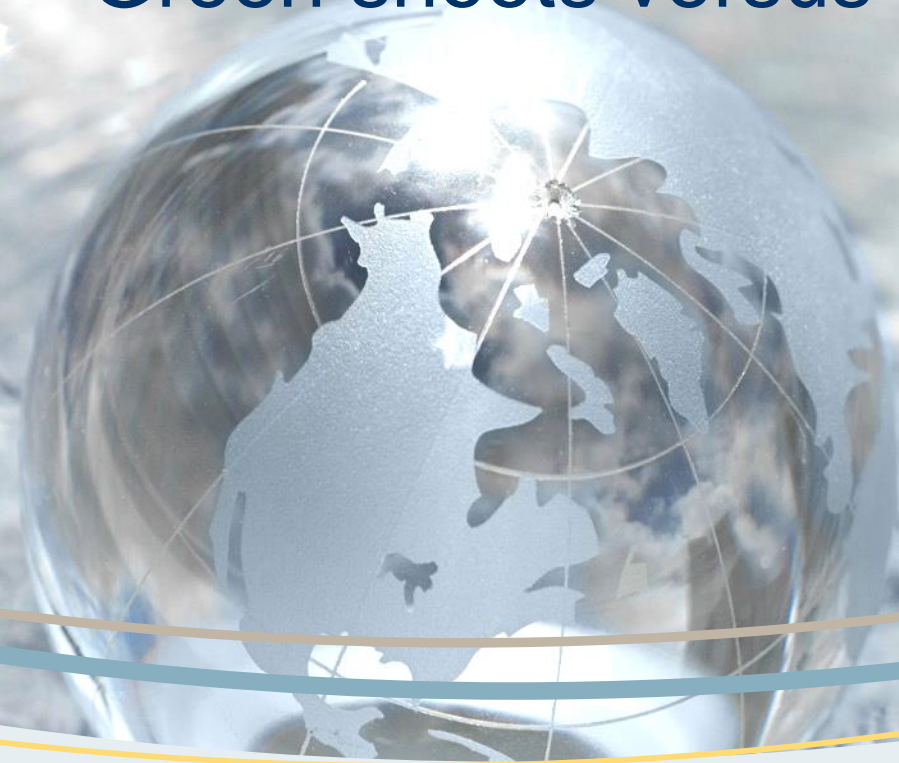


RBC Global Asset Management

# Monthly economic webcast: Green shoots versus tariffs



Eric Lascelles, Chief Economist  
June 2019



# Report card

## NEGATIVE DEVELOPMENTS



- Yield curve inverts again
- Chinese data wobbles
- U.S.-China trade dispute intensifies
- Risk assets fell
- Late in business cycle
- Brexit: May resigned
- Politics: Iran, North Korea, Israel, Mueller speech, Trump tax return

## POSITIVE DEVELOPMENTS



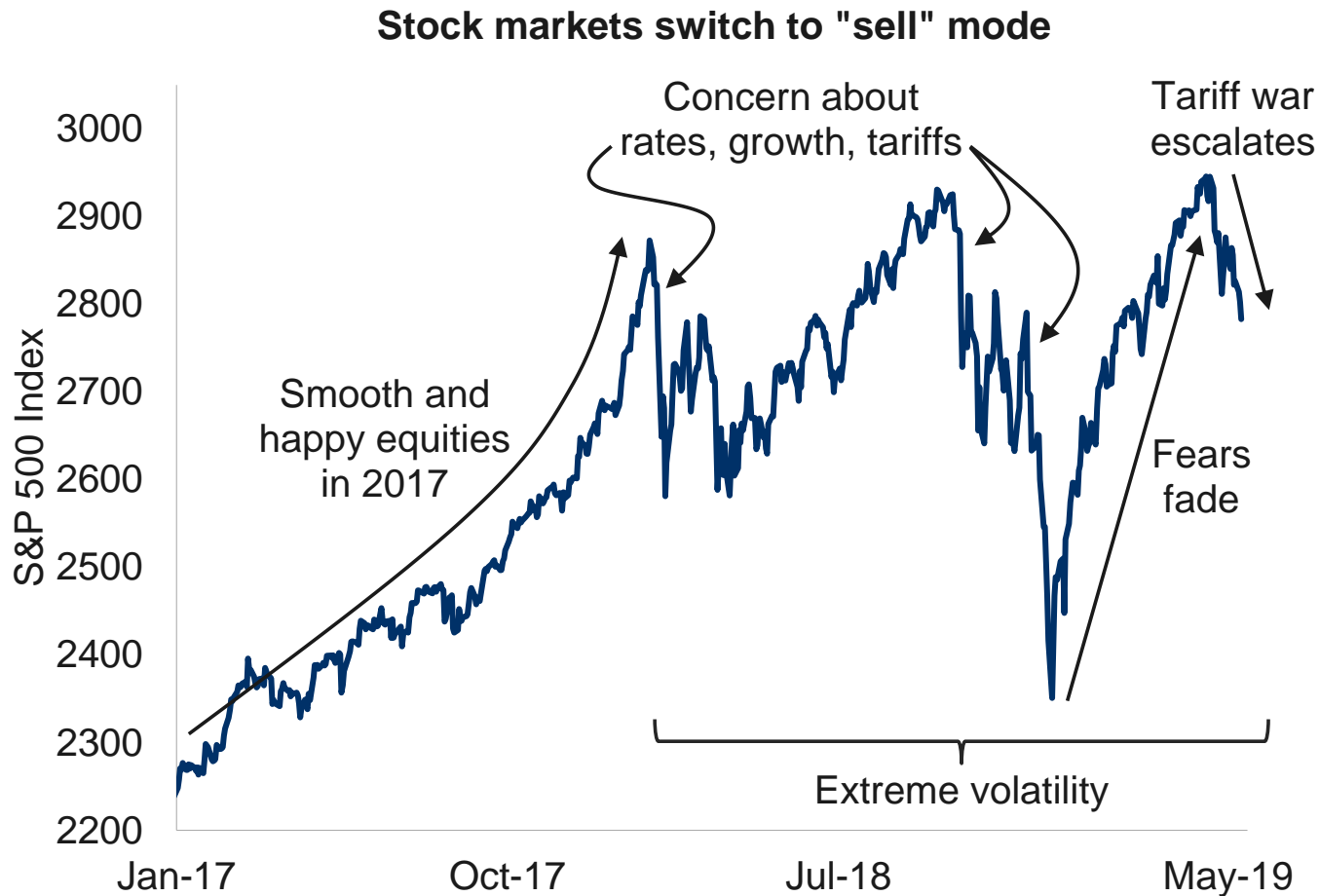
- Some economic green shoots
- Protectionism improves on other fronts: autos, steel & aluminum, USMCA
- Centrist parties retain control after EU election
- Modi won India election

