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The Shaky Case for Reversing Keynes

by Avery Shenfeld

It goes against everything you learned in Economics 101. But a case is being made these days for fiscal stimulus at the top of the business cycle. We have very little slack globally (see pages 8-9), and the US and Canada are either at full employment now or will be by 2019.

The reverse-Keynesian view is tied to the idea that juicing the economy with tax cuts or government spending will give central banks more room for offsetting interest rate hikes. In turn, a higher peak rate is seen as a plus by creating room for monetary easing during the next economic downturn (although reducing the budgetary room for a later fiscal ease). It also reduces the temptation for an already indebted household sector to pile on further debt.

That case for turning Keynes on his head is shaky on several grounds. For one, in the US, recent increases in federal government spending, or consumption driven by tax cuts at the peak of the cycle, will crowd out private sector capital spending, reducing subsequent productivity growth. There are only so many construction workers to go around. The rate hikes themselves are a deterrent to private sector capital spending, offsetting the incentives from corporate tax cuts.

In Canada, we're talking about a much more modest potential dose of fiscal stimulus coming from some provincial governments, with Ottawa actually slowing government program spending growth in the year ahead. The two largest provinces that make up central Canada seem tempted to aim at reduced surpluses or a return to deficits in upcoming election-year budgets. As well, infrastructure spending is still ramping up in some parts of the country.

One problem is that provinces that are already near full employment are the ones considering a fiscal easing. Looking at government capital spending plans, growth in the coming year will end up missing the provinces with the greatest slack (see pages 3-7). Moreover, unlike the AAA-rated federal government, where the debt/GDP ratio is low by historical standards, among the provinces, all but the three most western provinces are still carrying relatively large debt loads.

Finally, in the case of Canada, it's not clear that a policy mix of fiscally stimulative budgets offset by a steeper dose of interest rate hikes would be a winner for economic or financial stability. Ramping up interest rates at a faster pace, in an economy with historically elevated household debt, increases the risk of an overshoot that ends up squeezing housing and consumption more than intended.

Indeed, the Bank of Canada seems eager to proceed only slowly towards higher interest rates. It has time on its side with no immediate inflation pressures, and wants to make sure that each hike is carefully assessed in terms of how well Canadian households will cope with it. Best to give them the luxury of that gradualist approach, rather than have fiscal stimulus put pressure on the central bank to hike rates at a faster clip.

MARKET CALL

- We're sticking to our guns that the Bank of Canada will be on hold until July, and that a quarter point hike could be the last we hear from them until 2019. True, there's a bit more hope now that a NAFTA deal can be reached. But we still have the BoC needing enough evidence that the only 1.6% growth pace in the second half of last year has given way to much better times, and that there isn't too much of a drag from new mortgage regulation and rate hikes to date.
- Dollar-Canada came a long way towards our 1.32 target, but could lose a few cents if the BoC takes a pass on rate hikes in the next two months. We would see anything through that level as an opportunity to buy the Canadian currency, expecting a weaker general trend for the US$ to give it at least a stable track in the last half of this year.
- The very long end of both the US and Canadian curves looks rich, given our expectations for an upward creep in CPI in both countries. Long rates will also be pressured higher globally if, as we expect, markets start to focus on the upcoming end to QE in Europe and a potential for major central banks to begin tightening policy earlier than they now assert.

INTEREST & FOREIGN EXCHANGE RATES

		2018				2019			
END OF PERIOD:		**21-Mar**	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**
CDA	Overnight target rate	1.25	1.25	1.50	1.50	1.75	1.75	2.00	2.00
	98-Day Treasury Bills	1.10	1.25	1.45	1.45	1.75	1.70	1.95	2.00
	2-Year Gov't Bond	1.87	1.85	2.05	2.05	2.10	2.10	2.20	2.25
	10-Year Gov't Bond	2.27	2.35	2.35	2.35	2.45	2.40	2.55	2.60
	30-Year Gov't Bond	2.38	2.50	2.65	2.70	2.75	2.80	2.90	2.95
U.S.	Federal Funds Rate	1.625	1.875	2.125	2.125	2.375	2.625	2.625	2.875
	91-Day Treasury Bills	1.74	1.80	1.90	2.05	2.25	2.55	2.65	2.80
	2-Year Gov't Note	2.31	2.30	2.40	2.50	2.60	2.70	2.70	2.80
	10-Year Gov't Note	2.88	2.85	2.80	2.90	3.05	3.10	3.10	3.15
	30-Year Gov't Bond	3.11	3.25	3.35	3.40	3.40	3.45	3.55	3.50
Canada - US T-Bill Spread		-0.63	-0.55	-0.45	-0.60	-0.50	-0.85	-0.70	-0.80
Canada - US 10-Year Bond Spread		-0.61	-0.50	-0.45	-0.55	-0.60	-0.70	-0.55	-0.55
Canada Yield Curve (10-Year — 2-Year)		0.40	0.50	0.30	0.30	0.35	0.30	0.35	0.35
US Yield Curve (10-Year — 2-Year)		0.58	0.55	0.40	0.40	0.45	0.40	0.40	0.35
EXCHANGE RATES	CADUSD	0.78	0.77	0.76	0.76	0.78	0.78	0.76	0.77
	USDCAD	1.29	1.30	1.32	1.31	1.28	1.29	1.31	1.30
	USDJPY	106	105	103	102	102	102	101	100
	EURUSD	1.23	1.25	1.27	1.28	1.29	1.29	1.30	1.32
	GBPUSD	1.41	1.37	1.38	1.43	1.45	1.47	1.48	1.52
	AUDUSD	0.78	0.80	0.82	0.83	0.85	0.86	0.86	0.85
	USDCHF	0.95	0.94	0.92	0.92	0.92	0.93	0.93	0.92
	USDBRL	3.27	3.26	3.40	3.45	3.40	3.50	3.52	3.58
	USDMXN	18.4	20.1	19.5	19.0	18.8	18.8	18.5	19.0

Provincial Outlook: Growth Slows, But Bond Buyers Busy

Avery Shenfeld and Andrew Grantham

Someone has to pay the price. As the Canadian economy narrows in on full employment, there's less elbow room for further growth, and that has to show up on the financial books of individual provinces. While bond markets should be generally braced for less robust provincial revenue gains, recent data offers some clues on where the slowdown will be focused, as well as the outlook for issuance and ratings pressures ahead.

We don't get timely real and nominal GDP data for all provinces, but recent results in three key sectors—manufacturing, wholesaling and retailing—show varying degrees of deceleration. The second-half of 2017 saw a marked cooling in the pace of growth in Alberta, after a red hot first half. Among the other large provinces, Ontario also registered a notable easing. In contrast, BC hung on to its first-half vigour, while Québec's moderation still left it running above the national average (Chart 1). Québec and Ontario also produce quarterly GDP data which confirmed that the former significantly outpaced the latter in Q3.

