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ECONOMIC INSIGHTS

October 4, 2018

Behold the USMCA: Now Expect Growth to Slow

by Avery Shenfeld

NAFTA is done for, but behold the beauty of the USMCA the newly minted US-Mexico-Canada trade deal. It's much, much better than an all-out trade war, but we expect Canadian growth to slow anyway, and other than an unrelated bump in our 2018 GDP projection, we have not altered our forecasts as a result.

The USMCA removes a cloud of uncertainty hanging over Canadian business. But our existing forecast had already assumed that a preliminary deal would be reached. Had we used an alternative scenario, including huge tariffs on Canadian auto exports, we wouldn't have been forecasting a Bank of Canada rate hike in October.

Remember that Canada is calling it a win because we didn't give up much versus the existing NAFTA deal. There are a few tidbits where export opportunities were opened up (sugary products, for example), but otherwise, this was about a successful run of defense, not offence, for Canada.

The details on government procurement, sunset clauses, protection for cultural industries, and dispute resolution that were all important concessions made by the US side, only preserved what Canada already had in the old NAFTA. Limits on the further bleeding to low-cost Mexican auto parts plants are a plus, but again, mostly to the extent that they will stand in the way of further blood-shedding in Canada's market share.

More broadly, aside from some spikes in oil prices, trade hasn't been a big winner for Canada dating all the way back to 2000. Real exports were essentially flat in the cycle that ended in 2007, and most of the post-recession recovery was simply returning to the pre-recession levels. Canada's trade and current account balance have been stuck in red ink since 2008. Nothing in this deal is going to be a cure for that on its own.

On the growth front, Canada's biggest threat is simply a result of our success in reaching something close to full employment. Population growth has picked up a bit, but the underemployment of new immigrants reduces the scale of the resulting GDP benefits (see pages 9-11). Our trading partners, including the US, Japan and Germany, are in an even worse position, as their further growth will be ever more constrained by the tightness of existing labour markets and the lack of a political consensus to ramp up immigration.

As we slow housing with gradual rate hikes and tighter mortgage rules, and adjust to softer workforce increases, economic growth in Canada will ease to less than 2% next year. That will be seen in most provincial growth rates (see pages 3-6). A Bank of Canada judging how much to hike rates, investors looking at growth-related equities, and governments projecting revenue streams in 2019 budgets, need to look past the cheer engendered by the USMCA deal at these less exciting realities.

MARKET CALL

- The resolution of NAFTA, sorry USMCA, clears the way for a move in October. We always anticipated a deal to be struck, so the announcement itself doesn't change our forecasts. Nevertheless, recent positive data points likely mean a subsequent rate hike (following an October move) will be on the way come January 2019, slightly earlier than previously expected. After that, though, the elevated sensitivity of households to rising interest rates will still require a prolonged pause by the central bank.

- The slight shift in timing for Bank of Canada rate hikes should result in a somewhat stronger C$ profile than we previously envisioned over the coming six months or so. But, as the BoC is set to lag the Fed thereafter, the currency will move back to the low 1.30s by mid-2019.

- Even though inflation appears to have peaked in the US and Canada on a headline basis, some firming in core measures as well as the end of QE in Europe should continue to put modest upward pressure on long-dated bond yields.

INTEREST & FOREIGN EXCHANGE RATES

		2018		2019				2020	
END OF PERIOD:		**3-Oct**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**	**Jun**	**Dec**
CDA	Overnight target rate	1.50	1.75	2.00	2.00	2.00	2.00	2.00	2.00
	98-Day Treasury Bills	1.61	1.70	1.80	1.95	2.00	2.05	1.70	1.70
	2-Year Gov't Bond	2.28	2.30	2.45	2.45	2.50	2.45	2.00	1.75
	10-Year Gov't Bond	2.50	2.55	2.75	2.75	2.70	2.75	2.55	2.25
	30-Year Gov't Bond	2.48	2.50	2.85	2.80	2.80	3.15	2.95	2.70
U.S.	Federal Funds Rate	2.125	2.375	2.375	2.625	2.625	2.875	2.625	2.375
	91-Day Treasury Bills	2.22	2.25	2.35	2.55	2.65	2.80	2.60	2.25
	2-Year Gov't Note	2.86	2.90	3.00	3.20	3.20	3.30	2.90	2.60
	10-Year Gov't Note	3.15	3.10	3.30	3.45	3.45	3.35	3.10	3.00
	30-Year Gov't Bond	3.31	3.25	3.40	3.55	3.60	3.60	3.45	3.45
Canada - US T-Bill Spread		-0.61	-0.55	-0.55	-0.60	-0.65	-0.75	-0.90	-0.55
Canada - US 10-Year Bond Spread		-0.66	-0.55	-0.55	-0.70	-0.75	-0.60	-0.55	-0.75
Canada Yield Curve (10-Year — 2-Year)		0.21	0.25	0.30	0.30	0.20	0.30	0.55	0.50
US Yield Curve (10-Year — 2-Year)		0.29	0.20	0.30	0.25	0.25	0.05	0.20	0.40
EXCHANGE RATES	CADUSD	0.78	0.78	0.78	0.76	0.76	0.75	0.76	0.77
	USDCAD	1.28	1.28	1.29	1.31	1.32	1.34	1.32	1.30
	USDJPY	114	110	108	106	105	104	102	100
	EURUSD	1.15	1.18	1.20	1.23	1.25	1.28	1.30	1.30
	GBPUSD	1.30	1.30	1.35	1.39	1.42	1.46	1.50	1.51
	AUDUSD	0.71	0.74	0.75	0.76	0.77	0.78	0.79	0.80
	USDCHF	0.99	0.97	0.96	0.94	0.94	0.92	0.91	0.89
	USDBRL	3.91	4.10	4.25	4.30	4.05	3.90	3.95	4.05
	USDMXN	19.0	19.4	19.1	18.9	18.8	19.5	19.4	20.3

Provincial Outlook: Challenges New and Old

by Andrew Grantham and Royce Mendes

NAFTA uncertainties have now subsided, but the Canadian economy still faces a number of challenges, new and old, in the coming years. Whether it be attracting and retaining workers, learning to live with higher mortgage rates or being impacted by a US slowdown come 2020, some provinces are better prepared to deal with these challenges than others.

