Weekly Updates Issue # 699

1. Weekly Markets Changes

[February 1, 2019]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,506.30 +140.25 +0.91%	2,706.53 +41.77 +1.57%	25,063.89 +326.7 +1.32%	7,263.87 +99.0 +1.38%	$0.7637 +0.93c +1.23%	$1,317.98 +12.73 +0.98%	$55.26 +1.57 +2.92%

2. Four macro reasons to worry

[February 1, 2019] "The American economy is adrift, like a huge sailing ship," C.D Howe Institute senior fellow Glen Hodgson wrote in an intelligence memo Friday. "When tides are high and winds are favourable, it can be headed in the right direction. But when conditions darken, the U.S. economy will have no mooring or anchor. It could even end up crashing on the rocks again as it did in 2008."

Hodgson's memo, "Four (Macroeconomic) Reasons to Worry," comes after a month of rebounding equity markets. S&P Dow Jones Indices reports an 8% January gain for the S&P 500, with small caps performing even better.

Canadian equities were stronger, as the S&P/TSX Composite started the year with a 9% gain.

Volatility moderated in equity markets, with a more dovish Fed, an oil rebound and improvement in the U.S.-China trade outlook driving results, an S&P DJI commentary said.

After a brutal end to 2018, investors have welcomed the results. Hodgson acknowledged reasons for short-term optimism, including low unemployment and forecasts for solid growth in 2019. But he points to four macro concerns with the U.S. economy.

1. Large deficits and public debt: While problems pre-date the financial crisis, the Trump administration tax cuts have made the situation worse,

Hodgson said. The Congressional Budget Office projects a US$1-trillion fiscal deficit by 2020, with public debt exceeding 90% of GDP that year. Many economists have forecast a recession beginning next year, partly due to the stimulus from U.S. tax cuts running out and the debt consequences becoming more apparent.
2. “Monetary morphine”: The U.S., like much of the global economy, has been “medicated for a decade with truly exceptional monetary stimulus,” Hodgson said, calling it “monetary morphine.” The drop in stocks in the fourth quarter of 2018 shows the U.S. economy hasn’t “completed its withdrawal.” This forces the Fed to tread very carefully to avoid destabilizing the recovery.
3. Lack of trade strategy: The Trump administration’s withdrawal from the Trans-Pacific Partnership, its insistence on a new NAFTA while maintaining steel and aluminum tariffs, and its trade war with China have all been made “without an overarching strategy and with no consideration of the collateral damage,” he said.
4. Climate change: The U.S. has withdrawn from the Paris Accord and pulled back other environmental regulations, ignoring “the ultimate existential threat facing the United States and the world,” Hodgson said.

All Canada can do is prepare itself to deal with the consequences of these four factors, Hodgson said, and implement strong policies.

3. Brexit may lead to exodus of U.K. firms: survey

[February 1, 2019] Nearly a third of U.K. firms may shift their operations abroad because of Britain’s looming departure from the European Union, a survey of 1,200 company directors suggested Friday, as the political stalemate over a Brexit deal heightened jitters among businesses.

The survey by the Institute of Directors, an employers’ group, found that 16% of businesses already had relocation plans while a further 13% were “actively considering” a move.

The group said while headlines have focused on big companies, less notice has been given to smaller U.K. businesses and their plans to relocate.

Institute interim director Edwin Morgan said smaller firms typically have tighter resources and for them “to be thinking about such a costly course of action makes clear the precarious position they are in.”

Britain is due to leave the EU on March 29, but a Brexit divorce agreement struck between British Prime Minister Theresa May’s government and the bloc late last year as been rejected by Britain’s Parliament.

U.K. lawmakers voted this week to send May back to Brussels to seek changes to the divorce agreement. But the EU is adamant that the deal cannot be renegotiated, leaving Britain lurching toward a cliff-edge "no-deal" departure from the bloc that many businesses fear will cause economic chaos.
A survey of companies released Friday showed that manufacturing firms stockpiled goods at a record rate in January to prepare for potential Brexit disruption to trade.
The survey of about 600 U.K. manufacturers by the market research company Markit and the Chartered Institute of Procurement and Supply found that inventories of finished goods rose sharply, while optimism in the sector was at a 30-month low and jobs were starting to be cut.
Senior government ministers have suggested that Britain may have to seek a delay to Brexit to make time to find a solution.
International Trade Secretary Liam Fox said Friday the government was "still aiming to get to the 29th March—that's the date we promised the British people." But he suggested there could be "a short delay" if Britain and the EU "had reached an agreement and needed the legislation to implement it."
A delay would need the approval of the 27 remaining EU states. Ireland's Europe Minister, Helen McEntee, said the bloc would likely agree, as long as Britain had a good reason.

