



Q2 Economic Update

Drivers and Investment Implications

May 31, 2018

Brett House
Vice-President & Deputy Chief Economist

 [@BrettEHouse](https://twitter.com/BrettEHouse)

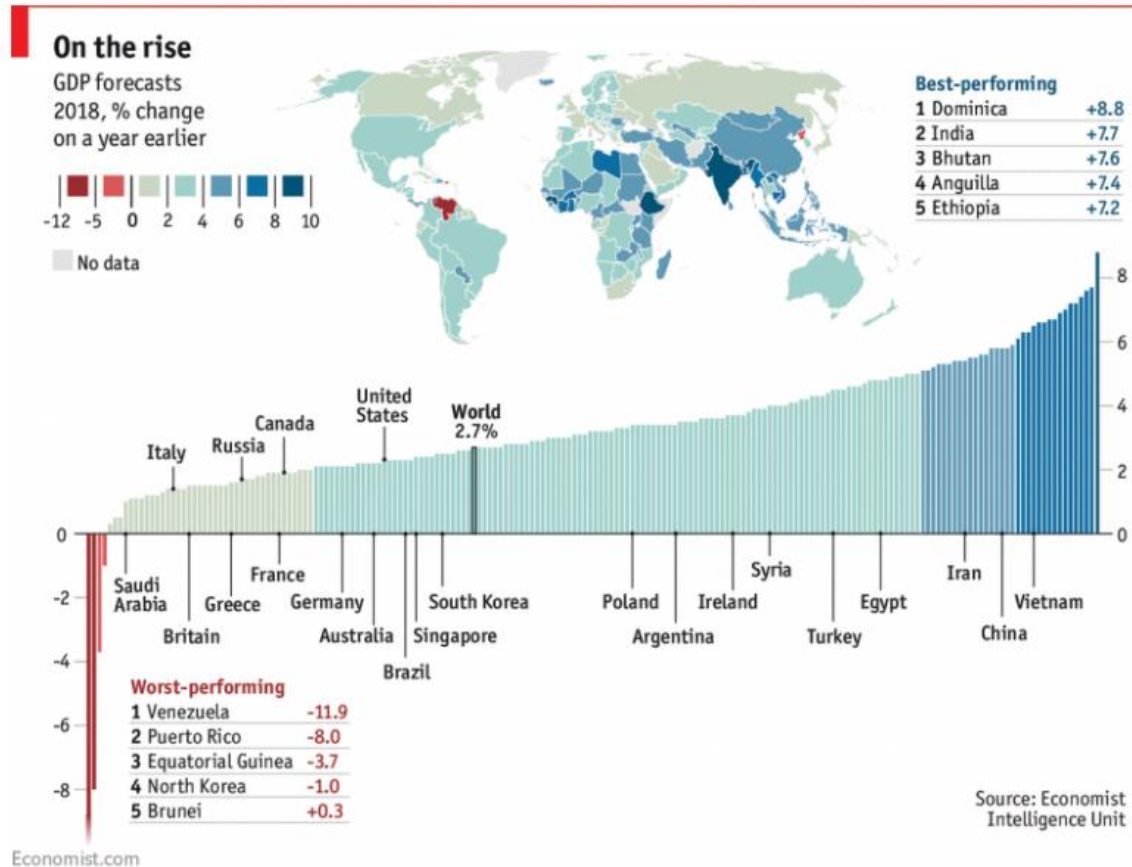


Highlights

Synchronized growth begins to roll over:

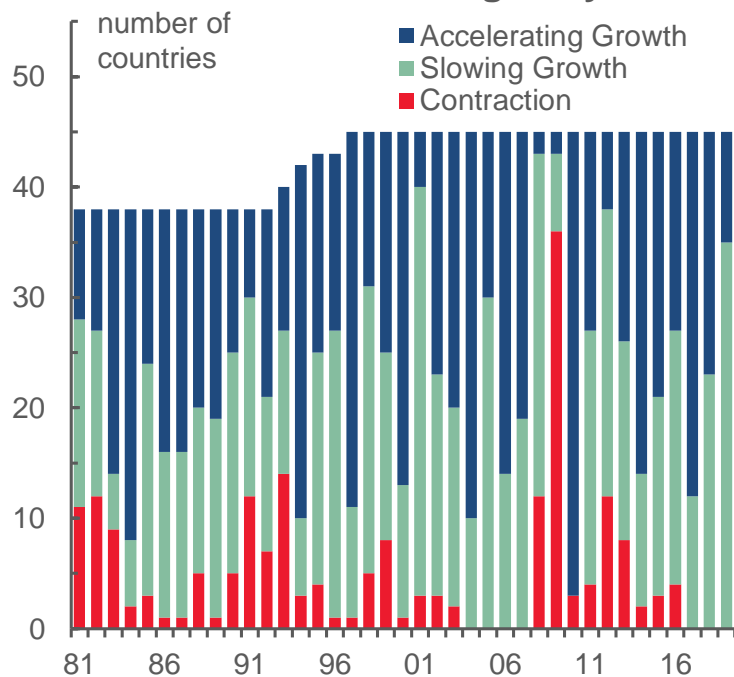
1. **Canada:** Solid growth and inflation mean more rate hikes by BoC
2. **Canadian housing:** Metrics remain strong
3. **US:** Fiscal stimulus primes an already hot economy, Fed tightens
4. **Yields:** Curves set to flatten further
5. **CAD:** Going sideways
6. **Commodities:** Oil prices to remain firm, metals higher
7. **NAFTA:** Heading into 2019

Global Growth Synchronized: Only 4 Economies Set to Contract



Global Synchronization is Rare; Trade Has Provided Some Support

OECD & Related EM Countries Growing in Sync



Sources: Scotiabank Economics, IMF.

World Trade Volume



Sources: Scotiabank Economics, Netherlands Bureau for Economic Policy Analysis.

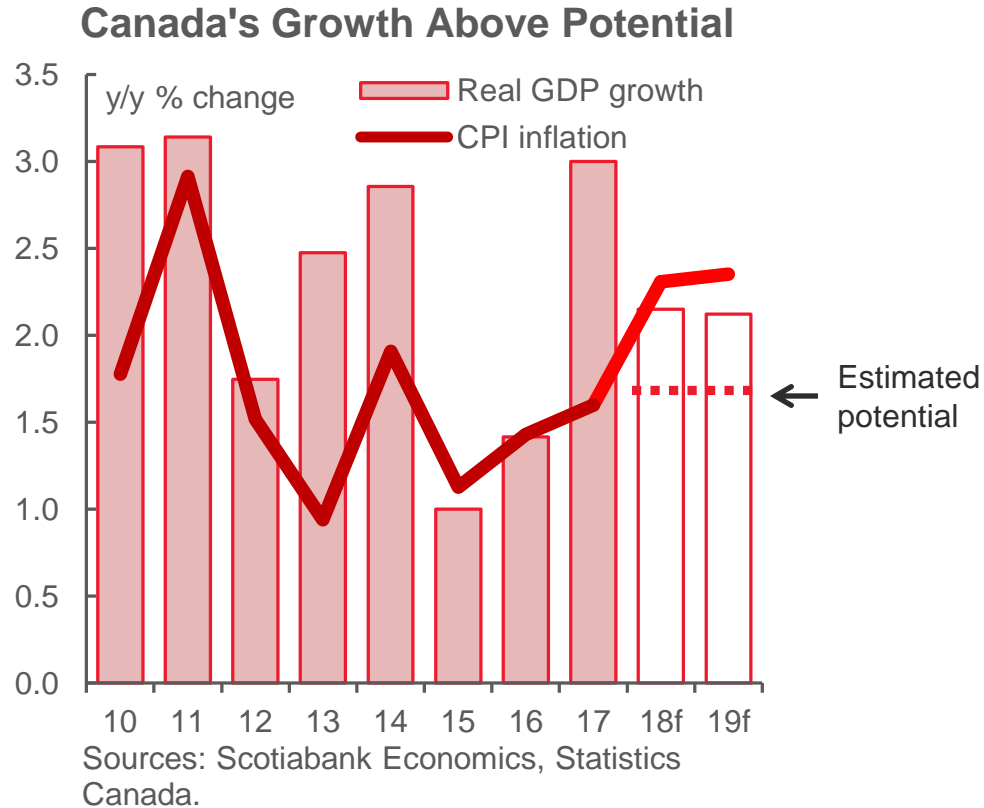
Canadian Growth: Upside Risks

Real GDP growth: impact of policy developments

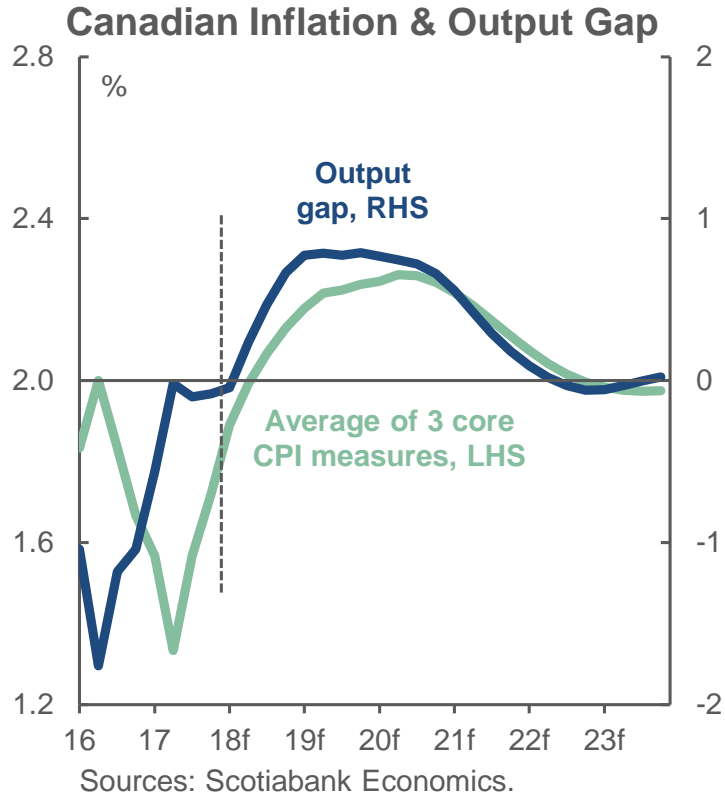
	2018f	2019f
Model-based projections based on fundamentals	2.5	2.2
Less: adjustments for policy developments	-0.3	-0.1
B-20 mortgage rules	-0.1	0.0
NAFTA uncertainty	-0.1	0.0
Global protectionism	-0.1	-0.1
Current baseline	2.2	2.1

Source: Scotiabank Economics.

