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Economics

ECONOMIC INSIGHTS

December 17, 2018

Now They Get It

by Avery Shenfeld

Traders who take central bankers at their word aren't too happy with Jay Powell or Stephen Poloz. The Fed Chair had said that rates were miles below neutral, only to change his mind weeks later and say that rates were perhaps only slightly below neutral.

Governor Poloz had sounded oddly certain in October that rates had to be back to the 2.5% to 3.5% range to keep inflation at bay. You can't fault him for failing to foresee a sudden plunge in oil prices. But he seemed shocked to see the lack of momentum in the last two months before the crude shock, even though that must have been built into the Bank's 1.8% Q3 growth forecast. More fundamentally, even if the oil drag is temporary, a 2% overnight was now seen by Poloz as "only a rounding error away from 2.5%" and therefore a potential candidate for the neutral rate.

From our view, it's better late than never for central banks to "get it." Model-based estimates of where neutral rates lie, or what levels of GDP and unemployment is inflationary, are highly imprecise, because these parameters vary widely from one cycle to the next. If growth is only mediocre, as we've seen in Canada over the past year, and in the US in recent months, that's an important clue that the neutral rate is close at hand. In Canada, tame wage inflation is at least some evidence that our decades-low unemployment rates might not yet be too low for a 2% inflation target.

That was the essence of our October critique of the overly hawkish stance we were hearing from the Fed and the Bank of Canada. At that time, we were well below consensus forecasts for where rates would sit by 2020. We could flatter ourselves by assuming that our October views reached key readers in Ottawa and Washington. Or perhaps it was a November speech with the same message from Fed Vice Chairman Richard Clarida that schooled both Powell and Poloz.

The Fed is still likely to pull the trigger on a rate hike in December after respectable data on employment, factory ISM and core retail sales. But we no longer see as big an overshoot risk for 2019. If, as we expect, growth isn't much better than 2%, the Fed will be limited to one final hike next year, one that it could end up reversing in 2020 as fiscal policy tightens.

As for the Bank of Canada, for now, we are staying with our call that rates will peak at 2.25% in the first half of 2019. But we'll need a global oil rebound to even get there. Spread narrowing has pushed WCS heavy oil sharply higher, but that's during a period of reduced volumes that will weigh on real GDP. Thus far, global crude prices have gone nowhere after an OPEC+ cut, a negative for Canada, but also, less widely understood, a net negative for US growth (see pages 6-8).

We'll need at least some energy from Canada's energy sector to make up for the slowing we're seeing in housing as rates climb (see page 9-11). But indebted homeowners will like the new and improved Stephen Poloz over the one we saw back in October.

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MARKET CALL

- We were among the most dovish forecasters for North American central banks, but markets have moved in a hurry to share that view, or even take it further. Stateside, the Fed no longer seems to be at risk of blindly overshooting the neutral rate, and we trimmed our 2019 forecast to only one further hike after this week's likely move, while leaving a small cut in place for 2020, as a signpost that we still see a mid-cycle ease when fiscal policy tightens. We also trimmed our peak Treasury yields as the Fed's downgraded view on where neutral sits will also impact market views.

- We're sticking to our prior call for two further Bank of Canada hikes, hitting a peak rate of 2.25% in the first half, but still at that level through 2020, a long way from the roughly 3% rate that the central bank saw as neutral only two months ago. Frankly, we're less assured about the timing of coming hikes, as we're publishing ahead of key indicators for October, and we'll also need to see at least a partial recovery in global oil prices to get the first of the hikes. Given those clouds, we see more risk of only one hike than three moves from here.

- If Poloz manages to squeeze in a hike while the Fed is on hold, it will also be because oil prices and other data have also turned a bit brighter. That would support a temporary rebound in the Canadian dollar, but one we don't see as sticking. Canada's track record on exports, and the need for improvement on that front as housing slows, suggests that we need to be on the topside of 1.30 to be competitive.

INTEREST & FOREIGN EXCHANGE RATES

		2018	2019				2020			
END OF PERIOD:		**14-Dec**	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**
CDA	Overnight target rate	1.75	2.00	2.25	2.25	2.25	2.25	2.25	2.25	2.25
	98-Day Treasury Bills	1.63	2.10	2.20	2.25	2.20	2.10	2.05	2.00	1.95
	2-Year Gov't Bond	2.02	2.50	2.55	2.40	2.30	2.25	2.20	2.15	2.05
	10-Year Gov't Bond	2.11	2.50	2.65	2.65	2.50	2.45	2.40	2.35	2.20
	30-Year Gov't Bond	2.28	2.45	2.55	2.60	2.60	2.65	2.65	2.55	2.50
U.S.	Federal Funds Rate	2.125	2.375	2.625	2.625	2.625	2.625	2.375	2.375	2.375
	91-Day Treasury Bills	2.42	2.35	2.65	2.70	2.80	2.60	2.40	2.25	2.25
	2-Year Gov't Note	2.73	3.00	3.25	3.20	3.10	2.85	2.65	2.55	2.50
	10-Year Gov't Note	2.88	3.15	3.35	3.35	3.25	3.10	3.05	2.90	2.80
	30-Year Gov't Bond	3.14	3.25	3.40	3.45	3.45	3.45	3.25	3.10	3.00
Canada - US T-Bill Spread		-0.79	-0.25	-0.45	-0.45	-0.60	-0.50	-0.35	-0.25	-0.30
Canada - US 10-Year Bond Spread		-0.78	-0.65	-0.70	-0.70	-0.75	-0.65	-0.65	-0.55	-0.60
Canada Yield Curve (10-Year — 2-Year)		0.09	0.00	0.10	0.25	0.20	0.20	0.20	0.20	0.15
US Yield Curve (10-Year — 2-Year)		0.15	0.15	0.10	0.15	0.15	0.25	0.40	0.35	0.30
EXCHANGE RATES	CADUSD	0.75	0.77	0.76	0.76	0.75	0.75	0.76	0.76	0.77
	USDCAD	1.34	1.30	1.31	1.32	1.34	1.33	1.32	1.31	1.30
	USDJPY	113	112	110	108	106	105	104	102	100
	EURUSD	1.13	1.15	1.18	1.20	1.22	1.25	1.26	1.25	1.24
	GBPUSD	1.26	1.32	1.37	1.41	1.44	1.45	1.46	1.45	1.44
	AUDUSD	0.72	0.74	0.75	0.76	0.77	0.78	0.79	0.79	0.80
	USDCHF	1.00	0.98	0.95	0.95	0.93	0.92	0.92	0.93	0.94
	USDBRL	3.90	3.90	3.70	3.90	4.10	4.00	3.95	3.90	3.80
	USDMXN	20.3	20.2	19.7	19.7	20.1	20.3	20.3	20.7	21.0

To Have and Have Not: Where the Québec-Ontario Gap Lies

by Avery Shenfeld and Andrew Grantham

The newly elected premier of Québec, François Legault, offered an ambitious pledge to "eliminate the wealth gap with the rest of Canada" and thereby end that province's dependence on federal equalization. That would be an historic turning point indeed, because central Canada's other province, Ontario, has long sat ahead of Québec in terms of per capita GDP (Chart 1), and Ontario itself has flirted in and out of "have-not status" in recent years. Understanding where that gap lies is the first step on the road to fixing it.