## INTERESTING



- Oil prices lower, dollar higher
- Fed and BoC on hold
- EU & ECB & BoE search for new president
- Canada's mysterious employment strength

# Stock market gains eroded by U.S.-China trade dispute



Note: As of 5/29/2019. Source: WSJ, Haver Analytics, RBC GAM

# Still some economic green shoots visible



# Trade scenarios tilt toward “Negative”

Scenario	Likelihood	Detail	Economic effect
<b>Worst case</b>	<b>15%</b>	Trade war	US: -2.1% CN: -2.5% CA: -2.0%
<b>Negative</b>	<b>40%</b>	Substantial tariffs	US: -0.3 to -0.6% CN: -0.4 to -0.8% CA: -0.2 to -0.4%
<b>Slightly negative</b>	<b>25%</b>	Small tariffs	US: -0.1 to -0.2% CN: -0.2 to -0.5% CA: -0.1%
<b>Neutral</b>	<b>10%</b>	Trump tariffs unwind	US: 0.0% CN: 0.0% CA: 0.0%
<b>Best case</b>	<b>10%</b>	Foreign barriers fall to pressure	US: positive CN: ? CA: ?

Source: RBC GAM, Oxford, Bloomberg, OECD, Nomura, Goldman Sachs, UBS, Barclays, Fajgelbaum et al

# Trade war ammunition extends well beyond tariffs

## Tariffs:

- Universal
- Geographic filter
- Product filter

## Non-tariff barriers:

- Import quota
- Domestic subsidy
- Border thickness
- Technical barrier
- U.S. blocking WTO judge appointments



## Investments:

- Restrict inward capital flows
- Restrict inward corporate acquisitions
- Sell foreign holdings (China: U.S. bonds)

## Export restrictions:

- Access to Chinese “rare earths”
- Access to advanced U.S. tech

## Other pressure points:

- Immigration restrictions
- Constrain individual firms (ZTE, Huawei, Qualcomm, Micron, Apple)
- Access to \$ clearance system
- Gov’t procurement contracts
- Exchange rate manipulation
- Universal Postal Union
- Inflame public sentiment (boycott, tourism)
- Military posturing

