RBC ECONOMIC RESEARCH

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March 9, 2018

Trading blows?

The relative calm that returned to financial markets in mid-February proved short lived. The Trump administration's threat to impose across-the-board tariffs on steel and aluminum imports sparked renewed equity market volatility and sent Treasury yields lower. We agree with the signal sent by investors: protectionist US trade policies will do more harm than good, not just to the country's export partners but the US economy itself. The reaction also suggests markets are concerned this could be the first salvo in a larger trade war. Indeed, US trading partners are readying counter measures. We aren't there yet, but tit-for-tat protectionism risks derailing the encouraging pickup in global growth and trade flows seen over the last year.

The issue was certainly on the minds of the Bank of Canada when they left interest rates unchanged in March. Their statement put growing uncertainty about trade policy front and centre. The subsequent announcement of a temporary exemption for Canadian producers means less direct exposure for now. But the central bank has to be worried about the broader implications, both for ongoing Nafta renegotiations and potential spillover if global trade tensions escalate.

At this point we don't think trade concerns will change the relatively upbeat US outlook recently presented by Fed Chair Powell. At least not enough to keep the Fed from raising rates in March. But the unpredictability of the US administration—announcing tariffs based on unsound economics, and despite significant domestic opposition—means policymakers can't become complacent about trade risks. Protectionist measures have the potential to slow the economy while at the same time generating inflationary pressure. That combination makes for a difficult tradeoff for central banks.

Central bank near-term bias

The economic backdrop continues to make the case for gradual tightening, but developments on the trade front will be equally important in the Bank of Canada's near-term decisions. That point was certainly emphasized in their March policy statement that left rates unchanged.

Fed Chair Powell noted an improving economic outlook and growing confidence that inflation will hit 2% on a sustained basis. He also hinted that four rate hikes might be needed this year. We agree and expect the next will come on March 21.

We think the UK economy will struggle to maintain an above-trend pace of growth this year. But given limited spare capacity and growing wages, the Bank of England looks set to pull back a bit on monetary policy stimulus. We think a rate hike in May will be their only move this year.

The European Central Bank continued to shape their forward guidance, laying the groundwork for an end to net bond-buying toward the end of the year. Rate hikes remain off the table until 2019.

The Reserve Bank of Australia made few changes in their latest policy statement and is showing no signs of deviating from the steady-rate course that has been in place since mid-2016.

Well-behaved inflation means the Reserve Bank of New Zealand isn't likely to shift from their neutral bias anytime soon. We think the cash rate will be held steady well into 2019.

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Highlights

▲ A number of supportive factors tee up for US consumer spending to recover from a weak January.

▲ Tariffs on steel and aluminum could negatively impact the US economy, particularly if they spark a global trade war.

▲ Import tariffs could also boost domestic prices at a time when upside risks to inflation are already emerging.

▲ Chair Powell reinforced expectations for a March rate hike.

US consumers were sluggish to start 2018

Our forecast for another year of strong growth in the US economy hinges on consumers keeping their pocketbooks open. But there was little evidence of that in January as auto sales and retail spending slipped and outlays on services only inched higher. A soft start to the year prompted us to mark down our consumer spending forecast for the first quarter—we now see a 2.1% annualized increase rather than the 2.8% gain we previously penciled in. That lowers our forecast for Q1 GDP to 2%, which would be the slowest increase in a year but still above the economy's longer run trend rate.

We are not throwing in the towel on our forecast for a consumer-led pickup this year. After all, the many positives for the household backdrop—low unemployment, rising wages, elevated confidence and personal income tax cuts—remain in place. We think a stronger trend in consumer spending will reassert itself after January's soft patch. That will help overall GDP growth pick up to 2.5% this year, building on 2017's 2.3% gain.

Steel tariffs: warning shot, or shot in the foot?

President Trump caused a global stir when he announced plans for tariffs of 25% and 10% on steel and aluminum imports, respectively. The 'national security' justification is flimsy given that a majority of US imports of those products come from allies like Canada and Europe. Canada and Mexico were ultimately granted a carve-out but reprieve is being linked to Nafta talks, leaving the threat of future tariffs in place. The administration has also floated potential exemptions for other trading partners but the process remains unclear. The ultimate scope of these tariffs, and particularly whether they set off a broader trade war, will be an important determinant of the domestic impact. But it isn't hard to see this protectionist move being net negative for the US economy. In the short-term, domestic production won't be able to fully replace imports—buyers of steel and aluminum will simply have to pay the tariff. That will raise input costs across a number of industries, ultimately leading to higher prices for consumers. The blow to US competitiveness also puts more jobs at risk than will be protected by any tariffs.

