Canadian Growth Stronger than Expected, Poloz to Raise Rates in September

- The global outlook is largely unchanged from our July forecast. Global momentum remains generally strong though trade-related risks remain quite significant. Our baseline view remains that trade tensions will fade in time as the damage of escalating trade tensions becomes evident to the White House. Despite President Trump's claim that he is a free-trader, he appears to be a protectionist at heart and clearly views commercial relations in terms of winners and losers. Given this perverse view of trade, the risks of a damaging trade war are not as low as they should be. We remain of the view (see trade war paper link here) that a dramatic escalation of trade actions could trigger a global recession. It is a low probability, high impact event.

- **Even as trade uncertainty remains elevated, developments in Canada have generally been more positive than anticipated.** We are increasing our model-based growth forecast for 2018 to 2.2%, from the 2.0% we predicted in July. Against the background of a very strong US expansion, incoming data suggest the Canadian economy has been more resilient to Trump policies than we had assumed: business investment appears stronger than earlier thought. Capacity pressures and job shortages likely account for this stronger-than-expected dynamic. Consumption is also stronger than thought despite rising interest rates and declining confidence. We attribute that largely to strong gains in disposable income, fueled by continued strength in the labour market and rising wages.

- **Given the improved outlook, we now expect that the Bank of Canada will raise rates more rapidly, with the next increase in September, followed by another in December**. We have not changed our view on the total amount of tightening required by end-2019, which remains 100 bps above current levels. The shift we now foresee simply brings forward some of that tightening. Growth will remain well above the BoC's estimate of potential this year, and we now forecast that core inflation, as defined by the average of the three measures used by the BoC will peak at 2.3% rather than the 2.2% we predicted in our last update. These factors add to what is clearly a more hawkish stance by Governor Poloz, in which he now argues, among other factors, that the BoC will only respond to negative developments if they occur.

- **Markets appear to be dramatically underpricing the odds of additional monetary policy tightening in Canada**. Roughly 5 basis points of tightening by the BoC are priced in for September. About 40 basis points are priced in by the end of next year. Developments in trade policy as well as the evolution of key economic indicators will naturally influence our thinking as we get closer to September. If the situation unfolds as we expect, we think Governor Poloz will be compelled to raise rates in September even if market pricing hasn't adjusted by then.

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International	2000–16	2016	2017	2018f	2019f	2000–16	2016	2017	2018f	2019f
	Real GDP (annual % change)					Consumer Prices (y/y % change, year-end)				
World (based on purchasing power parity)	3.9	3.2	3.7	3.8	3.7					
Canada	2.1	1.4	3.0	2.2	2.0	1.9	1.4	1.8	2.8	2.2
United States	2.0	1.6	2.2	2.8	2.3	2.2	1.8	2.1	2.6	2.3
Mexico	2.2	2.9	2.0	2.1	2.5	4.4	3.4	6.8	4.2	3.8
United Kingdom	1.9	1.8	1.7	1.5	1.9	2.0	0.7	2.7	2.0	1.8
Eurozone	1.3	1.8	2.4	2.3	2.3	1.8	1.1	1.4	1.9	1.7
Germany	1.3	1.9	2.2	3.0	3.0	1.5	1.7	1.7	1.6	1.9
France	1.3	1.2	2.2	2.5	2.0	1.4	0.6	1.2	1.5	1.5
China	9.4	6.7	6.9	6.6	6.3	2.3	2.1	1.8	2.1	2.5
India	7.1	7.9	6.3	7.5	7.5	6.9	3.4	5.2	4.4	5.4
Japan	0.9	1.0	1.7	1.1	0.9	0.1	0.3	1.0	1.0	2.3
South Korea	4.2	2.9	3.1	2.9	2.8	2.6	1.3	1.5	2.1	2.5
Australia	3.0	2.6	2.2	2.8	2.5	2.8	1.5	1.9	2.2	2.6
Thailand	4.0	3.3	3.9	4.1	3.6	2.0	1.1	0.8	1.1	2.0
Brazil	2.6	-3.5	1.0	2.3	2.5	6.7	6.3	3.0	4.1	4.6
Colombia	4.0	2.0	1.8	2.5	3.5	5.1	5.8	4.1	3.3	3.4
Peru	5.1	4.0	2.5	3.5	4.0	2.8	3.2	1.4	2.0	2.5
Chile	4.0	1.3	1.5	3.7	3.9	3.4	2.7	2.3	2.9	3.0

