

Contributors

Derek Holt

VP & Head of Capital Markets Economics
Scotiabank Economics
416.863.7707
derek.holt@scotiabank.com

Chart 1

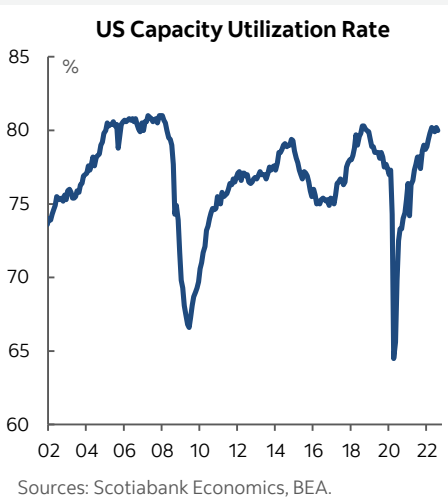
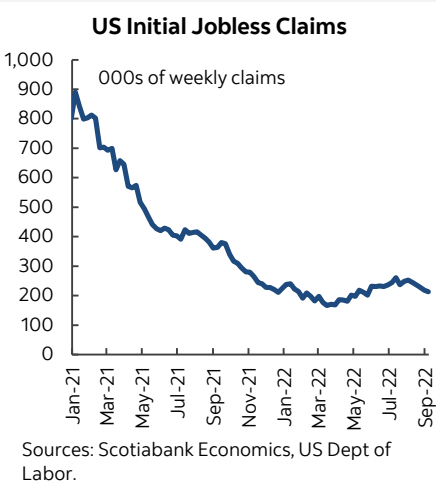


Chart 2



5 Key Takeaways From US and Canadian Releases

The US and Canada updated a suite of releases covering US consumers, US industry and Canadian housing. Here are what I think are some worthwhile takeaways accompanied by additional charts at the end.

TAKEAWAY #1

US industrial capacity use remains very high at 2018 levels with no signs of slack emerging (chart 1). Demand and damaged capacity likely combine to explain this. For as long as capacity use remains high, the broad sector will have pricing power. Industrial production fell 0.2% m/m but manufacturing was a touch firmer at +0.1% m/m.

TAKEAWAY #2

The US job market remains strong. Weekly initial jobless claims fell again and have been declining for several weeks (chart 2). I'm a little leery toward the quality of the data given uncertainty around whether seasonal adjustment factors were reliable on the prior upswing and in the more recent downswing period. Still, smoothing through it all would still leave behind little evidence that the job market is weakening.

TAKEAWAY #3

US retailers are at best treading water into Q3. That may be partly because consumption patterns continue to shift toward services not well captured by retail sales and partly due to ongoing product shortages in some sectors. In any event, sales were up 0.3% m/m in August (-0.1% consensus) in nominal terms but were revised down to -0.4% (from 0%) the prior month for an overall draw relative to expectations and in terms of the two-month trend. Breadth was soft. The surprise is that autos and parts increased by 2.8% m/m despite lower new vehicle sales volumes. Recall that these are nominal numbers needing adjustment for prices. In volume terms, overall retail sales fell again last month given CPI was strong in case anyone needs a reminder of the market effects. US nominal retail sales are tracking a Q3 q/q SAAR gain of just 2.4% after 10.9% in Q2 (chart 3). In real terms there is no growth in Q3 as higher prices are hitting demand at retailers.

TAKEAWAY #4

US supply chains are putting in a mixed performance at the manufacturing level into this month. The Empire manufacturing gauge jumped higher which is a positive signal around the NY/NJ region, but the Philly Fed's gauge barfed on all that (charts 4, 5). Global supply chains are healing, but be careful with respect to how far one goes with that argument as some of the metrics (Baltic Dry, semiconductor prices, order backlogs etc) may be falling partly because of improved supply chains but partly on increased uncertainty toward the economic outlook.

TAKEAWAY #5

Canada's housing market continues to weaken, but for how long and how much is a big source of uncertainty. I have no faith in the ability of economists to forecast percentage price changes in house prices as splashy attention-seeking forecasts always miss the mark on the upswing and downswing and by a band roughly equivalent to the width of Canada. Home sales fell for a sixth month and were down 1% last month. New listings fell 5% m/m and fell just about everywhere across the country in a nationwide sellers' strike. That kept the market pretty tight with months' supply at just 3.5 months which is below the long-term average of 5 months and well below peaks but ~double where it was at the start of the year, while sales to new listings increased to 54.5% which remains in mild sellers' territory (chart 6). And so prices controlled for compositional shifts (splashy forecasts often choose average prices instead...) were down 1.6% m/m SA, 5% over 3 months, 7.4%

over 6 months but are still 7.6% higher y/y and 44% higher than 3 years ago. There is a tonne of padding in home equity.

