Focus

Feature Article

Canadian Business Activity Index: Tracking the Recovery

Our Thoughts

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The Good, the Bad and the Awful

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Roughly three months after the North American economy hit bottom, and nearly four months after global equities hit their lows, we are getting a much better sense of how the recovery is unfolding. And, as largely expected, there are some sectors and regions that are flaring back with purpose, while others are struggling to get back to some kind of normalcy, and others that are stuck on the runway. Here is a quick list of five from each of these three buckets:

V-shaped Recoveries (The Good)

- **U.S. retail sales:** The 7.5% bounce in June sales, on top of May's record 18.2% snapback, left sales slightly above year-ago levels last month. Even with ongoing weakness in restaurants, clothing stores and lower gasoline prices, outsized strength in on-line spending, home improvement stores, and grocers has brought receipts full circle. While consumer confidence isn't all the way back, heavy-duty income supports, strong financial conditions and pent-up demand have led to a V-shaped recovery in U.S. consumer spending.
- **China's industrial production:** China is experiencing a very different cycle than the U.S. and Europe. After dealing with the virus first, and shutting down almost two months earlier, China's retail sales have yet to fully recover (still down 1.8% y/y in June). Yet, industrial production has completely recovered, and was up 4.8% y/y last month (and up 4.4% for all of Q2). While that recovery may stall if domestic demand doesn't soon strengthen, it helped power GDP back up 11.5% in Q2, and 3.2% y/y (after the 6.8% y/y drop in Q1).
- **Global equities:** Another solid gain this week lifted the MSCI World index 40% above its March 23 low, and slightly above year-ago levels. While the index is still down 4% since the start of the year, the rapid rebound from the lows has been broadly based from a regional perspective, and many major markets have driven through their 200-day MA (the TSX did that this week). No doubt, massive central bank asset buying and microscopic bond yields have played a huge role in back-stopping equity markets. But, as we have long contended, the fact that the economic pain is landing mostly on small- and medium-sized businesses—not well-represented in equity indexes—partially explains the seeming mismatch between strong stocks and weak economies.
- **Canadian housing:** Long-regarded as Canada's key vulnerability, the housing market seems to be defying the bears yet again. Existing sales and prices roared back into positive territory on a year-on-year basis in June, following last week's surprisingly perky starts figure. Even with very real concerns about weak employment and slower immigration, not to mention the practical realities of buying/selling homes in a pandemic, the sector has been supported by low rates, a fundamental supply shortage, and demand for more space. While legitimate questions remain on the sustainability of the bounce with double-digit joblessness and with mortgage deferrals ending soon, we would again note that employment stresses have been focussed more on traditional renters. And, the outlook differs markedly between condos/single-detached homes, as well as urban/suburban.
- **Copper and lumber:** Even with an historic drop in global GDP this year, there are still some commodities that have managed to mount a full recovery. In part, the impressive rebounds in copper and lumber represent a comeback in demand—

China's factory rebound for the red metal, North American housing and reno work for wood products. However, these two have in particular been supported by specific supply factors as well; virus outbreaks have caused serious problems at copper mines in South America, while mill shutdowns have heavily curtailed lumber supply. Softwood prices leapt above $500 this week, for only the second time ever.

Partial or U-shaped Recoveries (The Bad)

- **Employment:** Unemployment rates backed down heavily in June from record highs, but remain in double-digits in North America, roughly 7 percentage points above last year's level. U.S. jobless claims are still slowly trending lower, but the emphasis is on slowly. And, at 1.3 million for initial and 17.3 million on continuing, claims remain agonizingly high. Moreover, permanent job losses are mounting remorsefully.
- **U.S. industrial production:** While the consumer may be back, U.S. manufacturing is not. True, industrial production rose a sturdy 5.4% in June, but it was still down a towering 10.8% y/y. We all know that large swathes of the service sector will struggle to get back to normal, but factory activity was supposed to be an area that could recover quickly. However, amid sluggish big-ticket purchases and cautious business capital outlays, the manufacturing recovery is proceeding slowly.
- **China's consumers:** As noted above, retail sales have yet to fully recover. In contrast to many other major economies, there has been little fiscal support aimed directly at households in China, a key factor holding back spending there.
- **Energy prices:** True, oil has come a long way from the desperate lows in April. And, true, natural gas has been not terribly affected by the shutdowns. However, the level of both oil and gas prices remains well down from pre-virus trends. And with OPEC poised to ease production cuts in August, it's going to be tough for oil to break away from its recent $40 marker, even with driving activity getting back to quasi-normal.
- **Bonds and gold:** To be clear, bond prices and gold prices are quite healthy, and are, in fact, at the top of the investment world charts this year. But as a signal for the economic outlook, that dual strength must be considered in the 'bad' bucket. Just as one example, Canadian 30-year yields dropped right back down to the 1% figure this week, after the briefest bounce in the wake of last week's Fiscal Snapshot. Meantime, even as global equities have mounted an astonishing comeback, the benchmark 10-year Treasury yield is basically close to the lows at just over 0.6%. Meantime, gold's relentless rise to above $1800 can scarcely be seen as a vote of confidence in the broader outlook.