Another upside risk for inflation

The potentially inflationary impact of steel and aluminum tariffs comes at a time when prices are already starting to trend higher. US CPI surprised to the upside in January with core inflation in particular posting a strong monthly increase. Year-over-year rates continue to be weighed down by some transitory factors from the first half of 2017, but more recent data shows core inflation running well above the Fed's 2% objective. Along with rising wage growth, it appears we are finally seeing tight economic and labour market conditions feeding through to prices. That trend will only be reinforced by fiscal stimulus, which is set to push the US economy into excess demand, or beyond its longer-run productive capacity. Combined with protectionist trade policies, inflation risks are now tilted to the upside following several years of sub-2% price growth.

New Fed chair sounding a touch hawkish

Roughly a month after taking charge of the Fed, Chair Powell presented his thoughts on the US economy and monetary policy to congress. He sounded fairly upbeat, noting his personal assessment of the economic outlook had improved since December. His confidence that inflation will return sustainably to the Fed's 2% objective also increased. As for the interest rate outlook, Powell didn't prejudge the central bank's dot plot for March but seemed to indicate four rate hikes might be necessary this year, rather than the median of three projected back in December. That would be in line with our own forecast as we envision little reason for the Fed to pause their tightening cycle with the economy facing capacity limits and fiscal stimulus in the pipeline. Markets remain somewhat under-priced for that pace of tightening, so any shift in the dot plot could reinforce the selloff in government bonds seen so far this year. A rate hike itself shouldn't move the needle too much—markets have mostly priced in move at what will be Powell's first meeting at the helm of the Fed.

Canada's economy reverting to trend after an impressive year

GDP data confirmed Canada's economy expanded by an impressive 3% in 2017, the fastest annual pace in six years. That reflected a burst of activity in the first half of the year followed by more trend-like gains in the second half. The recent moderation isn't due to a slowdown in spending—domestic demand continued to run at a 4% clip through the end of the year. Rather, softer growth numbers reflect a bit more of that demand being met by inventories and imports. Net trade and inventory investment subtracted 1.8 percentage points from Q4/17 growth, limiting headline GDP to a 1.7% pace. While the increase fell short of the Bank of Canada's 2.5% forecast, trend-like growth isn't all that disappointing when the economy is already operating at capacity. Our current tracking points to another quarter of just-below-2% growth in Q1/18. While the drag from trade and inventories isn't expected to be repeated, we are due for some payback in business investment and housing after regulatory changes brought forward activity into late-2017.

Federal government's latest budget keeps deficits intact

The federal government released their annual budget on February 27. There were minimal changes to their projections with an average shortfall of $15 billion expected over the next five years. That doesn't mean there wasn't any new spending—nearly $20 billion from positive economic and fiscal developments was allocated to a number of new initiatives. Some measures, like those that encourage female labour force participation, have the potential to pay for themselves by boosting Canada's economy in the long run. That said, we would have liked to see a bit more spending restraint in an effort to balance the budget. With the economy running at full capacity, now is the time to eliminate deficits and rebuild fiscal room ahead of any future bumps in the road. We were also disappointed that Budget 2018 did little to address growing competitiveness issues faced by Canadian businesses, including a disappearing tax advantage relative to the US.

Bank of Canada biding its time amid trade uncertainty

The Bank of Canada held interest rates steady in March at their first meeting since January's hike. Odds of a move were already low—the central bank has a 'cautious' tightening bias—but effectively went to zero when the Trump administration announced potential tariffs on aluminum and steel imports. The Governing Council made a nod in that direction, noting trade policy is "an important and growing source of uncertainty." The central bank has been worried about the impact of Nafta uncertainty for some time and the latest rhetoric from the US clearly increased the odds of a negative outcome.

