Fall Time... Except for COVID

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Financial markets sagged broadly this week, as **September continues to live down to its surly reputation for stocks**. A bevy of concerns weighed on investors, from resurgent virus cases in many areas, fading prospects for a U.S. fiscal package, mounting concerns about post-election uncertainty in Washington, and even some weakness in European banks. The ugly combination sent the Euro Stoxx 50 skidding to a 5% setback, its worst outing since a similar drop in early June. Stateside, the correction in tech deepened, with the Nasdaq now down roughly 11% from the records hit on September 2—which already seems like a long time ago. The pullback in tech has left the broader S&P 500 dancing right around correction terrain. The retreat in risk assets sent most major currencies notably lower against a revived U.S. dollar, while also dimming inflation expectations and carving into gold's earlier gains. The one market that mostly sat out the large moves this week was government bonds; although, even there, yields obeyed the laws of risk-off-gravity, with 10-year Treasuries and GoCs dipping 4 bps.

This week's slate of economic data provided little respite, partly because it was decidedly second-tier material. And, the real-time indicators generally suggested that the rebound is losing momentum in a meaningful way in many economies. In the U.S., the slightly more stale official data were generally on the positive side of the ledger, if not quite meeting earlier big high-side surprises. Housing remains a major area of pronounced strength, with new home sales—admittedly a wildly whippy series—vaulting above 1.1 million units for the first time since 2006 in August. The mixed durable goods report for the same month pointed to some upside risk for our Q3 GDP call of 25%, but we **continue to expect growth to chill deeply in Q4**. The early read on manufacturing surveys for September points to some further gains, but flattening jobless claims in recent weeks (at a still-lofty 870,000) and fading fiscal support point to modest growth in the final three months of the year. We remain comfortable with our call of just 2.5% annualized growth in Q4, a refreshingly "normal" pace of activity amid a depressingly abnormal time.

The economic menu was even lighter in Canada, with the **Throne Speech** dominating the headlines. Cutting through the reams of rhetoric, the major message was that Ottawa fully intends on using all the "fiscal firepower" it can muster to support the economy through the second wave. Channelling their inner Mario Draghi, the federal government pledged to do *"whatever it takes"* on that front. Whether that is a promise or a threat is in the eye of the beholder, but it was followed the next day with the announcement of an even more generous replacement than initially planned for CERB (which, frankly, doesn't look that different). In addition, the wage subsidy program (CEWS) will now run at least until deep into 2021. There are two major takeaways here: First, the already groaning **budget deficit** ($343 billion, or nearly 16% of GDP) looks set to grow even fatter. That's despite the fact that the underlying economy has done

better than assumed in the July fiscal update (it was based on a 6.8% drop in GDP this year; the OECD now says -5.8%).

The second big takeaway from Ottawa this week is that—unlike the stalemate in the U.S.—**fiscal policy appears poised to continue fully backstopping the Canadian economy** in the year ahead. (This is all assuming that the Throne Speech passes the confidence vote in Parliament, a seemingly safe assumption.) By itself, this would suggest that Canada's near-term growth prospects should be firmer than the U.S. as we proceed through the volatile period ahead. Barring a last-gasp miracle, it appears that the U.S. economy will be left to its own devices, with no new fiscal support at least until well after the election. And, even then, there are zero guarantees that anything meaningful can get done in the lame-duck session—especially if there is still wrangling over the election results. Still, there are **at least two factors that will likely keep Canadian growth from fully separating from U.S. trends**. First, there will be an inevitable drag on Canada's **exports** from slower U.S. spending, as well as a pull on some key commodity prices. Second, Canada is also now dealing with a clear upswing in **new virus cases**; while not yet in the same league as the summer levels seen in the U.S. on a per capita basis, they are high enough to prompt some moderate new restrictions.

On balance, we **still look for slightly firmer growth in Canada than the U.S. over the next few quarters, but not a major separation**. And, besides a heavier fiscal hand, the other factor at work here is that Canada is still playing catch-up for a deeper drop in the spring. Big picture, we expect the Canadian economy to contract by roughly a percentage point more than the U.S. for all of 2020 (officially, -5.5% versus -4.5%). In very broad terms, about half of that difference is due to a more complete shutdown in the spring, and half due to the extra hit from the deep drop in oil prices this year.

As light as this week's fare was on the economic front, next week will make up for it, with a high-calorie diet on deck. **The first real glimpse of how the North American economy fared in September will begin to roll in**, and the highlight will be the U.S. jobs report on Friday. The general consensus is that payroll growth will dip below 1 million, while the unemployment rate could dip slightly further after the heavy drop to 8.4% in August. Also late next week, we'll see the manufacturing ISM, which likely held up well, and an early read on auto sales for this month. The issue there is whether sales were able to build on their remarkably quick recovery to the 15 million unit level in the prior month.

Canada's jobs data isn't due until the following week, so the focus in the days ahead will be on the **monthly GDP** report. The flash estimate for July was a hearty 3.0% rise, which we believe will stick, but the big mystery will be the initial take on August. Strong gains in hours worked, a 1.1% rise in retail sales, and sizzling housing activity had us pencilling in a strong gain of around 1.5% for the month, which boosted our view on a very strong Q3 overall. However, this week brought a pair of soggy flash estimates for manufacturing sales (-2.0%) and wholesale trade (+0.1%), casting some serious shade on our estimate. The bigger picture for both economies is that after the initial heartening snap-back in activity in many sectors, the longer and much harder

slog for still-affected industries is now setting in, and will bring the economic data back down to reality in the days and weeks ahead.

One of the curious sidebar comments in this week's Throne Speech was a pledge to **reduce inequality**, through—and not to put too fine a point on it—taxing the ultra-rich. This of course raises many, many questions. First, is it simply a nod to their presumed political dance partner in order to get the Speech passed? If it's more than that, where precisely is the line drawn to qualify as ultra-rich—i.e., starter for the Raptors, or homeowner in Toronto/Vancouver? Third, what kind of tax (income, wealth?) and what scale? But finally, and probably most importantly, precisely why?

If the focus is on economic recovery, why are policymakers even pondering policies that could potentially dent consumer or business sentiment? More fundamentally, the government spent much of the post-speech period listing all the many reasons why this is a reasonable time to be running outsized deficits. They relentlessly pointed to Canada's relatively mild public sector debt levels versus the rest of the G7, as well as the 100-year lows in interest rates, and of course the pressing economic need for fiscal support. Well, yes, if you accept all of those talking points, then the staggeringly obvious rejoinder is… so why then is there any need to raise revenues at this point? That is, **why should new public sector spending take up all of this valuable fiscal space?**

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