Non Recoveries (The Awful)

- **COVID cases:** Global infections reached new daily record highs this week, with the sustained rise in the U.S. by far the most troubling development for the outlook. With hospitalizations now also rising steadily, a number of key states are walking back parts of their economic reopenings, notably now California. Markets have largely looked past this awful fact, and have instead been buoyed by encouraging news on potential vaccines. However, the surge in U.S. cases likely caps the upside for the broader economy, and reinforces the key theme that certain sectors will struggle to have any recovery.

- **Travel:** On that theme, the travel industry is clearly most at risk. A wave of layoff announcements in the sector continues to build, from airlines, to airports, to passenger rail. The TSA reports that as of the latest 7 days of data (up to July 16), air passenger levels in the U.S. averaged just 25.8% of 2019 levels.
- **Dining and bars:** The renewed case surge has prompted a number of states (and at least one province) to reverse course on indoor restaurants and bars. OpenTable reservations have seen the recovery falter and even reverse course in many key cities, raising concerns about the broader economic recovery in coming months. We still believe that this will blunt the upturn, not stall it, but it certainly limits the upside.
- **Hog prices and corn:** While some commodities have thrived, many others are struggling massively with the profound impacts of COVID. Hog prices definitely top the list of hardest hit. Prices are down to 15-year lows given elevated supply before the pandemic, widespread processor disruptions, and now distressed selling. Corn likely ranks as second hardest hit, since ethanol production has plunged and it normally uses 40% of the U.S. crop. Broadly, while there have been concerns about food security, overall food consumption has actually dropped notably amid the pandemic due to the massive shift from restaurants to home cooking (where there is much less waste).
- **Government finances:** Ottawa's shocking $343 billion deficit forecast (15.9% of GDP) is likely to turn out to be not at all unusual among its OECD peers. In fact, Washington reported an $864 billion deficit for the month of June alone. With the latter likely to unveil yet another stimulus package in coming weeks (details, size pending), we may well be looking at a U.S. deficit well north of $4 trillion this year, pushing 20% of GDP. The economic recovery will help bring down these towering shortfalls next year, but anything less than a full-V-shape means that we will be left with large deficits and further big steps up in debt/GDP ratios as result of the pandemic.

The title of this week's effort of course harkens back to the 1966 spaghetti western movie, and there's a reason for the (over-used) reference to *The Good, the Bad and the Ugly*. The flick itself is a classic (starring Clint Eastwood, now 90), but the movie's score may be even better known. Its composer, Ennio Morricone passed away last week, and was probably best known for that music in his long and storied career. Somehow, though, he did not win the Oscar that year. Unbelievably, he didn't win an Oscar for a film score until fifty years later (in 2016 for *The Hateful Eight*, of all things). And that's despite writing one of the single best movie scores of the past 50 years (*The Mission*), and roughly 400 others (including *Cinema Paradiso* and *Once Upon a Time in America*). Relevance? For investors, Morricone's career arc shows that if you stick with quality, you will eventually be richly rewarded, even as some temporary high-fliers apparently pass you by… for a spell.

U.S. Budget Deficit: A Year's Worth in a Month

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The budget deficit was $864 billion in June, the most for any month on record (the figures date back to 1954). This amount is not far off the $984 billion registered for all of fiscal 2019. Indeed, last month's deficit is larger than the full-year shortfalls in every other year since 2013. The culprit is the colossal fiscal policy response to the pandemic, which includes the Coronavirus Aid, Relief and Economic Security (CARES) Act, in March; along with the Paycheck Protection Program and Health Care Enhancement Act, in April. Through the first nine months of the fiscal year, the cumulative deficit now sits at $2.7 trillion. Note that the second- and third-largest monthly shortfalls on record occurred in April ($788 billion) and May ($399 billion), respectively.

Reflecting all the legislation on the books through April, the CBO estimated this year's deficit would come in at $3.7 trillion or 17.9% of GDP—the latter being the highest since WWII—before slipping to $2.1 trillion in 2021 (9.8%). The deficit was $984 billion or 4.6% of GDP last year. By the end of this fiscal year, federal debt held by the public will be 101% of GDP—the highest on record—up from 79% last year and before growing further to 108% by 2021-end. And, all of these amounts are bound to become bigger. The House of Representatives has already passed the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, which the CBO estimates will add $1.7 trillion to this year's deficit and $1.4 trillion to next year's. The Senate has finally gotten around to this bill (which was passed by the House in mid-May), with some government support programs, such as the $600 UI top-up, ending as early as next week. The Senate version will probably be smaller, but we're still talking trillions.

With the debt-to-GDP ratio hitting a record high and continuing to escalate, the current fiscal path is clearly unsustainable. With 14.7 million Americans still needing to get their jobs lost owing to the pandemic back, and with the jobless rate expected to run at much higher levels than before, nothing will be done about this in the near-term. Even Fed Chair Powell, in his recent semi-annual congressional testimony, argued that *"the time to work on that hard* [stabilizing or reducing the debt-to-GDP ratio] *is when the economy is strong, unemployment is low, there's growth… but I wouldn't prioritize them at a time like this, when the spending is giving us a better economy moving forward, which will really help service the debt."*

When the time comes for fiscal consolidation, spending growth will have to be reined in, but there are limits to how much austerity can be achieved, be they political, social (aging society, income inequality) or environmental (climate change). Revenue growth will have to be spurred, but this could require more than a simple reversal of the 2018 tax cuts. As it stands, beyond this year and next, the run-rate for the federal deficit looks to be much larger that the CBO's pre-pandemic projection of a $1.1-to-$1.8 trillion range.