Source: RBC GAM

# U.S. is “Late cycle” though no further along than last quarter

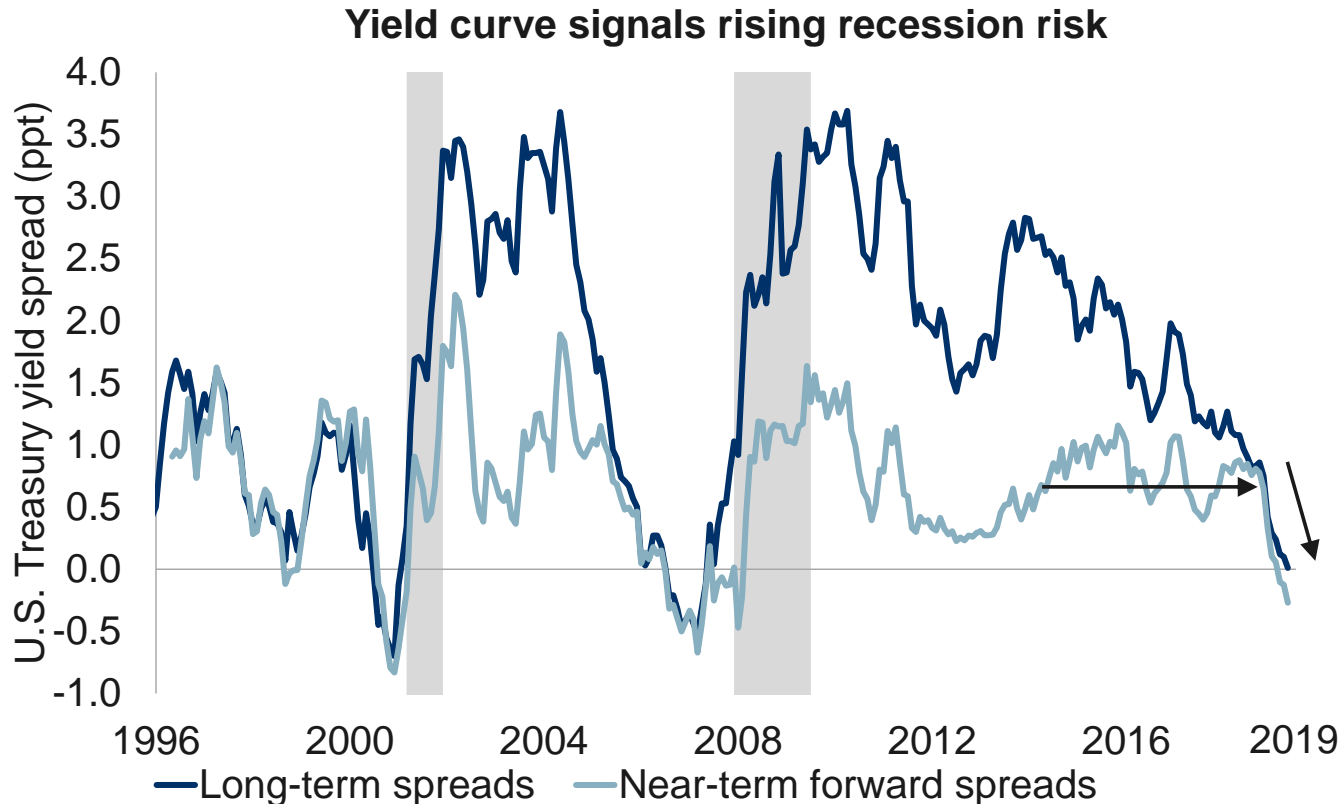
## U.S. business cycle scorecard

	Start of cycle	Early cycle	Mid cycle	Late cycle	End of cycle	Recession
Volatility			Dark shading			
Corporate profitability			Dark shading	Dark shading		
Prices			Dark shading	Dark shading		
Credit			Dark shading	Dark shading		
Business investment			Dark shading	Dark shading		
Employment			Dark shading	Dark shading	Light shading	
Inventories				Dark shading		
Housing				Dark shading		
Equities			Light shading	Dark shading	Light shading	
Sentiment			Light shading	Dark shading	Light shading	
Leverage				Dark shading	Light shading	
Economic trend				Dark shading	Light shading	
Consumer				Dark shading	Dark shading	
Economic slack				Dark shading	Dark shading	
Monetary policy				Light shading	Dark shading	
Cycle age					Dark shading	
Bonds				Light shading	Dark shading	Light shading
<b>Scores for each stage of business cycle</b>	<b>0</b>	<b>0</b>	<b>7</b>	<b>14</b>	<b>7.5</b>	<b>0.5</b>

Note: As at 5/3/2019. Dark shading indicates the most likely stage of business cycle (full weight); light shading indicates alternative interpretation (0.5 weight).

Source: RBC GAM

# Yield curve inverted: recession risk warning



Note: As of 5/29/2019. Long-term spreads measured as 10-year U.S. Treasury yield minus 3-month Treasury yield. Near-term forward spread is forward rate of 3-month Treasury bill six quarters from now minus spot 3-month Treasury yield. Shaded area represents recession. Source: Engstrom and Sharpe (2018), FEDS Notes, Washington: Board of Governors of the Federal Reserve System; Bloomberg; Haver Analytics; RBC GAM



# Yield curve debate

## Reasons for optimism

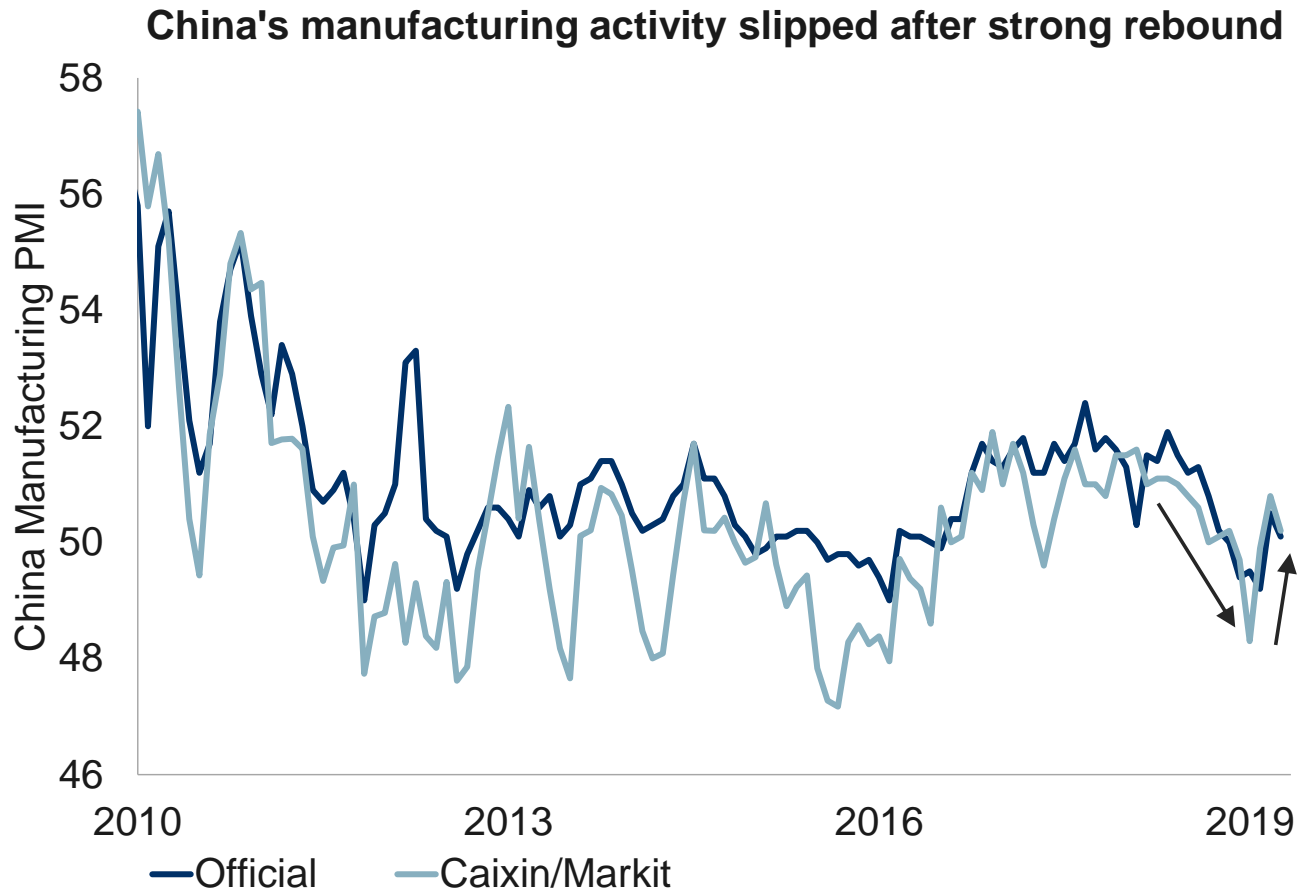
- 1) **Barely:** 3m-10yr barely inverted
- 2) **Briefly:** 3m-10yr only briefly inverted
- 3) **Lack of corroboration:** 2yr-10yr didn't invert
- 4) **Distortion:** Lack of term premium = distorted signal
- 5) **Lag:** Inversion doesn't mean immediate recession

