CIBC

Economics

Economic Insights

July 4, 2018

Avery Shenfeld
(416) 594-7356
avery.shenfeld@cibc.com

Benjamin Tal
(416) 956-3698
benjamin.tal@cibc.com

Andrew Grantham
(416) 956-3219
andrew.grantham@cibc.com

Royce Mendes
(416) 594-7354
royce.mendes@cibc.com

Katherine Judge
(416) 956-6527
katherine.judge@cibc.com

"TEXT TEXT TEXT"

A Sword of Damocles

by Avery Shenfeld

If what we've seen thus far doesn't constitute an all-out trade war in North America, hitting Canadian autos and parts with heavy US tariffs, and the likely retaliatory response from Ottawa, would surely get us there.

The economic damage would then depend on a host of other *what-ifs* (see pages 3-5). If the US hits all imported vehicles with the same tariff, that reduces the short-term ability of American consumers to buy un-tariffed substitutes. The longer the tariffs are in place, the greater will be the opportunity to add capacity within the US at the expense of Canada. That said, time will also allow the Canadian economy to adjust with a much weaker exchange rate, and a lower path for interest rates, than would otherwise have been the case.

As forecasters, we can only print one growth, exchange rate and interest rate table. That means choosing now between the various alternative scenarios. Do we assume that Americans will still be buying our cars or not?

Donald Trump has a pattern of doing what he said he would do. If the Commerce Department uses the same twisted logic it applied to metals to rule that producing "only" 14 million vehicles annually is a national security risk, tariffs will be applied on some imported vehicles. But, as Wilbur Ross conceded in recent testimony, imports from Canada aren't really a national security threat to the US. These tariffs are being used to pressure Canada and Mexico into signing on to a US-tilted NAFTA or bilateral trade deal.

If that's the purpose, Trump could opt to give Canada at least a temporary exemption from US auto tariffs while we return to the negotiating table after the Mexican elections. That only lasted a month for steel and aluminum, but we see the two US-headquartered major auto companies as having the clout necessary to gain a longer standstill for cars and trucks. They can't shift production stateside overnight.

A delayed tariff would be a sword of Damocles hanging over the head of the Canadian economy. That will be enough to meet three Trumpian aims: to pressure America's partners into a more US-tilted trade deal, to instill uncertainty that favours building the next plant in the US, and to demonstrate a toughness on trade to the voting base. We've included the impacts on capital spending in Canada from all the uncertainties on the trade file, but are not incorporating a dramatic plunge in automotive product output, or a permanent and ever-escalating trade war.

Investors can also have only one portfolio, but can adjust the weightings based on the risks of various scenarios playing out. In the TSX, that favours an overweight in companies less exposed to a US protectionist threat, including energy (where the US has to import from somewhere), and TSX-listed companies with substantial US production for the American domestic market. In FX, that means buying some protection against a large drop in the Canadian dollar. In fixed income, the trade file is one of several factors behind our view that the Bank of Canada will put its rate hike pen away for at least six months after a likely tightening in July.

MARKET CALL

- Back in January, we argued that the moderate pace to economic growth since mid-2017 would put the Bank of Canada on the sidelines until July, expecting a firmer pace to growth in Q2. The numbers have cooperated, and a July hike looks very probable. But thereafter, we again see another half-year pause on rates, in line with our view that trade headwinds and tighter mortgage rules obviate the need for a faster pace to monetary tightening.

- In the past month, we shifted one of our 2019 forecast Fed hikes into 2018, in line with an upgraded near term growth outlook and on target inflation. That still leaves us with fed funds topping out just below 3% in 2019, and if fiscal policy tightens in 2020 to address the deficit, that might be a near term peak. Long yields still need to move higher as the term premium adjusts to modest momentum in inflation and supply pressures as global central banks step away from QE.

- Much of the pressure on the loonie in recent months has simply reflected global US dollar strength. Should the greenback shed some of that supremacy, that will keep a lid on how weak the Canadian dollar can get against its US counterpart even if, as we expect, the C$ weakens on other crosses when the Bank of Canada goes back on hold. A much softer C$ would be in the offing should the US go ahead with punitive tariffs on Canadian automotive products.

