Weekly Updates Issue # 630

1. Weekly Markets Changes

[September 8, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
14,985.32 -206.3 -1.36%	2,461.43 +18.38 +0.75%	21,797.79 -15.88 -0.07%	6,360.19 +143.7 +2.31%	$0.82243 +1.60c +1.98%	$1,346.60 +62.66 +4.88%	$47.87 -0.39 -0.81%

2. How full employment affects wages and the economy

[September 8, 2017] The unemployment rate ticked down to a nine-year low of 6.2% in August, approaching what economists refer to as "full employment."

But what is full employment? It's the lowest rate of unemployment before a scarcity of job seekers starts to inflate wages and hit the economy.

Economists disagree on exactly what that unemployment rate is, but Maurice Mazerolle, an associate professor at Ryerson University's Ted Rogers School of Management, says it's somewhere between 5% and 6%.

"When you start pushing it down below 6%, this is when you start seeing lots of job openings […] there's lots of turnover, lot of movement, people are finding it hard to hold on to employees because they've got other options," he said.

"So if you don't raise wages, you'll have this constant churning. In order to retain labour, people start putting a premium on wages in order to have people stay."

Employees would no doubt welcome the rise in wages, but for those managing the economy, the concern is that the trend will lead to accelerating inflation in the economy as a whole.

"If you push unemployment too low, or below what is deemed a normal rate in the case of the full rate, then you start to put inflationary pressures on different parts of the economy," said Mazerolle.

"So the idea is you want the economy churning along at a non-inflationary rate of unemployment."

The latest job numbers show nine months of dropping unemployment rates, the longest streak since before the financial crisis, but Mazerolle said wages have been slow to respond.

"Lately, because wage growth is so slow, we really haven't seen a lot of inflation in the market. Even though prices are going up, wages haven't been, and that's because the unemployment rate has been at a level whereby there's been no real need to raise wages, because there hasn't been that much difficulty in hiring."

That is finally starting to change as the unemployment rate steadily drops, with Statistics Canada reporting that compared to a year earlier, average hourly wages expanded at a faster rate than inflation to reach 1.8%.

But tempering a rise in wages is the fact that many of the jobs created recently are part-time, meaning some people at least are still looking for steadier work.

The main unemployment rate also hides the number of people who have given up looking for work. That number is reflected in the participation rate, which shows the percentage of the population who either have, or are looking for, a job. Statistics Canada said the participation rate improved 0.2% in August compared to the year before to 65.7%, but it's still down from the high of 67.6% in 2007.

3. What Canada's hot streak means for interest rates

[September 8, 2017] The Canadian economy is firing on all cylinders and growing faster than its potential, says the latest RBC Economic Outlook. The main drivers are consumer spending, business investment and government spending.

"That should see above-potential growth continue through the rest of this year," the bank says in a release. RBC Economics expects real GDP to grow 3.1% in 2017 and 2.2% in 2018.

"Canada's economy continues to hit it out of the park," said Craig Wright, senior vice-president and chief economist at RBC. "For the fourth consecutive quarter, we've seen above-potential growth, and despite the cooling of the housing market and uncertainly around NAFTA, we expect the momentum to carry through to the end of the year."

As well, the bank says consumers aren't showing signs of slowing down and, as a result, they're poised to remain the key driver of growth in 2017. While consumer spending will likely lessen somewhat in 2018, it adds, "business investment continues its significant turnaround. Investment spending is expected to add growth every in quarter this year, and will likely remain an important driver of the economy in 2018."

Following this week's Bank of Canada rate hike, RBC Economics expects the central bank to continue to reduce policy stimulus. In its outlook report, it says "the overnight rate is expected to finish 2018 at 2%, up from 1% today."

RBC isn't alone in its optimism.

Jean-François Perrault, senior vice-president and chief economist for Scotiabank Global Economics, also calls for growth to surpass 3% in 2017 before slowing to about 2% in 2018, in a Friday report.