Canada received a last-minute exemption but it is contingent on Nafta talks, meaning the threat of tariffs remains. Duties on steel and aluminum could have a sizeable impact on certain regions—those industries represent an important part of the economy in pockets of Ontario and Quebec, respectively. But more broadly speaking, the hit to Canada's economy wouldn't be devastating. Steel and aluminum combined account for about 1/2 percent of both GDP and jobs. And the experience from softwood lumber indicates any dampening effect of tariffs could be short-lived—after initially declining when tariffs were placed on Canadian softwood lumber, those exports have rebounded and are now flat relative to a year ago. That fits with the idea that in the near term, rather than US buyers substituting domestic products for imports, these tariffs will simply result in tighter margins and/or higher consumer prices.

We don't think the threat of individual product tariffs will alter the Bank of Canada's course. What would have the Governing Council more concerned is if the US's move sparks tit-for-tat protectionism and leads to a broader trade war. That would have a more sizeable impact not just in Canada, but also in the US and globally. We think the BoC will be keeping a close eye on trade developments in the lead-up to April's meeting. How businesses are responding to growing uncertainty—the bank's next Business Outlook Survey will be released April 9—will also be a factor in their policy decision.

Highlights

▲ Canadian GDP growth slowed over the second half of 2017 but domestic spending remained strong.

▲ The federal government announced a number of new spending measures in Budget 2018, none of which addressed competitive issues.

▲ Growing trade concerns were front and centre in the Bank of Canada's policy statement in March.

▲ Trade developments, and how businesses are reacting to uncertainty, will be watched closely ahead of the BoC's next policy meeting in April.

Highlights

▲ The BoE has signaled that a near-term rate hike is likely.

▲ The ECB is no longer indicating that they might increase the size and/or duration of QE.

▲ Australian GDP growth was a bit softer than expected in Q4/17, with a composition that isn't likely to be maintained this year.

UK's middling growth not necessarily an obstacle to raising rates

The UK economy ended 2017 with a bit less momentum than initially thought—GDP growth was revised down to 0.4% from the advance reading of 0.5%. And expenditure details were less than encouraging with government doing much of the heavy lifting. Business investment was flat in the quarter, exports declined and consumer spending continued to increase at a much more moderate pace than was seen prior to the Brexit referendum. Survey data points to the economy continuing to expand at a pace close to or slightly below trend at the start of 2018. We'll be watching for the effect of severe weather on Q1/18 GDP but would expect any negative impact will be made up in the following quarter.

While we expect the UK's growth rate will tick lower this year, the economy is operating close to full capacity and unemployment is at multi-decade lows. Tight labour market conditions are gradually feeding through to higher wages. A recent survey from the Bank of England showed businesses expect to increase wages by 3% this year, up from the current pace of 2.5%. An at-capacity economy and increasing labour costs raise the risk that inflation will remain above the BoE's 2% target even after the impact of Brexit-induced currency weakness fades. That prospect had the central bank strengthening their tightening bias in February, noting interest rates might have to rise somewhat faster and earlier than markets had been expecting. We see them following through on that with a rate hike in May and two further increase in 2019. That would still be a rather gradual pace of tightening, though we think caution is appropriate given persistent Brexit uncertainty.

ECB taking baby steps toward end of QE

Euro area GDP rose a solid 0.6% in Q4/17 with most major member economies growing near their recent trend pace. Purchasing managers' indices showed the currency bloc jumping out of the gates to start 2018 but we did see some pullback in February—more reversion to earlier levels rather than a loss of momentum. On balance the survey data lends some upside risk to our forecast for another quarter of 0.6% GDP growth, though we'll want some hard data confirming that signal before changing our projection. The Italian election, which saw the rise of a number of anti-establishment parties but no clear majority or obvious coalition, will see political uncertainty persisting this year. But that is nothing new, and didn't prevent the Italian economy recording its strongest growth since 2010 last year.

Strong growth has pushed unemployment lower across the euro area, with the aggregate unemployment rate down 1 percentage point from a year ago. However, wage growth remains muted and there are few signs of inflation picking up in response to tightening economic conditions. That will allow the European Central Bank to remain cautious in backing away from ultra-accommodative monetary policy. The ECB made another small step in that direction in March with their policy statement dropping previous reference to being ready to increase the size and/or duration of their asset purchase program. We think the central bank is laying the groundwork to phase out net QE purchases by the end of this year.

