US & Canada Macro Outlook

Slow & Steady Wins the Race

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June 2018

G10 Central Banks: Snapshot of Our Views

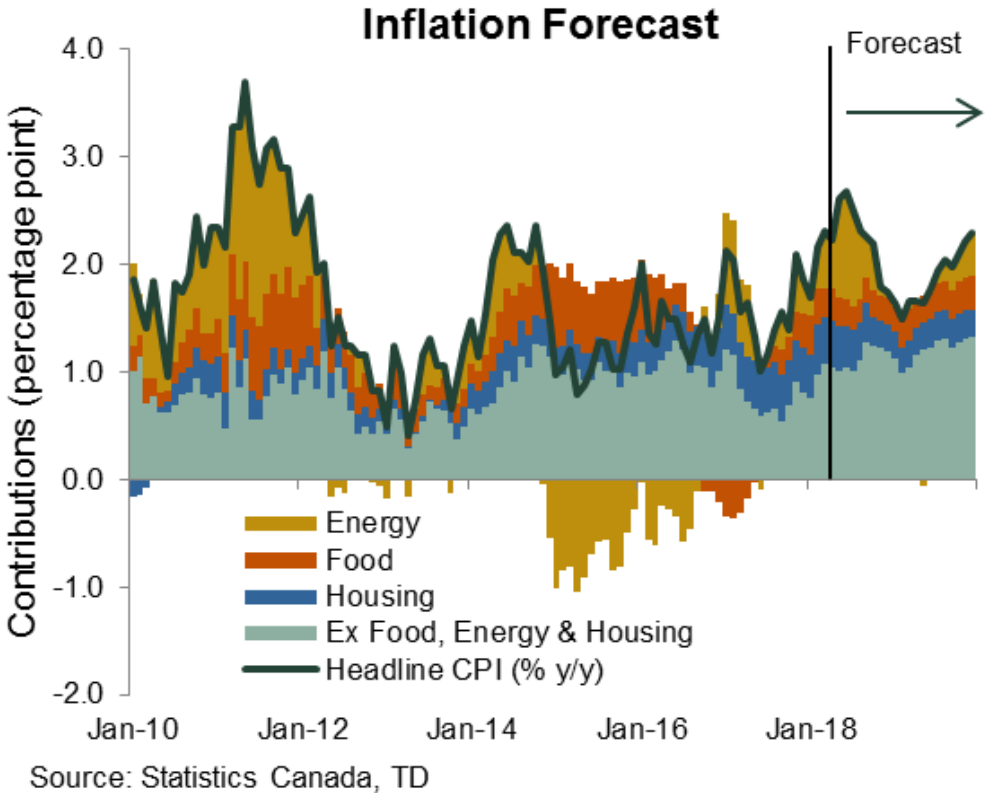
		TD's Current Call	Risks to the Call	
			Dovish	Hawkish
NORTH AMERICA				
	FED	**Hikes in Sep and Dec 2018, three hikes in 2019. On-going balance sheet unwind**	Inflation reverts lower; excessive market volatility or large selloff from global shocks	Upside surprises to growth, inflation, or wages; more hawkish Board appointees
	BOC	**+25bps in July, two hikes in 2019 (Jan & Jul)**	Article 2205 on NAFTA, Section 232 auto tariffs. Housing in near-term, debt overhang for medium-term.	Jobs and wages respond to demand; core CPI firming above 2%; NAFTA deal in principle
EUROPE				
	ECB	**QE €15bn/mo Sept-Dec 2018, then zero; +15bps depo rate in 19Q3, +25bps on all rates in 19Q4**	Risks around rate hike tilted toward later rather than sooner, potential for disappointments on growth or inflation	Stronger inflation outcomes more likely to see faster rate hike than sooner rate hikes; bar to hike pre-Sept19 is high
	BOE	**+25bps in Aug 2018, and two more hikes in 2019**	Brexit negotiations get derailed; economic growth remains slow / labour mkt softens	Clear resolution to Brexit unleashes investment, solid Q2 + Q3 growth
	RIKSBANK	**+25bps in Q4 2018**	Quick SEK rise pushes hike into 2019; some risk of a smaller 10-15bs hike	Higher inflation leaves Riksbank comfortable with ECB policy divergence
	NORGES	**+25bp in Q3 2018**	Rapid NOK appreciation limits scope for policy divergence with ECB	Housing market accelerates further and Norges Bank leans against the wind
ASIA/PACIFIC				
	RBA	**Hike pushed back to two hikes in 2019 (May and November)**	Disappointing wage and CPI growth pushes first hike into H2 2019.	Wage and CPI upside brings forward from Q2 2019 into Q1 2019. Need a big shock for a year-end hike now.
	RBNZ	**Hike pushed back to Feb 2019**	RBNZ Governor Orr lets the economy run even hotter with 1.75% well into H2 2019.	Wage and inflation spikes via fiscal stimulus could see the markets bring forward hikes to earlier in 2019.
	BOJ	**Continue YCC**	BoJ extends YCC/restarts QE with inflation hopes in doubt and Abe's future uncertain	Small risk may signal less easing late in 2018

2018-2019 Risks: What Could Possibly Go Wrong?

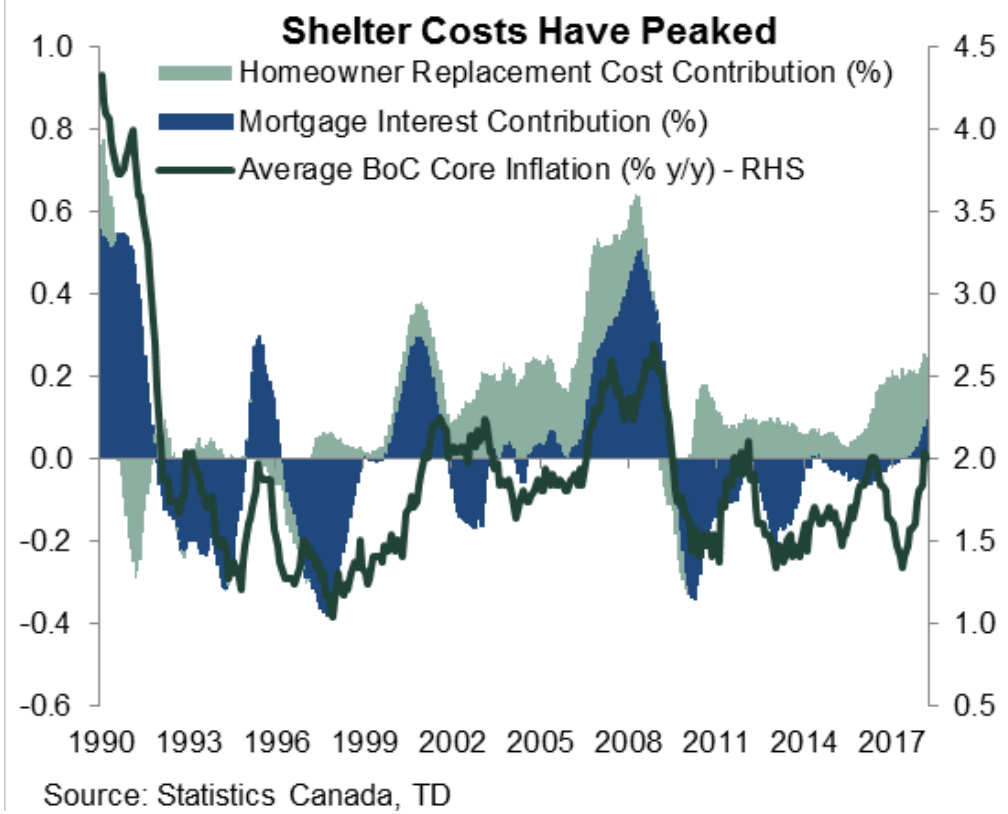
- **Inflation:** Upside risks on oil prices and US fiscal stimulus, downside risks on supply-side factors
- **US recession risks:** 33% in 12-24 months but <5% within a year
- **Quantitative Tightening:** Fed balance sheet unwind, ECB taper, BoJ exit
- **Debt & Deleveraging:** Debt in uncharted territory in China, Canada, Australia/New Zealand but still needs a spark
- **Political Risks:** Risk of NAFTA termination still low but uncertainty of negotiations and risk of trade wars is higher

2018-2019 Risks: What Could Possibly Go Wrong?

- **Inflation:** Upside risks on oil prices and US fiscal stimulus, downside risks on supply-side factors → only gradual rise in core inflation is in store



