2 July 2010

Economics
Canada

HSBC Global Research

Canada: Weekly Notes

Key events for the weeks of July 5-23, 2010

Economic diary – Canada

Date		Last	Median	HSBC	Impact	Comments
Jul 6	Building Permits M/M – May (8:30)	5.4%		-10.9%	Minor	▸ Canada is approaching what we think ostensibly is an inflection point for the residential builder category. Changes in the funding model for mortgages, the onset of changes to the tax structure in Ontario and BC (two of the most active housing markets) and higher interest rates overall, are expected to curb builder appetite for residential projects. ▸ In May our expectation is for non residential permits to be the principle driver behind the decline in the headline. Specifically, we are looking at a -34% decline in institutional and government permits following last months 70% jump. Residential permits are expected to have declined by a more moderate, but still sizeable -4.5% as the sector continues to burn off March's 21% jump in approvals.
Jul 7	IVEY PMI – Jun (10:00)	62.7		64.5	Med	▸ Typically June is a very strong month for the IVEY purchaser index due to seasonal factors. On average – outside of 2000's recession riddled reading of 51.1 – the IVEY purchaser index has averaged 63.7 for the month of June. Given that May's 62.7 was in keeping with the seasonal norms for the number, we are forecasting the June IVEY at 64.5. A high print yes, but well within the historical context of the number set – a number that is not seasonally adjusted.
Jul 8	New Housing Price Index M/M – May (8:30)	0.3%		0.1%	Minor	▸ The introduction of a harmonized sales tax in BC and Ontario is expected to depress prices as builders continue to work the HST into the cost of a new home. In the calculation of the new home price index, value added taxes like the HST are stripped out. Given the impact of both market conditions (the existing home sale market has shifted from a sellers market on over to a buyers market) and the onset of the HST, we are looking for new home prices to rise by a rather modest 0.1%m/m or 2.7%y/y. ▸ **Continued on page 2.**

Source: HSBC Canada

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Economic diary – Canada (cont'd)