RBA sits contently on the sidelines

Australia's Q4/17 GDP came in slightly softer than expected at 0.4%, though an upward revision to the previous quarter still kept growth tracking close to the Reserve Bank of Australia's expected 2-1/2% year-over-year pace. Activity was driven by household spending, some of which reflected transitory factors, and higher public spending while net trade and housing each provided some offset. We don't think that composition of growth will continue this year—less strength in consumer spending but better export growth should be the norm in 2018. The RBA left the cash rate unchanged in April, extending what is now their longest pause on record. There was no sign of an imminent change in direction, either—the central bank delivered a familiar policy statement and maintained a neutral bias. They dropped an earlier reference to growth picking up above 3% but still expect stronger growth this year than last—not exactlly a high hurdle as 2017's gain was the slowest in four years. We also forecast stronger growth this year but think any associated increase in wages and inflation will be slow to develop. That should keep the central bank on the sidelines through the end of 2018.

Interest rate outlook

%, end of period

	Actuals				Forecast							
	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
Canada												
Overnight	0.50	0.50	1.00	1.00	1.25	1.50	1.75	2.00	2.25	2.25	2.25	2.25
Three-month	0.52	0.71	1.00	1.06	1.20	1.45	1.70	2.05	2.25	2.15	2.15	2.15
Two-year	0.75	1.10	1.52	1.69	1.75	2.05	2.25	2.45	2.60	2.50	2.40	2.30
Five-year	1.12	1.40	1.75	1.87	2.00	2.30	2.55	2.75	2.90	2.85	2.85	2.80
10-year	1.62	1.76	2.10	2.04	2.20	2.50	2.75	2.95	3.10	3.10	3.05	3.05
30-year	2.30	2.14	2.47	2.27	2.45	2.75	3.05	3.15	3.25	3.25	3.30	3.30
United States												
Fed funds**	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.50
Three-month	0.76	1.03	1.06	1.39	1.55	1.80	2.05	2.30	2.55	2.80	3.05	3.30
Two-year	1.27	1.38	1.47	1.89	2.10	2.35	2.55	2.75	3.00	3.25	3.40	3.55
Five-year	1.93	1.89	1.92	2.20	2.50	2.70	2.90	3.05	3.25	3.45	3.55	3.65
10-year	2.40	2.31	2.33	2.40	2.80	3.00	3.15	3.30	3.45	3.60	3.70	3.75
30-year	3.02	2.84	2.86	2.74	3.20	3.35	3.50	3.60	3.70	3.75	3.80	3.85
United Kingdom												
Bank rate	0.25	0.25	0.25	0.50	0.50	0.75	0.75	0.75	1.00	1.00	1.00	1.25
Two-year	0.12	0.36	0.46	0.45	0.75	0.80	0.85	0.95	1.00	1.05	1.10	1.15
10-year	1.14	1.26	1.38	1.19	1.65	1.75	1.85	1.90	2.00	2.10	2.20	2.30
Euro area												
Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20
Two-year	-0.74	-0.57	-0.69	-0.63	-0.65	-0.65	-0.60	-0.50	-0.50	-0.50	-0.40	-0.30
10-year	0.33	0.47	0.47	0.43	0.65	0.65	0.70	0.80	1.00	1.05	1.25	1.25
Australia												
Cash target rate	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75	2.00	2.00	2.00
Two-year	1.76	1.78	1.94	2.00	2.00	2.10	2.25	2.40	2.50	2.60	2.60	2.60
10-year	2.70	2.60	2.84	2.63	2.70	2.75	3.05	3.30	3.70	4.10	4.10	4.05
New Zealand												
Cash target rate	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00
Two-year swap	2.31	2.32	2.19	2.20	2.20	2.30	2.40	2.50	2.60	2.75	2.80	2.80
10-year swap	3.41	3.35	3.24	3.13	3.25	3.40	3.50	3.60	3.75	3.85	4.10	4.25
Yield curve*												
Canada	87	66	58	35	45	45	50	50	50	60	65	75
United States	113	93	86	51	70	65	60	55	45	35	30	20
United Kingdom	102	90	92	74	90	95	100	95	100	105	110	115
Eurozone	107	104	116	106	130	130	130	130	150	155	165	155
Australia	94	82	90	63	70	65	80	90	120	150	150	145
New Zealand	110	103	105	93	105	110	110	110	115	110	130	145

