Weekly Updates Issue # 671

1. Weekly Markets Changes
2. Expect BoC rate hike next week, followed by a fall pause
3. Unemployment rate rises in Canada and U.S. despite adding jobs
4. Absent U.S., Iran nuclear deal negotiations continue
5. June GTA home sales edge up with drop in listings
6. Two cities saw housing affordability improve in Q1: RBC

1. Weekly Markets Changes

[July 6, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,371.78 +94.05 +0.58%	2,759.82 +41.45 +1.52%	24,456.48 +185.07 +0.76%	7,688.39 +178.1 +2.37%	$0.7631 +0.37c +0.49%	$1,255.48 +2.88 +0.23%	$73.92 -0.23 -0.31%

2. Expect BoC rate hike next week, followed by a fall pause

[July 6, 2018] The Bank of Canada is expected to raise its target for the overnight rate to 1.5% on Wednesday.

Canada’s Big Five banks have unanimously called for a hike on July 11 in recent reports, and the C.D. Howe Institute’s Monetary Policy Council (MPC) is expecting the same.

The MPC, which in a July 5 report offers an assessment of the monetary stance consistent with the BoC’s 2% inflation target, says, “All but one of the nine MPC members who attended [a recent] meeting called for an overnight rate target higher than the current one at the upcoming [BoC] meeting.”

The main reason is “the group’s view that Canadian economic data in the second quarter have rebounded from a sluggish beginning to 2018,” the MPC says, noting that domestic output has risen since April, the labour market is tightening and the housing market is stabilizing.

The MPC also points to headline inflation in the latest CPI data, “and two of the Bank’s three core CPI measures above the 2% target,” as well as”strong” U.S. data.

While the central bank’s latest Business Outlook Survey was largely taken prior to U.S. tariffs on steel and aluminum being imposed—a fact that the BoC also highlighted—the resulting uncertainty did not sway the C.D. Howe council’s vote for next week’s BoC meeting.

It did, however, lead to “caution” regarding the next meeting. At the BoC’s September meeting, the MPC predicts the central bank will hold at 1.5%, with "further increases raising [the target for the overnight rate] to 2% by July of 2019."

What the Big Five banks expect

"If the relative softness of prior months' jobs figures were not enough to move Governor Poloz and company off a July hike, there is nothing in this latest data likely to do the trick," says TD Bank in a July 6 report on Canada's June employment data.

Despite potential economic hurdles and global tensions, the bank says, "We continue to look for a policy interest rate hike on July 11th."

BMO agrees, noting there's not enough in Friday's employment data "to change [the BoC's] outlook, so if they were biased to hike next week prior to today (as we and the market believe), they are still biased to hike now."

A July 3 report from Scotiabank says the BoC "will raise rates another 125 basis points, to 2.5%, by end-2019," on the back of moderating growth and capacity pressures. A separate report, also from July 3, notes the U.S. Federal Reserve will only be 0.5% ahead of the BoC, with a federal funds interest rate of 3% by the end of next year.

CIBC, in its week ahead report for July 2 to 6, said "a nice rebound in Canada's labour force survey for June" would be "the last piece of the puzzle for a Bank of Canada rate hike in July." Following the release of those numbers on July 6, CIBC Capital Markets chief economist Avery Shenfeld said in a research note that the data is "good enough" to encourage the central bank to hike.

However, CIBC's week ahead said it expects "that economic growth will moderate enough after Q2 to force another extended pause on rates."

RBC doesn't expect markets will be surprised if the BoC is optimistic in its coming announcement. In a July 6 research note, RBC cites "generally solid data flow and relatively upbeat commentary from Governor Poloz" as two factors leading to a hike.

3. Unemployment rate rises in Canada and U.S. despite adding jobs

[July 6, 2018] A healthy gain of 31,800 jobs last month wasn't enough to keep Canada's unemployment rate from rising to 6% as more people searched for work, Statistics Canada said Friday.

The agency's latest labour force survey shows the jobless rate for June increased from 5.8% in May to break the 6% barrier for the first time since last October, when it was 6.2%.

The unemployment rate moved up last month despite the addition of new jobs because nearly 76,000 more people entered the workforce.

The report also found that average hourly wage growth, which is closely watched by the Bank of Canada, remained strong last month at 3.6%. The number, however, did come down from its nine-year high in May of 3.9%.

