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Six Months after Shutdown

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Today marks not just the 19-year anniversary of that tragic day in 2001, but also six months of the pandemic (according to the WHO). On the latter, it's appropriate to take stock of where we stand. Even with a further softening in tech this week, the bigger picture is that **markets have staged a remarkably rapid recovery** from the fearsome five-week plunge earlier in the year. The TSX, for one, managed to hold steady amid this week's choppiness—ah, September—and is now up nearly 45% from the March depths (almost precisely in line with the MSCI World index). And, we would respectfully submit that **the overall North American economic backdrop has also come back faster and stronger than widely expected**, at least compared to the conventional wisdom at the depths in the spring.

While this week was relatively light on the economic data front, the few key selected indicators on hand mostly fit into the bigger narrative of a firmer-than-anticipated recovery. In the U.S., **inflation is moving back to some kind of normal**, with CPI popping 0.4% on both headline and core in August, largely due to a snap-back in used vehicle prices. While 1.7% y/y underlying inflation won't scare anyone, it shows that deflation risks are fading fast. Meantime, the **JOLTS survey** revealed that layoffs fell back to below-normal levels in July, suggesting there is no big second wave coming in joblessness. The latest quarterly **Manpower survey** pointed to a surprisingly big pick-up in hiring plans for Q4; the +14% result is still down from +19% at the start of 2020, but it didn't get this high until we were five *years* into the prior recovery. Finally, the **NFIB** reported that small business hiring plans and sentiment rebounded last month; while the latter was still down 4% from pre-pandemic levels, it would still rank above almost any reading in the decade prior to 2016.

Forecasters are taking note of the steady run of high-side economic surprises. The latest Blue Chip survey, which was conducted late last week, reveals that the **consensus call on U.S. GDP growth has risen for three months in row**, after bottoming out in early June. The median forecast is now a drop of 4.6% this year (up a hefty 1.5 percentage points from the low of -6.1% three months ago), and a rebound of 3.8% in 2021. That consensus view has moved almost in line with our calls (we are a tad stronger on both years at -4.5% and +4.0%), and the range of estimates has narrowed notably. Dispensing with a few outliers at both extremes, the spread of forecasts around the average is now roughly +/-1 ppt in 2020 and +/-1.5 ppts next year.

Similarly, **forecasts are nudging up overseas**, with the emphasis on nudging. **China** looks to be one of the rare economies headed for outright growth this year, with GDP likely to be up at least 2%. August trade was a bit light of expectations, but still posted a 9.5% y/y gain in exports (in USD terms), as factories benefit from the robust global rebound in goods purchases. Unfortunately, that strength has not been mirrored in China's domestic demand, as imports were still down 2.1% y/y. As a result, the trade surplus has gapped wider again, to $59 billion in the month and $409 billion in the past year—a bit <u>above</u> the average of the prior three years. The persistence of the trade imbalance points to ongoing friction with the U.S. on this front, likely regardless of the outcome of the U.S. elections (less than 8 weeks away!).

Germany, too, is seeing a rebound in exports, a big reason GDP forecasts are being lifted there as well. As but one example, the DIW institute cranked up its view on 2020 to -6% from the previous dour call of -9.4%. We believe the result will be closer to -5%, although Germany is definitely at the positive end of the EU spectrum. Given the recent upswing in virus cases in a number of key economies there, and some rollbacks in opening measures, we have trimmed our call slightly on Euro Area GDP to -7% (from -6.7%) for this year, and +6.0% for 2021 (from +6.3%). Rollbacks were prominent this week for the U.K., and we continue to look for roughly a 10% drop in GDP there this year. Note that given the monthly patterns, with activity hitting rock bottom in April, annualized GDP growth is on track for a gaudy rise in Q3 (of roughly 80%), yet Britain will still post one of the biggest declines this year due to a sharp first-half plunge.

The overwhelming factor behind the generally positive surprises for economic data has been the **tidal wave of government support**. Essentially, transfer payments have kept households whole, and in some cases more than making up for lost wages. That's been the case in the U.S. and Canada, where disposable incomes have actually accelerated this year, not cratered... as is typically the case in a downturn. And, frankly, it is the extent of government support that many forecasters underestimated at the depths of the downturn. Just as one example from Canada, the Q2 spike in income and savings helped carve deeply into closely-watched household debt/income ratios. Along with a slowing in debt growth, the smoothed ratio fell to just below 167%, down nearly 8 ppts from last year's record high. The flip side is that government gross debt/GDP fired up 18 ppts to above 132% (also skewed by the plunge in GDP that quarter).

Looking ahead, there are clearly at least **three sources of uncertainty/concern** for the broader outlook. **First**, there is the apparently complete impasse on another round of U.S. fiscal stimulus. As hard as it would have been to believe a few weeks ago, it now seems entirely believable that we are headed into the election with no new measures. **Second**, the markets are increasingly focussing on said election, and its associated uncertainty with the race tightening in key battleground states. **Finally**, there is the ongoing concern about the rising number of new virus cases in many nations; in some cases, a rapid rise. On that note, we would offer the reassuring fact that U.S. new cases have quietly receded in recent weeks to nearly half the peaks of late July, and that the U.S. economy managed to soldier through its upswing in cases over the summer. True, even Canada has seen the pace of new cases almost double in the past week; but, in per capita terms, it's still running at less than 1/6th the U.S. pace. That's not to downplay the risks ahead, but just to keep them in perspective.

Perhaps the award for the *"Biggest Upside Surprise during the Pandemic"* may well go to **Canadian housing**. Robert Kavcic goes into much greater detail in this week's Feature, but some of the results have shocked even the least bearish forecasters *(ahem)*. To pick just one data point, housing starts vaulted in August to 262,396 units, one of their highest monthly tallies in the past 30 years. While no doubt some of this outsized strength simply makes up for lost activity in the spring, we now believe that starts will actually manage to nudge slightly higher for 2020 versus last year. As is the case for U.S. starts, this means home building will be one of the very rare areas that will post positive growth in an extremely challenging year for the broader economy.

The strength in building is simply following in the wake of the rapid recovery in home sales. We expect next week's August existing sales to post another rise of roughly 30% y/y, leaping to a record high in seasonally adjusted terms. Like starts, we believe that this surge will largely offset the spring shutdown, leaving year-to-date sales almost level. On the price front, cities that were hot before the pandemic—Montreal, Ottawa, Toronto, and pretty much all of Southwestern Ontario—have re-emerged even hotter than before. As a result, look for mortgage debt to begin re-accelerating. We suspect that policymakers will mostly grin and bear this renewed heat in housing, tacitly accepting growth where they can find it in these deeply challenging times.

