The Bigger Picture

A weekly snapshot of the markets

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"Perfect storm" driving loonie lower as it trades at 5½-year low

Difference in Canadian and U.S. jobs data highlights diverging economic outlook

Elvis Picardo, CFA

The Canadian dollar is being hit by the perfect storm of negative factors that could drive it even lower from current levels. The difference in the December jobs number on both sides of the border highlights the divergence in the economic outlooks for Canada and the U.S. over the year ahead.

It should be noted that the Canadian jobs numbers were not unequivocally bearish (for example, the job lost last month were due to declines in part-time positions, as full-time positions increased by more than 50,000), and the U.S. data was not totally bullish (average hourly wages fell 0.2%, the most since at least 2006). However, <u>investors are not looking much past the headline numbers as the perception grows that the Canadian economy may feel the impact of the "crude (oil price) crash" before long</u>.

Canada lost 4,300 jobs last month, after losing 10,700 jobs in November. Those job losses may be a natural corollary to unexpected job strength in previous months, as the economy added 43,100 jobs in October and 74,100 positions in September. Overall, the Canadian economy added 185,700 jobs in 2014, with most of the job additions coming in the second half of the year. The unemployment rate was unchanged at 6.6%.

For the second month, a loss of part-time positions offset gains in full-time positions. The economy lost 57,700 part-time jobs in December, predominantly service jobs in areas such as accommodation & food services (-32.8k), misc. services (-13.5k) and professional services (-13.2k). The goods-producing sector added 22,100 positions, as gains in agriculture and construction offset a decline in manufacturing jobs (-18.3k). The lower loonie is expected to boost manufacturing, but that may yet take some time.

<u>Three positive takeaways from a year of exceptionally volatile jobs data are:</u>

- The overall quality of job creation was high in 2014, with an increase of 190,300 full-time positions offsetting a decline of 4,500 part-time jobs.
- The net 185,700 jobs created in 2014 comprised 131,100 employee positions (three-quarters of which were private-sector jobs) and 54,600 self-employed.

- Average hourly wages of permanent employees rose 2.2% in December from a year earlier, compared with a 1.6% pace in November.

In Alberta, the province most exposed to oil price swings, the economy added 5,700 jobs (+8.4k full-time, -2.8k part-time), while the jobless rate rose to 4.7% (from 4.5% in November) as the labour force increased by 12,100. Overall, Alberta added close to 66,000 jobs in 2014 (of which about 50k were full-time positions), second only to the nearly 80,000 jobs created by Ontario. The sweeping cuts being made to capital expenditures by many energy heavyweights and the number of projects that will be put on hold if crude oil prices remain depressed, implies that the employment outlook for Alberta in 2015 is likely to have deteriorated considerably in comparison to 2014.

In the U.S., the economy added 252,000 jobs in December, following an upward revision to 353,000 in November. Last month's job gains made 2014 the best year for the U.S. labour market since 1999, as job growth averaged 246,000 per month (compared with an average monthly gain of 194,000 in 2013) and nearly 3 million Americans found employment over the year. The unemployment rate fell to 5.6% (from 5.8% in November), the lowest since June 2008, and down 1.1 percentage point from the year-ago jobless rate of 6.7%.

For most of 2014, U.S. job creation has been driven by the private services sector, and December was no exception to this trend. The private sector accounted for 240,000 jobs created last month (or 95% of the total), of which service providers contributed 173,000 jobs, led by strong growth in professional & business services, education & health services, and leisure & hospitality. Goods producers contributed 67,000 jobs, thanks to unusual strength in construction (+48k).

