Zero Shades of Grey

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Regardless of one’s political stripe, most reasonable people would agree that President Trump is not prone to understatement. If something isn’t huge, big league, the best in the world, massive, or phenomenal, then it’s a disaster, terrible, awful, bad, or the worst ever. In fact, it may be fair to say that, in his world, there are zero shades of grey. That makes it all the more notable that the President is suddenly sounding so restrained on the fiscal policy front.

In this week’s speech to Congress, many applauded the (relatively) measured tone of the President’s remarks—certainly stocks did, with the Dow piercing the 21,000 mark—and he again pledged $1 trillion in infrastructure spending. Yet, he was conspicuously circumspect about tax reform; hardly surprising, given the intense debate underway on how best to approach that complex subject. And, of course, there’s the small matter of first dealing with the even more complex issue of health care—and, really, who knew it could be so complicated?

We are now of the view that any fiscal stimulus in the U.S. is likely to be a 2018 story and we have built in virtually nothing on that front for this year into our growth forecast. Compounding the absence of fiscal help this year, some recent data suggest that GDP growth may stumble out of the starting gates yet again in 2017 (as it so often does in Q1 for the U.S.). Some outfits are now looking for Q1 GDP to actually slow a tad from the modest 1.9% pace last quarter, with softness in January consumer spending and trade. However, most other indicators suggest growth will still be solid this year, with small business and consumer confidence sizzling, auto sales holding near record highs, and the ISM suggesting manufacturing had one of its best months in almost six years in February. As well, record equity markets and the ongoing recovery in home prices suggest that any lull in consumer spending won’t last long, as the wealth effect from lofty asset prices kicks in more meaningfully in the months ahead.

Certainly, the Fed seems entirely comfortable with the economic outlook and does not appear fazed by any slow pickup in fiscal stimulus. The consistent message Fed speakers conveyed this week is that the job market continues to improve—the plunge in initial jobless claims to just 223,000 last week was an added exclamation point—and that fiscal policy will, on net, add to growth over the next few years. There were no shades of grey in Fed officials’ comments this week as they sent a loud, co-ordinated message that a rate hike is coming “soon”. And, on cue, the market now largely expects the move in mid-March. We are also now looking for the Fed to hike this month, and go two more times this year—barring a big shock in next week’s jobs report for the former and a big shock elsewhere on the latter.

Admittedly, this is a change in view. Prior to this week, we were of the view that this ultra-cautious, and reliably dovish Fed would again err on the side of keeping things loose. Not so, it seems. Given that we have consistently called for the Fed to up the
tempo on rate hikes for the past two years, we can scarcely gripe about their sudden change in tone.

Well, that didn’t take long. Just last week, we suggested that the Canadian economy was primed to surprise the consensus and the Bank of Canada to the high side in 2017. Following a perkier-than-expected GDP finish to 2016, including a stream of upward revisions, we now feel confident enough to **lift our call for this year’s Canadian growth rate by a hefty 0.3 percentage points to 2.3%**. While that may not sound ground-quaking, this would leave us well north of the prior consensus estimate (1.9%) and almost a full point above last year’s modest growth rate (1.4%, which itself was revised up a tick this week). As well, it would also leave growth essentially in line with the expected U.S. pace for 2017, after two years of notable underperformance.

Another factor behind our decision to boost this year’s growth estimate is a run of **better-than-expected domestic data** so far in 2017. Alongside solid employment gains in recent months (and we’ll see next Friday if the streak continued in February), auto and home sales keep chugging along, suggesting the consumer is still doing its thing. And, on cue, the early returns from February home sales point to still-strong activity. To wit, Calgary home sales were up 19% y/y last month and prices turned higher, while even Vancouver, which sagged after the government slapped a sales tax on non-resident buyers, is showing signs of stabilizing. Speaking of no shades of grey, Toronto continues to run wild with average prices vaulting nearly 28% from year-ago levels. Skipping past the semantics over whether or not to call Toronto a bubble, most reasonable folks would agree that a 28% surge would not qualify as a normal market—and, recall, this is after the federal government took steps last fall to cool demand! If policymakers leave this market to its own devices, there is a real risk that a still-manageable bubble is pumped by rampant speculation into something much more dangerous.
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