Instead of the numerator, the debt-to-GDP ratio can also be stabilized or reduced by addressing the denominator, nominal GDP… or growing your way out of the problem. This would require stronger real growth or faster inflation, or some combination of both. After WWII, during the 1950s and 1960s, policymakers could count on potential real GDP growth regularly topping 4% and, at times, even 5%. The CBO reckons potential growth now runs well under 2%. There was also a time when inflation could easily top 10% (mid-1970s, early 1980s), but in the wake of the Great Recession, the

Fed, along with many other developed-economy central banks, have had a difficult time just keeping inflation at, or slightly above, their low targets. This likely reflects the impact of structural disinflationary/deflationary forces such as advancing technology, aging populations and globalization. And, these forces are here to stay.

Of course, there's another tool to manage the situation, financial repression… keeping interest rates as low as possible to keep debt service payments and their increasing share of outlays relatively low. This was practiced during the 1940s, via an explicit agreement between the Fed and the Treasury, when the Fed *"capped yields across the curve to keep Treasury borrowing costs low and stable."* However, the Fed is already concerned that under yield caps policies *"monetary policy goals might come in conflict with public debt management goals, which could pose risks to the independence of the central bank"* (from the latest FOMC Minutes).

With fiscal consolidation, faster nominal GDP growth or financial repression, individually, providing no panacea for these fiscal problems, the medium-term solution will likely involve a mélange of them all. And, we may need to wait for at least a couple years before the *"hard"* work begins.

BoC Unveils Forward Guidance

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The Bank of Canada implemented forward guidance at this week's policy announcement, which we highlighted as the most likely policy action in last week's Focus. Indeed, Governor Macklem went so far as to state on a post-meeting interview that policy rates will be at the lower bound for "*at least two years*". The policy move seems to be having its intended effect with bond yields seeing fresh lows in the back half of the week (outside of the March meltdown). If more easing is needed, the BoC will likely be leaning on its QE programs (which were left unchanged this week), but given they're already buying nearly everything the federal government is issuing, conditions have to clearly deteriorate to get further action.

The BoC once again chose not to provide its usual point forecasts for GDP and CPI, with the Monetary Policy Report instead outlining a "central scenario". The latter is just a less detailed point forecast with increased uncertainty. Indeed, the BoC is looking for 2020 GDP to contract 7.8% and rebound 5.1% in 2021. That's materially weaker than our forecast of -6% for this year and +6% for next year. The major difference is that we're expecting a much sharper rebound in Q3. We'll have clarity on that soon enough, but this week's Focus feature supports our thesis.

The move to forward guidance is a clear shift from the direction under Governor Poloz, who was generally opposed to the tactic. One area where there is no daylight between Poloz and Macklem is the total lack of interest in taking policy rates into negative territory. While negative rates haven't been completely ruled out, we continue to view it as a truly last ditch option when every other easing avenue has been exhausted.

Key Takeaway: Amid the extreme uncertainty surrounding the rebound and longer-term damage from COVID, policy rates look like they are going to be low for a very long time. Indeed, even our above-consensus forecast doesn't have GDP returning to pre-COVID levels until the end of 2021, which would still put potential rate hikes at least two years away.

China: Remarkable Resilience?

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China continues to confound the skeptics amid exceptionally challenging circumstances. Although prior high-frequency data showed that the economy was already springing back to life in Q2, real GDP's stronger-than-expected increase of 3.2% y/y was impressive. The accompanying battery of Q2 data, especially industrial production (+4.4% y/y) and merchandise exports in U.S. dollar terms (+0.1% y/y) moving back into positive territory, should alleviate concerns that elevated trade tensions and deglobalization risks could suddenly topple China's role as the world's factory.

Nonetheless, China's economy remains far from picture-perfect health. Key domestic demand data, which usually provide a good idea of the durability of an economic recovery, are still patchy. The Chinese consumer, unsurprisingly, remains cautious. Nominal retail sales contracted 4.0% y/y in Q2 and will likely remain soft for an extended period given the weakened job market. Note that Chinese unemployment statistics still do not accurately reflect the shape of the job market. The relatively new surveyed-based urban unemployment rate, which stood at 5.7% in June, excludes the country's large pool of migrant workers.

Interpreting the fixed asset investment (FAI) data is tricky but our calculations show that FAI actually climbed 9.9% y/y in Q2 (vs -16.1% in Q1). However, the snapback appears to be mainly driven by fiscal stimulus and a sharp easing in bank credit conditions as infrastructure FAI climbed 14.3% y/y and FAI by state-owned enterprise surged 17% y/y. In comparison, manufacturing FAI grew 1.8% y/y. While Beijing will continue to rely on the tried-and-true infrastructure/SOE spending to anchor the economic recovery, ongoing concerns over financial leverage/stability suggest that this method may also have its limits.

In a nutshell, China's economy has displayed rather remarkable resilience this year. However, it's too early to conclude that it will be able to quickly return to its pre-pandemic state given that the multitude of challenges the country is presently facing is likely to persist for some time.

