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.

US economy entering 2018 with a head of steam…

US Q3 GDP growth was revised up to 3.3% as business investment in equipment and inventories was stronger than initially estimated while consumer spending continued to increase at a solid pace. Recent data point to households and businesses once again fueling above-trend growth in Q4. Spending on durables in particular—autos in the case of households, capital goods for businesses—has been strong in recent months. And the residential sector looks like it will contribute to growth once again after pulling back over the last two quarters. Housing starts jumped to their highest level in a year in October, some of which likely reflects rebuilding efforts in hurricane-impacted areas, and home sales ticked higher. While we expect a solid domestic demand profile in Q4, headline GDP growth is expected to come in at a slightly softer, albeit still above-trend 2.4% pace as Q3's inventory build isn't likely to be repeated.

…as domestic drivers should continue to fuel growth

Solid domestic spending is expected to keep the economy growing at an above-trend rate through 2018. Consumers will continue to be a major contributor—low unemployment, strong confidence readings, wealth effects and what we expect will be rising wages all argue for households keeping their pocketbooks open. We think the same will go for housing, which hasn't seen the consistent gains we've come to expect but should get back on track in 2018. Mirroring consumer optimism, business sentiment is on an improving trend with the ISM composite index hovering around decade highs. Combined with solid demand and emerging capacity constraints, we are confident that the trend of improving business investment that emerged this year will extend in 2018. The upshot is GDP should continue growing at a 2 to 2-1/2% pace next year—still above the economy's longer run speed limit of slightly less than 2%.

Fiscal boost looking more likely…

The US Senate and House of Representatives each passed their own tax bills that are fairly similar in broad strokes—namely, a substantial cut in the corporate tax rate to 20% as well as a reduction in personal income taxes that is partially offset by eliminating a number of deductions. Some of the personal tax cuts are set to expire in the next decade, limiting the cost of the overall package to a still-sizeable $1.5 trillion over ten years. It is now up to the two chambers to reconcile their respective bills before the president signs off. So while we await final details, it appears increasingly likely that something along the lines described above will be passed into law. Our forecast has assumed a modest add from fiscal stimulus, and we will firm up that estimate when the legislation is finalized. But once again we caution that the boost from tax changes might not be as large as at first blush. With much of the tax savings going to corporations and those with higher incomes, the stimulative impact won't be as significant as a similar cut for lower- and middle-income households. As well, with the economy near its longer run capacity limits, the stimulus is more likely to be offset, in part, by higher interest rates.

…which should keep the Fed in tightening mode

We are with markets in expecting that a solid run of data will see the Fed raise rates once again in December. It will be the penultimate meeting for Chair Yellen, and her last with a scheduled press conference, meaning policy implications are more likely to be drawn from the updated economic projections than her comments. The latest 'dot plot' showed a wide range of views on how much monetary policy will need to tighten in 2018. We don't expect a consensus will emerge in December—minutes from the last meeting showed continued division on whether slower inflation this year will prove persistent, and thus little agreement on the appropriate pace of rate hikes going forward. But with the potential for an inflationary fiscal boost looking more likely, we could see a few more committee members favouring a less stimulative stance next year. The pending change in Fed leadership adds an extra dose of uncertainty to the future path of monetary policy, but early indications are that Governor Powell won't significantly alter his predecessor's course. Powell's comments have generally echoed Chair Yellen's tone—if anything, he has sounded slightly more dovish, mentioning lingering labour market slack in a recent speech. Yellen has made similar comments in the past, but left that out of her latest testimony to Congress.