Fed Policy: Low for Even Longer

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On September 16, we'll be assessing the **FOMC's policy statement** and **Summary of Economic Projections (SEP)**, including the 'dot plot', along with Chair Powell's presser, in light of the profound changes to the Statement on Longer-Run Goals and Monetary Policy Strategy announced on August 27. While the **goals of maximum employment and price stability remained, the strategy to achieve them changed**. For maximum employment, policy will now be informed by the Committee's assessment of the "shortfall" of employment from its maximum level, no longer the "deviation" from its maximum level. The latter meant that as the unemployment rate approached its longer-run, or natural, rate (4.1% being the current median call), the Fed would be inclined to tighten policy. However, seeing what the pre-pandemic run of sub-natural jobless rates resulted in (a much-welcomed social broadening of employment and wage gains) and didn't result in (generalized inflation), preemptive tightening will now no longer transpire. And, joblessness running above the natural rate will be consistent with more accommodative policy than would otherwise have been the case. On price stability, the FOMC is targeting inflation that "averages" 2% "over time" (period not defined). This means that policy *"will likely aim to achieve inflation moderately above 2 percent for some time"* after periods of persistent sub-2% inflation.

The **forward guidance** currently being employed in the policy statement **doesn't have to be altered much**. For example, *"the Committee expects to maintain this target range [0%-to-0.25%] until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals"* still works. For the other phrase, *"in determining the timing and size of future adjustments to the stance of monetary policy, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective"*, we could see the word "symmetric" being replaced by "average".

The **SEP will be much more interesting** because September is when they extend their projections out to 2023. Currently (from June), the median projection for the unemployment rate is 9.3% for 2020 (Q4 average), 6.5% for 2021 and 5.5% for 2022. While the 2020 call should be lowered (the August reading alone was 8.4%), the remaining years should still sit noticeably above the longer-run level (likely to remain at 4.1% but with downside risk). The median projection for core PCE inflation was 1.0% for 2020 (Q4 average), 1.5% for 2021 and 1.7% for 2022. While the 2020 call could be lifted a bit (the July reading alone was 1.2% with the core CPI metric picking up in August), the remaining years should still stay at or below 2%. And, should these themes be repeated in the 2023 calls for the jobless rate and core inflation, this would be a strong signal of an accommodative Fed policy lasting for at least the next three years.

The 'dot plot' will reveal how strong the conviction is to keep policy rates at the effective lower bound. The current median call for the fed funds target range midpoint is for it to remain at 0.125% through 2022. Among the 17 policymakers, this view was unanimous for 2020 and 2021 with only 2 of 17 participants putting in a rate hike for 2022. We look for the 2023 median call to also remain at 0.125% with most participants (at least 9) concurring. Although the general tone of the economic projections might have improved from June, it's unlikely to improve sufficiently to move the Fed from an accommodative course given the profound changes to monetary policy strategy. **It's looking like rate hikes are going to be a 2024 story, at the earliest**.

BoC: Ready to Recalibrate

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The **Bank of Canada** stuck to the script this week, keeping policy rates at the effective lower bound of 25 bps and keeping the various QE programs steady. As expected, the Bank recognized that the macro backdrop has evolved better than it expected in the July MPR. Indeed, Q2 wasn't quite as negative and the Q3 rebound is tracking well above its projection. Even so, the policy Statement repeated policymakers' belief that the period after the initial rebound (think Q4 and beyond) will be far more challenging. We're fully on board with that thesis as our GDP forecast has growth slowing from 45% annualized in Q3 to under 7% in Q4. The latter would be very solid in normal times, but these are not normal times and would still leave the economy well below pre-COVID activity levels. Accordingly, the Statement and Governor Macklem repeatedly stressed that policy is going to be extraordinarily supportive for some time.

A new wrinkle in the Statement was that the BoC noted the QE program "*will be calibrated to provide the monetary policy stimulus needed to support the recovery and achieve the inflation target*." That suggests **the QE program will be the first policy tool to be tweaked** if conditions continue to improve or if they deteriorate and more needs to be done. What would trigger a re-calibration isn't clear. However, given that the BoC expects that the recuperation phase will be "*slow and choppy*", that suggests they are closer to adding more stimulus than withdrawing at this point. That's not our call, but is where the near-term risks lie. In addition, any slowing on the QE front would send a different message than the low-for-long mantra being stressed by Governor Macklem. Also, we're not going to have a good idea of how Q4 is evolving until late in the quarter when we start getting October figures. And, finally, there's still plenty of Government of Canada bond issuance in the pipeline that the BoC needs to ensure the market can digest. All told, **it doesn't look like QE can be tapered until 2021 at the absolute earliest**.

Key Takeaway: During Thursday's press conference Governor Macklem said that it's "*very premature to talk about stimulus exit*." We take him at his word.

Consumer Prices Are Retracing Not Inflating

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With U.S. consumer prices surprising to the upside for a third month in a row, it's time to ask whether there is more heat beneath the surface than we think. Core prices jumped another 0.4% in August after a jumbo gain the prior month. This lifted the yearly core rate to 1.74% from 1.57%, retracing almost half of the earlier plunge. Amid widespread gains, core prices have snapped back 5.1% annualized in the past three months, pushing them above pre-pandemic levels.

Still, the song remains the same, we believe. Except for some isolated cases such as food (due to earlier supply chain disruptions, notably for beef), household appliances (due to a resilient housing market) and used motor vehicles, prices are mostly rebounding from earlier aggressive discounting to coax nervous shoppers back to stores. While items such as gasoline, airfares and clothing have turned higher, they are still well below their pre-virus level (airfares are 23% below). Most other items, including shelter and new vehicles, have risen only moderately. The core measure itself is up a subdued 1.3% annualized since February.

With the world facing a similar catastrophic shock, there is no reason for U.S. inflation to behave any differently than in other countries. For the most part, inflation remains subdued in Canada and elsewhere. The core CPI for advanced countries is up 1.0% y/y in June, with little sign of returning to February's level of 1.7%. Core prices ran at 1.3% in the Euro Area in July and just 0.7% in Germany.

Bottom Line: While U.S. inflation is showing a little more spark than we previously thought, it still faces the muting effects of elevated unemployment, economic anxiety and increased automation. We look for core consumer prices to rise 1.9% in 2021 and core PCE prices to increase 1.6%. The Fed has set a higher bar for itself with average inflation targeting, and, despite the recent upturn, will struggle to clear it.