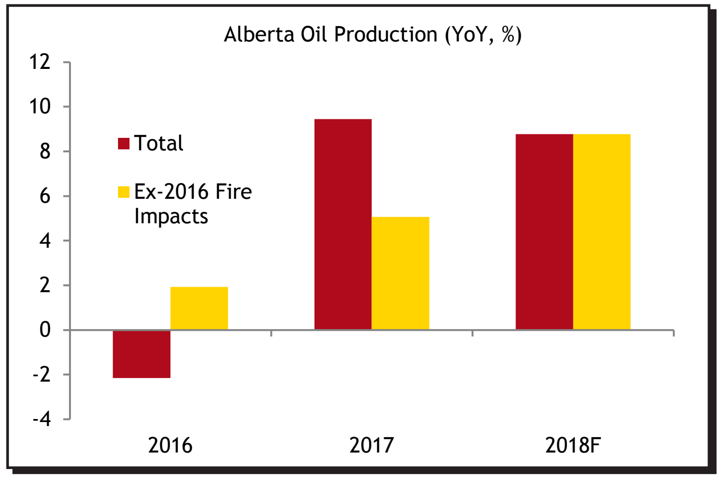
Clearer Present, Less Danger

The trade deal between Canada, the US and Mexico removes a massive cloud of uncertainty which was hanging over the Canadian economy. But, since we expected such an agreement to materialize, it doesn't change our outlook for provincial growth or inflation.

Still, given that we now have hard data in hand for part of 2018, we've tweaked some of our expectations since our last full forecast. After 2017's year-over-year oil production increase was flattered by a rebound from the fire disruption of 2016, we'd expected a slower pace to Alberta growth this year (Chart 1). However, oil production has been stronger than we'd originally assumed. That probably leaves Alberta GDP tracking higher this year than previously projected, even though new investments in the oil patch have been slow in coming due to transportation bottlenecks and the larger spread between Western Canadian oil and global benchmarks.

Chart 1

Strong Growth in Alberta Oil Production Maintained



Source: NEB, CIBC

Meanwhile, the BC economy, often head-and-shoulders above the rest in recent years, may be running slightly cooler than we'd previously anticipated this year. We were

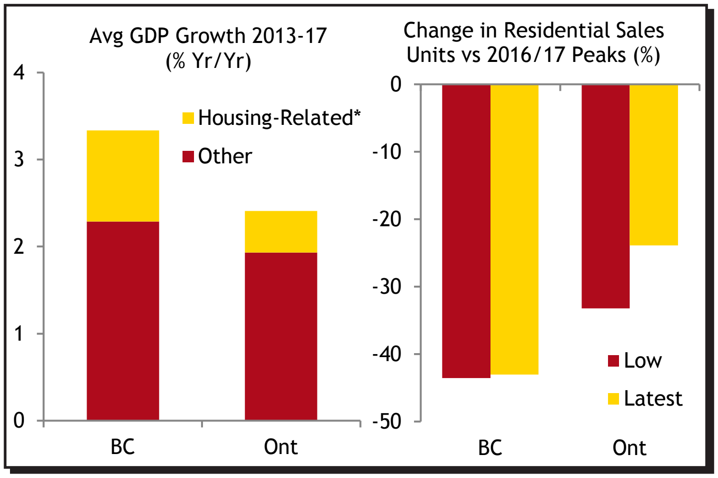
Table 1

Provincial Forecast

	Real GDP Y/Y % Chg				Nominal GDP Y/Y % Chg				Unemployment Rate %				Housing Starts 000s Units			
	2017F	2018F	2019F	2020F	2017F	2018F	2019F	2020F	2017A	2018F	2019F	2020F	2017A	2018F	2019F	2020F
BC	3.6	2.1	2.0	2.2	5.7	4.2	4.3	4.2	5.1	5.0	4.9	5.0	43.5	40.0	34.0	32.0
Alta	4.6	2.4	1.9	1.1	8.4	5.3	4.4	2.6	7.8	6.6	6.5	6.7	29.3	30.0	31.0	30.0
Sask	2.8	1.5	1.8	1.3	6.3	4.2	4.3	2.8	6.3	6.2	6.0	6.3	5.0	4.0	6.0	6.0
Man	2.8	1.8	1.8	1.5	4.9	3.6	3.8	3.3	5.4	5.9	5.7	5.9	7.6	7.0	8.0	7.0
Ont	2.7	2.1	1.8	1.3	4.8	4.1	4.1	3.2	6.0	5.6	5.5	5.8	80.2	74.0	68.0	63.0
Qué	2.9	2.5	1.7	1.1	5.0	4.4	3.8	2.9	6.1	5.6	5.5	5.8	46.3	42.0	34.0	31.0
NB	1.7	0.9	1.0	0.8	3.8	2.7	3.0	2.6	8.1	8.1	8.2	8.5	2.3	2.0	2.0	2.0
NS	1.0	1.2	0.9	1.5	3.1	3.0	2.9	3.3	8.4	7.6	8.0	8.3	4.0	4.0	3.0	3.0
PEI	2.9	1.7	0.8	1.0	5.0	3.5	2.8	2.8	9.8	9.6	9.7	9.9	1.0	1.0	1.0	0.8
N&L	1.9	-0.9	1.5	-0.8	5.3	1.7	4.0	0.7	14.8	14.5	14.3	14.3	1.4	1.5	1.5	1.0
Canada	**3.0**	**2.1**	**1.8**	**1.3**	**5.4**	**4.3**	**4.1**	**3.1**	**6.3**	**5.9**	**5.8**	**6.1**	**220**	**205**	**188**	**176**

Chart 2

BC Was Always More Reliant on Housing (L), Sales Volumes Haven't Started to Recover (R)



** Residential Construction, Housing-Related Retail, Real Estate*
Source: Statistics Canada, CREA, CIBC

well aware that growth there had been more dependent on housing than even the Ontario economy (Chart 2, left). However, the slowdown in housing activity has not only been more pronounced than that seen in Ontario, but has also failed to see much of a rebound following the initial policy-driven hit (Chart 2, right).

Elsewhere, growth in Saskatchewan has continued to lag behind neighbouring Alberta, while quarterly figures produced for Ontario and Quebec suggest that the latter remains ahead in terms of growth after having overtaken Ontario last year (see table).

Getting New Boots on the Ground

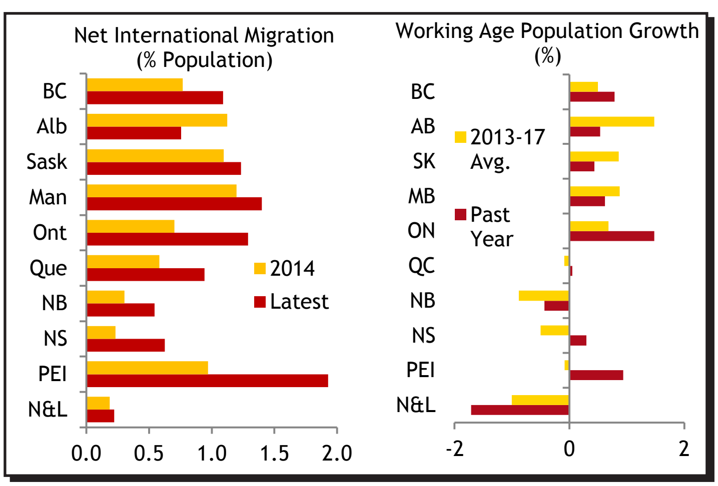
A developing obstacle to growth in a number of provinces is the tightness of labour markets, which makes sourcing suitable workers more difficult for companies. In prior years, increasing participation rates, particularly among women in areas such as BC and Quebec, helped ease that pressure. More recently, help has come in the form of net international migration that has accelerated the pace of working age population growth on a national basis.