I'll conclude by repeating points I've made with clients on Canadian housing. It's a different housing market in Canada than elsewhere. Generalist articles on global housing markets fail to take into account important distinctions as follows:

- OSFI's B20 already prepped the market for much of the rate shock facing originations, unlike elsewhere. The rise of the US 30 year mortgage rate has been a 300bps shock to originations this year whereas the way to look at the rate shock in Canada is relative to how the market had adjusted to B20's qualifying criteria at 5¼%. Relative to that de facto qualifying rate before the run up in mortgage rates, Canada is getting about half of the incremental rate shock to originations through the dominant 5-year product than the US is through 30s.
- Canada is the only G7 country with accelerating population growth. Italy is still shrinking. The Euro-area is flat. The US has practically stalled out and not just because of complications around the Mexico border. Canada is getting 1% population growth just through higher immigration targets alone as Canada is now importing the equivalent of a city of Edmonton or Ottawa roughly every couple of years and with a tighter focus upon the economic class (destined to labour, housing, consumer markets, versus family class).
- Canada is getting a terms of trade lift to incomes that every other G7 country is wishing they had.
- Canada is run by serial stimulators across all levels of government. Enough said!
- Then we have all the usual arguments on differences in the Canadian housing finance model, like well capitalized banks subject to regulatory stress testing exercises, little product tossed into off-balance sheet leveraged conduits, gov't guarantees provided to insured mortgage borrowers, attractive pick-up on mortgage bonds, the fact that it's hard to do a 'big short' and that most hedge fund types who have tried over the years have repeatedly gotten their heads handed to them, and tighter macroprudential rules that started in 2008.

Instead, I'm more focused on the likelihood that housing corrects as the economy and job market weaken but doesn't stay down which has been a repeated pattern. There is still a wall of cash on household balance sheets. There remains investor appetite in tight rental markets from people who balance the cost of carry against the income stream relative to uncertainty facing financial assets. There remain a lot of sidelined first-time buyers who will find more attractive entry points to pounce upon and each time that happens housing charges higher. Canada needs to expand the housing stock by over 1 million every 3–5 years and won't and so demand leaks into resales.

If I'm right on the medium-term drivers, then the BoC needs to be very careful if and when we get to the point of risking a premature declaration of victory over inflation as it could well boomerang the other way again. Decisions made into the environment of peak house price weakness may not be the best ones.

Please see additional charts for US industrial output and retail sales on the next page.

