



Monthly economic webcast: Good growth versus bad tariffs

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**Global Asset
Management**

Report card

NEGATIVE DEVELOPMENTS



- Sour G7 meetings
- Tariff barriers rise: China, NAFTA, metals, autos
- U.S. to restrict Chinese investments
- Consensus forecasts tilt downward
- Business cycle advancing
- Turkish, Mexican, Italian elections; Merkel migrant crisis
- Democracy in structural decline

POSITIVE DEVELOPMENTS



- Global economy stabilizing, moving well
- Strong U.S. economy
- Economic speed limit is rising
- Interest rates give back some of prior gains
- U.S. oil sector booms
- U.S.-North Korean meetings went well

INTERESTING



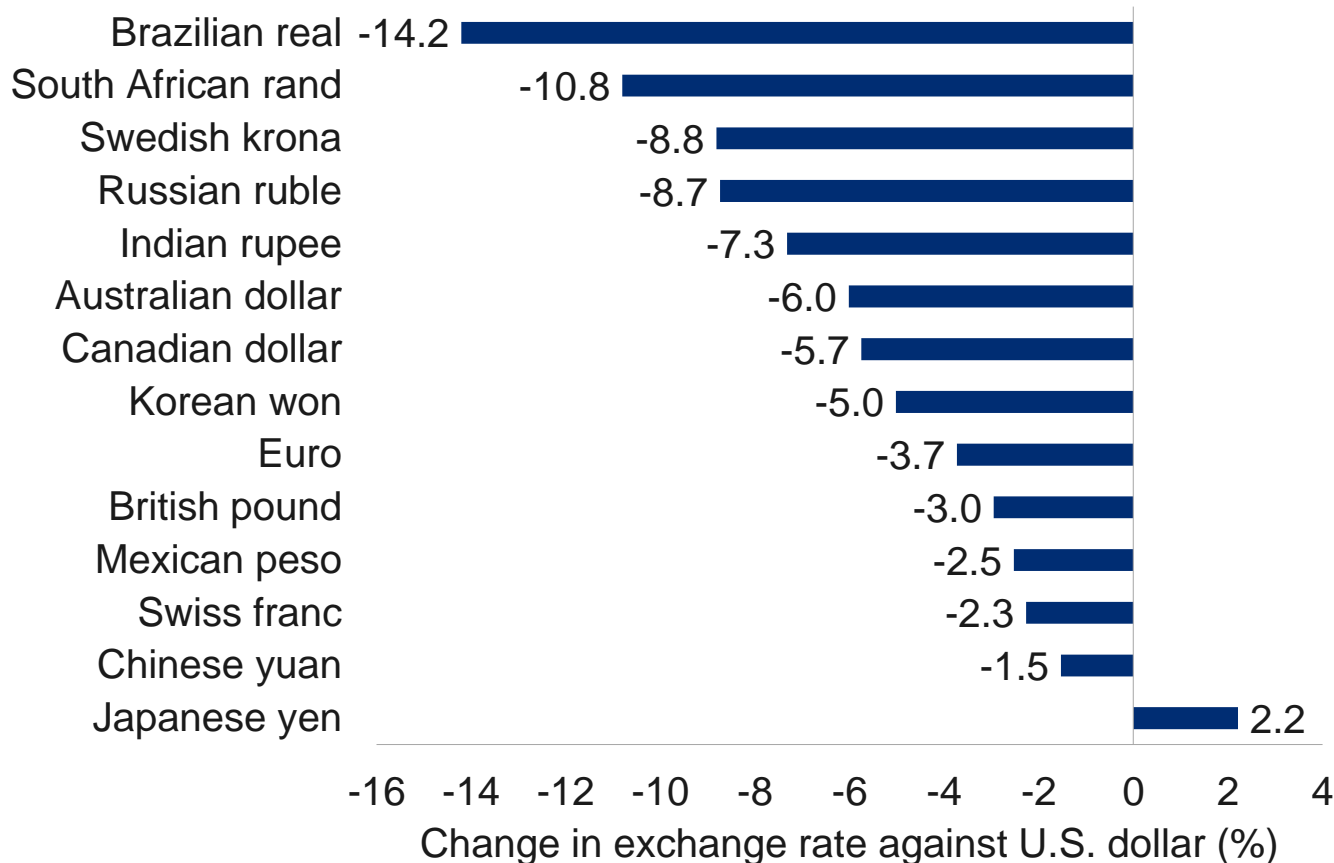
- ECB to end bond buying by end of 2018
- OPEC oil deal; U.S. revives sanction on Iran
- China RRR rate cut
- Fed hiked rates
- BoC contemplates July hike