4. GM to start laying off 4,000 salaried workers on Monday

[February 1, 2019] Layoffs for about 4,000 salaried staff at General Motors are due to start Monday -- a previously announced move that comes just as President Donald Trump prepares to trumpet American manufacturing at next week's State of the Union address.
The layoffs are part of a 15% reduction in white collar jobs in North America that the automaker first announced back in November. At the same time, it announced plans to close four US plants as well as a fifth in Canada.
The job cuts and plant closings are part of ongoing cost reductions to free up $6 billion annually to invest in a new generation of autos, such as electric and self-driving vehicles. It is also making a push to develop a ride hailing service that will allow GM to make more money by selling rides to customers rather than vehicles.
But the move enraged Trump, who repeatedly lambasted GM CEO Mary Barra over the decision. In his rebuke of GM, Trump focused on the closures in Ohio, a state he won in the 2016 election. The company also announced plans to shutter facilities in Maryland and Michigan.

He said the company would face punishment for the closures, which included a plant in Lordstown, Ohio, that Trump personally promised to revive during the 2016 campaign.

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The president said he was "very tough" on Barra in a phone call after the company announced the closures, and referred to the federal auto bailout money the company received in 2008.

"You know, the United States saved General Motors, and for her to take that company out of Ohio is not good," Trump said in November.

He commiserated about the closures in a series of phone calls with his Canadian counterpart Justin Trudeau. And he claimed GM would soon announce steps that could counteract the effect of the plant closures, though what those actions are remain unclear.

Trump is due to tout his economic successes on Tuesday during the annual State of the Union address to Congress. A senior administration official said Friday the speech's theme would be "Choosing greatness."

Overall, Trump is presiding over a strong American economy. Friday's job reports beat expectations, showing more than 300,000 jobs were created last month. But trade tensions and global economic anxiety have led some companies to rethink their business plans and sparked concerns about the risk of a slowdown.

The GM plants, which include about 6,000 hourly jobs, have yet to close, GM is moving ahead with the salaried staff reductions, a GM spokesman confirmed Friday. The timing of the layoffs was first reported by the Detroit News.

The company had about 2,300 salaried staff accept voluntary buyout packages that were offered to 18,000 employees. In addition, there were 1,500 contract employees who were not retained by the company.

That leaves the remainder of the 8,000 planned job cuts to be accomplished with the involuntary layoffs.

5. Canada’s GDP dips 0.1% in November

[January 31, 2019] Real GDP decreased by 0.1% in November, Statistics Canada reported Thursday, partly offsetting October’s increase of 0.3%. The decrease was in line with consensus expectations.

While there were gains in 13 of the 20 sectors tracked, those increases were more than offset by decreases in finance and insurance, wholesale trade, manufacturing and construction.

With Canada's economy losing momentum toward the end of last year, fourth quarter growth for 2018 is tracking at about 1% annualized, said Krishen Rangasamy, senior economist at National Bank, in a report. The first quarter of 2019 likely won't be better, he added, considering oil production cuts and negative spillover from the U.S. government shutdown.

That means Canada's central bank won't be raising its key rate any time soon. Canada's output gap will remain wide, keeping inflation manageable, Rangasamy said. "As such, the Bank of Canada is likely to delay monetary policy normalization."

CIBC made similar comments: "The current soft patch will keep the Bank of Canada firmly on the sidelines for the first half of 2019," CIBC director and senior economist Royce Mendes said in a report.

Despite being in line with consensus, today's data resulted in a selloff of the Canadian dollar, as well as lower yields on government bonds. That market impact was likely the result of relatively broad-based sector weakness, Mendes said.

GDP details

The finance and insurance sector declined 0.7% in the month, offsetting much of its 1.1% increase in October. In November, bond and equity market activity declined, contributing to decreases in financial investment services, funds and other financial vehicles and depository credit intermediation services, StatsCan said.

Insurance carriers and related activities were essentially unchanged.