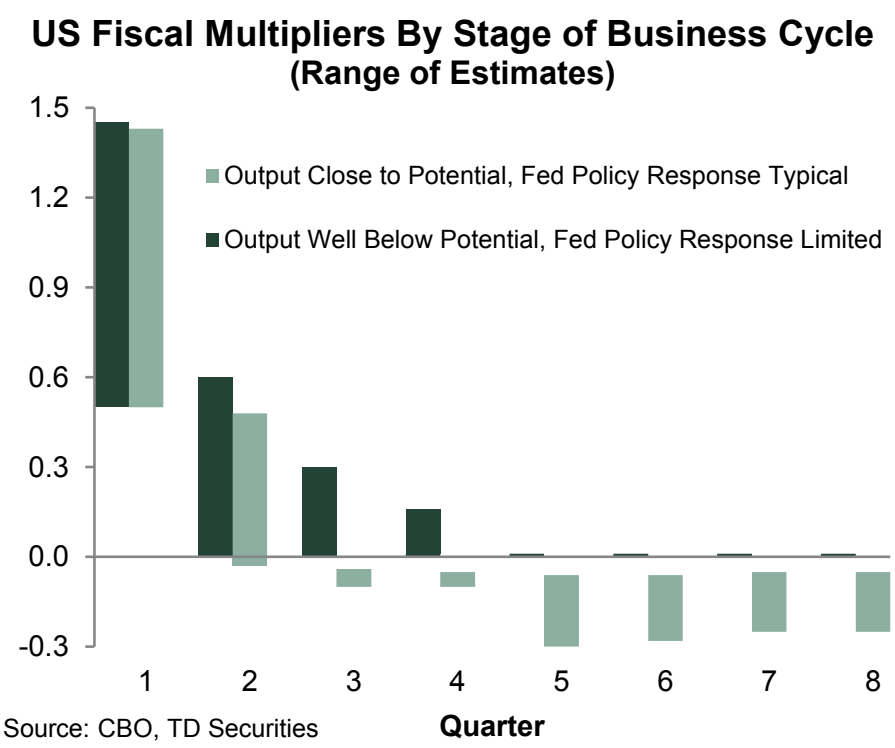
Source: Statistics Canada, TD



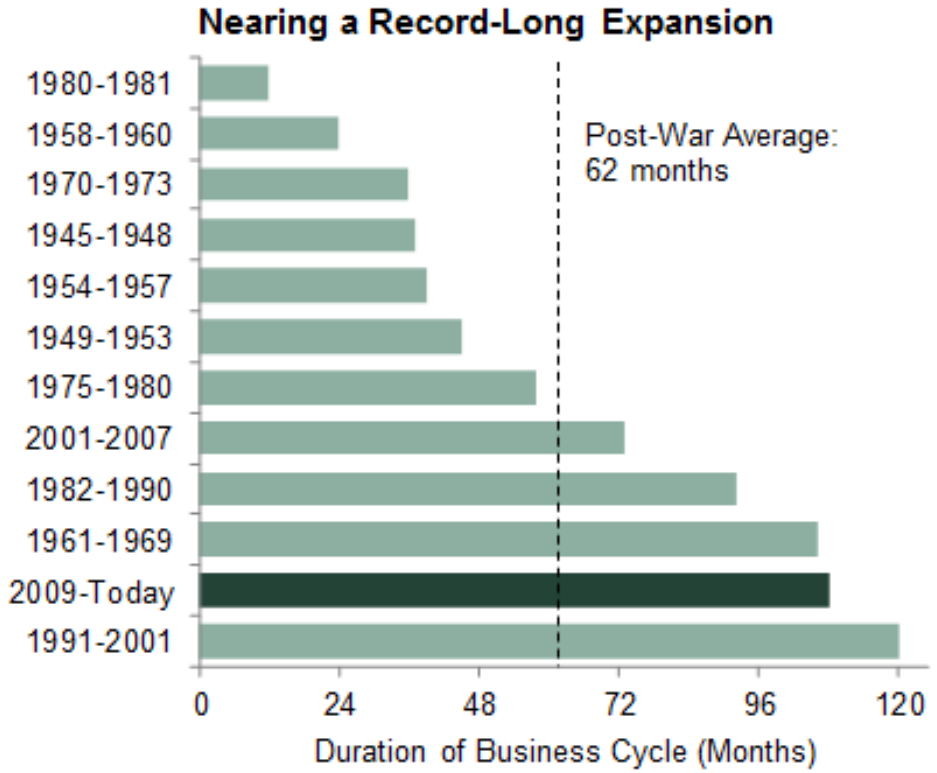
Source: Statistics Canada, TD

2018-2019 Risks: What Could Possibly Go Wrong?

- **US recession risks:** 33% in 12-24 months but <5% within a year → US fiscal policy and still accommodative monetary policy to extend cycle



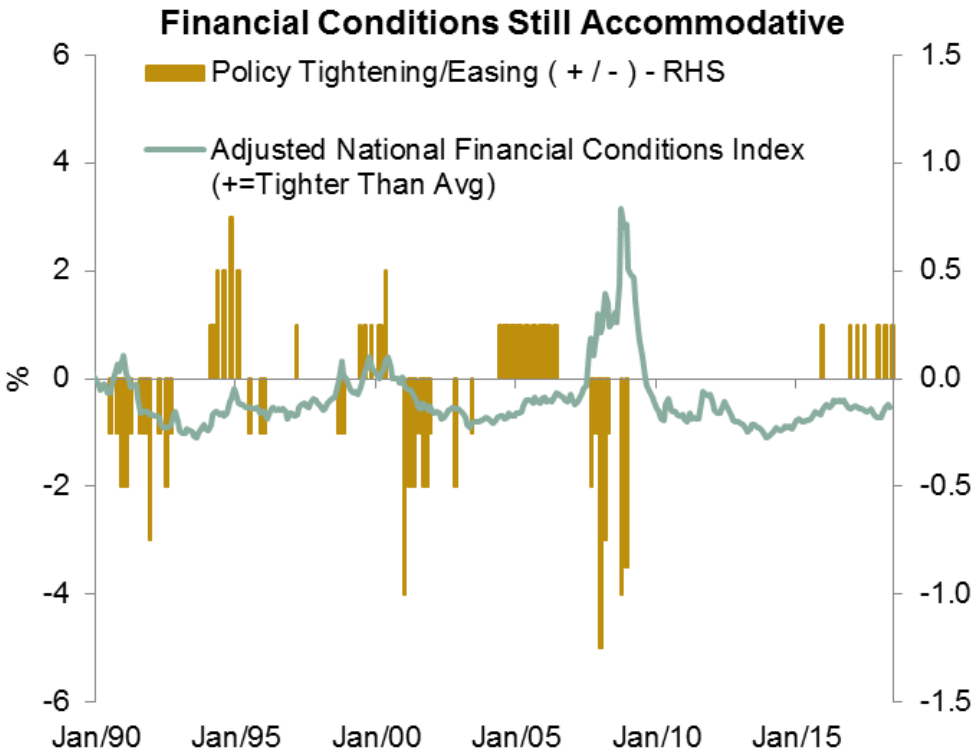
Source: CBO, TD Securities



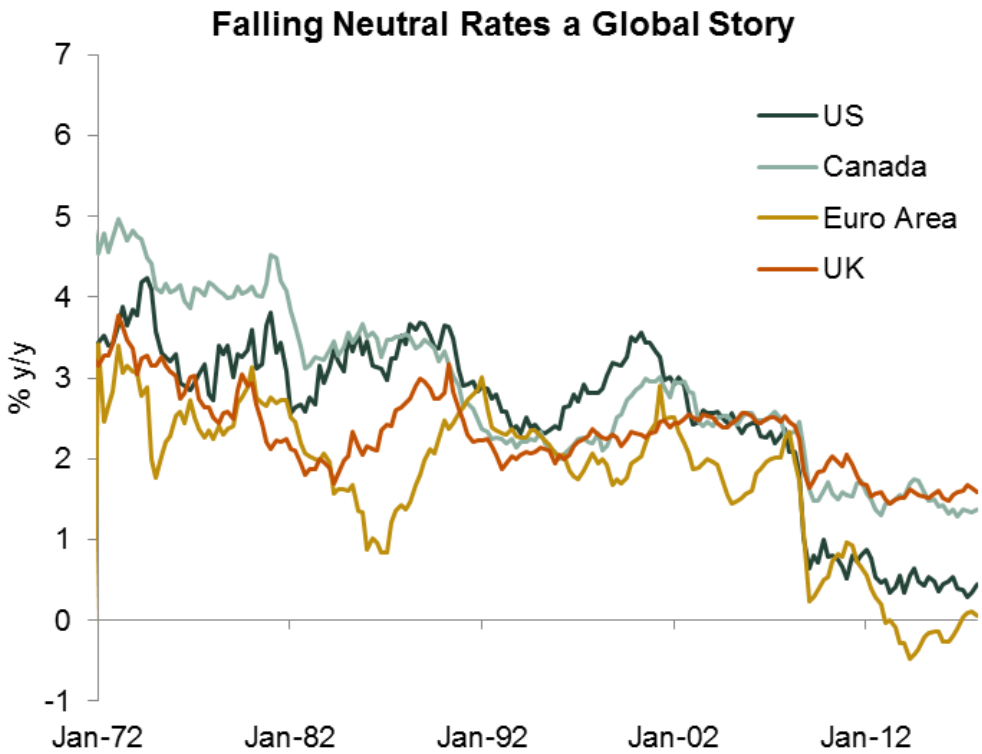
Source: NBER, TD Securities

2018-2019 Risks: What Could Possibly Go Wrong?

- **Quantitative Tightening:** Fed balance sheet unwind, ECB taper, BoJ exit → implications for term premia and financial conditions but not neutral rates



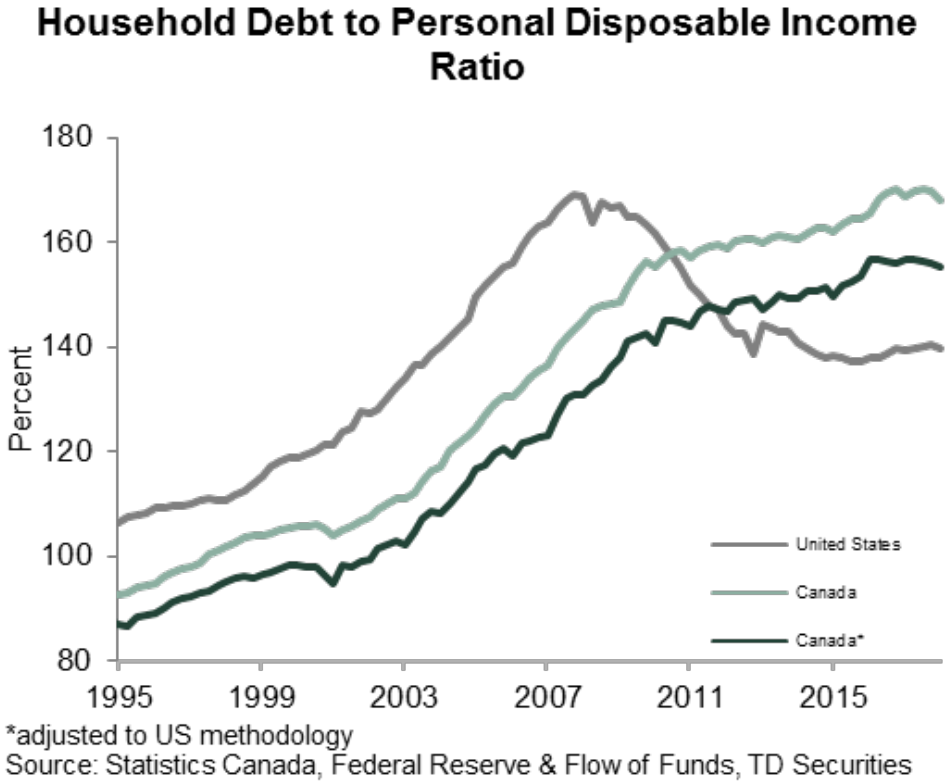
Source: Chicago Fed, FOMC, TD Securities