Financial markets choppy in 2018



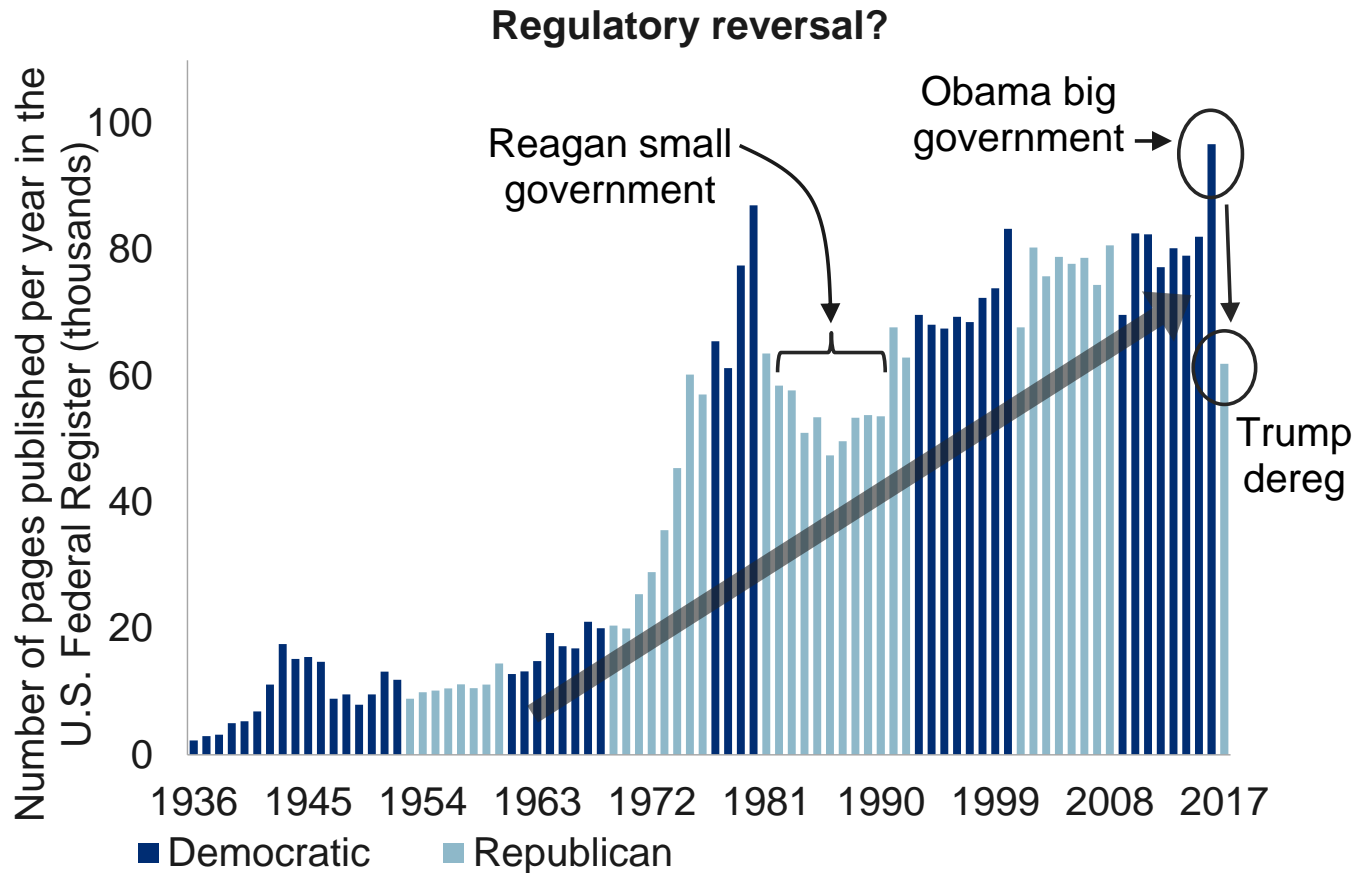
U.S. dollar strengthens on trade war & softer data

U.S. dollar strengthened against most currencies



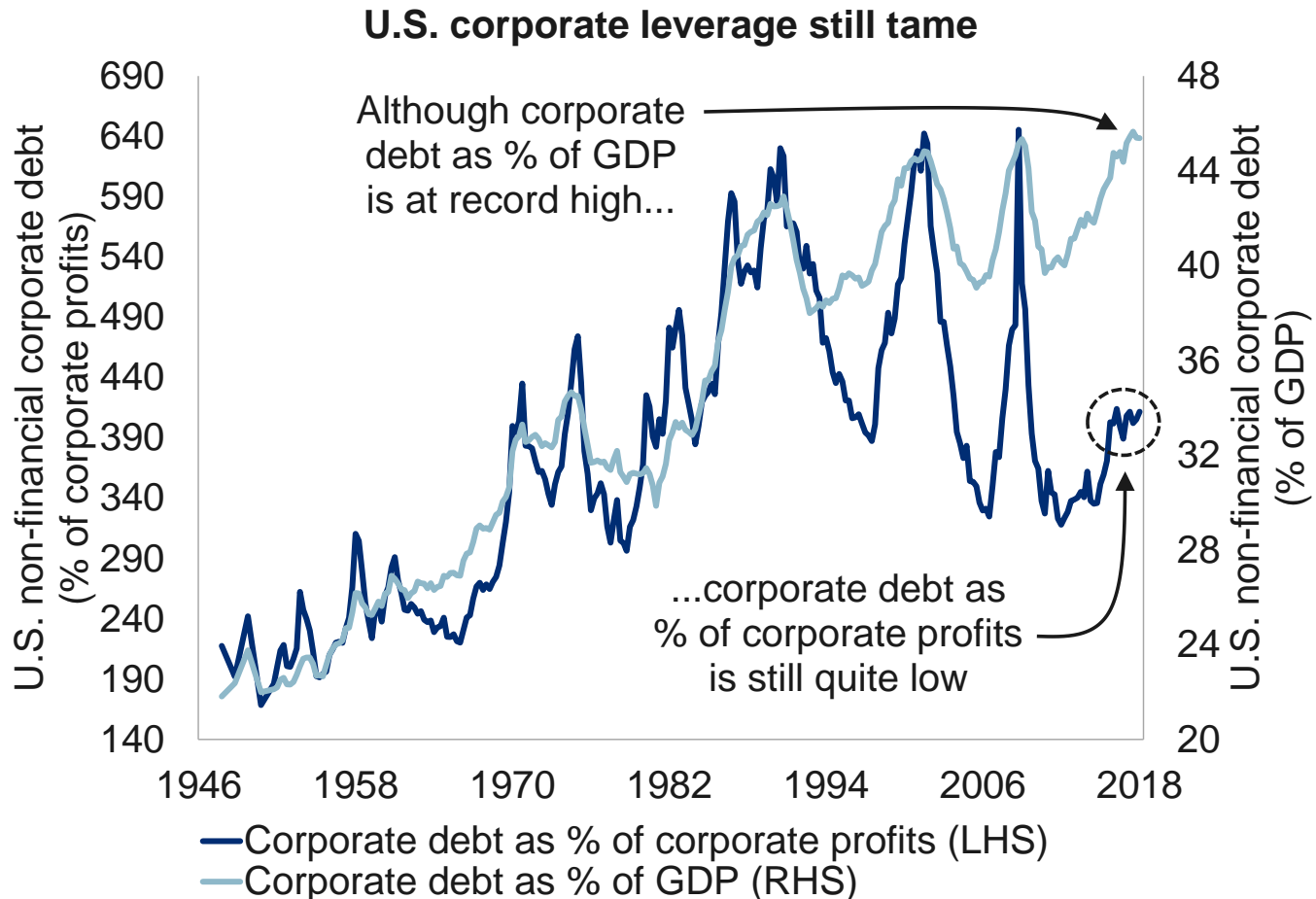
Note: As at 6/27/2018. % change since 12/29/2017. Source: WSJ, Haver Analytics, RBC GAM