## Reasons for pessimism

- 1) **Alarm triggered:** 3m-10yr inverted = recession
- 2) **Alternative corroboration:** 1Q-6Q T-bill forward inverted (not biased by term premium)
- 3) **Logical:** Monetary policy peaking = classic reason for curve inversion
- 4) **Distortion:** Structurally low yields makes curve artificially steeper than otherwise?
- 5) **Continuum:** Signal is a continuum: curve has been flattening for years, now quite flat
- 6) **"This Time is Different":** Long history of wrong-headed excuses:
  - 2019: "Legacy of QE" means signal distorted
  - 2007: "Foreign buying" means signal distorted
  - 2000: "Government surplus" means signal distorted
  - 1989: "Low inflation" means signal distorted

Source: RBC GAM

# China growth trend wavering



Note: As of Apr 2019. Source: China Federation of Logistics & Purchasing, IHS Markit, Macrobond, RBC GAM

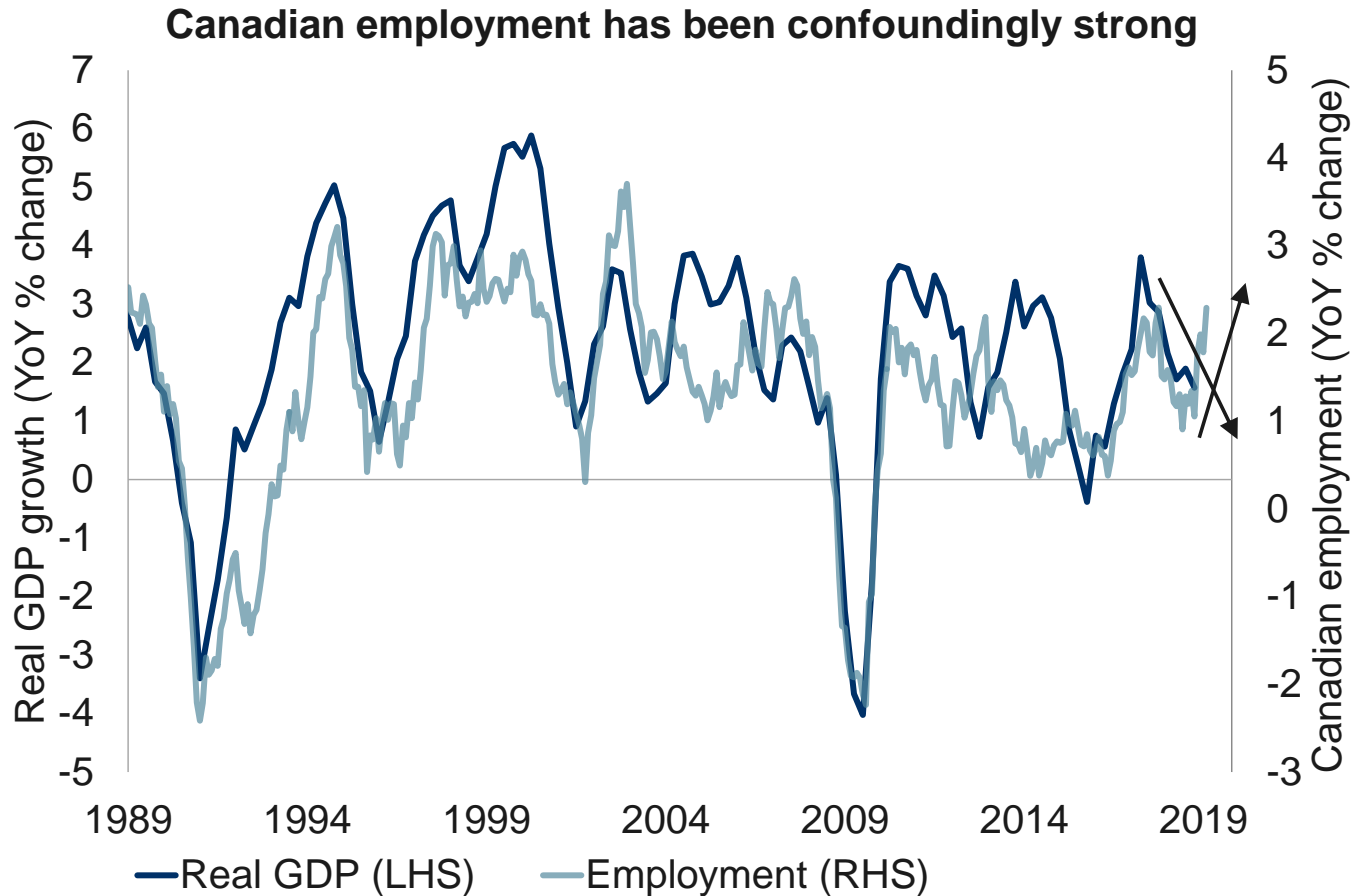
# Canadian provinces operating at different speeds

