Market Perspectives

PRIVATE CLIENT SOLUTIONS

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Canadian Economic Update

The Canadian economy shrank at a staggering 40% annualized rate in Q2/20 as our nation remained in a self-induced lockdown in a bid to slow the pace of COVID-19. With two consecutive quarters of negative GDP prints, the Canadian economy has met the threshold of a technical recession. However, we don't need quarterly GDP numbers to tell us we're in recession as evidenced from the labour market and consumer confidence levels clearly paint a picture of an economy that is struggling. Significant action taken by the Bank of Canada (BoC), federal and provincial governments have limited the potentially negative outcome of bringing our economy to a screeching halt, and the good news in recent weeks is that monthly GDP figures have pointed to a rebound/recovery that is underway.

- On the employment front, many of the millions that were temporarily unemployed due to the economic lockdown slowly returned to work as evidenced by the sharp reversal in June employment data. While employment numbers rebounded by 950,000 in June, those gains were not enough to offset the declines that occurred in the prior months. As such, the unemployment rate remained elevated at 12.3%. The challenge moving forward will be for the hundreds of thousands of people who had been permanently laid off during the lockdown to find employment in the coming quarters.
- With a full recovery at a minimum a year and half away, federal and monetary stimulus measures will remain supportive for the foreseeable future. The BoC has committed to maintain rates lower for longer as indicated by Bank of Canada Governor Tiff Macklem's comment, "our message to Canadians is that interest rates are very low and they're going to be there for a long time". This forward guidance is important for housing and those with consumer debt. As long as our financial institutions are willing to extend credit, the housing market and consumption can avoid any material softening. However, one headwind for housing, particularly multi-residential units, will be the slowdown in immigration that has been a significant driver for this category. Nonetheless, with nominal rates near zero and the potential for inflation to overshoot (more on this below), real rates (nominal rate less inflation) will be solidly in negative territory, which provides a nice tailwind for hard assets like real estate.
- The generous government transfer payments not only limited the contraction in the broader economy, but provided some unusual benefits. First, this is the only time in history personal incomes actually *increased* during a recession and, second, the saving rates for those that remained employed have skyrocketed.

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GDP & Jobs

The Canadian economy shrank at a staggering 40% annualized rate in Q2/20 as our nation remained in a self-induced lockdown in a bid to slow the pace of COVID-19. With two consecutive quarters of negative GDP prints, the Canadian economy has met the threshold of a technical recession. However, we don't need quarterly GDP numbers to tell us we're in recession as evidenced from the labour market and consumer confidence levels clearly paint a picture of an economy that is struggling. Significant action taken by the Bank of Canada (BoC), federal and provincial governments have limited the potentially negative outcome of bringing our economy to a screeching halt, and the good news in recent weeks is that monthly GDP figures have pointed to a rebound/recovery that is underway.

As the Canadian economy slowly reopened, May GDP rose in almost every sector. Construction, retail and accommodation & food services saw strong month-over-month (m-o-m) gains of between 17% and 24% as COVID-19 restrictions were lifted. We also saw some modestly positive gains in the mining industries thanks to higher commodity prices. The rebound points to Q3/20 GDP annualized growth of about 34%. Nonetheless, the absolute level of GDP will remain below its pre-virus level until late 2021.

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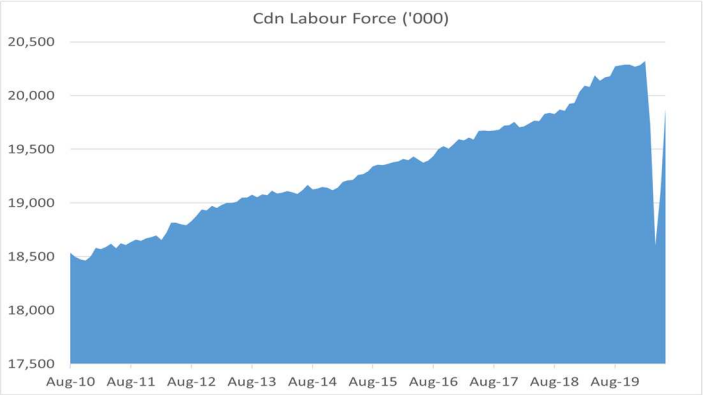
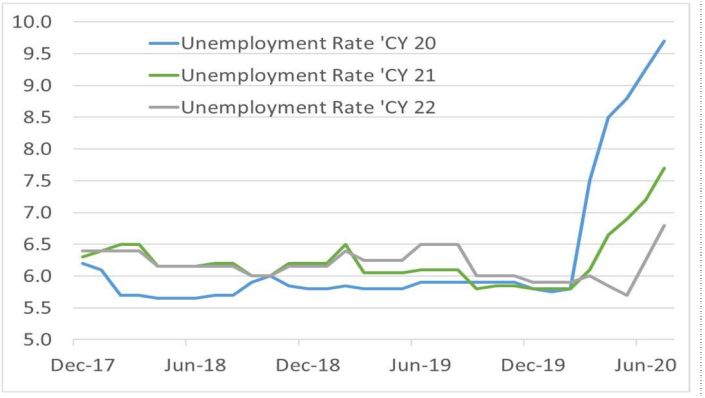
Canadian Labour Market – Rebound in June…



…But Unemployment to Remain Elevated



Source: FactSet, Raymond James Ltd.