"A higher unemployment rate coinciding with a strong jobs gain in June is the best of possible worlds for Canada, with more of us working, but perhaps a bit more room for that to continue without triggering an inflation spike," says CIBC Capital Markets chief economist Avery Shenfeld, in Friday commentary.

The latest jobs figures arrived less than a week before the Bank of Canada's next interest-rate decision.

Expectations have strengthened that governor Stephen Poloz will raise the benchmark for the first time since January. Experts predict the move even though the economy is facing significant uncertainty from Canada's intensifying trade dispute with the United States as well as growing fears of a global trade war.

In his commentary, Shenfeld says the data is "good enough" to encourage the central bank to hike.

On trade, he says, the news "wasn't as good, with the deficit rising to $2.8 [billion], as a 1.7% rise in imports (1.2% in volume terms) combined with a 0.1% dip in exports that was a more notable 1% fall in real terms, led by metal ores and minerals." However, he doesn't expect the loonie will be affected.

Employment and trade details

Compared with a year earlier, overall employment was up 1.2% following the creation of 214,900 jobs, which was driven by 284,100 new full-time positions.

A closer look at the June numbers shows Canada added 9,100 full-time jobs in June and 22,700 part-time positions. The public sector gained 11,800 jobs and the private sector lost 2,000.

The goods-producing sector added 46,600 positions in June thanks to job-creation boosts in construction, natural resources and manufacturing.

Services sectors, meanwhile, lost 14,700 jobs mostly because of big decreases in accommodation and food services positions as well as wholesale and trade.

Ontario added 34,900 jobs for an increase of 0.5% compared with the previous month, while Saskatchewan posted its largest monthly gain in over six years with the creation of 8,300 positions, which represented 1.5% growth.

Youth unemployment increased to 11.7% last month, up from 11.1% in May.

In a separate report Friday, Statistics Canada said the country's merchandise trade deficit with the world widened in May to nearly $2.8 billion. The international trade deficit was about $1.9 billion in April and $3.9 billion in March.

The May numbers show that imports expanded 1.7%, while exports dipped 0.1%.

Higher imports in May of aircraft, other transportation equipment and energy products fuelled most of the increase. The figure for aircraft imports more than tripled to $937 million due to the purchase of several air liners from the U.S.

Exports declined mostly because of weaker trade on motor vehicles and parts as well as metal ores and non-metallic minerals.

The report showed that Canada's trade surplus with the U.S. narrowed to $3.3 billion in May, from $3.7 billion April, as more imports headed north across the border and south-bound exports decreased.

U.S. unemployment rate also rises

U.S. employers kept up a brisk hiring pace in June by adding 213,000 jobs in a sign of confidence despite the start of a trade war with China.

The Labor Department said Friday that the unemployment rate rose to 4% from 3.8% as more people began looking for work and not all of them found it.

On the same day that the Trump administration began imposing tariffs on US$34 billion in Chinese imports and China retaliated with their own tariffs, the job gain showed that the nine-year old U.S. economic expansion—the second-longest on record—remains on solid ground.

Average hourly pay rose just 2.7% from a year earlier. The low jobless rate has yet to force employers to offer higher wages in order to fill job openings.

The broader U.S. economy appears to be on sturdy ground. Economists are forecasting that economic growth accelerated to an annual pace of roughly 4% during the April-June quarter, about double the previous quarter's pace.

Signs of economic strength have helped bolster hiring despite the difficulty many employers say they're having in finding enough qualified workers to fill jobs.

Manufacturers and services firms have said in recent surveys that their business is improving despite anxiety about the tariff showdown between the United States and China. Housing starts have climbed 11% so far this year. Retail sales jumped a strong 0.8% in May in a sign that consumers feel secure enough to spend.

But while economic growth appears solid, the gains have been spread unevenly. President Donald Trump's tax cuts have provided a dose of stimulus this year, though it has been tilted significantly toward wealthy individuals and corporations. Savings from the tax cuts enabled companies in the Standard & Poor’s 500 stock index to buy back a record number of shares in the first three months of 2018.

Yet the tax cuts have done little to generate substantial pay growth. After adjusting for inflation, the Labor Department reported last month that wages have essentially been flat for the past year. Still, economists say they think the low unemployment rate will eventually force more employers to offer higher pay in order to fill jobs.

The economy also faces a wild card in the tariffs being imposed on China. On Friday, the Trump administration begins taxing US$34 billion of Chinese imports at a 25% rate. China has pledged retaliatory tariffs of the same magnitude. Any escalation in the trade conflict could disrupt hiring as companies deal with higher prices.