Crude Oil Outlook: Back on the Ropes?

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After a hot summer run, WTI has slid well below the US$40/bbl mark in recent days. Concerns over both the short-term outlook for global oil demand and OPEC+ production curbs appear to be the predominant factors behind crude's sudden struggles. The former has been sparked by worries that the recovery in oil demand could be easing simultaneously across the world's major regions. In the U.S., the prospect of a softer-than-usual winter driving season has risen following a disappointing summer. In Europe, fears of a second wave of COVID-19 cases have been hitting the headlines, leading to concerns that its nascent economic recovery could stall. There is also mounting anxiety in China, as the Middle Kingdom's oil storage capacity may be reaching its limits, a sign that the country may have completed the restocking process.

On the supply side, doubts over the ability of OPEC+ members to stick to their production cut targets have resurfaced. This explains why OPEC+'s upcoming Joint Ministerial Monitoring Committee (JMMC) meeting on September 17th is capturing more media attention than normal. Note that the JMMC meets every month to assess the future state of the oil market and member compliance, not to review potential changes in the cartel's production cut strategy. Thus, it's highly unlikely that OPEC+ could unexpectedly adjust (i.e., increase) its current target of 7.7 mb/d that is currently set to remain until the end of the year and then subsequently fall to 5.8 mb/d until

April 2022. Instead, the meeting is likely to focus on getting the laggards, such as Iraq and Nigeria, to stick to their quotas in an effort to curb the cartel's actual production.

In a nutshell, **near-term risks for WTI remain tilted towards the downside** as concerns over a second wave of COVID-19 are likely to persist. This will undoubtedly fuel speculation that OPEC+ may need to reverse course and deepen its production cuts to rebalance the oil market and shore up prices.

Has U.K. law been broken? Depends on how you define it.

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This past week was a critical one. It was Round 8 of the U.K./EU negotiations and expectations that both sides would be able to overcome the two big hurdles—access to fishing waters and having a level playing field—by October 31st were pretty low. It couldn't get worse, right? Wrong. Britain felt that Brussels was refusing to be realistic so it decided to take precautionary measures, or a Plan B. The Internal Market Bill was introduced, and it permits U.K. ministers to interpret parts of the Withdrawal Agreement differently, ensures smoother trade flows between the U.K., Scotland, Wales and Northern Ireland; and, thus allows the actual agreement to be revised, in practice. Is this breaking the law? The legal agreement signed by both sides in January? Kinda. Sorta. Only a little bit. In the words of Northern Ireland's Secretary of State, Brandon Lewis, "*Yes, this does break international law in a very specific and limited way… We are taking the powers to disapply the EU law concept of direct effect required by article 4 in a certain, very tightly defined circumstance.*" So the short answer is yes: it is breaking the law. You either break it, or you don't.

So all heck has now broken loose. EU Commission President **Ursula von der Leyen** warned PM Johnson not to mess with the treaty; European People's Party leader **Manfred Weber** declared that "*there is no such thing as a good outcome in Brexit*"; former British leaders **Theresa May** and **John Major** warned that the U.K.'s international credibility was at risk; and, **Nancy Pelosi** threatened that there would be no U.S./U.K. trade deal if the treaty is violated. **Michael Gove** declared that the U.K. cannot and will not withdraw the bill, and **Michel Barnier** fumed that mutual trust and confidence from both sides are required. And lest one thinks that the trade talks must have fallen apart, there will be **another meeting next week** in Brussels. The EU is giving the U.K. until the end of September to undo this, or they may embark into legal action. British Parliament will debate the bill on Monday, and will likely push it through the House of Commons and the House of Lords in coming days.

Meantime, the **BoE's** policy announcement is on Thursday. No changes are expected, as improving economic growth gives the central bank some breathing room. But this new hurdle certainly opens up the possibility of more stimulus and the MPC is open to using all of the tools at its disposal, including negative rates. As far as the pound is concerned, brace for more volatility. **Stephen Gallo**, our European Head of FX Strategy, feels that things could be different this time. "*On the one hand, we are nearing the culmination of the first U.K./EU negotiations since the 2019 U.K. election, which provided the government with a powerful democratic mandate. On the other hand, COVID-19 has drastically shifted the government's calculus on so many levels. Our base case remains that a U.K./EU deal covering some merchandise trade will get done. But it may only happen after one side leaves the negotiating table, or well after the end of 2020. The GBP is fully a 'headline-driven' currency again.*"

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

Canada

- BoC on hold amid *"slow and choppy"* recovery
- New virus cases climb; B.C. first province to bring back some shutdown measures

Good News

- **Housing Starts** +6.9% to 262,396 a.r. (Aug.)
- **Manpower Survey—Net Outlook** +6% (Q4)
- **Household Debt-to-Income Ratio** -4.96 ppts to 166.78% n.s.a; -17.16 ppts to 158.21% s.a. (Q2)
- **Industrial Product Prices** +0.1% (Aug. P)

Bad News

- **Capacity Utilization** -9.5 ppts to 70.3% (Q2)

United States

- Congress in stalemate over "skinny" stimulus bill
- Another volatile week for stocks

Good News

- **Consumer Prices** +0.4%; **Producer Prices** +0.3% (Aug.)
- **Job Openings** climbed to 6,618k (July)—and **Layoffs** back to normal at 1,721k
- **Manpower Survey—Net Outlook** +14% (Q4)
- **Consumer Credit** +$12.2 bln (July)
- **NFIB Small Business Optimism Index** +1.4 pts to 100.2 (Aug.)

Bad News

- **Initial Claims** steady at 884k (Sep. 5 week)
- **Wholesale Inventories** revised down to -0.3% (July)

Japan

- Chief Cabinet Minister Suga frontrunner in presidential race ahead of LDP party vote

Good News

- **Bank Lending Ex-Trusts** +6.7% y/y (Aug.)
- **Core Machine Orders** +6.3% (July)

Bad News

- **Real GDP** revised lower to -7.9% q/q (Q2)
- **Machine Tool Orders** -23.3% y/y (Aug. P)
- **Real Household Spending** -7.6% y/y (July)
- **Current Account Surplus** ¥1.5 trln (July)—from ¥2.0 trln a year ago

Europe

- ECB on hold; watching euro's strength
- U.K. plans to break parts of the Withdrawal Bill, raising fears of a no-deal Brexit

Good News

- **Germany—Industrial Production** +1.2% (July)
- **Germany—Trade Surplus** grew to €18.0 bln (July)
- **France—Trade Deficit** narrowed to €7.0 bln (July)
- **France—Industrial Production** +3.8% (July)
- **Italy—Industrial Production** +7.4% (July)
- **U.K.—Monthly Real GDP** +6.6% (July)—and **Index of Services** +6.1%
- **U.K.—Industrial Production** +5.2% (July)
- **U.K.—RICS House Price Balance** +44% (Aug.)

