Economic Commentary

Second Quarter 2018

Trade Tariffs Roil Markets

The global trade tariffs implemented by President Trump are quickly turning into the potential for an all-out trade war. Although China has been the main target, tariffs have been levied on Canada along with other major trading partners in Europe. As expected, many of these countries have retaliated by implementing their own tariffs against the U.S. A further escalation could result in a global trade war which would be very damaging to the global economy, including the economy of the United States.

Trump has announced $34 billion of tariffs on Chinese imports along with increased tariffs on steel and aluminum for several countries. Initial estimates of the negative impact that a trade war could have on world trade are in the range of 4%. The impact would be magnified by the fact that global central banks are beginning to withdraw stimulus from the economy by either reducing quantitative easing measures or by increasing interest rates. Increased risk aversion, along with a slowdown in economic growth, could be very damaging to financial markets.

US Economy Continuous to Gain Strength

Corporate tax cuts and the fiscal stimulus package have added a strong boost to economic growth prospects in the U.S. Despite the fact that first quarter GDP came in at a revised 2.0% annual rate, expectations are that growth picked up significantly during the second quarter. Consumer spending has been robust as lower taxes and gradually increasing wages have put consumers in a much better financial position. A strong labour market has also helped propel growth as the unemployment rate dropped to 3.8% in May, the lowest level in fifty years.

Inflation indicators have picked up recently but are not yet at the worrisome stage. Although headline inflation accelerated to the fastest pace in six years, core CPI is at 2.2%, just over the Federal Reserve's target of 2.0%. The Fed did raise interest rates at its meeting in June, the second increase this year. Expectations are for three rate hikes in total during 2018, however, stronger inflation could increase the potential for a fourth hike before year-end. However, uncertainty resulting from the on-going trade wars could keep the Fed on target for the three hikes that they forecast to begin the year.

Canadian Export Sector Vulnerable

The Bank of Canada kept the overnight rate unchanged during the second quarter. At the June Bank of Canada meeting Governor Poloz adopted a more hawkish stance with regard to future rate hikes. Poloz, however, subsequently back-pedaled at a later speech, providing a dovish tone. He outlined the potential negative impact that trade tariffs could have on the Canadian economy, particularly the export sector. Prospects for any future rate hikes will be very much data dependent along with the potential impact of any escalation in trade talks. The Canadian dollar has suffered during this process and declined further during the quarter.

Key Metrics

Indicator	Value	Chg Q2	Chg 1Y
S&P/TSX Composite	16,277.73	6.8%	10.4%
S&P 500 (USD)	2,718.37	3.4%	14.4%
MSCI EAFE (USD)	1,958.64	-1.1%	7.4%
FTSE TMX Universe Bond Index	1,043.18	0.5%	0.8%
USD/CAD	0.76	-1.9%	-1.3%
WTI Crude ($/bl))	$74.15	15.8%	53.5%
GoC 10Y Bond	2.17%	7.7 bps	40.6 bps
GoC Deposit Rate	1.25%	0 bps	75 bps
Cdn CPI YoY	2.2%	-0.1%	1.2%
US 10Y Treasury	2.86%	12.1 bps	55.6 bps
Fed Funds Rate	2.00%	25 bps	75 bps
USD CPI YoY	2.8%	0.4%	1.2%

Top Themes

Global trade tariffs initiated by President Trump roils financial markets

U.S. economy strengthens as unemployment rate continues its decline

Canadian export sector vulnerable to negative impact from U.S tariffs

Top Chart: U.S. Unemployment Rate

Source: Bloomberg, Lincluden