Aside from Alberta, where fewer foreigners are being drawn in than during the period of higher oil prices, most provinces are benefitting — although to different degrees. Ontario has seen the biggest acceleration in net international migration as a percentage of the population, and with many of them relatively young, the province has seen the fastest pace of working age population growth (Chart 3). Meanwhile higher net international migration levels in Atlantic Canada have helped to offset part of the headwind from an ageing population, with the working age headcount falling less than in the recent past.

The major problem for Atlantic Canada, historically, hasn't just been attracting new workers, but also retaining them. Often after a few years they've moved to other parts of the country. More recently, however, those retention rates have been much better — not as high as other parts of the country, but much improved versus where they stood historically (Chart 4). For Nova Scotia and New Brunswick in particular, that's being helped by stronger demand for labour than what was seen during most of the past 20-30 years.

Chart 3

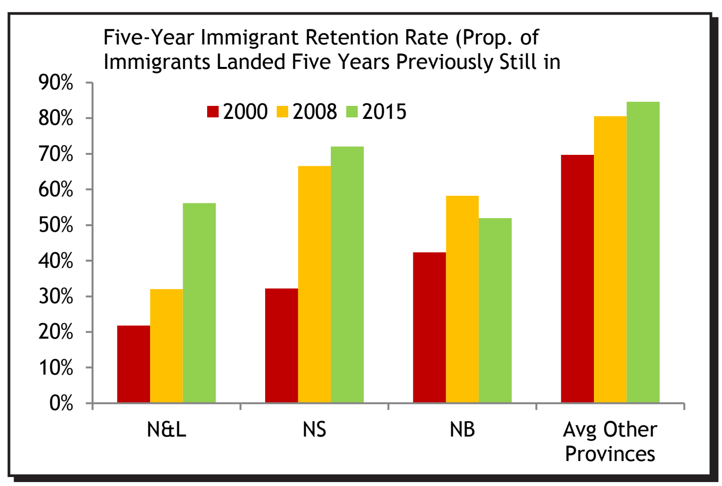
Net Int'l Migration Pick Up Widespread (L), Accelerating Population Growth in ONT and BC (R)



Source: Statistics Canada, CIBC

Chart 4

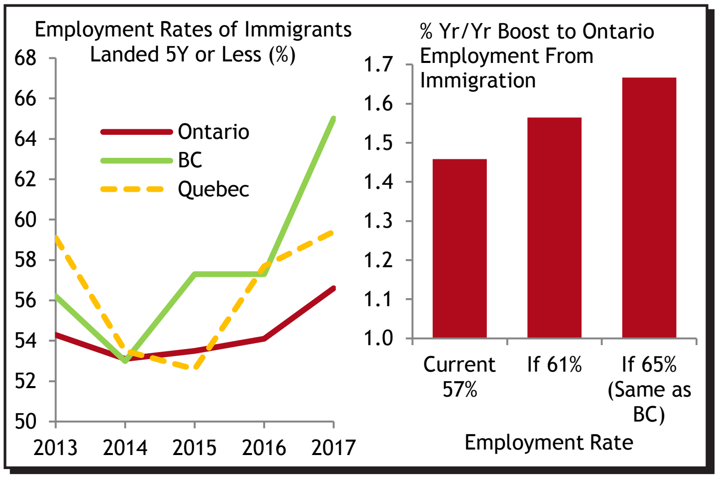
Immigrants Increasingly Likely to Stay in Atlantic Canada



Source: Statistics Canada, CIBC

Chart 5

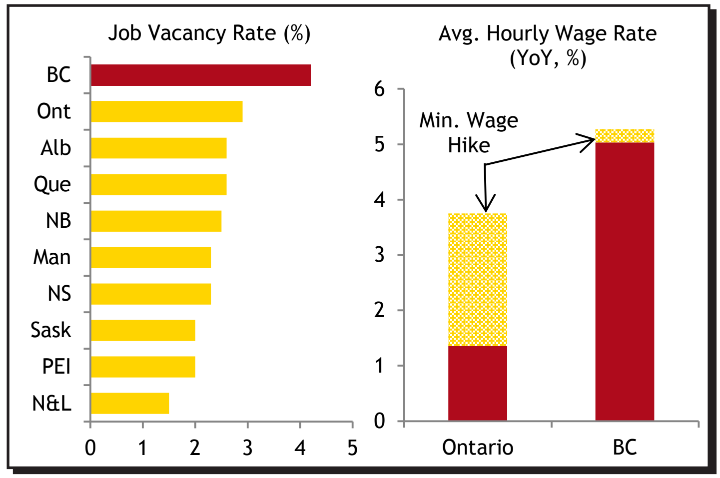
New Immigrant Employment Rates Rise in BC, Que (L), Potential For Ontario to do Better (R)



Source: Statistics Canada, CIBC

Chart 6

BC Vacancy Rates (L) and Wage Growth (R) Signal Labour Tightness



Source: Statistics Canada, CIBC

For Ontario, the boost from immigration to employment and economic growth in general could be even bigger if improvements are made getting those people to work. While in BC and to a lesser extent Quebec, employment rates among immigrants landed less than five years have risen, Ontario hasn't seen much move in this metric (Chart 5, left). Using those employment rates, Ontario has probably seen about a ¼% smaller boost to its economy from recent immigration than it would have done if those employment rates had risen in line with BC (Chart 5, right).

A Tighter Limit on BC

In BC, even with a modest acceleration in net international migration, we've got the clearest signs of a provincial economy reaching its limits in terms of potential growth. Job vacancy rates in BC are much higher than even Ontario and Quebec, where unemployment rates are similarly low compared to past cycles (Chart 6, left). And even though on the surface wage growth in BC isn't much higher than Ontario, the latter is the result of a much larger boost from recent minimum wage changes rather than a reflection of a very tight labour market (Chart 6, right).