Visual evidence of U.S. deregulation



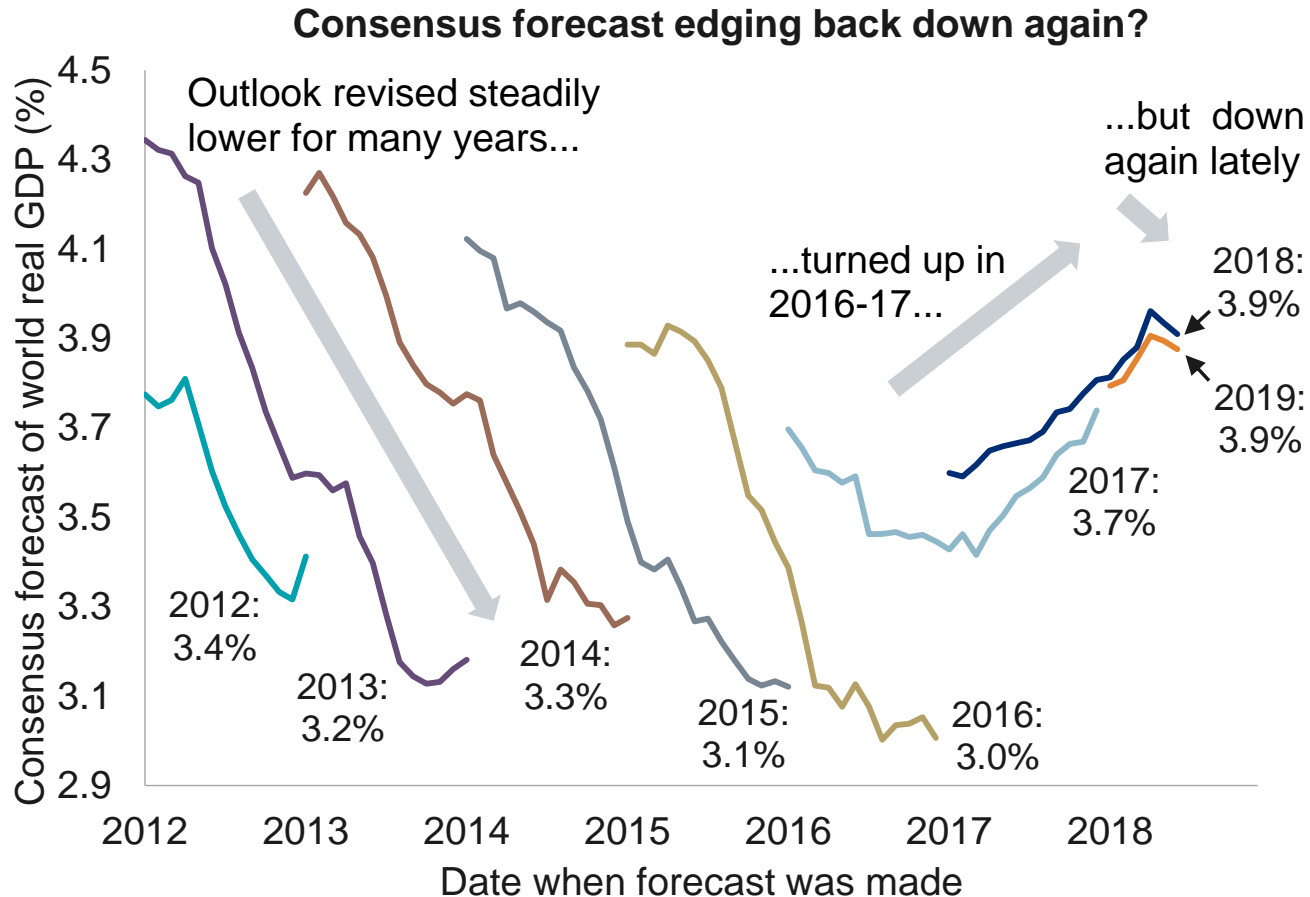
Note: The Federal Register publishes new federal agency regulations, proposed rules and public notices, executive orders, proclamations and other presidential documents. Different colors used to indicate the party in control of the White House. Source: U.S. National Archives, RBC GAM

U.S. corporate leverage is ultimately fine



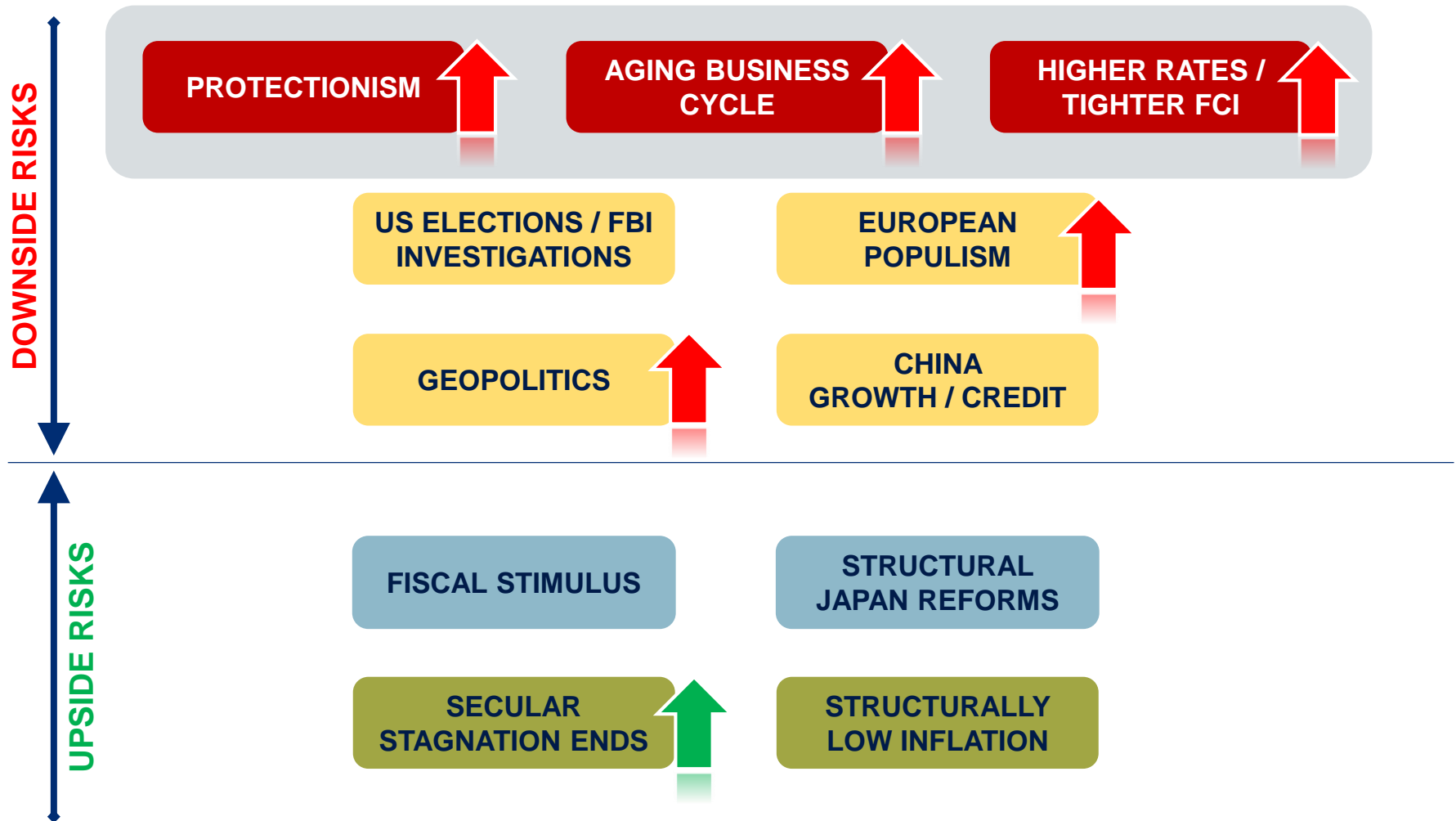
Source: BEA, Federal Reserve Board, Haver Analytics, RBC GAM