INTEREST & FOREIGN EXCHANGE RATES

		2018	2018		2019			
END OF PERIOD:		**3-Jul**	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**
CDA	Overnight target rate	1.25	1.50	1.50	1.75	1.75	2.00	2.00
	98-Day Treasury Bills	1.24	1.45	1.45	1.75	1.70	1.95	2.00
	2-Year Gov't Bond	1.91	2.05	2.05	2.10	2.10	2.20	2.25
	10-Year Gov't Bond	2.19	2.50	2.55	2.65	2.70	2.65	2.60
	30-Year Gov't Bond	2.22	2.45	2.75	2.85	2.85	2.90	3.05
U.S.	Federal Funds Rate	1.875	2.125	2.375	2.375	2.625	2.625	2.875
	91-Day Treasury Bills	1.98	2.05	2.25	2.35	2.55	2.65	2.80
	2-Year Gov't Note	2.55	2.60	2.75	2.75	2.80	2.80	2.85
	10-Year Gov't Note	2.86	2.95	3.05	3.20	3.30	3.25	3.15
	30-Year Gov't Bond	2.98	3.25	3.45	3.50	3.50	3.55	3.60
Canada - US T-Bill Spread		-0.74	-0.60	-0.80	-0.60	-0.85	-0.70	-0.80
Canada - US 10-Year Bond Spread		-0.67	-0.45	-0.50	-0.55	-0.60	-0.60	-0.55
Canada Yield Curve (10-Year — 2-Year)		0.28	0.45	0.50	0.55	0.60	0.45	0.35
US Yield Curve (10-Year — 2-Year)		0.31	0.35	0.30	0.45	0.50	0.45	0.30
EXCHANGE RATES	CADUSD	0.76	0.75	0.75	0.76	0.78	0.76	0.77
	USDCAD	1.32	1.33	1.34	1.31	1.28	1.31	1.30
	USDJPY	111	112	110	108	106	104	104
	EURUSD	1.16	1.17	1.19	1.21	1.23	1.25	1.28
	GBPUSD	1.32	1.31	1.32	1.36	1.38	1.42	1.47
	AUDUSD	0.74	0.76	0.79	0.81	0.82	0.84	0.85
	USDCHF	0.99	0.98	0.97	0.96	0.95	0.94	0.94
	USDBRL	3.90	3.70	3.55	3.50	3.45	3.50	3.55
	USDMXN	19.6	19.4	18.9	18.5	18.1	18.4	18.0

Auto Tariffs: More Than A Fender Bender

by Royce Mendes

It wasn't that long ago when it was commonplace to question whether President Trump could make good on his promises. But, so far, he's generally found ways to stay true to his word, and that's exactly what's so concerning about auto tariffs. There are quite literally carloads of reasons not to raise tariffs, but that might not mean much.

Crash Test

Trump does, however, have a handful of options in front of him. He could, of course, reasonably come to the conclusion that auto imports are not a national security threat and drop the issue. He's seen firm pushback from his own party and major businesses have raised significant red flags about the idea, but again that hasn't stopped him before.

In a more likely scenario, he could choose to raise tariffs, while granting a temporary exemption to Canada, hopefully for longer than was the case for steel and aluminum. That would actually boost US demand for all North American-made vehicles for as long as the exemption lasted. However, the uncertainty (Chart 1) surrounding whether or not there was another shoe to drop would act to further push investment away from Canada and into the US. Such a scenario would be a win-win for Trump and is, as a result, our base-case forecast.

But, while it would face considerable opposition in some US quarters, there's a non-zero probability that Canadian vehicles are also slapped with tariffs. If that's the case, it's actually better if everyone else is in the same boat.