Bad News

- **Italy—Retail Sales** -2.2% (July)
- **U.K.—Trade Deficit** widened to £8.1 bln (July)

Other

- Oil drops on concerns of OPEC supply

Good News

- **China—Exports** +9.5% y/y (Aug.)
- **China—Consumer Prices** +2.4% y/y (Aug.)
- **China—Aggregate Yuan Financing** 3.6 trln (Aug.)—and **New Yuan Loans** 1.3 trln
- **China—M2 Money Supply** +10.4% y/y (Aug.)
- **China—Foreign Direct Investment** +18.7% y/y (Aug.)
- **China—Foreign Reserves** $3.16 trln (Aug.)
- **Australia—Westpac Consumer Confidence** +18.0% (Sep.)

Bad News

- **China—Imports** -2.1% y/y (Aug.)
- **China—Producer Prices** -2.0% y/y (Aug.)
- **Australia—NAB Business Conditions** -6 pts to -6 (Aug.)

Betting Against the House? Canadian Real Estate Through the Pandemic

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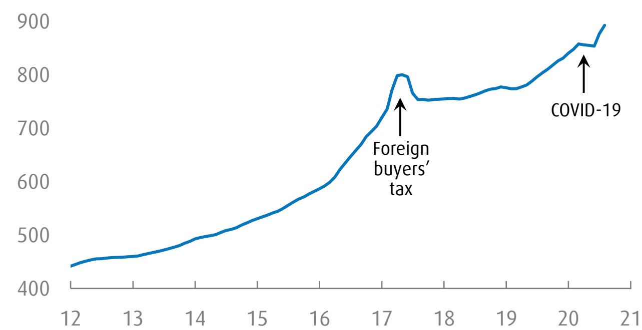
Anyone expecting even a modest contraction in Canadian home prices as a result of COVID-19 has been sorely offside. After a pause in activity at the height of the pandemic in the spring, the market opened up hot in most major cities, and has only seen the temperature rise through the summer. Here's a look at why residential real estate has performed uncharacteristically well through the downturn, and some questions about what lies ahead.

In Toronto, sales were up a hefty 40.3% from quite normal year-ago levels in August, the strongest month on record after seasonal adjustment. In Vancouver, sales jumped 36.6% y/y, with the level of activity now pushing to the highest since late-2017—recall that market was soggy heading into COVID. Montreal sales topped both, up 47% y/y. To be sure, listings are coming back onto the market at a solid clip, but not nearly fast enough to satiate heated demand. Prices in Toronto are up more than 11% from a year ago (*Chart 1*); Vancouver is up 5.3% (best since 2017); and, the median single-family price in Montreal was up a hefty 24%. In some markets like the Prairies, however, the re-opening has been much more subdued.

Chart 1
What Correction?

Greater Toronto Area (C$ 000s : s.a.)
MLS HPI Benchmark Price — Composite

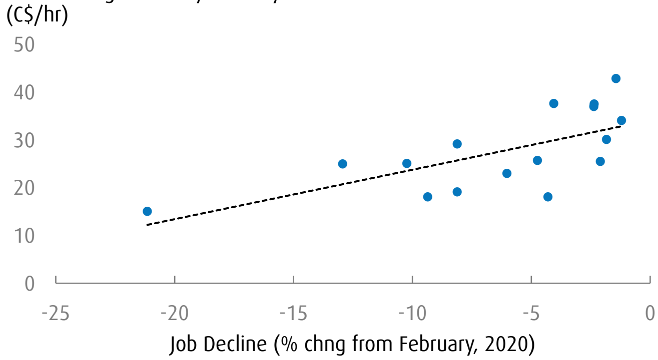


Sources: BMO Economics, Haver Analytics

Part of the surge in activity simply reflects pent-up demand after the market was closed for about three months during prime buying season. That said, the bigger picture still suggests that there is more going on as well. First, demand-side factors are surprisingly supportive. While broad Canadian employment was still down almost 6% from pre-COVID levels in August, the declines are typically deeper in lower-paying industries (*Chart 2*). That is not where the typical home-buying demographic resides, especially for the mid-to-higher end of the market where there has been a lot of strength. All the while, sub-2% five-year fixed-rate mortgages have been readily available for the first time.

Chart 2
Lower Pay = Bigger Job Losses

Canada
Median Wage Level by Industry (C$/hr)



Sources: BMO Economics, Haver Analytics

Meantime, preferences have shifted in response to the new normal, leading to a spike in demand for more spacious homes on larger lots, sometimes well outside the core of the major cities. The shift to work-from-home has opened up markets that were never previously in the realm of possibility for those commuting. In Toronto, for example, condo sales in the 416 were up 'just' 9.2% y/y in August vs. a 50.6% increase in broader detached homes across the 416 and 905. Also, the strongest year-over-year price gain (+18%) was in a region about 1-to-2 hours northwest of the city. The anecdotes about booming rural markets have been aplenty; and now, there's some supportive data, too.

Even in the hard-hit areas of the job market, massive federal benefit programs have held up, or even lifted, disposable incomes. In fact, household net disposable income actually rose sharply in 2020Q2, as the increase in federal transfers and various tax deferrals more than offset the decline in primary income, and actually led to a record increase in real net household disposable income—in a recession no less (*Chart 3*). Interestingly, this has actually pulled down the closely-scrutinized household debt-to-disposable income ratio (*Chart 4*). Not because borrowing *has* slowed—consumer credit has contracted, but residential mortgage credit has accelerated—but because the historic transfer of income from the federal government to households has sharply lifted the denominator. For now.

With all that in mind, there are plenty of questions on how the market will evolve from here.