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Indications of stronger growth and a move toward price stability are **good news** *for the economy.*

	Good News	Bad News
Canada ▪ BoC signals rates to stay low amid "*long climb back*" from downturn ▪ U.S./Canada border to remain closed until at least August 21	**Wholesale Trade Volumes** +5.2% (May) **Manufacturing Sales Volumes** +8.8% (May) **Manufacturing New Orders** +9.4% (May) **Existing Home Sales** +63.0% (June) **MLS Home Prices** +5.4% y/y (June) **Industrial Product Prices** +0.4% (June P) **ADP Employment** +1,042,863 (June) **Global Investors** bought a net $22.4 bln in Canadian securities (May)	**New Motor Vehicle Sales** -47.2% y/y (May)
United States ▪ Stocks waver after some states scale back reopenings ▪ Fed officials still sound cautious	**Retail Sales** +7.5% (June) **Consumer Prices** +0.6% y/y (June) **Industrial Production** +5.4% (June)—and Capacity Utilization +3.5 ppts to 68.6% **Empire State Manufacturing Survey** +2.6 pts to an ISM-adjusted 52.6 (July) **NFIB Small Business Optimism** +6.2 pts to 100.6 (June) **Initial Claims** -10k to 1,300k (July 11 week) **Continuing Claims** -422k to 17,338k (July 4 week) **Housing Starts** +17.3% to 1.186 mln a.r. (June) **Building Permits** +2.1% to 1.241 mln a.r. (June) **NAHB Housing Market Index** +14 pts to 72 (July) **Global Investors** bought a net $68.0 bln in U.S. securities (May)	**Import Prices** -3.8% y/y (June) **Budget Deficit** widened to a record $864.1 bln (June) **Philly Fed Index** -0.1 pts to an ISM-adjusted 53.6 (July) **U of M Consumer Sentiment** -4.9 pts to 73.2 (July P)
Japan ▪ BoJ on hold but cuts growth outlook		**Tertiary Industry Index** -2.1% (May) **Industrial Production** -8.9% (May)—revised down
Europe ▪ ECB on hold as economy in "*good place at the moment*" ▪ U.K. economy barely growing	**Euro Area—Industrial Production** +12.4% (May) **Euro Area—Trade Surplus** grew to €8.0 bln (May) **Italy—Industrial Orders** +42.2% (May) **U.K.—Consumer Prices** +0.6% y/y (June) **U.K.—Industrial Production** +6.0% (May) **U.K.—Trade Deficit** narrowed to £2.8 bln (May) **U.K.—Jobless Rate** steady at 3.9% (3 mths to May) **U.K.—Jobless Claims** -28,100 (June)—but still high	**Germany—ZEW Survey** -4.1 pts to 59.3 (July) **U.K.—Monthly Real GDP** -19.1% (3 months to May)—**Index of Services** -18.9% **U.K.—Employment** -125,000 (3 mths to May) **U.K.—Average Weekly Earnings (Ex. Bonus)** slowed to **+**0.7% y/y (3 mths to May)
Other ▪ China's consumer spending disappoints ▪ Oil falls after OPEC+ agrees to ease output cuts	**China—Real GDP** +3.2% y/y (Q2) **China—Exports** +0.5% y/y; **Imports** +2.7% y/y (June) **China—Industrial Production** +4.8% y/y (June) **China—Foreign Direct Investment** +7.1% y/y (June)—but slowing **Australia—NAB Business Confidence** +21 pts to 1 (June) **Australia—Employment** +210,800 (June)	**China—Retail Sales** -1.8% y/y (June) **China—Fixed Asset Investment** -3.1% y/y (June) **Australia—Jobless Rate** +0.3 ppts to 7.4% (June) **Australia—Consumer Confidence** -6.1% (July)

Canadian Business Activity Index: Tracking the Recovery

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The Canadian economy has clearly entered the recovery phase, with strong gains already reported by various indicators including employment and home sales. But, the shape of the recovery remains in question, and there is an **increased need for *timely* information**. In that light, we've created the **BMO Business Activity Index** (BMO BAI) to track aggregate monthly activity in a more timely manner, including information on jobs, spending and sentiment. By incorporating some increasingly-available real-time data, as well as our own in-house forecasts, the index can be updated much sooner than traditional GDP data.

Motivation

Apart from the dated industry-based GDP report (latest official data are for April, though StatsCan has recently started publishing "flash" estimates for the following month), there is **little timely data on aggregate business activity in Canada**. And, given the unparalleled economic crisis caused by the pandemic, the need to track the recovery has never been greater. A tepid recovery would raise the sober prospect of numerous business insolvencies and permanent job losses. By contrast, a speedier expansion would quickly reduce the jobless rate from current double-digits while supporting incomes, government revenues, and profitability.

With this aim in mind, the BMO BAI was born. The index should help track an expected two-stage recovery, one that is initially rapid during the reopening phase, followed by a long and jagged return to pre-virus levels by late 2021. Much will depend on the course of the virus itself, not just in Canada but in other countries, notably the U.S.