Consensus expectations falling, business cycle advancing



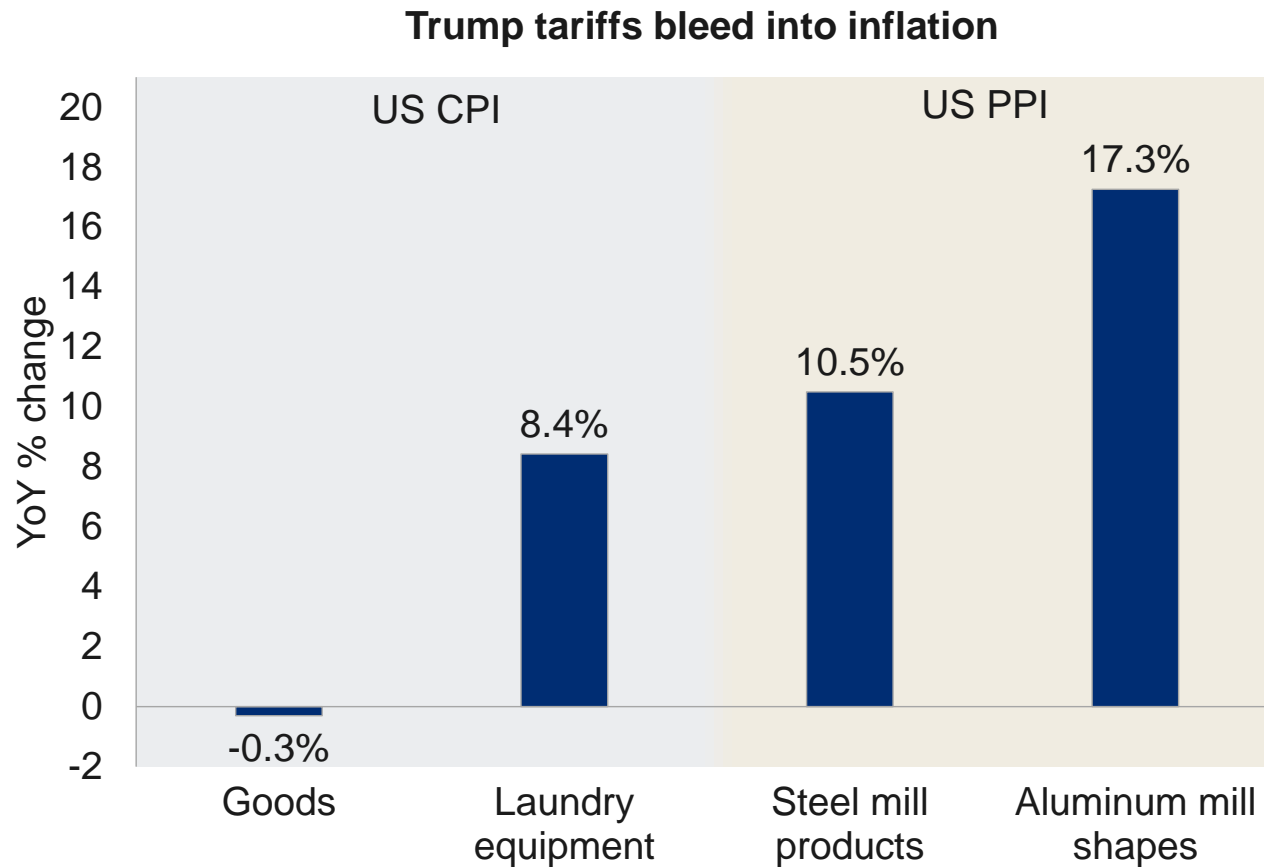
Source: Consensus Economics, IMF, RBC GAM

Macro risks: A wide range of issues



Source: RBC GAM

Trump tariffs increasing U.S. product prices already



Note: Based on latest data available.

Source: Bureau of Labor Statistics, Haver Analytics, RBC GAM

Key protectionist risks

NAFTA

*Narrow deal
focused on
autos?*

**U.S. &
China**

*Asymmetric
access to China
is key issue*

**Blanket
tariffs**

*Steel, aluminum &
auto tariffs meant
to extract trade
concessions*

Trade war? 20% chance

Source: RBC GAM

U.S. trade scenarios

Scenario	Worst case	Negative	Slightly negative	Neutral	Best case
Likelihood	20%	25%	35%	15%	10%
Detail	Trade war	Substantial increase in tariffs	Several smallish tariffs	Reverse Trump tariffs	Foreign barriers fall to pressure
Economic effect	US: -0.7 to -4.0% CN: -0.8 to -1.8% CA: -1.1 to -4.8%	US: -0.4 to -0.8% CN: -0.4 to -0.8% CA: -0.4 to -0.8%	US: -0.3% CN: -0.2% CA: -0.4%	US: 0.0% CN: 0.0% CA: 0.0%	US: positive CN: ? CA: ?

Other thoughts:

- Most trade models say protectionism damage is fairly small (see above).
- Trade uncertainty likely exerting economic drag in meantime.
- Damage to corporations may be several times larger than hit to GDP.
- Ossa (2015) argues standard models understate gains to trade by factor of 2-3
- Integrated U.S.-China and North American supply chains increase damage for multi-nationals.

