Talking Points

The latest view on the economy

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When Economies and Markets Collide

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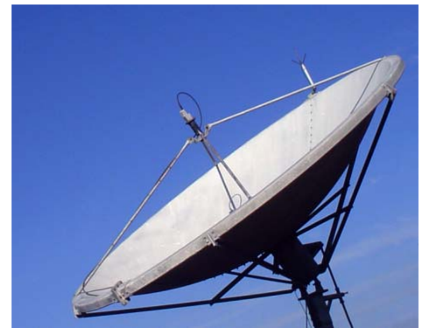


Quick quiz: What is the worst-performing major equity market so far in 2017 outside of Russia? (Quick quiz, part b: Is Russia a major equity market?) **Answer:** Canada. The S&P TSX index had clawed out a trivial gain of just 0.6% this year in Friday's early action, at a time when many other markets have posted solid gains, including roughly 8% for the S&P 500, European averages and even the Mexican Bolsa. Why, even China, Brazil and the U.K. markets have managed gains of 5% or more this year, despite dealing with a raft of specific issues. Loaded on top, the small sag in the Canadian dollar in 2017—even with a modest post-BoC rally this week—has left it as one of the weakest currencies in the world. Combining these two factors renders the US$ returns of Canadian stocks trailing far behind the peloton (*see Chart 1*).

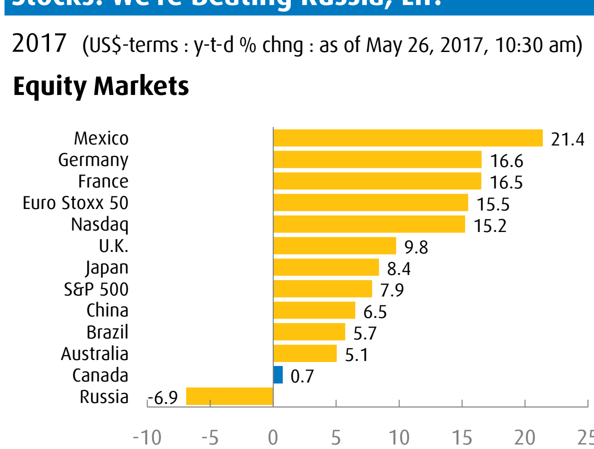
Next quiz: Which economy is now expected to post the fastest growth in the G7 this year, and has generally been a pleasant surprise so far in 2017? **Answer:** Canada. Next week's Q1 GDP report is expected to reveal growth of at least 3.5% annualized (our call), or as much as 4.5% (the monthly GDP reports are headed for such a gain), compared with 2% in the EU, 1.2% in the U.S. and 0.7% in Britain. And, it's not like this powerful growth is payback for weakness in earlier quarters, as it follows average gains of more than 3% in Q3 and Q4 of last year. With this sustained performance, Canada is now on track to post GDP growth of around 2.5% in 2017, topping our freshly revised-up U.S. call of 2.2%. It's pretty safe to say that no major forecaster was looking for Canada to outpace the U.S. at the start of this year.

Final Quiz: What gives? **Answer:** It's complicated. The pullback in oil prices, on net, since the start of 2017 helps explain some of the softness in both the loonie and the TSX. After starting the year at almost $54, WTI has meandered about, mostly with some downside drift, pulling back below $49 this week on the official OPEC deal to extend production cuts into 2018. In turn, this has chopped the heavyweight energy index by 9%, leaving it as the weakest sector in the TSX this year. As well, the TSX's paltry tech weighting has proven to be a drag on relative performance in a year when the sector has been on fire globally (and, no, we won't stoop to saying that they are partying like it's 1999). Meantime, the massive weighting of financials has been a hindrance, as the sector has lagged this year with a small drop, and the wave of Q2 bank earnings this week did little to turn the tide.

Looking at the bigger picture, of course some of the economic improvement this year was flagged by a rip-roaring performance by the TSX last year, when it was close to being a world beater. Reversion to the mean, and all that, has been at work. As well, Canada has been weighed upon by a couple of issues from left-field—the well-advertised problems at the largest alternative mortgage lender, as well as the surprising villainization of Canadian trade policy by President Trump. Yet, note the relative performance of Mexican equities and the peso this year, with the currency-

Chart 1

Stocks: We're Beating Russia, Eh?



Sources: BMO Economics, Bloomberg

adjusted return in the Bolsa a world leader even with the ongoing threats to NAFTA.

On the flip side, U.S. markets shrugged off last week's political drama in amazingly short order, taking the S&P 500 and Nasdaq to new all-time highs on Thursday. Yet, the U.S. economy has been singularly unimpressive in 2017. While Q1 GDP was revised up more than expected, the 1.2% pace is still woeful, and the FOMC Minutes revealed at least some members need reassurance that growth is set to improve in Q2 before hiking further. Next Friday's jobs report could provide a trace of comfort, although our call of an 180,000 gain and an uptick in the jobless rate to 4.5% is unlikely to change votes. Equities have seemingly managed to power ahead *despite* the economy, as earnings have been solid and hope springs eternal on the prospect for tax reform (even if the timeline keeps getting pushed further and further out).

To put it in a neat package, the S&P 500 is now almost 13% higher than it was on election day. Yet, the consensus forecast on U.S. GDP growth for 2017 has gone from 2.2% on that day to, wait for it, 2.2% currently. All the drama, all the market rally, all the burst in sentiment surveys, and zero change in the economic outlook.

Now that Toronto home prices have apparently seized global market attention (judging by Bloomberg headlines), every twitch matters. Preliminary results in the month since Ontario's new measures kicked in show an entirely predictable double-digit cooling in sales, and slightly less frothy prices. This almost precisely follows the Vancouver playbook from last summer, the difference being that Ontario's moves were no shock, but were more broadly aimed. Vancouver's playbook also showed that, after an initial big chill, activity eventually stabilized, and prices slowly stirred again, especially in the quasi-affordable condo space. Strong population growth in Toronto is likely to keep firm support under the GTA market. As will low-low interest rates—while the Bank of Canada indicated this week it was now more inclined to hike than cut, the hikes still look very far down the road.

One curious factoid we unearthed this week is that Toronto home prices aren't even at record highs when expressed in terms of gold. It now requires just over 540 ounces of gold to buy an average GTA home, below roughly 600 ounces during the late-1980s bubble and the record 655 ounces needed in spring 2005. The slightly more serious point is that gold is again close to a record high in Canadian dollar terms—and no one is calling the gold market a bubble. Now Bitcoin (just 284 now needed for a GTA home) may be a different matter…