Methodology

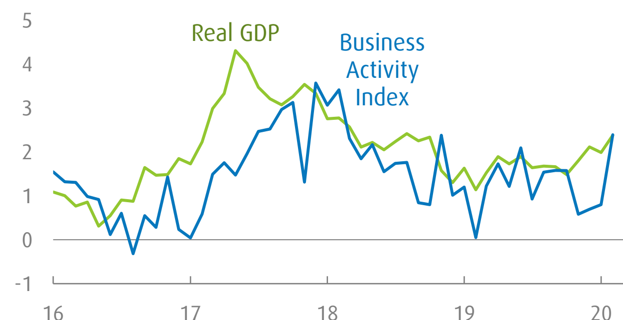
The BMO BAI is based on the Conference Board's method for constructing composite indexes of business activity.[1] It is derived from monthly percentage changes in individual indicators. One exception is the CFIB business sentiment index, whose contribution is based on its deviation from neutral (50).

The contribution of each indicator is adjusted to equalize its volatility, so that no single component dominates the index.

The aggregate index includes **ten indicators**: hours worked, unemployment rate, home sales, housing starts, business credit, wholesale trade, retail sales, manufacturing shipments, small business sentiment, and the TSX stock price index. All indicators are available on at least a monthly basis.

In addition, data on retail mobility and internal credit card transactions are used to estimate **retail sales** prior to the release of official data. BMO Economics' view of the economy is also used to benchmark estimates of other indicators when necessary.

Chart 1
Tracking the Economy Before the Pandemic



Sources: BMO Economics, Statistics Canada

As shown in *Chart 1*, the **BAI tracks real GDP growth reasonably well**, with a 59% correlation from 2016 to early 2020 (i.e., pre-pandemic). Note that GDP includes government spending and trade, the latter of which is only partly reflected in some of the BAI's components. Though not a perfect fit, the BAI should provide a timelier read on the direction and speed of the recovery than the official monthly GDP report.

Recent Performance

The **BAI plunged faster than real GDP during the March/April recession**, by 24% versus 18%, in part because the latter is insulated by a steadier government sector (*Chart 2*). Accordingly, it should see a quicker initial snapback than GDP during the reopening.

Official data are available for all indicators in May except retail sales, and for six indicators in June, along with real-time data on retail mobility and credit card transactions. Based on this information, we **estimate that the BAI rose 6% in May and 9% in June**. The former suggests some upside risk to StatsCan's advance estimate of a 3% rise in May GDP.

Business activity looks to have retraced about half of its contraction by June, a good start, but the second half of the year will be a much tougher grind. To that point, the mobility and card data suggest the recovery in retail spending lost some steam in June (*Chart 3*). Beyond the summer, we would expect the pace of increase in the BAI to moderate as pent-up demand wanes and consumer caution lingers.

Business confidence seems to have run ahead of the BAI, closing much more of the gap versus pre-virus levels (*Chart 4*). That's either a positive omen or the makings of a big disappointment.

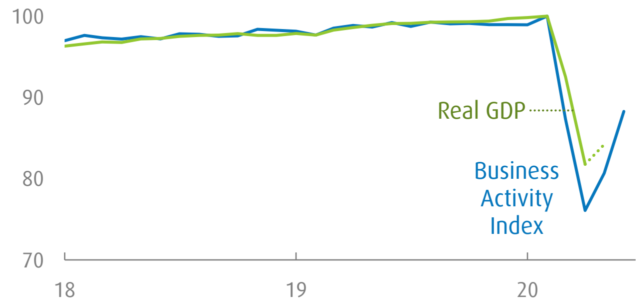
Bottom Line: BMO's Business Activity Index will provide a timelier look at how the recovery is progressing than monthly GDP; and, in this world of fast-changing conditions, timeliness is probably the key missing aspect of current available data. It's clear that the initial, easy phase of the recovery is well underway. The index will inform how well the expansion is proceeding on what is sure to be a long and bumpy journey.

[1] Conference Board. Calculating the Composite Indexes. https://www.conference-board.org/data/bci/index.cfm?id=2154

Chart 2
Possible Sharp Recovery in Reopening

Canada (February 2020 = 100)

Business Activity Index vs. Real GDP



May Real GDP (dashed line) = StatsCan estimate
Sources: BMO Economics, Statistics Canada

Chart 3
Offline Sales Grind Higher

Canada – 2020 (7-day m.a. : as of July 10, 2020)[1]

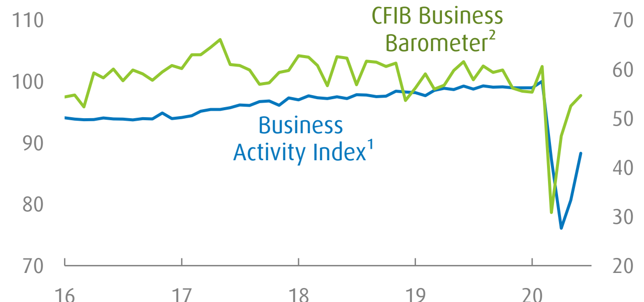
Retail and Recreation Mobility

[1] (% of baseline : January 3-February 6 = 0)
Sources: BMO Economics, Google

Chart 4
Business Confidence Rebounds

Canada

Business Activity Index vs. Business Confidence



[1] (lhs : February 2020 = 100); [2] (rhs : > 50 = stronger in the next year)
Sources: BMO Economics, Statistics Canada