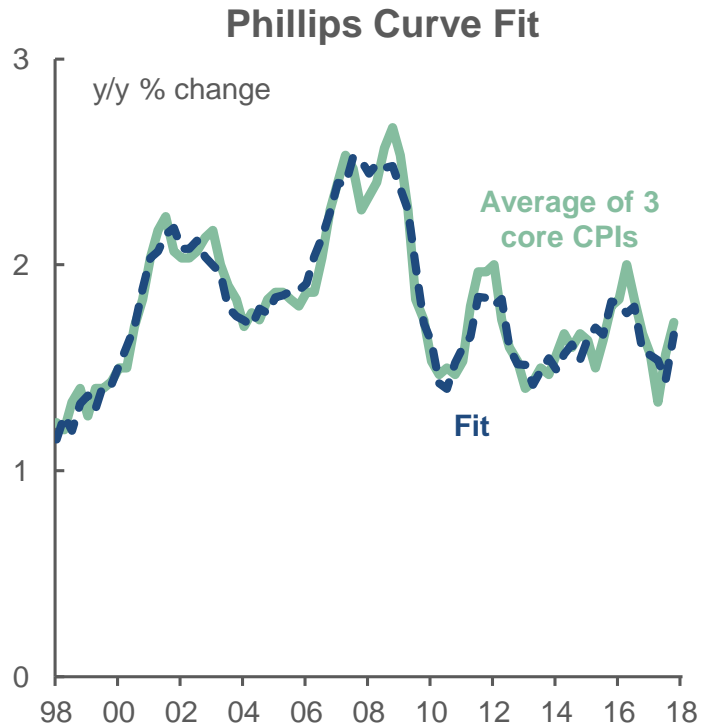
Canadian Growth Above Potential



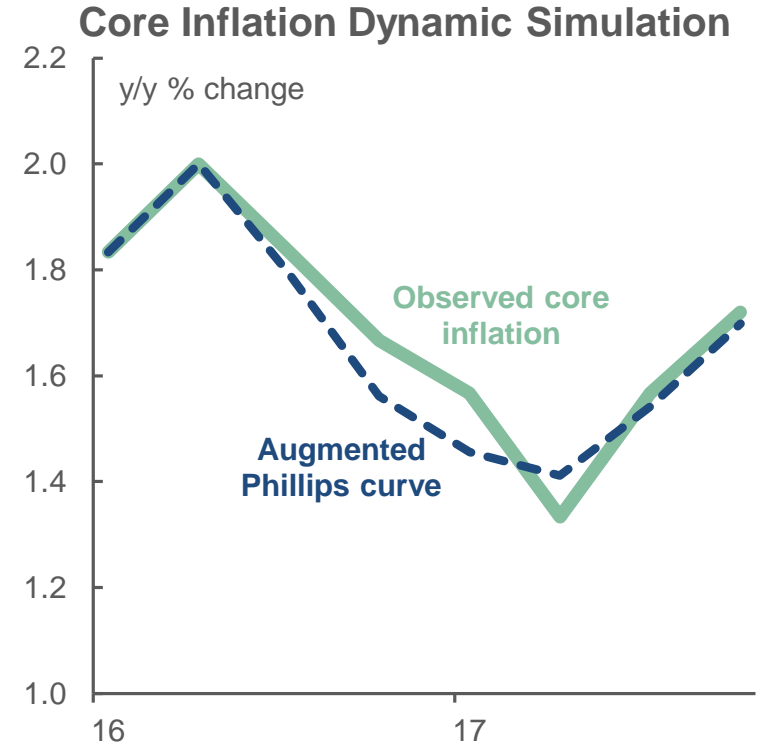
Canadian Supply Side: Excess Demand, Inflation Picking Up



Scotiabank Economics' Augmented Phillips Curve for Canada



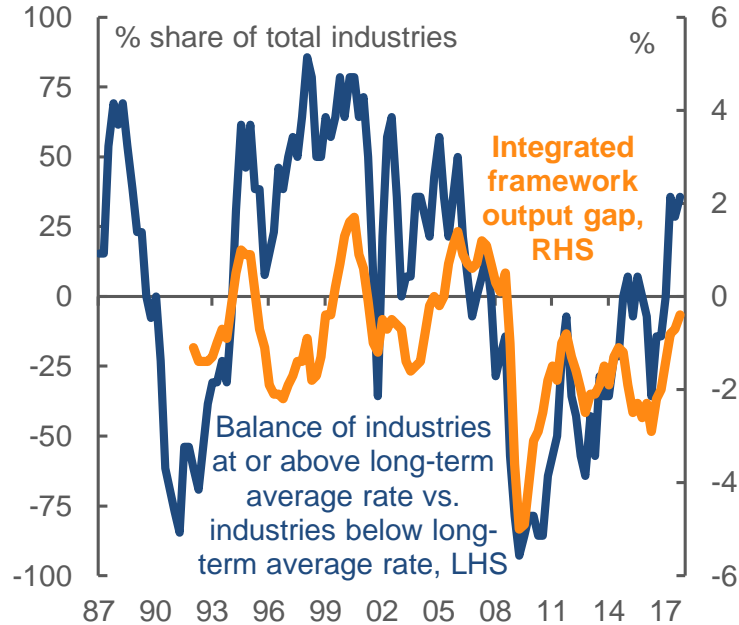
Sources: Scotiabank Economics, Statistics Canada.



Sources: Scotiabank Economics, Statistics Canada.

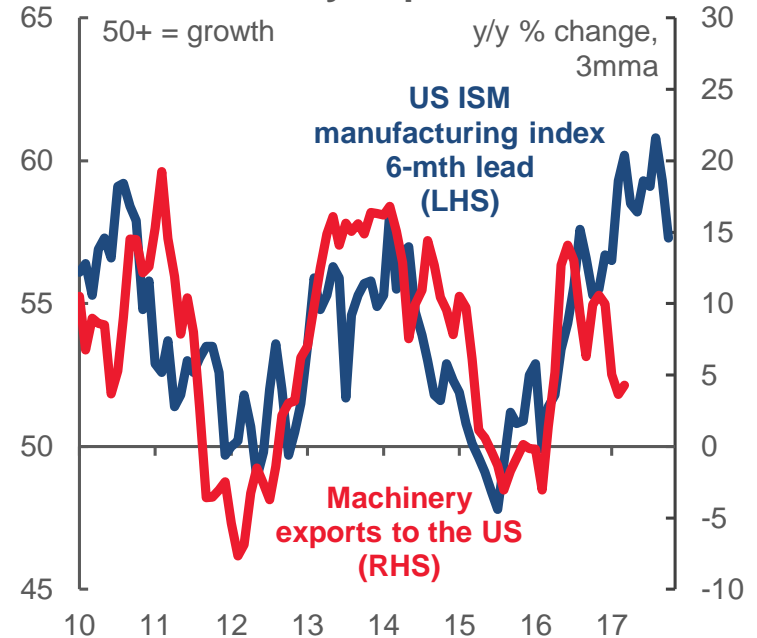
Capacity Tightest in Export-Intensive Sectors Set to Benefit from US Demand

Canadian Capacity Utilization Rate Diffusion Index



Sources: Scotiabank Economics, Statistics Canada.

Rising Manufacturing Sentiment to Lift Machinery Exports to the US

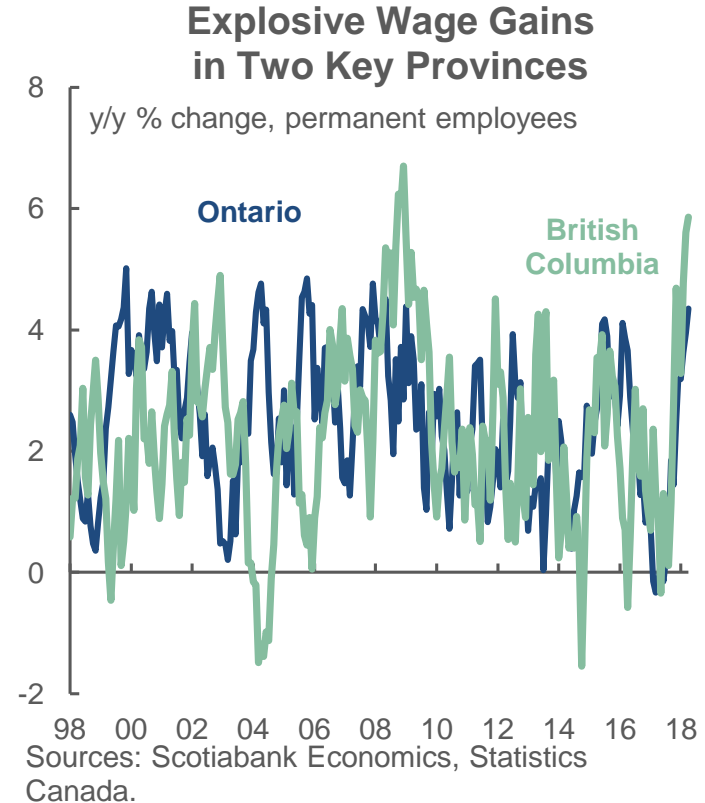


Sources: Scotiabank Economics, ISM, Statistics Canada.

Canadian Wage Growth: Organic and Mandated

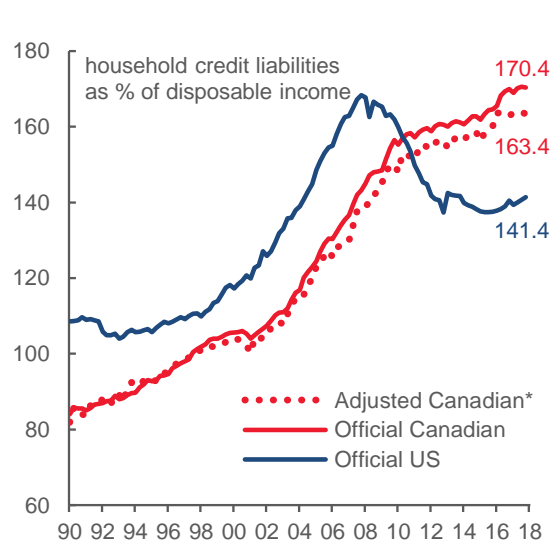


* Weighted hourly earnings of salaried and hourly employees. Sources: Scotiabank Economics, Statistics Canada.



Canadian Household Balance Sheets

Household Credit-Market Debt to Disposable Income



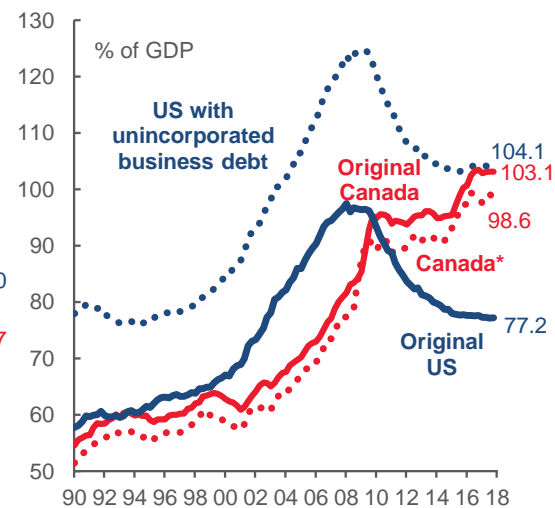
* Adjusted for US concepts and definitions.
 Sources: Scotiabank Economics, BEA, Federal Reserve Board, Statistics Canada.

Total Household Liabilities as % of Total Assets



Sources: Scotiabank Economics, Statistics Canada, Federal Reserve Board.