Source: RBC GAM

Trade war ammunition

Tariffs:

- Universal
- Geographic filter
- Product filter

Non-tariff barriers:

- Import quota
- Domestic subsidy
- Border thickness
- Technical barrier



Investments:

- Restrict inward capital flows
- Restrict inward corporate acquisitions
- Sell foreign holdings
(China: U.S. gov't bonds)

Export restrictions:

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

Other pressure points:

- Immigration restrictions
- Constrain individual firms
(ZTE, Huawei, U.S. firms in China)
- Access to \$ clearance system
- Gov't procurement contracts
- Exchange rate manipulation
- Inflame public sentiment
(boycott, tourism)
- Military posturing

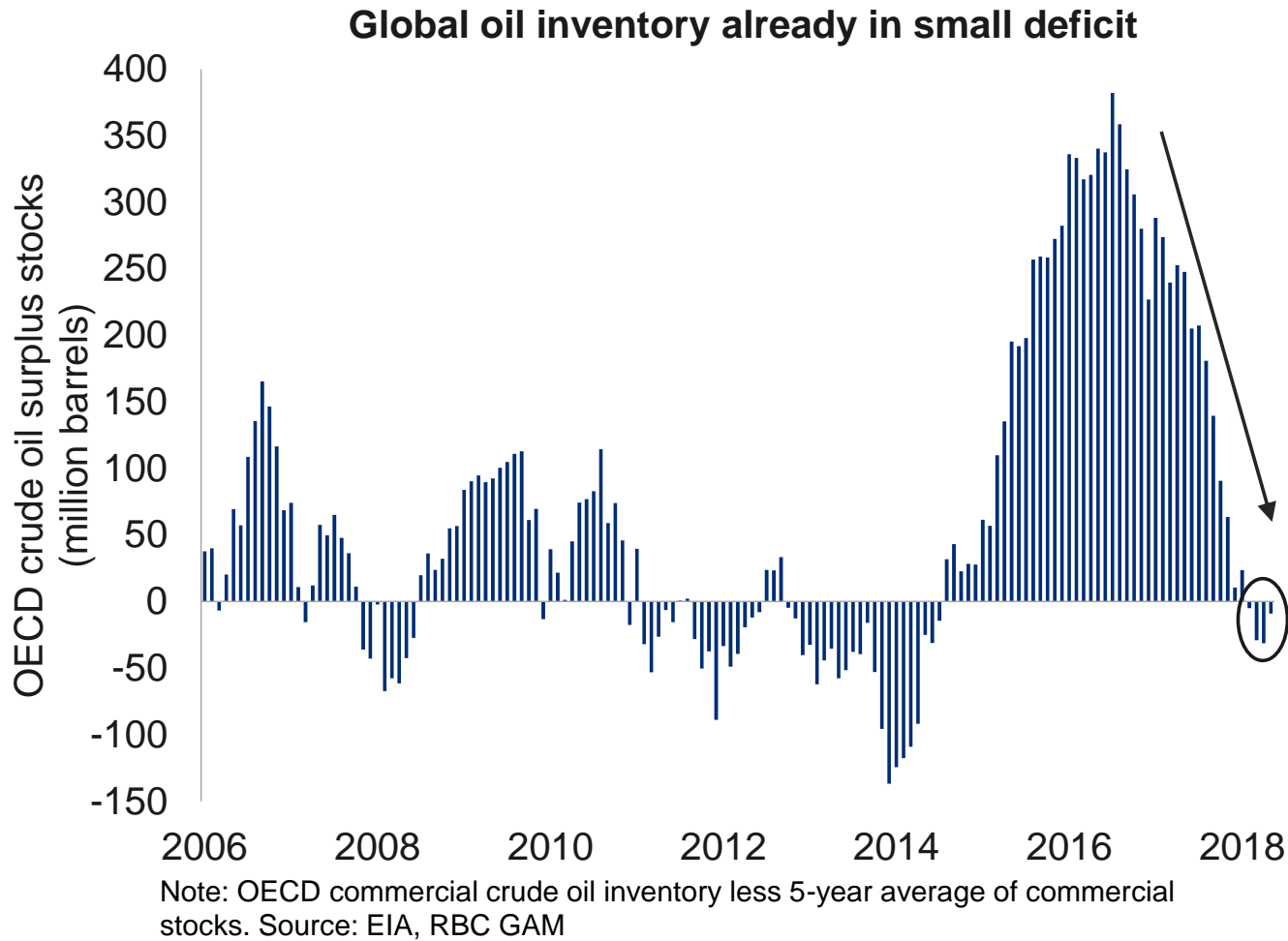
Source: RBC GAM

Flatter yield curve signals advancing cycle/ recession concerns

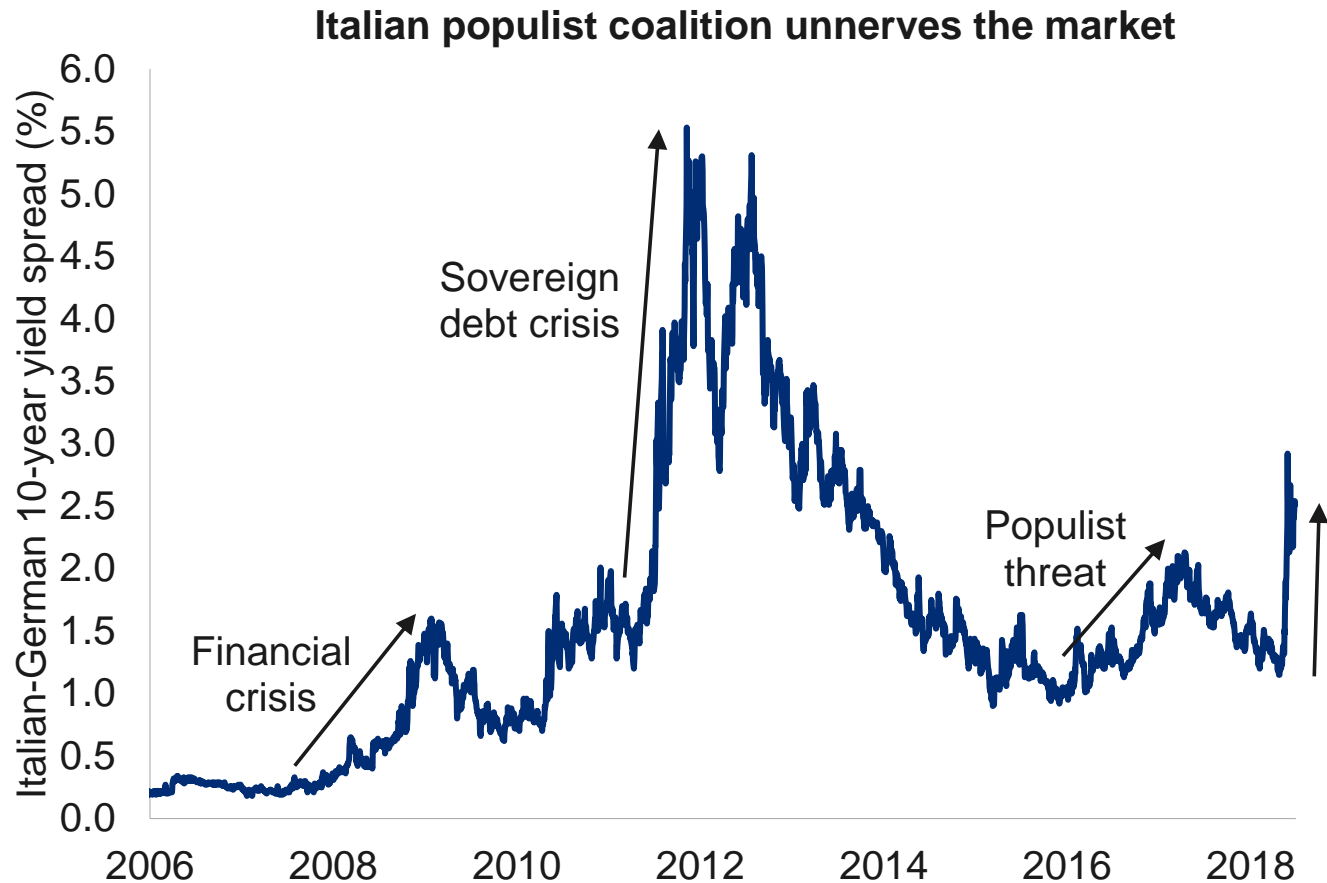


Source: Federal Reserve Board, Haver Analytics, RBC GAM

Global oil markets tighten



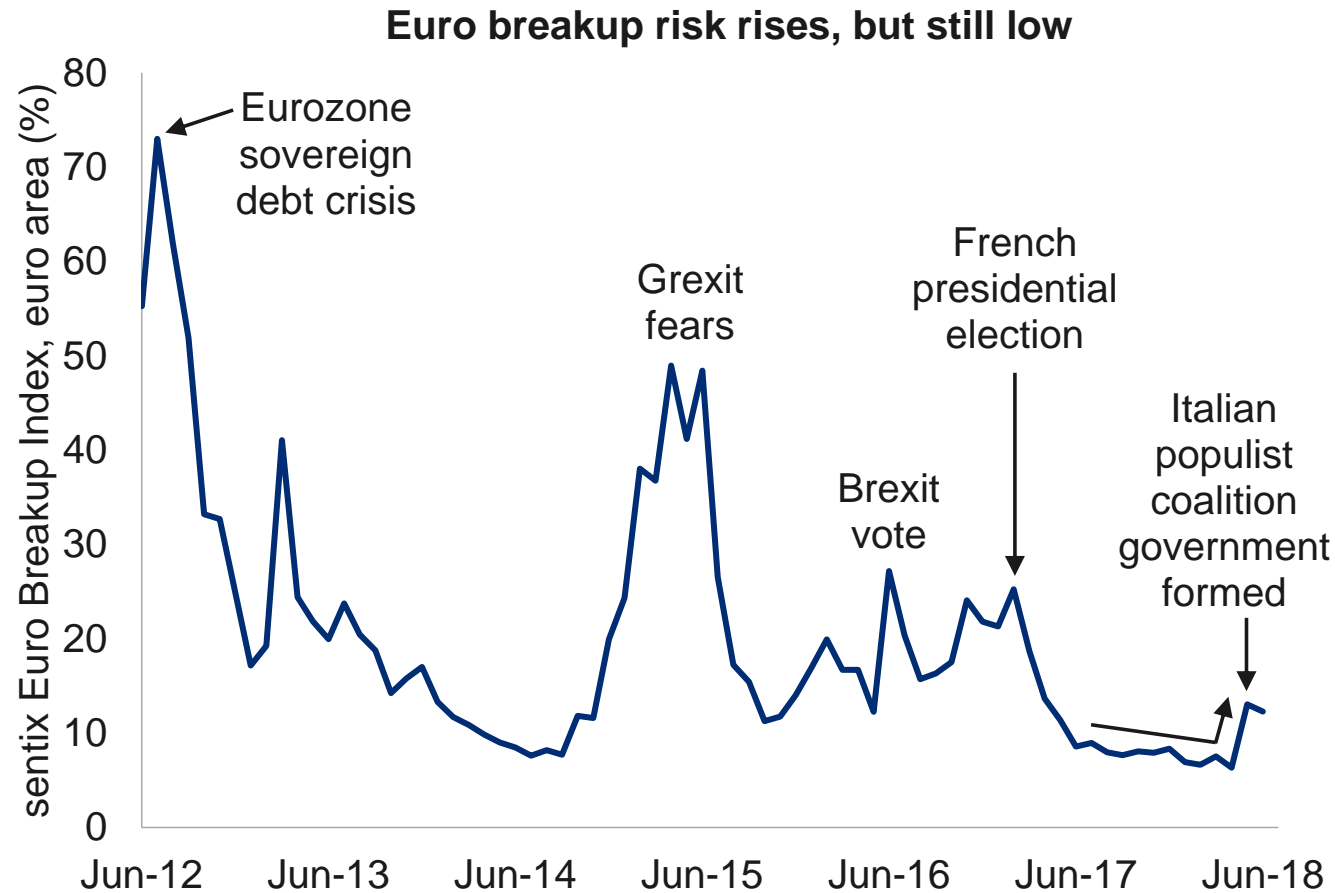
Higher risk premium sticks around after Italy's populist shift



Note: Spread of Italian and German 10-year government bond yields.

