# Weekly Trends

PRIVATE CLIENT SOLUTIONS

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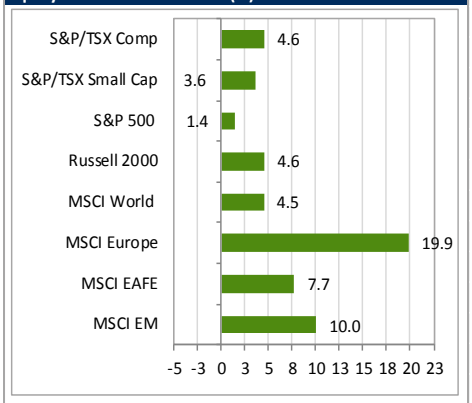
## Canadian Economy – Down But Not Out

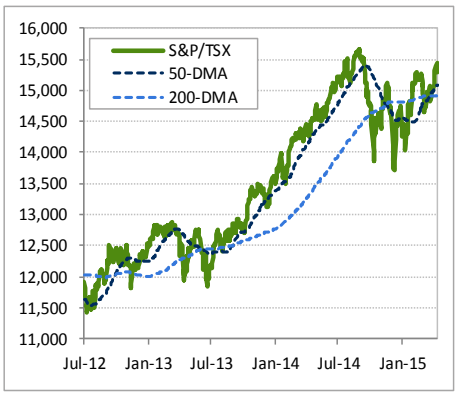
- This week the Bank of Canada (BoC) released its quarterly Monetary Policy Report (MPR) outlining their updated economic views while also announcing their interest rate decision to keep the benchmark rate unchanged at 0.75%.
- The material decline in oil prices is providing a significant headwind to the Canadian economy. The BoC expects the hit to the economy from low oil prices to be "front-loaded" with zero growth in Q1/15, down from their earlier estimate of 1.5% growth. However, they expect economic activity to improve in Q2 to 1.8%, followed by 2.8% and 2.5% for Q3 and Q4, respectively.
- The BoC sees a stronger H2/15 and 2016 on the back of a stronger US economy, rising net exports, and easing financial conditions.
- Our assessment of the MPR was of a more upbeat BoC, with the central bank expecting an improvement in economic activity in the coming quarters. Given this view we believe another rate cut is unlikely, with the next BoC move likely to be a hike sometime in 2016.
- We share a similar view with the BoC expecting 2015 GDP growth of 2% (in line with the BoC) and for growth to improve in H2/15. We see our economy gradually improving in the H2/15 on the back of a stronger US economy, weaker Canadian dollar, and rebounding oil prices (see Chart of the Week).

**Equity Market YTD Returns (%)**




| Canadian Sector | TSX Weight | Recommendation |
|---|---|---|
| Consumer Discretionary | 6.3 | Overweight |
| Consumer Staples | 3.6 | Market weight |
| Energy | 22.1 | Market weight |
| Financials | 34.6 | Market weight |
| Health Care | 5.1 | Underweight |
| Industrials | 8.1 | Overweight |
| Information Technology | 2.5 | Overweight |
| Materials | 10.7 | Underweight |
| Telecom | 4.6 | Market weight |
| Utilities | 2.2 | Underweight |

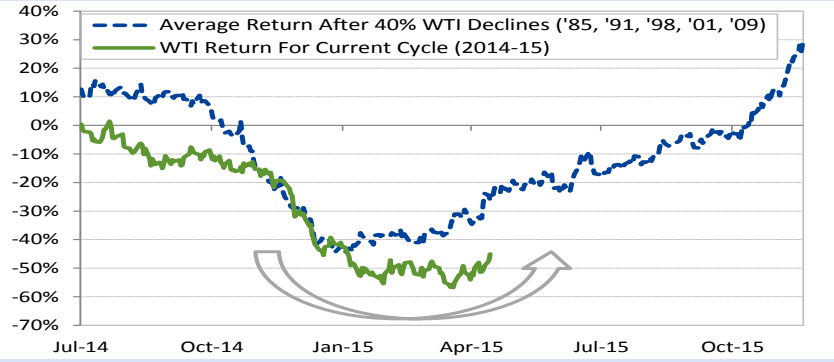
| Technical Considerations | Level | Reading |
|---|---|---|
| S&P/TSX Composite | 15,299.3 | |
| 50-DMA | 15,081.1 | Uptrend |
| 200-DMA | 14,922.7 | Uptrend |
| RSI (14-day) | 65.8 | Neutral |




Source: Bloomberg, Raymond James Ltd.