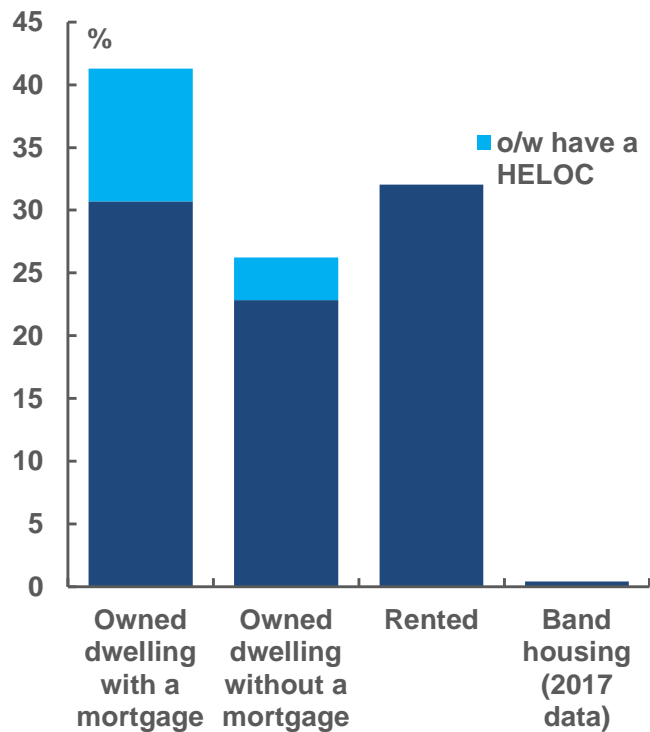
Household Credit-Market Debt to GDP



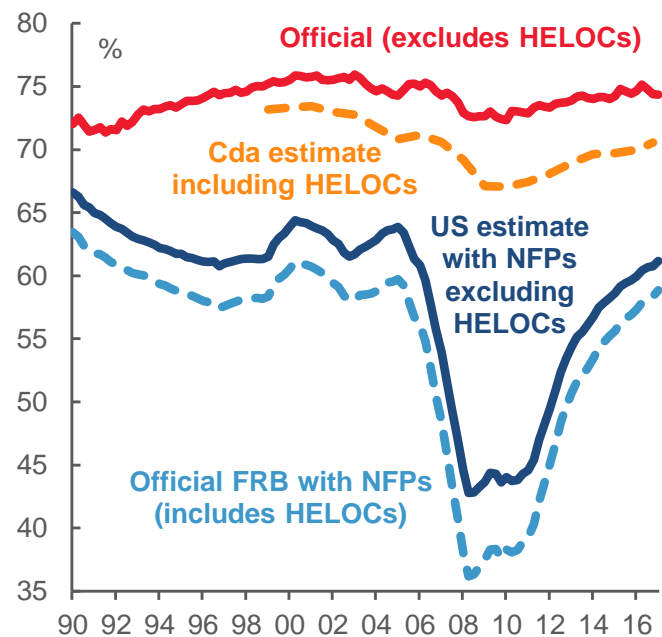
* Adjusted for US concepts and definitions.
 Sources: Scotiabank Economics, BEA, Federal Reserve Board, Statistics Canada.

Canadian Real Estate: Not the US

More than 50 Percent of Households Do Not Have a Mortgage or HELOC

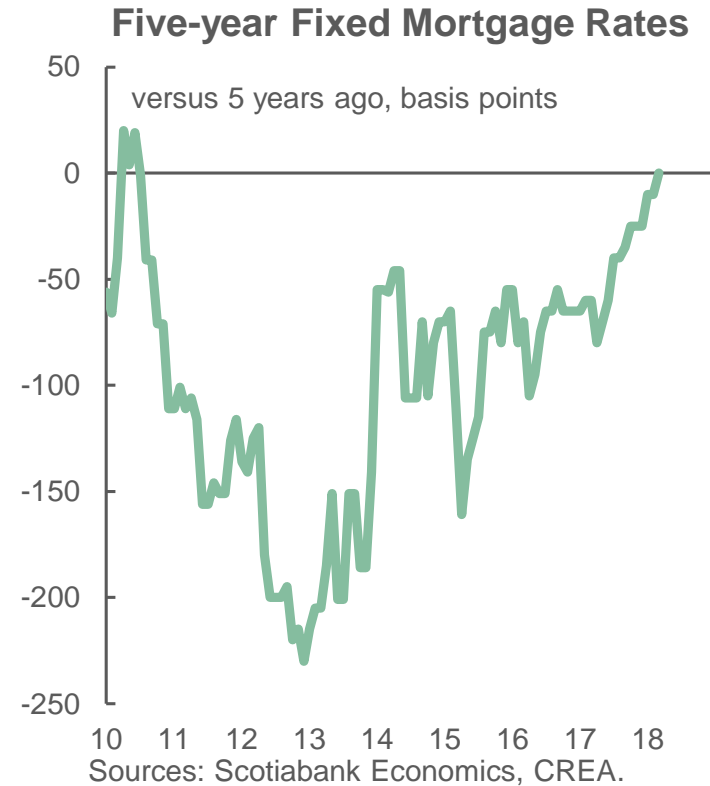
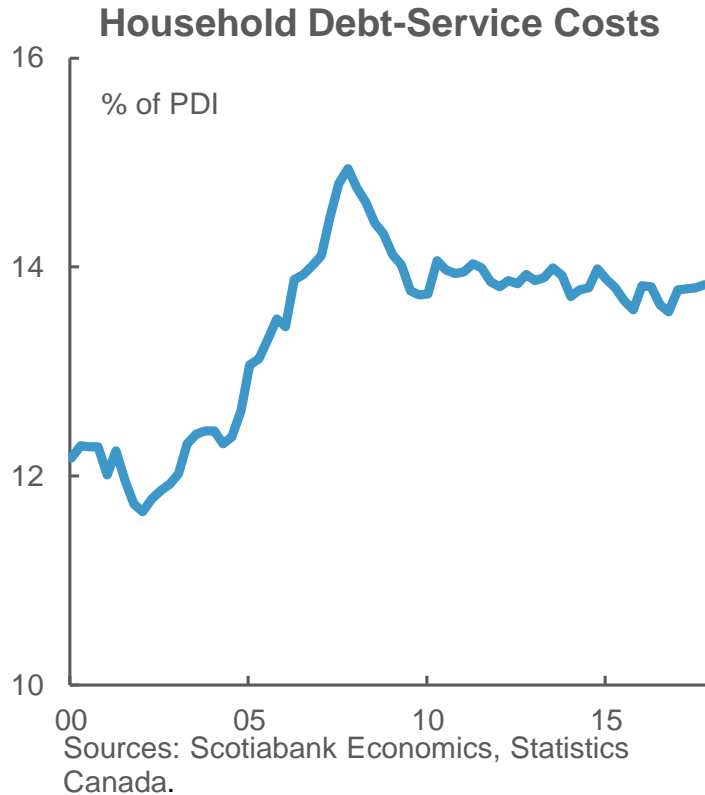


High Percentage of Equity (equity as % of real estate assets)



Sources: Scotiabank Economics, OSFI, FCAC, Statistics Canada, Federal Reserve Board.

Mortgage Debt Remains Sustainable



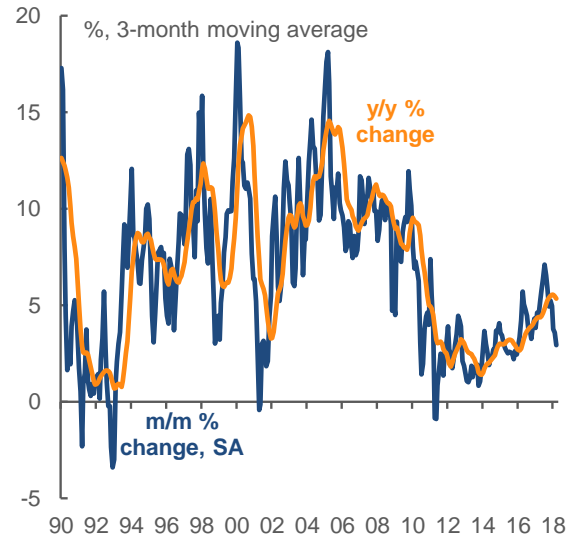
Credit Growth: Adjustment to B-20 Rules

HOUSEHOLD CREDIT GROWTH



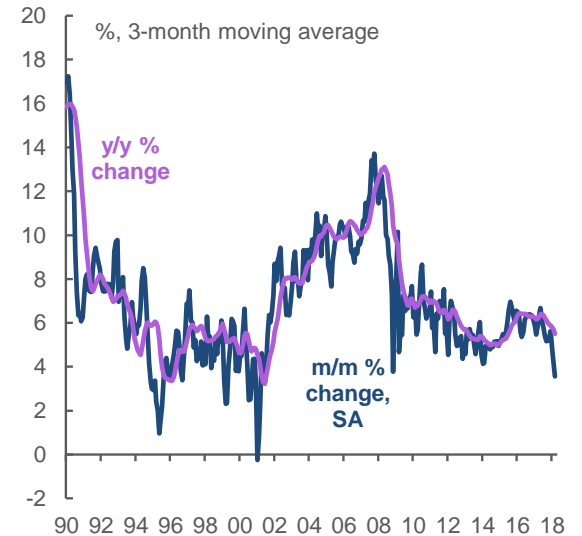
Source: Scotiabank Economics, Bank of Canada.

CONSUMER LOAN GROWTH



Sources: Scotiabank Economics, Bank of Canada.

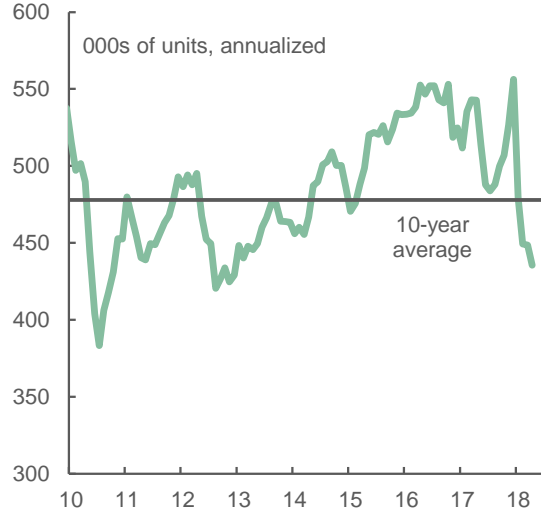
RESIDENTIAL-MORTGAGE GROWTH



Sources: Scotiabank Economics, Bank of Canada.

Real Estate: Adjustment to B-20 Rules

National Home Sales



Sources: Scotiabank Economics, CREA.

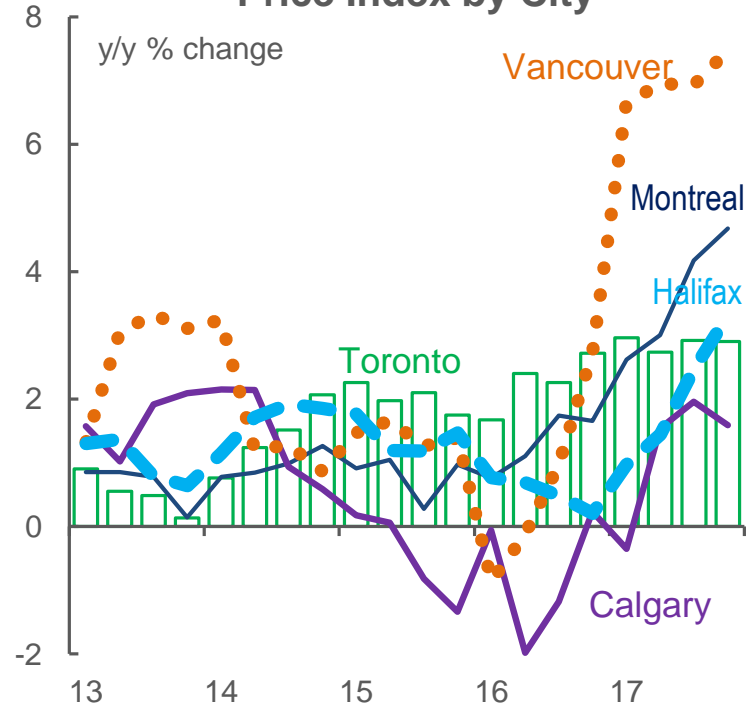
April 2018

National Housing Activity	m/m sa	y/y nsa
Sales	-2.9	-13.9
Listings	-4.8	-5.6
Average Price	0.0	-11.3
MLS HPI	0.6	1.5
Sales-to-new listings (ratio)	53.7	56.6

Sources: Scotiabank Economics, CREA.