Province	Current GDP growth rate (YoY % change)
Manitoba	2.4
British Columbia	2.1
Quebec	2.1
Nova Scotia	2.0
Newfoundland and Labrador	1.9
Prince Edward Island	1.9
Ontario	1.7
Saskatchewan	1.2
Alberta	1.0
New Brunswick	0.8

Note: RBC GAM estimate of provincial GDP year-over-year growth rate as of Mar 2019.

Source: Macrobond, RBC GAM

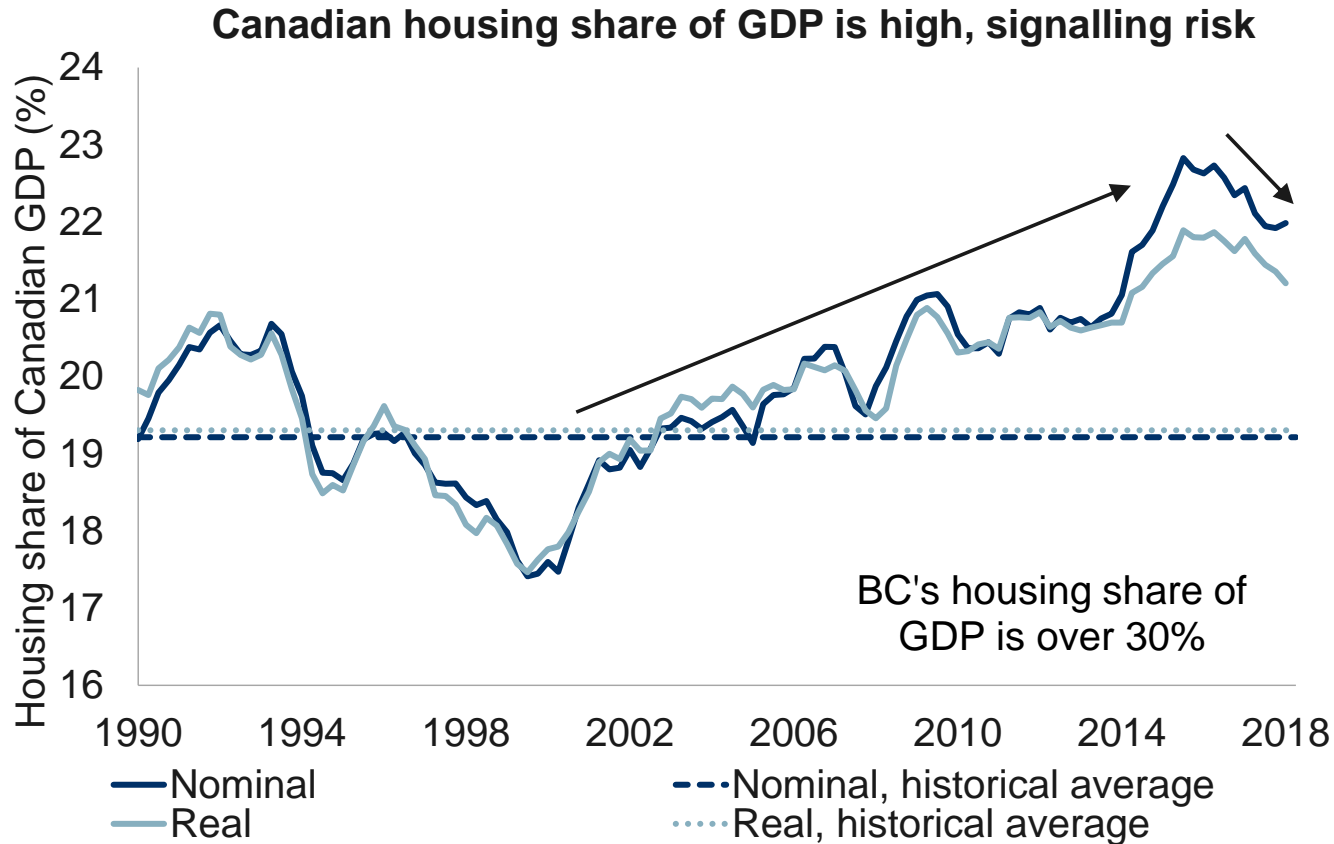
# Canadian GDP and employment disagree



Note: As of Q4 2018 for GDP, Apr 2019 for employment.

