Economic Commentary

Third Quarter 2018

Trade Tensions Escalating

The global trade war initiated by President Trump is beginning to spiral out of control. It is beginning to have a dramatic impact on world trade. Global exports are declining as the U.S. and China, the world's two largest economies, are embroiled in an escalating trade war as each country retaliates by levying additional tariffs on selected goods. China has reported a current account deficit for the first time in twenty years as it faces a slowdown in its export sector.

China's economy has experienced significant downward pressure. China has begun to cut production as factory orders have declined dramatically. Trump recently announced a further $200 billion of tariffs on Chinese goods and has threatened to impose tariffs on virtually all of the goods that China exports to the United States. Policymakers in China have begun to help cushion the blow by implementing measures to boost growth.

USMCA Replaces NAFTA

Canada and the United States finally agreed on a long-awaited new trade agreement to replace the former NAFTA. The U.S. and Mexico had previously entered into a bilateral agreement without involvement from Canada. Pressure was building to come to terms on a new deal based on deadlines imposed by the U.S. The new trilateral deal will be known as the United States-Mexico-Canada Agreement (USMCA). Major outcomes include the fact that the U.S. will gain greater access to Canada's dairy market while Canada is able to retain the key Chapter 19 dispute resolution.

One major benefit of the new agreement is that it removes a high degree of uncertainty going forward with respect to what could have happened to the Canadian economy had the deal not been consummated. Canada was going to be subject to onerous tariffs in the auto sector which would have had a dramatic negative impact on the Canadian economy. The Canadian dollar rebounded nicely on the back of the news, however, it still remains at relatively low levels compared to the U.S. dollar.

Canadian Export Sector Vulnerable

The U.S. Federal Reserve raised interest rates by 25 b.p. at its meeting in September, continuing its policy of gradual interest rate hikes. This was the third increase this year. The U.S. economy continues to strengthen despite global trade uncertainty. US gross domestic product grew at an annual pace of 4.2% in the second quarter, and the unemployment rate continues to hover below 4%, near historic lows. Inflation, which had been increasing steadily throughout the year, unexpectedly cooled in August, with the core reading dropping from 2.4% to 2.2%.

The Bank of Canada raised its benchmark interest rate by 25 b.p. in July, its second increase this year and fourth in the past twelve months. Despite on-going trade concerns, the central bank expects that the recently implemented tariffs on steel and aluminum will only have a modest impact on economic growth and inflation. Higher oil prices will help offset the negative impact of trade policies on the Canadian economy.

Key Metrics

Indicator	Value	Chg Q3	Chg 1Y
S&P/TSX Composite	16,073.14	-0.6%	5.9%
S&P 500 (USD)	2,913.98	7.7%	17.9%
MSCI EAFE (USD)	1,973.6	1.4%	3.3%
USD/CAD	$0.77	1.7%	-3.4%
WTI Crude ($/bl))	$73.25	-1.2%	41.8%
GoC 10Y Bond	2.43%	25.9 bps	32.8 bps
GoC Deposit Rate	1.50%	25 bps	50 bps
Cdn CPI YoY	2.8%	0.3%	1.2%
US 10Y Treasury	3.06%	20.1 bps	72.8 bps
Fed Funds Rate	2.25%	25 bps	100 bps
USD CPI YoY	2.7%	-0.2%	0.5%

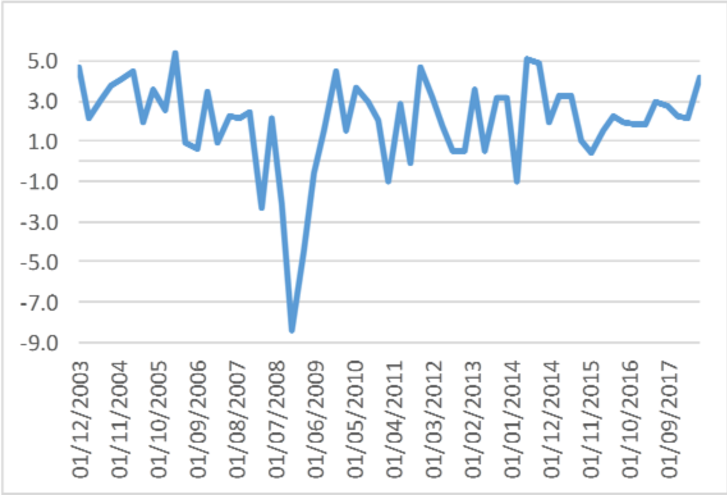
Top Themes

Escalating trade tensions pose risk to global economic outlook

Canada and the U.S. agree on revised USMCA trade deal

U.S. Fed and Bank of Canada continue with gradual rate hikes

Top Chart: U.S. Quarterly GDP Annualized



Source: Bloomberg, Lincluden