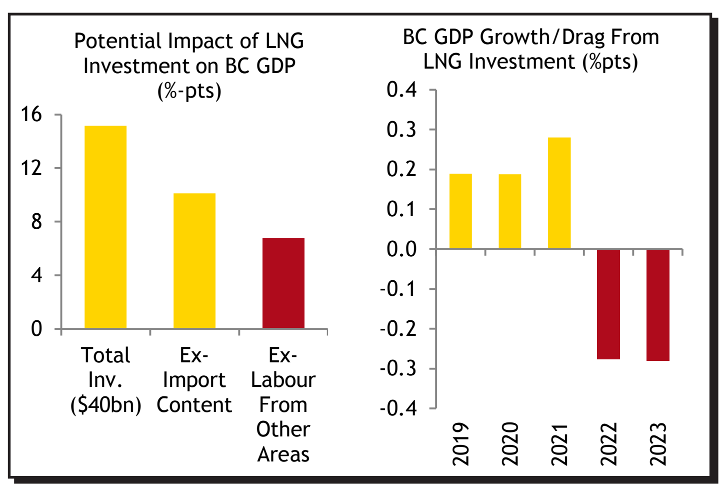
That labour market tightness could restrict the boost to growth from the $40bn LNG project. That's obviously a big investment relative to the size of the provincial economy and will leave it leading the way in terms of growth. However, if a significant proportion of inputs need to be imported, and if the labour required results in shortages for other industries like housing construction, the net lift to BC growth could be much less than the headline number implies (Chart 7, left). Furthermore, with the investment spanning five years and ramping up gradually, the largest lift to growth might not arrive until 2021 (Chart 7, right).

Tapping on the Brakes

Labour market shortages go hand in hand with another challenge facing the provinces — higher interest rates. With unemployment tracking historic lows and inflation

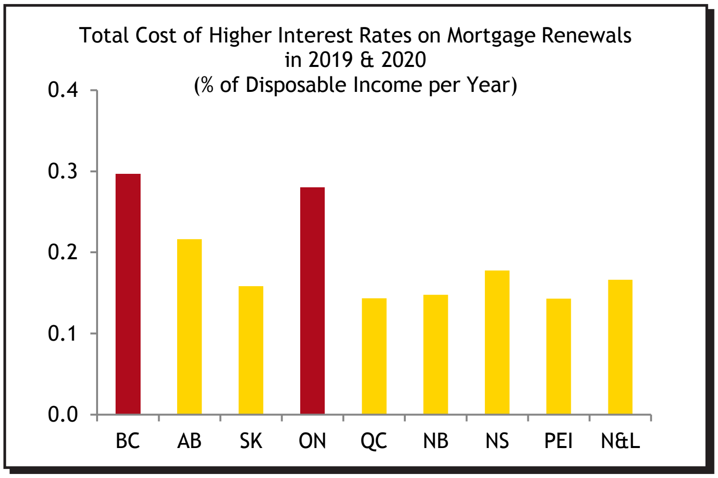
Chart 7

LNG Boost to BC Economy Lowered if Labour Diverted (L), Would Peak in 2020/2021 (R)



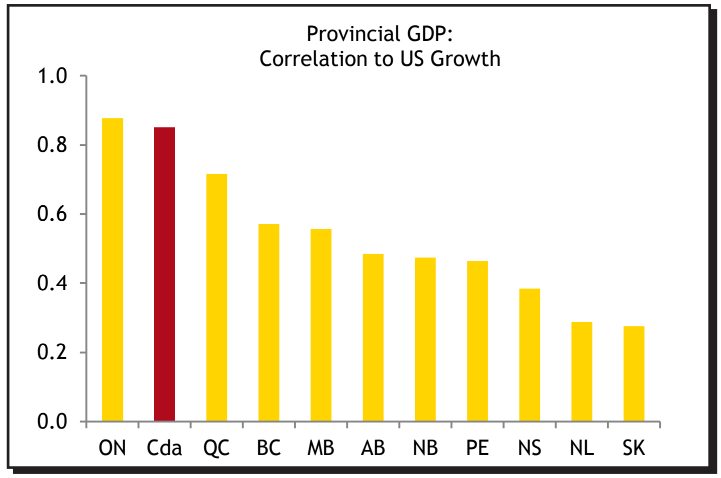
Source: Statistics Canada, CIBC

Chart 8
BC & Ontario to Feel the Most Pinch From Higher Rates



Source: Haver Analytics, CIBC

Chart 10
Ontario Most Exposed to a US Slowdown

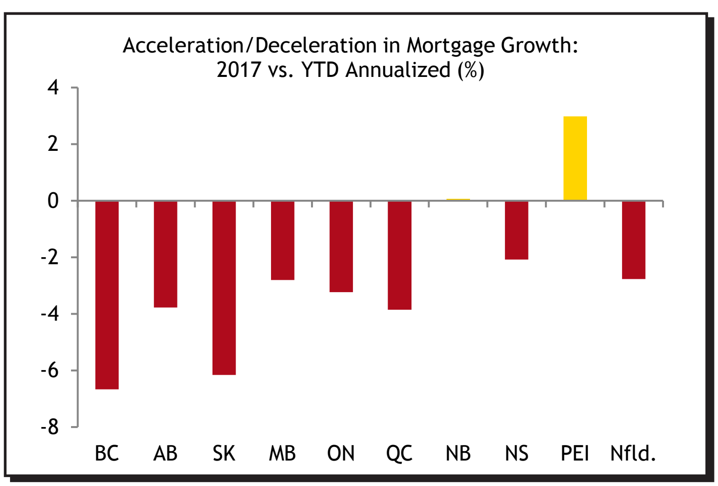


Source: Statistics Canada, BEA, CIBC

trending around target, the Bank of Canada is now well into its rate hiking cycle, and that's marked a milestone of sorts. For the first time in a generation, five-year mortgages are being renewed at higher interest rates. The leaps in house prices across BC and Ontario have left those provinces's set to pay the steepest price (Chart 8). While we don't see tighter monetary policy tipping either into recession, they could still take a notable bite out of consumer spending in the years ahead.

New macro-prudential policies aimed at the mortgage market are cutting the same way, having helped cool mortgage lending and housing market activity across the nation (Chart 9).

Chart 9
Mortgage Growth Slowing Across Regions



Source: Statistics Canada, CIBC

On their own, the combination of higher interest rates and tighter lending standards would likely have achieved their intended effects of keeping the Canadian economy from overheating and gradually reducing some of the risks posed by over-indebted households and sky-high housing prices. But, an expected slowdown in the US economy come 2020, driven by a turn in fiscal policy, will drag many provinces back below full employment. While that's unlikely to lead to a recession even in Ontario (Chart 10), a rise in unemployment across the board is likely to materialize come 2020.

Challenges from tight labour markets, higher interest rates and a slowing US economy mean that cooler growth is likely on the horizon in most provinces. The pain will, however, be somewhat uneven. BC should be able to buck that trend given newly announced investments. Stronger population growth in Ontario should leave the province declerating in line with the national average. However, the leader of the pack in 2018, Alberta, will become a laggared as oil patch investments continue to struggle and production increases provide less of a boost to GDP growth in the years to come.

All That Glitters

by Avery Shenfeld and Katherine Judge

Looking at how the bullion price has tracked in the last few years, it's clear that, as the saying goes, all that glitters is not gold. The yellow metal hasn't delivered a shining performance, particularly relative to risk assets like US equities. But looking at what's driven precious metals prices, 2019 could deliver at least a bit of relief.