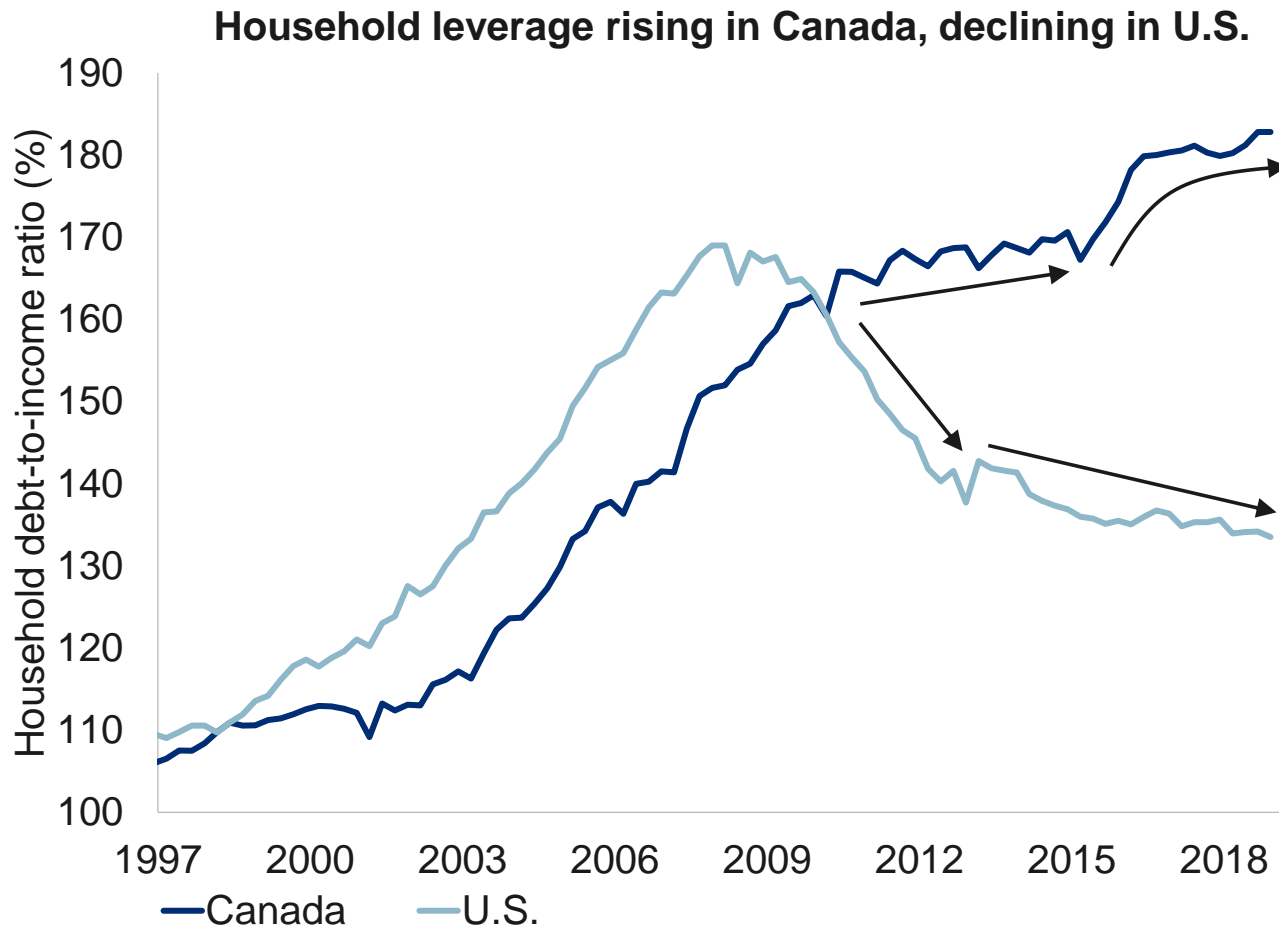
Source: Statistics Canada, Macrobond, RBC GAM