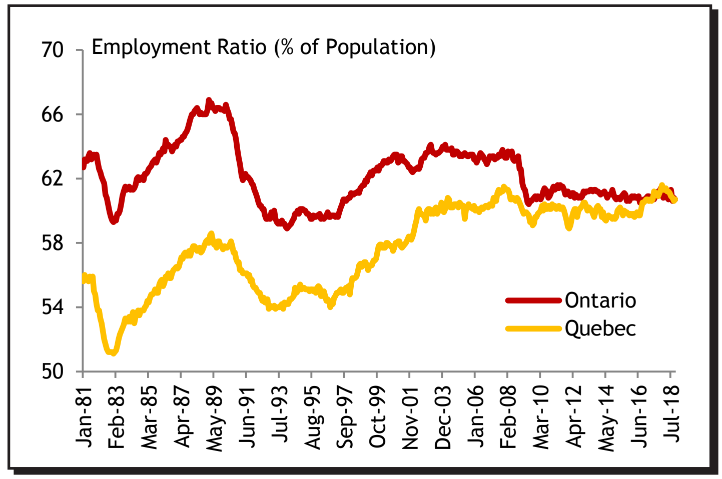
Still Not as Many Hours on the Job

In the past, there was a persistent gap in the shares of the Québec and Ontario populations that were on the job. But a sharp rise in Québec's female labour force participation in the past decade has changed that story. The new reality is that employment represents virtually the same share of the total population in these two provinces (Chart 2).

Still, Quebecers aren't putting in quite as many hours on those jobs. For similar reasons (more contract work for new hires, workers opting for part-time as they age) average hours are lower in both provinces than they were in the 1980s, but the gap favouring Ontario has actually widened a bit (Chart 3).

Chart 2

Employment Rates Now Matching

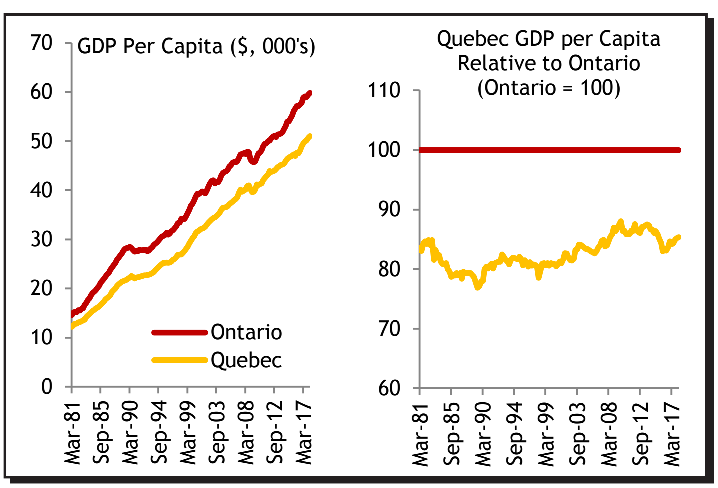


Source: Statistics Canada, CIBC

Depending on the value one places on having those non-working hours, and the extent to which the choice to work less is voluntary, that might be something one doesn't want public policy to address. Indeed, of the some 800K people, on average, working part-time in Québec each month of 2018, slightly more than 80% attribute this to "non-economic" reasons. A full 35% state that it is simply personal preference. Those figures are only about 5% higher than they are in Ontario (75% for all

Chart 1

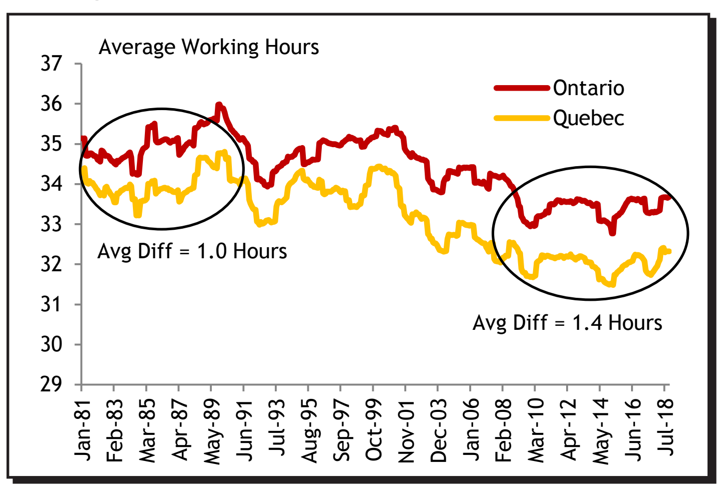
GDP Per Capita Ontario vs Québec: Still a Wide Gap



Source: Statistics Canada, Ontario & Quebec Finance, CIBC

Chart 3

Average Hours Fall and Gap Widens



Source: Statistics Canada, CIBC

non-economic reasons and 29% personal preference). But voluntary or not, the shorter work week accounts for nearly half of the gap between Québec's output per person and Ontario's.

Less to Show for Those Hours…But Why?

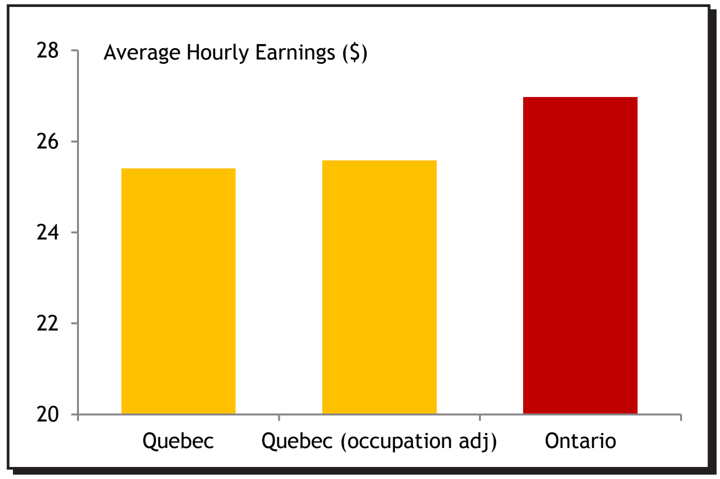
Tautologically, the remaining half of the per capita GDP shortfall must be attributable to labour productivity, squeezing less real output out of each hour worked. That's not a code for working less hard on the job. Instead, it typically reflects differences in the type of work: higher output per hour mostly aligns with the skill level required for the job, the nature of the occupation, the degree to which the industry is labour intensive or mechanized, and the degree to which workers are employed in larger enterprises.