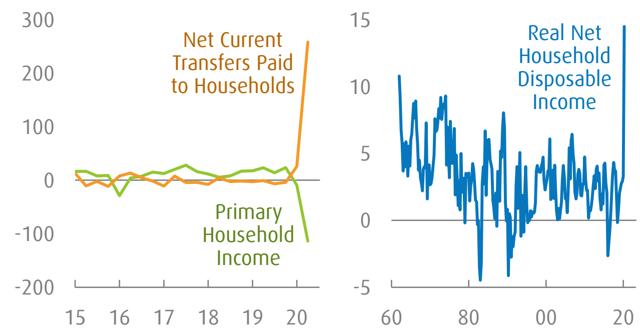
Sales and prices: Pent-up demand will likely run through the fall. Underlying resale demand was settling in to a run rate of about 42,000 units per month nationally (seasonally adjusted) just before COVID hit. Assuming that underlying demand didn't change much (with offsetting negatives and positives), even after very strong sales levels in July and August, there's still almost 20,000 units to make up in excess of that run rate (*Chart 5*). In other words, we would still need a few more months of record sales activity in order to just fill in the pandemic hole. And, if listings can't keep up, you can bet that the recent run in prices has more room to go, especially in some smaller markets peripheral to the major cities that are now subject to a feeding frenzy.

Interest rates: Record low mortgage rates are here to stay, with the Bank of Canada arguing that the economy *"will continue to require extraordinary monetary policy support"* until excess capacity is absorbed—we judge rate hikes won't even be in the conversation until 2023.

Federal support: The flagship CERB was extended for another four weeks, to 28 weeks, but will wind down for most in 2020Q4. That will be replaced with the CRB and a modified (i.e., more generous) EI program for another 26 weeks that will take us into 2021Q2. At that point, federal

Chart 3
Government Income Support

Canada

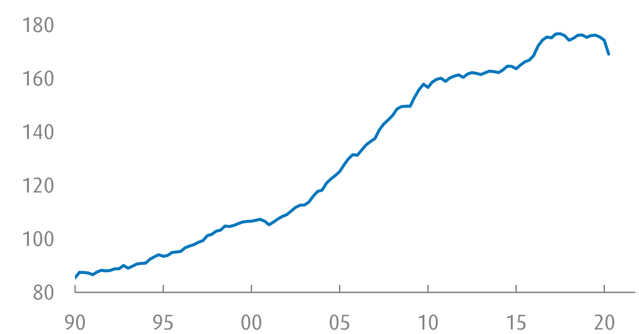


Sources: BMO Economics, Haver Analytics

Chart 4
Debt Dynamics Change

Canada (% of 4-qtr m.s.)

Household Debt to Disposable Income



Sources: BMO Economics, Haver Analytics

Chart 5
More Pent-Up Demand to Meet

Canada (000s units : s.a.)

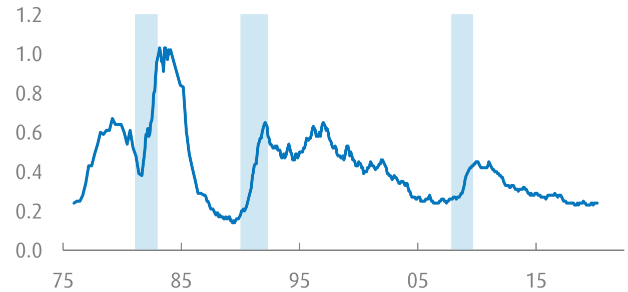
Residential Sales

Sources: BMO Economics, Haver Analytics; ● = Aug. 2020 estimates fiscal policy could evolve further, but suffice it to say that Ottawa is spending everything it can to prevent a serious income cliff for those that moved onto support programs earlier in the pandemic.

Mortgage deferrals: Deferrals are also about to wind down, and the first-wave of six-month deferrals should begin to run their course this month, though some have already resumed payment. OSFI has begun to phase out special capital treatment that allowed banks to report deferred mortgages as performing loans. As of September, newly-deferred mortgages will see that treatment period scaled down to three months; with a return to normal rules by October. CMHC has estimated that about 14% of mortgages were in deferral as of late-August, and the bulk of those will presumably be restarted in 2020Q4.

Chart 6
Sound Payment History

Canada (%)
Percent of Residential Mortgages in Arrears



Shading marks periods of Canadian recession
Sources: BMO Economics, Haver Analytics

But, it's very unclear how many of those deferrals will fall into arrears. The job market continues to recover, and many that deferred likely took the option as a precautionary measure, rather than out of necessity. Padded savings, credit lines and ongoing government support should help. There will not be a sudden payment shock either, as missed principal and interest will, in most cases, be tacked back onto the outstanding balance and re-amortized. And, anyone that does reach the point of having to sell will likely do so in a tight market—at least in most major cities. All told, delinquencies will indeed likely tick up in 2020Q4, but the move could be more modest than many fear. For some perspective, even through the worst of the financial crisis and deep market troubles of the early-1990s, Canadian mortgages in arrears have never pushed much above 1% (*Chart 6*).

New supply: Housing starts jumped to the highest level since 2007 in August, led by a surge in Ontario. Similar to sales, builders are making up for lost time (less than in the resale market), and the year-to-date average is now roughly in line with year-ago levels. New construction will likely calm down later in the year once the backlog of new projects is cleared, and potentially weaker demographic flows come into view (immigration was down 44% y/y through June, with the recovery still uncertain). On the resale side, we continue to believe that most of the new listings will come at the lower end of the market and in the urban condo space. On the latter, investment fundamentals were already stretched pre-COVID with most buyers cash flow negative. Now, with rents under some pressure, vacancies potentially ticking up and a less robust short-term rental market, we could see some offloading over time.

The Bottom Line: The residential real estate market has essentially laughed in the face of the bears, sailing through the pandemic on the back of record-low mortgage rates, job-market dynamics, massive federal support and a dearth of resale listings. In some markets, the near-term risk might even be tilted toward excessive strength rather than serious weakness. Longer-term challenges will certainly dampen some markets/segments once the initial post-pandemic rush fades, but the more significant concern is in pockets of commercial real estate.