* Two-year/10-year spread in basis points, **Top of 25 basis point range

Source: Reuters, RBC Economics Research

Central bank policy rate

%, end of period

		Current	Last				Current	Last	
United States	Fed funds	1.25-1.50	1.00-1.25	December 13, 2017	Eurozone	Deposit rate	-0.40	-0.30	March 10, 2016
Canada	Overnight rate	1.25	1.00	January 17, 2018	Australia	Cash rate	1.50	1.75	August 3, 2016
United Kingdom	Bank rate	0.50	0.25	November 2, 2017	New Zealand	Cash rate	1.75	2.00	November 10, 2016

Source: Bloomberg, Reuters, RBC Economics Research

Economic outlook

Growth outlook

% change, quarter-over-quarter in real GDP

	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	2016	2017	2018F	2019F
Canada*	4.0	4.4	1.5	1.7	1.9	1.7	1.7	1.6	1.6	1.6	1.5	1.5	1.4	3.0	1.9	1.6
United States*	1.2	3.1	3.2	2.5	2.0	2.5	2.7	2.7	2.2	2.0	1.7	1.7	1.5	2.3	2.5	2.2
United Kingdom	0.2	0.3	0.5	0.4	0.3	0.4	0.3	0.4	0.3	0.4	0.3	0.4	1.9	1.7	1.5	1.4
Euro area	0.6	0.7	0.7	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	1.8	2.5	2.3	1.9
Australia	0.5	0.8	0.7	0.4	0.8	0.8	0.7	0.6	0.7	0.7	0.8	0.9	2.6	2.3	2.7	2.8
New Zealand	0.8	1.0	0.6	0.8	1.0	0.8	0.8	0.7	0.7	0.7	0.7	0.7	4.0	2.7	3.4	2.9

*annualized

Inflation outlook

% change, year-over-year

	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	2016	2017	2018F	2019F
Canada	1.9	1.3	1.4	1.8	1.9	2.2	2.3	2.0	1.7	2.0	2.1	2.0	1.4	1.6	2.1	1.9
United States	2.5	1.9	2.0	2.1	2.3	2.4	2.1	1.7	1.3	1.7	2.0	2.1	1.3	2.1	2.1	1.8
United Kingdom	2.2	2.8	2.8	3.0	2.8	2.6	2.6	2.5	2.3	2.2	2.2	2.0	0.6	2.7	2.7	2.2
Euro area	1.8	1.5	1.4	1.4	1.4	1.3	1.4	1.4	1.4	1.4	1.5	1.5	0.2	1.5	1.4	1.5
Australia	2.1	1.9	1.8	1.9	2.1	2.5	2.4	2.3	2.1	2.5	2.4	2.3	1.3	1.9	2.3	2.3
New Zealand	2.1	1.7	1.9	1.6	1.4	2.0	2.1	2.0	2.0	2.0	2.0	2.0	0.6	1.9	2.0	2.0

Source: Statistics Canada, Bureau of Economic Analysis, Bureau of Labor Statistics, Office for National Statistics, Statistical Office of the European Communities, Australian Bureau of Statistics, Statistics New Zealand, RBC Economics Research

Inflation tracking

Inflation Watch

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	CPI ex food & energy[1]	Jan	0.2	1.5	2.7	1.6
United States	Core PCE[1,2]	Jan	0.3	1.5	2.0	1.6
United Kingdom	All-items CPI	Jan	-0.5	3.0	2.3	2.8
Euro area	All-items CPI[1]	Feb	0.1	1.2	2.1	1.5
Australia	Trimmed mean CPI[1]	Q4	0.4	1.8	N/A	N/A
New Zealand	All-items CPI	Q4	0.1	1.6	N/A	N/A

1 Seasonally adjusted measurement.
2 Personal consumption expenditures less food and energy price indices.

Source: Statistics Canada, Bureau of Labor Statistics, Office for National Statistics, Statistical Office of the European Communities, Australian Bureau of Statistics, Statistics New Zealand, RBC Economics Research