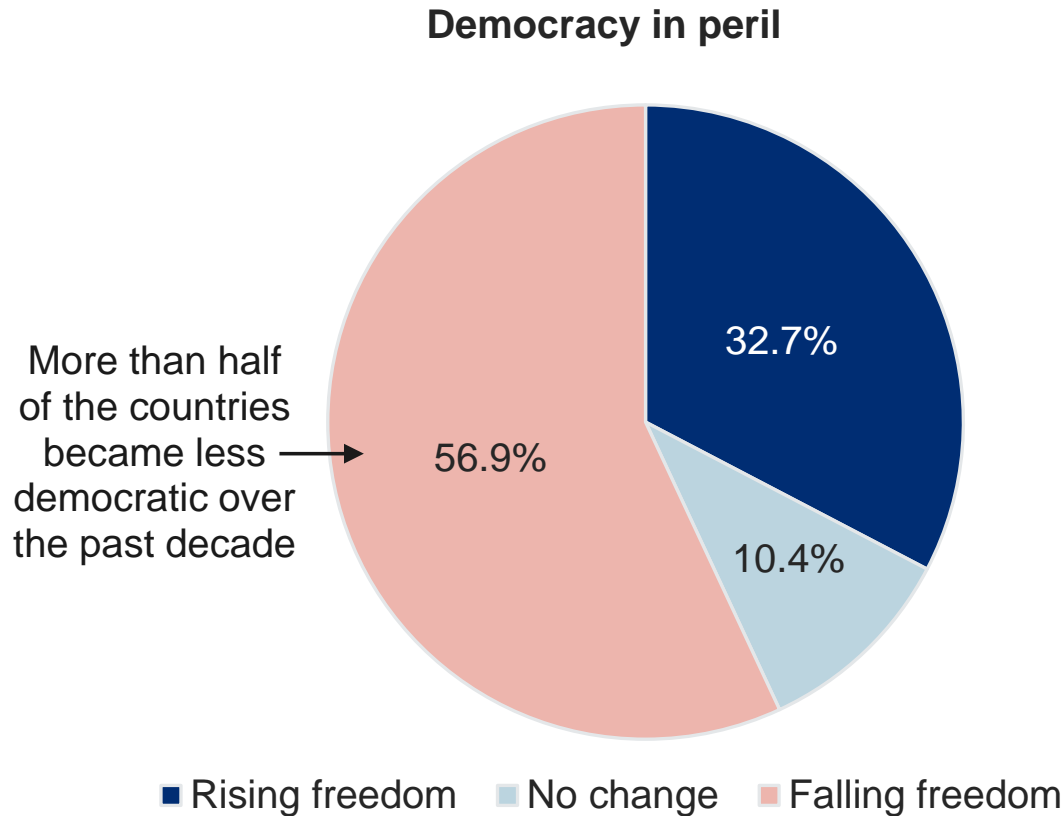
Source: Reuters, Haver Analytics, RBC GAM

But Italian government ultimately just a bump in the journey



Note: Index measures the percentage of investors that expect at least one country to leave the euro area within the next 12 months. Source: sentix GmbH, Haver Analytics, RBC GAM

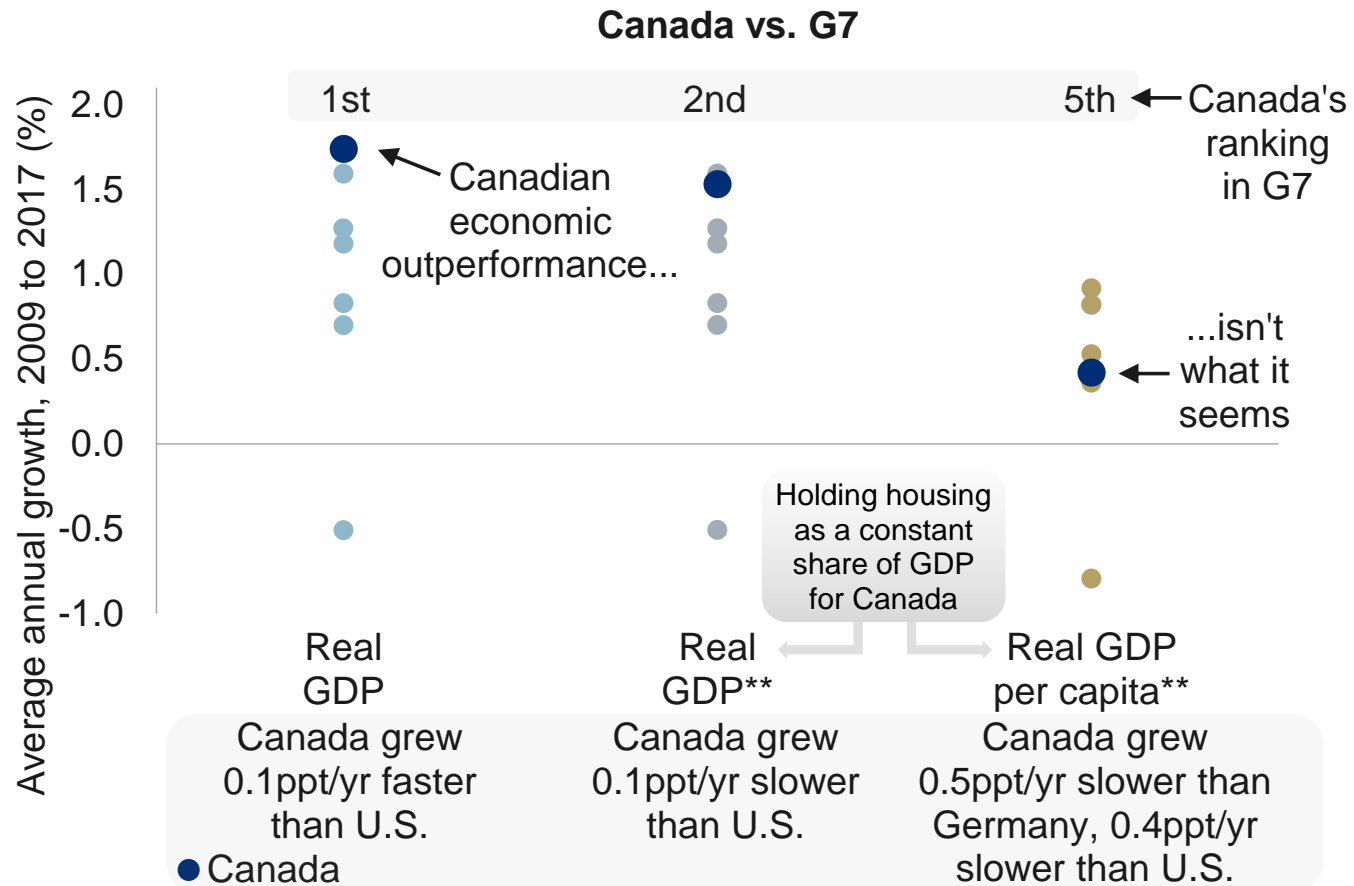
The world has become less democratic



Change in Freedom in the World Aggregate Score, 2008 to 2018

Note: Freedom in the World is an annual global assessment of political rights and civil liberties enjoyed by individuals in a country or territory. A score of 100 is most free. Source: Freedom House, RBC GAM

