Up-Tick Talk

A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group

ECONOMIC RESEARCH
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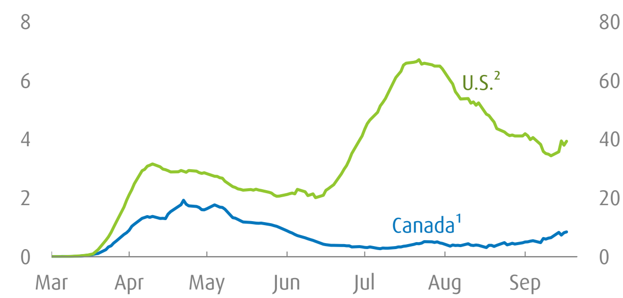
Markets see-sawed this week, searching for direction in stormy waters. An uptick in new virus cases in a variety of important economies is dulling some of the summer optimism over a generally better-than-expected start to the recovery. And even the U.S. saw a stalling out of the recent improvement in new cases from the July highs (*chart*), with real-time economic indicators flashing a resulting cooler rebound. The much-anticipated FOMC meeting fell a bit flat, offering little that wasn't known and providing no move whatsoever in the policy levers. And, the countdown clock on U.S. fiscal stimulus keeps running down with no move there either. Even so, both bond and equity markets (outside of tech) looked to end the week roughly where the festivities began—not bad for September, in the middle of a pandemic, with ongoing drama around TikTok, and U.S. fiscal policy caught in gridlock.

On the economic front, the **August data continued to roll in with two main takeaways**. First, despite the mounting concern in some regions over rising virus cases, the **recovery continued to grind ahead**. The other key point is that after the enormously wild swings in data through the spring and early summer—numbers the likes of which none of us have ever previously witnessed—the **economic data are almost now "normal"**. That is, we're starting to see monthly moves in retail sales and industrial production of less than 1%, inflation that's tracking close to zero or slightly above, and even housing activity that appears to be coming back into orbit.

New Virus Cases: Two Solitudes

2020 (000s : 7-day m.a. : as of September 17, 2020)



[1] (lhs); [2] (rhs)
Sources: BMO Economics, Haver Analytics, John Hopkins University

The U.S. economy, for one, reported decent August gains in industrial production (+0.4%) and retail sales (+0.6%), a pullback in housing starts from lofty levels, and another sag in initial jobless claims (to a still sky-high 860,000). But every single one of these indicators fell shy of expectations, suggesting that the **multi-month run of high-side surprises for U.S. economic data is drawing to a close**. Still, a wave of survey results for September this week uniformly flashed strength, with homebuilder sentiment at a record high, consumer confidence rising, and Fed factory surveys from Philly and the Empire State solid. So, true, the quick summer rebound in activity looks to be cooling, but the widespread sentiment is firm heading into the fall.

It was a **broadly similar story in Canada**, albeit with slightly more dated data on hand. July's retail report was mildly disappointing (+0.6%); yet, the early August read was better (at +1.1%), and wholesale activity was strong (+4.3%). Combined with an earlier strong read on manufacturing sales for July (+7.0%), and yet another powerful home sales result for August (up 33.5% y/y and a record high in seasonally adjusted terms), our **Business Activity Index** chalked up strength in both months—up 5% in July and 2.7% in August. We estimate that, in turn, this translates to monthly GDP gains of roughly 3% and around 1.5%. With this sturdy momentum in August, **we have modestly nudged up our call on Q3 GDP growth to a whopping 48% annual rate,** but have also **shaved our Q4 call** on some assumed modest rollbacks in openings amid the rising virus cases. Overall, we remain comfortable with our call of a 5.5% GDP drop this year and a 6% snap-back in 2021.

Both of those estimates are a bit firmer than consensus (where we have been for months now), and also a bit stronger than the latest official forecasts from the **OECD**. The latter organization unveiled its most recent outlook this week, and it was significantly stronger across most countries than its June effort. To pick but one example, they now see Canada's economy contracting 5.8% this year versus an earlier call of an 8% drop. Their upward revision to the U.S. was even larger, as the OECD now sees that economy falling 3.8% in 2020, versus the June call of a punishing 7.3% plunge. Two notes on its -3.8% call: 1) It's actually a bit less negative than both our call (-4.5%) and the latest consensus (-4.4%), and 2) it's getting within earshot of the 2009 drop in activity of 2.5%. For the global economy, the OECD upgraded its view to a drop of 4.5% this year and a still-sizeable rebound of 5.0% in 2021. Previously, its calls were -6.0% and +5.2%, and that was the so-called "*optimistic*" forecast.

The **big re-think** by the OECD on the depths of this year's downturn has been repeated across a wide variety of forecasters in recent days, especially official agencies and policymakers. To wit, the Fed heavily upgraded its own GDP forecast for the U.S. economy from its June view. Instead of a 6.5% drop this year, it now sees -3.7%. Notably, the FOMC looks at it on a Q4/Q4 basis, not annual averages like the rest of the numbers quoted above; roughly, they have moved from a call of about a 6% drop this year to around -4.2% as we would report it. While the Bank of Canada didn't offer new numbers in last week's policy statement—an update will come in mid-October—they, too, allowed that activity is coming in better than their latest call of a 7.8% drop this year. Next up will no doubt be the IMF, with a hefty upward revision almost certain there as well. And note that even as the official view on 2020 has been raised almost across the board, the large rebound expected for next year has not been scaled back in kind.

This brings us to the punchline. We can't help but wonder aloud **why official agencies and public policymakers were so very dour on the economic outlook during the depths of the shutdowns**. Yes, we all knew during the spring that the numbers were going to be extraordinarily awful this year, but did these agencies really need to compound the gloom with overly downbeat forecasts? True, the private sector consensus has been grinding upward from the spring depths, but the revisions there have been nowhere near as large. For example, the weakest these fell to were a 5.6% drop for the U.S. this year and a 6.8% sag in Canada, all well shy of the depths that the IMF, OECD, or central banks plumbed in their calls. This leads to a broader point that

forecast misses on the downside are every bit as problematic as overly optimistic calls, yet bears never seem to pay any reputational price when they are dead wrong.

We haven't even touched on one of the biggest forecast "swing-and-a-miss" this year, and that's on **North American housing markets**. Instead of the bearish view that this big-ticket item would be bludgeoned by ultra-weak job markets, deep uncertainty, and the basic issue of transacting in a pandemic, housing has come roaring back on both sides of the border. We now expect home building to increase slightly this year, a rare source of growth for both economies.

In Canada, home sales and starts have completely made up for the lost activity in the spring, with both now up a touch on a year-to-date basis. While new listings are beginning to ramp up again, the resale market is now the tightest since at least 2004. And prices are responding, in a massive fashion. Average transactions prices vaulted 18.5% above year-ago levels in August, with widespread surges across much of central Canada. While that figure is flattered by stronger activity at the high end of the market, even the MLS Home Price Index is up a powerful 9.4% y/y. That's a long way from reported headline CPI inflation last month of just 0.1%, and a long, long way from a certain agency's call of a 9%-to-18% drop in home prices this year. That major misfire almost makes my picks for the NHL and NBA playoffs look prescient…well, almost.

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