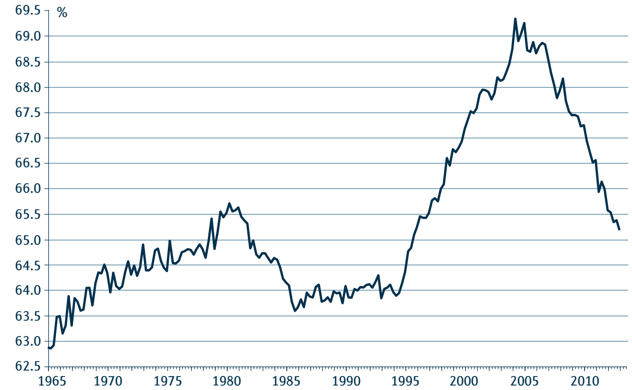
United States

U.S. indicators confirm a loss of economic momentum in Q2 (we see quarterly GDP growth of about 1% annualized). Retail sales beat expectations in April, but their quarterly growth is likely to come in at less than half the 4.3% annual pace of Q1. This sluggishness, coupled with lagging overseas demand and a hit from the federal government sequester, is taking a toll on manufacturing. U.S. factory output fell in April for a second straight month.

Fortunately, manufacturing weakness is offset by resilience in the U.S. labour market. The May employment report was encouraging for the economic outlook. Payrolls added more than 175,000 jobs during the month, the best gain in four months. Full-time employment was up 185,000, the largest monthly rise so far in 2013. This development is crucial for continued household formation, a reversal in homeownership rate and home-price appreciation. The demographics of job creation certainly argue for such an outcome – employment for people aged 25 and over is now almost back to the pre-recession peak. Impressively, more than half of the jobs added in May were for people aged 25-34, setting the stage for more consumer-driven spending growth in the second half of this year.

Rebound in homeownership rate depends on jobs for younger people

Homeownership rate – United States



NBFM Economy and Strategy Group (data from U.S. Census)

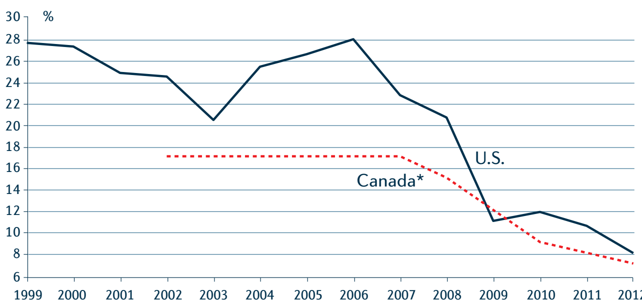
Canada

Canadian GDP grew at 2.5% annualized in the first quarter of 2013, accelerating from the fourth quarter's upwardly revised pace of 0.9%. In Q1, the economy got boosts from trade, domestic demand and inventories. Domestic demand is likely to be soft in the coming months as a result of continued drag from the housing market, moderation of government spending growth (as provincial and federal budgets tighten) and continuing weakness in consumption as Canadians wrestle down their high household debt. So while first-quarter growth came in a full percentage point above the Bank of Canada's estimate, that doesn't mean the central bank is about to turn hawkish, especially with 12-month inflation well below the Bank's 2% target (0.4% in April, the lowest since 2009).

Residential investment has been on the decline in recent months and 12-month home-price inflation is now the lowest since 2009. A softening of housing demand was largely expected and even intended by the federal government when it tightened mortgage rules last year. That said, the housing market still has support in the form of low interest rates, which are unlikely to ramp up quickly given tepid inflation and the very low likelihood of a spike in defaults, since mortgage underwriting standards are much more conservative in Canada than in the United States. Additional support for the housing market comes from the relatively low leverage of Canadian homeowners, 83% of whom have more than 25% equity in their homes. In our view, a soft landing of the Canadian housing market is far more likely than, say, a U.S.-style collapse.

Canada: Housing has some support

Share of first-time homebuyers with low credit scores (FICO < 620 and Beacon < 660)



**CMHC did not produce data prior to 2002*

Net equity of homeowning households in 2013 (equity as % of home value)

Negative	1%
0-4.99%	1%
5-9.99%	2%
10-14.99%	3%
15-24.99%	9%
25-49.99%	21%
50-74.99%	17%
75-99.99%	13%
100%	32%
Number of households	9.7 million
Mean equity ratio	67%

83% of Canadian households have more than 25% equity in their homes!

NBF Economy and Strategy Group (data via CAAMP, CMHC and Fed: "A View from the Federal Reserve Board: The Mortgage Market and Housing Conditions", May 9, 2013)