Wholesale trade dropped 1.1% in November as machinery, equipment and supplies wholesaling contracted 2.1%.

Manufacturing decreased 0.5% for the month, the third decline in four months, and construction dropped 0.3% to its lowest level since mid-2017.

Retail trade dropped 0.3%, driven by lower activity at motor vehicle and parts dealers.

6. Small biz confidence low, finds CFIB

[January 31, 2019] Research by the Canadian Federation of Independent Business (CFIB) found a slight increase in small business confidence this month, but it remains relatively low.

The CFIB's Business Barometer is at 56.1 for January 2019, and the organization notes that an index level between 65 and 70 is what's expected if the economy is growing at potential.

"We're seeing an uptick in confidence levels, but they are still well below what you would expect to see in a healthy, growing economy," Ted Mallett, vice president and chief economist, says in a statement. "The continued slump in business confidence is reflected in lower wage and price expectations. Businesses' unfilled orders and accounts receivable are also taking a hit, falling to 2016 conditions."

These numbers echo survey results released yesterday by CPA Canada, which found that Canadian CPAs are at their least optimistic about the economy since 2016.

Across the country, CFIB says, 41% of owners say their businesses are in "good shape," while 14% have a negative outlook. Eighteen percent of businesses plan to hire full-time staff in the next three months and 15% plan to cut back.

Alberta's small business owners are the least confident in the country (the index there lost 7.6 points and is now at 37.5), as optimism about the natural resource sector drops. The most confident are in Prince Edward Island and Quebec. CFIB also found that business confidence was higher in major metropolitan areas.

7. Fed keeps key rate unchanged and pledges to be 'patient'

[January 30, 2019] The Federal Reserve is keeping its key interest rate unchanged and signalling that it could leave rates alone in coming months given economic pressures and mild inflation. The Fed also says it's prepared to slow the reduction of its bond holdings if needed to help the economy.

The central bank said Wednesday that it plans to be "patient" about future rate hikes. Its benchmark short-term rate will remain in a range of 2.25% to 2.5% after having been raised four times last year. The Fed's key rate influences many loan rates for businesses and consumers, including mortgages.

Investors cheered the Fed's message after its latest meeting that it foresees no need to raise borrowing rates anytime soon even while the economy remains on firm footing. The Dow Jones Industrial Average, which had already been up strongly, surged about 200 points once the Fed statement was released and was up about 460 points nearly an hour later.

Its "decision will reinforce expectations that the Fed is almost done raising interest rates," Michael Pearce, senior U.S. economist, Capital Economics, said in a research note.

The Fed has been gradually reducing its bond portfolio, a move that has likely contributed to higher borrowing rates. But at some point, to avoid weakening the economy, it could slow that process or end it sooner than now envisioned. Doing so would help keep a lid on loan rates and help support the economy.

On Wednesday, the central bank said it's ready to use all its tools—including an adjustment to its bond portfolio—if it decided the economy needed more support.

The Fed's note of patience about rate hikes marks a reversal from a theme that Chairman Jerome Powell had sounded at a news conference after the Fed's previous policy meeting in December. Powell had appeared to leave open the prospect of further increases soon. That message had sparked fears in financial markets that the Fed might tighten credit too aggressively this year.

With pressures on the U.S. economy rising—a global slowdown, a trade war with China, a nervous stock market—the Powell Fed is now signalling that it's in no hurry to resume raising rates. And with inflation remaining tame, the rationale to tighten credit has become less compelling.

Still, the Fed is having to maintain a delicate balancing act because some gauges of the economy look healthy. The job market, for example, remains robust, with solid and steady hiring. And corporate earnings have so far been holding up in the face of the global slowdown and trade conflicts. Of the companies in the Standard & Poor's 500 that have reported results for the final three months of 2018, 77% have delivered earnings growth that topped Wall Street's forecasts. Some, though, are lowering expectations for 2019.

Since the Fed's December meeting, Powell and others on the Fed's policymaking committee have been clear in suggesting that they're in no rush to raise rates again after having done so nine times over the past three years. Besides invoking the word "patient" to describe the Fed's outlook toward future hikes, Powell has stressed there's no "preset course" for rate increases. The Fed, in other words, will tailor its rate policy to the latest economic data.

In its statement Wednesday, the Fed said, "In light of global economic and financial developments and muted inflation pressures, the committee will be patient in determining what future adjustments" to the Fed's interest-rate policy will be appropriate.

