Jeopardy! *Canadian Economy Edition*

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

Let's try "Uh-Oh Canada" for $200, Alex.

***Answer:** It's the single biggest risk to the domestic economy as we end 2018.*

What are desperately low WCS prices?

***For $400;** It's the main reason inflation is likely to fall heavily next month after edging up in today's report for October to 2.4%.*

What is the recent dive in global oil prices?

***For $600:** They will cost $5 billion for FY19/20, but provide only limited relief for the oil industry.*

What are Ottawa's new accelerated depreciation rules for business?

***For $800:** Despite all of the above, the market still believes it will happen.*

What is a Bank of Canada rate hike at the January 9 meeting?

***For $1000:** Answer—It's the Daily Double!*

Let's make it a true Daily Double, Alex.

***Ok, for $2000:** The next crucial clue from the BoC on its intentions.*

What is the speech by Governor Poloz on December 6th?

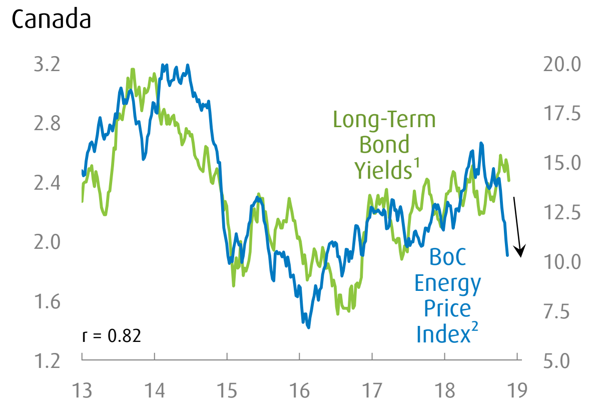
There was a news item this week that an elevator in a Chicago skyscraper went into an 84-floor free-fall after a cable snapped, and the six occupants of said plummeting elevator weren't initially aware that anything was amiss. Apparently, the ride at first just seemed a tad faster and bumpier than normal, after starting on the 95th floor, and coming to halt at the 11th. Which, naturally, brings us to **oil prices**. After hitting a four-year high a mere seven weeks ago, WTI has fallen in almost a straight line, shedding exactly a third in that time to US$51/barrel. Coincidentally, today's price exactly matches the average for all of last year, but the relentless free-fall is beginning to chip away at inflation expectations, the growth outlook, and bond yields. In the elevator story, no one was harmed; it's not clear the oil story will end in relief.

This week alone, oil prices fell roughly 10%, even with a temporary mid-week reprieve. Massive gains in production by each of the "Big 3"—the U.S., Russia and Saudi Arabia—are the biggest factor behind the weakness, but questions on the strength of demand are also emerging as global growth loses its edge. A slowing global economy, alongside a determined Fed, a simmering trade war, and—yes—faltering oil prices have kept equity markets on edge. In a choppy, holiday-truncated week, broad U.S. measures fell for the seventh time in nine weeks, with the S&P 500 dropping 3.8%

to below the October closing low. So, despite bursting out of the gate at the start of November, the index is now poised to slip for a second consecutive month.

That's the good news. Turning to Canada, the TSX dipped again this week, despite its single-best daily gain in almost three years on Wednesday—that 218-point flurry was washed away by setbacks in all the other four sessions. The false dawn on oil prices was the biggest factor weighing on the index. Meantime, **the pain continues for Western Canadian Select**, despite a string of announcements from Alberta on everything from possible new refineries, buying rail cars to ship oil, and tax breaks for drillers. Ottawa's much-hyped Fall Statement was aimed squarely at supporting capital spending—the show-piece was accelerated capital cost allowances, costing $5 billion next year and $14 billion over a five-year period—but carried no specific measures for the energy sector.

Chart 1
Mind the Gap



[1] (lhs : GoCs 10+ yrs : %) [2] (rhs : index : C$-terms)
Sources: BMO Economics, Haver Analytics

The longer the extreme lows persist for Canadian oil prices, the greater the economic damage for Alberta, and thus the national economy. The received wisdom is that WCS will mount a comeback in coming months, but in the meantime, we will keep shaving our growth forecasts on a drip-drip-drip basis until that recovery shows up in the real world. For example, we cut our call on Alberta GDP for 2019 to 1.7% (from 2.1%) this week, and that's probably about a point lower than had oil prices not gone into the tank in the past two months.

For the most part, Bank of Canada watchers are quite simply not budging on their call for a string of rate hikes in 2019. Markets are still leaning quite heavily to a move at the early-January meeting (there's also a decision on December 5, but the already low odds of a rate hike then have dipped a tad further). Today's pair of sturdy reports on CPI and retail sales only reinforced the consensus conviction that the Bank will move at the start of next year, with core inflation nudging up to 2.0% on average, and consumers strong enough to keep GDP growth right around 2% in both Q3 and Q4.

We officially also still have the Bank hiking in January, and two more times later in 2019. But, suffice it to say that the **call relies heavily on the assumption that oil**—and specifically WCS—**will make at least a modest comeback in the next six weeks**. If not, we will continue to gradually mark down our growth and inflation forecast in coming weeks, and the odds of a January move will descend with those markdowns. Recall, also, that with the Bank dropping the "*gradual*" mantra, it gives them the latitude to go at any meeting; so, they could wait out January, and then play catch-up on March 6 (a non-MPR meeting). Realizing that this is a lot of inside baseball, but the main point is that **we simply don't share the market's seeming indifference on BoC expectations to the prolonged and deepening slide in oil prices**. For a staggering view of the current disconnect, please see Chart 1. The biggest signposts that could trigger a market rethink—besides the economic data, including the ever-important quarterly GDP release next Friday for Q3—will be the Bank's Statement and the speech by Governor Poloz the first week of December. If oil prices haven't budged by then, market sentiment could shift in a hurry right around that time.

Final Jeopardy… category is: Extremely Unusual Events… Answer: Currently, this city boasts the best team in the NBA, near the top in the NHL, and the reigning champ in the AHL, the CFL (until this weekend) and the MLS (until next month).

(Music… dee dah dee dum, dee dah dum, dee-dee-dah-dee-dee-dum)

Question: What is Toronto?