3 Reasons the Canadian Economy Could Decline in 2018

Description

The Canadian economy is currently running strong, and you only need to look as far as the TSX's record numbers to see proof of this. Although initially, it was off to a slow start, the market was able to recover in the latter half of the year and has now grown 6% since the start of 2017.

In 2018, we may see the market go in a very different direction. There are many factors that could weigh down the economy next year, and the TSX might not be able to stay out of the red for much longer. Below are three reasons I expect the TSX to underperform in 2018.

Strong U.S. economy fueled by corporate-friendly tax cuts

U.S. president Donald Trump finally got a big piece of legislation done before his first year in office, and that will mean big things for companies that are based south of the border. A big drop in the corporate tax rate will mean more profit and more cash that is kept by U.S. corporations.

From an investor's point of view, this means that an already strong U.S. economy will only see corporations rake in even more profit.

Typically, companies are evaluated by EBITDA and all sorts of adjusted earnings calculations, but cash is what matters in the end. More cash means that a company will need less debt, and that's important for companies that are looking to expand their businesses.

This impacts Canada because it makes the U.S. exchanges far more attractive for an investor and will likely result in fewer dollars being invested in Canadian companies.

Higher interest rates

We saw two rate hikes in 2017, and more could be on the way in 2018. With housing prices continuing to rise, and household debt also at record levels, we could be seeing a perfect storm come together.

Not only will rising rates impact consumers, but companies that rely on debt, like **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX), will find it more expensive to take out additional loans. Although Valeant recently cut a big chunk of its debt off, the company is still highly leveraged.

High interest rates could also slow down the expansion plans of **Dollarama Inc.** (TSX:DOL) and **Restaurant Brands International Inc.** (TSX:QSR)(NYSE:QSR), two companies that could run into liquidity issues.

Rising minimum wages

On January 1, 2018, the minimum wage in Ontario will rise to $14/hr and will become $15/hr the following year. From the current rate of $11.60/hr, this will increase wages by more than 20%. Ontario also isn't the only province that plans to raise its minimum wage in 2018, as Alberta will hike its minimum to $15 by October.

This all sounds well and good for employees, but the problem is that it could lead to a real decline in jobs, as companies will look for ways to counter these rising costs, and reducing staff might be the easiest option.

In extreme cases, we may even see some companies close up shop. A 20% increase in cost is not something that will be easy to absorb, especially for Canada's struggling retail sector.

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