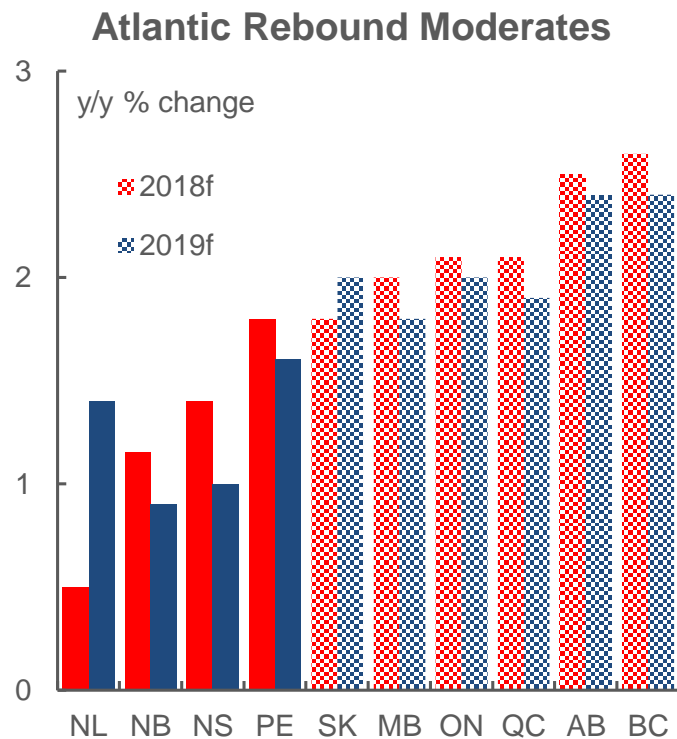


Apartment Construction Price Index by City

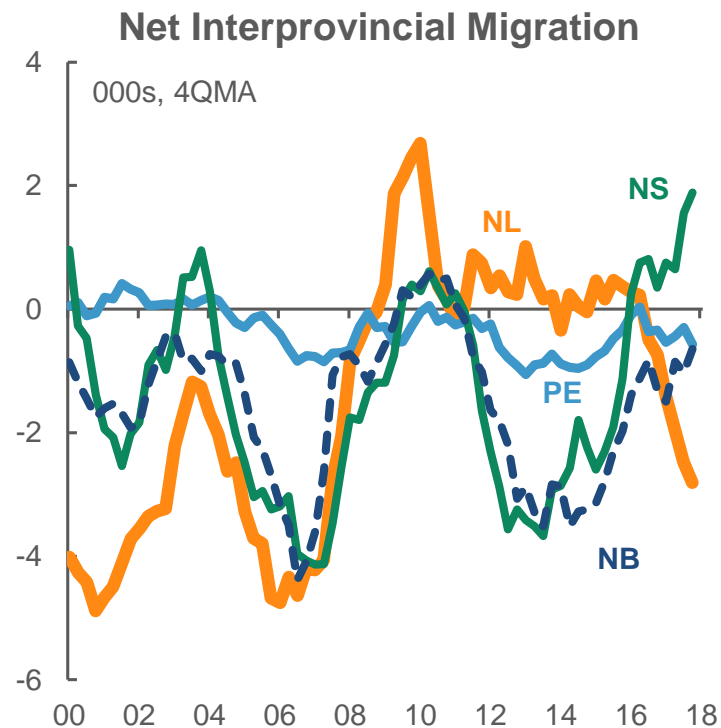


Source: Statistics Canada.

Atlantic Canada: Rebound Moderates



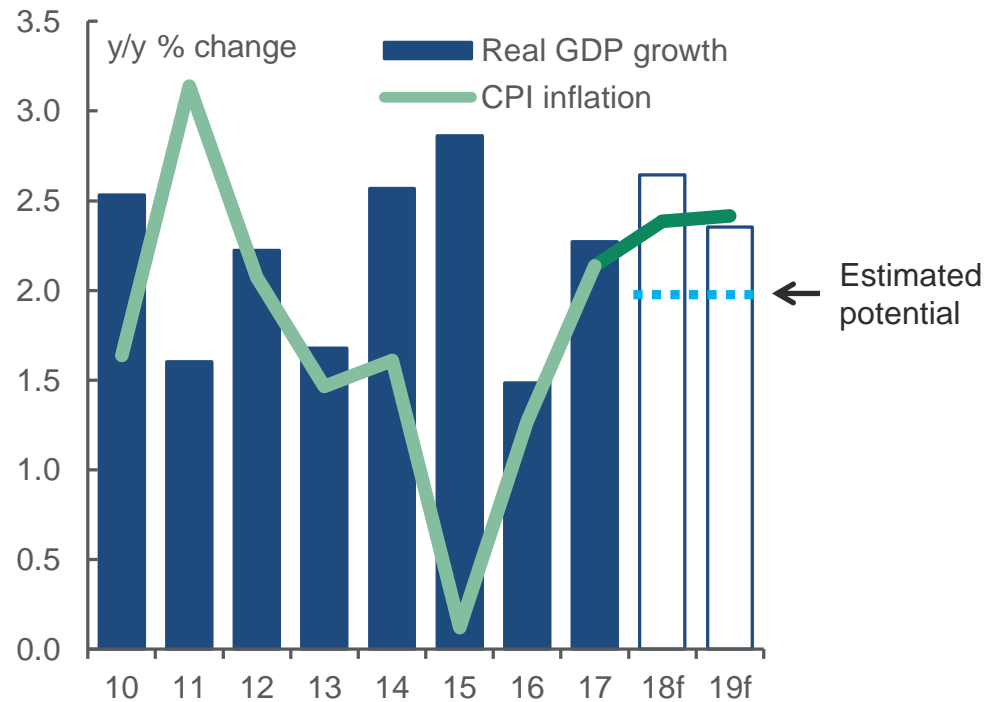
Sources: Scotiabank Economics.



Sources: Scotiabank Economics, Statistics Canada.

US Growth: Hot and Getting Hotter

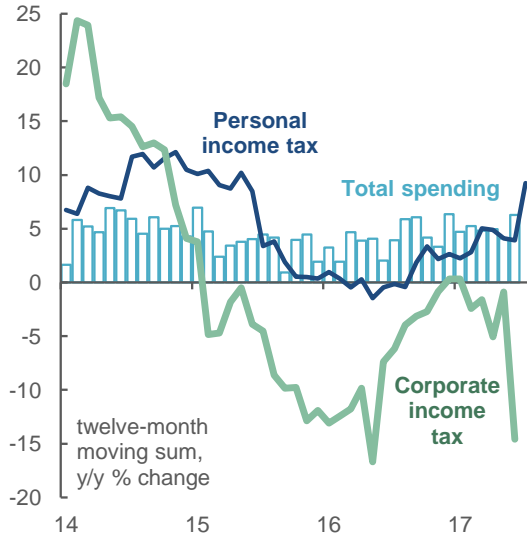
US Growth Above Potential



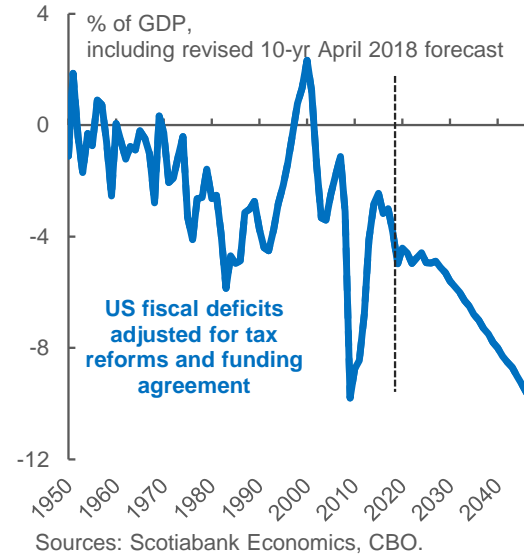
Sources: Scotiabank Economics, BEA, BLS.

US: Fiscal Policy Provides Unnecessary Stimulus

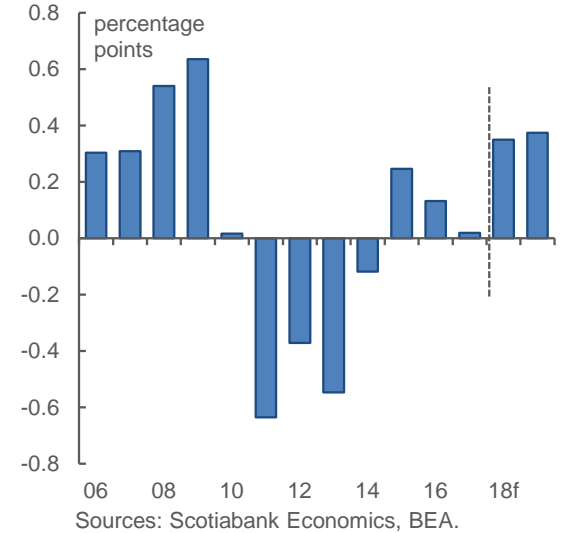
US Federal Receipts



US Fiscal Train Wreck



US Government Expenditures: Contribution to Real GDP Growth



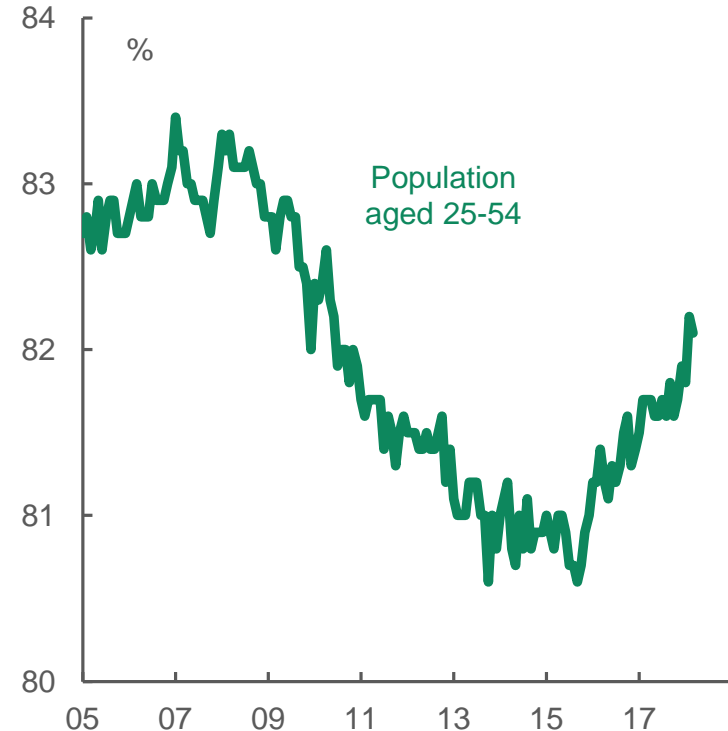
US Labour Markets Tight

Job Vacancies Versus Active Job Seekers



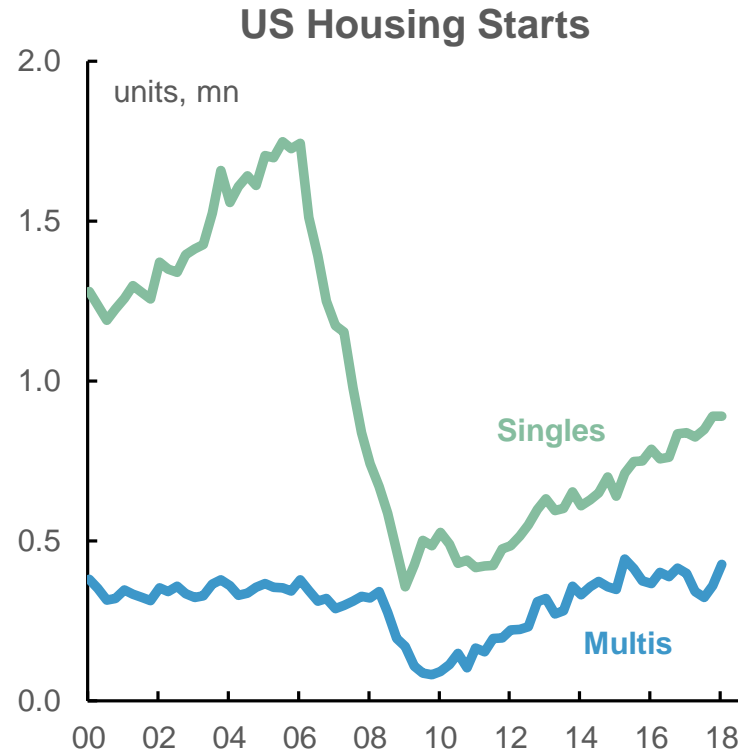
Sources: Scotiabank Economics, BLS.

