Economic Commentary

Second Quarter 2017

President Trump

Donald Trump's election victory has created a great deal of economic uncertainty around the world. Allegations that Trump divulged secrets to the Russians as well as interfered with the subsequent FBI investigation have cast doubt on the credibility of his presidency. There have also been delays in Trump's implementation of his campaign promises. He has yet to table a health care reform bill that will receive senate approval and his reform of the tax code keeps getting pushed back, with the possibility that it may not occur until next year. All of these issues create uncertainty in global financial markets.

Fed Continues to Raises Rates

As expected, the U.S. Federal Reserve increased interest rates by 25 b.p. at its meeting in June, the second increase so far in 2017. However, market expectations for the next hike have been pushed out, possibly until early 2018. Lower-than-expected inflation could be the main contributor keeping the Fed on the sidelines through the balance of this year. Core inflation has fallen below 2%, sitting at 1.7% in May. Although job growth has been steady, average wage growth remains subdued, further illustrating the lack of inflationary pressures.

BOC Changes Direction

While the U.S. Federal Reserve was the first major central bank to increase interest rates, we have started to see a shift in policy from other central banks around the world. The accommodative policies that markets have become accustomed to are nearing their end as reflationary forces are beginning to surface. In particular, Canada has seen strong economic growth and employment, leading the Bank of Canada to alter its interest rate outlook. Earlier this year the BOC was still talking about the possibility of cutting rates. However, they have now stated that previous rate cuts have "done their job" and that they "will be assessing whether the entire considerable monetary stimulus presently in place is still required." The market is now expecting the Bank of Canada to hike rates at its meeting in July.

The Canadian dollar has rallied dramatically on this change in sentiment by the Bank of Canada as the market was not contemplating any movement in the bank rate for the balance of the year. The strong performance of the loonie is somewhat surprising given the depressed oil market which dipped below $43 during the quarter.

Draghi Shifts to Reflationary Tone

The eurozone economy has grown steadily over the past four years while the employment rate continues to decline. After peaking at 12.1% in June 2013, the rate now sits at 9.3%. Draghi stated that the risk of deflation has diminished and that inflationary pressures are beginning to build. The ECB also indicated that interest rates would probably not be cut further and hinted at a possible winding down of the eurozone's quantitative easing program. The euro rose dramatically following these comments and sovereign bond yields moved higher.

Key Metrics

Indicator	Value	Chg Q2	Chg 1Y
S&P/TSX Composite	15,182.19	-1.6%	11.0%
S&P 500 (USD)	2,423.41	3.1%	17.9%
MSCI EAFE (USD)	1,883.19	6.3%	20.9%
FTSE TMX Universe Bond Index	1,035.3	1.1%	0.0%
USD/CAD	$0.77	2.7%	-0.3%
WTI Crude ($/bl))	$46.04	-10.9%	-12.2%
GoC 10Y Bond	1.76%	13.7 bps	70.1 bps
GoC Deposit Rate	0.50%	0	0
Cdn CPI YoY	1.3%	-0.3%	-0.2%
US 10Y Treasury	2.31%	-8.3	83.4
Fed Funds Rate	1.25%	0.25%	0.75%
USD CPI YoY	1.9%	-0.5%	0.9%

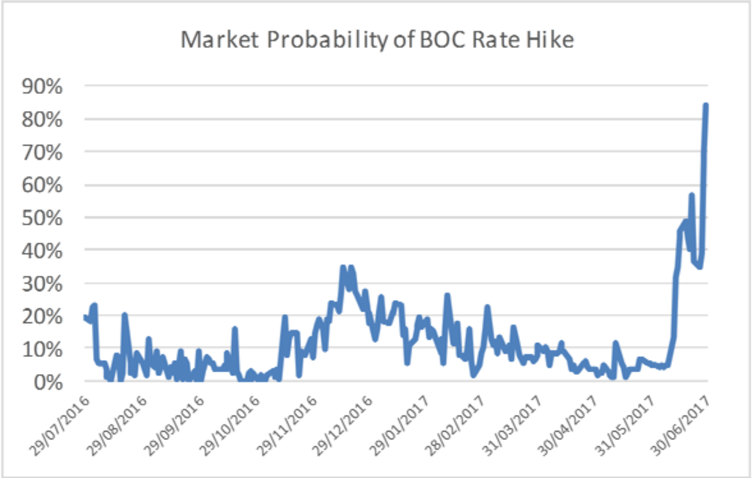
Top Themes

Trump's presidency continue to fuel uncertainty

U.S. Fed stays on course with rate hikes

BOC and ECB starting to sing a more hawkish tune

Top Chart: Possibility of BOC Rate Hikes Surges to the Forefront



Source: Bloomberg, Lincluden