The Fed's decision was approved on a 10-0 vote.

The assurances from the central bank have helped allay fears that higher borrowing costs might depress corporate earnings and economic growth. They have also helped spur a stock market rally. With the turnaround, stocks are on pace for their best month since March 2016.

In recent weeks, though, the Fed has been hamstrung in its effort to assess the health of the economy. That's because the partial shutdown of the government that has ended late last week—at least until mid-February—essentially closed the Commerce and Treasury departments, among other agencies. So key economic data that those departments normally issue—involving retail sales, home construction and factory orders, among others—haven't been available

to the Fed. Beginning Thursday, though, the government will start gradually distributing the delayed economic reports.
The economic impact of the partial government shutdown will be among topics Powell will face at his news conference, in addition to the global slowdown, the U.S.-China conflict and Britain's struggles to achieve a smooth exit from the European Union. All those threats could potentially jeopardize the Fed policymakers' outlook for this year.

8. When will the next recession hit?

[January 30, 2019] Slowing global growth and market volatility have investors monitoring the horizon for a potential recession. However, the expansion could last for several more quarters, says a report from Desjardins that provides an economic analysis to support its position.
For example, despite a slower pace, growth for several countries remains above its long-term potential—a sign that mitigates recessionary concerns. "Among other things, the unemployment rate should not increase as long as economic growth does not fall below its potential," the report says.
That's important, since a persistent hit to the labour market shakes consumer confidence and can lead to a recession, says a TD report published this month. "Once the consumer goes to sleep, the expansion is over," it says.
We're not there yet. Real GDP must contract for at least two consecutive quarters to constitute a recession—not simply slow down, as is currently the case.
Other factors beyond real GDP used to identify a recession (depending on the country) are also holding up, Desjardins says. For example, in the U.S., employment, industrial production, business sales and personal income less transfer payments show no reversal in the current cycle.
There are, however, some caveats to this analysis. For example, leading economic indicators, as opposed to those tracking the current cycle, show few signs of improvement in growth over the next few months.
"At best, we might see the situation stabilize in emerging countries," the Desjardins report says, referring to OECD leading indicators. "For the United States, the euro zone and a number of other economies, the situation might still deteriorate."
Risks, including protectionism and political uncertainty, add to the potential for deterioration. These make investors more cautious, negatively affecting growth.
Still, investor sentiment rebounded this month, in part because federal banks sounded more dovish. "By slowing the pace of its monetary tightening, the

Fed should leave more breathing room for an economy that seems to need to catch its breath," Desjardins says.
Finally, it notes that the current cycle has some unique characteristics that might support a continued expansion. For example, its recovery phase took longer to take root relative to other cycles, at two years.
Also relatively long was the time for excess production capacity to be used—that's when real GDP outstrips potential output. "Once potential GDP is surpassed, the economic cycle can be said to be maturing," the report says. "This period lasts approximately three years on average."
Since real GDP in the U.S. passed its potential in spring 2018, the current cycle could run until early 2021.
The bottom line is that it's too early to call for a recession, at least with a high degree of certainty, says the Desjardins report. Still, caution is warranted as the cycle winds down.

9. Economic sentiment deteriorates among business leaders

[January 30, 2019] Pessimism about the strength of the Canadian economy is growing, finds a survey by Toronto-based Chartered Professional Accountants of Canada (CPA Canada).
In the fourth quarter of 2018, 35% of professional accountants in leadership positions said they were pessimistic about the economy in the next 12 months, a significant increase from 16% a year prior. These findings, CPA Canada notes, came before the Bank of Canada reduced its forecast for 2019 GDP growth.
More than a quarter (26%) of respondents were optimistic about the economy, the lowest level since 2016 and down 48% year-over-year.
"Despite the recent spate of strong economic data, the sharp deterioration in economic sentiment highlights that Canada's business leaders are rightly worried about the numerous external risks facing the economy," Joy Thomas, president and CEO, said in a statement.
Some of these external risks as cited by survey participants are: protectionist trade sentiment south of the border (18%); uncertainty surrounding the Canadian economy (15%); and oil prices (12%).
Professional accountants were also less optimistic about prospects for their own organizations; company optimism was down to 49%, from 61% at the end of 2017.

Have a nice and fruitful week!