Commodities	2000–16	2016	2017	2018f	2019f
	(annual average)				
WTI Oil (USD/bbl)	63	43	51	68	71
Brent Oil (USD/bbl)	66	45	55	74	77
WCS - WTI Discount* (USD/bbl)	-17	-14	-13	-23	-23
Nymex Natural Gas (USD/mmbtu)	4.94	2.55	3.02	2.93	2.90
Copper (USD/lb)	2.35	2.21	2.80	3.10	3.25
Zinc (USD/lb)	0.81	0.95	1.31	1.45	1.45
Nickel (USD/lb)	7.26	4.36	4.72	6.50	7.00
Aluminium (USD/lb)	0.86	0.73	0.89	0.95	1.00
Iron Ore (USD/tonne)	67	58	72	63	60
Metallurgical Coal (USD/tonne)	127	114	187	190	160
Gold, London PM Fix (USD/oz)	869	1,251	1,257	1,311	1,300
Silver, London PM Fix (USD/oz)	14.67	17.14	17.05	18.00	19.00

* 2008-16 average.
Sources: Scotiabank Economics, Statistics Canada, BEA, BLS, IMF, Bloomberg.

North America	2000–16	2016	2017	2018f	2019f	2000–16	2016	2017	2018f	2019f
	Canada (annual % change, unless noted)					United States (annual % change, unless noted)				
Real GDP	2.1	1.4	3.0	2.2	2.0	2.0	1.6	2.2	2.8	2.3
Consumer spending	2.9	2.3	3.4	2.2	2.0	2.4	2.7	2.5	2.5	2.3
Residential investment	3.7	3.4	2.8	0.1	0.4	-0.5	6.5	3.3	0.9	1.9
Business investment	2.2	-8.8	2.7	7.0	2.7	2.9	0.5	5.3	6.5	2.9
Government	2.2	2.7	2.6	2.7	1.5	1.1	1.4	-0.1	2.1	2.6
Exports	1.3	1.0	1.1	2.5	3.4	3.7	-0.1	3.0	4.2	2.1
Imports	2.9	-1.0	3.6	4.3	2.6	3.7	1.9	4.6	4.2	3.1
Nominal GDP	4.2	2.0	5.4	4.4	4.6	4.0	2.7	4.2	5.2	4.8
GDP deflator	2.1	0.6	2.3	2.3	2.5	1.9	1.1	1.9	2.4	2.4
Consumer price index (CPI)	1.9	1.4	1.6	2.5	2.4	2.2	1.3	2.1	2.5	2.4
CPI ex. food & energy	1.6	1.9	1.6	1.9	2.1	2.0	2.2	1.8	2.2	2.3
Pre-tax corporate profits	3.6	-1.9	19.9	4.8	4.3	5.4	-1.1	3.2	5.9	2.6
Employment	1.3	0.7	1.9	1.2	1.0	0.7	1.8	1.6	1.5	1.1
Unemployment rate (%)	7.1	7.0	6.3	5.8	5.8	6.2	4.9	4.4	3.9	3.8
Current account balance (CAD, USD bn)	-17.1	-65.4	-63.3	-70.3	-61.6	-504	-433	-449	-461	-510
Merchandise trade balance (CAD, USD bn)	25.1	-25.9	-24.0	-29.3	-23.9	-672	-751	-807	-853	-916
Federal budget balance* (FY, CAD, USD bn)	-2.8	-1.0	-17.8	-20.0	-18.0	-532	-585	-665	-805	-1,000
percent of GDP	-0.2	0.0	-0.9	-0.9	-0.8	-3.7	-3.1	-3.4	-3.9	-4.7
Housing starts (000s, mn)	199	198	220	215	202	1.27	1.17	1.20	1.30	1.30
Motor vehicle sales (000s, mn)	1,657	1,949	2,041	2,000	1,950	15.5	17.5	17.1	17.1	17.0
Industrial production	0.6	0.1	5.1	3.0	1.9	0.6	-2.0	1.6	3.6	2.1
	Mexico (annual % change)									
Real GDP	2.2	2.9	2.0	2.1	2.5					
Consumer price index (year-end)	4.4	3.4	6.8	4.2	3.8					
Current account balance (USD bn)	-14.8	-23.3	-19.4	-27.4	-29.9					
Merchandise trade balance (USD bn)	-7.2	-13.1	-11.0	-4.6	-6.7					

