Talking Points

BMO Capital Markets
We're here to help.™

The latest view on the economy March 8, 2019

Spring Brake

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

Ever been rudely interrupted from an idyllic dream, only to face the hard reality of another brutal winter morning, skidding over endless ice floes, grappling with the local band of wild coyotes, and then dealing with the usual soul-crushing lengthy commute? I mean other than today? Well, that's about how global financial markets felt this week, as the cold slap of clammy economic data awoke them from the nine-week nirvana to start the year. Equity markets struggled through their first serious weekly setback since the middle of December, with the S&P 500 on course for almost a 3% drop and the MSCI falling broadly. Meantime, bond yields sagged anew, as Treasuries slid 10-to-14 bps across the curve, oil receded, and the U.S. dollar broadly strengthened, in a classic risk-off move.

Markets had been sagging steadily all week as **a variety of central banks turned more cautious on the outlook**—hello ECB, BoC and RBA—and then **a pair of key economic reports for February delivered a telling blow** on Friday. A deep drop in China's trade flows in the month was followed by an eye-popping slowdown in U.S. payroll growth. Both reports came loaded with caveats, and a simple two-month average of both China's exports and U.S. job gains would quickly show that growth was cooling, not sliding, at the start of the year. Still, the loud message was that both economies need a trade deal, and soon. Yet, the tone around the U.S./China talks also turned a bit more cautious this week, with President Trump suggesting on Friday that the U.S. could do "very well" even without a deal, and other officials claiming there was "more work to do" and they will not sign a bad deal.

Turning back to the data, the U.S. February employment report was truly an odd duck. The 20,000 headline job gain was so low that even Canada produced more jobs (55,900) than the U.S. did in the month. However, the meagre gain was likely weather-affected and follows exceptionally strong rises in prior months, so the three-month average payroll rise of 186,000 barely breaks stride from the longer-term trend of around 200,000. Meantime, the household survey zigged as payrolls zagged, reporting a solid 255,000 gain, chopping the jobless rate 2 ticks to 3.8% and slashing the broader U6 measure to a cycle low. As if to emphasize how tight the job market remains, wages hit a cycle high of 3.4% y/y.

The **strange jobs report** completely overshadowed a **snapback in housing starts** in January, which fully reversed the very weak report of the prior month. This is important, since many were busy burying the U.S. housing sector, even as it seems to be reviving. Completing the mixed jumble of conflicting indicators, the ISM for non-manufacturing rebounded in February to a three-month high of 59.7, which left it above the 2018 average, even as auto sales matched a four-year low of 16.5 million units in the month. The blend of confusing indicators suggests that growth is grinding lower, but not braking as hard as in—say—Europe. Next week's two big releases stateside will be January retail sales on Monday and February consumer prices on Tuesday. The retail figure is widely expected to mimic the comeback we just saw in housing starts, at least partially reversing the shocking deep 1.2% dive seen in

December. However, the softness in vehicle sales and lower gasoline prices in the month will weigh on the headline.

Meanwhile, **Canadian employment was up to its usual pranking** of markets, analysts, and policymakers alike. Just as the Bank of Canada all but officially turned neutral itself in this week's rate decision announcement, and markets began pricing in the possibility of rate cuts later this year, Canadian jobs casually knocked down yet another robust reading for February. What made this especially notable is that it arrived just as U.S. payrolls struggled mightily, Canadian housing starts were flailing, and amid a very tough weather month—and yet jobs jumped. And, this is no one-month wonder, as employment has just posted its biggest six-month increase in 17 years, and the second strongest such gain in 35 years.

Of course, two big caveats are that Canada's labour force population is also on a tear, so the jobless rate has not improved one iota in the past year (holding steady at 5.8%), and total hours worked are not rising in line with the jobs bonanza. In fact, hours worked have dipped 0.1% in the past year. While harsh weather likely played a role in cutting hours in February, the trend has been sluggish in any event, and reinforces the view that growth stalled in Q1, even with the big employment rise. In other words, while the headline job gains in Canada and the U.S. were almost the polar vortex opposites, the appropriate response should be the same—**largely ignore it**. For instance, even with the jobs whopper, Canadian yields still ended the week down massively from last Friday on the dovish BoC remarks, with 10s dropping 17 bps to below 1.8% (i.e., barely above the Bank's 1.75% overnight target rate). And, the lagging loonie fell 1% to its lowest ebb since the start of the year at 74.5 cents.

Looking more broadly at the overall message from the many moving parts in the economic and financial data, the bottom line is that, while rate hikes are now a very distant prospect, markets were also getting way ahead of themselves pricing in rate cuts this year.

Tomorrow marks **the 10-year anniversary of the market bottom** during the financial crisis. Through the many twists and turns in the market over that long spell, the fact is that the S&P 500 now stands a towering four times above the low levels of that dark day. That translates into a massive average annual increase of 15%, even before dividends. The TSX also hit rock bottom the same day, although it's had a much more erratic recovery over the past decade, sidetracked by a variety of energy-related woes. Still, the index has more than doubled over that span, yielding an average annual gain of just under 8% (again, before quite healthy dividends, which would easily lift total returns above 10%).

Notably, looking back on that day a decade ago, while stocks are in a different world, many other financial variables would not look at all out of place even today—the Canadian dollar stood just below $1.30/US$ ($1.342 now), WTI was just above US$47 ($55), and the 10-year Treasury yield closed at 2.89% (2.62%). Curiously, and appropriately enough, the number one song that week was the talented Mr. Flo Rida's "Right Round"—who says no one called the bottom at that time?