Economic Forecast Summary for September 11, 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	-38.7	45.0	6.6	6.5	4.5	4.0	3.2	1.7	-5.5	6.0
Consumer Price Index	(y/y % chng)	1.8	0.0	0.4	0.3 ↓	0.6 ↓	1.9	1.6	1.7	1.9	0.6 ↓	1.4 ↓
Unemployment Rate	(percent)	6.3	13.0	10.2	8.9	8.4	8.1	7.9	7.5	5.7	9.6	8.0
Housing Starts	(000s : a.r.)	209	191	236 ↑	205	210	206	202	202	209	210 ↑	205
Current Account Balance	($blns : a.r.)	-52.9	-34.5	-31.6	-29.2	-31.2	-31.6	-31.8	-33.2	-47.0	-37.0	-32.0
Interest Rates				(average for the quarter : %)								
Overnight Rate		1.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1.75	0.50	0.25
3-month Treasury Bill		1.29	0.22	0.15	0.15	0.15	0.15	0.15	0.15	1.65	0.45	0.15
10-year Bond		1.20	0.59	0.55	0.60 ↓	0.70 ↓	0.85 ↓	1.00	1.10 ↓	1.59	0.75	0.90 ↓
Canada-U.S. Interest Rate Spreads				(average for the quarter : bps)								
90-day		16	8	5 ↓	3 ↓	3 ↓	3 ↓	3 ↓	3 ↓	-45	8 ↓	3 ↓
10-year		-18	-10	-10 ↓	-12 ↓	-11 ↓	-11 ↓	-10 ↓	-10 ↓	-56	-12 ↓	-11 ↓
UNITED STATES												
Real GDP	(q/q % chng : a.r.)	-5.0	-31.7	25.0	2.5	5.8	5.7	4.1	3.2	2.2	-4.5	4.0
Consumer Price Index	(y/y % chng)	2.1	0.4	1.2 ↑	1.2 ↑	1.4 ↑	2.6 ↑	1.9	1.9 ↑	1.8	1.2	1.9 ↑
Unemployment Rate	(percent)	3.8	13.0	9.0	8.2	7.6	7.0	6.4	6.0	3.7	8.5	6.8
Housing Starts	(mlns : a.r.)	1.48	1.06	1.43	1.33	1.30	1.31	1.31	1.32	1.30	1.33	1.31
Current Account Balance	($blns : a.r.)	-417	-640 ↓	-698 ↓	-683 ↓	-707 ↓	-722 ↓	-732 ↓	-741 ↓	-480	-610 ↓	-725 ↓
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	0.10	0.10	0.10	0.10	0.10	0.10	2.10	0.40 ↑	0.10
10-year Note		1.38	0.69	0.65	0.75	0.85	0.95	1.10	1.20	2.14	0.85	1.00
EXCHANGE RATES				(average for the quarter)								
US¢/C$		74.4	72.2	75.1	75.7	75.9	76.2	76.5	76.8	75.4	74.4	76.4
C$/US$		1.34	1.39	1.33	1.32	1.32	1.31	1.31	1.30	1.33	1.35	1.31
¥/US$		109	108	106	105	105	106	106	107	109	107	106
US$/Euro		1.10	1.10	1.17	1.20	1.20	1.21	1.21	1.22	1.12	1.14	1.21
US$/£		1.28	1.24	1.29 ↓	1.29 ↓	1.30	1.31	1.32	1.33	1.28	1.27 ↓	1.31

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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Existing Home Sales

Tuesday, 9:00 am (expected)

		Average Prices
Aug. (e)	**+31.0% y/y**	**+17.0% y/y**
July	+30.5% y/y	+14.3% y/y

MLS Home Price Index

Aug. (e)	**+9.0% y/y**
July	+7.4% y/y

Home sales had another stellar month in August, as pent-up demand created during the shutdown continues to push activity higher. Nearly every major city saw sales up double-digits in August, with Calgary one of the few soft spots. Toronto, Montreal, Victoria, Vancouver and Fraser Valley were all on fire, up about 40% y/y or better. Note that the pandemic delayed the normal buying season a few months, so the seasonally-adjusted figures are a bit falsely flattering. Even so, there's no denying housing has made a remarkable comeback, leaving sales little changed from a year ago on a year-to-date basis. Average prices are expected to climb 17% y/y, while the quality-adjusted MLS HPI looks to pick up to +9% y/y, a near three-year high. Amazing what sub-2% mortgage rates will do.

Consumer Price Index

Wednesday, 8:30 am

Aug. (e)	**-0.1% (-0.1% sa)**	**+0.2% y/y**
July	unch	+0.1% y/y

Core CPI Measures (July)

CPI Core - Trim	+1.7% y/y
CPI Core - Median	+1.9% y/y
CPI Core - Common	+1.3% y/y

Canadian consumer prices look to fall a touch in August, with energy prices providing a modest drag. August is a seasonally soft month, with prices falling in three of the past four years. There's more uncertainty this year (as there is with all data) due to the pandemic, and there are countervailing forces impacting inflation at the moment. On the disinflationary side, firms are likely to cut prices or at least refrain from raising prices to bring customers back; that's especially true in the services sector. On the inflationary side, the cost of PPE and other COVID mitigation efforts might be passed along. Our call would lift the yearly pace a tick to a still subdued +0.2% y/y.

The average of the Bank of Canada's three core CPI measures matched a near three-year low in July of 1.6%. With price pressures expected to be pretty subdued, the core measures look to hold steady overall. Given the wide output gap, look for underlying inflation to remain below target for some time.

Retail Sales

Friday, 8:30 am

		Ex. Autos
July (e)	**+0.7%**	**+0.5%**
June	+23.7%	+15.7%

After some wild volatility, **retail sales** growth is expected to print a more "normal" 0.7% gain according to StatsCan's preliminary estimate. That shouldn't come as a big surprise after retail sales rebounded above pre-COVID levels in June. Retail activity has benefitted from services such as travel remaining out of service for the most part, and that's expected to continue to keep activity elevated until we get a vaccine or effective treatment for the virus. There will be a close eye on an estimate for August sales, as markets will be watching for any sign that conditions regressed at all as the summer progressed. However, if the crazy strong housing market says anything, it's that spending likely remained solid.

United States

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Industrial Production

Tuesday, 9:15 am

	Industrial Production	Capacity Utilization
Aug. (e)	**+0.9%**	**71.2%**
Consensus	*+1.0%*	*71.6%*
July	+3.0%	70.6%

Manufacturing activity continues to recover strongly but at an ebbing clip. For example, after averaging more than a 5½% monthly gain in May and June, production expanded 3.3% in July, and August should slow further if aggregate hours are any guide. Hours worked averaged an almost 4% monthly gain in the May-June interval, 1.9% in July and 1.0% in August. Meanwhile, the ISM index's production component increased 1.2 points to 63.3 in August, the smallest increase in the past four months, but still the highest level in more than 2½ years. Elsewhere, mining output probably dropped in August as some oil production was shut-in owing to Hurricane Laura. By month's end, crude output slipped under 10 mbpd for the first time in more than 2½ years. And, although less energy was used to run air conditioners in August, utilities output should still get a lift from the continued recovery in the broader economy. Overall, we look for **industrial production** to increase 0.9%, which should raise the capacity utilization rate 0.6 points to 71.2 (still well below the pre-pandemic range of around 77%).