Fiscal Stimulus and Restraint

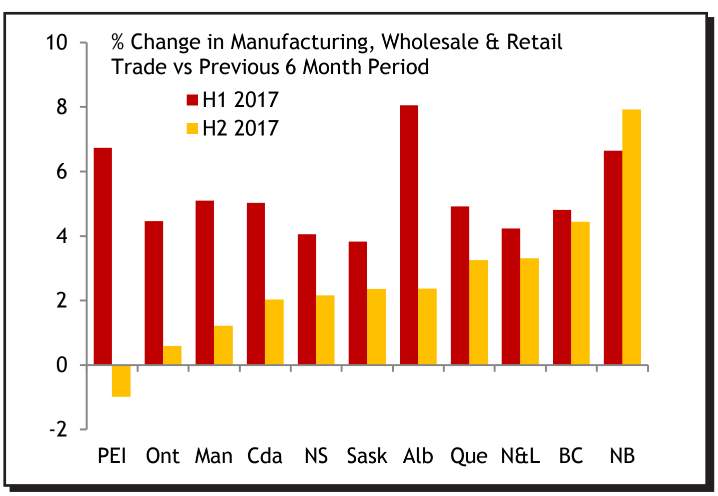
Fiscal policy developments lean in the same direction in terms of Alberta seeing a steeper deceleration than we had previously forecast. Drawing on data from the latest Statistics Canada capital spending survey, government cap-ex on infrastructure looks slated to decelerate in Alberta after a big Keynesian ramp-up, with an even deeper slide in Saskatchewan and Newfoundland and Labrador (Chart 2). These provinces all are coming off sizeable deficits, and Newfoundland's existing debt level adds to the pressure to curtail additional borrowing.

Oddly then, the three provinces still plagued by significant economic slack will be those that get less government capital spending largesse. At the same time, three recent economic winners—Ontario, BC and Québec—are ironically those in which an acceleration in government capital spending will be trying to crowd into an already tight labour market.

The same might be true on the tax and spending side, at least for Ontario. Its finance minister projected that the upcoming budget would tolerate a deficit of 1% of GDP after achieving balance in 2017/18—the first in ten years. A subsequent election will in effect put that plan to the voters. Québec's budget is still on the drawing board, but could dangle some further tax relief ahead of its election this year.

Chart 1

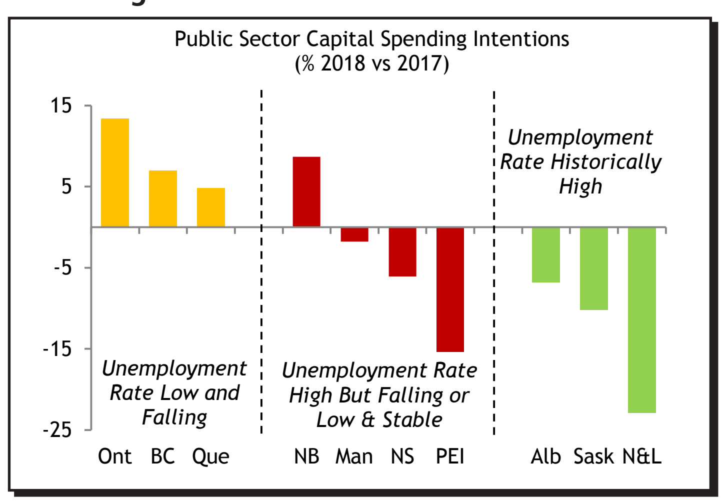
Ontario and Alberta Decelerated More Than BC or Québec in Second Half of 2017



Source: Statistics Canada, CIBC

Chart 2

Government Investment Dollars Not Going Where the Economic Slack Is



Source: Statistics Canada, CIBC

Private Sector Momentum

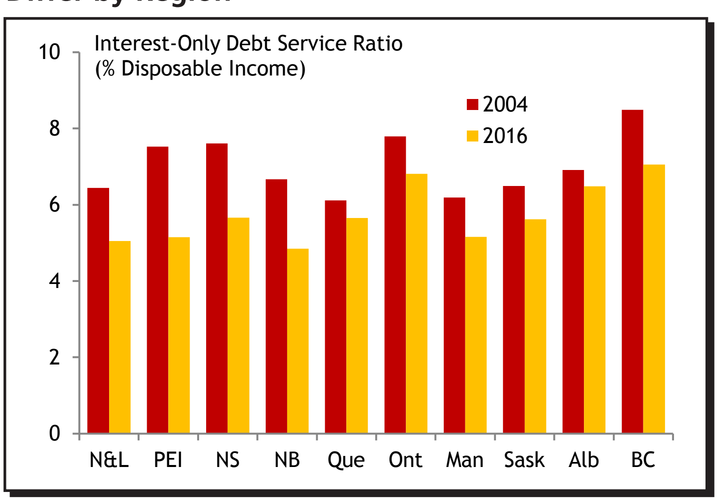
All provinces will bear some of the adjustments to growth coming from monetary policy tightening and rising bond yields. Given how low interest rates have been in the last few years, it's no surprise to see that as of 2016, households in all provinces were paying less interest expense as a percentage of income than they were in 2004 (around the time rates started rising in the prior cycle).

However, there are a few differences which hint at how provinces will be impacted by rising rates this time around. Compared to 2004 interest payments have fallen more in Atlantic provinces than in most others (Chart 3). It's no shock that Ontario and BC have the two highest interest-only debt service ratios given their elevated housing prices. But there has been a change in the composition of those payments which could make Ontarians more immediately susceptible to interest rate increases.

In the two years before Poloz's rate hikes, Ontario's interest-only debt service rate fell less than BC's, largely because households there are now paying more non-mortgage interest (Chart 4). An increase in non-mortgage debt such as lines of credit, which move directly with BoC rate hikes, could suggest a higher sensitivity to rising interest rates relative to BC. Due to the prevalence of fixed rate mortgages, interest expense there tends to move more slowly.