Date		Last	Median	HSBC	Impact	Comments
Jul 9	Net Change in Employment – Jun (7:00)	24.7K		-5.5K	Major	▸ May's report showed that the economy had managed to hold on to the 109K jobs that had been showered on the labor force in April, by adding handily to the number in May. In June, we suspect that some of the extraordinary strength in the jobs picture relents some what with declines in construction, transportation and warehousing, management and "other services", offsetting gains in public administration, agriculture and manufacturing. The breakdown favours goods producing industries (+6K) at the expense of service sector (-11.5K) employment.
	Unemployment Rate – Jun (7:00)	8.1%		8.2%	Major	▸ On the assumption that the participation rate remains unchanged, the natural growth in the labor force will add another 22K workers to the pool of available labor, which when coupled with our forecast for a decline of 5.5K jobs, will push the unemployment rate up to 8.2%.
	Participation Rate – Jun (7:00)	67.3		67.3	Med	▸ The participation rate is on the rise as improving economic prospects pull in the previously discouraged. April's whopper of a job report supported a 0.2ppt pickup in the participation rate, while May's continued jobs growth pulled even more people into the labor force, pushing up the participation rate by another 0.1ppt. After rising 0.3ppt in the past two months, we are expecting the participation rate to have remained unchanged in June.
	Housing Starts – Jun (8:15)	189.1K		185.0K	Med	▸ Although at the time of writing we have yet to see the details of the building permits data, we are at this time forecasting a continued decline in the dollar value of approved residential permits with the expectation that this translates into a decline in approved units. For the starts forecast, we looked at the changes to the tax regime in Ontario and BC, a changed funding model for mortgages and higher interest rates are all conspiring to take the steam out of the real estate market in Canada which is expected to feed into the new build market. ▸ In terms of the June housing starts number, we continue to look for the significant spike in multi-unit construction starts in March to continue to work itself out of the data. On that basis, we are forecasting multi-family starts at 84K units, a decline from May's still rather lofty looking 92.8K. Rural starts are expected to have added to May's gains, moving up to 26K from 23.9K. Single-family starts fill out the rest of the report at 75K up from 72.4K.
Jul 13	Int'l Merchandise Trade – May (8:30)	C$0.2B		-C$0.3B	Med	▸ The trade data will provide us with the first real whiff of how May GDP may be shaping up. In terms of the trade balance, we are looking for an increase in crude export volumes linked to a rise in US refinery capacity related to buildup in high grade gasoline in front of the summer driving season. On the downside, poor pricing metrics for both crude and natural gas along with weaker demand for the latter, more than offset whatever upside is linked with crude. So too demand for metals begins to abate in May, an event reflected in weaker pricing metrics for key metals. ▸ On the upside, the machinery and equipment exports are expected to have continued to grow. A weaker CAD vs USD (Canada still ships 74% of exports to the US) over the month would have contributed to improved dollar receipts over the reporting period which would have partially offset the declines in the value of energy exports. Still, while the value of CAD declined in USD terms, the price of raw materials including oil fell by 7.2% in May. ▸ Chinese imports from Canada in the month of May slipped just slightly from the previous month, declining by a modest CAD50m but supporting our thesis looking for a weaker surplus.
Jul 15	New Motor Vehicle Sales M/M – May (8:30)	-4.7%		0.0%	Minor	▸ Preliminary evidence suggests that new vehicle sales on a unit basis were flat in May following declines in each of the months of April 4.7%, and March 4.2%. Of course declines in March and April are largely a function of the 8.5% spike in unit sales that occurred in February. It is on this preliminary evidence that we are basing the forecast. ▸ Unfortunately the preliminary report provides no breakdown of sales per category class of vehicle. The sales mix provides some insight into what dollar sales may look like given that the SUV/truck and foreign vehicle categories tend to come in at higher MSRP than the North American passenger car group. In other words, changes in unit sales for the SUV and truck categories will tend to have a bigger impact on the retail dollar sales than changes in the number of unit sales for passenger vehicles.
	Manufacturing Sales M/M – May (8:30)	0.2%		-1.0%	Med	▸ Weaker pricing metrics for petroleum and coal products, along with primary metals, are expected to drag the headline manufacturing sales number lower. We are also looking at aerospace to be hard hit as evidenced by the US durable goods shipments data.

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Economic diary – Canada (cont'd)