# Canadian housing is no longer adding to GDP



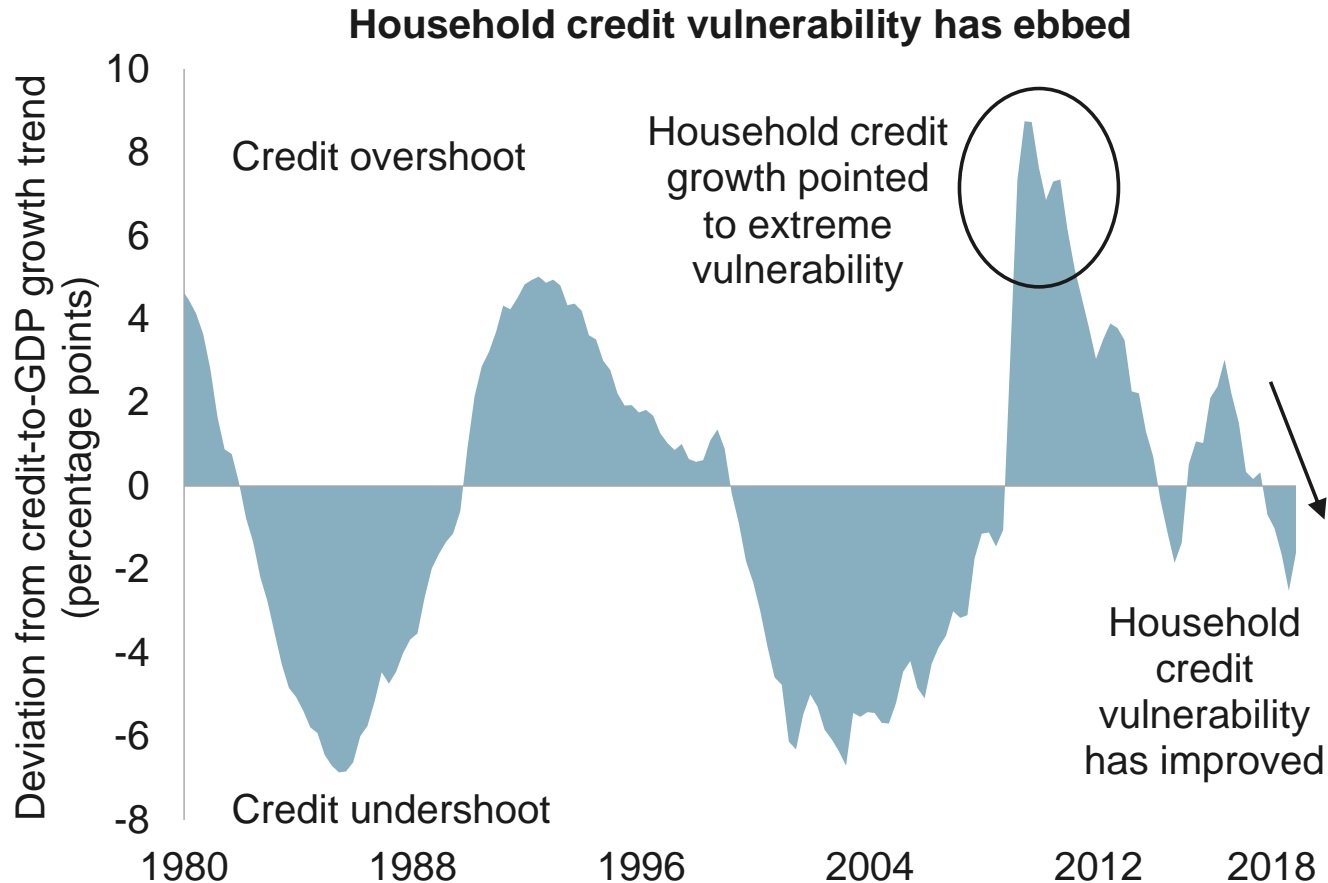
Note: As of Q4 2018. Housing share of GDP calculated as residential construction, renovations, transfer costs, housing rent (both actual and imputed for home owners), maintenance and repair of dwellings, utilities, a housing wealth effect, plus half of furniture, textiles and appliances & equipment for house and garden. Historical average from 1990 to 2006. Source: Haver Analytics, RBC GAM

# Canadian households are over-leveraged



Note: As of Q4 2018. Source: Haver Analytics, RBC GAM

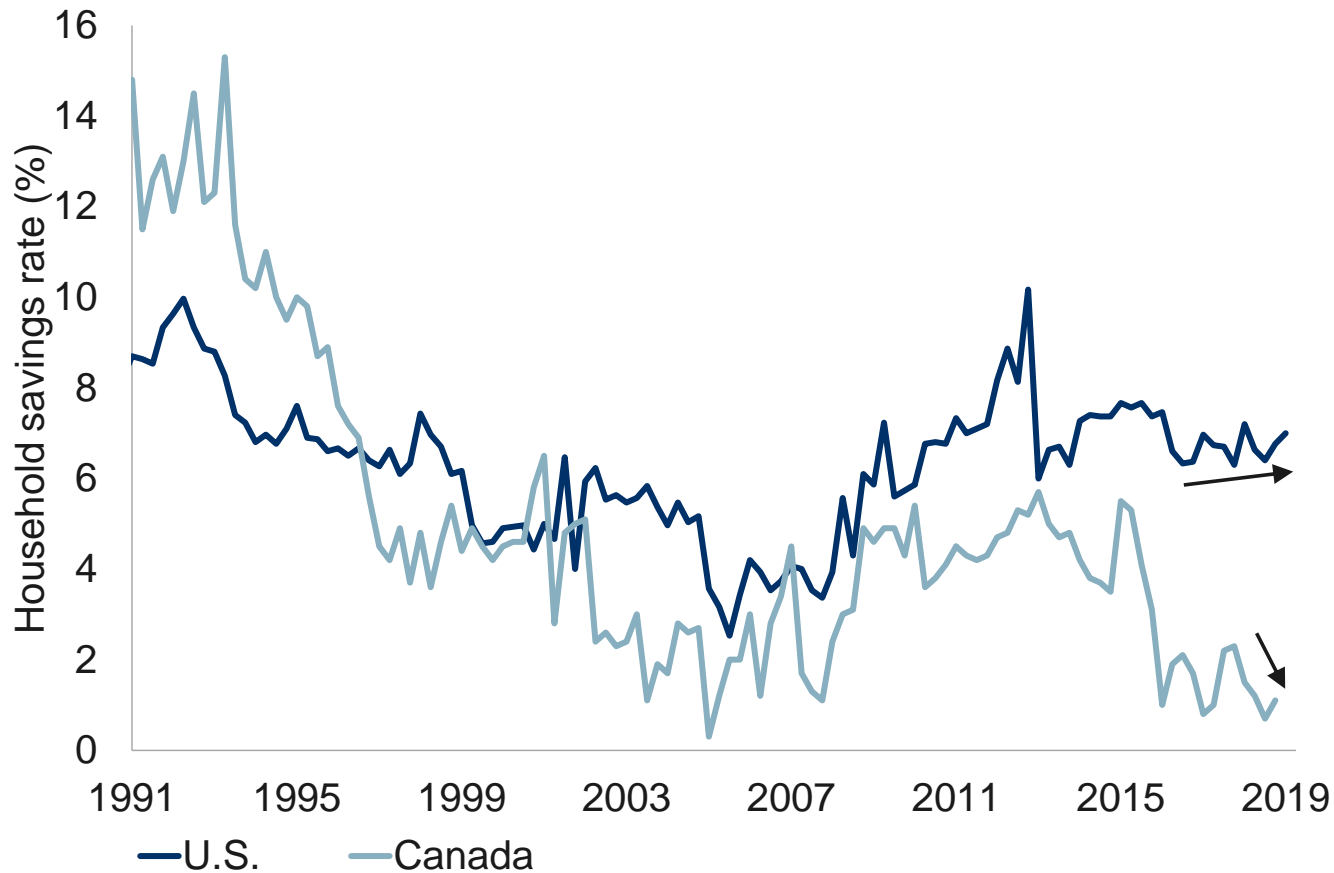
# Household credit risk actually quite tame