Chart 3

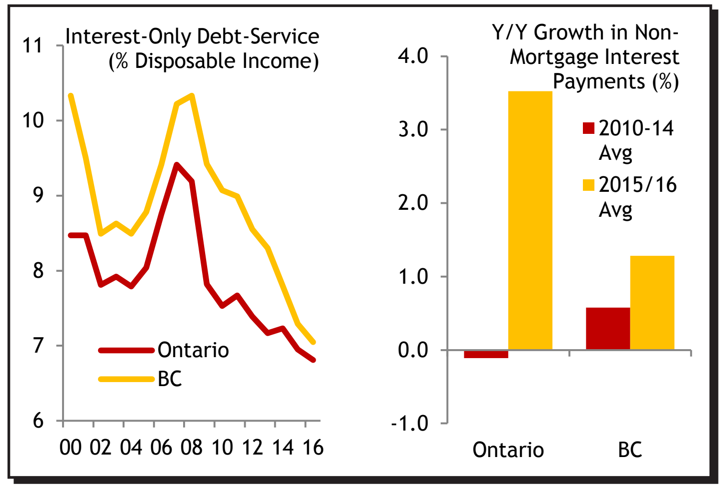
Declines in Interest-to-Income Payments vs 2004 Differ by Region



Source: Statistics Canada, CIBC

Chart 4

Interest Payments Fell More in BC (L), Ontarians Paying More Non-Mortgage Interest Recently (R)



Source: Statistics Canada, CIBC

With a general trend towards a smaller growth contribution from the household sector, interprovincial differences in the overall private sector pace could be driven by business capital spending.

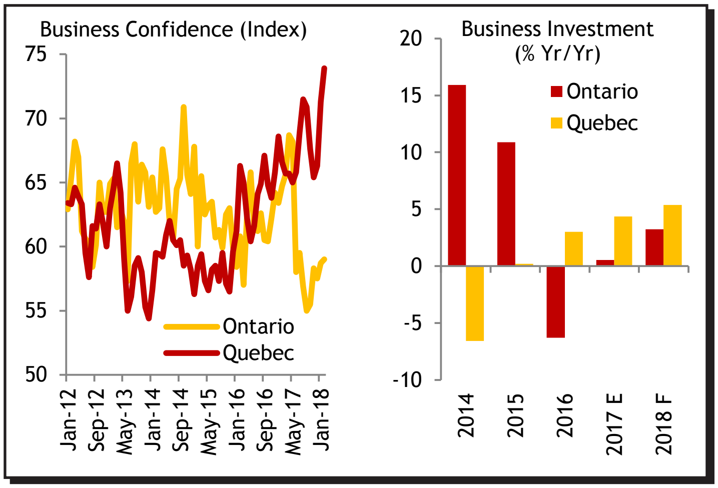
Last year, Alberta's growth leadership was supported by a rebound in energy sector cap-ex from the depths reached in 2016. But the latest survey of capital spending intentions in that industry, which despite some methodological differences does capture much of the swing in actual cap-ex in the national accounts, suggests that the sector might see a marginal drop in capital plans. A recent widening in price differentials plaguing heavy oil, unfavourable national gas prices in western Canada, and a lack of new big ticket projects, would be consistent with at least a levelling off in capital expenditures. If so, that could be enough to swing Alberta's growth numbers lower again.

Another notable result from the same survey was that business capital spending plans showed more growth ahead in Québec than in Ontario. That's echoed in small business confidence, with recent surveys showing more optimism in Québec (Chart 5).

Given these trends, we've made some adjustments in our provincial forecasts. Among the large provinces, we've lifted our Québec and BC forecasts, but taken some of the juice out of both Alberta and Ontario (Table 1). This is still a story of a deceleration nationally, but one with some regional variations in the magnitude of that turn.

Chart 5

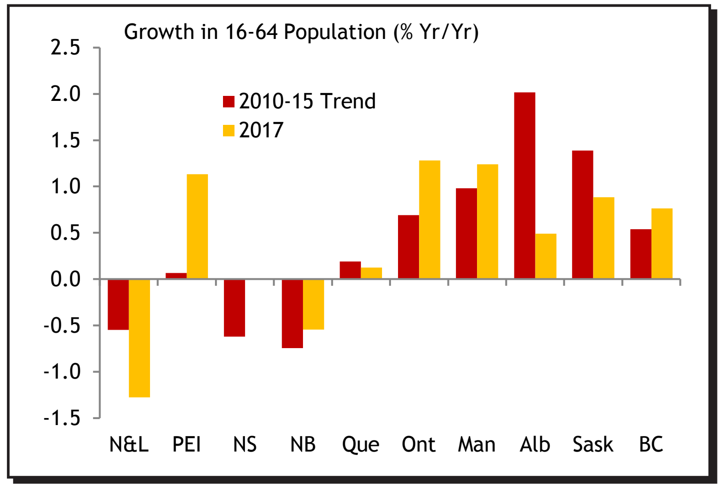
Business Confidence (L) and Investment Intentions (R) Better in Québec vs Ontario



Source: CFIB, Provincial Statistics Agencies, Statistics Canada, CIBC

Chart 6

Population Growth No Longer Strongest in Alberta, But Sluggish Eastern Trend Persists



Source: Statistics Canada, CIBC

Longer Term Elbow Room

Investors in long-term bonds also think about the medium-term elbow room for growth beyond 2019. With the national economy near full employment already, that mostly comes down to trends in the available workforce, and the less easy-to-predict pace for productivity.

Alberta and Newfoundland are still at historically elevated levels of unemployment, so they could benefit over the medium term if economic conditions allow that slack to close. But elsewhere, the issue will largely come down to population growth and labour force participation.

We've previously noted the lack of growth in the working-age population in all provinces east of Ontario, and the better demographics of western Canada. That has converged a little since the oil shock, with inter-provincial and international migration trends no longer largely sending workers to commodity-producing provinces (Chart 6). However, the general theme of slow population growth east of Ontario remains.

Québec has been able to fend off some of its unfavourable population picture through policies that have successfully raised its female participation rate to one of the world's highest levels. In addition, along with BC, it has also been finding good hunting ground for workers over 60 years old (Chart 7). Unlike the female participation rate, where Québec has run out of room for further improvement, it's joined by Atlantic Canada in having more scope remaining to get more growth out of older members of the population (Chart 8).