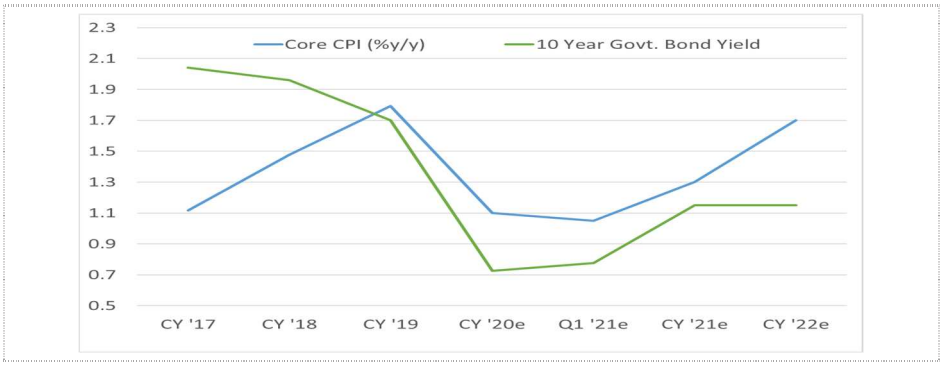
Monetary Policy & Inflation

With a full recovery at a minimum a year and half away, federal and monetary stimulus measures will remain supportive for the foreseeable future. The BoC has committed to maintain rates lower for longer as indicated by Bank of Canada Governor Tiff Macklem's comment, "our message to Canadians is that interest rates are very low and they're going to be there for a long time". This forward guidance is important for housing and those with consumer debt. As long as our financial institutions are willing to extend credit, the housing market and consumption can avoid any material softening. However, one headwind for housing, particularly multi-residential units, will be the slowdown in immigration that has been a significant driver for this category. Nonetheless, with nominal rates near zero and the potential for inflation to overshoot (more on this below), real rates (nominal rate less inflation) will be solidly in negative territory, which provides a nice tailwind for hard assets like real estate. We suspect housing prices may push even higher despite income levels that are not fully supportive of further gains. The latest sales data seems to support this view. In the Toronto region, July sales jumped 30% year-on-year (y-o-y) to 11,081 homes with the average selling price rising 17% to a record $943,710, according to the Toronto Real Estate Board. In the Vancouver area, sales increased by 22% y-o-y, to a record 3,128 homes, according to the Real Estate Board of Greater Vancouver.

The BoC has also engaged in quantitative easing by expanding its balance sheet by $420 bln, a rise equivalent to 18% of GDP. The asset purchases have targeted government bonds, as well as corporates to lower borrowing costs for both. While the BoC has been slowing its asset purchases, we anticipate the central bank to continue providing this extraordinary support until economic conditions begin to normalize. If the US financial crisis is any indication, the Federal Reserve only began shrinking its balance sheet in 2017, a full eight years after the crisis.

On the inflation front, the BoC said it will "hold the policy rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved". Like other developed market central banks, the BoC is indicating that it will allow inflation to run hot or above its targeted level. This is a rather significant change for the BoC, as in previous cycles rates would begin to increase ahead of inflation reaching the 2% target. This time around, the BoC appears ready to wait until inflation has reached 2%, and stay there for some time, before hiking rates.