"Of particular note in Canada is the breadth of activity: most provinces are growing rapidly, in sharp contrast to previous years, and there is broad strength across many sectors of the economy," he says.

As a result, Perrault predicts the BoC will "raise interest rates well beyond current levels." A hike may occur in December, with two more following in 2018, he says. He notes that even though lower growth is in the cards for 2018, "it would remain well above estimates of potential growth, which implies greater inflationary pressures through the year. Additional rate increases will likely be required in 2019."

In a separate Scotiabank report, head of Capital Markets Economics Derek Holt writes "the BoC is behind the curve with firming wage and price dynamics that are unique to Canada." When it comes to employment data – on Friday, Statistics Canada said Canada's unemployment rate nudged down in August – Holt suggests focusing on wage data in relation to the BoC.

He explains, "Average hourly wages for permanent workers is the measure the BoC focuses upon, and that accelerated to 1.7% y/y, which is up a half point from the prior month."

Other highlights from RBC

The Canadian dollar rebounds. The Canadian dollar has risen 11% from its early May low. Also, the Bank of Canada's rate hike solidified the dollar's gains even in the face of declining oil prices. RBC forecasts the Canadian dollar will average close to 80 U.S. cents over the forecast horizon.

Alberta back in the saddle and Quebec taking off. Most provincial economies have stepped up their pace relative to last year, but the country's economic momentum is not shared equally across all provinces. A rebound in Alberta's energy sector has led RBC to revise its forecast for the province upwards to 4.2% growth in 2017. At the same time, a major turnaround in Quebec will see the provincial economy growing 2.8% in 2017 – its strongest rate in 15 years. The outlook for Newfoundland and Labrador is less optimistic given its economic contraction continues. The provincial economy is expected to shrink 1% in 2017, says RBC.

Global growth versus geopolitical concerns. The global economy's strong momentum over the summer has shifted some of the focus away from geopolitics, says RBC. Its forecast for global growth is 3.5% in 2017 and 3.6% in 2018.

U.S. optimism in the face of uncertainty. RBC is still optimistic about the U.S. economy. It projects growth of 2.2% in 2017 and 2.4% in 2018. The U.S. dollar has significantly underperformed other major currencies so far this year, the bank notes, but that may change as the U.S. Federal Reserve "likely to hike rates more than markets anticipate."

4. Canada posts ninth straight monthly job gain

[September 8, 2017] In August, Canada's labour market posted its ninth straight month of job gains, giving the economy its longest monthly growth streak since before the financial crisis nine years ago.

Statistics Canada says last month's increase of 22,200 jobs also helped nudge the unemployment rate down from 6.3% in July to a nine-year low of 6.2%.

But Friday's data showed the August growth was fuelled by less-desirable work, as the economy gained 110,400 part-time jobs and shed 88,100 full-time positions.

The agency said most of the decline in full-time work was concentrated among young Canadians aged 15 to 24 years old. The youth category also showed a notable decrease last month in participation as fewer young people looked for work.

The August numbers also showed a decline of 10,400 paid employee positions, while the number of people who described themselves as self-employed, including unpaid workers in family businesses, increased by 32,700.

Looking at the bigger picture, however, the latest numbers said the labour market expanded 2.1% compared to a year earlier with the addition of 374,300 net new jobs. Of those new jobs, 213,400 were full time.

The data provided yet another sign the economy continued to have momentum after a stronger-than-expected start to 2017 that has also prompted two interest rate hikes by the Bank of Canada.

The latest rate increase came earlier this week after a report showed Canadian economic growth expanded at an annual pace of 4.5% from April to June.

Last month's labour data showed that the services sector gained 35,900 jobs while the number of factory positions fell by 13,700. The goods-sector slide was led by a loss of 11,100 manufacturing positions.

By region, the agency reported that Ontario posted the only notable gain among provinces, while employment declined in Nova Scotia. The headline job numbers were little changed in the other provinces.
The agency also said wages grew 1.8% last month compared to a year earlier for the biggest increase since last October.