Note: As of Q4 2018. Trend calculated using HP filter on quarterly data with lambda of 500,000. Source: Haver Analytics, BIS, Bank of Canada, RBC GAM

# Canadian households have less room for spending growth

## Canadian households have been saving less
























Note: As of Q1 2019 for U.S., Q4 2018 for Canada. Source: Macrobond, RBC GAM



# Canadian provincial elections reveal clear rightward trend

## Latest provincial elections

Province	Latest election	Prior government	Latest government	Change
Newfoundland and Labrador	05/16/2019			
Prince Edward Island	04/23/2019			
Alberta	04/16/2019			
Quebec	10/01/2018			
New Brunswick	09/24/2018			
Ontario	06/07/2018			
Nova Scotia	05/30/2017			
British Columbia	05/09/2017			
Manitoba	04/19/2016			
Saskatchewan	04/04/2016			

Note: Red flag represents left-wing parties (non-BC Liberal, NDP), blue for right-wing parties (Conservatives, BC Liberals, Quebec CAQ, Alberta UCP).  
 Source: Wikipedia, RBC GAM



## Follow us on social media

---



@RBCGAMChiefEcon



[www.linkedin.com/in/ericlascelles](http://www.linkedin.com/in/ericlascelles)

# Disclosure

This document has been provided by RBC Global Asset Management (RBC GAM) for informational purposes only and may not be reproduced, distributed or published without the written consent of RBC Global Asset Management Inc. (RBC GAM Inc.). In Canada, this document is provided by RBC GAM Inc. (including Phillips, Hager & North Investment Management). In the United States, this document is provided by RBC Global Asset Management (U.S.) Inc., a federally registered investment adviser. In Europe, this document is provided by RBC Global Asset Management (UK) Limited, which is authorised and regulated by the UK Financial Conduct Authority. In Asia, this document is provided by RBC Investment Management (Asia) Limited, to professional, institutional investors and wholesale clients only and not to the retail public. RBC Investment Management (Asia) Limited is registered with the Securities and Futures Commission (SFC) in Hong Kong.

RBC GAM is the asset management division of Royal Bank of Canada (RBC) which includes RBC GAM Inc., RBC Global Asset Management (U.S.) Inc., RBC Global Asset Management (UK) Limited, RBC Investment Management (Asia) Limited, and BlueBay Asset Management LLP, which are separate, but affiliated subsidiaries of RBC.

This document has not been reviewed by, and is not registered with any securities or other regulatory authority, and may, where appropriate, be distributed by the above-listed entities in their respective jurisdictions. Additional information about RBC GAM may be found at [www.rbcgam.com](http://www.rbcgam.com).

This document is not intended to provide legal, accounting, tax, investment, financial or other advice and such information should not be relied upon for providing such advice. The investment process as described in this document may change over time. The characteristics set forth in this document are intended as a general illustration of some of the criteria considered in selecting securities for client portfolios. Not all investments in a client portfolio will meet such criteria. RBC GAM takes reasonable steps to provide up-to-date, accurate and reliable information, and believes the information to be so when printed. RBC GAM reserves the right at any time and without notice to change, amend or cease publication of the information.

Any investment and economic outlook information contained in this document has been compiled by RBC GAM from various sources. Information obtained from third parties is believed to be reliable, but no representation or warranty, express or implied, is made by RBC GAM, its affiliates or any other person as to its accuracy, completeness or correctness. RBC GAM and its affiliates assume no responsibility for any errors or omissions.

All opinions and estimates contained in this document constitute RBC GAM's judgment as of the indicated date of the information, are subject to change without notice and are provided in good faith but without legal responsibility. Interest rates and market conditions are subject to change.

Return estimates are for illustrative purposes only and are not a prediction of returns. Actual returns may be higher or lower than those shown and may vary substantially over shorter time periods. It is not possible to invest directly in an unmanaged index.

## **A note on forward-looking statements**

This document may contain forward-looking statements about future performance, strategies or prospects, and possible future action. The words "may," "could," "should," "would," "suspect," "outlook," "believe," "plan," "anticipate," "estimate," "expect," "intend," "forecast," "objective" and similar expressions are intended to identify forward-looking statements. Forward-looking statements are not guarantees of future performance. Forward-looking statements involve inherent risks and uncertainties about general economic factors, so it is possible that predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution you not to place undue reliance on these statements as a number of important factors could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made. These factors include, but are not limited to, general economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity and capital markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings and catastrophic events. The above list of important factors that may affect future results is not exhaustive. Before making any investment decisions, we encourage you to consider these and other factors carefully. All opinions contained in forward-looking statements are subject to change without notice and are provided in good faith but without legal responsibility.

® / TM Trademark(s) of Royal Bank of Canada. Used under licence.

© RBC Global Asset Management Inc., 2019

Publication date: May 30, 2019