Economic Commentary

First Quarter 2018

Growth Improves as Central Banks Withdraw

The global economy is growing at its fastest pace since 2010. For the first time in many years there is coordinated growth around the world, with strengthening economies in North America, Europe, Asia and emerging markets. Overall global growth is expected to be in the range of 3.8% in 2018. Increasing fears of a global trade war initiated by the United States, however, could cloud the overall economic outlook. The implementation of tariffs by President Trump will no doubt trigger retaliatory action by several countries, particularly from China.

With the global economy strengthening, central banks have begun the process of unwinding the quantitative easing measures put in place following the global financial crisis. The U.S. has embarked on its tightening path towards higher interest rates, with at least three rate hikes forecast for this year, following similar moves last year. The U.S. Federal Reserve did increase interest rates by 25 b.p. at its meeting in March. Although the European Central Bank has not yet begun to tighten interest rates, it is reducing the amount of overall liquidity that is being injected into the European financial system.

NAFTA Uncertainty Impacting Canadian Dollar

The Bank of Canada did raise interest rates by 25 b.p. at its meeting in January, however, it is expected that the pace of future interest rate hikes in Canada will lag that of the U.S. Ongoing uncertainty with the NAFTA negotiations could dampen the prospect of any near-term rate hikes by the Bank of Canada. Governor Poloz has adopted a more tentative stance with regard to monetary policy, waiting to see more concrete evidence that the economy can withstand higher borrowing costs before moving further.

Although interest rates are increasing in both Canada and the U.S., the divergent path of rate hikes, with the U.S. being more aggressive, has had a negative impact on the Canadian dollar over the past few months. After reaching a level of 1.21 in early September, the Canadian dollar hit a near-term low of 1.31 in mid-March before finishing the quarter at 1.29.

Inflation Fears Stoke Increase in Rates & Volatility

Financial markets remained quite volatile during the first quarter. Interest rates increased fairly dramatically to start the year, with the yield on the ten year Government of Canada bond rising from 2.05% to a high of 2.37% in mid-February, before rallying to end the quarter at 2.09%. A jump in U.S. average hourly earnings in January was the catalyst for the rapid spike in interest rates.

Following a strong performance in 2017, equity markets continued to rally through the end of January. However, the stock market did not react well to higher interest rates as markets declined rapidly into early February, wiping out most of the recent gains. Major equity markets posted negative returns for the first quarter. Despite the overall strength in economic growth, the potential for inflationary pressures and the corresponding threat of higher interest rates, along with on-going trade war fears, could keep markets on edge.

Key Metrics

Indicator	Value	Chg Q1	Chg 1Y
S&P/TSX Composite	15,367.29	-0.3%	1.7%
S&P 500 (USD)	2,640.87	5.8%	14.0%
MSCI EAFE (USD)	2,002.23	2.8%	15.3%
FTSE TMX Universe Bond Index	1,037.85	2.1%	1.4%
USD/CAD	$ 0.78	-2.4%	3.4%
WTI Crude ($/bl))	$ 64.94	7.7%	24.9%
GoC 10Y Bond	2.09%	+4.6 bp	+46.6 bp
GoC Deposit Rate	1.25%	+25 bp	+75 bp
Cdn CPI YoY	2.2%	0.3%	0.6%
US 10Y Treasury	2.74%	+33.4 bp	+35.2 bp
Fed Funds Rate	1.75%	+25 bp	+75 bp
USD CPI YoY	2.2%	0.1%	-0.2%

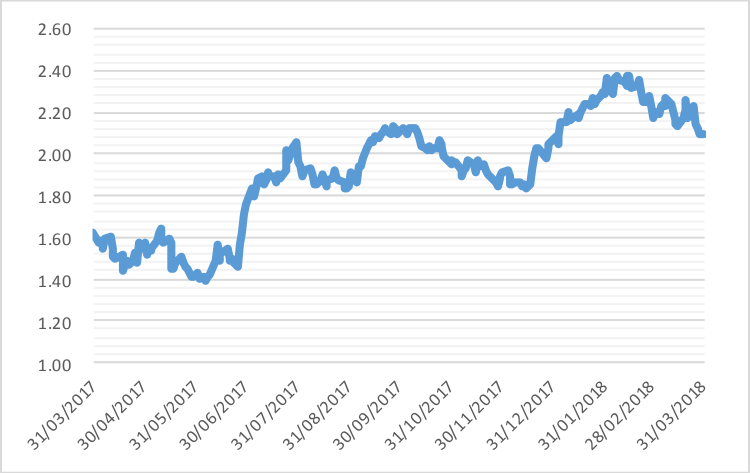
Top Themes

Global economic growth improves while central bank liquidity wanes

Trade war fears beginning to cloud economic outlook

Inflationary concerns could lead to increased market volatility

Top Chart: Gov't of Canada 10 Year Bond Yield



Source: Bloomberg, Lincluden