Nor is the trade showdown with China an isolated skirmish. The Trump administration has applied tariffs on steel and aluminum from allies like Canada and Mexico and has threatened to abandon the North American Free Trade Agreement with those two countries. Trump has also spoken about slapping tariffs on imported cars, trucks and auto parts, which General Motors has warned could hurt the U.S. auto industry and drive up car prices.

4. Absent U.S., Iran nuclear deal negotiations continue

[July 6, 2018] Five world powers agreed with Iran on Friday to forge ahead with negotiations with the country and maintain its ability to export gas and oil as they seek to preserve a nuclear deal with Tehran despite the withdrawal of the United States.

European Union foreign policy chief Federica Mogherini told reporters that top diplomats from Germany, Britain, France, Russia and China reaffirmed their commitment to the 2015 deal, known as the Joint Comprehensive Plan of Action, “which is in the security interest of all.”

“The participants recognized that, in return for the implementation by Iran of its nuclear-related commitments, the lifting of sanctions, including the economic dividends arising from it, constitutes an essential part of the JCPOA,” Mogherini told reporters after the meeting without taking questions.

Iranian President Hassan Rouhani had previously called the latest package of incentives offered “disappointing,” but Iranian Foreign Minister Javad Zarif said he would convey “deeper explanation” observed at the Vienna meeting to Tehran.

“We prefer to continue to stay in the nuclear deal,” he told reporters. “But the final decision will be made in Tehran.”

Still, he called the meeting “one step forward.”

“The concerns, which we had last night and which were also expressed by President Rouhani, were addressed in the meeting and more details were disclosed, and they make us more optimistic than we were yesterday,” he said. “The EU package is a commitment, but we have to wait and see how it will be put into practice before the first sanction date” of August 6.

The JCPOA is meant to prevent Tehran from developing nuclear weapons, but U.S. President Donald Trump in May said he was unilaterally pulling out because he felt it wasn’t strong enough and didn’t cover other issues of concern to the U.S. and its allies, such as Iran’s military influence in the Middle East and a ballistic missile program.

Iran’s economy is already suffering from the sanctions that Washington re-imposed after walking away from the nuclear agreement, and the U.S. has threatened to punish companies from other nations that continue doing business with Iran.

Ahead of the talks, Chinese Foreign Minister Wang Yi said preserving the deal was critical, and that the treaty states would send a “united, determined and strong signal” that they were committed to it despite Trump’s decision.

“If this treaty can’t be upheld then this doesn’t just hurt the interests of Iran, it also damages the peace in the Middle East and the credibility of the international world order,” Wang said.

Mogherini noted that companies pursuing business in Iran “have been acting in good faith based on the commitments contained in the JCPOA and endorsed at the highest level by the UN Security Council” and said the treaty states were committed to providing “clear and effective support for economic operators trading with Iran.”

She didn’t get into greater detail, but before the meeting German Foreign Minister Heiko Maas conceded that the treaty nations would not be able to compensate Iran entirely for the loss of business from companies withdrawing. But Maas said they would advise firms that want to continue investing and emphasize to Iran that leaving the deal “would have much greater disadvantages.”

“We want to make it clear to Iran today that it still has economic benefits from this agreement,” Maas told reporters. “Above all we will try to create the conditions for that.”

Other objectives Mogherini outlined included maintaining wider economic relations with Iran, financial channels, Iran’s export of oil and gas, and the continuation of sea, land, air and rail transportation links.

Mogherini said all participants had agreed to reconvene the JCPOA again at a later date.

5. June GTA home sales edge up with drop in listings

[July 5, 2018] The pace of Toronto home sales picked up last month, in a sign that the market is rebounding from recent regulatory changes and higher borrowing costs.

The Toronto Real Estate Board (TREB) revealed Thursday that home sales in the Greater Toronto Area rose 2.4% to 8,082 in June, up from the 7,893 homes that changed hands the same month a year ago. When compared with May, those number represented a 17.6% spike.

The slight year-over-year increase followed a steep sales drop of 22.2% in May across the GTA compared to May 2017, reflecting what TREB said is a continuing trend of volatile buyer reaction to various policy changes impacting the market.

"After some adjustment to the Fair Housing Plan, the new Office of The Superintendent of Financial Institutions (OSFI) stress test requirement and generally higher borrowing costs, home buyers are starting to move back into the market, with sales trending up from last year's lows," said TREB's new president Garry Bhaura, in a release, referring to a slew of measures put into place by the federal and provincial governments in the wake of last year's heated market, where bidding wars and skyrocketing prices were the norm.