Date		Last	Median	HSBC	Impact	Comments
Jul 16	Leading Indicators M/M – Jun (8:30)	0.9%		0.5%	Minor	▸ A number of components will tug at the leading indicators index. Our June forecast looks for declines in the new orders for durable goods (following a rather significant 4% jump in May) along with continued weakness in the real estate index and stock markets. On the upside, M1 continues to grow, and retail sales in the furniture and appliance category are expected to have remained firm. The US LEI continues to contribute positively. ▸ At 0.5%, the LEI in May is well off the pace established over the previous 10 months which on average has been growing by 1.0%m/m. Gone are the sizeable increases in the housing index that defined 2009 along with a significant slowdown in the pace of new orders (durables). Lurching equity markets have not helped the outlook on the LEI either.
Jul 19	Int'l Securities Transactions – May (8:30)	C$12.4B		C$6.5B	Minor	▸ Boring is beautiful. A number of factors have been boosting the transactions numbers. Front and centre, Canada is seen as a safe haven. For patient capital that is willing to give up the level of liquidity associated with the US Treasury market, in the absence of any associated sovereign credit event risk Canada is seen by investors as a decent receptical for parking funds. That's the pull. The push factor has been opportunistic issuance out of Canadian entities into foreign markets. ▸ Canadian financials were frequent issuers of USD floating rate notes in May which invariably would have been marketed to foreign investors. So too did a number of provinces tap into foreign markets for funding in May. A quick calculation – by no means comprehensive – shows a CAD equivalent of about 8.0bn in non CAD paper issued. ▸ Categorically, money market paper has fallen out of favour with yields scuppering along near to zero. A well telegraphed rate hike in June may have sponsored some selling in the front-end of the curve negatively impacting foreign appetite for Canadian money market. Softer prices for equity and a retreat on the Canadian dollar over the period may have encouraged some lightening up on Canadian stock positions. Expressing a favorable view on Canada has tended to come through in the bond market which has been the primary recipient of capital flow. YTD, net bond purchasers by foreigners stands at CAD29bn vs. –CAD700m for money market and CAD2.3bn for stocks.
Jul 20	BoC Rate Decision - (9:00)	0.50		0.75	**Major**	▸ We are forecasting a 25bp rate hike, following on the heels of the June 2nd rate hike which kicked off what is expected to be a cycle of rate hikes that will continue through to the end of 2010 with a year end O/N rate forecast at 1.50%. The question surrounding the July 20 rate meeting is whether or not market uncertainty and issues regarding solvency in the EU trumps a Canadian economy that is performing well ahead of plan (in April the BoC advanced its forecast for the closing of the output gap by a quarter). ▸ We would suggest the answer is no. At this time, while there is very clearly uncertainty attached to the progression of events in Europe and the associated concerns for slowing growth, Canada is not currently experiencing a break down in the dissemination of market capital or interbank lending. At this stage, there is no clearcut evidence that market uncertainty is impacting domestic lending and the overall dissemination of capital with in the Canadian economy. Both the consumer consumption of credit has continued largely unabated while at the same time M3 has begun to accelerate at rather uncomfortable levels. As of May, M3 was growing at 5.2%y/y or 1.3%m/m. That said, nobody would necessarily fault the BoC for pausing the rate cycle. ▸ As for the post meeting statement, look for comments to remain inconclusive given the BoC desire to control the process and head off either an aggressive pricing of future expectations in the yield curve or providing fodder for a runup in CAD.
Jul 21	Wholesale Sales M/M – May (8:30)	-0.3%		0.3%	Med	▸ Despite the upside to be associated with a weaker Canadian dollar in May, there remains plenty of downside associated with a 19%m/m jump in apparel that needs to be smoothed out, a continued moderation in the persistent strength seen in the first quarter of the year in the building materials category, and weak unit auto sales which point to continued softness in the wholesale auto category. On the upside, we expect the machinery and electronics to have benefited from solid cross border demand. Although the forecast looks for dollar sales to have risen by 0.3%, we are expecting to see underlying wholesale volumes to have declined.
Jul 22	Retail Sales M/M – May (8:30)	-2.0%		0.8%	Med	▸ An early Easter in conjunction with other major religious holiday's falling in March managed to cannibalize April sales. For May, we are expecting to see the return of more trend-like consumer behavior.

Source: HSBC Canada

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Economic diary – Canada (cont'd)

