Never Say Never, Yet Again

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In any other year, **this week** would have ranked high on the drama scale, because it was **oh-so-2020**. Stocks came charging back after a see-saw September—okay, mostly "saw"—with the S&P 500 headed for its best week since late June with a gain well above 3%. Markets swayed on prospects for further U.S. fiscal support, with the President exiting the hospital and first calling off negotiations until after the election, then welcoming a restart late in the week ("never say never!"). While Mitch McConnell downplayed last gasp efforts, markets remained hopeful. The civil Vice-Presidential debate sharpened focus on the fast-approaching election, and it may prove to be the last formal debate. Meantime, Hurricane Delta bore down on Louisiana, helping lift WTI more than 10% from last Friday's low.

Whether the latest burst of negotiation-by-tweet on new fiscal measures is real, or just a show to pin the blame on the other party for its failure is unclear. But the overriding view is that **a significant major package will eventually get done, even if it is after the election**. Of course, the outcome of the vote will likely determine the shape and scope of the next package, but there will almost certainly be additional fiscal support for the U.S. economy in coming months. And we would assert that **consumers can deal with a relatively short delay** in new measures. Note that even with an expected pullback in personal incomes in October, the savings rate will still be well north of 10% in the month, since spending remains down markedly from pre-pandemic levels. And, U.S. households built up an enormous buffer of excess savings in the past six months, which we reckon could represent nearly 6% of GDP—strong ballast to withstand a few months of lean support.

On the economic data front, it was relatively thin gruel stateside, but the few major releases continued to roll in generally on the firm side of the ledger. The **services ISM** perked up to a solid 57.8, while **continuing jobless claims** stepped down by more than 1 million in the latest week. At the same time, **China** came back from a long holiday and reported that the private sector's composite **PMI** stayed solid last month at 54.5, with services gaining ground. That's important, because unlike many other economies, China's industrial sector was quick to rebound but consumers were slower to return; strength in services suggests that spending is coming back. The **Euro Area composite PMI** stepped back in September amid the rapid run-up in virus cases, but stayed just above 50.

In contrast to sparse economic calendars in many areas, it was a full plate in **Canada**. The heavyweight jobs report on Friday was the main draw, and it soared above expectations with a massive 378,200 advance. To put it mildly, it has been (*ahem*) a challenging year for employment forecasts, with even the quality of the data suspect. For example, StatsCan's two employment surveys have been sending quite different messages in 2020 (with the heavily delayed payroll survey much weaker than the up-to-date household measure). Generally speaking, the **surprises have landed on the positive side on jobs**, but September's broad-based gains were another step up.

The big gain left employment down just 3.7% from February's high, a much milder slice than the 7.1% shortfall in U.S. payrolls. Given that Canada's GDP will almost certainly fall more than the U.S. this year (we estimate a 5.6% drop versus 4.0% in the U.S.), the relatively lighter hit in Canada likely reflects policy measures to help keep workers on the job. Note that total hours worked in both Canada and the U.S. have dropped by just under 7% since February. Still, as a result of the solid jobs report, **we have trimmed our forecast for Canada's jobless rate**, looking for it to dip to about 8% by year-end, and then to around 7% by the end of next year.

Besides jobs, Canada reported a moderately **disappointing trade** report for August, with both exports and imports stepping back a bit. This seems to be a theme, that many parts of the economy saw a lull in that month (including, arguably, jobs) after most of the reopenings were complete in July. But one area that did not see a lull was **home sales**, which hit record highs in August and, by all accounts, leapt further last month (more on that below). Home building instead came back to earth in September, but remained healthy at 209,000 units. The key point is that starts are on track to rise slightly for all of 2020 from last year, one of the very few areas to report any kind of growth in this deeply challenging year.

Hot for housing: For Canada's economy, it always seems to come back to housing, doesn't it? This week's speech by BoC Governor Tiff Macklem focused on the risk backdrop, and a highlight was in the Q&A. When asked about negative interest rates, he again said the Bank wasn't seriously looking at them at this point, but said "*never say never*", keeping the embers alive. But, between the continuing sturdy comeback in jobs and a raging housing market, it would seem that the likelihood for negative rates is fading further. On housing, Macklem said:

"We will also watch for signs that housing markets are being driven higher by <u>speculation</u> that prices will keep rising. And we will watch whether people buying houses are <u>taking on outsized debt</u> relative to their income. We are not back to the <u>frothy</u> housing markets we saw in 2016, and we expect the bounceback in housing to dampen. But if too many Canadian households start to become <u>dangerously over-leveraged</u>, policy-makers have several macroprudential tools they can use. Our experience with the mortgage-interest stress test shows how effective these tools can be." (Emphasis ours, for dramatic effect.)

This is the **first bead of sweat** we have detected on the BoC's brow about the rapid-fire rebound in the Canadian housing market. Next week's national report is likely to show that existing home sales blasted 40% above year-ago levels in September (to, by far, a record high) alongside a blistering average price gain of around 19%. Mortgage debt has perked up to a 5.2% y/y growth rate from 4.7% last year, and looks set to forge higher in coming months as it responds in delayed reaction to this run-up in prices. Quite simply, it was previously unheard of to have mortgage growth gathering speed in a recession. And, clearly, while the BoC no doubt welcomes the growth support from housing—at this point, they will take growth where they can find it—they are also a tad unnerved about the potential for a renewed run-up in debt at this fragile point of the recovery.

But, the **key message** here is that **the BoC would rely on tighter regulatory rules** (i.e., macroprudential measures) **to eventually control the housing market**, and **not rate hikes**. Still, it's instructive at this very early stage of the recovery that concerns about a too-hot-for-comfort housing market are already arising. One could say that the Bank is concerned that housing, typically an economic model citizen, could lapse into zero discipline. RIP EVH.

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