Retail Sales

Wednesday, 8:30 am

		Ex. Autos
Aug. (e)	**+1.2%**	**+1.1%**
Consensus	*+1.0%*	*+1.0%*
July	+1.2%	+1.9%

Retail Sales ex. Autos/Gas

Aug. (e)	**+0.9%**
Consensus	*+0.7%*
July	+1.5%

Faster auto sales and Redbook retail receipts suggest **retail spending** sprinted 1.2% in August, matching the prior month's pace. Ex-autos and gas stations, sales likely rose 0.9%. Although renewed restrictions may have curbed appetites at restaurants and bars, and back-to-school sales where stunted by the shift to online learning, most retailers look to have extended a rebound that has already pushed receipts above pre-virus levels. Even with the scaling back of supplemental UI benefits and a retreat in consumer confidence, personal spending looks to rebound sharply in the third quarter as earlier substantial income-support programs created a large savings cushion for many households.

FOMC Announcement and Summary of Economic Projections

Wednesday, 2:00 pm
Press briefing at 2:30 pm

See Michael Gregory's Thought on page 4.

Housing Starts

Thursday, 8:30 am

Aug. (e)	**1.44 mln a.r. (-4.4%)**
Consensus	*1.49 mln a.r. (-0.7%)*
July	1.50 mln a.r. (+22.6%)

Building Permits

Aug. (e)	**1.49 mln a.r. (+0.5%)**
Consensus	*1.53 mln a.r. (+2.8%)*
July	1.48 mln a.r. (+17.9%)

After carving out a V-shaped recovery in the past three months, U.S. **housing starts** are expected to retreat 4.4% to 1.44 million annualized in August due to payback from the prior month's 58% surge in the volatile multi-unit segment. However, an expected further climb in building permits should confirm that the housing market remains one of the most resilient sectors in the pandemic. New home sales are at 14-year highs and builder sentiment is at a record peak. Low mortgage rates, lean inventories, and the migration of teleworkers to the suburbs should keep builders hammering away for some time. However, starts could simmer down later this year in response to less pent-up demand, soaring lumber costs, and economic uncertainty.

Financial Markets Update for September 11, 2020

		Sep 11 [1]	Sep 4	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	0.15	0.15	0	-1	-151
	United States	0.11	0.10	1	2	-143
	Japan	-0.12	-0.14	2	-4	-1
	Eurozone	-0.48	-0.48	0	0	-10
	United Kingdom	0.06	0.07	-1	-1	-73
	Australia	0.10	0.09	1	0	-81
2-Year Bonds	Canada	0.27	0.27	-1	-3	-143
	United States	0.14	0.15	-1	-1	-144
10-Year Bonds	Canada	0.56	0.59	-4	-6	-114
	United States	0.67	0.72	-5	-4	-125
	Japan	0.03	0.04	-1	-2	5
	Germany	-0.48	-0.47	-1	-6	-29
	United Kingdom	0.18	0.26	-8	-6	-64
	Australia	0.91	0.89	2	-2	-46
Risk Indicators	VIX	27.4	30.8	-3.3 pts	5.4 pts	13.7 pts
	TED Spread	14	15	-1	-4	-22
	Inv. Grade CDS Spread [2]	67	67	0	-1	22
	High Yield CDS Spread [2]	367	370	-3	-45	87
					(percent change)	
Currencies	US¢/C$	75.86	76.56	-0.9	0.6	-1.5
	C$/US$	1.318	1.306	—	—	—
	¥/US$	106.19	106.24	0.0	-0.4	-2.2
	US$/€	1.1836	1.1838	0.0	-0.1	5.6
	US$/£	1.278	1.328	-3.8	-2.3	-3.6
	US¢/A$	72.77	72.82	-0.1	1.5	3.6
Commodities	CRB Futures Index	146.77	149.69	-2.0	-1.6	-21.0
	Oil (generic contract)	37.60	39.77	-5.5	-10.5	-38.4
	Natural Gas (generic contract)	2.28	2.59	-11.8	-3.1	4.3
	Gold (spot price)	1,949.12	1,933.94	0.8	0.2	28.5
Equities	S&P/TSX Composite	16,302	16,218	0.5	-1.3	-4.5
	S&P 500	3,366	3,427	-1.8	-0.2	4.2
	Nasdaq	10,938	11,313	-3.3	-0.7	21.9
	Dow Jones Industrial	27,739	28,133	-1.4	-0.7	-2.8
	Nikkei	23,406	23,205	0.9	0.5	-1.1
	Frankfurt DAX	13,231	12,843	3.0	2.6	-0.1
	London FT100	6,045	5,799	4.2	-0.7	-19.9
	France CAC40	5,049	4,965	1.7	1.7	-15.5
	S&P ASX 200	5,859	5,926	-1.1	-4.4	-12.3

[1] = as of 11:30 am   *[2] = One day delay*

Global Calendar — September 14–18

	Monday September 14	Tuesday September 15	Wednesday September 16	Thursday September 17	Friday September 18
Japan	**Tertiary Industry Index** **July (e) +0.5%** June +7.9% **Industrial Production** **July F (e) +8.0% -16.1% y/y** June +1.9% -18.2% y/y **LDP Party Election**		**Trade Deficit** **Aug. '20 ¥13.9 bln** Aug. '19 ¥152.2 bln **BoJ Monetary Policy Meeting (Sep. 16-17)**		**CPI / Core CPI** **Aug. (e) +0.2% y/y -0.4% y/y** July +0.3% y/y unch y/y **CPI Ex. Food & Energy** **Aug. (e) -0.1% y/y** July +0.4% y/y
Euro Area	**EURO AREA** **Industrial Production** **July (e) +4.0% -8.1% y/y** June +9.1% -12.3% y/y	**GERMANY** **ZEW Survey—Expectations** **Sep. (e) 69.8** Aug. 71.5 **FRANCE** **Consumer Price Index** **Aug. F (e) -0.1% +0.2% y/y** July +0.4% +0.9% y/y **ITALY** **Consumer Price Index** **Aug. F (e) -1.3% -0.5% y/y** July -0.7% +0.8% y/y	**EURO AREA** **Trade Surplus** **July (e) €18.7 bln** June €17.1 bln	**EURO AREA** **Consumer Price Index** **Aug. F (e) -0.4% -0.2% y/y** July -0.4% +0.4% y/y **Core CPI** **Aug. F (e) +0.4% y/y** July +1.2% y/y	**ITALY** **Industrial Orders** **July** June +23.4% -11.8% y/y
U.K.		**Jobless Claims** **Aug.** July +94,400 **Employment (3m/3m)** **July (e) -109,000** June -220,000 **Avg. Wkly Earnings Ex. Bonus (3 mma)** **July (e) -0.2% y/y** June -0.2% y/y **Jobless Rate (3 mma)** **July (e) 4.1%** June 3.9%	**Consumer Price Index** **Aug. (e) -0.6% unch y/y** July +0.4% +1.0% y/y **Core CPI** **Aug. (e) +0.6% y/y** July +1.8% y/y	**7:00 am ET BoE Monetary Policy Announcement**	**Retail Sales (incl. Fuel)** **Aug. (e) +0.6% +2.7% y/y** July +3.6% +1.4% y/y
Other		**CHINA** **Industrial Production / Retail Sales** **Aug. (e) +5.2% y/y unch y/y** July +4.8% y/y -1.1% y/y **Fixed Asset Investment (YTD)** **Aug. (e) -0.4% y/y** July -1.6% y/y **AUSTRALIA** **RBA Minutes from Sep. 1 meeting**	**BRAZIL** **Central Bank of Brazil Monetary Policy Meeting**	**AUSTRALIA** **Employment / Jobless Rate** **Aug. (e) -40,000 7.7%** July +114,700 7.5% **NEW ZEALAND** **Real GDP** **Q2 (e) -12.5% -12.8% y/y** Q1 -1.6% -0.2% y/y	