In terms of education, Québec made massive inroads after the so called "Quiet Revolution" of the 1960s, but it still has a somewhat different mix of attainment levels than Ontario. Fewer Quebecers have a high school diploma or less (even if one counted CEGEPs) in that tally. But fewer have a university or college degree than in Ontario, with more Quebecers completing a registered apprenticeship (Chart 4). We've argued elsewhere that Canada needs more people in the skilled trades, and not all college or even university programs generate income gains, but Québec's weaker higher-education achievement is likely part of the productivity divide.

Even so, while this translates into some differences in the mix of occupations, that does not appear to explain much of the gap in average earnings between the two provinces, where Quebecers earn about $2 less per hour. That gap would be virtually identical if we re-weighted the shares of Quebecers in each occupation to match the Ontario distribution (Chart 5).

Chart 5

Occupation Difference Explains Only Fraction of Wage Gap



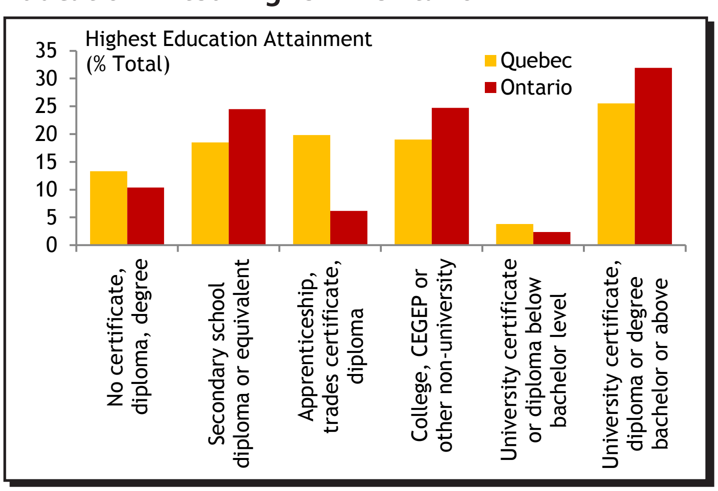
Source: Statistics Canada, CIBC

Still, a small service company could employ an "accountant" as could a large head office of a financial institution, but pay rates and productivity would likely be higher in the latter. Sectors that are more mechanized (oil refining) show very high value added per hour relative to more labour intensive, basic services.

The sectoral mix of employment in Québec vs. Ontario currently explains about a quarter of the productivity gap (Chart 6), but has accounted for a much higher

Chart 4

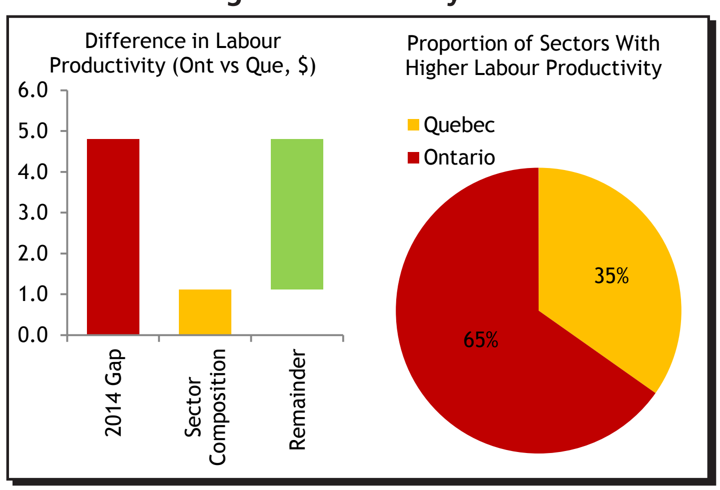
Education Tilted Higher in Ontario



Source: Statistics Canada, CIBC

Chart 6

Composition Plays a Part (L), But Two-thirds of Sectors Have Higher Productivity in Ontario



Source: Statistics Canada, CIBC

percentage in previous years. The details show that Ontario's larger weights in banking and real estate are important drivers of its higher output per worker versus Québec. Québec is overweight in less capital-intensive areas, such as government services, administration and support services.

But the majority of the gap currently is associated with differences in productivity within the same industry. Québec productivity is lower than Ontario's in banking, insurance, professional services and wholesaling, for example, and there are gaps in a number of other sectors as well.

Some of that gap could be a different mix of activities with a diverse sector like "other professional services", but firm scale and the role of the establishment within the firm are factors. Toronto has a slightly higher share of head office employment than Montreal, for example.

But there's a greater gap in corporate size. More Ontarians work for larger businesses (Chart 7), and that could be a telling factor for Québec's underperformance. Previous research by Statistics Canada has found that a similar gap between Canadian company sizes versus those in the US explained a lot of the reason why the States enjoys a productivity edge over Canada.

The Challenge for Government

To some extent, the challenge for the Québec government in attempting to wean the province off equalization is that some of the easier items to address from decades ago are no longer an issue. Quebecers are out there working, so it's not simply a matter of encouraging labour force participation or getting people a job. Although there are differences in educational attainment that could be narrowed over time, occupational choices aren't a major factor.

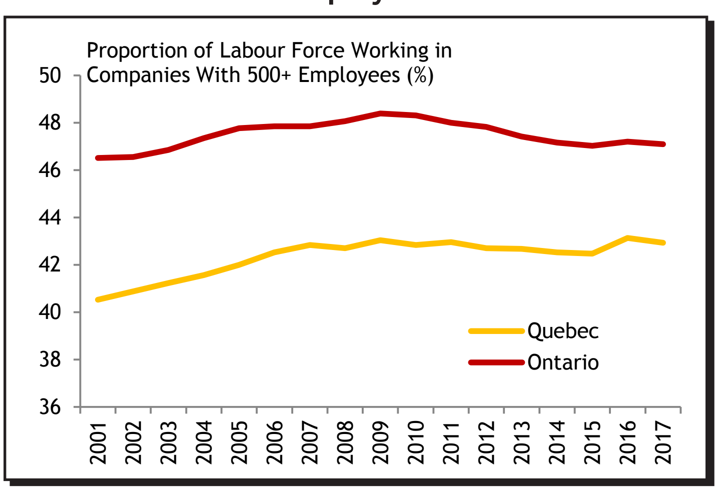
Instead, much of the gap now relates to the degree to which jobs are full-time positions, in larger companies, and in higher productivity sectors. That was already true back in 2014, the latest year in which we have the detailed sectoral data necessary to decompose the per capita GDP gap into its components (Chart 8). Since then the "employment rate gap" has disappeared.

What our analysis suggests is that to move from "have-not" to "have" status, Québec needs to be on course to attract the types of people, companies and sectors that generate higher output per worker and higher pay per hour. That means shifting more of the workforce into more productive, private sector firms, attracting more head office mandates, and growing sectors like advanced technology, financial services and insurance.

In turn, that rests on having the skilled workers, both home grown and immigrants, who are educated in the right disciplines, and the tax and economic development policies in place to support them. There's no quick fix for any of that, but having done a lot to right its fiscal ship, the province has some elbow room to devote scarce government funding to support these initiatives. We'll be watching its first budget in 2019 for steps in that direction.