Currency outlook

Level, end of period

	Actuals				Forecast							
	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
Canadian dollar	1.33	1.30	1.25	1.26	1.28	1.26	1.24	1.22	1.24	1.26	1.27	1.28
Euro	1.07	1.14	1.18	1.20	1.23	1.20	1.16	1.18	1.20	1.22	1.24	1.26
U.K. pound sterling	1.26	1.30	1.34	1.35	1.37	1.32	1.26	1.27	1.29	1.31	1.33	1.35
New Zealand dollar	0.70	0.73	0.72	0.71	0.75	0.74	0.73	0.71	0.69	0.69	0.69	0.69
Japanese yen	111.4	112.4	112.5	112.7	107.0	105.0	107.0	109.0	112.0	115.0	118.0	120.0
Australian dollar	0.76	0.77	0.78	0.78	0.80	0.78	0.75	0.73	0.73	0.73	0.73	0.73

Canadian dollar cross-rates

	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
EUR/CAD	1.42	1.48	1.47	1.51	1.42	1.51	1.44	1.44	1.49	1.54	1.57	1.61
GBP/CAD	1.67	1.69	1.67	1.70	1.75	1.66	1.56	1.55	1.60	1.65	1.69	1.73
NZD/CAD	0.93	0.95	0.90	0.89	0.96	0.93	0.91	0.87	0.86	0.87	0.88	0.88
CAD/JPY	83.6	86.7	90.2	89.6	83.6	83.3	86.3	89.3	90.3	91.3	92.9	93.8
AUD/CAD	1.02	1.00	0.98	0.98	1.02	0.98	0.93	0.89	0.91	0.92	0.93	0.93

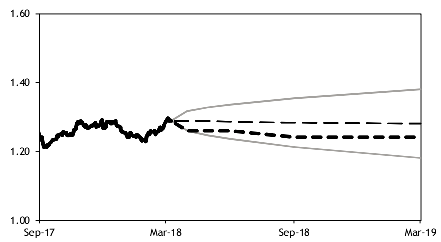
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

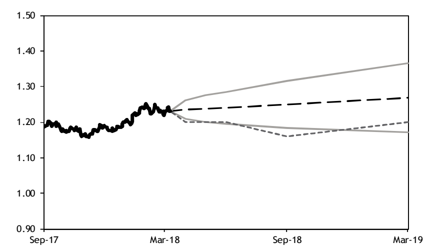
RBC Economics outlook compared to the market

The following charts track historical exchange rates plus the forward rate (dashed line) compared to the RBC Economics forecast (dotted line) out one year. The cone for the forecast period frames the forward rate with confidence bounds using implied option volatilities as of the date of publication.

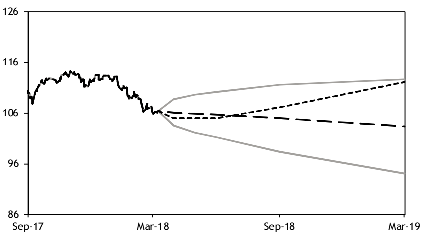
Canadian dollar



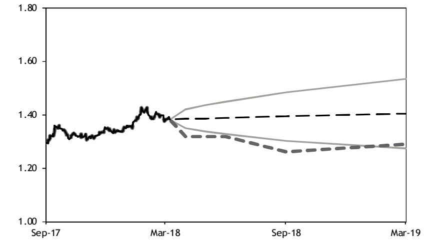
Euro



Japanese yen



U.K. pound

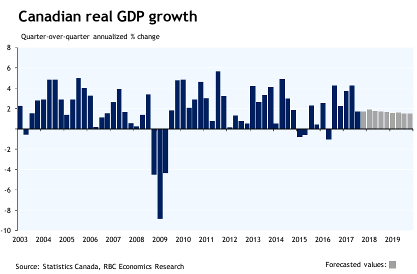


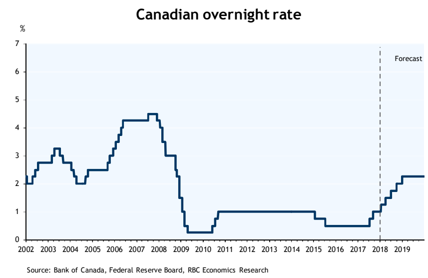
Central bank watch

Bank of Canada

Canadian GDP growth came in below the Bank of Canada's 2.5% forecast in Q4/17, but strong domestic demand limited their disappointment.

Firmer wage and inflation data supports the BoC's tightening bias, but policymakers are right to be cautious amid growing trade concerns. How tariff discussions and Nafta talks evolve between now and April will impact the bank's next rate decision.