Table 1

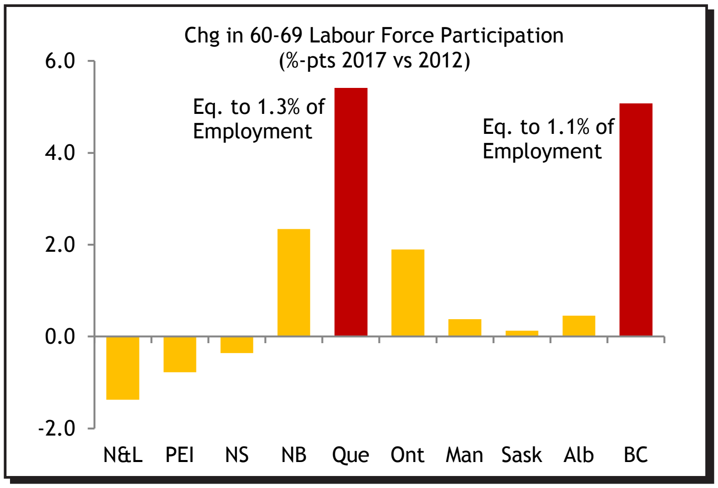
Provincial Outlook

	Real GDP Y/Y % Chg				Nominal GDP Y/Y % Chg				Employment Y/Y % Chg				Unemployment Rate %			
	2016A	2017F	2018F	2019F	2016A	2017F	2018F	2019F	2016A	2017A	2018F	2019F	2016A	2017A	2018F	2019F
BC	3.5	3.3	2.5	1.5	4.9	5.4	4.8	3.4	3.2	3.7	1.3	0.9	6.0	5.1	4.8	4.8
Alta	-3.7	3.8	1.9	1.9	-4.9	7.1	5.5	5.2	-1.6	1.0	1.4	1.1	8.1	7.8	6.7	6.4
Sask	-0.5	2.3	2.1	1.8	-4.0	5.6	5.5	4.7	-0.9	-0.2	0.3	0.8	6.3	6.3	5.6	5.4
Man	2.2	2.9	2.0	1.8	2.3	5.0	4.1	3.7	-0.4	1.7	0.5	0.8	6.1	5.4	5.7	5.5
Ont	2.6	2.9	2.1	1.7	4.3	5.0	4.6	3.6	1.1	1.8	1.4	1.1	6.5	6.0	5.6	5.5
Qué	1.4	3.0	2.3	1.5	2.7	5.0	4.2	3.2	0.9	2.2	1.6	0.9	7.1	6.1	5.4	5.3
NB	1.2	1.8	1.1	1.0	3.6	3.9	3.0	2.7	-0.1	0.4	0.4	0.1	9.5	8.1	8.0	7.9
NS	0.8	1.7	1.2	0.9	2.8	3.8	3.0	2.6	-0.4	0.6	0.1	0.0	8.3	8.4	8.2	8.2
PEI	2.3	2.4	1.7	0.8	4.0	4.5	3.5	2.6	-2.3	3.1	1.5	0.5	10.8	9.8	9.3	8.9
N&L	1.9	-1.8	-0.9	1.5	2.6	1.6	2.5	4.4	-1.5	-3.7	0.4	0.2	13.4	14.8	14.1	13.9
Canada	**1.4**	**3.0**	**2.1**	**1.6**	**2.0**	**5.3**	**4.6**	**3.7**	**0.7**	**1.9**	**1.3**	**1.0**	**7.0**	**6.3**	**5.8**	**5.7**

Source: Statistics Canada, CIBC

Chart 7

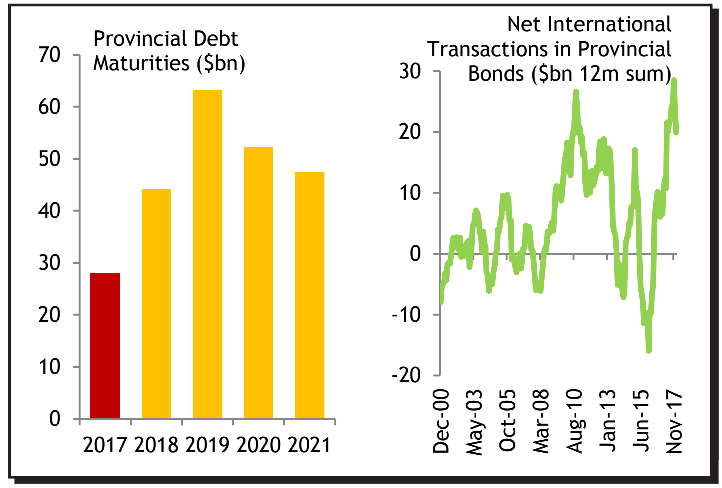
Increasing Age-60+ Participation Boosts Labour Force in Québec, BC



Source: Statistics Canada, CIBC

Chart 9

Provincial Maturities Jump in 2018/2019 (L), Strong Foreign Demand Will Fade (R)



Source: Bloomberg, Statistics Canada, CIBC

Bond Market Deals With Fewer Pleasant Surprises

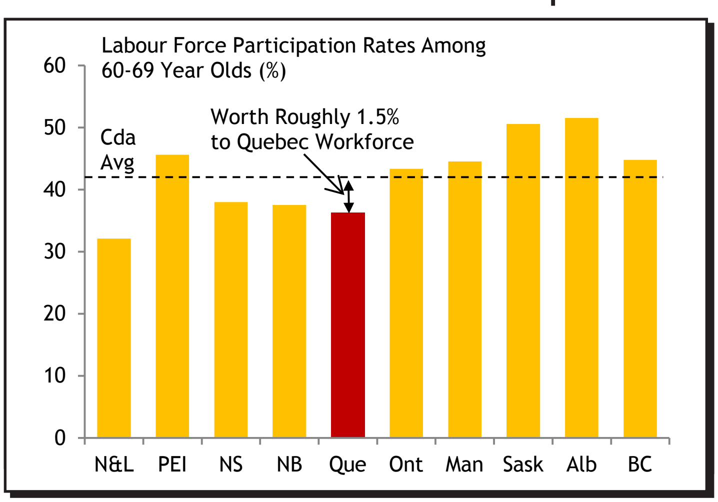
A moderation in growth will leave what has been a period of largely pleasant surprises on the government revenue front in the rear-view mirror. There's much more limited room for such surprises with the Bank of Canada actually targeting slower growth.

Moreover, while top-of-cycle economic activity will still keep the level of revenues elevated, it's not going to mean a light period for issuance. The two largest provinces—Ontario and Québec—could be aiming at either smaller surpluses or renewed deficits.

A leap in maturities in 2018 and 2019 (Chart 9, left) will also feed into gross financing requirements. And more of that financing might have to be done on the home front. Large scale QE programs overseas left markets abroad hungry for issues to buy, and that led to a sharp upswing in foreign demand for provincial debt (Chart 9, right). However, the latest figures show that's already waning. By 2019, not only will the Eurozone be done with QE, but it could be raising rates or allowing its balance sheet to unwind, leaving that market less receptive to foreign issuance.