Bhaura said he has noticed that market conditions appear to be tightening with new listings falling by 18.6% to 15,922, down from 19,561 when compared to last year.

Meanwhile, the average selling price edged up by 2% on a year-over-year basis to $807,871.

Sales of detached homes led the way, with the board reporting 3,589 sales at average price of $1,033,574.

In the City of Toronto in June, 3,096 homes were sold at average price of $870,559 while 4,986 homes were sold in the rest of the GTA at an average price of $768,945.

TREB said 2,234 condos were sold during the month for an average of $561,097.

Jason Mercer, TREB's director of market analysis, said the board expects to see sales improve over the next year, although issues surrounding the supply of listings will persist.

"This suggests that competition between buyers could increase, exerting increased upward pressure on home prices," he said.

Bank of Montreal economist Robert Kavcic also took the data to show the market is staging a "snappy turnaround."

“To be fair, sales were plunging on a month-over-month basis at this time last year, so an improved annual trend was inevitable,” he said, in a note to investors.

“At any rate, it does look like activity is stabilizing, though still at subdued levels.”

6. Two cities saw housing affordability improve in Q1: RBC

[July 3, 2018] Homes in Canada became less affordable in Q1 2018, due largely to higher mortgage rates and rising interest rates, says a report by RBC Economic Research.

Based on activity in the first quarter, the bank’s Housing Trends and Affordability Report says the average Canadian household must now allocate 48.4% of its income to carry the costs of owning a home. That’s a 0.4 percentage point increase relative to the previous quarter, and a multi-year high, says RBC in a release.

The report calculates what the bank calls its housing affordability measure, which shows “the proportion of median pre-tax household income that would be needed to service the cost of mortgage payments (principal and interest), property taxes and utilities based on the average market price for single-family detached homes and condo apartments, as well as for an overall aggregate of all housing types in a given market”, the report says.

Affordability breakdown, by city

Even though Canadian housing prices were flat overall in Q1, RBC says in its release, the costs of owning a home in Vancouver reached its highest level on record.

RBC’s aggregate measure for that city rose to 87.8%, an increase of 1.5% over the previous quarter. Higher interest rates and the re-acceleration in home prices caused a “further material deterioration to affordability,” the bank says.

Ottawa, Halifax, St. John’s and Saskatoon all had their housing aggregate measures rise significantly year over year, due to higher interest rates.

Montreal also saw its measure rise, leading to reduced affordability for a third-straight quarter. The share of household income needed to carry a home in Montreal reached 43.7%, its highest level since 2011.

Meanwhile, housing affordability in Toronto improved, with its aggregate measure easing very slightly by 0.1 percentage points to 74.2%. However, the share of household income needed to cover the costs of home ownership rose year over year by nearly 2%, and the report says lack of affordability “poses a tremendous challenge for many Toronto-area buyers.”

Also, “The scope for further relief is limited […],” the report adds, saying, “Home prices [for Toronto] are poised to turn slightly higher near-term after declining modestly in the past two quarters. Prices will get support from balanced demand-supply conditions, which will prevail despite much cooler resale activity.”

RBC says Winnipeg was the only other housing market to become slightly more affordable in Q1. The bank says there’s been “significant slowing in market activity in the past two quarters” in that city, leading to a measure of 29.9%—that 0.2% lower compared to the previous quarter, but 0.8% higher year over year.

What’s next for Bank of Canada?

By the middle of 2019, RBC forecasts that the Bank of Canada will have raised interest rates to 2.25%, up from 1.25% currently. This would make it more challenging to own a home, the report says.

“With the prospect of more interest rate hikes in the period ahead, there’s a definite risk that affordability will erode further in the coming year,” said Craig Wright, senior vice-president and chief economist at RBC, in the release. The odds of this occurring will also depend on the degree to which household income increases.”

The report notes mortgage rate hikes are also a key factor. “We estimate that, everything else remaining constant, a 100-basis-point increase in mortgage rates would lift RBC’s aggregate affordability measure for Canada by about [four] percentage points,” it says.

While cooler housing markets and “a levelling-off of property values in some areas” could help alleviate pressure, the bank says it doesn’t “expect affordability conditions to get any easier in Canada in the period ahead. At best they will remain unchanged. Most likely, though, they will become more challenging.”

Have a nice and fruitful week!