# Wee, The Growth

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Markets see-sawed this week, on conflicting signals from the trade front as well as from the global economy. Equities initially bounced on the dog that didn't bite, as the U.S. Administration backed off on tariffs on Mexico. However, the U.S./China tiff deteriorated, with even a meeting between the two Presidents appearing unlikely at this month's G20, let alone some last-minute patch-work deal. Probably wise to assume pretty much the worst on that front. The economic data were mixed, perhaps best characterized by Friday's respectable retail sales gains in May for both the U.S. and China, but soggy industrial production trends for the same two economies in the same month. That seeming mismatch between solid consumers and sluggish factories makes entire sense in a world of closing trade doors, but falling borrowing costs—domestic spending rules, exports struggle.

While the data are mixed, **the investing world is getting much more comfortable with the idea that the Fed's next move will be a rate cut, possibly as early as this summer**. We believe next week's FOMC meeting is too early for such a step, but are circling the July 31 decision date for the first of two 25 bp trims. Clearly, the biggest change in the economic landscape to prompt this profound shift in Fed expectations has been the rapid deterioration in the U.S./China trade outlook. Just six short weeks ago, when most still believed a trade deal was near, two-year Treasuries were sitting at 2.35%, or very close to the fed funds target. Today, even with a small backup in the wake of the retail sales data, 2s are more than 50 bps lower, while 10-year yields have slid a hefty 45 bps. Meantime, oil prices are off roughly $10/barrel, while gold prices have jumped 6%.

In a nutshell, **the global growth outlook has been pared heavily**, **inflation expectations have receded sharply**, and there are **some flickering signs that investors are eying the exits**. However, amid the much less certain growth backdrop, equities have generally held up well, defying the deepening bond market gloom. The S&P 500 is still little more than 2% off its record high, while the TSX has shed less than 3% from its late-April peak despite the oil price slide. While virtually everyone is struggling to judge the ultimate cost of the trade war—further blindfolded by the uncertainty over where it's headed next—prospects of Fed easing are providing plenty of offsetting calm. Of course, the President's insistence on offering free advice on where rates should go next is far from helpful. Still, as always, we suspect that the economic and financial realities on the ground will drive Fed policy.

Some have suggested that the Bank of Canada will have little choice but to eventually follow the Fed's lead. We beg to differ. As argued in this week's Focus Feature, **the case for BoC cuts is simply not there...yet**. Some have suggested that the loonie could rocket if the Bank doesn't ape the Fed's moves, but that ignores the fact that markets have 50 bps more easing from the Fed priced in than for the BoC this year. And that's not even dealing with the obvious issue here—does anyone truly believe that the loonie is at risk of "rocketing" anytime soon, especially with oil prices retreating and Canada's massive competitiveness challenges? Naturally, if the global backdrop truly does slide off the rails, rates everywhere will be falling fast, but unless/until that happens, we see the Bank staying on the sidelines.

Perhaps **the strongest argument in favour of the Bank staying put is the fear of fuelling another round of housing fervour**. Today's Canadian existing home sales results for May revealed the fastest yearly rise (6.7%) in three years, with Toronto leading the charge. While prices are mixed across the country, many of the weakest markets—primarily in the West—are showing signs of stabilizing, while the robust markets remain robust. Meanwhile, home building is doing just fine, with starts holding above the 200,000 level last month. The latest consensus results show that our call for starts to average just above that level over the next 18 months is at the very top of the heap among Canadian forecasters. But, if anything, our call looks a tad conservative, given ongoing population gains and receding bond yields.

The relative calm in Canadian housing in the past year seems to have finally reined in household debt ratios. Debt growth has moderated to 3.3% y/y, with mortgages slightly cooler, a bit below underlying personal income trends. As a result, the closely-watched debt/income measure nudged down in Q1, albeit to a still-lofty 173% (off less than 1 percentage point from the record high in the prior quarter). The risk is that BoC rate cuts could send a loud message to potential home buyers: *"All is forgiven, the taps are open wide again, and let loose the borrowing."* After years of struggling to guide the good ship Canadian housing in for a soft landing, the last thing policymakers want to see is a renewed takeoff—lesson learned in 2015.

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Heard at today's water cooler huddle:

Big, big win last night, huh? *Yes, the Jays really broke out the bats.*

... Umm, I was referring to the Championship. *Oh, yes, the Cricket World Cup in the U.K. has been thrilling.*

... Umm, I was referring to something with more North American appeal. *Oh, yes, smashing win by the U.S. women in the World Cup of Soccer. 13-nil. Loved the over-the-top celebrations, all 13 of them.*

... Umm, I was referring to something played closer to home. *Oh, yes, the U.S. Open; fantastic start by Justin Rose.*

... Umm, I was referring to the one that concluded this week. *Oh, yes, Rafa Nadal winning his 12th French Open, didn't see that coming.*

... Umm, closer to Canadian hearts. *Oh, yes, the St. Louis Blues taking their first Stanley Cup, incredible story lines.*

... Umm, back to work.

Well done Raptors, well done. And two champions crowned this week, one from Toronto and none from Boston... wonders may never cease.

**Economic angle?** Let's just say the wave of spending and massive gate receipts will give a small bump to Canadian GDP in May/June (call it 0.1 ppt), but something tells me productivity is going to suffer before, during, and after Monday's parade.

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