Date		Last	Median	HSBC	Impact	Comments
Jul 22	Retail Sales Less Auto – May (8:30)	-1.2%		0.8%		New car auto sales on a unit basis were unchanged in May. Unfortunately at the time of writing, we do not know the exact categorical breakdown and vehicle mix. SUV and foreign made cars tend to come in at higher pricing points than domestic passenger cars. Knowing the vehicle mix aids in determining the impact of unit sales on the retail report which is reported in terms of dollar sales.
	BoC Monetary Policy Report (10:30)					Expected. To be followed by a press conference with the BoC governor.
	BoC Business Outlook Future Sales – Q2 (10:30)	44.0			**Major**	The Bank of Canada business survey is expected to reflect a balance of opinion on future sales that continues to run at strong levels. Although with the recovery now well along, the historically high levels at which the index has been running (a function of the severely depressed state of sales during the recession) is expected to have continued to moderate as the initial flush of the economic recovery fades. From a policy standpoint, it is our belief that the BoC tends to ignore the headline number and concentrate on those survey questions concerned with economic capacity and inflation expectations. Shifts in these particular areas of the survey have in the past tended to dovetail with changes in rates policy. The BoC is scheduled to deliver a rate decision on July 20, and will have by that time digested the details of this report. Changes in gasoline prices tend to correlate with changes in inflation expectations. Since the last survey there has been a fairly significant decline in petrol prices that may very well get picked up in the inflation expectations component. Regardless, expectations remain well contained within the BoC's target range.
	BoC Senior Loan Officer Survey – Q2 (10:30)	-18.7			**Major**	Canadian lending officers, on balance, are expected to have continued to ease up on credit conditions in keeping with what was seen in Q1/10. In the previous survey, the balance of opinion at -18.7 was indicative of an outright easing in overall lending conditions. For the current quarter, we are looking to see continued improvements in both the price and non-pricing elements of credit. To wit, we would point to a dramatic turn around in M3 growth as indicative of a banking sector that is taking up all that liquidity afforded by central bank policy and lending it out. In May, M3 had accelerated to 5.2%y/y or 1.3%m/m. Pricing of credit will come across as having tightened, a reflection of current events but not necessarily to a troublesome extent. On a cautious note, business lending remains depressed, having grown by a paltry 0.6%y/y in May. Although the trend has turned positive and begun to reflect some growth it is still well below the historical average. Corporate demand for credit is believed to have remained weak as businesses remain reticent to expand capacity and invest in their companies given the large amount of excess capacity sloshing about in the domestic economy and the uncertainty associated with global current events.
Jul 23	CPI M/M – Jun (7:00)	0.3%		-0.2%	**Major**	Gasoline declined rather dramatically in June. For the forecast we are assuming a drop of nearly 5%m/m which will knock 0.17ppt out of the headline CPI. June is also expected to usher in seasonal declines in the cost of a vehicle as dealers reduce prices to drive customer traffic during the slow summer sales period. We see a very similar picture on apparel prices which are expected to cascade lower. Food costs are slightly higher. Shelter costs continue to rise with higher prices for electricity and natural gas prices. Overall, we are looking for consumer prices to have fallen by 0.21%m/m.
	CPI Y/Y – Jun (7:00)			0.8%	**Major**	Base effects. Aside from the month to month pricing variations, June's CPI is going to be dominated by a year over year base effect in part associated with the wild swings in gasoline prices that will knock as much as 0.4ppt out of the headline. Our forecast for a 0.2%m/m decline in prices will translate into a year over year rate of 0.8%. A preliminary peek at July's CPI points to a reversal of the base effect striking at June's number set. Suffice to say, what looked like a potentially challenging inflation profile at the outset of 2010 has dissipated rather dramatically due to the underlying base effects associated with the ebb and flow of gasoline prices. That said, monetary policy isn't about what prices were doing in May 2010, but about what the expectations are for prices in May 2012. On that basis, policy is more about what the BoC assumptions are as they pertain to output gaps and capacity utilization, along with the flavoring afforded by changes in inflationary expectations rather than CPI, which by all intents and purpose, is a historical look back on where prices were, rather than where prices are going.

Source: HSBC Canada

Economic diary – Canada (cont'd)

Date		Last	Median	HSBC	Impact	Comments
Jul 23	Core CPI M/M – Jun (7:00)	0.3%		0.0%	**Major**	▸ The core will remove the impact of a dramatic decline in gasoline prices.
	Core CPI Y/Y – Jun (7:00)	1.8%		1.8%	**Major**	▸ No base effect on core CPI in June. From a policy standpoint, the CPI dissected of its energy component seems to pose little in the way of an inflationary problem for the BoC. In May, CPI x-energy was running at 1.0%y/y. We see little reason to believe the pricing profile x-energy has radically changed. Goods prices alone are running at 1.2%y/y while service prices have been providing the bulk of what little pricing pressure is evident, up 1.6%y/y.

Source: HSBC Canada

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