Chart 8

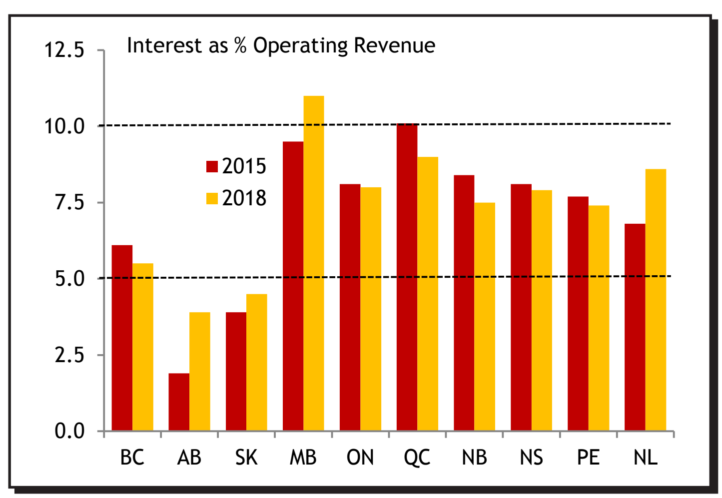
Québec and Atlantic Labour Force Could Get Further Boost From Older Labour Participation



Source: Statistics Canada, CIBC

Chart 10

Interest Payments as % Revenue Have Risen in Alta, Sask, Man, Fallen in Québec



Source: S&P, CIBC Macro Strategy

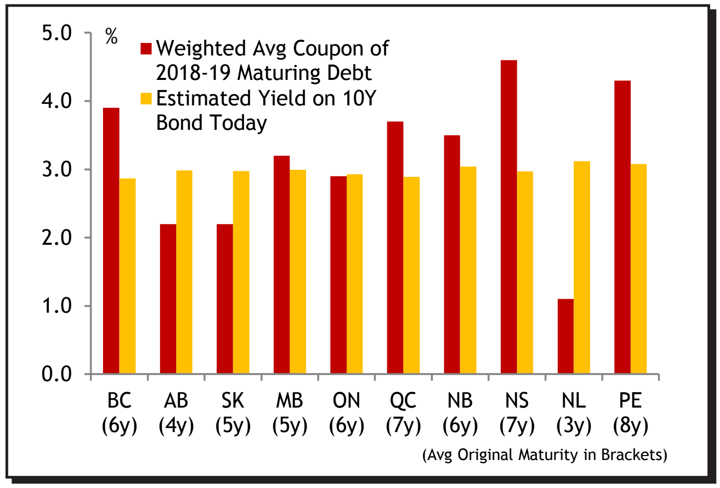
Interest costs are somewhat elevated as a share of revenues for provinces from Manitoba east, but still quite tame in the three most western provinces (Chart 10). If higher sovereign yields and the end of global QE also reduce the need for investors to overweight spread product, we could be facing an atypical combination of rising rates, consistent with a solid economy justifying monetary tightening, but also higher spreads.

But don't expect higher yields to put much of a squeeze on provincial finances just yet. Much of what is maturing in the next two years was issued many years ago, so the coupons on that debt are still higher than what the Province would issue at today for an assumed 10-year term (Chart 11). That's particularly true for Québec and BC, less so for provinces such as Alberta, Saskatchewan and Newfoundland which have had to tap markets more vigourously since the commodity price slump.

Living in what looks to be a lower interest-rate environment than in decades past does leave provinces better equipped to carry a higher debt load. But in the cooler growth climate of 2018/19, there won't be as widespread ammunition for the positive fiscal surprises enjoyed last year. Investors will therefore be keeping a closer eye on the degree to which budget revenue targets are well-aligned with provincial economic trends on the ground.

Chart 11

Québec, BC Could Still be Paying Less Interest on New Debt Than on Maturing Debt



Source: CIBC Macro Strategy, Bloomberg, CIBC Economics

Where are We in the US Cycle (And What Does It Mean For the Long End)?

Royce Mendes

There's no arguing that it's been a long road to recovery for the US economy. The current expansion is now the second oldest in history, with the oldest now in sight (Chart 1, left), and America is now being weaned off the monetary stimulus that played such an important role earlier in the recovery.

So, is it time to start gearing up for the next downturn? It's important to reiterate that expansions die for a number of reasons, but old age isn't one of them. According to other yardsticks, we may actually be closer to the sixth inning than the ninth.

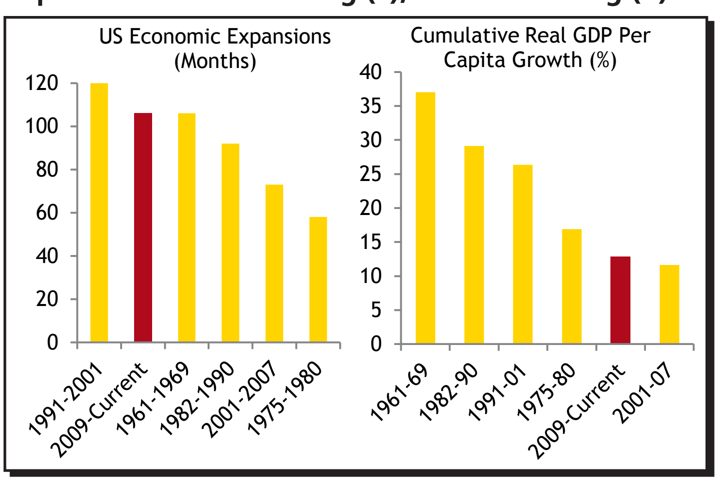
In terms of cumulative growth per capita, the current expansion has made barely a third of the progress made during the 1961-69 expansion (Chart 1, right). But, despite those underwhelming growth numbers, corporate bottom lines, which have been a reliable leading indicator of recessions, are running in healthy territory and showing few signs of fatigue (Chart 2). President Trump's tax cuts are likely to make profits even juicier this year and next.

A Neighbourly Helping Hand

A stronger global backdrop is also creating a favourable environment for the US economy. Since plateauing from 2014 to mid-2016, real US exports have been on an uptrend, a sign that more synchronized growth across regions is spilling over into demand for America's wares.

Chart 1

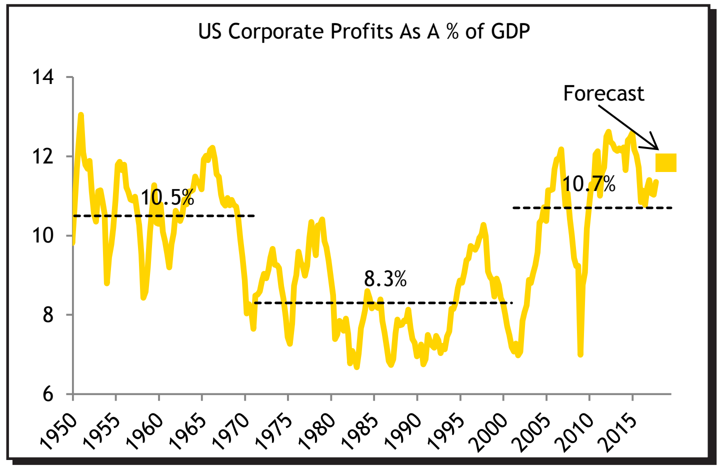
Expansion Has Been Long (L), But Not Strong (R)



Source: BEA, CIBC

Chart 2

Corporate Profits Remain Healthy And Will be Supported by Tax Cuts



Source: BEA, CIBC

While the World Bank estimates that there is no longer a global output gap (Chart 3, left), there's reason to believe world growth in 2018 and '19 will only decelerate slightly from last year's healthy run. Despite modest restraint in some regions, major central banks continue to provide ample stimulus to the global economy (Chart 3, right).