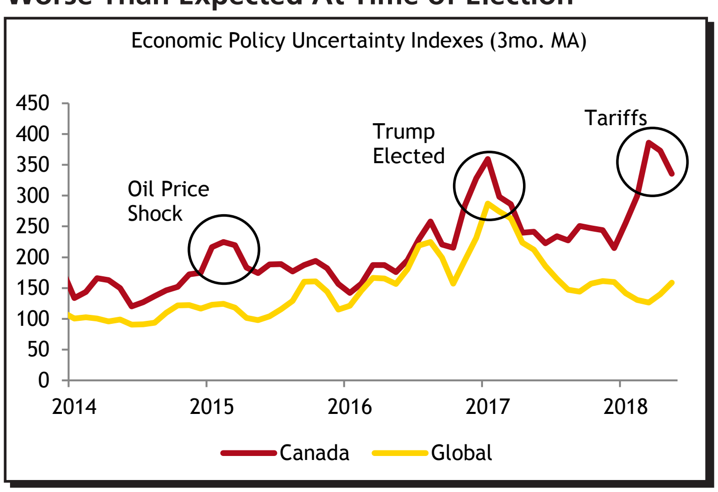
If all foreign-made cars faced a tariff, Americans would have a tougher time finding alternatives. However, if Canada were singled out, it wouldn't be too difficult for consumers to just avoid buying vehicles assembled north of the border. In other words, the elasticity of demand for Canadian-made autos in the latter case is higher.

Pinning down an estimate of elasticity for each scenario is an inexact science, but academic literature provides some guidance. We find that 25% tariffs on all foreign imports would see Canadian auto production fall by more than 400k units per year, while a tariff on only Canada would leave Canadian plants producing almost 900k fewer vehicles per year (Chart 2).

After also accounting for a 10% US tariff on parts, and the fact that reduced Canadian production would require fewer foreign inputs, we estimate the direct drag on GDP to be ½% and 1% respectively for each scenario. That doesn't take into account a resultant weaker Canadian dollar which would work to soften the blow, but a hit to confidence which could potentially seriously worsen the situation.

Chart 1

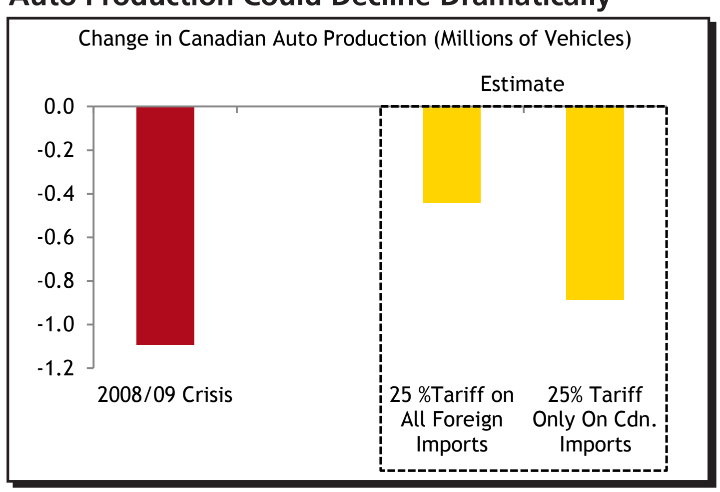
Canadian Economic Uncertainty in the Trump Era is Worse Than Expected At Time of Election



Source: Baker, Bloom & Davis, CIBC

Chart 2

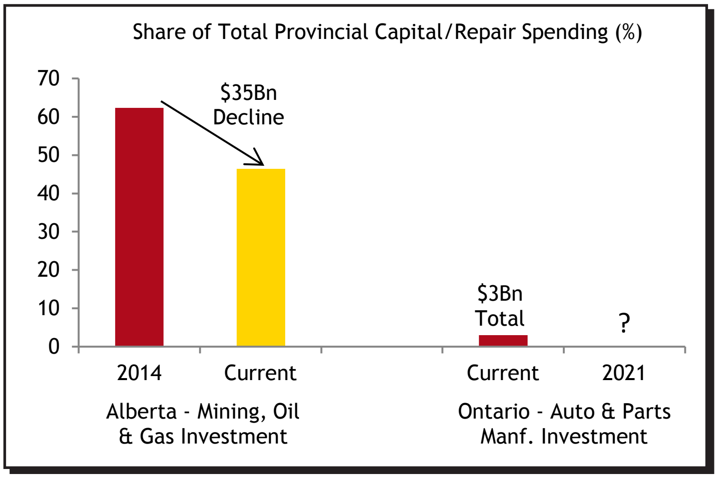
Auto Production Could Decline Dramatically