Chart 7

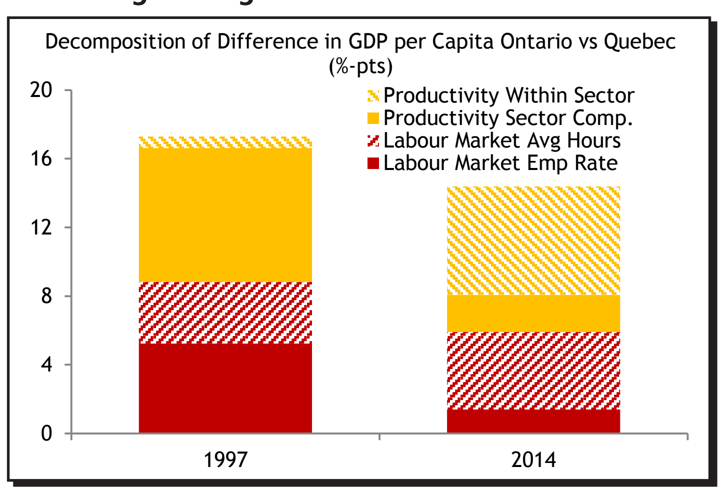
Large Businesses in Ontario Account for Greater Employment Share



Source: Statistics Canada, CIBC

Chart 8

Challenge Now is Improving Productivity and Increasing Average Hours



Source: Statistics Canada, CIBC

US and Oil: Lower Isn't Better Anymore

by Andrew Grantham and Katherine Judge

President Trump hasn't changed his position on OPEC and oil prices since entering the Oval Office. Back in 2011, he tweeted that "OPEC is ripping us off". Just before the last OPEC meeting, he expressed hope that production wouldn't be cut, saying that "the world does not want to see, or need, higher oil prices".

However, the US economy's response to oil prices has changed, even since 2011. Indeed, given how important shale oil has become for business investment and spurring growth in certain states, and given the looser link between gasoline prices and discretionary spending when unemployment rates are as low as they are currently, we could be in a situation where higher oil prices would actually be a positive for US growth.

Households: Not Pulling the Trigger

It's true that the US consumer gets a big boost in spending power from lower gasoline prices. Indeed, the fall in pump prices seen over the past couples of months would boost real disposable incomes by about $30 bn, or 0.25%. A strong start to the holiday shopping season has raised expectations for consumer spending growth ahead. However, sometimes an ability to spend more doesn't translate into a desire to do so.

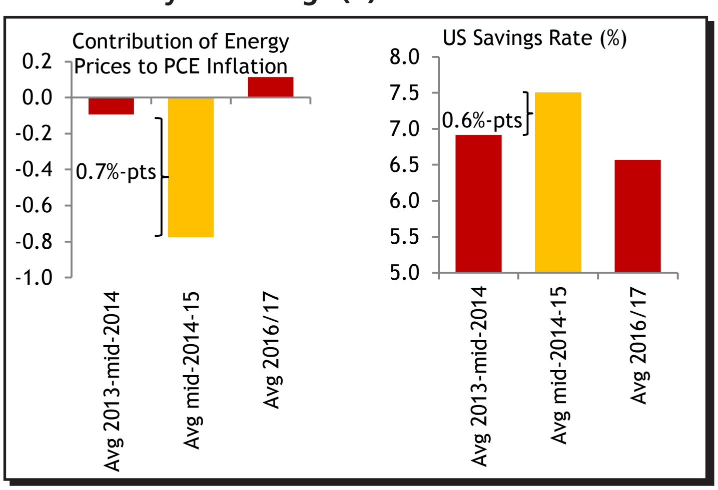
Indeed, when oil prices slumped in 2014/15, the reduction boosted real spending power by around 0.75%-pts (Chart 1, left). But, during that same period there was a notable rise in the savings rate as well, which is even more prominent after revisions were made to that series earlier this year. As it stands now, the savings rate rose by around 0.6%-pts on average during that period of falling/low oil prices, suggesting much of the benefit to real disposable incomes simply went to savings (Chart 1, right).

This simple analysis suggests a somewhat lower propensity to consume the real income lift from lower gasoline prices than most academic work. Of course, there could be a delayed response as savings initially build but are then spent later. However, there's little evidence of such a delayed response in the most recent period, as the subsequent fall back in the savings rate during 2016/17 can be mostly explained by households cushioning the partial rebound in gasoline costs.

One important factor during the current period is how low the unemployment rate is, and by extension how strong household incomes already are. In the past, large downswings in oil and gasoline prices have often been driven at least in part by US recessions, occurring during periods of high and/or rising unemployment rates (Chart 2). Falling gasoline prices therefore acted to

Chart 1

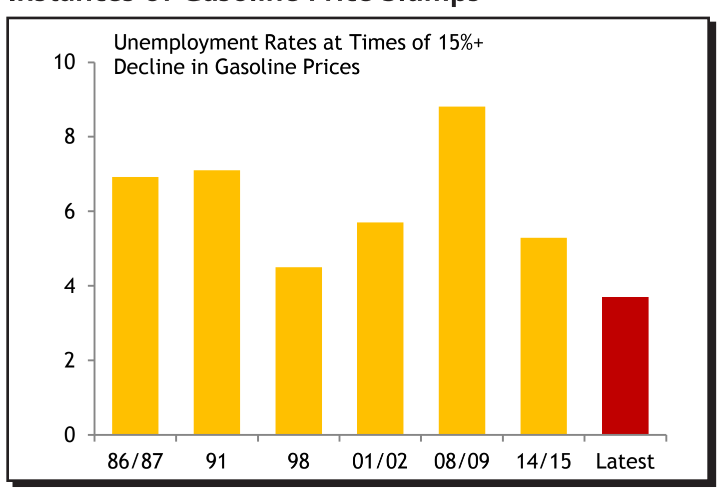
Boost to Disposable Incomes in 2014/15 (L) Went Mainly to Savings (R)



Source: BEA, CIBC

Chart 2

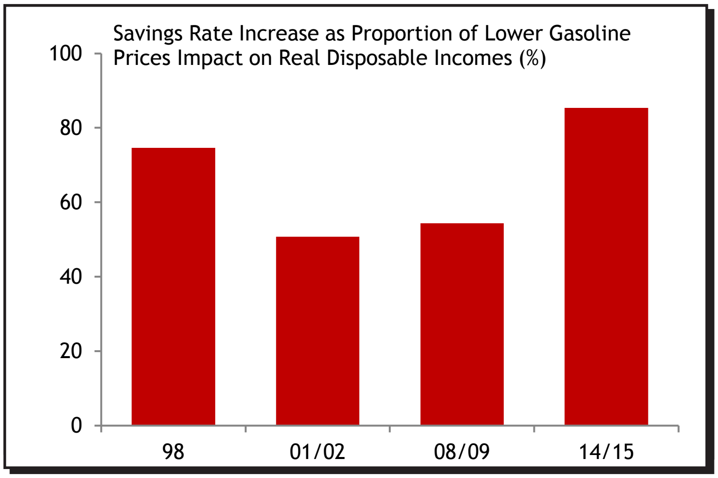
Unemployment Rate Lower Than Previous Instances of Gasoline Price Slumps