Economic Forecast Summary for July 17, 2020

	2020				2021				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2019	2020	2021
CANADA											
Real GDP (q/q % chng : a.r.)	-8.2	-40.0	42.0	10.0	7.0	4.2	2.5	2.5	1.7	-6.0	6.0
Consumer Price Index (y/y % chng)	1.8	-0.2	0.1	0.2	0.5	2.1	1.8	1.7	1.9	0.4	1.5
Unemployment Rate (percent)	6.3	13.0	9.9	9.0	8.5	8.2	7.8	7.5	5.7	9.5	8.0
Housing Starts (000s : a.r.)	209	191	190	193	205	205	220	228	209	195	215
Current Account Balance ($blns : a.r.)	-44.4	-73.7	-63.4	-58.6	-55.1	-54.0	-51.8	-51.0	-47.0	-60.0	-53.0
Interest Rates	(average for the quarter : %)										
Overnight Rate	1.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.75	0.50	0.25
3-month Treasury Bill	1.29	0.22	0.20	0.20	0.20	0.20	0.20	0.20	1.65	0.45	0.20
10-year Bond	1.20	0.59	0.60 ↓	0.75 ↓	0.85 ↓	0.95 ↓	1.05	1.15	1.59	0.80	1.00
Canada-U.S. Interest Rate Spreads	(average for the quarter : bps)										
90-day	16	8	3	3	3	3	3	3	-45	7	3
10-year	-18	-10	-11 ↑	-10 ↑	-9 ↑	-8 ↑	-8 ↑	-7 ↑	-56	-12 ↑	-8 ↑
UNITED STATES											
Real GDP (q/q % chng : a.r.)	-5.0	-40.0	36.0	7.0	5.9	5.2	4.1	3.2	2.3	-5.5	5.0
Consumer Price Index (y/y % chng)	2.1	0.4	0.6 ↓	0.5 ↓	0.6 ↓	1.9 ↓	1.7	1.7 ↑	1.8	0.9 ↓	1.5
Unemployment Rate (percent)	3.8	13.0	9.8	9.0	8.1	7.3	6.6	6.2	3.7	8.9	7.0
Housing Starts (mlns : a.r.)	1.48	1.04	1.25	1.31	1.28	1.29	1.29	1.30	1.30	1.27 ↑	1.29
Current Account Balance ($blns : a.r.)	-417	-558	-593	-612	-624	-630	-639	-647	-480	-545	-635
Interest Rates	(average for the quarter : %)										
Fed Funds Target Rate	1.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	2.13	0.38	0.13
3-month Treasury Bill	1.13	0.14	0.15	0.15	0.15	0.15	0.15	0.15	2.10	0.40	0.15
10-year Note	1.38	0.69	0.70 ↓	0.85 ↓	0.95 ↓	1.05 ↓	1.15	1.20 ↓	2.14	0.90 ↓	1.10 ↓
EXCHANGE RATES	(average for the quarter)										
US¢/C$	74.4	72.2	73.9	74.0	74.3	74.5	74.8	75.1	75.4	73.6	74.7
C$/US$	1.34	1.39	1.35	1.35	1.35	1.34	1.34	1.33	1.33	1.36	1.34
¥/US$	109	108	108	109	111	112	113	115	109	108	113
US$/Euro	1.10	1.10	1.13	1.15	1.15	1.15	1.16	1.16	1.12	1.12	1.16
US$/£	1.28	1.24	1.25	1.26	1.27	1.28	1.29	1.30	1.28	1.26	1.28

Blocked areas mark BMO Capital Markets forecasts; up and down arrows (↑↓) indicate forecast changes; spreads may differ due to rounding

Canada

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Retail Sales
Tuesday, 8:30 am

		Ex. Autos
May (e)	**+20.0%**	**+11.0%**
Consensus	*+20.1%*	*+12.5%*
Apr.	-26.4%	-22.0%

Much of the country moved ahead with reopening plans in May, with a few major regions being held back. Despite the latter, we're expecting **Canadian retail sales** to rebound 20% in May, with gains anticipated across the board. That would still leave sales at just over 20% below February levels. While gains are expected to be broad, auto sales look to lead the way, with unit sales more than double from the nadir hit in April. Gasoline prices were also up sharply which will support the headline. Excluding autos & gas, sales look to be up a more subdued 10%, though here, too, that still leaves spending about 15% below pre-COVID levels. April was the bottom for the economy, but a full recovery will be lengthy. Note that our headline forecast is above Statcan's initial estimate of +19.1%, as we view the risks as tilted to the upside.

Consumer Price Index
Wednesday, 8:30 am

June (e)	**+0.4% (+0.3% sa)**	**+0.2% y/y**
Consensus	*+0.3%*	*+0.2% y/y*
May	+0.3%	-0.4% y/y

Core CPI Measures (May)

CPI Core - Trim	+1.7% y/y
CPI Core - Median	+1.9% y/y
CPI Core - Common	+1.4% y/y

Canadian consumer prices likely continued their rebound in June as gasoline prices rose at a double-digit pace for a second consecutive month. We're looking for CPI to rise 0.4% m/m, which is about +0.3% on a seasonally-adjusted basis. Other energy products climbed as well, with fuel oil up, and electricity pricing rising in Ontario. The other major mover since the start of the pandemic is clothing which has seen a 7.6% two-month drop, though there's no reason to expect any reversal there as retailers continue to do their utmost to attract consumers (online or in store as the reopening continues). A bounce in home sales might have provided some support to furniture prices after May saw the biggest drop in six years. Our call would lift the yearly pace to +0.2% y/y, following the first back-to-back negative readings in just over a decade. Note that StatsCan, in concert with the Bank of Canada, released analysis on how the basket of purchases has shifted during COVID. That led to CPI understating inflation (by 0.3 ppts in May); though unless those basket changes become permanent, they likely won't have much impact on the BoC. That's especially the case with a massive output gap looming over the inflation outlook.