Cdn Real Rates (nominal less inflation) in Negative Territory

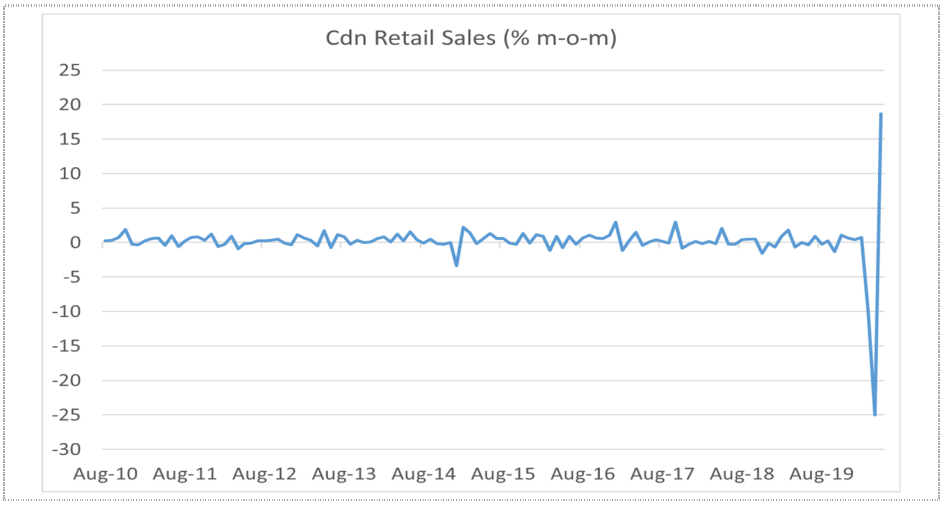


Source: FactSet, Raymond James Ltd.

The Consumer - Retail Sales

The generous government transfer payments not only limited the contraction in the broader economy, but provided some unusual benefits. First, this is the only time in history personal incomes actually *increased* during a recession and, second, the saving rates for those that remained employed have skyrocketed. In the US and Canada, government transfers have more than made up for the lost wages of low-wage earners (in some, cases individuals were making more from the transfer payment than working full time) and, because low-income earners generally spend the bulk of their income, retail sales likely benefited. As government transfer payments end (or moderate), this will create headwinds for consumption growth particularly if saving rates remain elevated. Though in the meantime, the measures taken to support individuals have resulted in a robust rebound in retail sales as the economy reopened. May retail sales data showed an 18.7% m-o-m rise and preliminary data pointed to a further 24.5% jump in June. Given the Greater Toronto Area has emerged from the lockdown in recent weeks, this should be supportive for a strong June print. If June's numbers are that strong, retail sales will have essentially returned to their pre-virus level!

Canadian Retail Sales – Strong Recovery



Source: FactSet, Raymond James Ltd.

Takeaways

- The economic recovery is underway, but stimulus will remain in place. On the fiscal side of the equation, the significant number of individuals that are unemployed will put pressure on governments to maintain some form of income support. We also anticipate additional fiscal spending programs to help maintain the economic momentum such as infrastructure-related projects.
- On the monetary side of the equation, interest rates will remain lower for longer. The short-end will be held near zero and longer maturity debt rates will be constrained via the BoC's asset purchase programs.
- A full economic recovery is not expected until late 2021 assuming the current trend of the recovery remains in place. An effective vaccine will have little impact on this outcome, in our opinion, given the complications of producing

and rolling out millions of doses. That said, an effective vaccine will improve sentiment and confidence, which may result in a reduction in the savings rate and subsequent increases in spending.

- Inflation is not a near-term risk, but we are laying the ground work for future inflation. The BoC (and other central banks) is committed to achieving, or exceeding, its inflationary target. Given years of undershooting the inflation target, the BoC may look to "average" things out by allowing inflation to run above target.
- Real rates (nominal less inflation) will therefore be negative. This will be supportive of hard assets such as real estate. Despite headwinds facing the Canadian housing market, we suspect prices will remain elevated as the economic recovery gains momentum.

Canadian Economic Outlook

	CY '17	CY '18	CY '19	Q1 '20	Q2 '20	Q3 '20	Q4 '20	CY '20	CY '21	CY '22
National Accounts										
Real GDP (%q/q, SAAR)	3.2	2.0	1.7	-8.2	-40.0	33.5	10.9	-7.0	5.2	3.0
Real GDP (%y/y)	3.2	2.0	1.7	-0.9	-13.5	-7.3	-5.2	-7.0	5.2	3.0
Inflation										
CPI (%q/q, SAAR)	1.6	2.3	1.9	0.5	-3.3	N/A	N/A	0.5	1.6	1.8
Core CPI (%y/y)	1.1	1.5	1.8	1.7	1.0	0.8	0.8	1.1	1.3	1.7
Other Indicators										
Unemployment Rate (%)	6.3	5.8	5.7	6.3	13.0	10.3	9.1	9.6	7.6	6.8
Budget Balance (% of GDP)	-0.8	-0.3	-1.0	-2.0	N/A	N/A	N/A	-11.3	-4.1	N/A
Interest Rates										
Target Rate	1.00	1.75	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10 Year Government Bond Yield	2.04	1.96	1.70	0.71	0.52	0.60	0.73	0.73	1.15	1.15
Exchange Rates										
USD/CAD	1.3	1.4	1.3	1.4	1.4	1.4	1.4	1.4	1.3	1.3
EUR/CAD	1.5	1.6	1.5	1.6	1.5	1.5	1.5	1.5	1.5	1.7

Source: FactSet Economics / FactSet Economic Estimates, Raymond James Ltd.

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