### Chart of the Week

WTI Oil Could Gain In H2/15 Providing A Boost To The Canadian Economy




Source: Bloomberg, Raymond James Ltd.



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## Bank of Canada Update

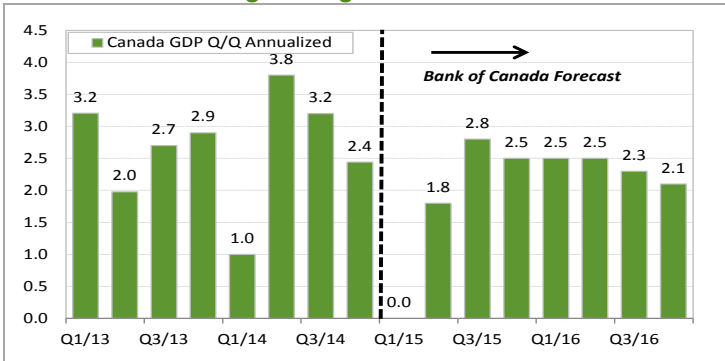
This week the Bank of Canada (BoC) released its quarterly Monetary Policy Report (MPR) outlining their updated economic views while also announcing their interest rate decision to keep the benchmark rate unchanged at 0.75%. In this week's publication we summarize the key findings from the MPR, and provide our outlook for interest rates and the Canadian economy.

BoC Govenor Stephan Poloz took a lot of heat a few weeks back after he warned to a Financial Times reporter that Q1/15 GDP growth was likely to be "atrocious." While Poloz's terminology may have been a bit superlative, we believe his concern over the Q1/15 weakness was on the mark. Below we highlight the key findings from the MPR which overall signals a weak start to the year for the Canadian economy:

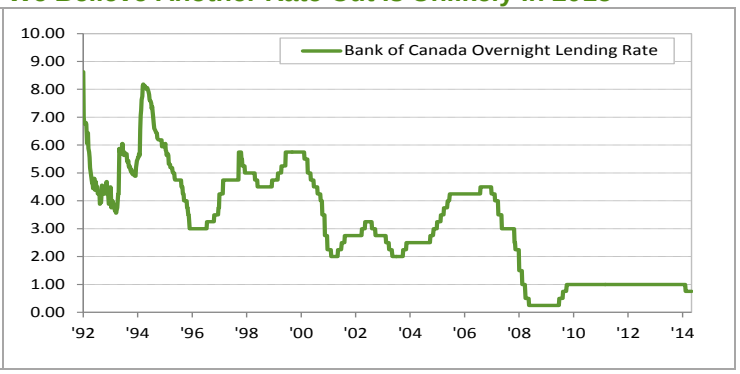
- No surprise, the material decline in oil prices is providing a significant headwind to the Canadian economy. The impact of lower oil prices is being felt in a number of ways including lower capital spending and investment, weaker job growth and incomes, and declining corporate profits. The BoC expects the hit to the economy from low oil prices to be "front-loaded" with zero growth in Q1/15, down from their earlier estimate of 1.5% growth. However, they expect economic activity to improve in Q2 to 1.8%, followed by 2.8% and 2.5% for Q3 and Q4, respectively.
- The BoC sees a stronger H2/15 and 2016 on the back of a stronger US economy, rising net exports, and easing financial conditions. With respect to financial conditions the BoC noted in the MPR that government bond yields have declined following their surprise 25 bp cut in January and that credit conditions have eased over the past three months. The BoC expects real GDP to average 1.9% in 2015 and 2.5% in 2016.
- The BoC expects headline inflation to ease in the coming months before rising to their 2% target in 2016. They expect core inflation to remain near the 2% level until the end of 2016 "as the economy reaches full capacity." Benign inflation pressures will allow the bank to maintain their accommodative stance; however, we believe the likelihood of another interest rate cut this year is unlikely.

Overall, our assessment of the MPR was of a more upbeat BoC, with the central bank expecting an improvement in economic activity in the coming quarters. Given this view we believe another rate cut is unlikely, with the next BoC move likely to be a hike sometime in 2016.

### BoC Is Forecasting Stronger Growth In H2/15




### We Believe Another Rate Cut Is Unlikely In 2015




Source: Bloomberg, Raymond James Ltd.