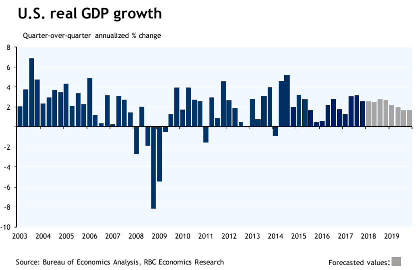


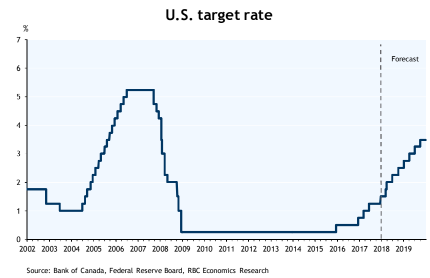


Federal Reserve

A slow start to the year for US consumer spending led us to mark down our Q1/18 GDP forecast to 2.0%. We still see stronger growth on the horizon thanks in part to tax cuts.

With the economy running at full capacity and getting a fiscal boost this year, the Fed is increasingly confident that inflation will hit 2% on a sustained basis. That should keep them hiking through 2019.

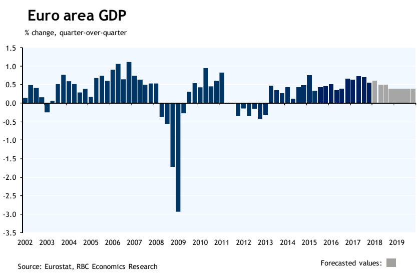


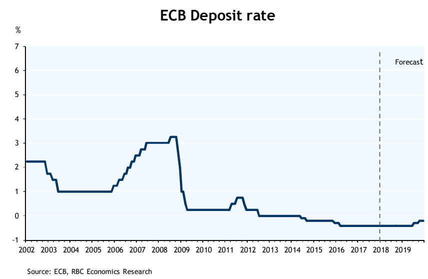


European Central Bank

The euro area appears to have maintained solid economic momentum at the start of 2018. Unemployment is trending lower but wages are showing no sign of accelerating.

A solid growth backdrop but limited inflationary pressure means the ECB will be gradual in withdrawing stimulus. March's policy statement took another small step toward winding down QE.

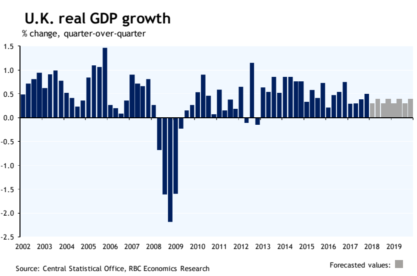


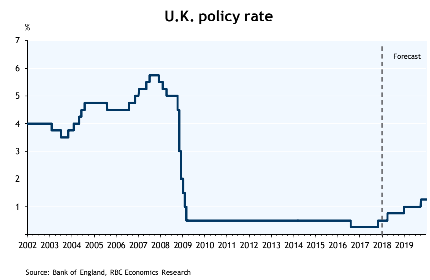


Bank of England

We think UK GDP growth will continue at a slightly-below-trend pace this year as the grind of Brexit negotiations weighs on sentiment.

The BoE is concerned that an at-capacity economy and rising wages will ultimately leave inflation above target if policy isn't tightened further. We think they'll raise rates in May.

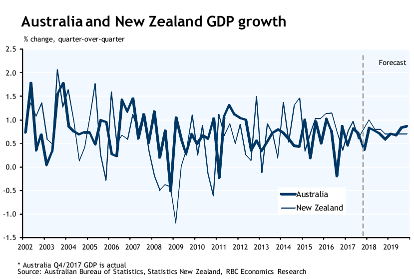


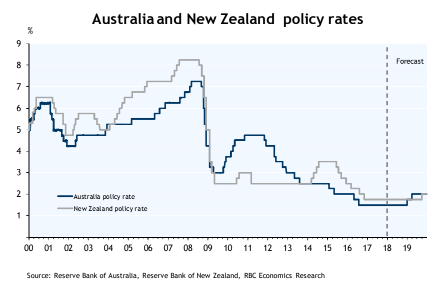


Australia

Australia's Q4/17 GDP growth came in a bit below expectations but was close to the RBA's projected 2-1/2% year-over-year increase. We expect a similar pace of expansion this year.