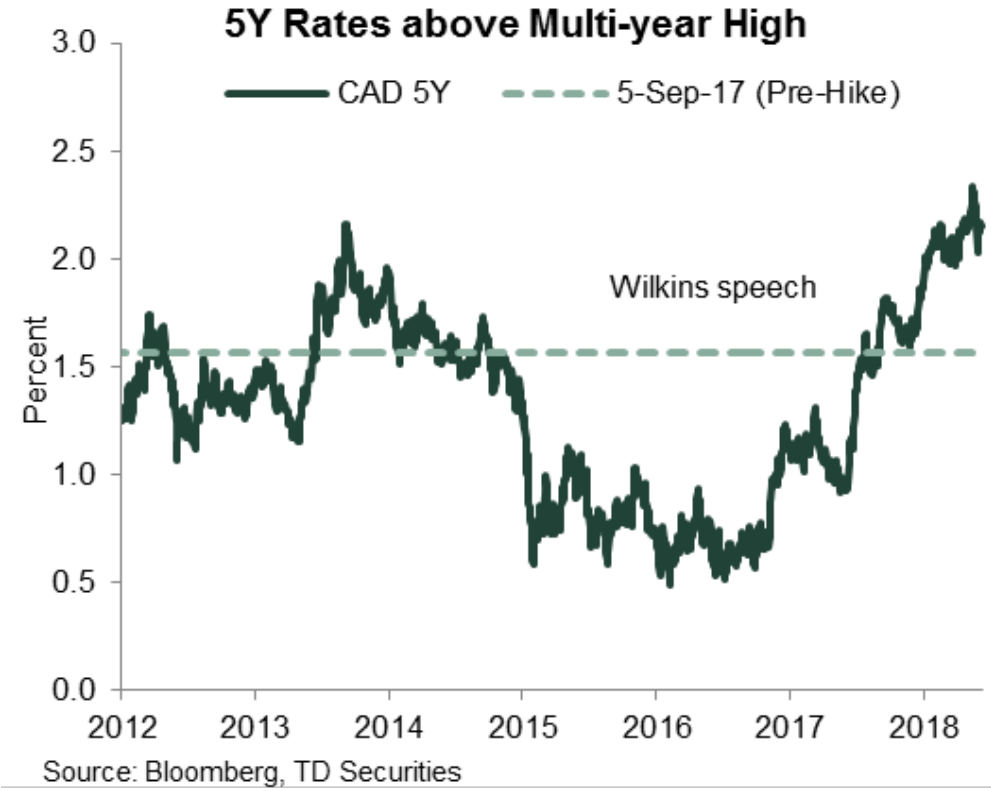
Source: Holston/Laubach/Williams, TD Securities

2018-2019 Risks: What Could Possibly Go Wrong?

- **Debt & Deleveraging:** Debt in uncharted territory in China, Canada, Australia/New Zealand but still needs a spark → low rates, still accommodative policy to keep hard landing a tail risk event

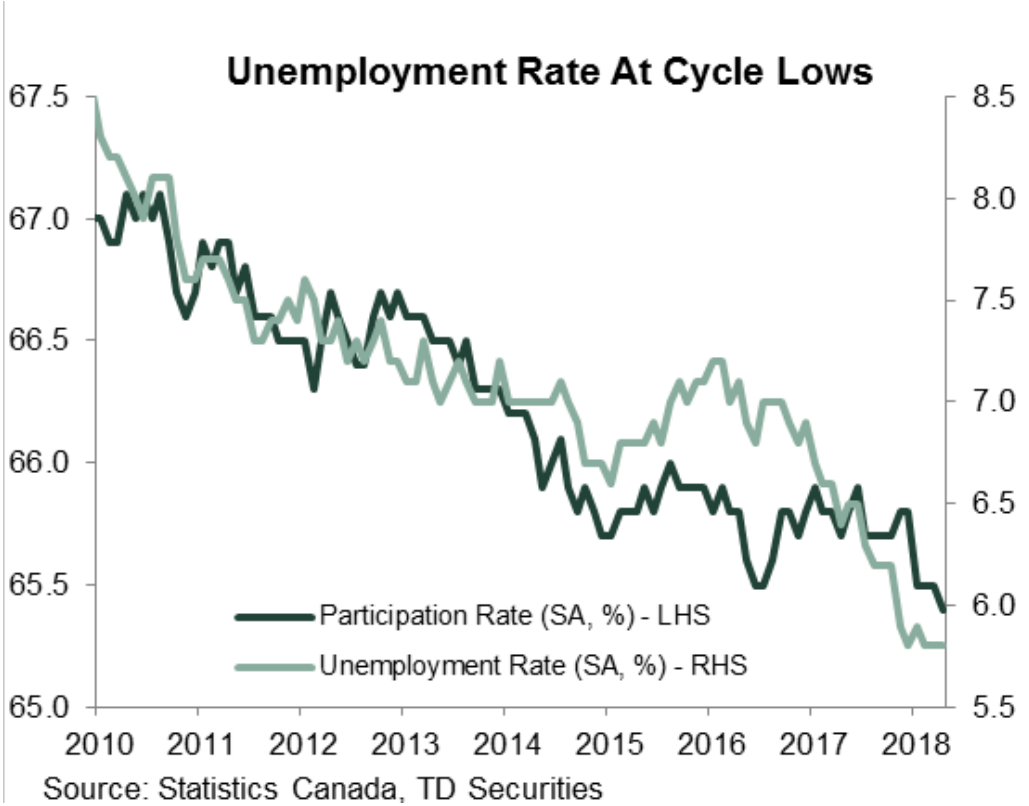


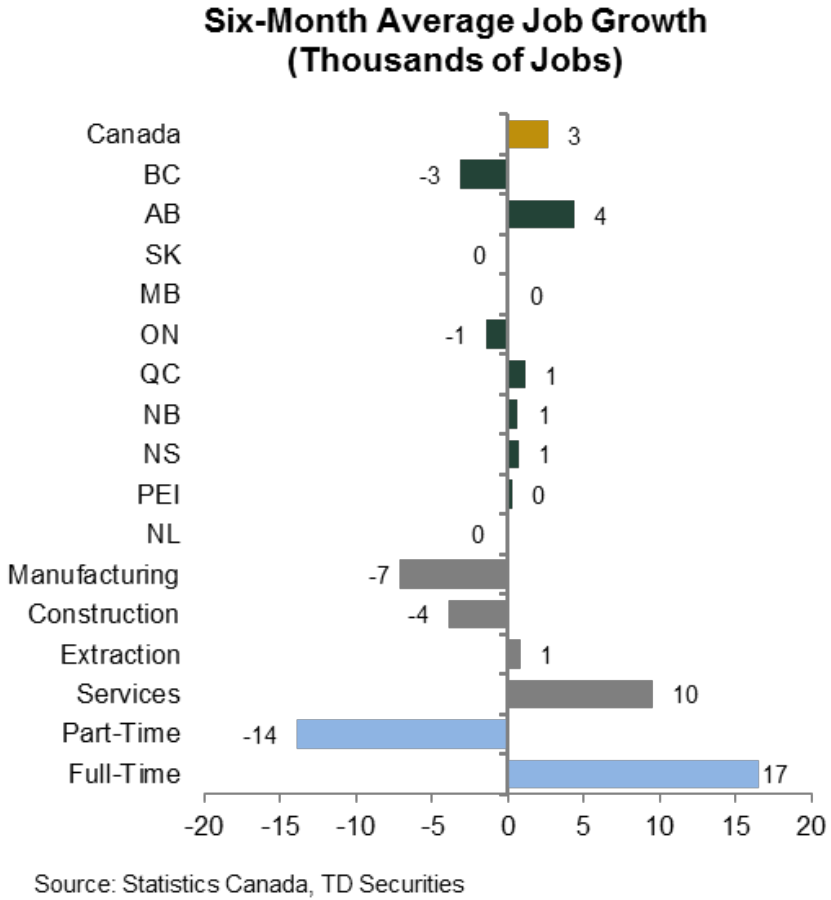
*adjusted to US methodology
Source: Statistics Canada, Federal Reserve & Flow of Funds, TD Securities