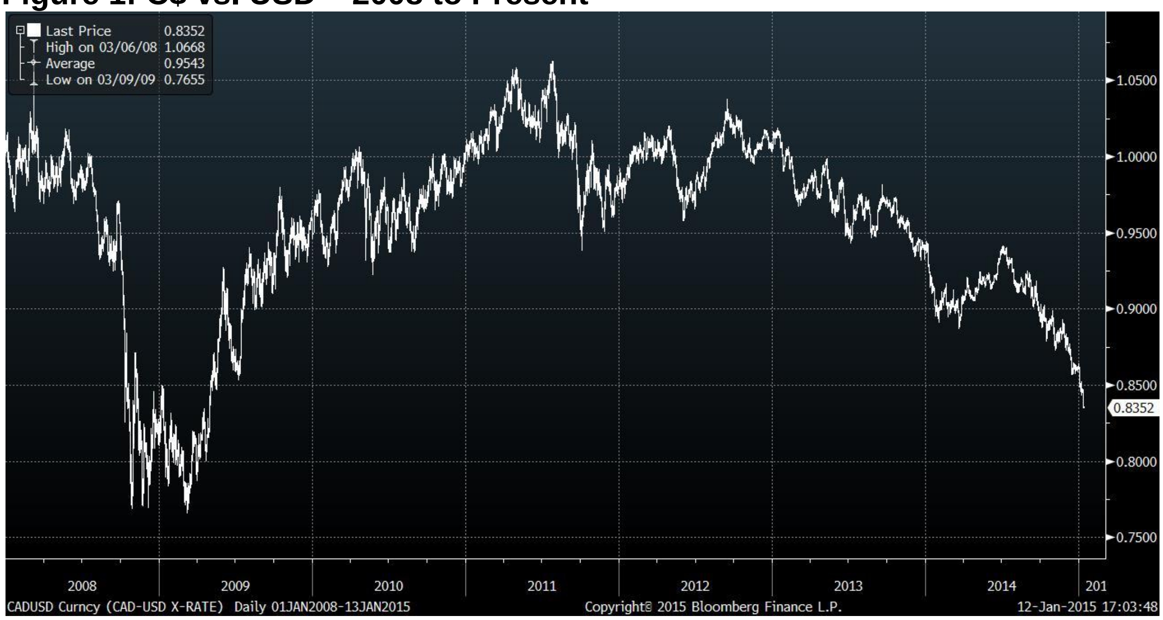
Economists seized upon the 0.2% decline in average hourly wages for all employees (from $24.62 in November to $24.57 in December) as further proof that wage gains continue to lag behind the pace of employment growth. But that moderation in wage growth means that the Federal Reserve can bide its time in terms of raising the federal funds rate. In any case, despite tepid wage growth, U.S. consumer spending will be boosted by gasoline prices that – at the current price of $2.17 per gallon – are already the lowest since May 2009.

Bottom-Line: The Canadian jobs numbers have added to downward pressure on the loonie at a time when the ramifications of collapsing crude oil prices on the Canadian economy are just beginning to be felt. For instance, Canada's oil shipments plunged almost 10% in November, triggering the biggest export decline in almost three years.

There is growing doubt about the ability of the Canadian economy to grow at close at 2.5% in 2015, which was the Bank of Canada's estimate in October. Incoming data and anecdotal evidence signal further deterioration in the Canadian economy may be on the cards – Canadian housing starts are at a 10-month low, the Calgary housing market is showing the first signs of a slowdown in Alberta, and car financier Carfinco said on Friday that it has seen an increase in delinquencies and losses on its finance receivables portfolio.

A number of economists now believe that the Bank of Canada may be unlikely to raise interest rates until 2016, while a few economists are beginning to voice the view that the Bank may actually cut interest rates this year. As for the Federal Reserve, while it may be in no rush to raise the federal funds rate, a rate hike is widely anticipated in the first half of 2015. This divergence in the economic outlook and monetary policy may contribute to a lower loonie over the course of this year. Currency strategists at a number of Canadian banks have already slashed their downside targets for the C$ to well below 83.33 cents (C$1.20 per USD). Like the price of crude oil, the loonie's decline has occurred faster than most people expected. The combination of a weaker domestic currency and an accelerating U.S. economy means that U.S. stocks may still have upside for Canadian investors in 2015.

Figure 1: C$ vs. USD – 2008 to Present



Market Snapshot

At close today

S&P TSX	14265.01	-119.91	Commodities			Yields (%)	Can.	US
TSX Venture	679.99	-7.22	Canadian $ (US cents)	83.52	-0.76	90 Day T-Bill	0.92	0.01
DJIA	17640.84	-96.53	Gold (Spot)-US$	1233.26	+10.74	2-Year Bond	0.92	0.54
S&P 500	2028.26	-16.55	Oil (WTI-Feb.)	45.75	-0.32	10-Yr.Bond	1.60	1.90
NASDAQ	4664.71	-39.36	CRB Index	220.83	-4.74	30-Yr. Bond	2.17	2.49

Thought for the Day

"Climate is what we expect, weather is what we get."— Mark Twain

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