Source: Bloomberg, BLS, CIBC

Chart 3

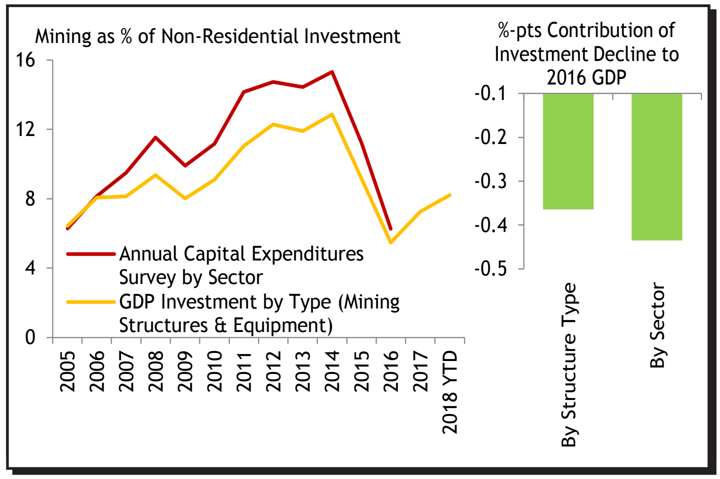
Lower Gasoline Prices Lead to Higher Savings When Unemployment is Low



Source: BEA, BLS, CIBC

Chart 4

Mining, Oil and Gas Investment Plays an Important Role in US Economy



Source: BEA, CIBC

cushion the blow to real incomes and allowed certain households to continue spending on at least some of their needs.

Prior to 2014, the last time gasoline prices fell severely in a non-recessionary period was 1998, when the unemployment rate averaged a little over 4%. During that period, the rise in the savings rate was equivalent to around 75% of the boost to household incomes from lower gasoline prices (Chart 3). That's a similar result to that seen in 2014/15 and much higher than that seen in recessionary periods when more of the money saved at the pumps was immediately spent.

A Key Investor

Boosting US growth when oil prices are high and weighing when prices are low, the oil sector has been key in determining swings in business investment recently. Most of the swings in non-residential structure investment since 2013 have been driven by the mining sector, which includes oil. As a proportion of overall business spending, investment in mining structures and equipment made up as much as 13% in 2014, falling to only around 5% in 2016. The hit to 2016 GDP growth alone from declining investment in those areas was a little over 0.3%-pts.

However, even that slightly underestimates the importance of the sector as an investor and contributor to GDP growth. Because companies also purchase equipment not specific to their specialist business (computers etc. for head offices), the broader annual survey of capital expenditures by sector shows that mining companies accounted for 15% of all business investment in 2014 (Chart 4 left). The decline seen afterwards also means it likely had a greater impact on 2016 GDP than the quarterly figures imply (Chart 4, right).

Although the annual survey isn't available past 2016, it's likely that a rebound in investment during 2017 and so far this year is contributing around 0.2%-pts to GDP growth. While November industrial production data showed an increase in mining activity, that's clearly at risk with WTI prices hovering just above $50/bbl.

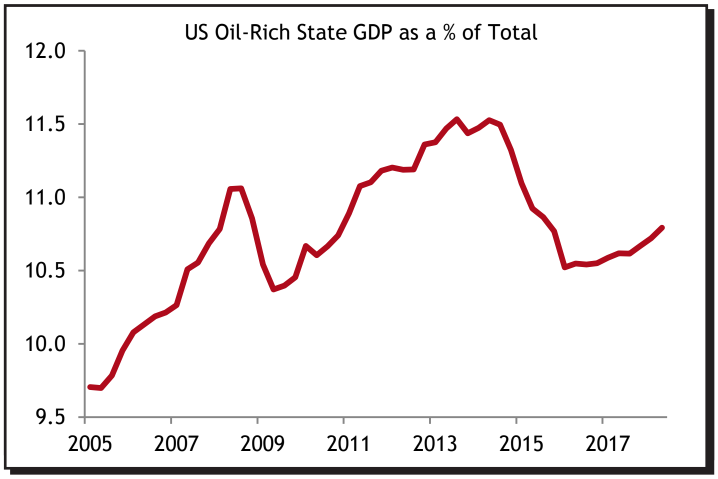
Sorrier States of Affair

Studying economic trends at the state level also reveals consequences from lower oil prices. Oil-rich states account for roughly one-tenth of US national economic activity, down from the highs seen prior to the 2014 oil price crash, and are over fourteen times more dependent on mining activity for growth than other states (Chart 5). Given the breadth of services that are associated with oil production, including transportation and R&D, that figure is likely even higher in employment terms.

That reliance on oil had been beneficial to incomes in such states, a reflection not just of wages offered in that sector being roughly 20% higher than they are in private industries in aggregate but also the knock-on impact on other sectors. After oil prices slumped in 2014/15, it wasn't just mining jobs that were impacted in oil-reliant states. The rate of earnings growth in other areas also slowed markedly from almost 6% to less than 2%. Interestingly, there was no discernible pick-up in other states to compensate at the national level (Chart 6).

Chart 5

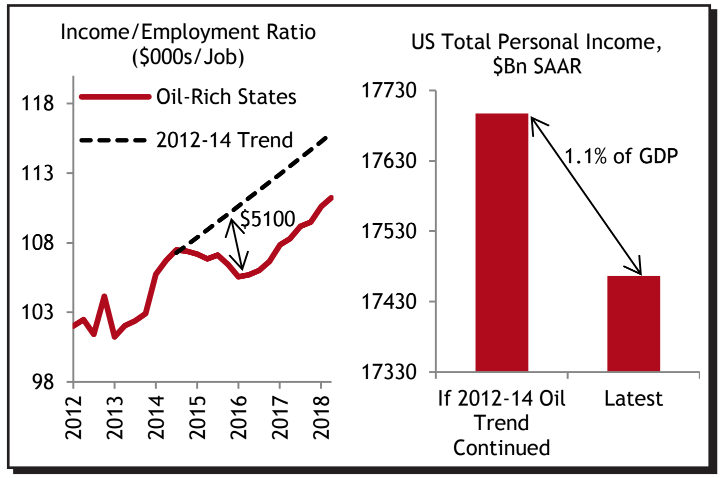
Oil-Reliant States* As Percentage of US Economy



Source: BEA, CIBC
**AK,NM,ND,OK,TX,WY*

Chart 7

Oil-Rich States See Lasting Income Gap (L) US Economy Less Wealthy From 2014 Oil Crash (R)