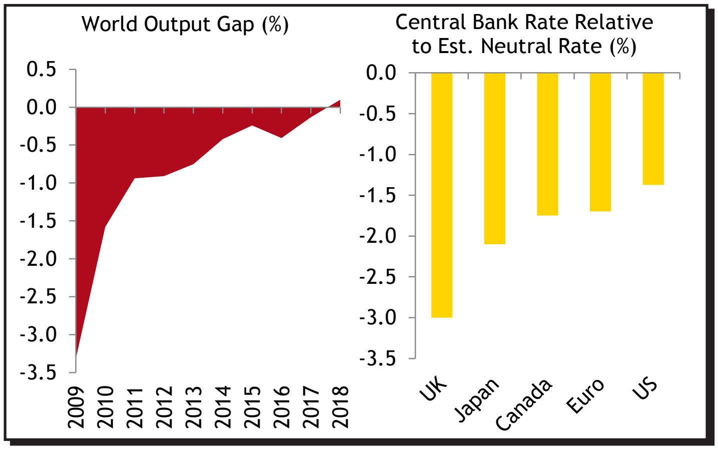
Of course, in the wake of President Trump's steel and aluminum tariffs, international concerns that protectionism could be an expansion-killer have risen. But so far there haven't been any major developments other than tough talk on potential US targets. That is unless you count new EU tariffs on American cranberries as a major development. As we write, Trump seems ready to unleash some tougher measures on China, but these might be negotiated away in return for some easing in Chinese restraints.

How Long Can the Party Last?

It's true that rising US interest rates mean fiscal stimulus will play a lesser role in boosting domestic activity than would have been the case a few years ago. But, tax cuts and additional government spending over the next couple of years will still provide an extra layer of protection against a recession (Chart 4). That is until 2020 when even without new legislation, planned deficit reductions and monetary

Chart 3

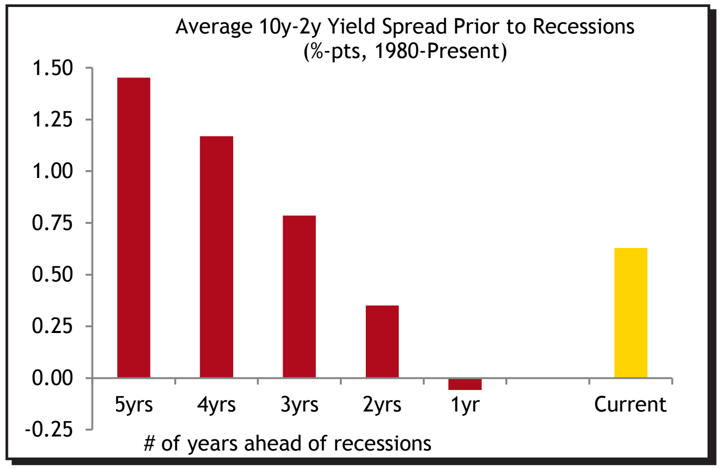
Global Output Gap Has Closed (L), But Central Banks Still Providing Stimulus (R)



Source: World Bank, Holston, Laubach and Williams, BoC, Federal Reserve

Chart 5

Flatter Yield Curve Not Indicative of Near-Term Recession



Source: Bloomberg, CIBC

policy which will be at best neutral, and possibly restrictive, will turn a couple of current tailwinds into headwinds.

The yield curve, while having flattened, is also not telling us a downturn is imminent. Looking at the average spread between 10-year and 2-year Treasury yields prior to past recessions indicates that bond markets are loosening up for the seventh inning stretch not the bottom of the ninth (Chart 5). While there's room for a steepening in the next few months, expect a quite-flat curve in late 2019 as the long end remains contained by well-anchored inflation expectations and lower growth readings than past cycles, and the Fed continues pushing short-term rates higher.

Looking Ahead, Far Ahead

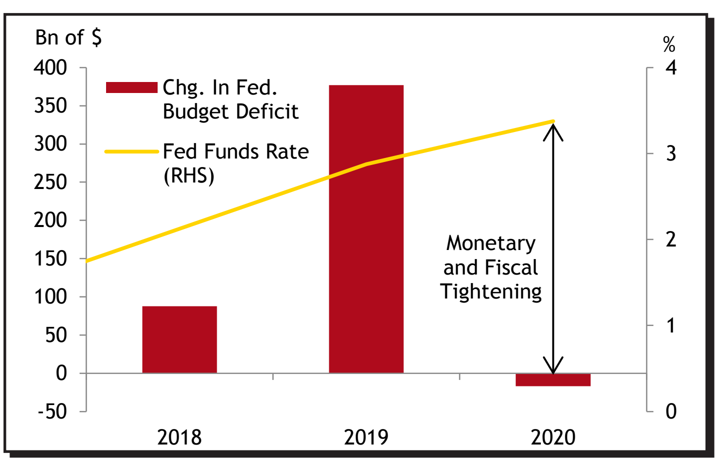
While 2020 is looking less optimistic, it's far too early to make any bold calls. Economists don't have a reliable way to predict when the next recession will occur, certainly not if it's likely to come more than a year into the future.

But, here's what we do know. Given that the fed funds rate has needed to fall between 4 and 5%-pts during past recessions, Fed researchers believe that interest rates will be at the zero-lower bound roughly 30% of the time in the future. That means, assuming a recession does occur sometime in the next 10 years, the funds rate will only average roughly 1½% in the upcoming decade (Chart 6).

For now, the good times are set to roll, and yields will creep higher. But after 2019, new Treasury supply will take a step back as deficits shrink at least modestly, and the dollar value of assets rolling off the Fed's balance will have begun to fall. We're in a bear market for bonds this year and next, but 2020 could potentially mark the end of that run.