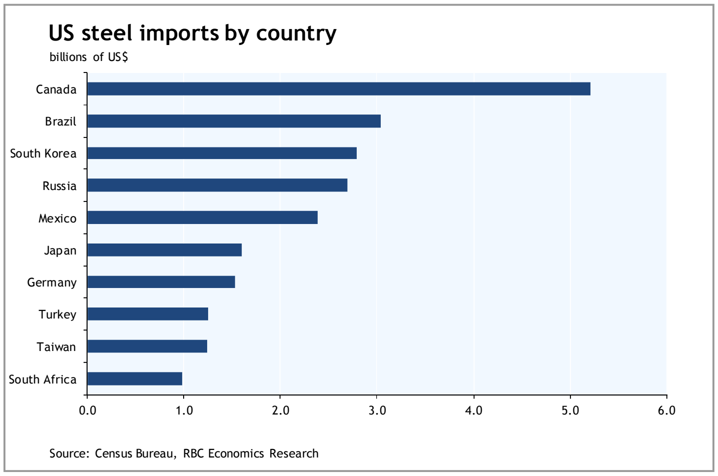
The RBA thinks wage growth has troughed and growth will pick up this year. But those developments will be gradual and we don't see the central bank shifting their neutral bias anytime soon.



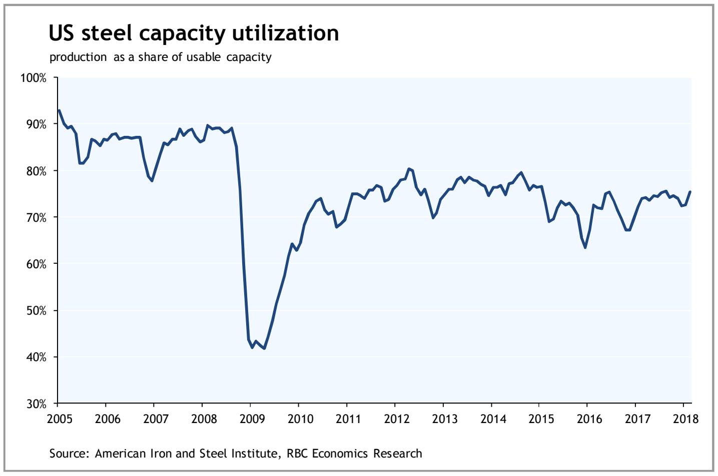


Tariff folly

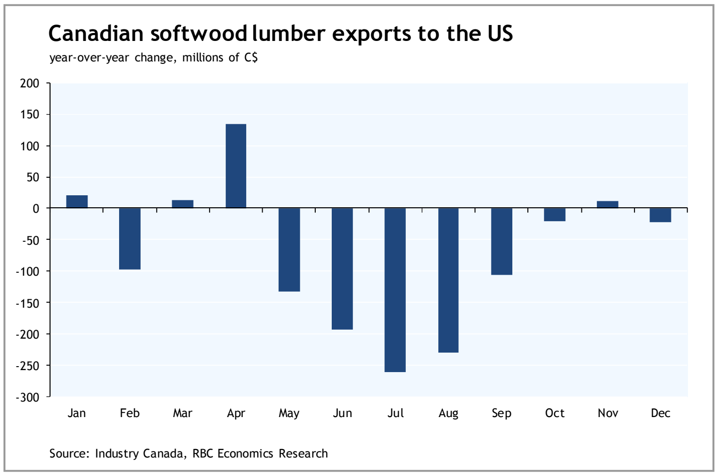
The Trump administration's proposal to slap tariffs on steel and aluminum was made in the name of national security, but most imports of those products come from allies. Canada and Mexico were granted exemptions (for now) and others might be spared. Those that aren't stand ready with counter-measures.



The US does have some spare capacity in steel production but won't be able to fully replace current imports, particularly for some types of steel products. So in the near-term domestic producers will end up paying higher prices for some of their inputs.



Canadian softwood lumber exports show the impact of tariffs can be temporary. Following an initial decline after softwood duties were applied (BC forest fires were also a factor), Canadian lumber exports are back to year-ago levels. The lesson: US buyers were ultimately unable to find a replacement.



There is growing concern that US tariffs could spark tit-for-tat protectionism and potentially a global trade war. This comes at a time when global GDP growth and trade flows are finally starting to pick up.