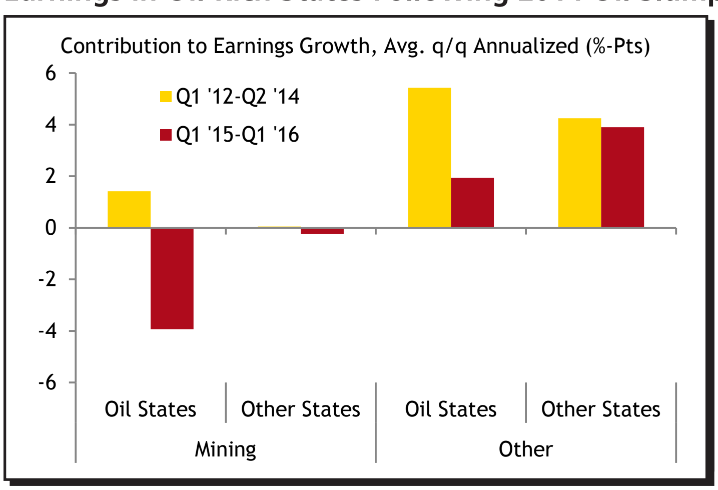


Source: BEA, BLS, CIBC

The 2014 oil price downturn actually had a more pronounced negative impact on GDP growth than the financial crisis in several of those states, and many smaller oil-producing economies have never fully recovered from that. There is a lasting gap in oil-rich states, where the income per job ratio fell by over $5,000/job in the years following the oil price crash and has remained salient since (Chart 7 left). With oil prices having fallen again recently, that gap is unlikely to narrow and could actually widen further.

Chart 6

Industries Apart from Mining Also Held Back Earnings in Oil-Rich States Following 2014 Oil Slump



Source: BEA, CIBC

That impact was large enough to be apparent at the national level, with total spending power of households roughly 1.1% lower as a share of GDP from that shift (Chart 7, right). Of course the impact on those states of the recent oil price decline will be smaller, given that mining activity only partly recovered. However, without a discernible pick-up in other states, that would still represent a negative for the overall economy.

No Longer the Lower the Better

The relationship between US economic growth and oil prices has changed dramatically over the past decade. And while the country is still a slight net importer of energy, and as such would typically benefit over the longer term from lower prices, in the near term and given the current economic climate the relationship could be reversed.

Already healthy labour markets and household incomes suggest that more of the money saved at the pumps today could be used to pay down debt or added to 401Ks, rather than spur additional consumer spending. Without evidence of a further spending boost, the negative impacts on business investment and growth in oil-reliant states may be the overriding consequence in 2019 if WTI stays around the current $50/bbl level. A price in the $60-$70 range would restore momentum in oil industry capital spending while not excessively denting consumption.

Where Are We in the Canadian Housing Slowdown?

by Benjamin Tal and Royce Mendes

It was a good run while it lasted, but the sun has officially set on the days of heady housing market growth fueling Canada's national economy. The combination of restrictive macroprudential policy measures and higher interest rates has taken a major bite out of housing activity. That's a development which will show up in cooler GDP growth readings ahead.

For Canada, the housing market is more important to the overall economy than at any other time on record. Residential investment makes up 7½% of the Canadian economy, just off the historical peak (Chart 1, left). And, while Canadian employment statistics leave much to be desired in terms of how far back they go, the available data similarly reveal that the share of residential construction workers and those employed in the real estate industry is also just off its historical peak (Chart 1, right). As a result, any slowdown will be magnified in terms of its impact on the Canadian economy relative to an equal decline in activity during past cycles.

Silver Linings?

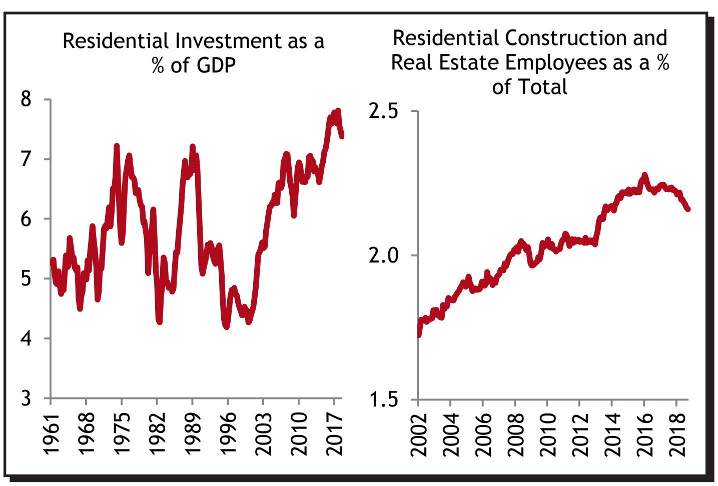
Policymakers have pointed out that safer mortgage and more stable housing markets are the silver linings, although that's hardly apparent just yet. True, over time, tighter lending standards will slowly improve the quality of borrowing, but the current stock of outstanding mortgages is still largely based on past, less restrictive lending rules.

The Bank of Canada also keeps arguing that the worst is now behind us and that housing markets are stabilizing. But, from our vantage point, it's difficult to agree. The central bank's own workhorse model says it takes six quarters before the full impact of any rate hike is felt in the economy. So it's concerning for the outlook then, that only five quarters since the first move of this cycle, let alone subsequent rate increases, we're already seeing a slowdown in housing-related indicators. As a result, we're not as optimistic as the Bank of Canada for the contribution to GDP growth from housing over the next few years (Chart 2).

Some might argue that while housing starts have fallen, they're only back to levels that were believed to be healthy in early 2016 (Chart 3, left). But, that misses a key point. The nature of homebuilding has changed. Total building activity is now skewed more heavily toward condos and townhouses as opposed to single-family homes which add up to a greater bump in GDP. Looking ahead, land constraints combined with lower absorption

Chart 1

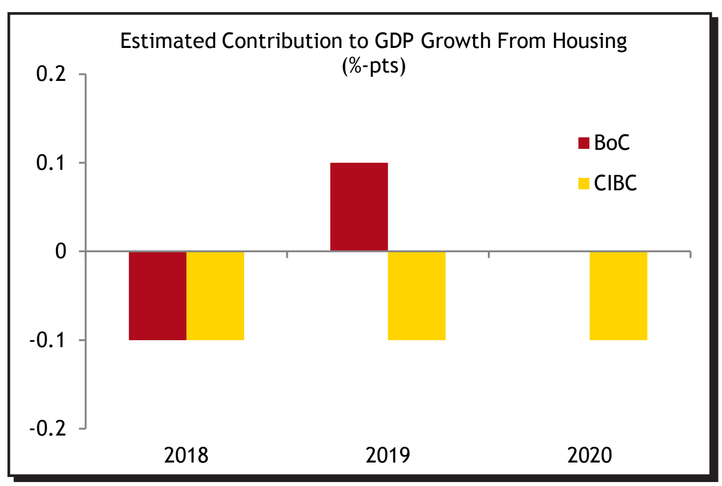
Residential Investment as a Share of GDP (L) and Housing Related Employment as a Share of Total (R) Just Shy of Historical Peaks