Labour Force Participation Rate



Sources: Scotiabank Economics, BLS.

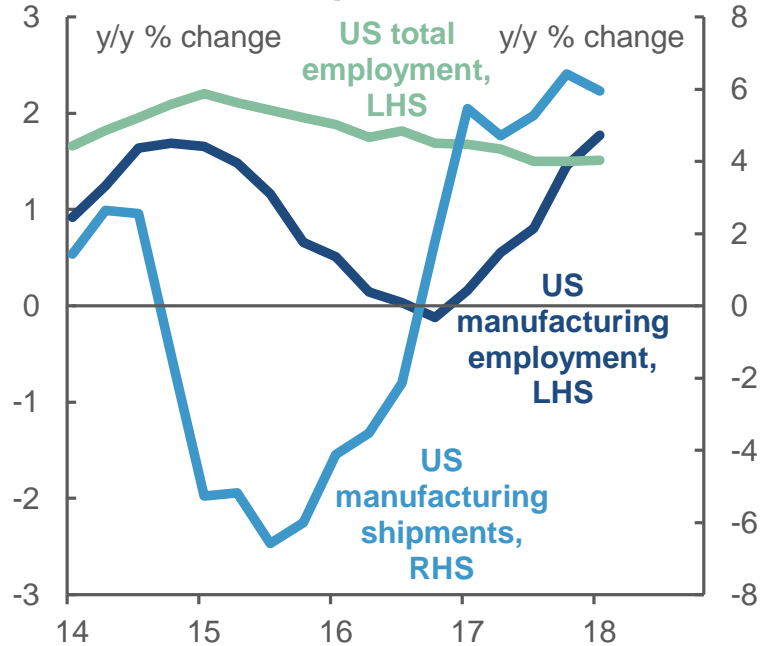
US Housing Rebounding: Affordability and Household Finances Solid



Sources: Scotiabank Economics,
US Census Bureau.

US Manufacturing Strong as Some PMIs Roll Over

Manufacturing Employment Outperforms



Sources: Scotiabank Economics, US Census Bureau, BLS.

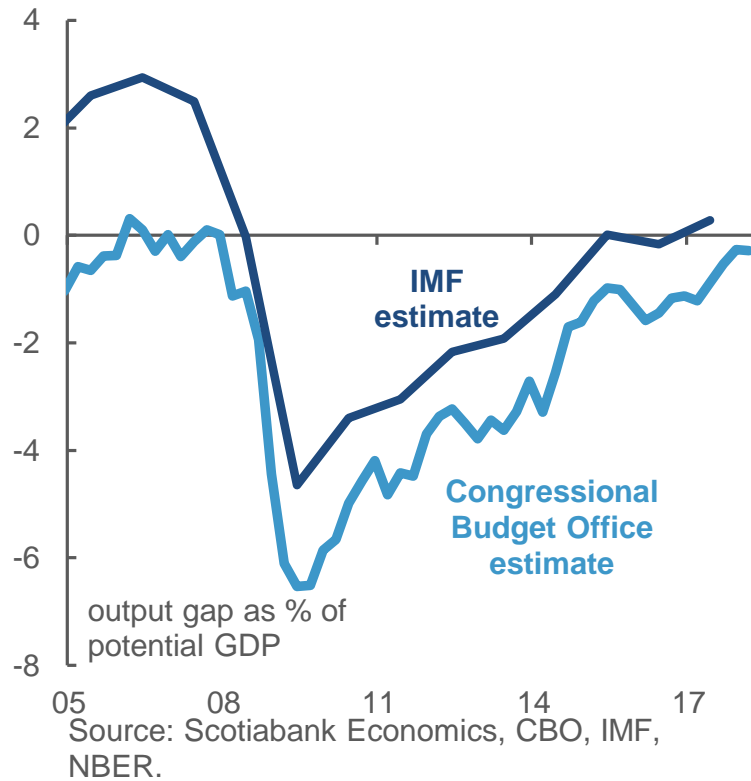
ISM Non-Manufacturing Index



Sources: Scotiabank Economics, ISM.

US Excess Demand Driving Prices Up

The US Gap Is Gone

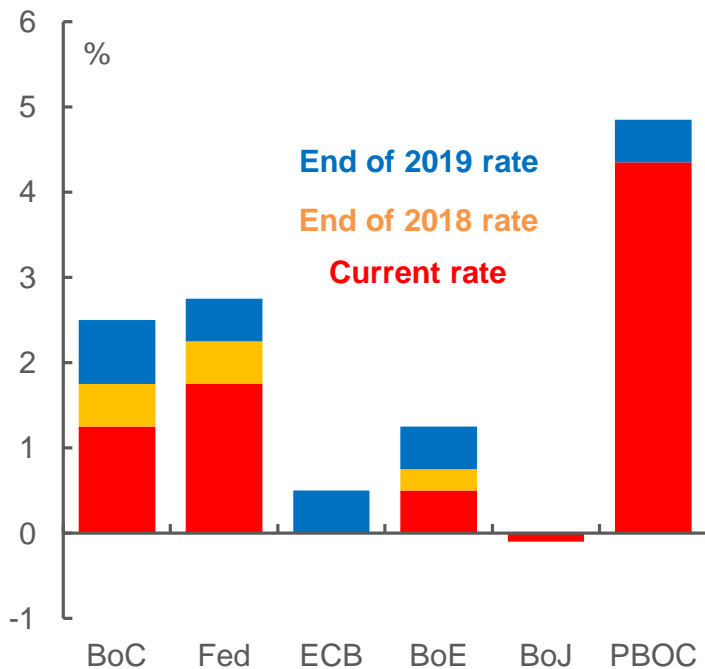


2% US Inflation Is Already Priced



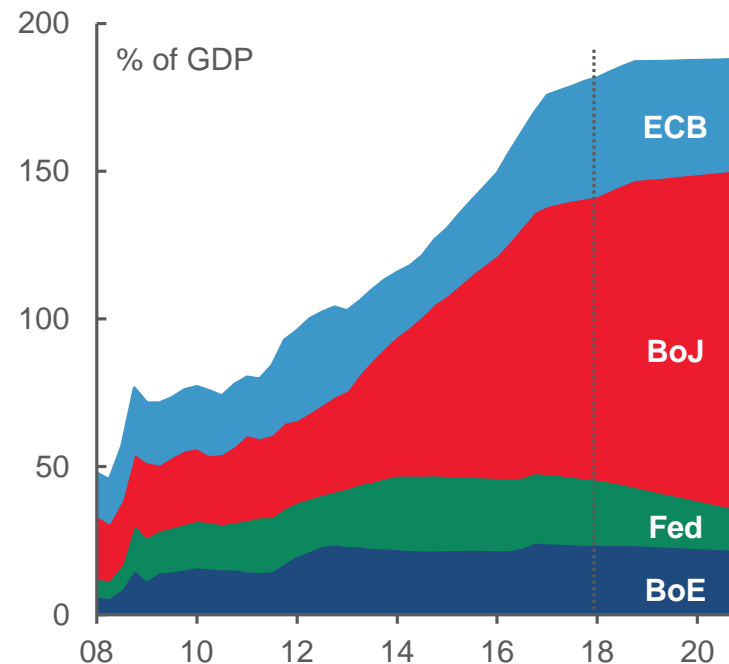
Anglo Central Banks Lead Tightening Amidst Abundant Liquidity

Forecasted Central Bank Rates



Sources: Scotiabank Economics, BoC, Fed, ECB, BoC, BoJ, CSIC.

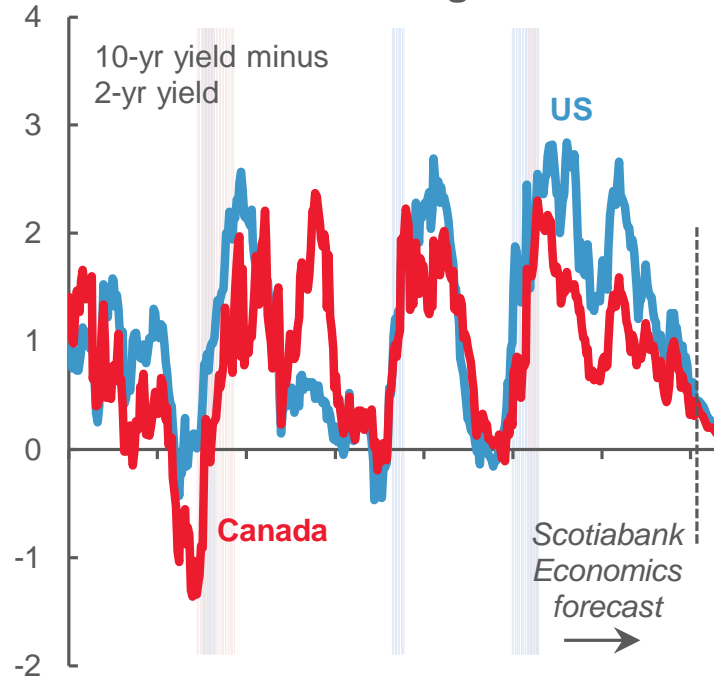
Combined QE Central Banks Won't Materially Shrink For Years



Sources: Scotiabank Economics, Haver Analytics, IMF.

North American Curves: Flat

Further Flattening Forecast

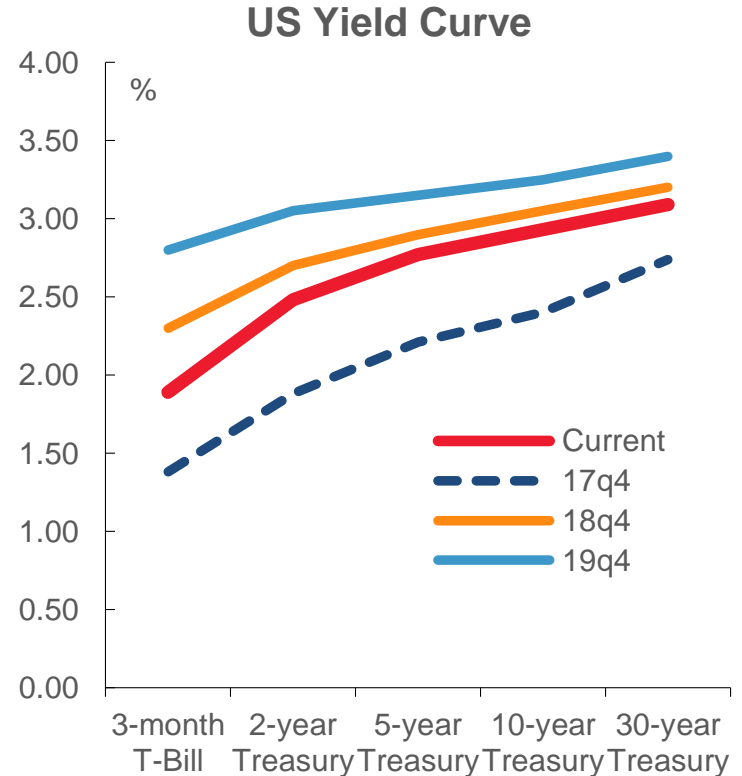


Sources: Scotiabank Economics, Bank of Canada, Federal Reserve Board, NBER, CD Howe Institute.

