ECONOMIC AND FINANCIAL MARKET UPDATE

December 2017

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Teflon 2017

This year it seemed nothing could dent sentiment or derail a long-overdue pickup in global growth. In the US, ever-present political uncertainty and limited legislative progress didn't stop the economy from accelerating to its best pace in two years—in the process pushing unemployment close to 4% for the first since 2000. That allowed the Fed to continue gradually removing accommodation and start shrinking their balance sheet, a move that was handled well by investors. Up north, Canada's economy put in a surprisingly strong performance, including a roaring labour market, despite some whipsawing in the housing market and plenty of concerns about North American trade. The improving backdrop allowed the Bank of Canada to reverse 2015's 'insurance' rate cuts, with more tightening on the table next year.

In Europe, a number of election hurdles were cleared and we saw the strongest, most broadly-based expansion since the currency bloc's double-dip recession. Things aren't as rosy in the UK where little progress has been made to kickstart Brexit negotiations. The issue is taking a toll on the economy, though the slowdown this year hasn't been as bad as initially feared. Indeed, conditions were strong enough for the Bank of England to raise rates for the first time in a decade.

Tighter monetary policy in a number of advanced economies and plenty of geopolitical uncertainty didn't prevent global equity markets from consistently hitting new highs, and volatility plumbing fresh lows. The MSCI world stock market index posted a gain of more than 20% and the S&P500 wasn't far behind. There are still a number of issues to look out for in 2018—Nafta renegotiations in Canada, Italian elections in Europe, Brexit in the UK, and an unpredictable leader in the US. The global economy was able to shrug off such issues in 2017, and solid momentum heading into 2018 is fueling optimism that next year will be much the same.

Slower growth, but Canada's economy still on solid footing…

After growing at a 3-1/2% pace over the prior four quarters, Canada's economy geared down in Q3, meeting expectations with a more trend-like 1.7% annualized increase. Consumers once again made a strong contribution with spending jumping an annualized 4% in Q3—a bit surprising given slower retail sales in the quarter. Businesses were also in on the action, increasing investment in machinery and equipment, while net trade provided a sizeable drag in what was an ugly quarter for exporters. On a monthly basis, Q3 ended on a positive note with GDP rising a stronger-than-expected 0.2% in September. A decent handoff leaves us comfortable looking for a slightly better 2% gain in Q4, rounding out Canada's best year of growth since 2011.

…after a banner year for Canada's job market

Canada's impressive GDP growth in 2017 has been mirrored in the labour market. Employment has increased in each of the last twelve months—something of a rarity in normally volatile jobs data. The 344 thousand positions added through November, all full-time, represents the strongest pace of hiring in a decade. Even with a modest cyclical pickup in labour force participation, the unemployment rate is down a percentage point from the end of last year. November's 5.9% rate is one of only a handful of sub-6% readings over the last four decades. And we're finally seeing some evidence of wages picking up in response to tight labour market conditions. Minimum wage hikes in a number of provinces have helped, but we think more employers competing for a shrinking pool of applicants has also been a factor pushing wages higher in recent months. We look for that trend to persist next year.

A few more challenges in 2018…

While a rapid pace of job growth bolstered household incomes in 2017, we don't expect employment gains will be so easy to come by in the year ahead. Tight labour market conditions should help with wages, but on balance we think disposable income growth will moderate somewhat in 2018. Meanwhile, Canada's all-important consumer sector will face growing headwinds as debt service costs rise. Similarly, the housing sector is expected to continue its recent slowdown as the combination of higher mortgage rates and further regulatory tightening cools demand. With consumer spending and residential investment—major drivers of growth in recent years—not contributing as much, other sectors of the economy will have to step up to keep the economy from slowing below its longer run trend.

Our forecast assumes a further modest increase in business investment will fill some of the void. Companies have spent more on equipment and structures this year and should continue to invest in 2018 as greater capacity pressures emerge. Dampening the outlook, however, is continued uncertainty about the future of Nafta. Businesses seem to have largely shrugged off trade concerns this year, but with a negative negotiating outcome looking increasingly likely, we are erring on the side of caution in our capex projections. The issue is, of course, also important for Canada's export sector, though our forecast doesn't assume any actual disruptions in North American trade. As long as goods and services continue to flow, we think a pickup in the traditional drivers of export growth and a relatively supportive currency will help trade reverse some if its disappointing performance over the last year.

…left the BoC with a cautious tone

After a couple of surprises earlier this year, the Bank of Canada's final meeting of 2017 was a relatively tame affair. The overnight rate was held steady at 1% and the statement's tone was little changed, once again providing vague forward guidance and emphasizing caution. The domestic outlook, including recent trends in investment, trade, infrastructure spending and housing, was seen as little changed from their forecasts laid out in October. Policymakers didn't get overly excited about November's employment report, noting some improvement in wages but still pointing to lingering, albeit diminishing, labour market slack. Our forecast assumes the bank's cautious mindset will keep them on the sidelines until April. That will give them some time to evaluate the impact of this summer's two rate hikes. They'll also (hopefully) have a better idea of how one of the most significant risks facing the economy, the Nafta renegotiation, is evolving. Markets are pricing some risk of an earlier move, but with the central bank not sounding overly excited, we remain comfortable with our call.