Source: Statistics Canada, CIBC

Chart 2

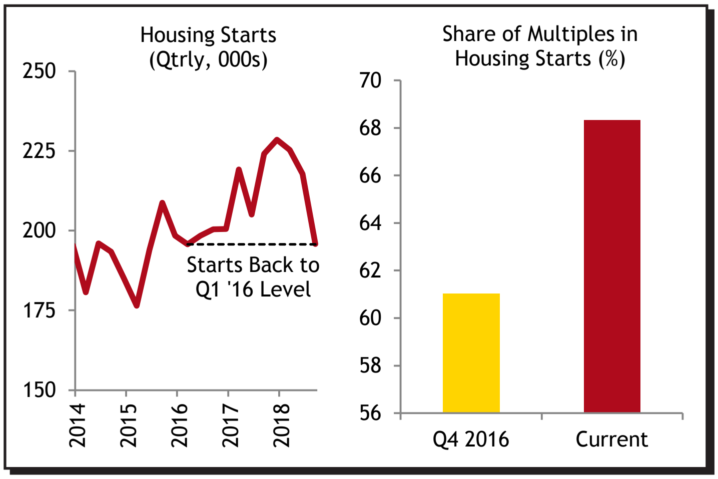
BoC Could Be Set Up For Disappointment From Housing Market



Source: Bank of Canada, CIBC

Chart 3

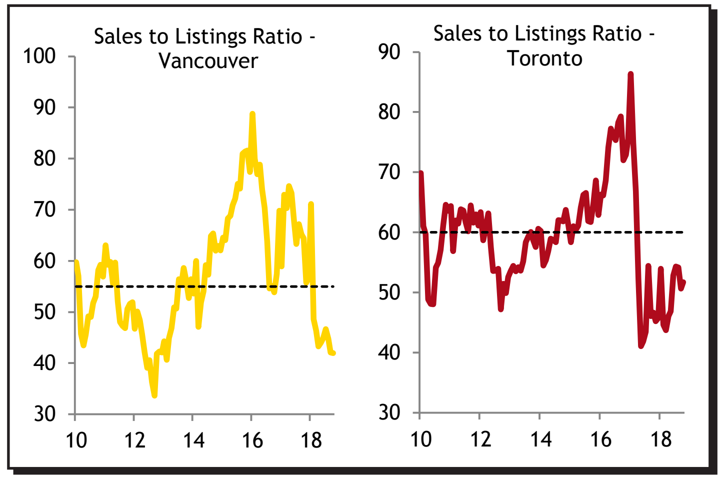
Headline Starts Back to 2016 Levels (L), But Breakdown Means Less Contribution to GDP (R)



Source: CMHC, CIBC

Chart 4

Undoing the Crazy Years in Vancouver (L) and Toronto (R)



Source: CREA, CIBC

rates for single-family homes than multi-units at the national level (the first time that's happened since 2009) mean that trend could continue (Chart 3, right).

A Tale of Two Cities

At the end of the day, when policymakers restrict borrowing eligibility, and in general when people discuss Canadian housing risks, what they have in mind is not St. John's, Newfoundland. Toronto and Vancouver are clearly the centre of attention here.

Let's start with Vancouver. Up until 2015 we were able to makes sense of the Vancouver market. Supply factors along with healthy demand were supporting activity and valuations. But then something happened in 2015 that none of our brilliant models were able to capture.

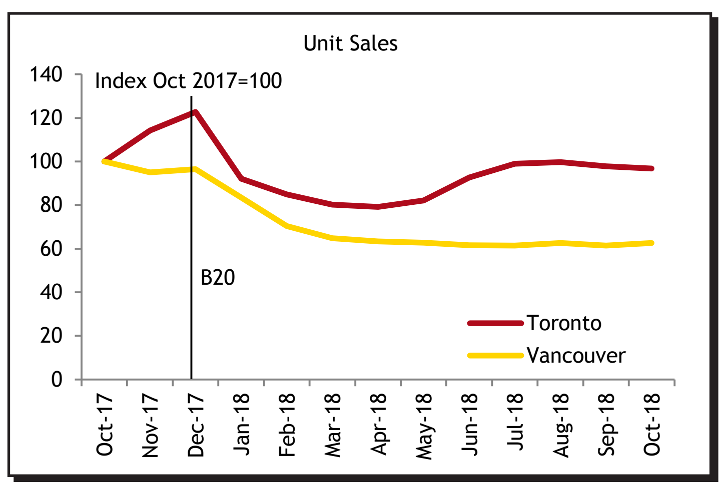
We believe that 2015, and part of 2016, saw a significant increase in speculative activity, leading to an unsustainable surge in Vancouver home prices. Since then, the market has softened due to its own gravitational force, along with policy changes and, more recently, higher interest rates. In many ways what we've seen over the past few years is an undoing of gains made during an abnormal period (Chart 4, left). The same is true for Toronto, where house prices in 2016 and early 2017 demonstrated bubbly conditions which appeared detached from fundamentals (Chart 4, right).

Now, while you're still on Chart 4, take a glance at the recent trajectory of both cities. It appears that Toronto is stabilizing while Vancouver is still correcting. Sales in Vancouver are down dramatically since the introduction of the B20 rules and tightened provincial regulations, while the damage in Toronto was more limited (Chart 5). That's not a big surprise since the regulations probably affected Vancouver to a greater degree given the more stretched affordability.

Looking ahead, we expect more of the same. Population growth in Vancouver has been lagging behind Toronto's over the past two years (Chart 6, left), while supply, mainly in the high-rise segment, has risen strongly. The end result? The number of completed and unabsorbed units in Vancouver is on the rise, while that measure is still trending down in Toronto (Chart 6, right). As of the third quarter, the ratio of units under construction

Chart 5

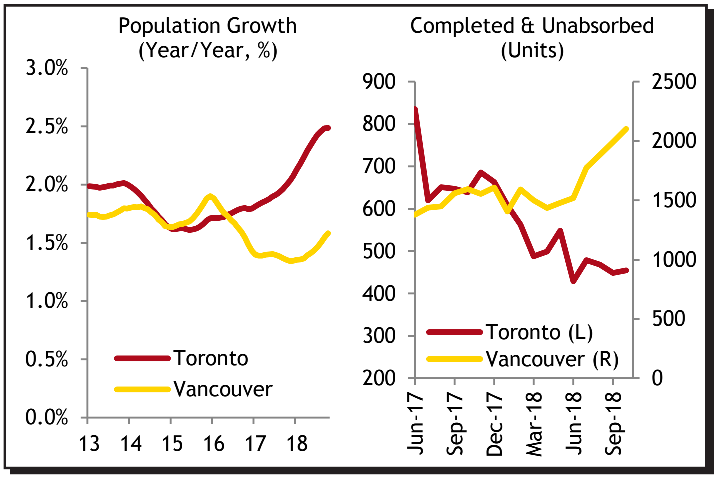
Since the Introduction of B20, Vancouver Housing Sales Have Fared Worse Than Toronto



Source: CREA, CIBC

Chart 6

Vancouver's Population Growth is Lagging (L), Leaving More Units Unabsorbed (R)



Source: CMHC, CIBC

to household formation in Vancouver was elevated in relative and absolute terms, while Toronto was still in line with long-term averages.