North American Curves: They Get Flatter

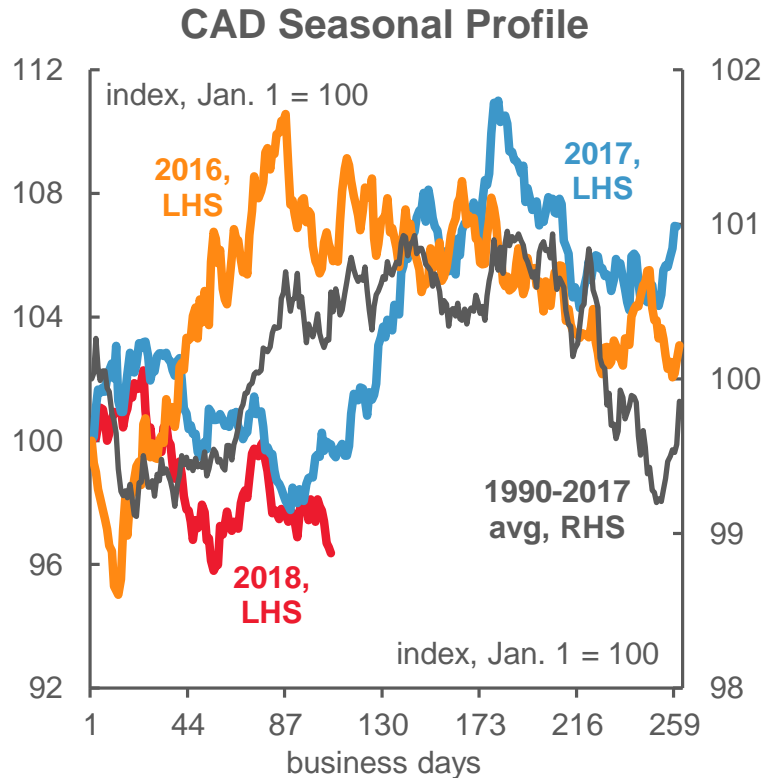


Source: Scotiabank Economics.

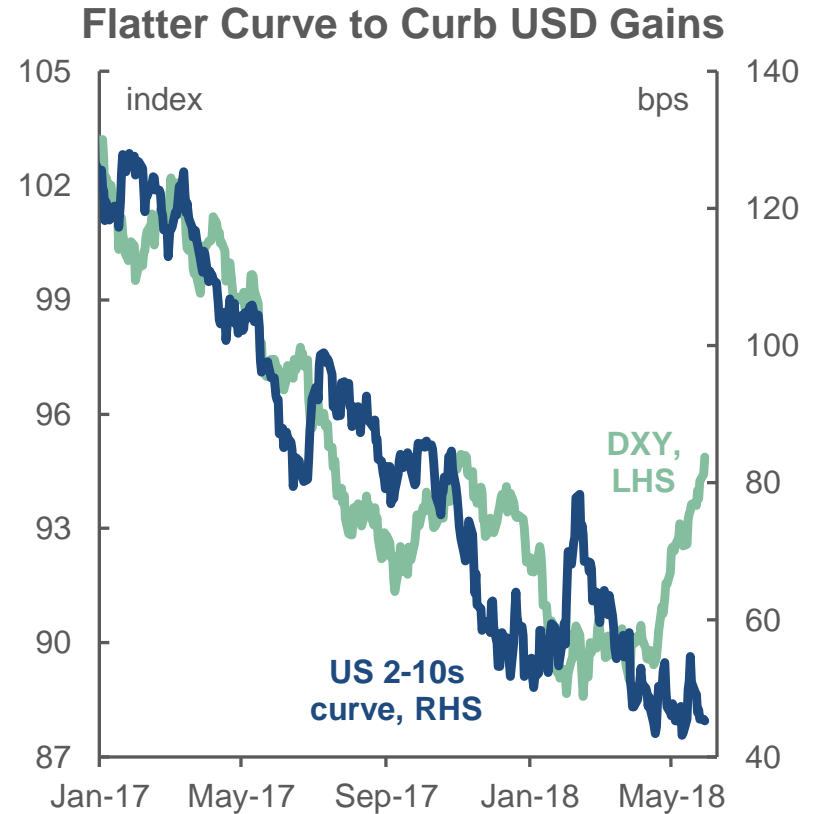


Sources: Scotiabank Economics, Bloomberg.

CAD Set to Strengthen Mildly As Yields Dampen USD Strength

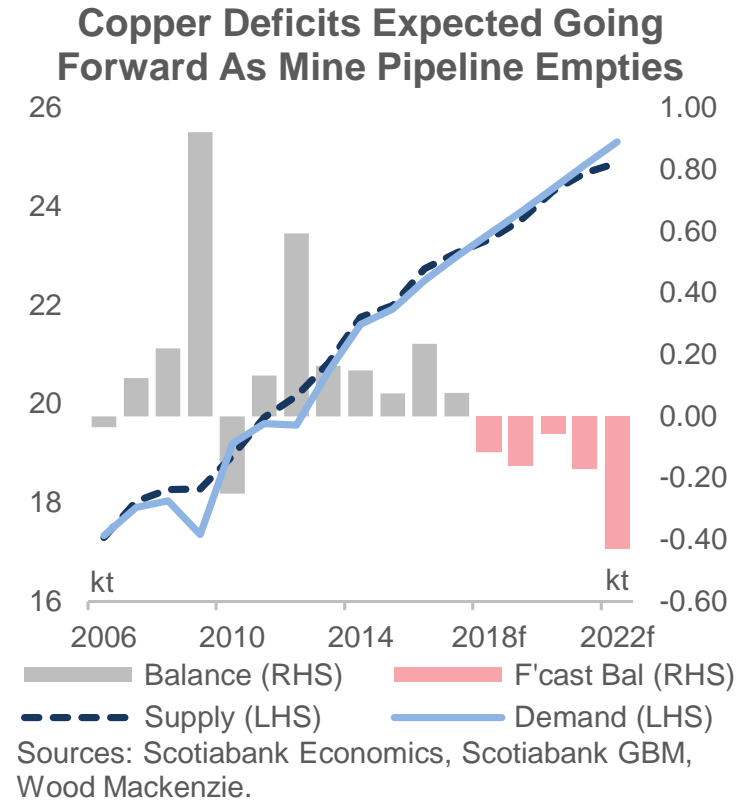
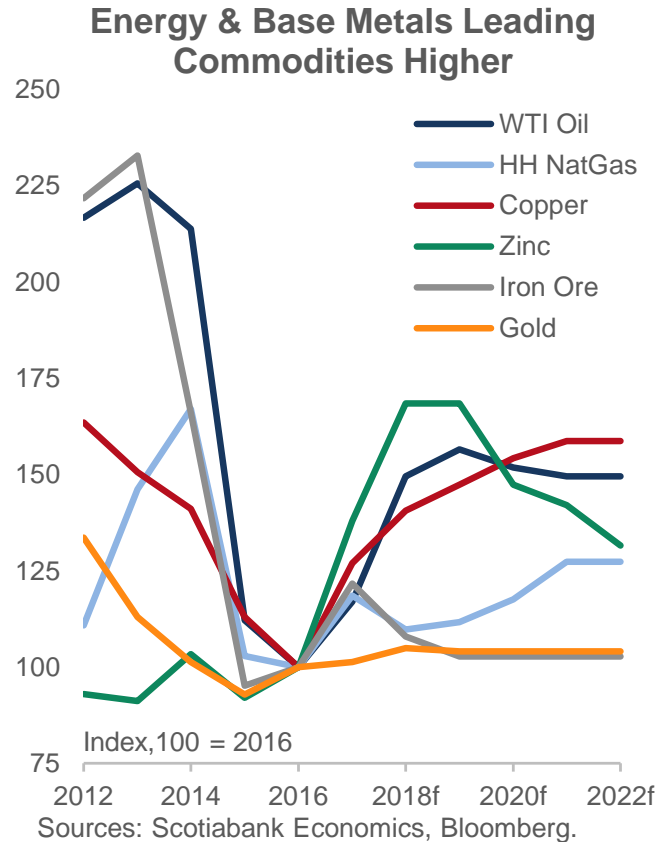


Sources: Scotiabank Economics, Bloomberg.



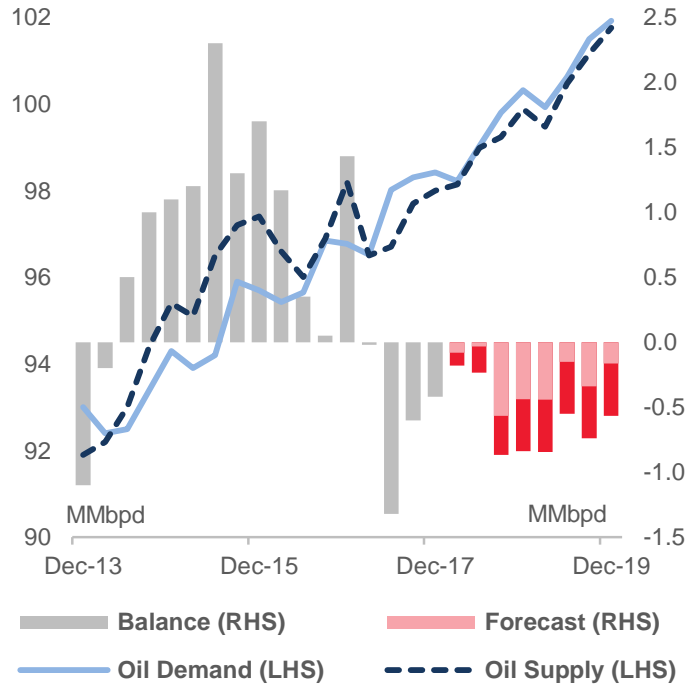
Sources: Scotiabank Economics, Bloomberg.