Chart 3

Retail Sales Growth Tracking

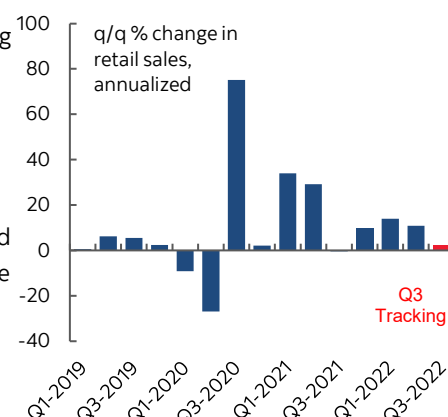


Chart 5

Philadelphia Fed Business Outlook Survey

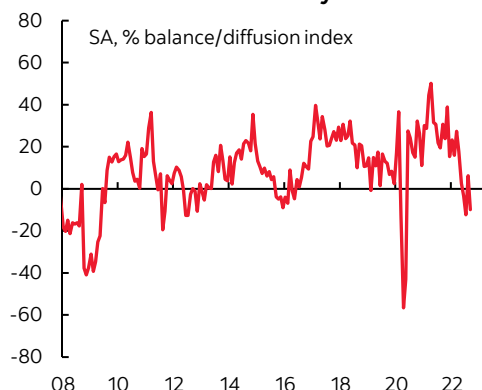


Chart 6

Rising but Still Low Supply of Canadian Homes

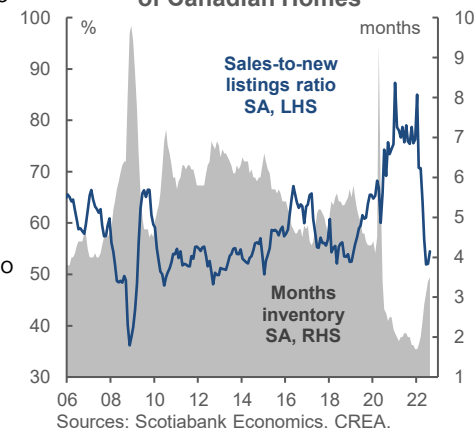


Chart 7

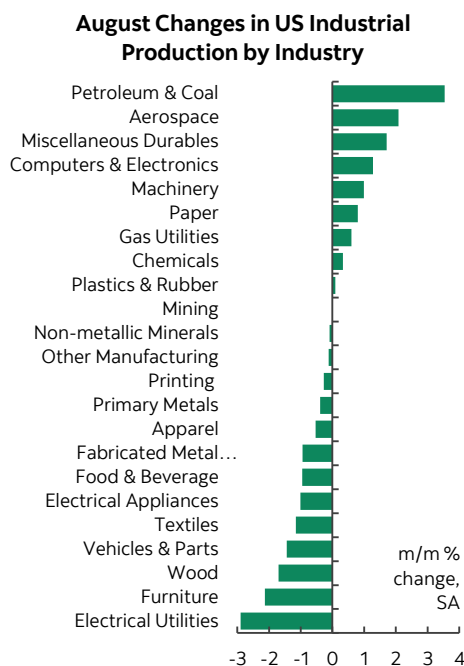


Chart 8

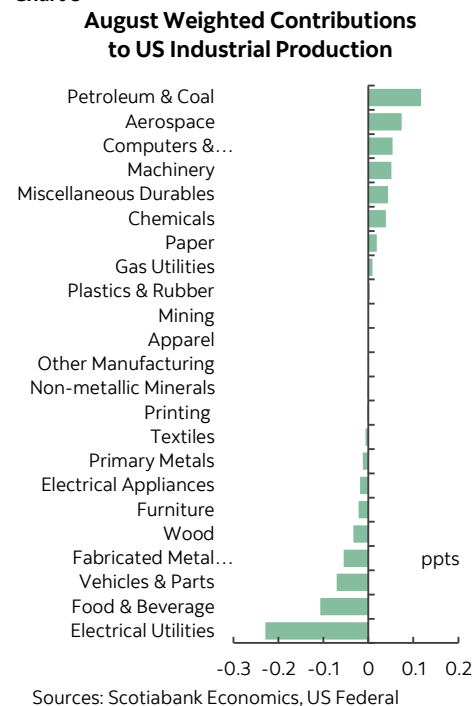


Chart 9

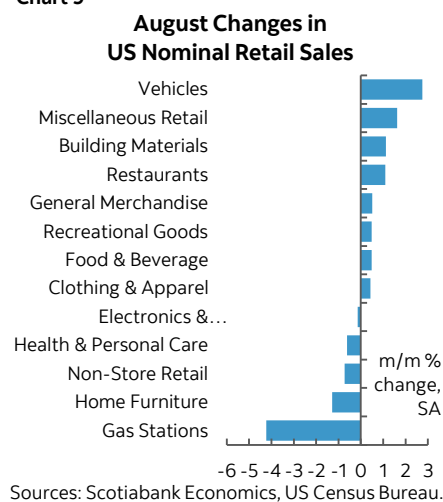


Chart 10

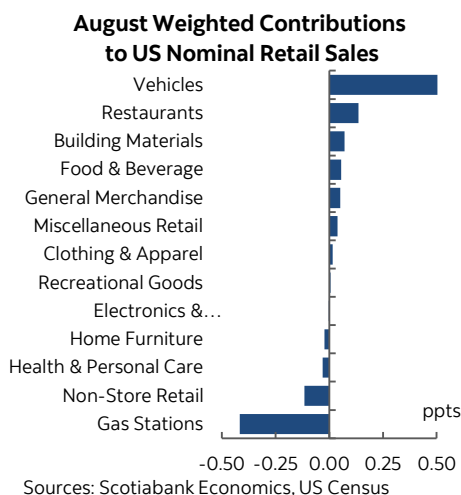


Chart 11

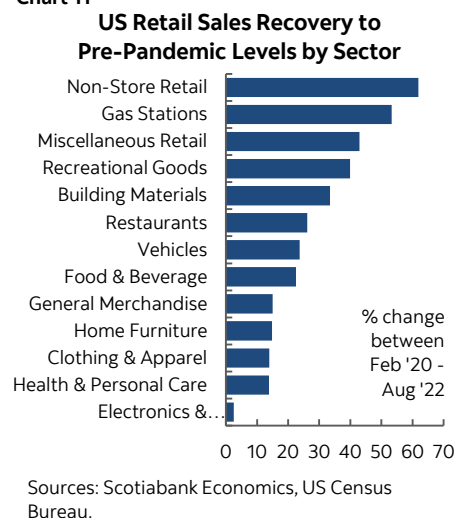
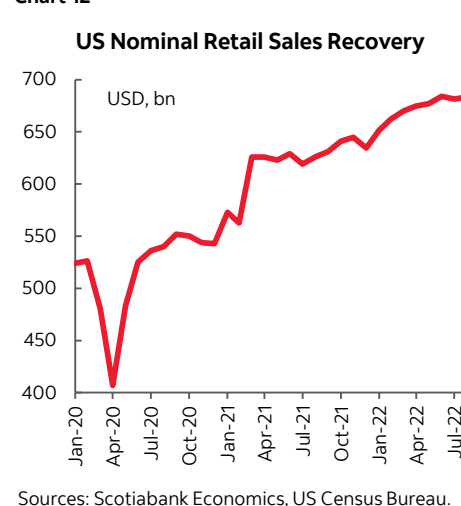


Chart 12



This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a “call to action” or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with “Global Banking and Markets”, is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including: Scotiabank Europe plc; Scotiabank (Ireland) Designated Activity Company; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat, Scotia Inverlat Casa de Bolsa, S.A. de C.V., Grupo Financiero Scotiabank Inverlat, Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorized by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorized by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., Grupo Financiero Scotiabank Inverlat, and Scotia Inverlat Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.