The Bank of Canada** has been firmly pinned to the sidelines since a pair of surprise rate cuts in 2015. While we don’t think the Bank will turn less dovish in the near term, their tone could start sounding more upbeat in the second half of the year.
- **Interest rates** would push higher across the curve, if Governor Poloz adopted a less dovish tone. Markets would swiftly price a more aggressive Bank of Canada policy rate profile. In the event, the 2-year through 10-year sectors would see the biggest back up. Mortgage rates would, in turn, push higher as well, dampening activity in the housing sector.
- **The Canadian dollar**, which has been unexpectedly resilient this year (*Chart 6*), would be given a lift by rising Canadian interest rates in the absence of a similar move in U.S. Treasuries. However, the impact probably wouldn’t be outsized, as commodity prices aren’t likely to shoot higher in sync.

**Chart 4**  
**Growth Finally Breaks Out**



<sup>1</sup> (ann. % chng) <sup>2</sup> (6-mnth ann. % chng)  
Shading marks period of Canadian recession  
Sources: BMO Economics, Haver Analytics

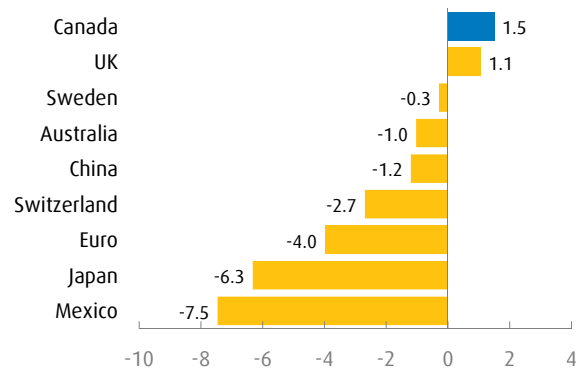
**Chart 5**  
**Wealth Effect: Mo’ Money, Mo’ Spending**



Shading marks periods of Canadian recession  
Sources: BMO Economics, Haver Analytics

**Chart 6**  
**No Trump Slump for C\$**

Since Nov. 8, 2016 (% chng vs US\$ : as of Feb. 24, 2017, 10:30 am)



Sources: BMO Economics, Bloomberg

---

**General Disclosure**

"BMO Capital Markets" is a trade name used by the BMO Financial Group for the wholesale banking businesses of Bank of Montreal and its subsidiaries BMO Nesbitt Burns Inc., BMO Capital Markets Limited in the U.K. and BMO Capital Markets Corp. in the U.S. BMO Nesbitt Burns Inc., BMO Capital Markets Limited and BMO Capital Markets Corp are affiliates. Bank of Montreal or its subsidiaries ("BMO Financial Group") has lending arrangements with, or provide other remunerated services to, many issuers covered by BMO Capital Markets. The opinions, estimates and projections contained in this report are those of BMO Capital Markets as of the date of this report and are subject to change without notice. BMO Capital Markets endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO Capital Markets makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO Capital Markets or its affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This material is for information purposes only and is not an offer to sell or the solicitation of an offer to buy any security. BMO Capital Markets or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO Capital Markets or its affiliates, officers, directors or employees have a long or short position in many of the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should assume that BMO Capital Markets or its affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein.

**Dissemination of Research**

Our publications are disseminated via email and may also be available via our web site <http://economics.bmocapitalmarkets.com>. Please contact your BMO Financial Group Representative for more information.

**Conflict Statement**

A general description of how BMO Financial Group identifies and manages conflicts of interest is contained in our public facing policy for managing conflicts of interest in connection with investment research which is available at [http://researchglobal.bmocapitalmarkets.com/Public/Conflict\\_Statement\\_Public.aspx](http://researchglobal.bmocapitalmarkets.com/Public/Conflict_Statement_Public.aspx).

**ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST**

BMO Financial Group (NYSE, TSX: BMO) is an integrated financial services provider offering a range of retail banking, wealth management, and investment and corporate banking products. BMO serves Canadian retail clients through BMO Bank of Montreal and BMO Nesbitt Burns. In the United States, personal and commercial banking clients are served by BMO Harris Bank N.A., Member FDIC. Investment and corporate banking services are provided in Canada and the US through BMO Capital Markets. BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A, BMO Ireland Plc, and Bank of Montreal (China) Co. Ltd. and the institutional broker dealer businesses of BMO Capital Markets Corp. (Member SIPC), BMO Nesbitt Burns Securities Limited (Member SIPC) and BMO Capital Markets GKST Inc. (Member SIPC) in the U.S., BMO Nesbitt Burns Inc. (Member Canadian Investor Protection Fund) in Canada, Europe and Asia, BMO Capital Markets Limited in Europe, Asia and Australia and BMO Advisors Private Limited in India.

"Nesbitt Burns" is a registered trademark of BMO Nesbitt Burns Inc., used under license. "BMO Capital Markets" is a trademark of Bank of Montreal, used under license. "BMO (M-Bar roundel symbol)" is a registered trademark of Bank of Montreal, used under license.

© Registered trademark of Bank of Montreal in the United States, Canada and elsewhere.

™ Trademark Bank of Montreal in the United States and Canada.

© COPYRIGHT 2017 BMO CAPITAL MARKETS CORP.

A member of BMO Financial Group