Sources: Scotiabank Economics, Statistics Canada, CMHC, BEA, BLS, Bloomberg. * Canada federal deficit ex risk adjustment of $3.0bn for FY19.

Quarterly Forecasts	2017	2018				2019			
Canada	Q4	Q1	Q2e	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Real GDP (q/q ann. % change)	1.7	1.3	3.2	2.2	2.3	1.9	1.8	1.8	1.8
Real GDP (y/y % change)	3.0	2.3	2.0	2.1	2.2	2.4	2.0	1.9	1.8
Consumer prices (y/y % change)	1.8	2.1	2.3	2.8	2.8	2.6	2.5	2.3	2.2
Avg. of new core CPIs (y/y % change)	1.7	1.9	2.0	2.1	2.2	2.2	2.3	2.3	2.3
United States									
Real GDP (q/q ann. % change)	2.3	2.2	4.1	2.5	2.5	2.1	2.1	2.0	2.0
Real GDP (y/y % change)	2.5	2.6	2.8	2.8	2.8	2.8	2.3	2.2	2.0
Consumer prices (y/y % change)	2.1	2.3	2.6	2.6	2.6	2.6	2.4	2.4	2.3
CPI ex. food & energy (y/y % change)	1.7	1.9	2.2	2.3	2.3	2.3	2.3	2.3	2.3
Core PCE deflator (y/y % change)	1.6	1.7	1.9	2.0	2.1	2.2	2.2	2.1	2.1

Sources: Scotiabank Economics, Statistics Canada, BEA, BLS, Bloomberg.

