Talking Points

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The latest view on the economy

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Smells Like Teen Attention Span

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Remind me again why the market is priced for rate cuts over the next year. I mean beyond the fact that the U.S. Administration is openly agitating for a cut, and is seemingly prepared to gradually stack the Fed to eventually get its way. But given how financial conditions have improved since the start of the year, and how the economic data are faring, **the case for a rate cut is paper thin**. Turning back the clock to the opening days of 2019, we were looking at a trade war with China, a U.S. government shutdown, low oil prices, a near-20% correction in the S&P 500, and a wave of weak global PMI readings. Not shockingly, the market aggressively priced out further rate hikes from the Fed, and the Fed obliged with a stream of dovish remarks. So far, so good.

Now, three months hence, we have oil prices right back around last year's average level, and up more than 40% since the start of the year. Equities have pretty much reversed 2018's late-year nastiness, with the S&P less than 2% from its all-time high. While global economic data have been mixed, the overall trend has improved in recent weeks (with the rather clanging exception of European manufacturing). The U.S. government is operating as usual (hold the snide remarks). And, while there are still issues, it appears that a U.S./China deal is on the horizon. Even President Trump's threat to close the Mexico border has been—graciously—granted a year's reprieve.

The one remaining case for even considering Fed easing was that domestic growth appeared to be softening amid the many earlier weights, as well as fading fiscal stimulus and past rate hikes. But that case was cut down to size this week amid a string of generally decent U.S. economic releases. Most importantly, payrolls popped back to their trend rate with a solid 196,000 gain in March, while the ISMs stayed firmly in mid-50s terrain in the month, and auto sales rebounded to 17.5 million in March, salvaging Q1 as a whole. And, jobless claims fell to a 50-year low in the latest week. Note that amid all the noise in the opening months of the year, U.S. employment rose at a sturdy 1.7% annual rate for all of Q1, precisely matching last year's average rise… when the Fed was busily hiking four times by 100 bps, we may add.

After this week's wave of reports on how the real economy fared in March, **the focus for next week will turn to how it's affecting inflation.** The solid jobs report was blunted by the latest instalment of the ongoing saga of surprisingly mild wage gains (+0.1%). However, we would hasten to point out that the annual wage rise of 3.2% is still more than double the latest inflation reading, and is also still above last year's average gain (of 3.0%). No doubt, the path to faster wages has been tortuously slow, but it is indeed heading higher. It's been a broadly similar story for core inflation—a very slow upward grind—and we suspect that March's CPI will echo that theme with a stable 2.1% y/y clip (and up 0.2% m/m). Note, though, that the comeback in oil and gasoline prices will fire up the headline, both on the month (+0.5%) and for the yearly inflation tally (back up to 1.9% y/y). While not exactly an advertisement for rate hikes, this economic backdrop hardly makes the case for rate cuts either.

It's a bit different for the Bank of Canada, largely because the starting point for rates is so much lower—with the overnight rate sitting 62.5 bps below the Fed's mid-point target. In a Monday appearance in Nunavut, Governor Poloz sounded some suitably cautious notes, especially on the trade outlook—appropriately so, given the growing headwinds for the USMCA. But, the overall thrust of his remarks suggested that the Bank remains quietly confident that growth will revive in the spring and summer, leaving a sliver of odds that rates could still be hiked at some point in the next two years. While March's jobs report did no favours for that view, reporting its first employment drop after six very strong months, the early read on auto and home sales points to modest monthly gains.

Next week is a quiet one on the Canadian economic calendar, highlighted mostly by the **Ontario Budget** on Thursday. Without being overly central-Canada-centric, this is the most important provincial budget of the year, representing the first fully-formed fiscal picture from the Ford government. The message from Finance Minister Fedeli has been that the Province will take a *"responsible"* tack on reining in the budget deficit (last pegged at $13.5 billion, or 1.5% of GDP). That likely translates into a four-year plan to bring it back to balance, with the restraint front-loaded into the first few budgets of the mandate.

For the broader Canadian outlook, moderate restraint from the largest province will largely counter the moderate stimulus from this year's Federal Budget. This leaves us with a sluggish economic growth outlook of 1.5% this year; which, in turn, likely leaves the Bank of Canada also on a prolonged pause. Yet that economic backdrop is also hardly a ringing endorsement of the market's pricing of rate cuts later this year.

Time again for Double Jeopardy:

Answer—Manchester, Munich, Chicago, Brisbane, Lyon, Osaka, Naples, Valencia, Tianjin, Incheon and Vancouver have this in common.

Question—What is the *third* largest city in each of the world's largest economies?

Bonus questions—Does anyone see Osaka or Munich as bellwethers for the Japanese or German housing markets, let alone their economies? Do monthly home sales figures in Lyon and Valencia make front-page reading in France and Spain? Is Bank of England or Bank of Korea policy driven by the path of home prices in Manchester or Incheon? Of course not to all three questions! So, why then the widespread obsession with the Vancouver housing market?

In the wake of another month of weak Vancouver home sales results—sales down 31% y/y, a three-decade low for March, and benchmark prices down 7.7% y/y—we were fielding the usual queries as to how the BoC would respond. First, Vancouver is in no way representative of the broader Canadian housing market, with outer-worldly lack-of-affordability. Second, it accounts for only 7% of overall Canadian home sales in a good year, and is now down to around 5% of all housing transactions. Third, always recall that the recent weakness in Vancouver's market is largely the result of specific policies, especially at the provincial level, aimed at bringing the market to heel.

No doubt, a further cooldown in that market will clip overall growth in the B.C. economy; but, note that even with Vancouver's housing moderation, B.C. still boasts the fastest job growth in the country (up a crackling 3.2% y/y), it still has the lowest jobless rate (4.7%) and we expect it to post the strongest GDP growth among the provinces this year. In other words, if there is any economy that can deal with a housing slowdown, B.C. is it.

Coda: Kurt Cobain, Born Feb 20, 1967, Died April 5, 1994, 25 years ago today, age 27. RIP

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