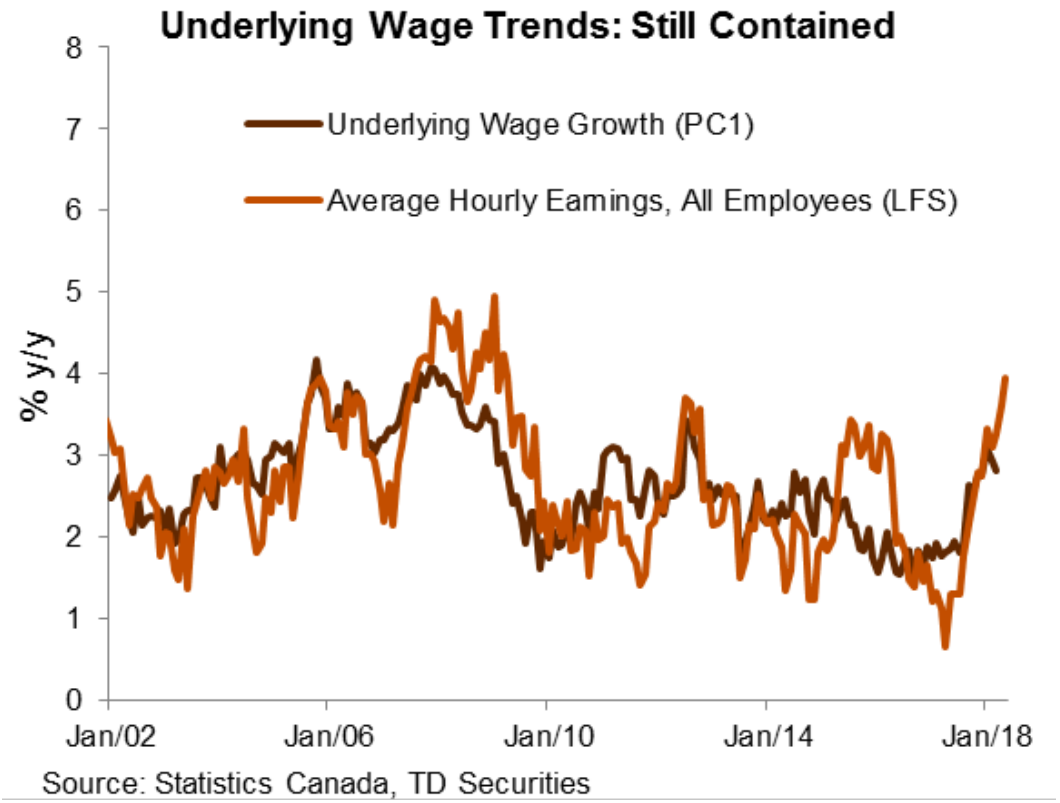
Source: Bloomberg, TD Securities

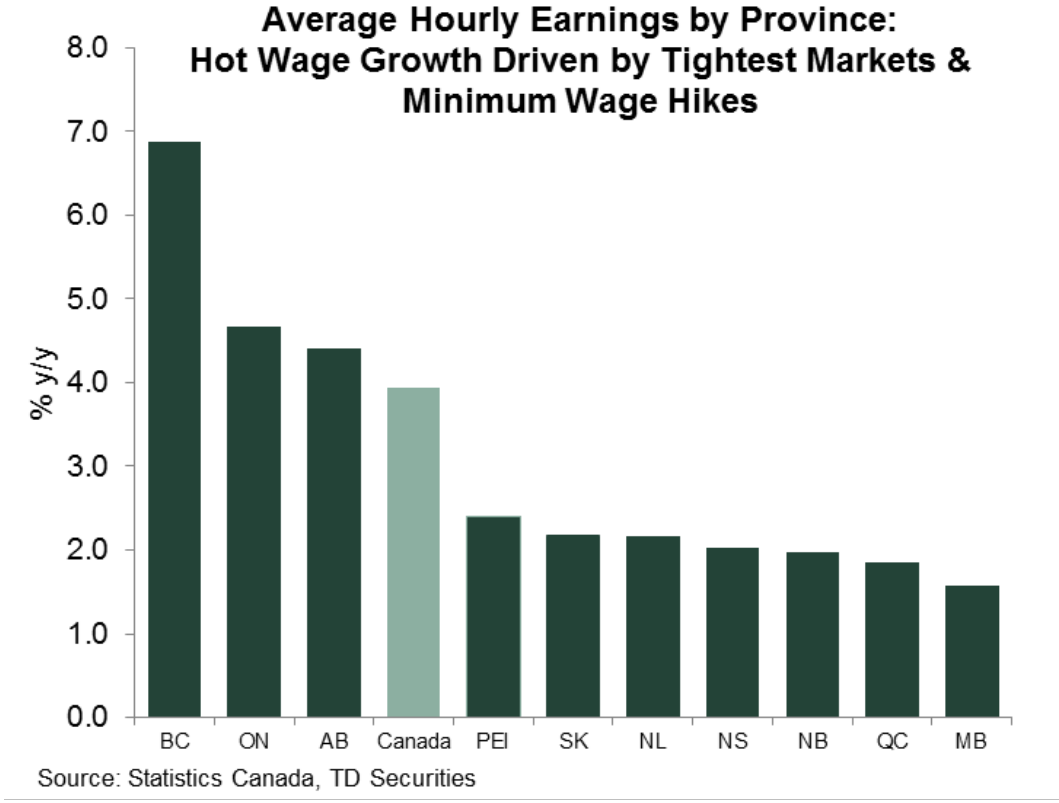
Canada: Labour Market is Tight but Job Growth is Slowing



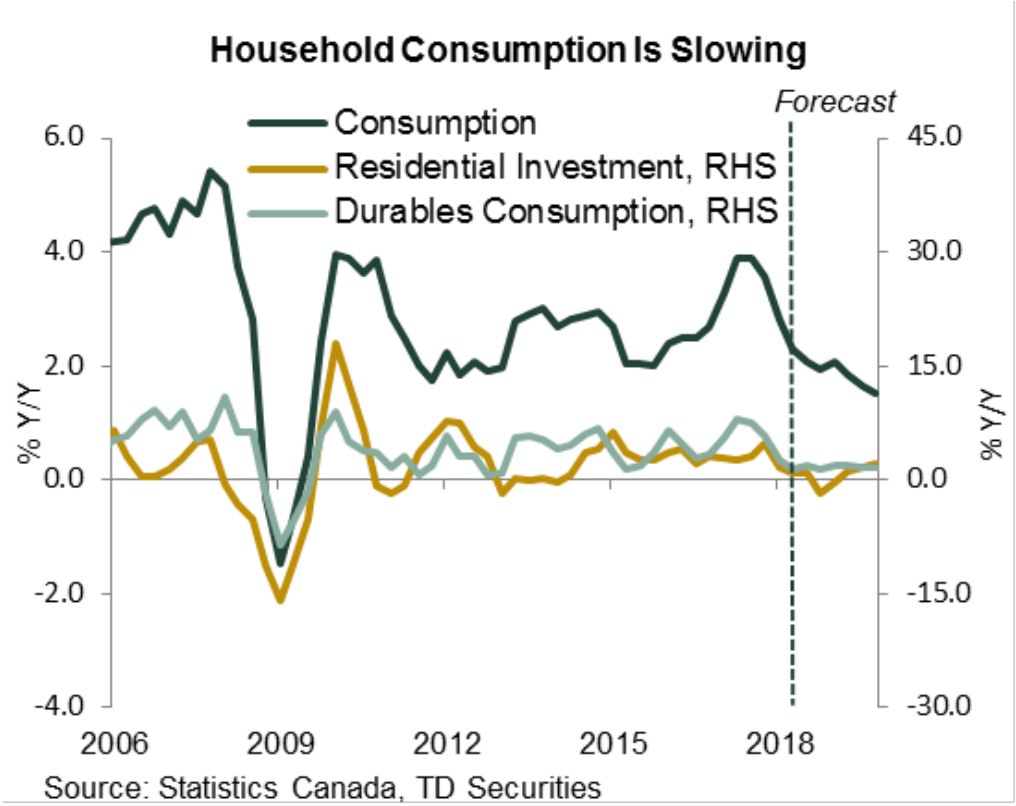


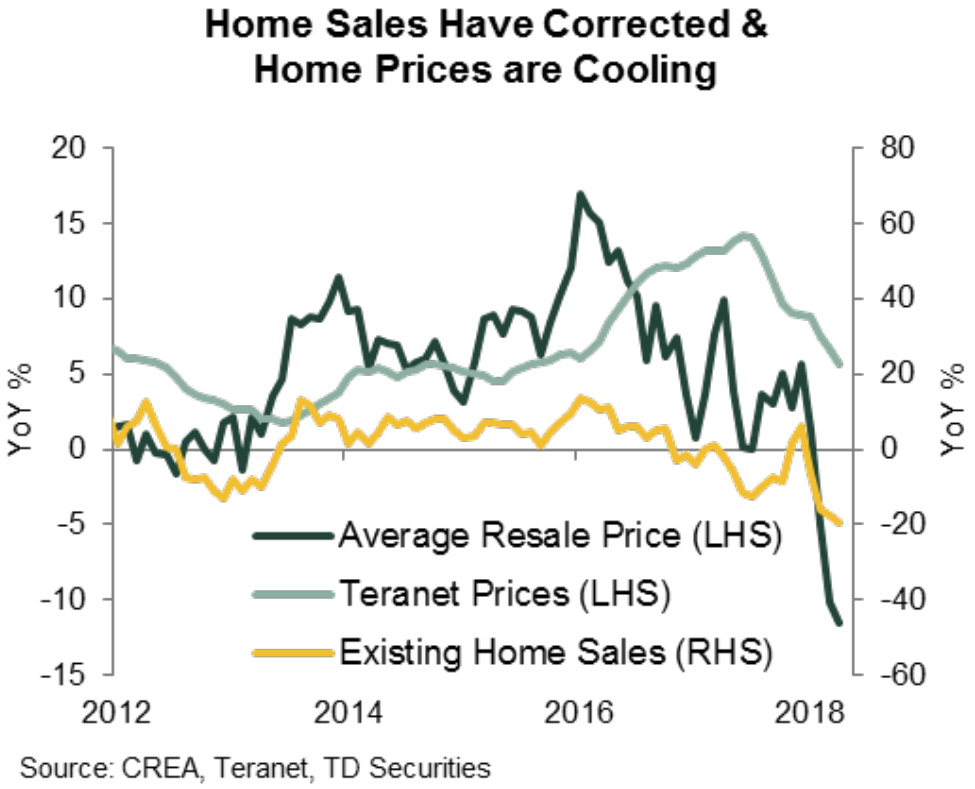
Canada: Wage Growth is Strong but Running at a Peak