Toronto's Not Out of the Woods Yet

While Toronto is faring better than Vancouver, not all is well in the GTA either. In fact, the Toronto market is a tale of many markets. So far, the low-rise segment has been the real casualty of rule changes and higher interest rates, but even within that market there has been a significant divergence between pre-sale (new) and existing homes.

Historically, the price gap between those two markets was relatively constant, and while both saw notable price inflation in 2016, the increase in the pre-sale market was much more dramatic, taking the price gap to a record-high in 2017 (Chart 7). Since then, the adjustment in the low-rise pre-sale market has been dramatic, with prices falling much faster than in the resale market. In fact, in many ways the low-rise pre-sale market is in a price searching mode with developers trying to find a way to sell 2017 inventories and repackage new products in a way more consistent with today's market conditions.

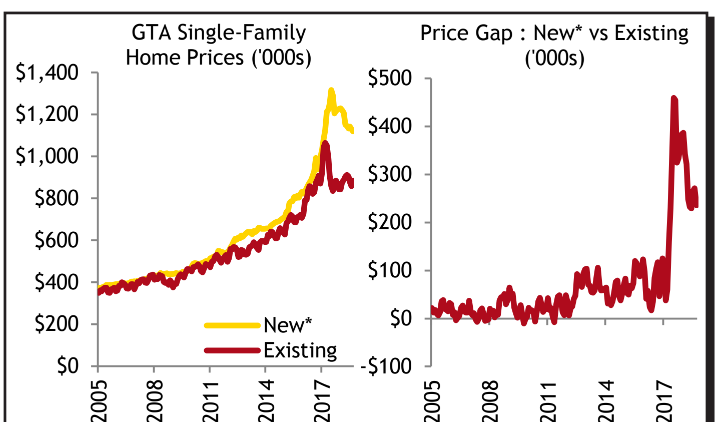
That process is not over and we expect the pre-sale low-rise market to continue to soften in the coming quarters. With a growing number of developers choosing to postpone new openings, limited supply will ensure that the market finds a new equilibrium in the not-too-distant future.

The high-rise segment of the market has seen a similar divergence in prices since 2016, with pre-sale units rising much faster than resales. However, that gap is currently at a record-high (Chart 8). We expect that segment of the market to follow the low-rise example with reduced demand from investors being the main catalyst. Having said that, we expect any adjustment in that market to be relatively swift and limited, given the less-elastic demand there.

The adjustment in the Canadian housing market in general, and in Vancouver and Toronto in particular, is not over yet, with the Toronto condo market likely to soften in the coming year. But, we believe that market forces suggest prices will find equilibrium next year even if slowing activity continues to weigh on GDP.

Chart 7

Single-Family Home GTA

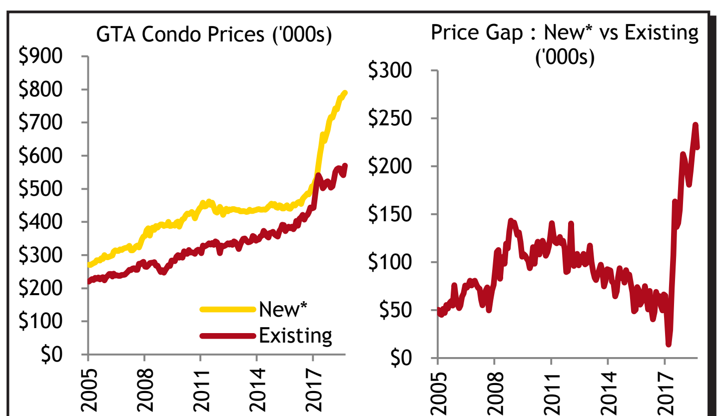


** Average asking price of available new home inventory at end of period with outliers removed*

Source: Altus Group (new homes) and TREB (existing homes) data, CIBC

Chart 8

Condominiums GTA



** Average asking price of available new home inventory at end of period with outliers removed*

Source: Altus Group (new homes) and TREB (existing homes) data, CIBC

ECONOMIC UPDATE

CANADA	18Q3F	18Q4F	19Q1F	19Q2F	19Q3F	19Q4F	20Q1F	20Q2F	2017A	2018F	2019F	2020F
Real GDP Growth (AR)	2.0	1.7	1.8	2.3	0.9	1.7	1.5	1.5	3.0	2.1	1.8	1.5
Real Final Domestic Demand (AR)	-0.1	1.9	1.8	1.7	0.9	1.2	1.6	1.6	3.1	2.5	1.4	1.4
Household Consumption (AR)	1.2	2.1	1.9	2.1	1.0	1.3	1.7	1.6	3.6	2.3	1.8	1.5
All Items CPI Inflation (Y/Y)	2.7	2.0	2.1	2.1	2.0	2.4	2.1	1.9	1.6	2.3	2.1	1.9
Unemployment Rate (%)	5.9	5.7	5.7	5.7	5.7	5.7	5.8	6.0	6.3	5.8	5.7	6.1

U.S.	18Q3A	18Q4F	19Q1F	19Q2F	19Q3F	19Q4F	20Q1F	20Q2F	2017A	2018F	2019F	2020F
Real GDP Growth (AR)	3.5	2.3	1.1	2.0	2.0	1.6	1.1	1.2	2.2	2.9	2.1	1.5
Real Final Sales (AR)	1.2	2.3	2.6	1.9	2.0	1.6	1.3	1.2	2.2	2.8	2.3	1.5
All Items CPI Inflation (Y/Y)	2.6	2.3	2.2	2.2	2.3	2.5	2.4	2.1	2.1	2.5	2.3	2.1
Core CPI Inflation (Y/Y)	2.2	2.2	2.0	2.3	2.4	2.5	2.5	2.3	1.8	2.1	2.3	2.2
Unemployment Rate (%)	3.8	3.7	3.6	3.6	3.8	3.6	3.9	4.2	4.4	3.9	3.7	4.3

CANADA

Production cuts in the oil patch have added to the woes for the Canadian economy, but we were already negative on that sector's contribution to GDP next year. So, with the accelerated depreciation boost a bit broader than we had expected, we've left our growth forecast for 2019 at 1.8%. We'll be keeping an eye on activity ex-energy to get a sense of the underlying economic momentum in the next couple of quarters.

UNITED STATES

Lower gas prices in combination with higher wages have helped propel robust consumption so far in Q4, something that led us to upgrade our Q4 growth forecast to 2.3%. However, as employment growth slows as the economy reaches full employment next year, income growth will be harder to come by and the ensuing cooling in consumption will add to slower growth in the more cyclical segments of the economy that is already underway.