Canadian economy wasn't the post-crisis darling that it seemed



Note: Average annual growth of G7 countries from 2009 to 2017. Housing share of GDP for Canada is held constant at 2009 level of 20.5% after 2009 for real GDP** and real GDP per capita**. Housing share for Canada rose to 21.9% in 2017. Source: Haver Analytics, RBC GAM

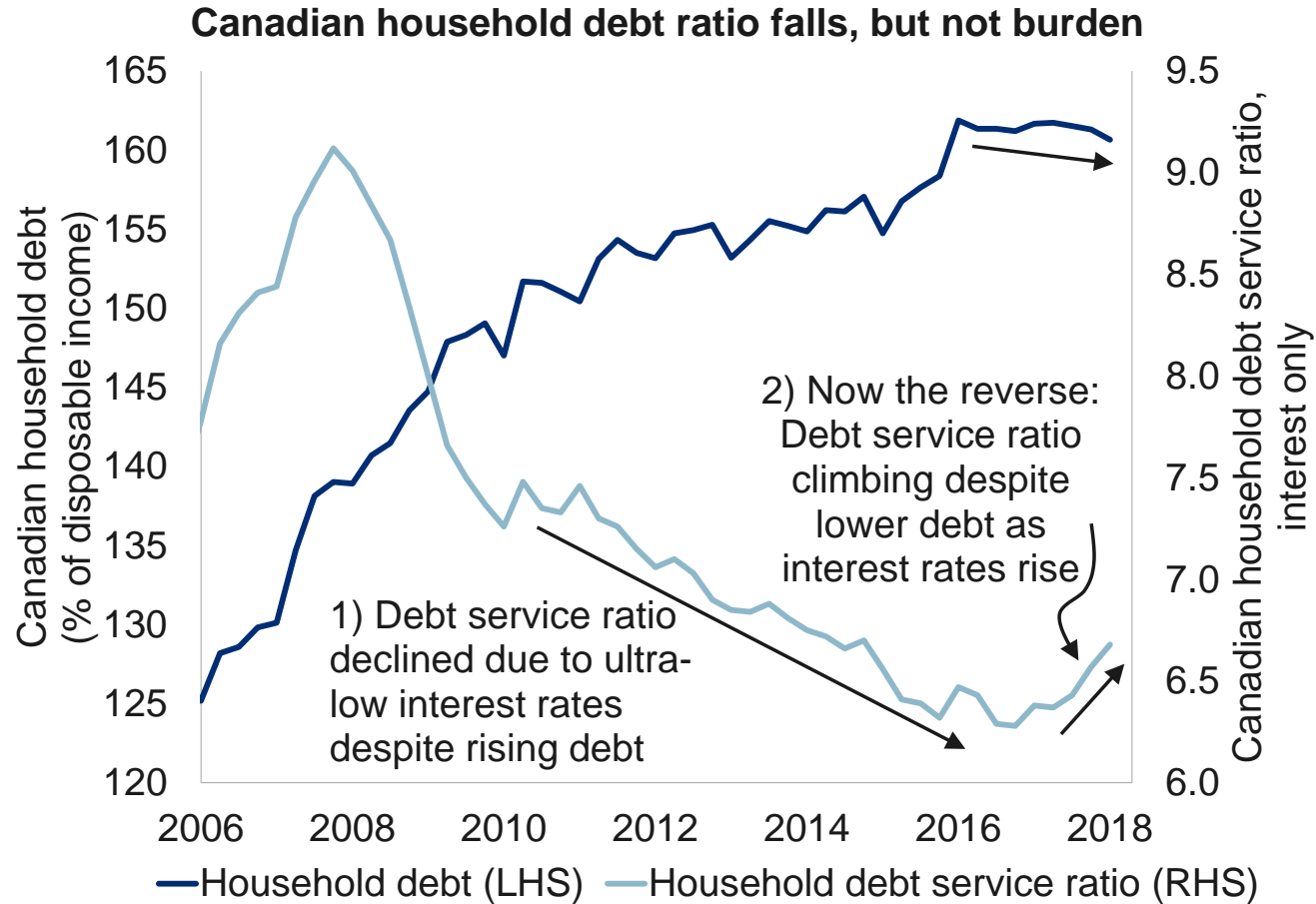
Canadian competitiveness challenges

Loss of Canadian competitiveness versus U.S.

Taxes	<ul style="list-style-type: none"> • U.S. taxes fell, Canadian taxes have mostly risen (-0.25% GDP)
Tariffs	<ul style="list-style-type: none"> • U.S. hitting Canada with tariffs (-0.5% to -1.0% GDP)
Regulations	<ul style="list-style-type: none"> • U.S. deregulating, Canada regulating • New, more extensive resource consultation process • New restrictive hiring and sourcing rules on infrastructure projects
Moral suasion	<ul style="list-style-type: none"> • White House threatens companies that expand outside U.S.
Environment	<ul style="list-style-type: none"> • Canada in Paris agreement, U.S. out • New carbon taxes ramp up over five years (-0.5% GDP)
Labour	<ul style="list-style-type: none"> • Tougher labour laws in Canada (ON, AB, BC) <ul style="list-style-type: none"> • Sharply rising minimum wage (-0.1% GDP) • Easier unionization, FT/PT equivalency
Other?	<ul style="list-style-type: none"> • <i>Transportation constraints</i>: Both pipeline and rail are problematic • <i>Housing rules</i>: tightening in Canada, easing in U.S. • <i>Household debt</i>: very high in Canada, middling in U.S. • <i>Electricity?</i>: Big jump in Ontario
On the other hand...	<ul style="list-style-type: none"> • <i>Free trade</i>: Canada signs CETA, CPTPP, interprovincial deals • <i>Immigration</i>: More and higher quality in Canada than U.S. • <i>Public debt</i>: Lower public debt than U.S. even with provinces • <i>Interest rates</i>: Lower in Canada (but rising in both nations) • <i>New IP strategy?</i>

Source: RBC GAM

Canada still vulnerable despite falling household debt ratio



Source: Haver Analytics, RBC GAM

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