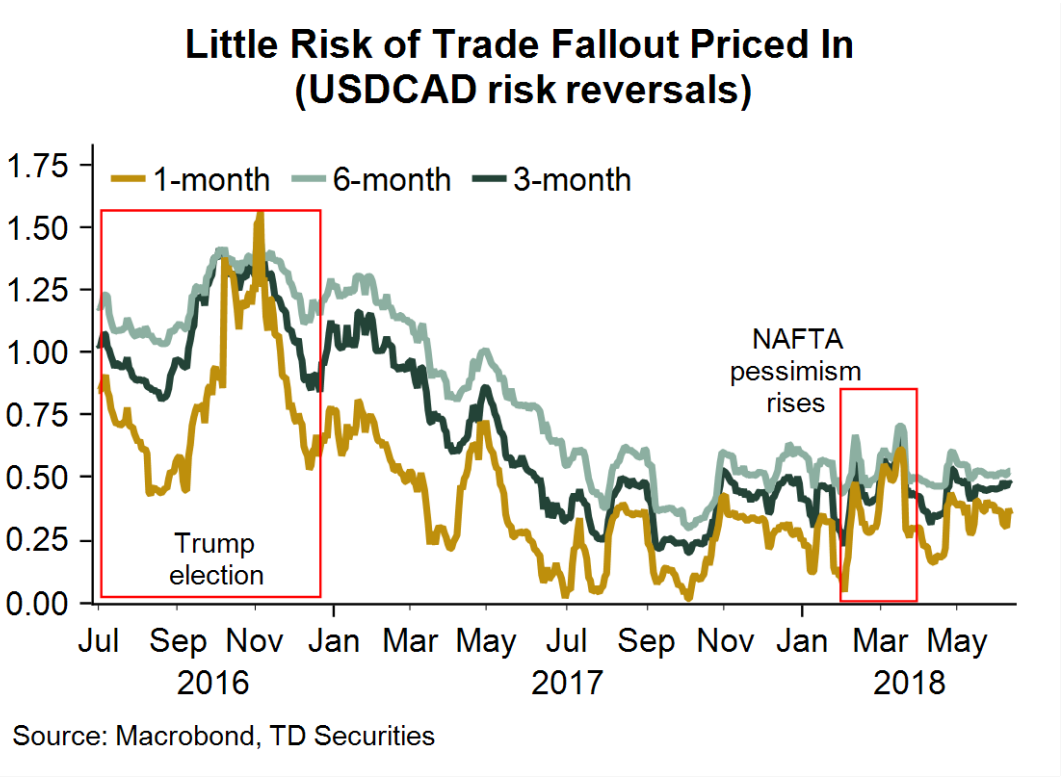
Canada: Consumers are Responding to Tighter Mortgage Rules & Higher Borrowing Costs



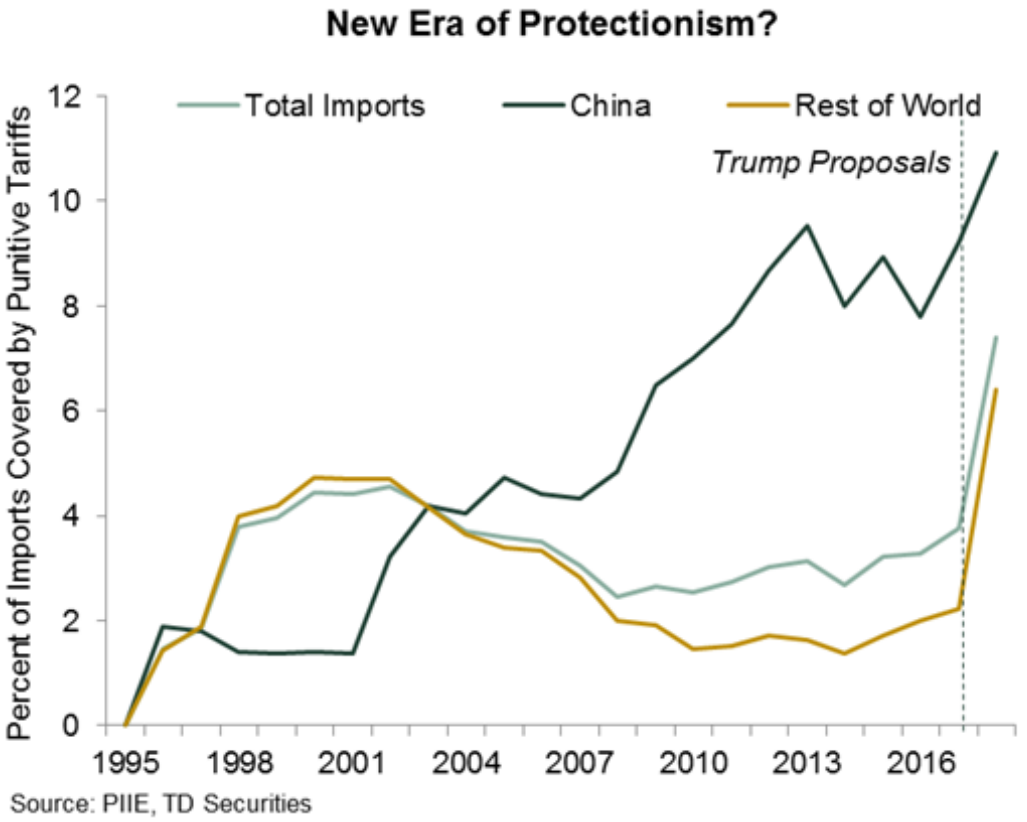


2018-2019 Risks: What Could Possibly Go Wrong?

- **Political Risks:** Risk of NAFTA termination still low but uncertainty of negotiations and risk of trade wars is higher → Policy uncertainty here to stay, negative for risk markets and business sentiment



Source: Macrobond, TD Securities



Source: PIIE, TD Securities

Canada: NAFTA Renegotiation is an Ongoing Risk But Resolve is More Likely Than Not

Scenarios (odds): Risk of Article 2205 still alive but termination a tail risk

- NAFTA deal reached ahead of US midterm elections (45%)
- NAFTA deal reached in 2019 (35%)
- Article 2205 but NAFTA deal within 6 months (15%)
- NAFTA termination (5%)

NAFTA 2.0: Biggest Risk is Ongoing Uncertainty

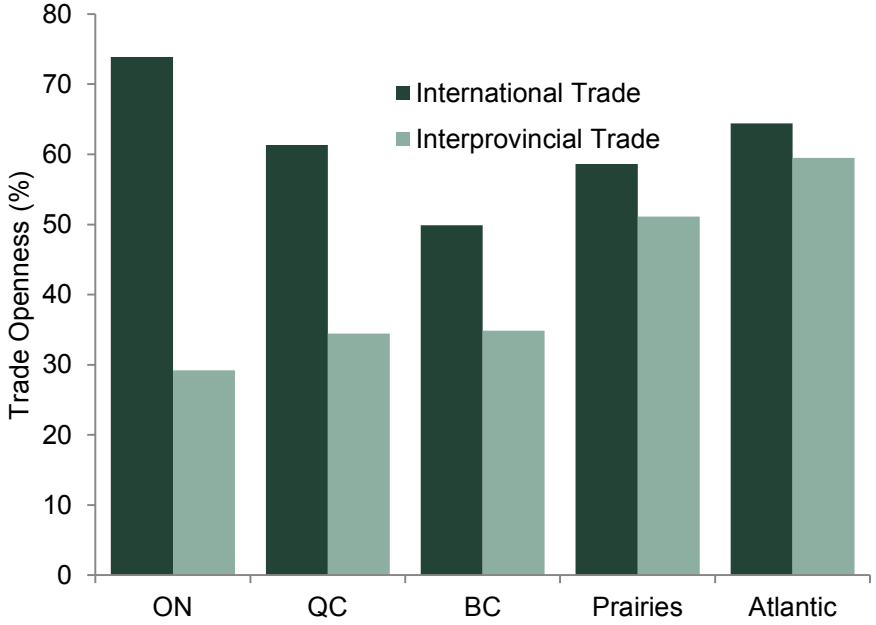
- **Contentious proposals on the table:**
  - Rules of origin in the auto sector
  - Sunset clause
  - Dispute-resolution
  - Government procurement
  - Canada's dairy supply management system

- **Economic impacts**
  - **Modest net positive**
  - **Benefits**
    - Removal of uncertainty
    - Extending to services, ecommerce, deregulatory
    - Raising the de minimis threshold (DMT)
  - **Costs**
    - Stricter rules of origin, less protective dispute settlement
    - Long process of Congressional approval

NAFTA Risks: Regional Exposure

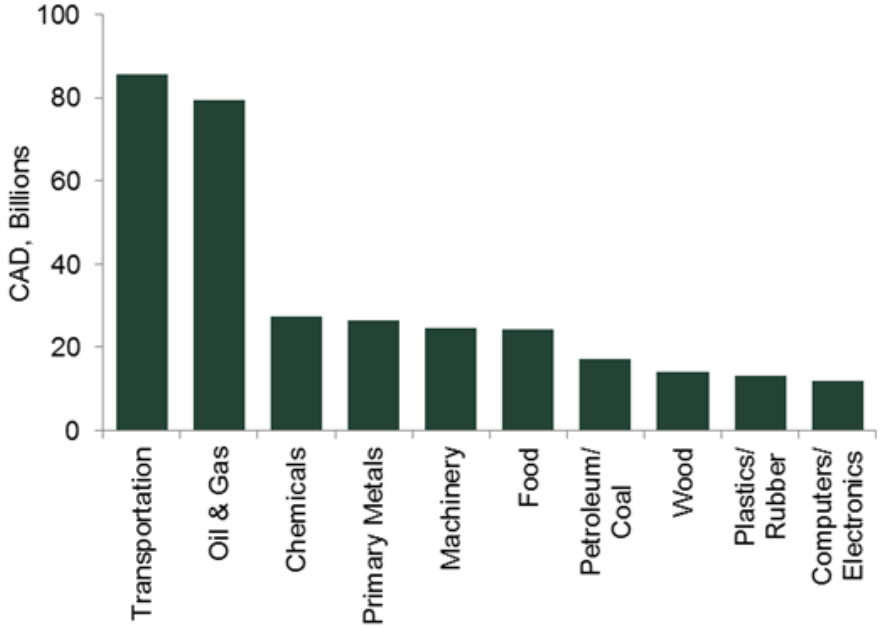
- Highly integrated sectors impacted (autos, machinery, chemicals) despite low tariffs
- Agriculture and apparel exposed to high tariffs
- Energy sector unharmed
- Ontario most exposed to trade shocks