Commodities Prices Heading Higher



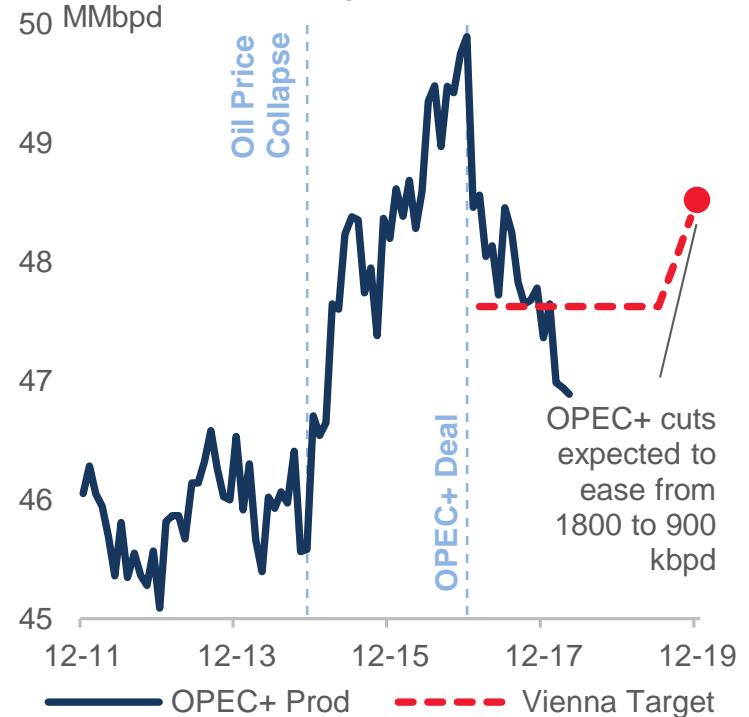
Oil Prices Firm

Oil Market was Already Tight Before the US Withdrew from the Iran Deal



Sources: Scotiabank Economics, Scotiabank GBM, IEA, EIA, JODI, OPEC.

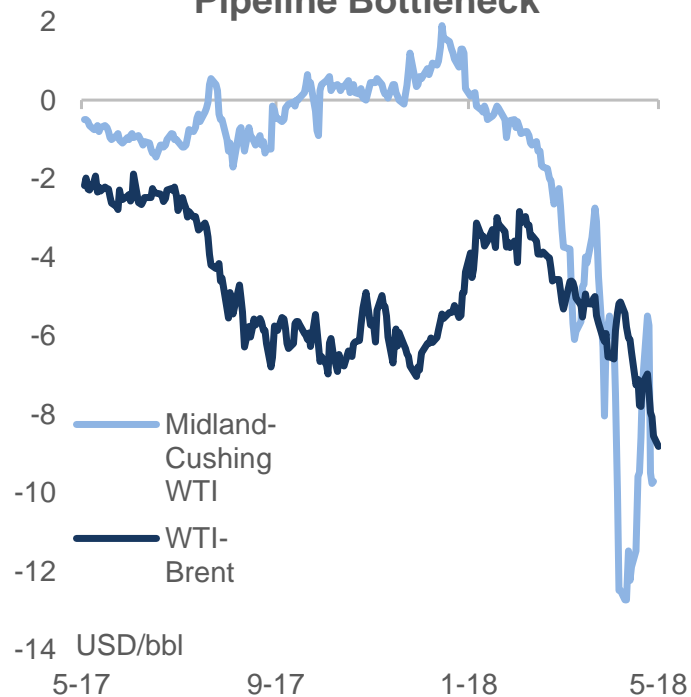
OPEC+ Production Cuts Expected to Ease to Satisfy Global Demand



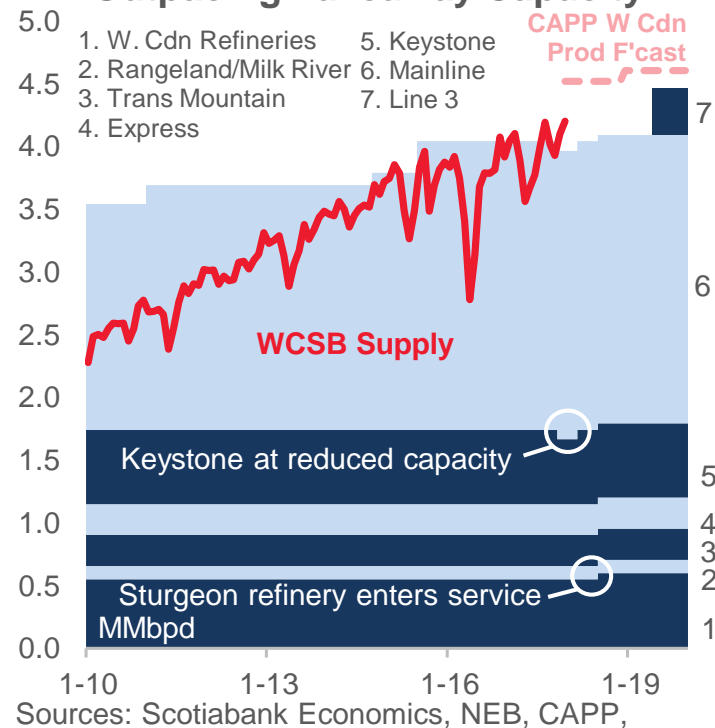
Sources: Scotiabank Economics, OPEC, OMI.

WCS Discount Set to Remain Wide

Oil Spreads Telling Tale of US Pipeline Bottleneck



Western Canadian Oil Supply Outpacing Takeaway Capacity



Extreme US demands:

- **Automobile rules of origin**
- **Sunset clause**
- **Dispute settlement mechanisms**
- **Canadian agricultural supply management**
- **Government procurement**

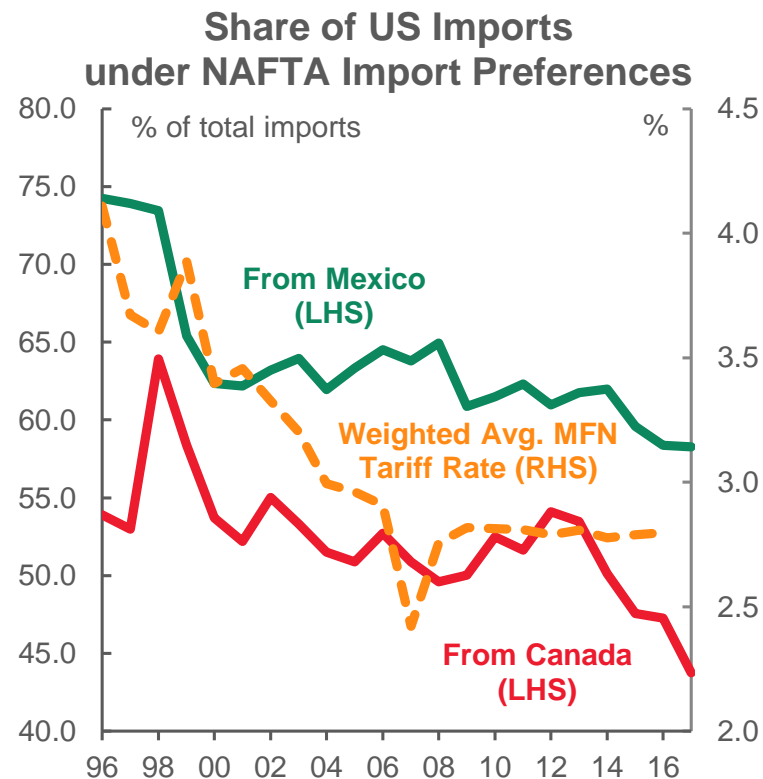
Talks concluded in 9 of 32 total NAFTA areas

Little work yet on intellectual property issues

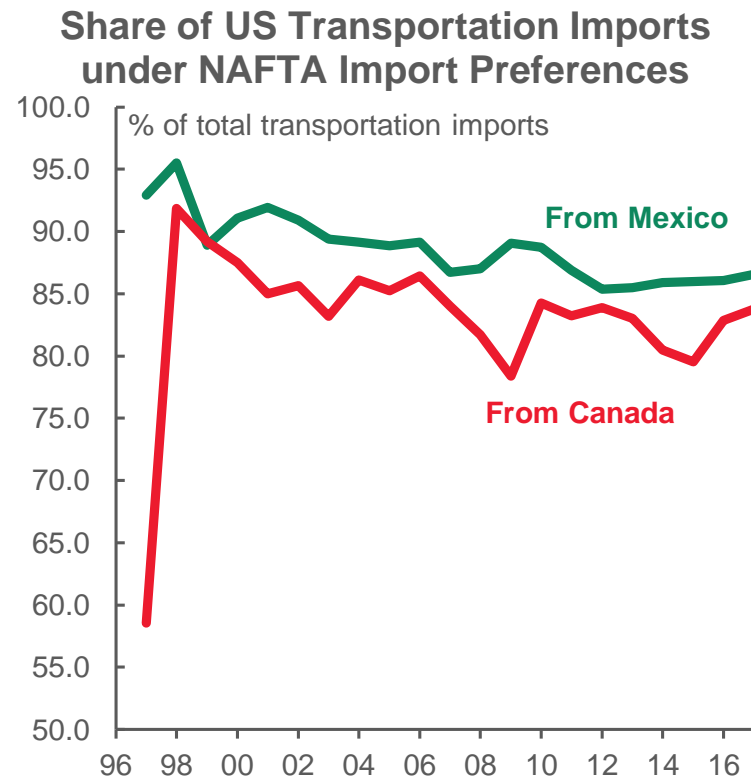
What's next:

- **1 June: US steel, aluminum, tariffs and responses**
- **Ratification unlikely before 2019 with new US Congress**

NAFTA: It Matters Less than It Used to for Canada



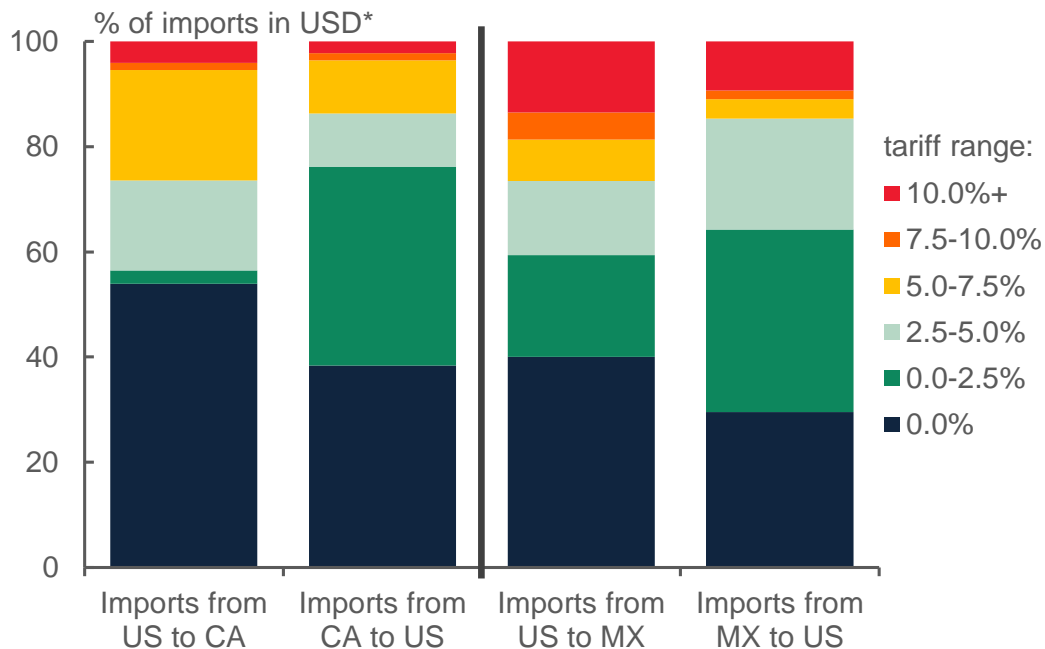
Sources: Scotiabank Economics, US ITC, WITS.



Sources: Scotiabank Economics, US ITC, WITS.