Gold is distinguished from other non-precious materials by the fact that it isn't "consumed" the way oil is, and new output has a trivial impact on that stock. So near-term supply is essentially fixed, and its value depends on investors' willingness to hold the stock of gold outstanding. Gold has been viewed historically as a safe haven during crisis times, an inflation hedge, and most notably, as an alternative to US dollars for central bank reserves and others diversifying from their home currencies.

So one of gold's problems is that, with the exception of a few emerging market economies, inflation has been quiet for so long that nobody fears its return. That's evident in low global long bond yields, and low breakeven rates on inflation-linked bonds. With so little volatility since the mid-1980s, US inflation fails to show up as statistically significant in our efforts to model the gold price. Nor do inflation triggers like oil prices, since investors assume that their CPI impacts will prove transitory.

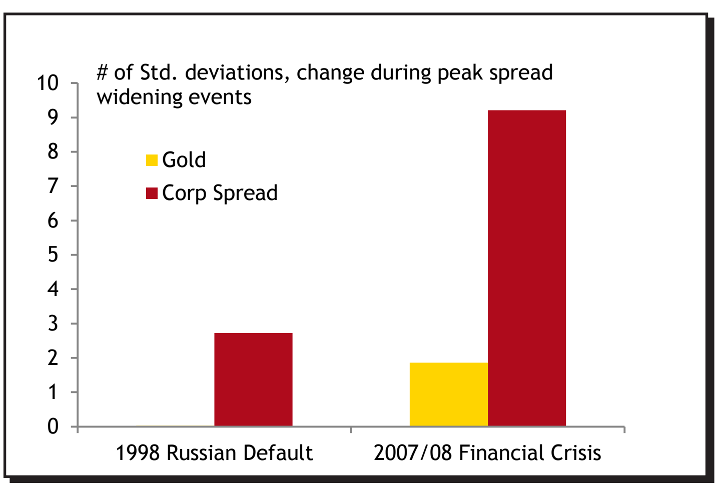
Real interest rates do matter, in the sense that higher real yields on bonds make non-yielding gold less attractive as a store of value. But again, it's been a while since yields really soared, so while statistically significant, neither real or nominal rates (either 2 or 10 years) move the needle much. A 25 bp rise in 10-year yields in our forecast for 2019, while in theory a drag on the gold price, won't do any significant damage based on our model.

Some see gold as a "flight to safety" asset that benefits from global turmoil, but statistical tests of that hypothesis don't perform well. Gold moved only two standards deviations higher during the 2007-08 crisis, but it took a nearly 10 standard deviation climb in corporate spreads for gold bugs to sit up and take notice (Chart 1). There was no reaction in gold to the earlier 1998 move in corporate spreads when Russia defaulted.

So what does matter? DXY, DXY and DXY. Essentially, global investors' willingness to buy gold is largely a function of whether they see it as a superior alternative to the greenback. A generally firm US$ has been a key

Chart 1

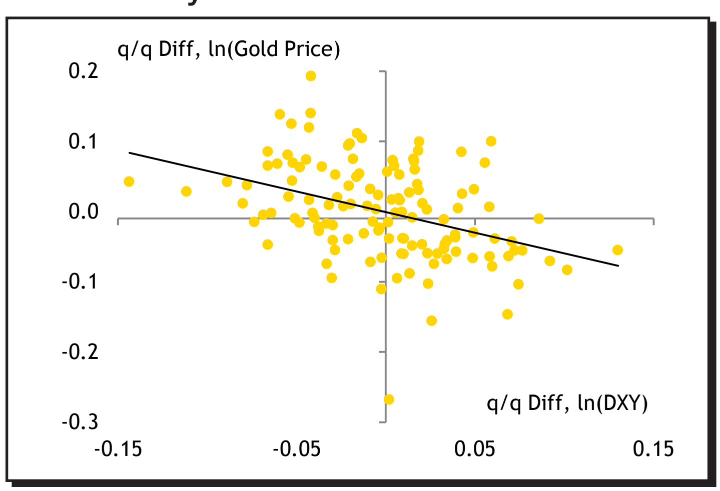
Safe Haven Asset Status of Gold Only Marginally Intact



Source: FRED, Bloomberg, CIBC

Chart 2

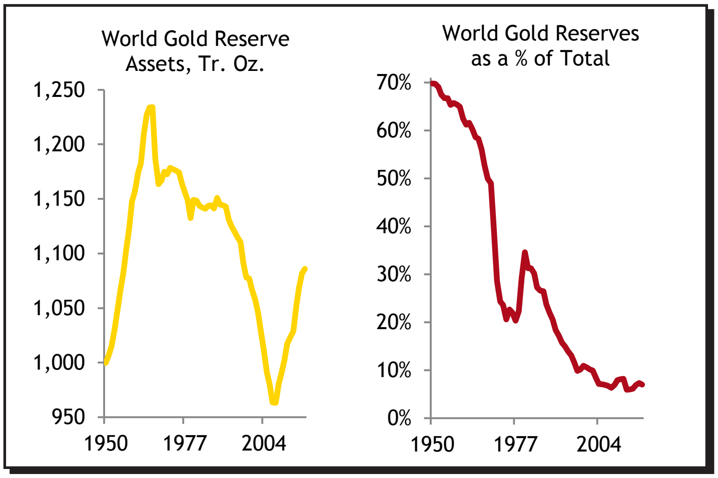
Dollar Loosely Drives Movements in Price of Gold



Source: Bloomberg, CIBC

Chart 3

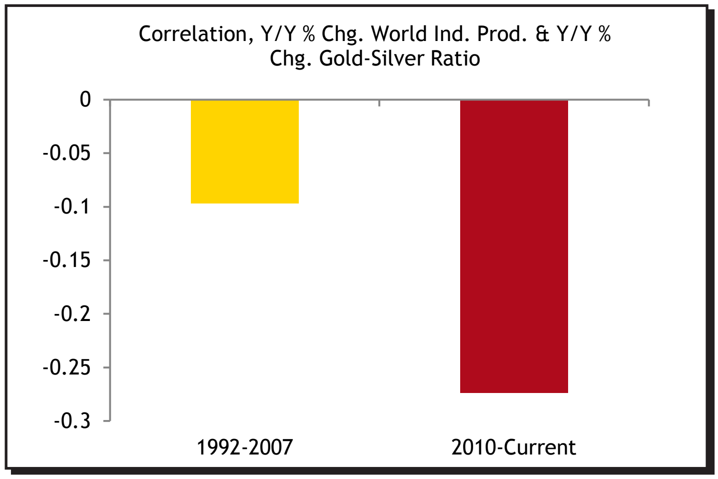
Gold Less Important in Reserves



Source: IMF, CIBC

Chart 4

Global Economic Activity Increasingly Driving Gold/Silver Ratio



Source: Bloomberg, CIBC

factor for the lack of lustre in gold. But as we get to the tail end of the Fed hiking cycle in 2019, and the start of rate hikes in the Eurozone (and late next year, Japan), we look for a weakening in the dollar against other majors, particularly given that it looks overvalued today based on trade and current account balances.