Ontario Most Vulnerable to Trade Shocks



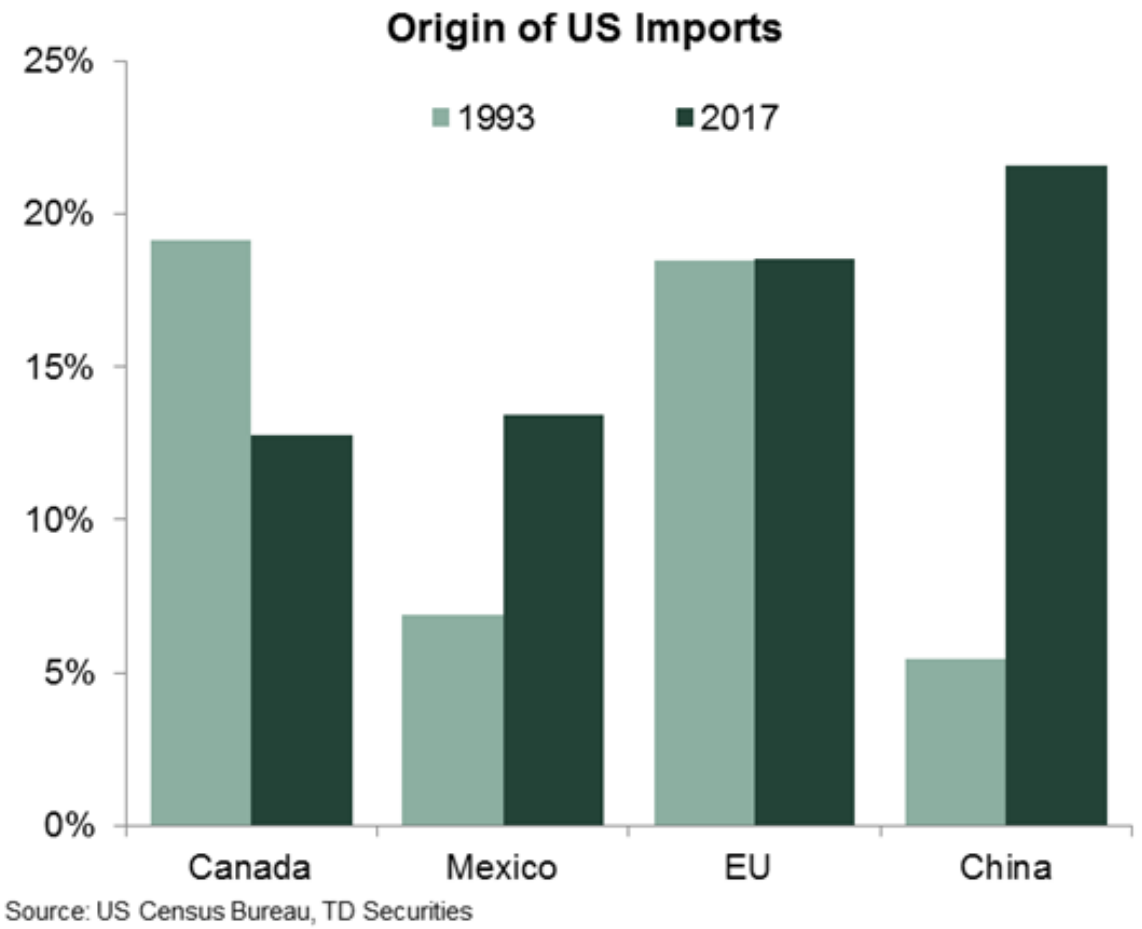
Source: Statistics Canada, TD Securities

Top Canadian Exporters to the US



Source: Statistics Canada, TD Securities

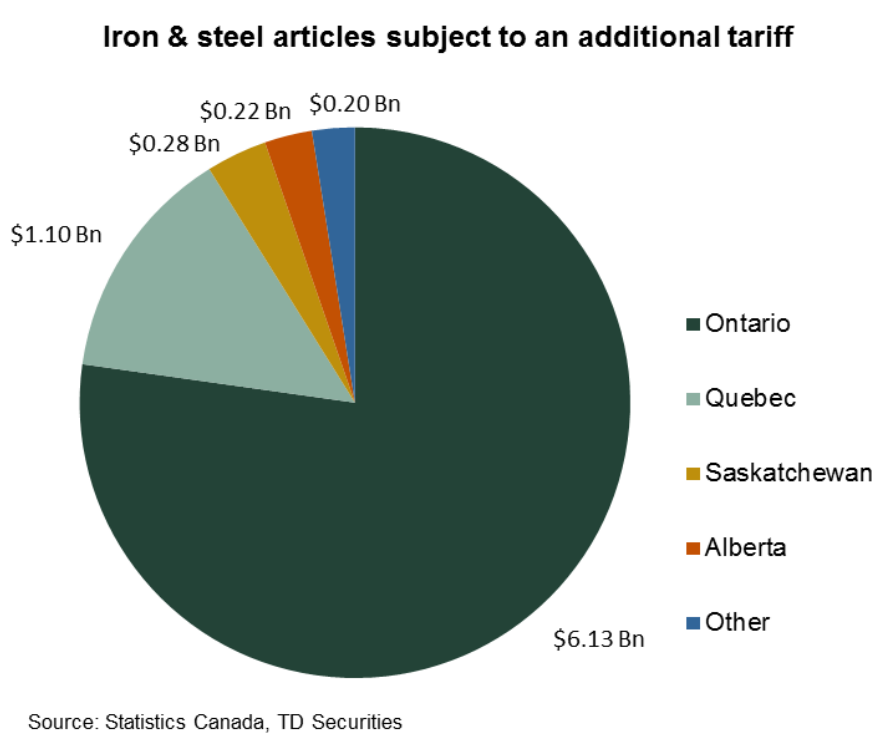
Beyond NAFTA: Protectionism is on the Rise



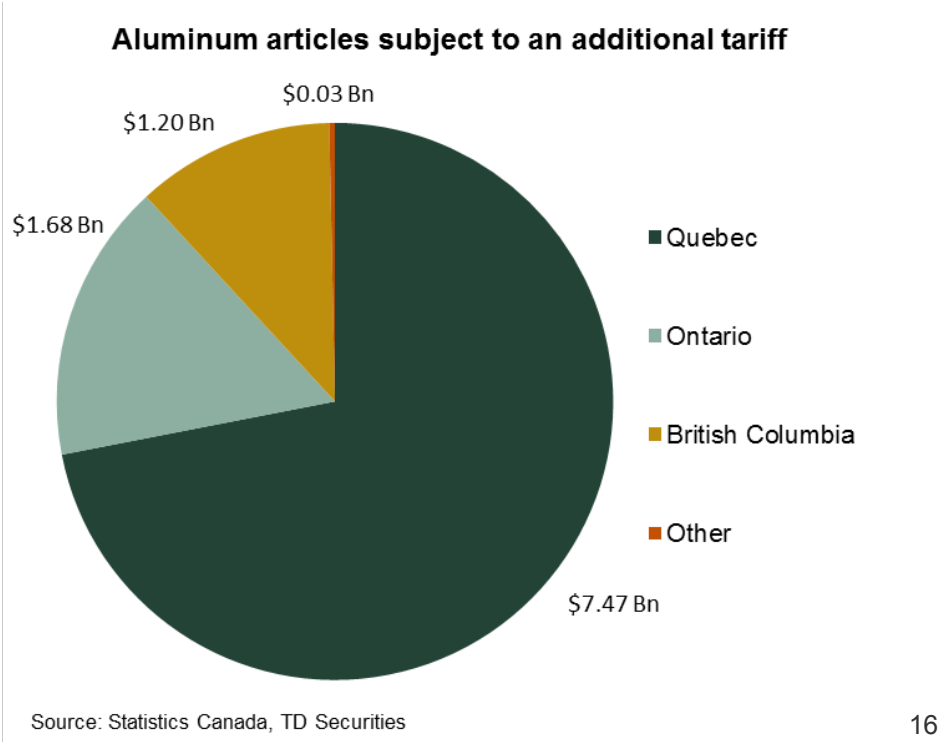
Source: US Census Bureau, TD Securities

Steel & Aluminum Tariffs: Kicking off Trade Wars

- Steel & Aluminum (Section 232):
  - US steel/aluminum tariffs
    - $53bn of US imports (2% of exports)
    - $13bn of Canadian exports (2% of exports)
  - Retaliation
    - $19bn of US exports hit with tariffs (Canada, Mexico, EU)
    - $12.8bn of Canada imports (1.5% of imports)



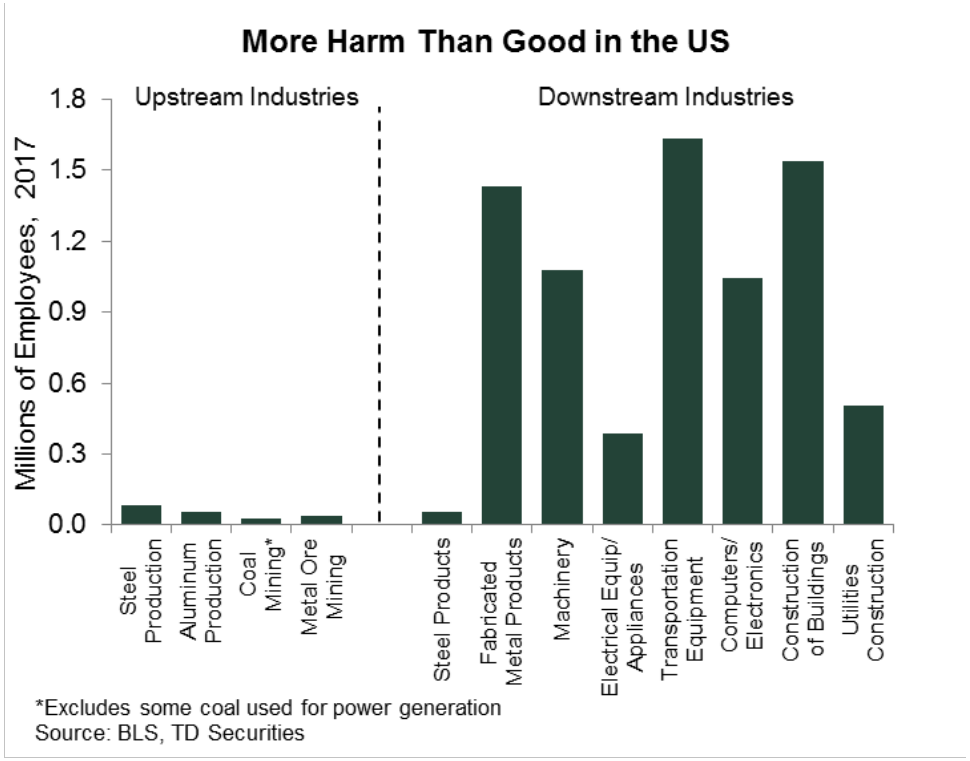
Source: Statistics Canada, TD Securities