5. Why to watch the Ontario government, pre-election

[September 7, 2017] One could say that Ontario, under Premier Kathleen Wynne, has had an outsized impact on Canada's economy.
From electricity rate cuts to minimum wage increases, the province has affected the national consumer psyche, business competitiveness, inflation and even BoC policy, writes Warren Lovely, head of public sector research for National Bank of Canada, in a research note.
The province, he says, has performed with 2.5% real GDP growth per year since 2014, offsetting weakness in Canada's resource-intensive jurisdictions.
Given significant policy changes under the current provincial government — what could be referred to as the "Wynne effect" — it's time to turn attention to potential "pro-cyclical" fiscal stimulus linked to next year's provincial election, Lovely says.
Below are some of Wynne's policy impacts, and what to watch for.

Housing market reforms

Ontario's "Fair Housing Plan," announced in April, "keyed a change in market psychology," Lovely says. Housing resales have fallen in the Toronto area's 416 and 905 area codes and prices have cooled. Ontario's measures have come amid additional federal rules intended to slow mortgage lending.

Electricity price relief

"You could write a book on Ontario's electricity market reforms," says Lovely.
The provincial government's bid to cut residential electricity rates by an average of 25% "has left an immediate and indelible mark on CPI," he writes, comparing the move to a tax cut for residential hydro customers.
All things being the same, he says the hydro savings should flow back into the economy in the form of additional near-term consumer spending.

Minimum wage increase

Ontario's minimum wage is set to rise from $11.40 per hour to $14 per hour as of January 2018, followed by an additional gain to $15 per hour in January 2019.
Lovely and his colleagues say this "near record increase" in Ontario's minimum wage could impact 41% of the provincial workforce – that is, the

24% of people earning less than $15 per hour and the 17% who make between $15 and $19.99 per hour.

Financial markets have yet to integrate the short-term impact of this minimum wage increase into the 2018 outlook, he says, which should mean faster growth with higher inflation.

Election stimulus?

Given what Wynne has done so far, it's important to consider pre-election policy pledges.

Ontarians head into a provincial election in June 2018, and it's not hard to foresee "a slate of pre-election goodies, above and beyond what's already been announced," Lovely writes.

Revenue from the province's economic growth could mean additional promises like tax relief, measures for businesses to counter the cost of the minimum wage increase, or further stimulus for consumers.

Writes Lovely: "An Ontario 'Fair Tax Plan' has a certain ring to it, don't you think?"

6. BoC hikes key rate to 1% as strong growth broadens

[September 6, 2017] The BoC cited a strong economy as it raised its target for the overnight rate to 1%. The bank rate is correspondingly 1.25%, and the deposit rate is 0.75%.

The move, likely a surprise for some, came less than a week after Statistics Canada numbers showed the economy expanded by an impressive 4.5% in Q2.

"Given the stronger-than-expected economic performance, Governing Council judges that today's removal of some of the considerable monetary policy stimulus in place is warranted," says the BoC in a release.

The central bank says economic data have been stronger than expected, supporting its view that growth is "becoming more broadly-based and self-sustaining." For example, the bank cites robust consumer spending, "underpinned by continued solid employment and income growth," as well as "more widespread strength" in business investment and exports.

Andrew Grantham, senior economist at CIBC, says in a note that the BoC's reference to removing stimulus "suggests that, at these levels, the bank still views policy as very stimulative." He notes that the bank says future hikes aren't predetermined, which could be a reminder to markets it won't be hiking a quarter point at every meeting.

"However, the statement didn't go so far as to say the current level of stimulus is now appropriate, which has been a phrase used in the past," says Grantham.

"As such, markets may now start pricing in further moves, meaning today's decision will be positive for the C$ and negative for fixed income."

Growth outlook

The BoC notes that the housing sector is cooling in response to changes in tax and housing policies, and says it expects economic growth to moderate in the second half of 2017.

The bank also says global growth is becoming "synchronous," as previously expected, based on strong economic indicators, including higher industrial commodity prices.