Chart 4

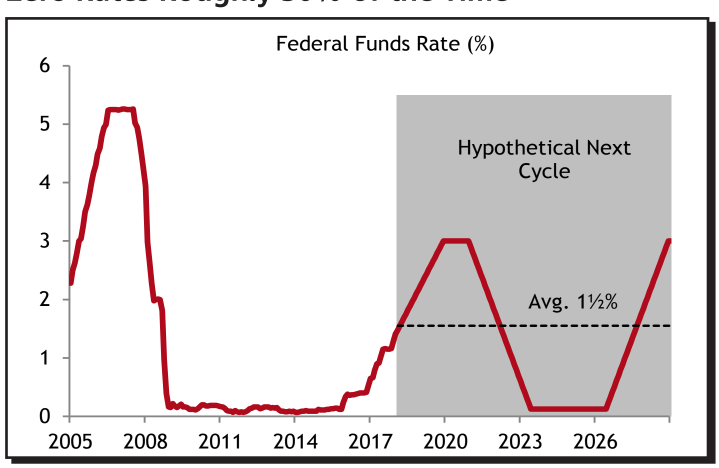
Deficit Declines in 2020, Even With No New Cuts



Source: CRFB, CIBC

Chart 6

Estimates Suggest That the Fed Will be at Zero Rates Roughly 30% of the Time



Source: Bloomberg, CIBC

And the Survey Says...
The Use and Misuse of ISM Data

Andrew Grantham

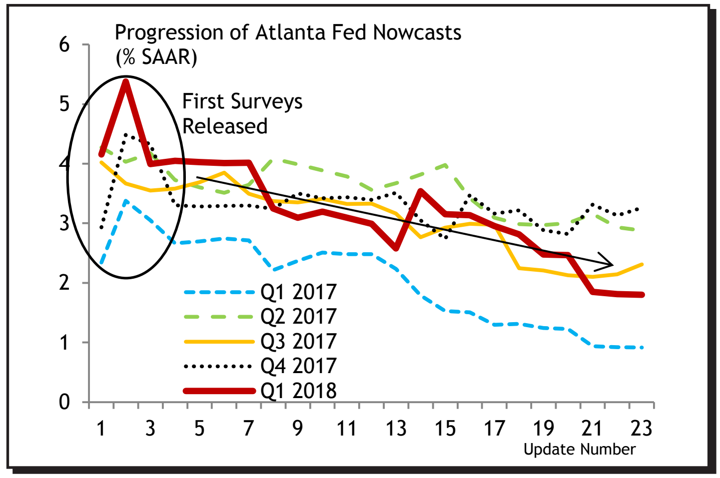
Looking at surveys such as the ISM, and then glancing at the actual growth numbers, you'd be excused for thinking you were looking at two different economies. After all, the ISM Manufacturing Survey has recently been near all-time highs, having trended between the 90th and 95th percentile of its long-term distribution (Chart 1, left). In contrast, manufacturing production growth, as monitored by the Federal Reserve, has been tracking only slightly above average (Chart 1, right).

This discrepancy is not new, but has become more pronounced this year. And it is causing issues for those trying to track quarterly GDP growth, providing false hope early in quarters for investors betting on a strong US economy.

In each of the last five quarters, strong ISM survey data have resulted in high initial estimates of the Atlanta Fed's Nowcast and/or big upgrades within the first couple of updates. However, as those survey results are replaced by actual data, that tracking estimate has trended down. The current quarter is no different, with the Nowcast having touched over 5% at one point, only to drift down to around 2% currently (Chart 2).

Chart 2

GDP Tracking Forecasts Start High But Trend Down as Survey Data Replaced With Actuals



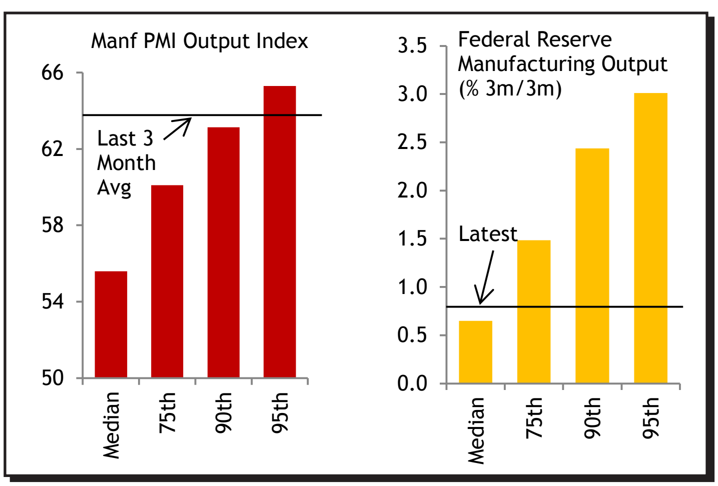
Source: Atlanta Fed, CIBC

Bad or Misunderstood

If you ask any producer of survey data what the merits of such series are, they will likely show you a picture similar to Chart 3. In this case we look at the correlation

Chart 1

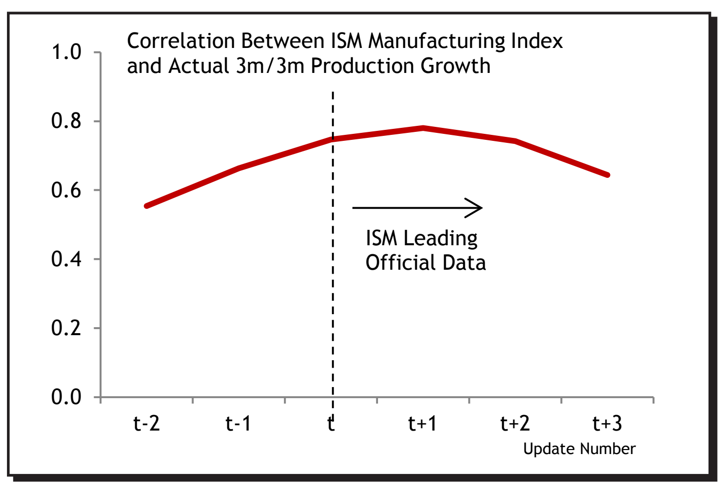
ISM Readings at Top End of Historic Range (L), Manufacturing Production Barely Above Average (R)



Source: ISM, Federal Reserve, CIBC

Chart 3

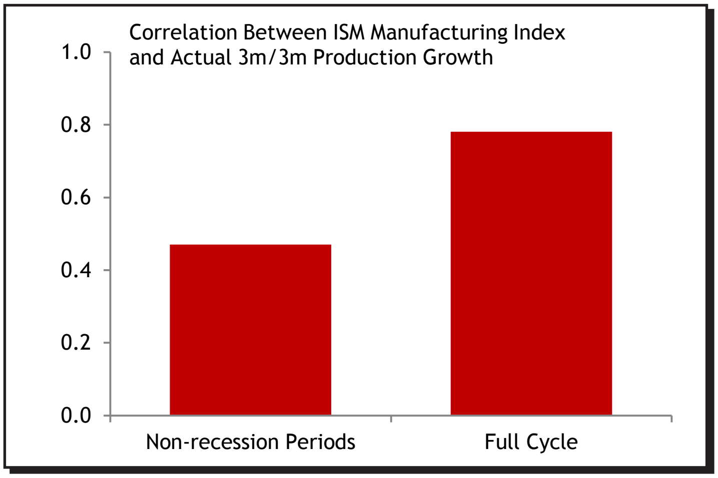
ISM and Manufacturing Production Highly Correlated Over Full Timeframe



Source: ISM, Federal Reserve, CIBC

Chart 4

ISM/Manufacturing Output Relationship Weaker in Non-Recessionary Periods



Source: ISM, Federal Reserve, CIBC

between the ISM and official manufacturing production data since 1970. The chart appears to suggest a very high correlation (just under 0.8). As the producers of the data claim, the ISM survey also appears to be a slight leading indicator of the official figures, but that result owes to the fact that the production measure is itself a three-month over three-month change.