The average of the Bank of Canada's three core CPI measures has pulled back a few ticks so far this year and looks to continue to slow further in the months ahead as the pandemic-driven drop in demand drives firms to cut prices. Look for broad inflation to decelerate over the coming months as businesses attempt to bring customers back as the lockdown eases.

United States

Michael Gregory, CFA,
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Existing Home Sales
Wednesday, 10:00 am

June (e)	**4.90 mln a.r. (+25.4%)**
Consensus	*4.82 mln a.r. (+23.1%)*
May	3.91 mln a.r. (-9.7%)

Mortgage applications for purchases increased 21% in June, on average, after surging a record 36% in May. The strong back-to-back gain pushed up the 'apps pace' to its highest level in nearly a dozen years, after falling to five-year lows in April. Record-low mortgage rates (30 years averaged just 3.16% in June) are helping to unleash housing demand built up during the lockdowns and ensure that the moderately firming pre-pandemic trend reasserts itself. The volume of existing home sales slipped below

the four million mark in May, for the first time in almost a decade, reflecting the full brunt of the pandemic (these sales are measured at the time of closing, not contract signing). However, there is a wall of post-lockdown transactions about to close; pending home sales surged 44% in May. On balance, we look for **existing sales** to jump at least 25% to 4.9 million, which is still below the 5.4 million pre-COVID trend.

New Home Sales

Friday, 10:00 am

June (e)	**716,000 a.r.**	**(+5.9%)**
Consensus	*700,000 a.r.*	*(+3.6%)*
May	676,000 a.r.	(+16.6%)

Concurrently measured (and notoriously volatile), **new home sales** should increase around 6% to register a full recovery back to February's 716,000 level. The NAHB's metric measuring present sales posted its second largest rise on record in July, after June's record jump, returning to 70-plus pre-pandemic readings. Despite the upbeat housing data amid record-low borrowing costs, lingering joblessness and languishing confidence could prevent the housing sector from pushing much past where it was before.

Financial Markets Update for July 17, 2020

		Jul 17 [1]	Jul 10	Week Ago	4 Weeks Ago	Dec 31, 2019
					(basis point change)	
Canadian Money Market	Call Money	0.25	0.25	0	0	-150
	Prime Rate	2.45	2.45	0	0	-150
U.S. Money Market	Fed Funds (effective)	0.25	0.25	0	0	-150
	Prime Rate	3.25	3.25	0	0	-150
3-Month Rates	Canada	0.18	0.18	0	-2	-148
	United States	0.11	0.12	-2	-4	-144
	Japan	-0.09	-0.11	3	5	2
	Eurozone	-0.44	-0.44	0	-4	-6
	United Kingdom	0.08	0.09	-2	-9	-71
	Australia	0.10	0.11	0	-1	-81
2-Year Bonds	Canada	0.27	0.28	-1	-3	-142
	United States	0.14	0.16	-1	-4	-143
10-Year Bonds	Canada	0.51	0.55	-4	-2	-119
	United States	0.61	0.65	-3	-8	-130
	Japan	0.02	0.01	0	1	4
	Germany	-0.46	-0.47	1	-4	-27
	United Kingdom	0.16	0.15	0	-8	-66
	Australia	0.87	0.86	1	1	-50
Risk Indicators	VIX	27.0	27.3	-0.3 pts	-8.1 pts	13.2 pts
	TED Spread	16	14	2	1	-20
	Inv. Grade CDS Spread [2]	73	75	-2	-2	28
	High Yield CDS Spread [2]	484	508	-24	-14	204
					(percent change)	
Currencies	US¢/C$	73.64	73.57	0.1	0.2	-4.3
	C$/US$	1.358	1.359	—	—	—
	¥/US$	107.14	106.93	0.2	0.3	-1.4
	US$/€	1.1423	1.1300	1.1	2.2	1.9
	US$/£	1.253	1.262	-0.7	1.5	-5.5
	US¢/A$	69.85	69.50	0.5	2.2	-0.5
Commodities	CRB Futures Index	140.73	141.52	-0.6	2.0	-24.2
	Oil (generic contract)	40.48	40.55	-0.2	1.8	-33.7
	Natural Gas (generic contract)	1.74	1.81	-3.6	4.3	-20.5
	Gold (spot price)	1,809.25	1,798.70	0.6	3.7	19.2
Equities	S&P/TSX Composite	16,048	15,714	2.1	3.7	-5.9
	S&P 500	3,213	3,185	0.9	3.7	-0.5
	Nasdaq	10,476	10,617	-1.3	5.3	16.8
	Dow Jones Industrial	26,722	26,075	2.5	3.3	-6.4
	Nikkei	22,696	22,291	1.8	1.0	-4.1
	Frankfurt DAX	12,905	12,634	2.1	4.7	-2.6
	London FT100	6,280	6,095	3.0	-0.2	-16.7
	France CAC40	5,054	4,970	1.7	1.5	-15.5
	S&P ASX 200	6,034	5,919	1.9	1.5	-9.7

