Economic Commentary

Fourth Quarter 2017

U.S. Fed Follows Through on Rate Hikes

The U.S. Federal Reserve raised interest rates by 25 b.p. at its meeting in December. The move was widely anticipated by the market. This was the third rate hike during the year and marked the first time in several years where the actual moves made by the Federal Reserve matched the forecasts outlined at the beginning of the year. Over the past couple of years, the number of interest rate hikes that occurred were lower than what was forecast. For 2018, the expectations are for the Fed to raise interest rates three times, although many economists are beginning to feel that four hikes may be more appropriate. The December meeting was the last meeting chaired by Janet Yellen as she turns over control to incoming Fed Chair Jerome Powell.

Mixed Messages from the BoC

The Bank of Canada did not change its overnight interest rate at either of its two meetings in the fourth quarter. BOC Governor Poloz, however, did send out mixed messages following the December meeting, indicating that the bank will take a cautious approach toward future interest rate hikes. Poloz has downplayed the significance of providing forward guidance to the markets. This stance, which differs from other major central banks, can often result in volatile reactions by market participants to comments that are made. Poloz is increasingly confident that the economy will need less monetary stimulus going forward as the economy approaches full potential. There are still uncertainties in the market which may prevent the Bank from aggressively raising rates, including the negative impact of lower oil prices. As a result, the path of future rate hikes in 2018 by the Bank of Canada, currently projected at two, will lag the expected moves in the U.S.

The Canadian economy exhibited signs of a slowdown following a stellar start to the year. After leading the G7 countries for the first half of the year, Canadian GDP growth rates have subsided during the second half of the year. Third quarter GDP grew at a 1.7% annual pace, following a Q1 reading of 3.7% and a Q2 rate of 4.5%.

Job Market Tightening

Employment rates in major countries continue to trend down indicating improved economic conditions around the world. However, inflation pressures to-date have remained modest, with inflation rates remaining below the 2% target in most countries. There is also little in the way of upward pressure in the form of wage growth occurring. Inflation will be a key economic indicator to watch in 2018 as any signs of a significant pick-up could result in more aggressive monetary policies being adopted by major central banks.

ECB Extends QE at Reduced Pace

At its October meeting, the European Central Bank announced that it would extend its quantitative easing program. However, beginning in 2018 the level of monthly purchases will decrease from 60 billion euros to 30 billion euros. The program will be extended from an original completion date of March 2018 to September 2018.

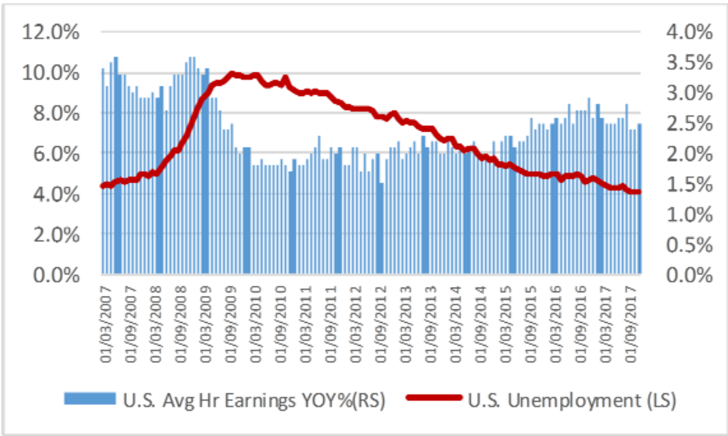
Key Metrics

Indicator	Value	Chg Q4	Chg 1Y
S&P/TSX Composite	16,209.13	4.4%	9.1%
S&P 500 (USD)	2,673.61	6.6%	21.8%
MSCI EAFE (USD)	2,050.79	4.3%	25.7%
FTSE TMX Universe Bond Index	1,036.84	2.0%	2.5%
USD/CAD	$0.80	-0.8%	6.9%
WTI Crude ($/bl))	$60.42	15.7%	6.2%
GoC 10Y Bond	2.05%	-5.4 bp	+32.4 bp
GoC Deposit Rate	1.00%	0	+50 bp
Cdn CPI YoY	2.1%	0.5%	0.6%
US 10Y Treasury	2.41%	+7.2 bp	-3.9 bp
Fed Funds Rate	1.50%	+25 bp	+75 bp
USD CPI YoY	2.2%	0.0%	0.1%

Top Themes

- U.S. Fed hikes rates for 3rd time this year
- Canadian economy slows after hot start
- Unemployment falls, but wage pressures remain modest

Top Chart: U.S Unemployment vs. Wage Growth



Source: Bloomberg, Lincluden