	2017	2018				2019			
Central Bank Rates	**Q4**	**Q1**	**Q2**	**Q3f**	**Q4f**	**Q1f**	**Q2f**	**Q3f**	**Q4f**
Americas				(%, end of period)					
Bank of Canada	1.00	1.25	1.25	1.75	2.00	2.25	2.50	2.50	2.50
US Federal Reserve (upper bound)	1.50	1.75	2.00	2.25	2.50	2.50	2.75	2.75	3.00
Bank of Mexico	7.25	7.50	7.75	7.75	8.00	8.25	8.25	8.25	8.00
Central Bank of Brazil	7.00	6.50	6.50	6.75	7.25	8.00	8.50	9.00	9.00
Bank of the Republic of Colombia	4.75	4.50	4.25	4.25	4.50	4.75	5.00	5.25	5.50
Central Reserve Bank of Peru	3.25	2.75	2.75	2.75	2.75	3.00	3.00	3.25	3.25
Central Bank of Chile	2.50	2.50	2.50	2.50	2.75	3.00	3.25	3.50	3.75
Europe									
European Central Bank	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bank of England	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	1.00
Asia/Oceania									
Reserve Bank of Australia	1.50	1.50	1.50	1.50	1.75	1.75	2.00	2.00	2.25
Bank of Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
People's Bank of China	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
Reserve Bank of India	6.00	6.00	6.25	6.50	6.50	6.50	6.75	6.75	6.75
Bank of Korea	1.50	1.50	1.50	1.75	1.75	1.75	2.00	2.00	2.25
Bank of Thailand	1.50	1.50	1.50	1.50	1.50	1.50	1.75	1.75	2.00
Currencies and Interest Rates									
Americas				(end of period)					
Canadian dollar (USDCAD)	1.26	1.29	1.31	1.28	1.28	1.25	1.22	1.22	1.25
Canadian dollar (CADUSD)	0.80	0.78	0.76	0.78	0.78	0.80	0.82	0.82	0.80
Mexican peso (USDMXN)	19.66	18.18	19.91	20.19	20.20	20.32	20.13	20.19	20.48
Brazilian real (USDBRL)	3.31	3.31	3.88	3.85	3.90	3.85	3.80	3.75	3.70
Colombian peso (USDCOP)	2,986	2,794	2,932	2,950	3,000	2,950	2,900	2,850	2,850
Peruvian sol (USDPEN)	3.24	3.23	3.29	3.20	3.18	3.18	3.14	3.15	3.12
Chilean peso (USDCLP)	615	604	654	638	603	600	597	594	591
Europe									
Euro (EURUSD)	1.20	1.23	1.17	1.17	1.20	1.22	1.25	1.30	1.35
UK pound (GBPUSD)	1.35	1.40	1.32	1.30	1.32	1.32	1.35	1.37	1.40
Asia/Oceania									
Japanese yen (USDJPY)	113	106	111	110	110	110	110	108	105
Australian dollar (AUDUSD)	0.78	0.77	0.74	0.73	0.73	0.75	0.77	0.77	0.77
Chinese yuan (USDCNY)	6.51	6.28	6.62	6.60	6.60	6.50	6.50	6.40	6.40
Indian rupee (USDINR)	63.9	65.2	67.8	67.0	67.0	66.0	66.0	65.0	65.0
South Korean won (USDKRW)	1,067	1,064	1,115	1,080	1,080	1,070	1,070	1,060	1,060
Thai baht (USDTHB)	32.6	31.2	33.1	32.5	32.5	32.0	32.0	31.5	31.5
Canada (Yields, %)									
3-month T-bill	1.06	1.15	1.26	1.80	2.05	2.30	2.50	2.55	2.55
2-year Canada	1.69	1.78	1.91	2.25	2.40	2.45	2.50	2.55	2.60
5-year Canada	1.87	1.97	2.07	2.30	2.45	2.55	2.60	2.65	2.70
10-year Canada	2.05	2.09	2.17	2.40	2.55	2.60	2.65	2.70	2.75
30-year Canada	2.27	2.23	2.20	2.50	2.70	2.80	2.85	2.90	2.95
United States (Yields, %)									
3-month T-bill	1.38	1.70	1.92	2.20	2.45	2.50	2.70	2.75	3.00
2-year Treasury	1.88	2.27	2.53	2.70	2.75	2.80	2.90	3.00	3.10
5-year Treasury	2.21	2.56	2.73	2.90	2.95	3.00	3.05	3.10	3.20
10-year Treasury	2.40	2.74	2.84	3.00	3.05	3.10	3.15	3.20	3.30
30-year Treasury	2.74	2.97	2.96	3.15	3.20	3.30	3.35	3.40	3.45

Sources: Scotiabank Economics, Bloomberg.

