

Anything *we* can do, *they* can do better?

By Warren Lovely & Taylor Schleich

It's sometimes said that Canadians possess an inferiority complex towards the U.S. And at the risk of sounding defeatist, a host of economic indicators point to significant Canadian economic underperformance. When it comes to the real economy, it seems anything we Canadians can do, Americans can do better.

Take real GDP for instance. We haven't fully closed the books on 2023, but it's obvious that Canadian output grew *much* slower than in the U.S. last year. The consensus view and our own forecast would see a relative GDP performance gap extending into 2024.

On productivity growth—the basis for one's standard of living—there's no need to put too fine a point on it. Canada's absolute record is bad and our relative productivity standing vs. the U.S. is atrocious.

On both sides of the border, employment conditions look to be softening, even if the well-used 'resilient' label may still apply. Using arguably the best gauge of labour market health—the share of working age population holding down a job or 'employment rate'—Canada is underperforming the United States. Consumers appear more cautious north of the border. Housing markets are likewise less robust in Canada, judging from growth in existing home prices.

Not for nothing, key financial variables reinforce the underperformance narrative. The loonie has shed ~1.6% so far this year. Meanwhile, Canada's benchmark equity index (the S&P TSX) has trailed well behind all major U.S. indices. In credit markets, Canada's relative spread performance may not be a major issue, but there's a much bigger hickey on YTD total returns for Canadian corporate credit vs. America (which is part of a rate story we're getting to).

[Lest Canadians despair *too* much, the country still boasts a healthy/sound banking sector. Collectively, Canadian governments aren't racking up nearly as much debt as in the U.S... not that bond

vigilantism is really in vogue at present. Vitality, from a national pride perspective, a Canadian—one Connor McDavid—handily won the NHL All-Star Skills Competition recently. So there's that.]

Back to our story... Normally, big-time economic underperformance would *at least* result in relative inflation relief. But you won't really find that in current Canada vs. U.S. inflation comps. At least not yet.

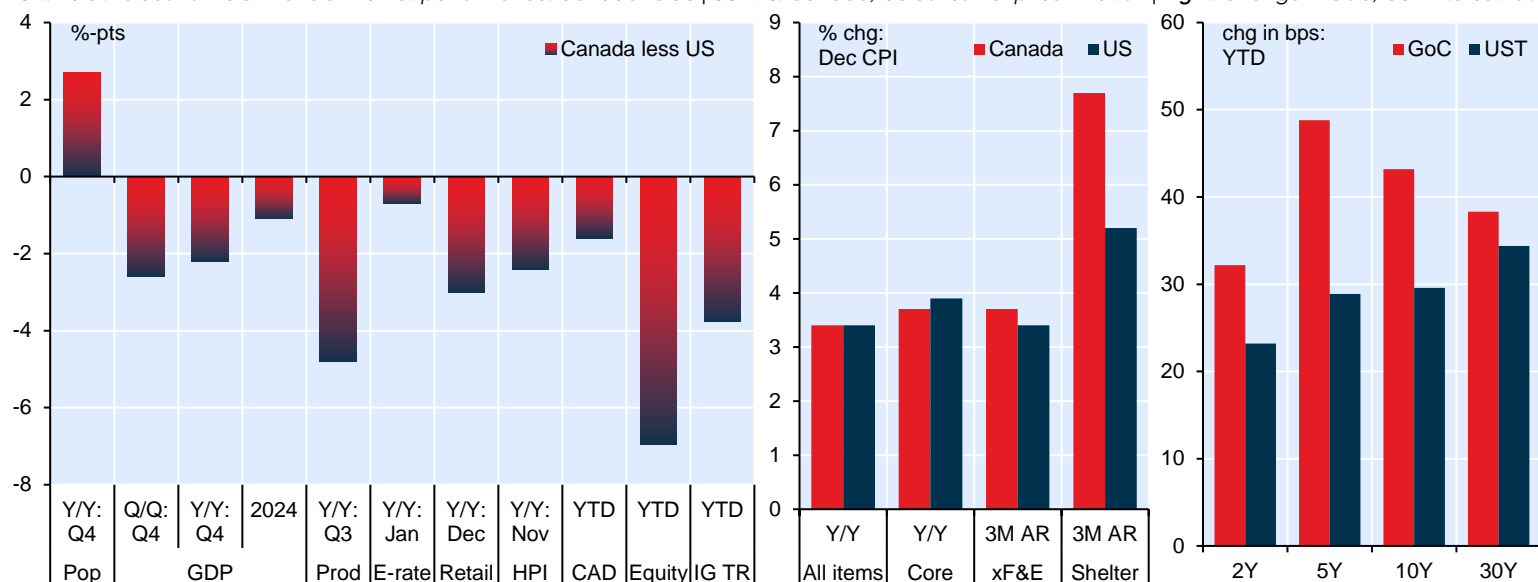
Fresh U.S. CPI data are due to arrive Tuesday. But as we write this, underlying inflation momentum is as at least as brisk/strong in Canada as in the U.S. Again, that's despite a northern economy that seems to be more clearly falling short of its potential.

The failure to secure marginal inflation relief links to one area where Canada is vastly outgrowing the U.S.: POPULATION! With so many new Canadians looking for a home, it's perhaps of little surprise that shelter cost inflation has so much momentum in Canada. A quick fix to Canada's shelter inflation problem is hard to see. If anything, the surge in Canada's working age population reported in Friday's LFS report hints at upside to 2024 population growth (vs. prior thinking).

So in the greatest and most painful of ironies, Canada gets the stick (i.e., relatively slower growth) without the carrot (i.e., relatively tamer inflation). With the Bank of Canada reluctant to look through shelter inflation, it suggests a delay in interest rate relief. Specifically, we're pushing back our first projected BoC rate cut from April to June, as our upcoming issue of *Fixed Income Monitor* will detail. Notwithstanding this delay in the expected policy rate pivot, our baseline macro forecast (including noted GDP weakness and serious non-shelter inflation relief) still makes a case for rate cuts. But we must acknowledge that now, more than in recent memory, Canada's interest rate trajectory hinges on the country's demographic impulse. Simply put, more heads could mean fewer (and slower) cuts.

Charts 1-3: Canada's economy underperforms but inflation fails to cooperate, leading to a re-think on relative rates

Left: Relative economic & financial market performance: Canada vs US | **Centre:** Canada/US consumer price inflation | **Right:** Change in GoC/UST interest rates



Sources: NBF, Bloomberg, StatCan, BLS | Note (left chart): All figures represent the difference between Canada & U.S.; pop=population growth; GDP=real GDP growth, using NBF estimate for Q4 & Bloomberg consensus for 2024; prod=labour productivity growth; E-rate=change in employment rate for latest 3 months; retail=retail sales growth, using StatCan advance estimate for Dec; HPI=existing home price index, using Teranet-National Bank & Case-Shiller; CAD=change in Canadian dollar vs. U.S. dollar; Equity=change in S&P TSX vs. S&P 500; IG TR=change in Canada/U.S. aggregate corporate bond index total returns (unhedged); YTD figures for CAD/Equity/IG are as at 9-Feb-24 | Note (centre chart): Based on Dec-23 CPI data; Cda core CPI is average of trim & median; xF&E & shelter based on SA data | Note (right chart): YTD change in benchmark bond yields as at 9-Feb-24

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