"However, significant geopolitical risks and uncertainties around international trade and fiscal policies remain, leading to a weaker U.S. dollar against many major currencies," says the bank, adding that the loonie has thereby appreciated on relative strength of Canada's economy.

Inflation remains below the 2% target, but the bank notes a slight increase in total CPI and core measures of inflation. That's consistent with the dissipating impact of temporary price shocks and the absorption of economic slack, says the bank.

"Nonetheless, there remains some excess capacity in Canada's labour market, and wage and price pressures are still more subdued than historical relationships would suggest, as observed in some other advanced economies," the BoC says.

The central bank says it will monitor "elevated" household debt, adding that "close attention will be paid to the sensitivity of the economy" to higher rates.

Further industry response

In a note, Desjardins senior economist Benoit P. Durocher says that, with strong GDP performance, expansionist monetary policy is no longer necessary. However, "the BoC appeared somewhat hasty to hike its key rate when it could have easily waited until October to do so," he says. He expects a gradual approach to rate hikes as the BoC assesses the impact of rising interest rates on households.

Reduced excess capacity "sets the stage for another rate hike before year end," says National Bank senior economist Krishen Rangasamy, in a note. "We are still calling for a rate hike in December, at which time more information will be available about the extent of fiscal stimulus both at the federal and provincial levels (e.g., pre-election spending in Ontario and Quebec)."

Also in a note, Derek Holt, vice-president and head of capital markets economics at Scotiabank, says, "A hike with a moderately hawkish bias met our expectations. One should not rule out another hike over the duration of 2017." He notes that the loonie appreciated by about $0.02 versus the U.S.

dollar post-statement, and the two-year bond yield increased by about 10 basis points.
The next scheduled date for announcing the benchmark interest rate is October 25, with the publication of the BoC's monetary policy report.

Banks make their move

In response to the rate hike, RBC, TD, BMO, CIBC, Scotiabank and Desjardins today increased their prime lending rates by 25 basis points to 3.20% from 2.95%, effective Sept. 7, 2017.

7. Toronto average home price falls for 4th consecutive month

[September 6, 2017] Clients looking for a home in Toronto will be pleased to know prices are cooling from the highs seen in the spring.
The Toronto Real Estate Board says the average price for all home types was $732,292, still up 3% from August 2016, but down from July's average of $746,033.
That makes August the fourth month in a row that the Toronto-area average home price has fallen since hitting a record $919,086 in April.
In April, the Ontario government introduced more than a dozen measures — including a 15% tax on foreign buyers — aimed at improving home affordability.
The board's director of analysis, Jason Mercer, says year-over-year price growth is expected to stabilize at slightly above the rate of inflation but could begin to accelerate if the number of properties for sale remains at low levels.
The real estate board says the number of new listings last month was the lowest for an August since 2010 and down 6.7% from a year ago. The number of residential properties sold in August was down 34.8% from the same month last year.

8. Gas prices jumped last week in some Canadian markets

[September 5, 2017] On Friday, the Canadian average gasoline price rose above $1.16 per litre ahead of the Labour Day long weekend. There were reports of shortages due to extensive flooding in Texas and other states along the U.S. Gulf Coast.
Gasbuddy.com said that was up eight cents following hurricane Harvey's Friday hit, and nine cents compared to the average price per litre in August. The site's sources say prices in Quebec and British Columbia jumped by several cents per litre last week.

The site reports drivers in B.C.'s Lower Mainland, northeastern Ontario, Newfoundland and in the Montreal area were paying upwards of that amount. Canadian gasoline prices vary substantially by region and city, with Alberta, Saskatchewan, Manitoba, and most of the Atlantic provinces below the national average.
Most Canadian markets have seen gasoline prices rise several cents per litre over the past week, which has seen refinery and pipeline shutdowns in the U.S. Gulf Coast region due to storm-related flooding.
As of Friday, at least two major pipelines — one that ships gasoline across the southern United States to New York, and another that flows north to Chicago — had been slowed or stopped since hurricane Harvey struck the Gulf region.

Have a nice and fruitful week!