[1] = as of 11 am *[2] = One day delay*

Global Calendar — July 20–July 24

	Monday July 20	Tuesday July 21	Wednesday July 22	Thursday July 23	Friday July 24
Japan	**Trade Balance** **June '20 (e) -¥11.9 bln** June '19 +¥588.1 bln **BoJ Minutes from June 15-16 meeting**	**CPI** / **Core CPI** **June (e) +0.1% y/y -0.1% y/y** May +0.1% y/y -0.2% y/y **CPI ex. Food & Energy** **June (e) +0.4% y/y** May +0.4% y/y **Department Store Sales** **June** May -65.6% y/y **Machine Tool Orders** **June F (e) -32.0% y/y** May -52.8% y/y	**Manufacturing PMI** **July P** June 40.1 **Services PMI** **July P** June 45.0 **Composite PMI** **July P** June 40.8	**Markets Closed**	**Markets Closed**
Euro Area				**EURO AREA** **Consumer Confidence** **July A (e) -12.0** June -14.7 **GERMANY** **GfK Consumer Confidence** **Aug. (e) -4.3** July -9.6 **FRANCE** **Business Confidence** **July (e) 86** June 78	**EURO AREA** **Manufacturing PMI** **July P (e) 49.5** June 47.4 **Services PMI** **July P (e) 51.0** June 48.3 **Composite PMI** **July P (e) 51.0** June 48.5 **ITALY** **Consumer Confidence** **July (e) 104.0** June 100.6
U.K.					**GfK Consumer Confidence** **July P (e) -25** June -27 **Retail Sales (incl. Fuel)** **June (e) +8.3% -6.0% y/y** May +12.0% -13.1% y/y **Manufacturing PMI** **July P (e) 51.3** June 50.1 **Services PMI** **July P (e) 51.0** June 47.1 **Composite PMI** **July P (e) 50.9** June 47.7
Other		**AUSTRALIA** **RBA Minutes from July 7 meeting**			

[D] = date approximate

Upcoming Policy Meetings | Bank of England: Aug. 6, Sep. 17, Nov. 5 | European Central Bank: Sep. 10, Oct. 29, Dec. 10

North American Calendar — July 20–July 24

	Monday July 20	Tuesday July 21	Wednesday July 22	Thursday July 23	Friday July 24
Canada	BoC Buyback: 30-year sector	**8:30 am Retail Sales Ex. Autos** **May (e) +20.0% +11.0%** *Consensus +20.1% +12.5%* Apr. -26.4% -22.0% **8:30 am New Housing Price Index** **June (e) +0.1% +1.3% y/y** May +0.1% +1.1% y/y 10:30 am 3-, 6- & 12-month bill auction $10.0 bln (new cash -$9.1 bln) BoC Buyback: Under 2-year sector	**8:30 am Consumer Price Index** **June (e) +0.4% +0.2% y/y (+0.3% sa)** *Consensus +0.3% +0.2% y/y* May +0.3% -0.4% y/y **8:30 am CPI Core (% y/y)** **Trim Median Common** **June** May +1.7% +1.9% +1.4% Noon 2-year bond auction $6.0 bln BoC Buyback: 2-year sector	Noon 30-year bond auction $3.0 bln 3-year bond auction announcement BoC Buyback: 30-year sector	BoC Buyback: 10-year sector
United States	11:30 am 13- & 26-week bill auctions $105 bln	**8:30 am Chicago Fed National Activity Index** **June (e) +4.0[C]** May +2.61 11:00 am Cash management bill auctions $80 bln, 4- & 8-week bill auction announcements	**7:00 am MBA Mortgage Apps** **July 17** July 10 +5.1% **9:00 am FHFA House Price Index** **May (e) +0.2% +5.4% y/y** *Consensus +0.4% +5.6% y/y* Apr. +0.2% +5.5% y/y **10:00 am Existing Home Sales** **June (e) 4.90 mln a.r. (+25.4%)** *Consensus 4.82 mln a.r. (+23.1%)* May 3.91 mln a.r. (-9.7%) 1:00 pm 20[R]-year bond auction $17 bln	**8:30 am Initial Claims** **July 18 (e) 1,400k (+100k)** *Consensus 1,280k (-20k)* July 11 1,300k (-10k) **8:30 am Continuing Claims** **July 11 17,100k (-288k)[C]** July 4 17,388k (-422k) **10:00 am Leading Indicator** **June (e) +2.1%[C]** May +2.8% **11:00 am Kansas City Fed Manufacturing Activity** **July (e) 5[C]** June 1 11:00 am 13- & 26-week bill, 2-, 5- & 7-year note, 2[R]-year FRN auction announcements 11:30 am 4- & 8-week bill auctions 1:00 pm 10-year TIPS auction $14 bln	**9:45 am Markit PMIs (July P)** **10:00 am New Home Sales** **June (e) 716,000 a.r. (+5.9%)** *Consensus 700,000 a.r. (+3.6%)* May 676,000 a.r. (+16.6%)

[C] = consensus [D] = date approximate [R] = reopening

Upcoming Policy Meetings | Bank of Canada: Sep. 9, Oct. 28, Dec. 9 | FOMC: July 28-29, Sep. 15-16, Nov. 4-5

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