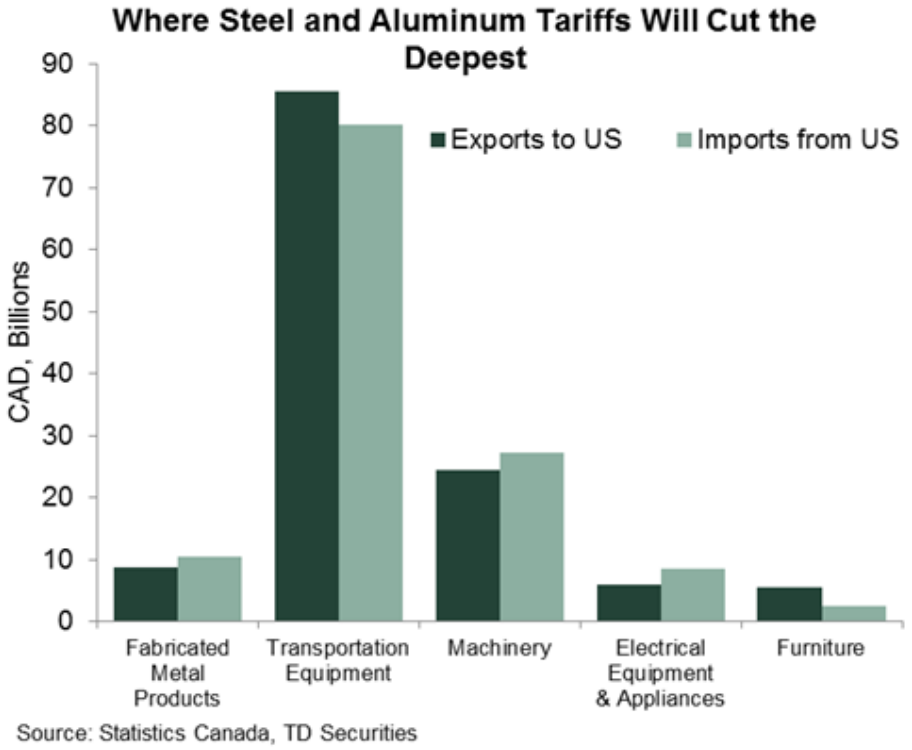


Source: Statistics Canada, TD Securities

Steel & Aluminum Tariffs: Kicking off Trade Wars

- Economic impacts: modest but growth negative and inflationary
  - Job losses in metal dependent industries (100-200k)
  - $11bn tariff revenue → +50bp increase in effective US tariff rate, highest since 1990s

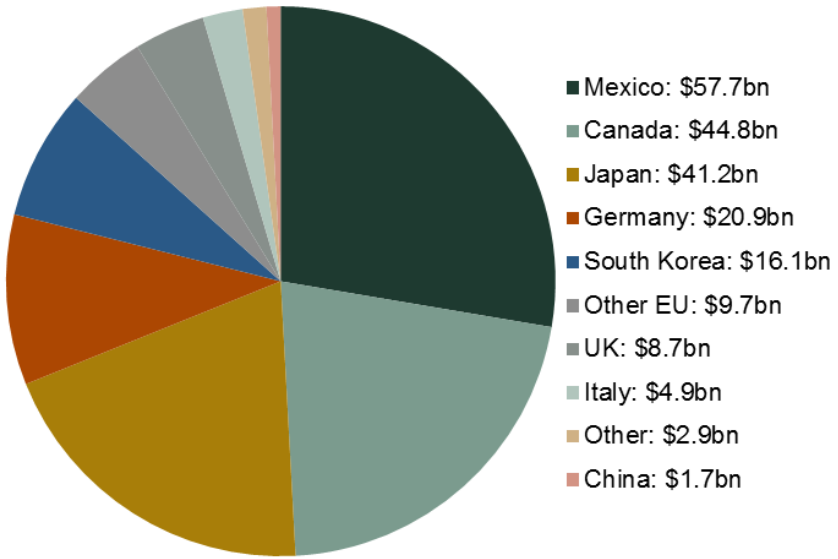




Tariffs in the Pipeline: Autos

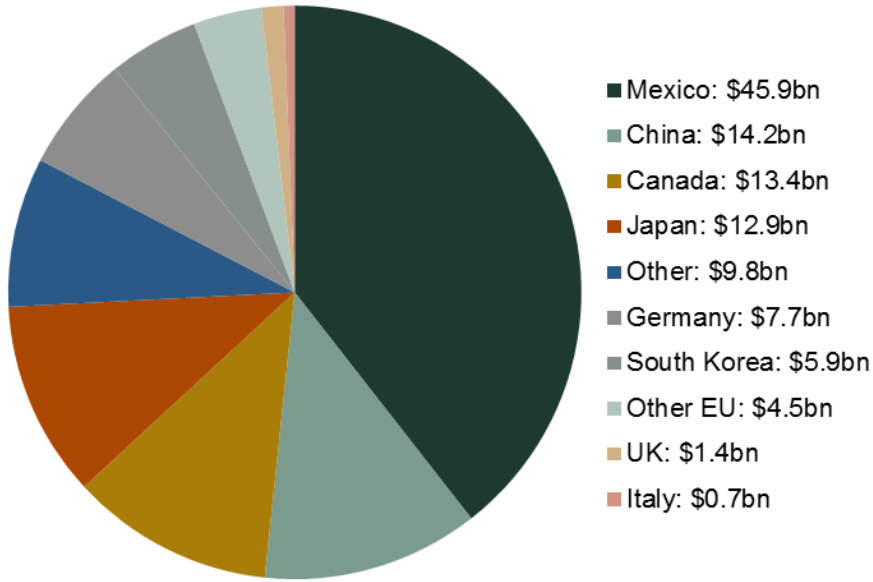
- Motor Vehicles (Section 232): investigation announced on May 23
  - Deadline to complete is 270 days → President must sign off within 90 days
  - Up to 25% tariff on of US auto and auto part imports: $325bn, or 10% of US imports
  - Canada auto exports to the US: $58bn, of 12% of total exports

Source of US Motor Vehicle Imports (2017)



Source: Census, TD Securities

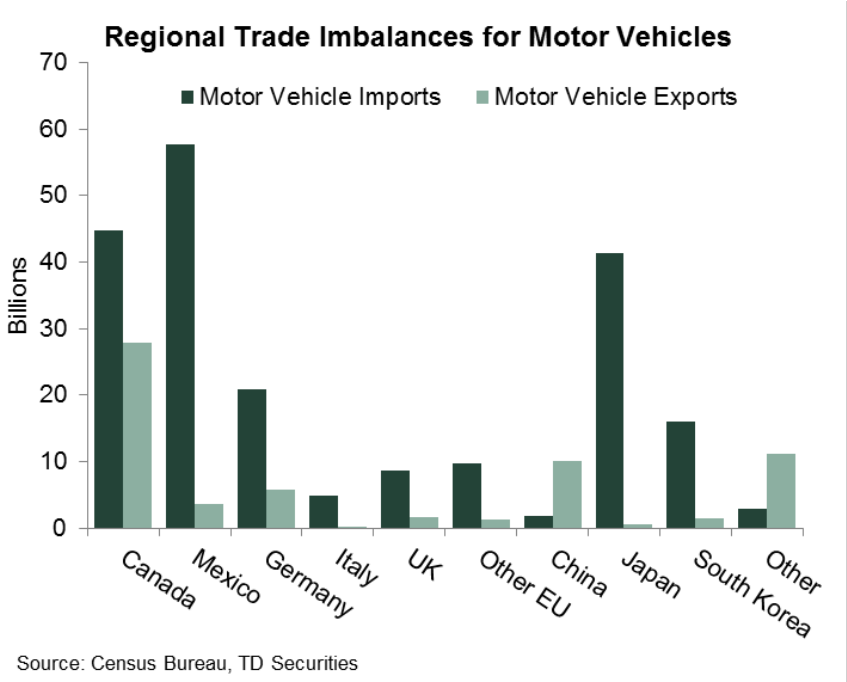
Source of US Auto Part Imports (2017)



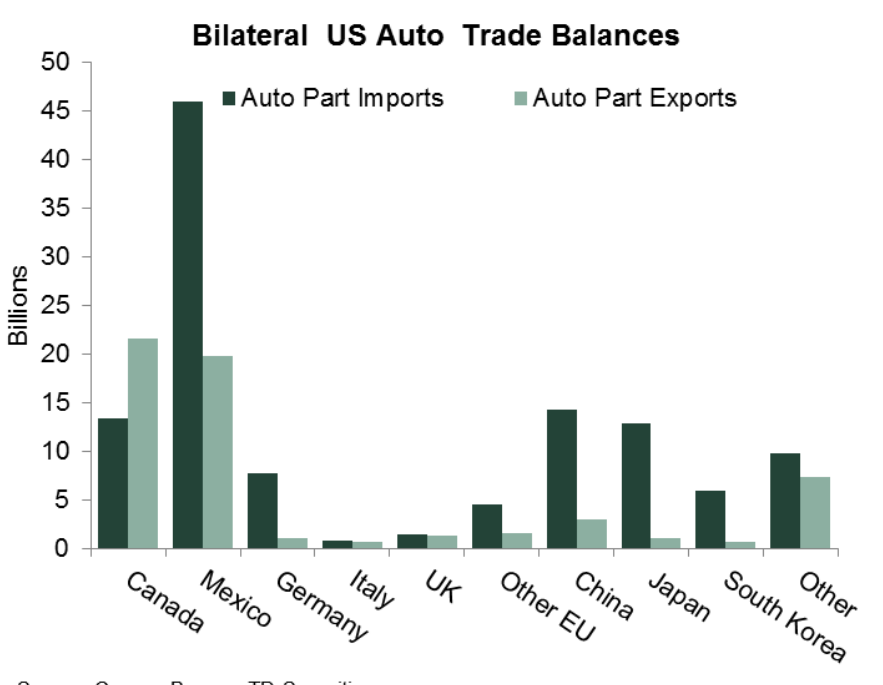
Source: Census, TD Securities

US-Canada Auto Trade: Highly Integrated

- Inflationary:
  - **US:** +0.2% on CPI
  - **Canada:** -0.2% drag on CPI as wider output gap outweighs changes to terms of trade and exchange rate adjustment
- Risk for recession in Canada:
  - **300-500k job losses in US & Canada**
  - **US:** -0.6% drag on level of GDP over 2 years
  - **Canada**: -1.3% drag on level of Canadian GDP within 1 year
  - **Global**: -0.2-0.3% drag

