Economic Commentary

Fourth Quarter 2018

Geopolitical Risk with China Escalating

Trade tensions, particularly between the United States and China, continue to dominate world headlines. Significant tariffs remain in place between the two countries while they attempt to negotiate an agreement on a trade deal. Dealings became even more tenuous when a top executive of Chinese tech giant Huawei Technologies was arrested in Canada at the request of the United States as they sought her extradition to the U.S.

Trump is now contemplating issuing a national emergency executive order that would stop American companies from buying equipment made abroad by foreign telecommunications companies. Although it is being communicated as a threat to national security, it appears to be directly related towards Huawei Technologies and ZTE Corp., two of China's biggest network equipment companies. This will make trade discussions even more contentious than they already are.

Central Banks to Slow Pace of Rate Hikes

The U.S. Federal Reserve raised interest rates by 25 b.p. at its meeting in December, the fourth increase in 2018. The move was expected by financial markets, however, comments made by Fed Chair Jerome Powell following the announcement indicated that the Fed could temper its pace of rate hikes in 2019. Higher interest rates have begun to hit the U.S. housing market as sales have declined more than expected.

In Canada, the Bank of Canada raised its overnight rate by 25 b.p. at its October meeting, the third increase this year. Expectations for further interest rate hikes in 2019 have also been pulled back sharply from previous estimates. The BOC adopted a more cautious tone at its December meeting, stating concerns about the impact on-going trade war between the U.S. and China, and the collapse in oil prices in Alberta will have on economic growth going forward.

Alberta Premier Rachel Notley ordered oil producers to cut production by 8.7%, or 350,000 barrels a day, beginning in January. The price of Alberta oil has been trading at a significant discount to that of international producers for some time now due to the lack of additional pipeline capacity in Canada. Efforts are being made to increase the transportation of oil through the purchase of additional rail cars. Although the discount for Western Canadian Select tightened dramatically following the announcement of the production cuts, global oil prices deteriorated sharply during the fourth quarter.

Equity Markets Enter Correction Stage

Global stock markets experienced significant declines during the fourth quarter, reversing any gains achieved in the prior nine months. Reasons behind the dramatic declines include global trade tensions, geopolitical risk, the impact of higher interest rates and the potential for a slowdown in the global economy. As stock markets deteriorated there was a corresponding flight-to-quality with yields on government bonds dropping precipitously, with interest rates ending the year near their lows.

Key Metrics

Indicator	Value	Chg Q3	Chg 1Y
S&P/TSX Composite	14,322.86	-10.1%	-8.9%
S&P 500 (USD)	2,506.85	-13.5%	-4.4%
MSCI EAFE (USD)	1,719.88	-12.5%	-13.3%
USD/CAD	$ 0.73	-5.3%	-7.8%
WTI Crude ($/bl))	$ 45.41	-38.0%	-24.8%
GoC 10Y Bond	1.97%	-46 bps	-7.8 bps
GoC Deposit Rate	1.75%	25 bps	75 bps
Cdn CPI YoY	1.7%	-0.5%	-0.2%
US 10Y Treasury	2.69%	-37.7	27.9
Fed Funds Rate	2.50%	25 bps	100 bps
USD CPI YoY	2.2%	-0.1%	0.1%

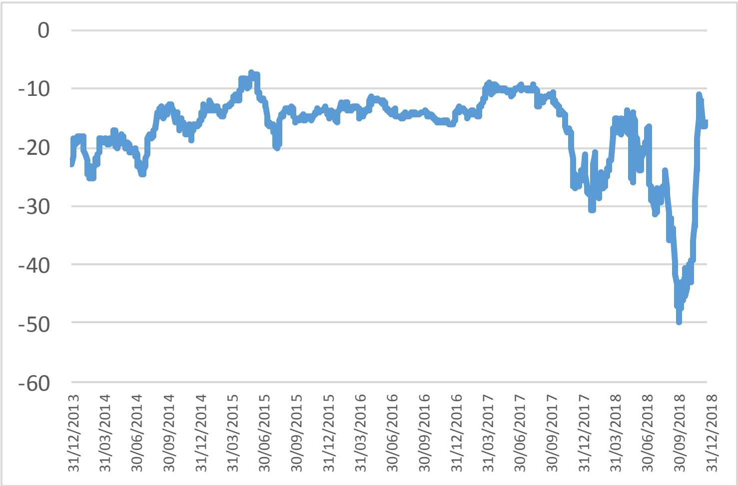
Top Themes

China dominates headlines with trade tensions and geopolitical risks rising

Central banks looking to slow pace of rate hikes

Stocks plunge to end the year, bonds rally in flight to quality

Top Chart: Canadian WCS Oil Differential to WTI



Source: Bloomberg, Lincluden