Given the historical elasticity to changes in DXY, our call for an 8% depreciation in the US dollar suggests a roughly 5% appreciation in gold by the end of 2019, or to about the low $1270/oz range (Chart 2). Not exactly a barnburner, but at least a dose of relief relative to the recent trend.

One limiting factor in that move is that central banks, who wield a fair bit of influence in global currency markets, aren't the gold buyers they used to be. After decades of decline, we've finally seen known gold reserves climb in recent years, but they still represent a much downsized fraction of total reserve holdings (Chart 3).

Silver Could Lag

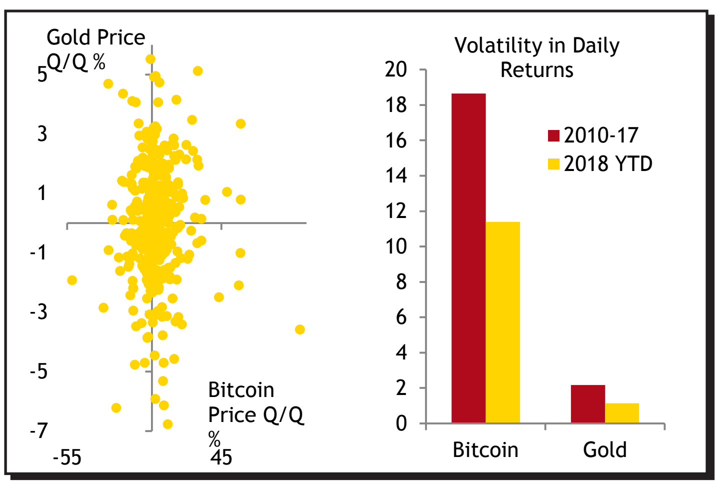
Given its industrial uses, silver tends to respond not only to the same forces affecting gold, but also to the growth rate in world industrial production. While statistically significant, the link between changes in gold/silver ratio and IP growth points to a firmer gold/silver ratio if, as we expect, world activity eases off next year as more central banks pull away from monetary stimulus (Chart 4).

Another interesting comparison is to those newfangled dollar alternatives: cryptocurrencies. Physical gold and bitcoin do have something in common: both are assets that can be exchanged without reporting to legal authorities. Both have a value that's largely psychological.

But there doesn't seem to be any correlation between the boom-bust track of cryptos and gold (Chart 5, left). Gold has a much longer history in use as a store of value or medium of exchange, and is a much more stable asset than bitcoins (Chart 5, right). That should be enough to allow it to avoid sharing the fate of cryptocurrencies if the latter continue to melt away.

Chart 5

Bitcoin is No Substitute for Gold



Source: Bloomberg, CIBC

The "Im" Factor: Immigration And The Economy

by Benjamin Tal and Andrew Grantham

During the second quarter of this year the Canadian population grew by a year- over-year rate of just under 1.4% or 500,000 — the strongest showing in more than 25 years (Chart 1, left). In fact, over the past five years the Canadian population grew faster than any other G7 country. Importantly, prime working age population growth outpaced that of the US by a wide margin (Chart 1, right). At 68%, the share of working age in the Canadian population is among the highest in the OECD.

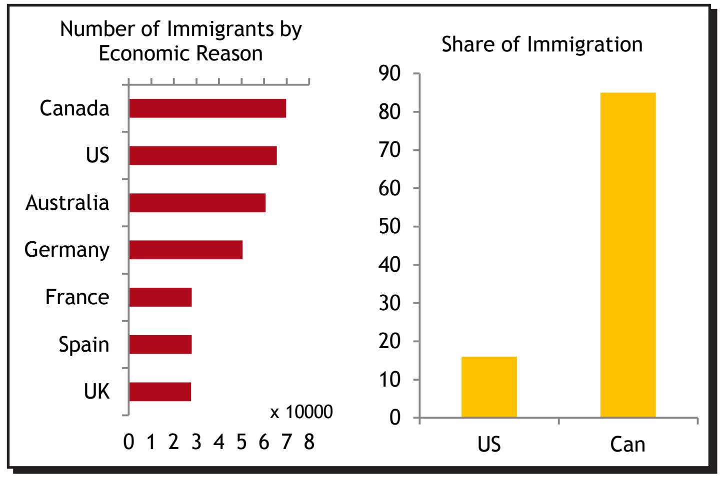
The "Im" Factor

That population boom clearly isn't the result of a new baby boom. In fact, the fertility rate in Canada has been below the replacement rate of 2.1 since the 1970s. Instead, the chief factor behind that impressive performance is international migration. The 20% share of foreign born in the Canadian population is the third highest in the OECD. What's more, in absolute and relative terms the number of those immigrants classified as economic immigrants is the highest in the OECD (Chart 2). And those numbers are going to be even higher, with the targeted number of new immigrants set at 310,000 for 2018, rising to 340,000 by 2020.

Comparable international population projections from the United Nations highlight just how important immigration has and will continue to be for working age population growth in Canada. Adjusting their base case forecast for recent trends, and then comparing with the zero immigration projection, shows a much wider gap in average annual growth rates for the prime working age population in Canada than other areas of the world (Chart 3).

Chart 2

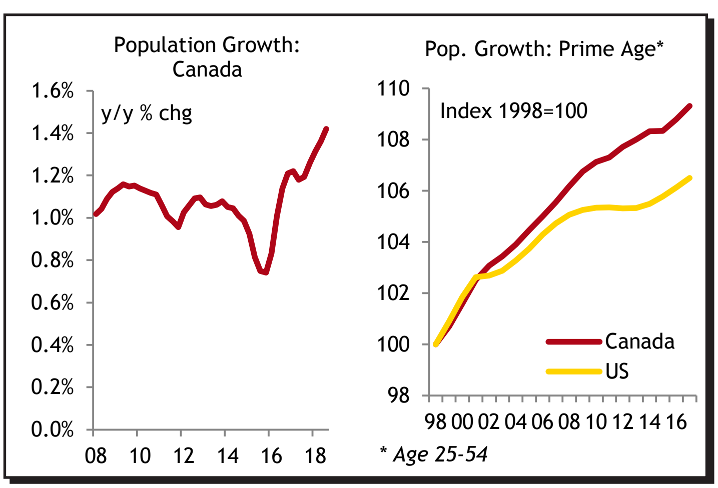
Canada Getting a Lot of Economic Immigrants



