Monthly economic webcast:
Political complications heat up
# Report card

## Negative Developments

- Italian political mess hits global markets
- U.S. protectionism: China, NAFTA, metals, autos
- U.S. public debt profile deteriorating
- Canadian mortgage crunch
- Macro signals waning slightly

## Positive Developments

- Global economy still moving fairly well
- Evidence that economic speed limit is rising
- Interest rates give back some of prior gains
- Chinese consumer on the ascent
- U.S. oil sector booms
- Europeans more positive on EU and euro

## Interesting

- EM-DM growth gap widening
- U.S. pulled out of Iran nuclear deal
- Geopolitics affect oil
- U.S.-North Korea summit off then on
- Canada nationalized Trans Mountain Pipeline
- BoC hints at July hike
Italy’s populist wave hits the markets hard

Italian president rejects populist coalition

Note: Spread of Italian and German 10-year government bond yields.
Source: Reuters, Haver Analytics, RBC GAM
Feelings about EU and euro have become more positive

Support for EU and euro has risen over time

Note: Net percent balance calculated as % of survey respondents who support a European economic and monetary union and euro minus % of survey respondents who are against.

Source: European Commission Standard Eurobarometer 88 and 80, RBC GAM
Companies have big plans for the future

Company investment intentions are up

Note: U.S. expected capex (% balance) is an average of the results from manufacturing outlook surveys conducted by Federal Reserve Banks - Dallas, Kansas, New York, Philadelphia, and Richmond. Source: Haver Analytics, RBC GAM
Global growth pickup is more structural than cyclical (good!)

Economic speed limit is rebounding

60% of acceleration is structural

More capital investment on the way

Note: IMF calculations for composition of growth in advanced economies. TFP is total factor productivity, the more efficient interplay of capital and labor. Source: IMF, 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? 10% chance

Source: RBC GAM
U.S. trade scenarios

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Worst case</th>
<th>Negative</th>
<th>Slightly negative</th>
<th>Neutral</th>
<th>Best case</th>
</tr>
</thead>
<tbody>
<tr>
<td>Likelihood</td>
<td>10%</td>
<td>25%</td>
<td>35%</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>Detail</td>
<td>Trade war w/ blanket tariffs</td>
<td>Substantial increase in tariffs</td>
<td>Small Trump tariffs persist</td>
<td>Reverse Trump tariffs</td>
<td>Foreign barriers fall to pressure</td>
</tr>
<tr>
<td>Economic effect</td>
<td>US: -1.0% China: -1.6%</td>
<td>US: -0.3% China: -0.3%</td>
<td>US: -0.1% China: -0.1%</td>
<td>US: 0.0% China: 0.0%</td>
<td>US: positive China: ?</td>
</tr>
</tbody>
</table>

Complications:

- Most trade models say protectionism damage is fairly small (see above).
- Trade uncertainty likely exerting economic drag in meantime.
- Integrated U.S.-China and North American supply chains could reduce economic damage in short run but increase it in long run.

Source: RBC GAM
Bad fiscal position for so late in cycle

U.S. fiscal deficit is much bigger than it should be

Source: CBO, OMB, Haver Analytics, RBC GAM

Budget balance (LHS, inverted) — Unemployment rate (RHS)


U.S. federal budget balance (% of GDP)

U.S. unemployment rate (%)

Korean War
Vietnam War

Trump stimulus package

CBO forecast
U.S. net interest payments set to become expensive

U.S. debt servicing cost to rise quickly

- Rising interest rates and Trump fiscal stimulus
- Interest rate surged during 1970s stagflation...
- ... and stayed high till early 1990s

Source: OMB, Haver Analytics, RBC GAM
U.S. inflation to rise, then fall back to slightly above target

U.S. inflation likely to rise above 3% in short run

Source: BLS, Haver Analytics, RBC GAM
A new chapter in Japan’s inflation

Prices of durable goods in Japan no longer falling

Durable goods were the main culprit during the deflationary spiral

Note: Shaded area represents Japan's deflationary spiral.
Source: Ministry of Internal Affairs and Communication, Haver Analytics, RBC GAM
EM-DM growth gap to widen

Growth gap between developed & emerging markets growing

Note: Real GDP growth differential measured as the difference between annual real GDP growth of developed and emerging countries.
Source: IMF, Haver Analytics, RBC GAM
China nearing U.S. global clout

China's retail sales to surpass U.S. soon

Retail sales (US$ billions)

Note: 12-month moving total of retail sales. Source: Haver Analytics, RBC GAM
A Chinese drag: the downside of gigantic cities…

You can own a car in Beijing if you win the lottery

Source: Beijing Passenger Car Index Regulatory Office, RBC GAM
Global oil glut dries up and geopolitical supply shocks loom

Global oil glut cleared

OECD crude oil surplus stocks

Note: OECD commercial crude oil inventory less 5-year average of commercial stocks. Source: EIA, RBC GAM
U.S. shale oil is now the true swing producer
U.S. oil can expand at $50/barrel

Profitability threshold for U.S. oil producers

Average breakeven price

Note: Bars show the maximum and minimum breakeven prices (WTI price) in the top two areas in which the respondent firm is active. Source: Federal Reserve Bank of Dallas Energy Survey Q1 2018, RBC GAM
Canadian capital spending has yet to fully recover

Oil and gas capex is still dragging

Canadian capital expenditures (CA$ billions)


Note: Capital expenditures for latest 2 years are preliminary actuals and intentions.
Source: Statistics Canada, Haver Analytics, RBC GAM
Higher rates to be a drag on Canadian housing market

Mortgage rates now higher for renewers

Mortgages renew at higher rate

Mortgages renew at lower rate

Source: CMHC, Haver Analytics, RBC GAM
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