As well, the correlation is flattered by periods of recession and initial recoveries, where both series tend to move sharply in the same direction. If we concentrate on just periods of growth, ignoring recessions and the first year of recovery, the correlation between the two series dips markedly (Chart 4). Interestingly, though, the correlation in the current expansionary period is almost bang in line with that average (Chart 5).

Levelling the Land

So if the survey figures are tracking turning points as accurately as they usually do in non-recessionary periods, the seemingly misleading, ultra-strong readings must actually be down to the way the figures are interpreted.

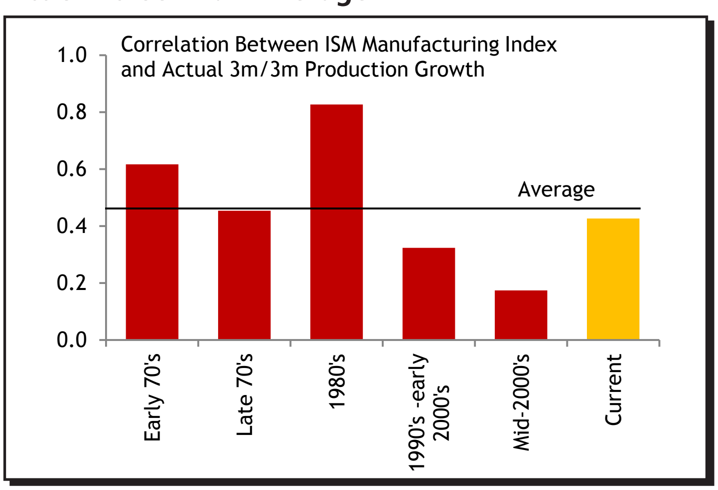
Economic surveys such as the ISM ask respondents whether activity was higher or lower than the prior month. They don't ask respondents to put quantities on such moves. Therefore, the results are really reflecting the dispersion of growth rather than how strong that growth is.

Over the last few decades, however, there's been a noticeable shift in what constitutes "normal" rates of growth. Because of the way survey questions are asked, they don't capture this shift in "potential" growth. That can easily be seen in the production growth rates which have been recorded during periods of 60+ readings on the ISM survey (Chart 6).

In sum, take survey data like the ISM for what they are—a signpost for broad turning points—and not as a benchmarking tool for the pace of growth.

Chart 5

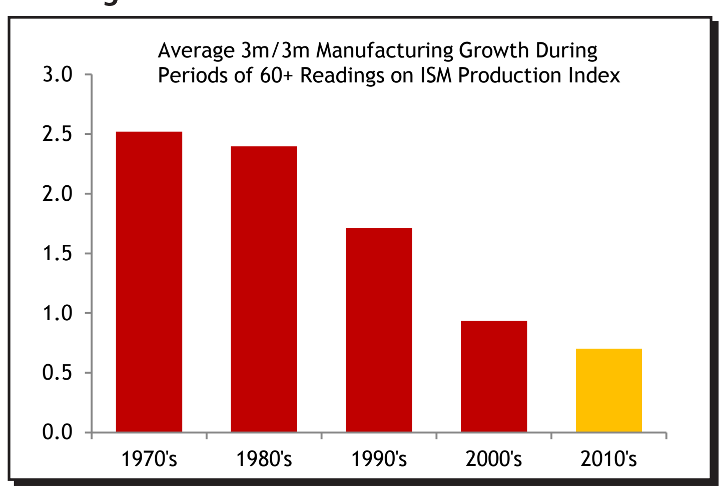
Current Non-Recessionary Period's Correlation Little Worse Than Average



Source: ISM, Federal Reserve, CIBC

Chart 6

Production Growth Rates Consistent With 60+ ISM Readings Have Fallen



Source: ISM, Federal Reserve, CIBC

ECONOMIC UPDATE

CANADA	17Q4A	18Q1F	18Q2F	18Q3F	18Q4F	19Q1F	19Q2F	2017F	2018F	2019F
Real GDP Growth (AR)	1.7	2.2	2.1	1.9	1.6	1.6	1.5	3.0	2.1	1.6
Real Final Domestic Demand (AR)	3.9	2.0	2.3	1.3	1.6	1.7	1.2	3.0	2.6	1.4
Household Consumption (AR)	2.1	2.3	2.7	1.5	1.8	1.9	1.3	3.5	2.5	1.6
All Items CPI Inflation (Y/Y)	1.8	2.0	2.2	2.5	2.4	2.1	2.0	1.6	2.3	2.0
Unemployment Rate (%)	6.0	5.8	5.8	5.8	5.7	5.7	5.7	6.3	5.8	5.7

U.S.	17Q4A	18Q1F	18Q2F	18Q3F	18Q4F	19Q1F	19Q2F	2017A	2018F	2019F
Real GDP Growth (AR)	2.6	1.9	3.2	3.0	2.4	1.3	1.4	2.3	2.7	1.9
Real Final Sales (AR)	3.2	1.8	3.2	3.0	2.3	1.3	1.5	2.4	2.6	1.9
All Items CPI Inflation (Y/Y)	2.1	2.2	2.3	2.4	2.4	2.2	2.3	2.1	2.3	2.3
Core CPI Inflation (Y/Y)	1.8	1.9	2.2	2.3	2.4	2.3	2.3	1.8	2.2	2.4
Unemployment Rate (%)	4.1	4.1	4.0	3.9	3.9	3.8	3.8	4.4	4.0	3.8

CANADA

Fourth quarter figures confirmed the slowdown in Canadian growth during the second half of the year. However, the deceleration seen was no worse than we had feared, and was largely focused on inventories and net trade. Solid final domestic demand makes us comfortable in expecting a slight improvement to 2.2% growth in Q1 2018 despite some disappointments in January. Our CPI forecast for this year has edged up slightly on energy prices and the pass-through from Ontario's minimum wage increase coming through a little faster than previously anticipated.

UNITED STATES

The US economy appears to be cooling in Q1, although that's a trend we've seen a number of times in recent years and could be due to imprecise seasonal adjustment rather than anything more concerning. The strong growth in payrolls during February lends credence to the view that the US economy is still growing at a solid pace. Because of that we haven't changed our call for 2.7% growth this year, or our expectation for a slowdown in 2019 as Fed rate hikes start to bite and fiscal policy provides less of a lift. We don't see enough slack to allow another year of solid non-inflationary growth in 2019.