Source: OECD, CIBC

Chart 1

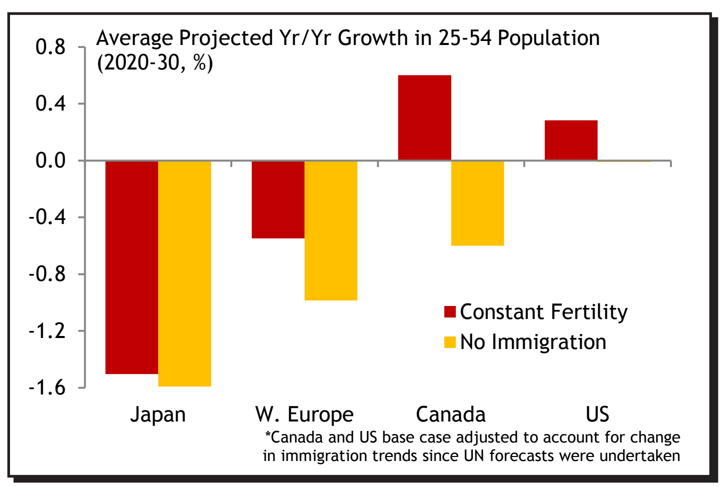
Population Growth UP (L), With Prime Working Age Leading US (R)



Source: Statistics Canada, Census, CIBC

Chart 3

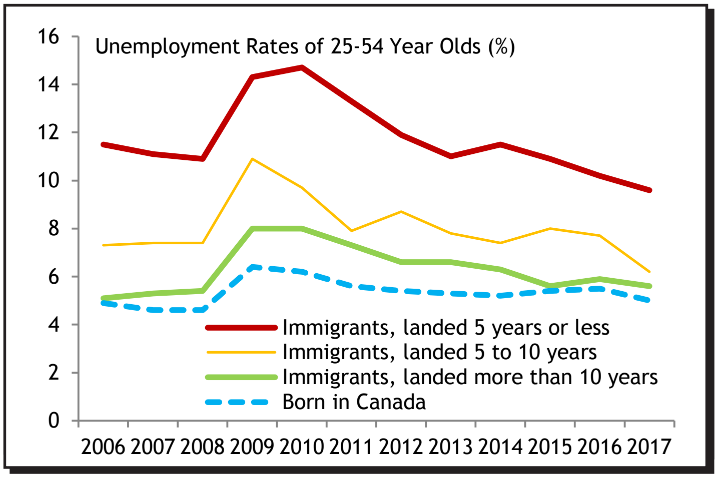
Immigration Important For Future Labour Force Growth



Source: United Nations, CIBC

Chart 4

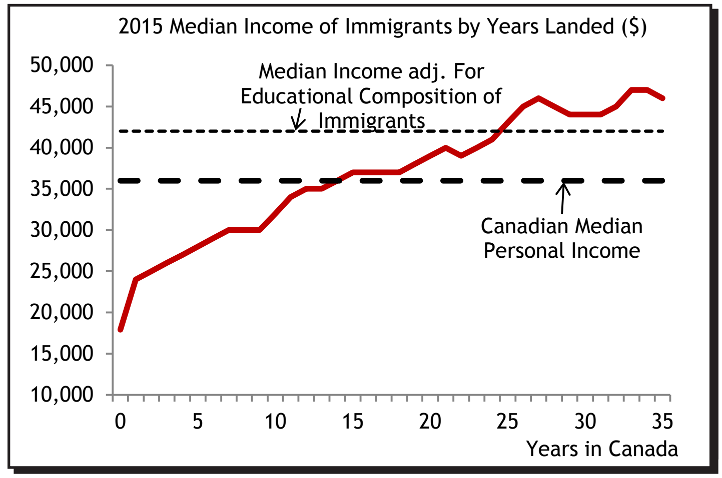
Newest Immigrants Still Seeing Higher Unemployment Rates



Source: Statistics Canada, CIBC

Chart 5

Immigrants Take a While to Reach Earnings Potential



Source: Statistics Canada, CIBC

Not That Easy

Of course, adding bodies to the population only adds to economic activity if those people can find work. From an international perspective Canada is doing well in this regard, with only a small gap between foreign born and domestic born unemployment rates. But it can still take some time for newcomers to assimilate into the workforce. While falling, the unemployment rate for immigrants landed 5 years or less is still well above the national average (Chart 4).

And then there's the question of productivity. Textbook economics suggests immigration should lift productivity. After all, new immigrants open up trade opportunities, they diversify the engines of economic growth, offer new and different perspectives on business, and inherently take risks in hope of greater gains — a key ingredient of innovation.

Yet the results have been quite different. A recent study by the OECD found immigration has no impact on overall productivity. In Canada, while immigration is clearly working to raise potential economic growth and national income, it might not contribute as much on a per capita basis given the chronic underemployment of immigrants in the country.

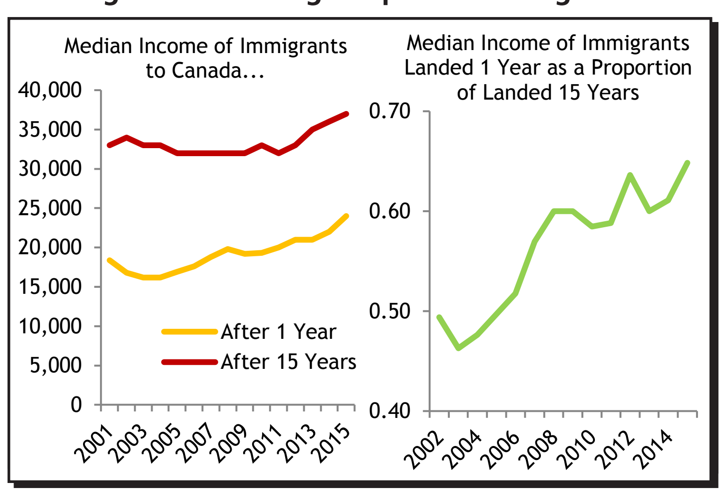
On the surface, the latest (2015) data on median incomes for immigrants and domestic born workers suggest that newcomers are faring very well. The median income for immigrants was $35,000, only $1,000 below the national figure. However, that aggregate figure is slightly misleading. Firstly, it often takes a number of years within the country, working lower paid jobs, for the average immigrant to reach that national average — around 15 years in fact (Chart 5).

And secondly, given the higher average educational status of the immigrant population, with around two-thirds having post-secondary education, their qualifications likely justify higher than median incomes. Indeed, adjusting the median income for that higher educational status, recent immigrants should be seeing earnings of around $42,000. That's something they only achieve on average after 25 years within the country (Chart 5 again).