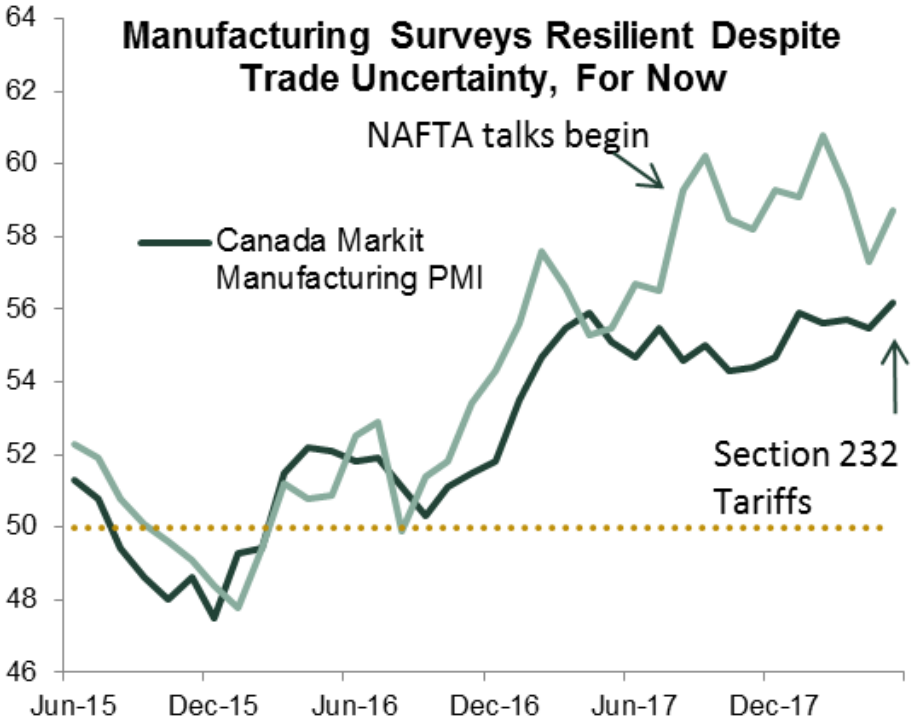


Source: Census Bureau, TD Securities

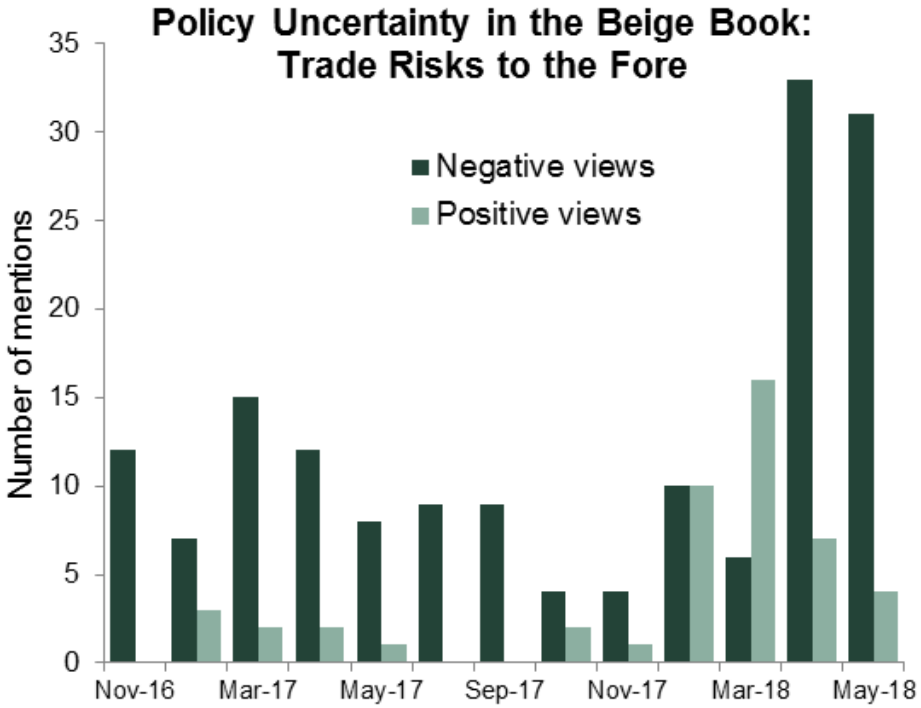


Source: Census Bureau, TD Securities

US & Canada: Business Sentiment Continues to Run Strong but at Risk of Deterioration



Source: Markit, Statistics Canada, TD Securities



Source: Federal Reserve, TD Securities

CAD: Bearish Near-Term Bias targeting 1.30 yearend 2018 and 1.25 yearend 2019

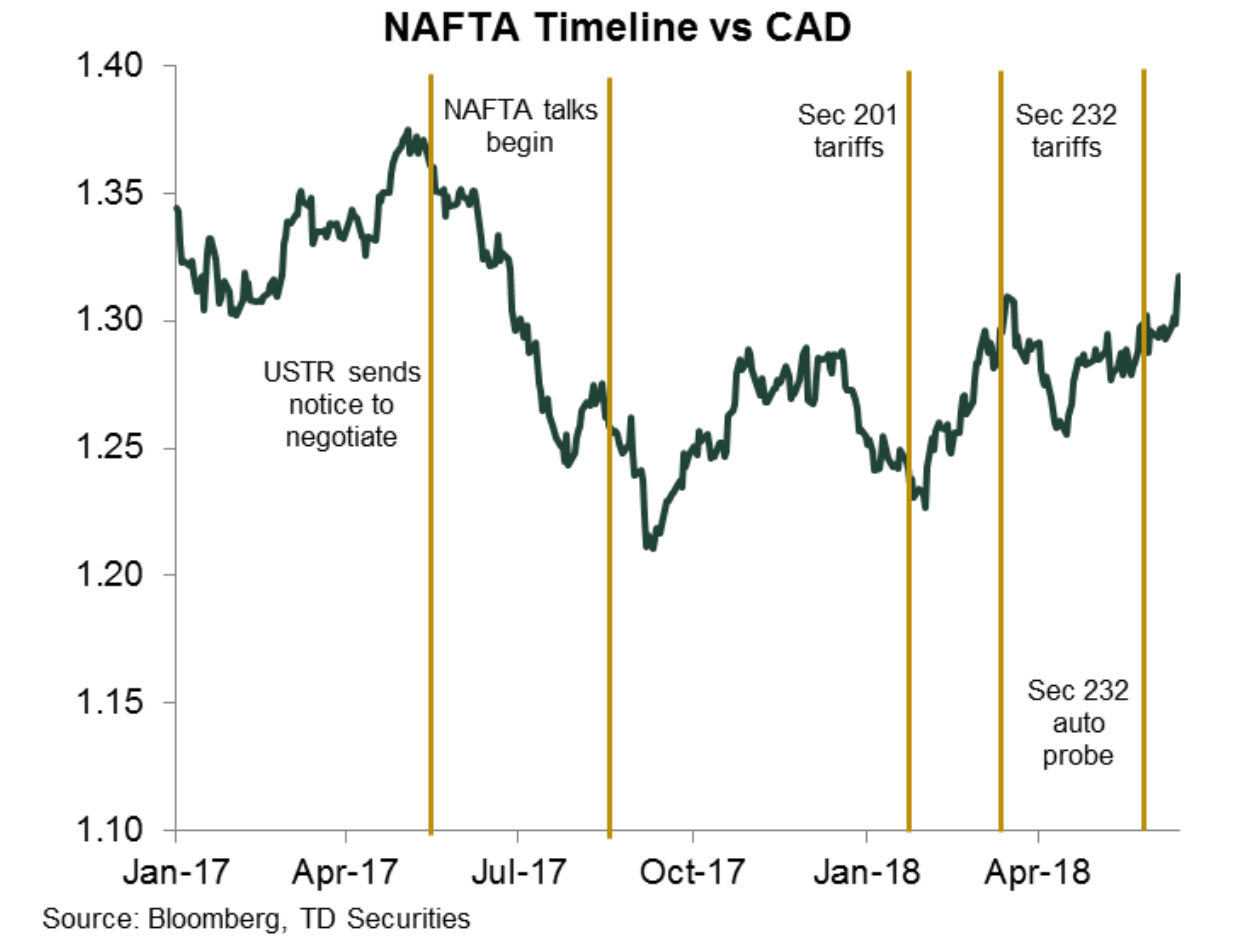
Drivers

- Bank of Canada unlikely to outpace Fed
- Oil prices rising to $70-80 to shift focus from rate spreads
- At-trend growth to continue on low rates, improving foreign demand, tight labour market
- Fair value keeping CAD anchored

Risks

- NAFTA premium on Article 2205
- Tariff retaliation, Section 232 auto tariffs
- Harding landing on housing prompted by mortgage rules and tighter financial conditions
- Higher wage growth, above-target core inflation

CAD: Bearish Near-Term Bias targeting 1.30 yearend 2018 and 1.25 yearend 2019



Source: Bloomberg, TD Securities

Thank you!

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