D = date approximate

Upcoming Policy Meetings | Bank of England: Nov. 5, Dec. 17, Feb. 4 | European Central Bank: Oct. 29, Dec. 10, Jan. 21

	Monday September 14	Tuesday September 15	Wednesday September 16	Thursday September 17	Friday September 18
Canada	**New Brunswick Election** BoC Buyback: 5-year sector	**8:30 am** Mfg. Sales / Mfg. New Orders **July (e)** +8.7% / +7.5% June +20.7% / +23.6% **8:30 am** New Motor Vehicle Sales[D] **July (e)** -5.0% y/y June -21.5% y/y **9:00 am** Existing Home Sales[D] / Average Prices **Aug. (e)** +31.0% y/y / +17.0% y/y July +30.5% y/y / +14.3% y/y **9:00 am** MLS Home Price Index[D] **Aug. (e)** +9.0% y/y July +7.4% y/y 10:30 am 3-, 6- & 12-month bill auction $10.0 bln (new cash -$4.4 bln) BoC Buyback: Under 2-year sector	**8:30 am** Consumer Price Index **Aug. (e)** -0.1% (-0.1% sa) / +0.2% y/y July unch / +0.1% y/y **8:30 am** CPI Core (% y/y) Trim / Median / Common **Aug.** July +1.7% / +1.9% / +1.3% **8:30 am** Int'l Securities Transactions Inflows / Outflows **July** June -$13.5 bln / $10.6 bln **Canadian tariffs on U.S. aluminum to begin by this date** BoC Buyback: 2-year sector	**8:30 am** ADP National Employment Report **Aug.** July +1,149,784 Noon 30-year bond auction $3.0 bln 3- and 10-year bond auction announcements BoC Buyback: 30-year sector	**8:30 am** Retail Sales / Ex. Autos **July (e)** +0.7% / +0.5% June +23.7% / +15.7% **8:30 am** Wholesale Trade **July (e)** +1.5% June +18.5% BoC Buyback: 10-year sector
United States	11:30 am 13- & 26-week bill auctions $105 bln	**8:30 am** Import Prices **Aug. (e)** +0.5% / -2.2% y/y *Consensus* *+0.5 %* / *-2.2% y/y* July +0.7% / -3.3% y/y **8:30 am** Empire State Manufacturing Survey **Sep. (e)** 6.0[C] Aug. 3.7 **9:15 am** Industrial Production / Capacity Utilization **Aug. (e)** +0.9% / 71.2% *Consensus* *+1.0%* / *71.6%* July +3.0% / 70.6% **FOMC Meeting begins** 11:00 am 4- & 8-week bill auction announcements 11:30 am 119-day CMB $30 bln 11:30 am 42-day CMB $30 bln 1:00 pm 20[R]-year bond auction $22 bln	**7:00 am** MBA Mortgage Apps **Sep. 11** Sep. 4 +2.9% **8:30 am** Retail Sales / Ex. Autos **Aug. (e)** +1.2% / +1.1% *Consensus* *+1.0%* / *+1.0%* July +1.2% / +1.9% **8:30 am** Retail Sales ex. Autos/Gas **Aug. (e)** +0.9% *Consensus* *+0.7%* July +1.5% **10:00 am** NAHB Housing Market Index **Sep. (e)** 78 *Consensus* *78* Aug. 78 **10:00 am** Business Inventories **July F (e)** +0.2% *Consensus* *+0.2%* June -1.1% **2:00 pm** FOMC Announcement and Summary of Economic Projections **2:30 pm** Fed Chair Powell's Press Briefing **4:00 pm** Net TIC Flows Total / Long Term **July** June -$67.9 bln / $113.0 bln	**8:30 am** Initial Claims **Sep. 12 (e)** 900k (+16k) *Consensus* *850k (-34k)* Sep. 5 884k (unch) **8:30 am** Continuing Claims **Sep. 5** Aug. 29 13,385k (+93k) **8:30 am** Housing Starts **Aug. (e)** 1.44 mln a.r. (-4.4%) *Consensus* *1.49 mln a.r. (-0.7%)* July 1.50 mln a.r. (+22.6%) **8:30 am** Building Permits **Aug. (e)** 1.49 mln a.r. (+0.5%) *Consensus* *1.53 mln a.r. (+2.8%)* July 1.48 mln a.r. (+17.9%) **8:30 am** Philadelphia Fed Index **Sep. (e)** 15.0[C] Aug. 17.2 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[R]-year TIPS auction $12 bln	**8:30 am** Current Account Deficit **Q2 (e)** $160.0 bln *Consensus* *$159.0 bln* Q1 $104.2 bln **10:00 am** University of Michigan Consumer Sentiment **Sep. P (e)** 75.0[C] Aug. 74.1 **10:00 am** Leading Indicator **Aug. (e)** +1.3%[C] July +1.4% Fed Speaker: St. Louis' Bullard (10:00 am)

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

Upcoming Policy Meetings | Bank of Canada: Oct. 28, Dec. 9, Jan. 20 | FOMC: Nov. 4-5, Dec. 15-16, Jan. 26-27

General Disclosures

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