The good news is that this earnings gap is narrowing, with inflation adjusted incomes of newly landed

Chart 6

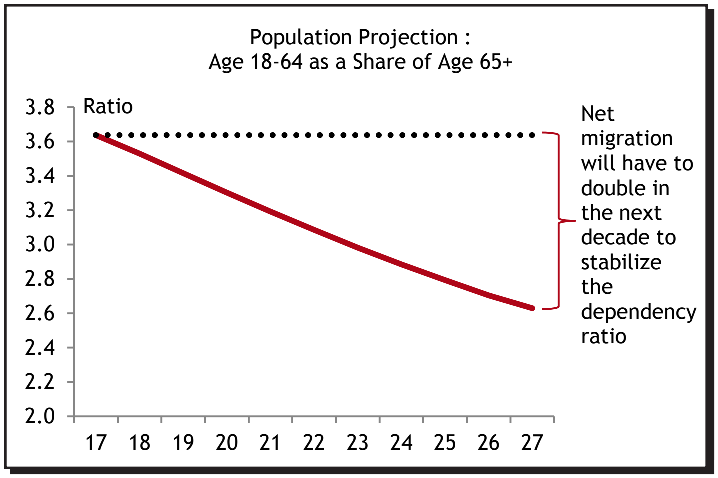
Although That Earnings Gap Isn't as Large as Before



Source: Statistics Canada, CIBC

Chart 7

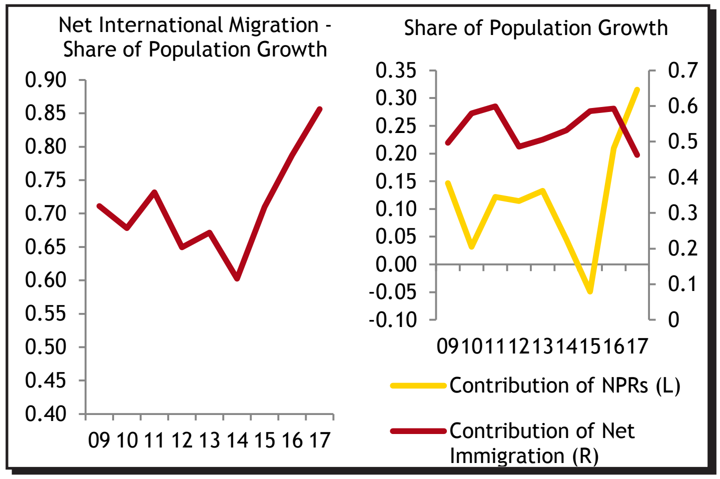
Immigration Can't Completely Solve Demographic Problems



Source: Statistics Canada, CIBC

Chart 8

Non-Permanent Residents Have Become Increasingly Important



Source: Statistics Canada, CIBC

immigrants trending higher both in dollar terms and as a percentage of later earnings (Chart 6). However, the disparity is not without a price. We estimate that the current employment and wage gaps between new immigrants and native-born Canadians costs the economy almost $20-billion in forgone earnings, or around 1.3% of aggregate household income.

Addressing productivity is becoming increasingly crucial for the Canadian economy. An aging population means that just to stabilize the ratio of working-age to non-working age population over the coming decade would require more than doubling the annual number of new arrivals for decades (Chart 7) — something not being contemplated.

The Non-Permanent Impact

Any discussion regarding the current demographic picture in Canada is not complete without a closer look at the growing role of Non-Permanent Residents (NPRs) in overall population growth. NPRs are foreign nationals who are lawfully in Canada on a temporary basis under the authority of a valid document for the purpose of entering Canada. As of 2016 there were close to 900,000 NPRs in Canada of which 40% are temporary workers, just under 60% students and a small number of refugees.

Over the past two years the number of NPRs in Canada rose by just over 230,000, accounting for a record high 26% of total population growth and almost one-third of total net international migration. In fact as illustrated in Chart 8, NPRs accounted for the entire acceleration in the number of net international migrants over the past two years.

NPRs tend to be young and thus provide a countervailing force to an aging population. For the age group 18-44 NPRs accounted for no less than 60% of population growth in 2017. That significant contribution has a notable impact on rental housing demand mainly in major cities. But the contribution goes beyond that as the growing role of NPRs in the Canadian economy might work to partly offset the immigration-related productivity issue we referred to earlier.

By definition temporary workers do not experience the same level of underemployment as they are assigned to a specific job consistent with their skill set upon arrival. Beyond that, an estimated 20%-30% of NPR workers and students become permanent residents. And given the Canadian experience they have accumulated at work and school their likelihood of finding suitable employment is probably higher than for a new immigrant.

Immigration has and will continue to be very important in providing the Canadian economy with the workers needed to grow. However, even with a highly educated immigrant population and with the flexibility that non-permanent residents provide, increasing potential growth isn't as simple as just adding new bodies. If newcomers to Canada continue to be underemployed versus their educational background, the boost to economic potential from this source of population growth will be somewhat dampened.

ECONOMIC UPDATE

CANADA	18Q2A	18Q3F	18Q4F	19Q1F	19Q2F	19Q3F	19Q4F	2018F	2019F	2020F
Real GDP Growth (AR)	2.9	2.2	2.0	1.6	1.8	1.4	1.7	2.1	1.8	1.3
Real Final Domestic Demand (AR)	2.1	2.0	2.0	1.7	1.7	1.3	1.2	2.6	1.7	1.4
Household Consumption (AR)	2.6	1.5	2.1	1.6	1.6	1.4	1.3	2.1	1.7	1.5
All Items CPI Inflation (Y/Y)	2.3	2.9	2.6	2.2	2.0	1.8	2.0	2.4	2.0	1.9
Unemployment Rate (%)	5.9	6.0	5.9	5.9	5.8	5.8	5.8	5.9	5.8	6.1

U.S.	18Q2A	18Q3F	18Q4F	19Q1F	19Q2F	19Q3F	19Q4F	2018F	2019F	2020F
Real GDP Growth (AR)	4.2	3.2	1.9	1.8	2.0	2.0	1.6	2.8	2.2	1.4
Real Final Sales (AR)	5.3	2.2	1.9	1.8	2.1	2.0	1.7	2.9	2.2	1.4
All Items CPI Inflation (Y/Y)	2.7	2.7	2.8	2.6	2.5	2.5	2.3	2.6	2.5	2.0
Core CPI Inflation (Y/Y)	2.2	2.3	2.5	2.4	2.5	2.5	2.3	2.3	2.4	2.2
Unemployment Rate (%)	3.9	3.9	3.8	3.7	3.6	3.6	3.8	3.9	3.7	4.3

CANADA

Given that we always expected a deal to materialize, the trade agreement with the US and Mexico doesn't change our outlook for the Canadian economy. The July GDP surprise was, however, enough to push our Q3 growth forecast above 2%, and raise 2018 tracking a tick to 2.1%. Still, we see growth cooling next year as households feel more of a pinch from higher rates, and business investment and exports struggle to gain significant traction.

UNITED STATES

A stronger-than-expected showing from American consumers boosted our Q3 growth forecast to 3.2%. Solid job growth and fiscal stimulus continue to propel healthy household spending. However, pockets of weakness in housing suggest that higher interest rates are starting to slow growth. The impact of hurricane Florence on national growth should be relatively muted given that the affected regions account for a small share of the economy.