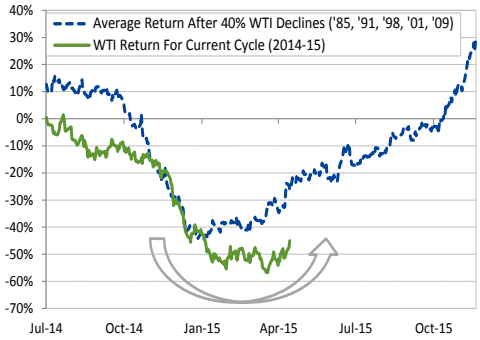
## Our Outlook

We share a similar view with the BoC expecting 2015 GDP growth of 2% (in line with the BoC) and for growth to improve in H2/15. Key supports for a stronger second half include:

- We believe the US economy will begin to show better momentum following the slowdown in the first quarter. As we've highlighed in recent reports, the US economy has exhibited a clear and consistent trend over the last few years of decelerating in the early months of the year, before improving in the second half. Below we illustrate this trend with the Citigroup US Economic Surprise Index, which measures actual economic results relative to expectations. This index has declined in each of the last four years early in the year, then accelerated in the second half. We expect this to playout again and with the Canadian economy having a 0.90 correlation with the US economy, we believe this should bode well for stronger Canadian economic activity in the H2/15.
- As we outlined in our February 27, 2015 Weekly Trends report, we believe oil prices are set to trough in H1/15 setting the stage for a second-half recovery. This view is predicated on the belief that US oil production is set to decline, and that WTI oil prices would follow its typical price pathway following major (40%+) oil declines. In the accompanying chart we overlay the current WTI oil price pathway with the average of the last five major oil prices declines. The current pathway is closely tracking the average or typical pathway, suggesting a bottom soon, and higher prices later this year. We are sticking with the call, and believe the recent positive price action is the first step in this recovery.
- Finally, we believe the weak Canadian dollar will be supportive of increased exports, particulary non-resource based exports such as industrial machinery and autos. Below we illustrate the tight relationship between the CAD/USD dollar (inverted on chart) and Canada's real trade balance. As the Canadian dollar depreciates this should lead to increased exports and rising real trade balances.

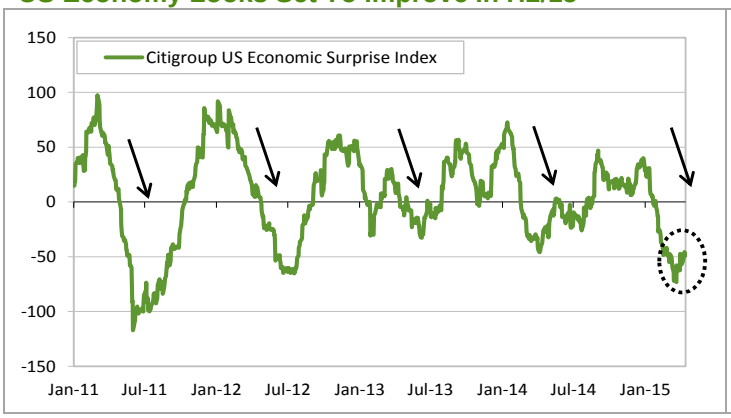
As a result of the low oil prices, the Canadian economy has clearly downshifted. But, we see our economy gradually improving in the H2/15 on the back of a stronger US economy, a weaker Canadian dollar, and rebounding oil prices.

### Historical Oil Trading Patterns Suggests Price Gains In H2/15

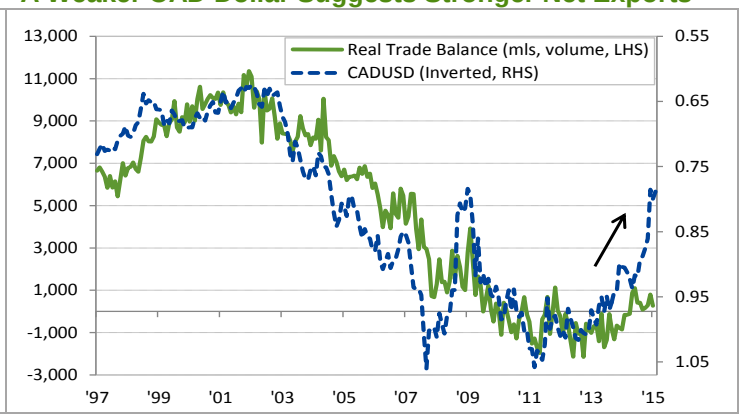



Source: Bloomberg, Raymond James Ltd.

### US Economy Looks Set To Improve In H2/15




### A Weaker CAD Dollar Suggests Stronger Net Exports




Source: Bloomberg, Raymond James Ltd.

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