The Provinces					(annual % change except where noted)						
Real GDP	**CA**	**NL**	**PE**	**NS**	**NB**	**QC**	**ON**	**MB**	**SK**	**AB**	**BC**
2000–16	2.1	2.5	1.7	1.3	1.2	1.7	2.0	2.3	2.0	2.7	2.8
2016	1.4	1.9	2.3	0.8	1.2	1.4	2.6	2.2	-0.5	-3.7	3.5
2017*	3.0	2.1	3.2	1.2	1.9	3.1	2.8	2.9	2.9	4.9	3.9
2018f	2.2	0.5	1.9	1.2	1.0	2.1	2.1	1.9	1.5	2.4	2.5
2019f	2.0	1.2	1.6	1.0	0.9	1.9	2.0	1.9	1.8	2.5	2.5
Nominal GDP											
2000–16	4.2	5.6	4.2	3.4	3.3	3.6	3.8	4.4	5.3	5.9	4.5
2016	2.0	2.6	4.0	2.8	3.6	2.7	4.3	2.3	-4.0	-4.9	4.8
2017e	5.4	5.6	4.7	3.1	3.2	4.5	4.8	4.3	5.4	7.9	5.9
2018f	4.4	4.1	3.8	3.2	2.8	3.9	4.2	3.9	4.1	5.5	5.0
2019f	4.6	4.0	3.9	3.1	3.0	4.1	4.4	4.2	4.1	5.5	5.1
Employment											
2000–16	1.3	0.8	1.0	0.6	0.4	1.3	1.3	0.9	1.1	2.3	1.4
2016	0.7	-1.5	-2.3	-0.4	-0.1	0.9	1.1	-0.4	-0.9	-1.6	3.2
2017	1.9	-3.7	3.1	0.6	0.4	2.2	1.8	1.7	-0.2	1.0	3.7
2018f	1.2	-0.6	2.1	0.7	0.4	1.4	1.4	0.7	0.0	1.6	1.2
2019f	1.0	-0.4	0.9	0.3	0.2	0.9	1.0	0.7	0.5	1.1	1.2
Unemployment Rate (%)											
2000–16	7.1	14.3	11.2	8.8	9.6	8.0	7.1	5.1	5.0	5.1	6.6
2016	7.0	13.4	10.7	8.3	9.5	7.1	6.5	6.1	6.3	8.1	6.0
2017	6.3	14.8	9.8	8.4	8.1	6.1	6.0	5.4	6.3	7.8	5.1
2018f	5.8	14.6	9.8	7.9	7.9	5.5	5.5	5.7	6.0	6.8	4.8
2019f	5.8	14.5	10.0	7.9	7.9	5.4	5.4	5.6	5.9	6.7	4.8
Housing Starts (units, 000s)											
2000–16	199	2.6	0.8	4.3	3.5	44	72	5.1	5.2	34	28
2016	198	1.6	0.5	3.7	1.8	39	75	5.3	4.8	25	42
2017	220	1.4	1.0	4.0	2.3	46	80	7.6	5.0	29	44
2018f	215	1.4	1.0	4.0	1.9	48	78	6.2	3.9	29	42
2019f	202	1.3	0.9	3.8	2.1	42	72	6.3	4.5	30	39
Motor Vehicle Sales (units, 000s)											
2000–16	1,657	29	6	48	38	413	635	47	45	216	180
2016	1,949	33	9	54	44	458	807	55	51	220	218
2017	2,041	33	9	59	42	453	847	62	56	245	235
2018f	2,000	32	8	58	40	445	821	61	56	248	231
2019f	1,950	30	8	56	39	434	791	60	56	250	226
Budget Balances, Fiscal Year Ending March 31 (CAD mn)											
2000–16**	-2,803	-93	-38	-30	-153	-768	-5,115	-142	307	1,064	319
2016	-987	-2,206	-13	-13	-261	2,191	-3,515	-839	-1,520	-6,442	811
2017	-17,770	-1,148	-1	151	-119	2,361	-991	-764	-1,218	-10,784	2,737
2018f***	-20,000	-812	1	230 †	-115	850	642	-726	-303 †	-8,023 †	151
2019f***	-18,000	-683	1	29	-187	0	-6,704	-521	-365	-8,802	219

Sources: Scotiabank Economics, Statistics Canada, CMHC, Budget documents. * Real GDP by industry, basic prices. ** MB:FY04–FY16; AB:FY05–FY16. *** Provinces' FY18 & FY19: Budget documents. Federal FY19: ex risk adjustment of $3.0bn. † FY18 final result.