US Needs NAFTA as Much as Canada & Mexico Do

Imports Across NAFTA Partners by MFN Tariff Rates



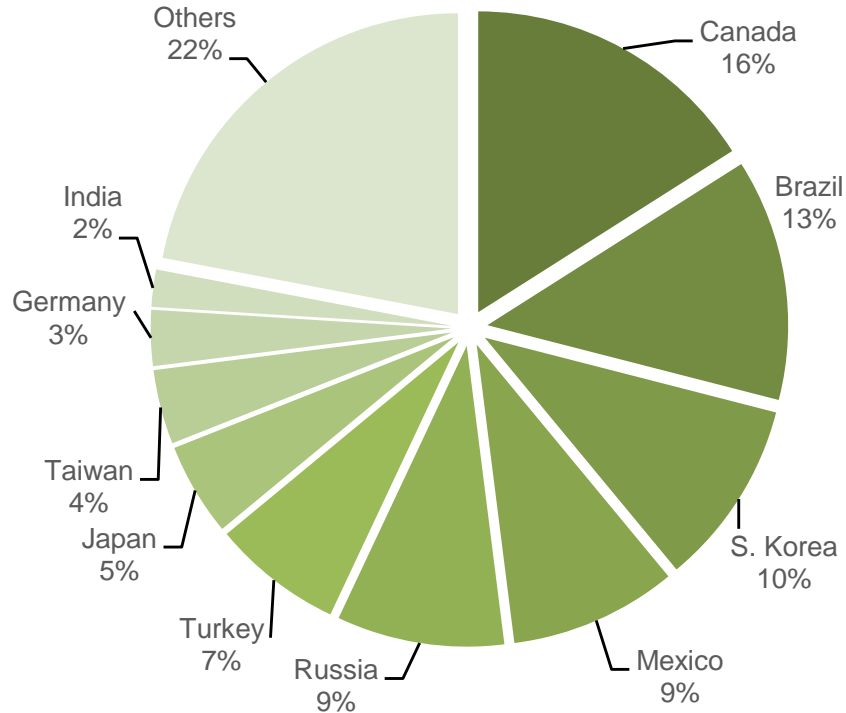
Source: Scotiabank Economics, World Bank WITS.

*2016 data for Canadian and Mexican imports, 2015 data for US imports.

Steel & Aluminum Tariffs Likely to Be Temporary

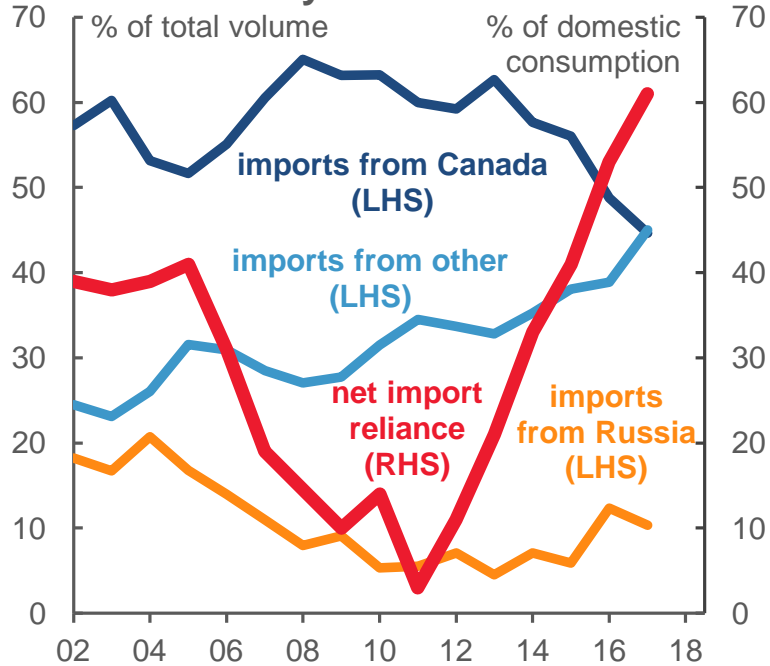
US Steel Imports by Origin

(2017, % share)



Sources: Scotiabank Economics, US Commerce Department.

The US Relies on Aluminum Imports, Mainly from Canada



Sources: Scotiabank Economics, US Census Bureau, USGS.

For more information...

Scotiabank Economics:

Web: www.scotiabank.com/economics

Email: scotia.economics@scotiabank.com

Twitter: @ScotiabankViews

Brett House:

Twitter: @BrettEHouse

NAFTA research:

www.scotiabank.com/NAFTA



Scotiabank Economics
talks NAFTA

Brett House

Vice-President & Deputy Chief Economist

Scotiabank Economics

416.863.7463

brett.house@scotiabank.com

Scotiabank | Economics

40 King Street West, 63rd Floor

Toronto, Ontario, Canada M5H 1H1

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Scotiabank Economics Forecasts as of 3 May

2000–16 2016 2017 2018f 2019f 2000–16 2016 2017 2018f 2019f

Real GDP
(annual % change)

Consumer Prices
(y/y % change, year-end)

World (based on purchasing power parity)	3.9	3.2	3.8	3.8	3.7					
Canada	2.1	1.4	3.0	2.2	2.1	1.9	1.4	1.8	2.4	2.3
United States	1.9	1.5	2.3	2.6	2.4	2.2	1.8	2.1	2.4	2.4
Mexico	2.2	2.9	2.0	2.3	2.8	4.4	3.4	6.8	4.1	3.8
United Kingdom	1.8	1.9	1.8	1.7	1.9	2.0	1.6	3.0	1.9	1.9
Eurozone	1.3	1.8	2.5	2.5	2.3	1.7	1.1	1.4	1.5	1.5
Germany	1.3	1.9	2.6	3.0	3.0	1.5	1.7	1.6	1.6	1.9
France	1.3	1.2	1.9	2.5	2.0	1.6	0.8	1.2	1.5	1.5
China	9.4	6.7	6.9	6.5	6.2	2.3	2.1	1.8	2.3	2.5
India	7.1	7.9	6.4	7.4	7.5	6.9	3.4	5.2	4.6	5.6
Japan	0.9	0.9	1.7	1.3	0.9	0.1	0.3	1.0	1.1	2.3
South Korea	4.2	2.9	3.1	2.8	2.8	2.6	1.3	1.5	2.1	2.5
Australia	3.0	2.6	2.3	2.6	2.5	2.8	1.5	1.9	2.2	2.6
Thailand	4.0	3.3	3.9	3.5	3.4	2.0	1.1	0.8	1.0	2.0
Brazil	2.6	-3.5	1.0	2.5	2.7	6.7	6.3	2.9	4.1	4.6
Colombia	4.1	2.1	1.8	2.5	3.5	5.1	5.7	4.1	3.3	3.4
Peru	5.1	3.9	2.5	3.3	3.7	2.8	3.2	1.4	2.0	2.5
Chile	4.0	1.2	1.5	3.6	3.9	3.4	2.7	2.3	2.7	3.0

Scotiabank Economics Forecasts as of 3 May

	2000–16	2016	2017	2018f	2019f	2000–16	2016	2017	2018f	2019f
	Canada					United States				
	(annual % change, unless noted)					(annual % change, unless noted)				
Real GDP	2.1	1.4	3.0	2.2	2.1	1.9	1.5	2.3	2.6	2.4
Consumer spending	2.9	2.3	3.4	2.5	2.0	2.4	2.7	2.8	2.4	2.4
Residential investment	3.7	3.4	3.0	1.2	0.4	-0.4	5.5	1.8	2.1	2.1
Business investment	2.2	-8.8	2.5	4.1	2.5	2.3	-0.6	4.7	5.2	2.9
Government	2.2	2.7	2.5	2.4	1.5	1.0	0.8	0.1	2.1	2.2
Exports	1.3	1.0	1.0	1.6	3.6	3.6	-0.3	3.4	3.9	2.5
Imports	2.9	-1.0	3.6	3.0	2.5	3.4	1.3	4.0	4.6	3.2
Nominal GDP	4.2	2.0	5.3	4.8	4.5	3.9	2.8	4.1	4.8	4.8
GDP deflator	2.1	0.6	2.3	2.6	2.4	2.0	1.3	1.8	2.1	2.4
Consumer price index (CPI)	1.9	1.4	1.6	2.3	2.4	2.2	1.3	2.1	2.4	2.4
CPI ex. food & energy	1.6	1.9	1.6	2.0	2.2	2.0	2.2	1.8	2.2	2.4
Pre-tax corporate profits	3.6	-1.9	20.2	6.0	1.0	5.5	-2.1	4.4	2.7	0.5
Employment	1.3	0.7	1.9	1.3	1.0	0.7	1.8	1.6	1.4	1.1
Unemployment rate (%)	7.1	7.0	6.3	5.8	5.7	6.2	4.9	4.4	4.0	3.9
Current account balance (CAD, USD bn)	-17.1	-65.4	-63.9	-58.6	-47.6	-507	-452	-466	-572	-632
Merchandise trade balance (CAD, USD bn)	25.1	-25.9	-23.9	-23.8	-16.0	-673	-753	-811	-925	-1001
Federal budget balance* (FY, CAD, USD bn)	-2.8	-1.0	-17.8	-19.4	-15.1	-150	-585	-665	-812	-990
percent of GDP	-0.2	0.0	-0.9	-0.9	-0.7	-1.0	-3.1	-3.4	-4.0	-4.6
Housing starts (000s, mn)	199	198	220	208	196	1.27	1.17	1.20	1.27	1.30
Motor vehicle sales (000s, mn)	1,657	1,949	2,041	2,000	1,950	15.5	17.5	17.1	17.4	17.3
Industrial production	0.6	0.1	5.1	2.2	1.0	0.6	-2.0	1.6	3.5	1.5

Scotiabank Economics Forecasts as of 3 May

	2017	2018				2019			
Central Bank Rates	Q4	Q1	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Americas									
Bank of Canada	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.25	2.50
US Federal Reserve (upper bound)	1.50	1.75	2.00	2.25	2.25	2.50	2.50	2.50	2.75
Bank of Mexico	7.25	7.50	7.50	7.50	7.75	7.75	7.50	7.25	7.00
Europe									
European Central Bank	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.50
Bank of England	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25
Currencies and Interest Rates									
Americas									
Canadian dollar (USDCAD)	1.26	1.29	1.27	1.26	1.25	1.25	1.22	1.22	1.25
Canadian dollar (CADUSD)	0.80	0.78	0.79	0.79	0.80	0.80	0.82	0.82	0.80
Mexican peso (USDMXN)	19.66	18.18	19.07	19.17	19.48	19.59	19.42	19.47	19.75
Europe									
Euro (EURUSD)	1.20	1.23	1.25	1.28	1.30	1.30	1.33	1.35	1.35
UK pound (GBPUSD)	1.35	1.40	1.40	1.42	1.47	1.48	1.48	1.50	1.50
Canada (Yields, %)									
3-month T-bill	1.06	1.15	1.40	1.55	1.80	2.05	2.30	2.30	2.50
2-year Canada	1.69	1.78	2.05	2.15	2.30	2.40	2.50	2.55	2.60
5-year Canada	1.87	1.97	2.25	2.35	2.45	2.55	2.60	2.65	2.70
10-year Canada	2.05	2.09	2.40	2.50	2.55	2.60	2.65	2.70	2.75
30-year Canada	2.27	2.23	2.45	2.60	2.70	2.80	2.85	2.90	2.95
United States (Yields, %)									
3-month T-bill	1.38	1.70	2.05	2.30	2.30	2.55	2.55	2.60	2.80
2-year Treasury	1.88	2.27	2.55	2.60	2.70	2.80	2.95	3.00	3.05
5-year Treasury	2.21	2.56	2.75	2.85	2.90	2.95	3.00	3.10	3.15
10-year Treasury	2.40	2.74	2.95	3.00	3.05	3.05	3.10	3.15	3.25
30-year Treasury	2.74	2.97	3.10	3.15	3.20	3.25	3.30	3.35	3.40