Source: Haver Analytics, CIBC

Chart 3

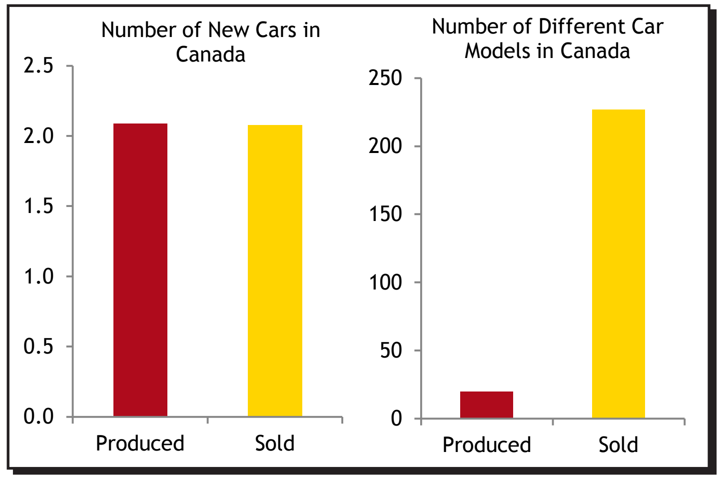
Short-Term Investment Impact Will Be Small



Source: Statistics Canada, CIBC

Chart 4

Cdn Production Equal Consumer Purchases (L); But is Limited to Very Few Models (R)



Source: Statistics Canada, CIBC

Of course, the vast majority of any decline would be concentrated in Ontario. Such a shock would likely throw the province into a mild recession, and depending on the speed at which production tails off, risk one at the national level as well.

However, unlike the recent provincial recession in Alberta, the slowdown won't be led by capital spending. Indeed, total business investment in the auto sector is miniscule when compared to even just the decline seen in the oil patch (Chart 3). The effect on the capital stock, and thereby Canada's potential output would more likely slowly rust away as additions to capacity swing to US locations and Canadian plants close.

Can Canadian Tariffs Protect the Auto Industry?

It's tempting to suggest that Canada could just raise its own tariffs and force Canadians to buy domestically produced vehicles. Looking at the number of cars produced in Canada relative to the almost exactly equal number of cars purchased by Canadian consumers indicates that notion could be the industry's saving grace (Chart 4, left). But, it has one major blind-spot.

Canada only produces a handful of models relative to the hundreds of choices to which consumers have become accustomed (Chart 4, right). Unless you believe someone looking to buy a flashy drop-top convertible sports car would be satisfied leaving their local car dealership with the keys to a minivan, it isn't a feasible solution to the potential problem at hand.

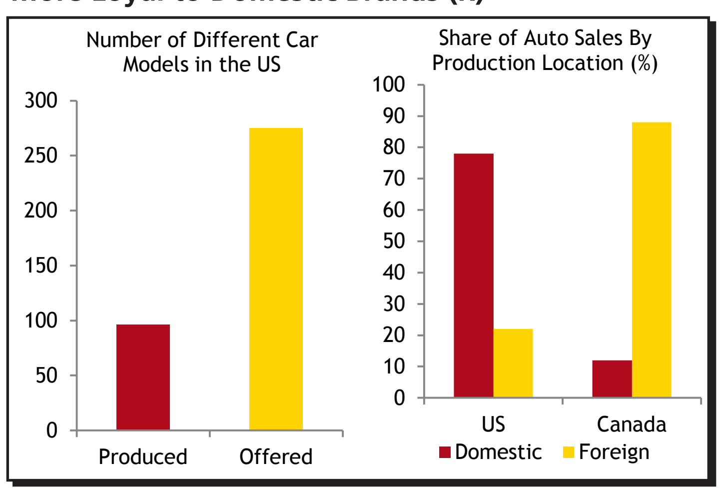
That applies to the US, but much less so. The US produces roughly a third of the models offered in America (Chart 5, left). But, more importantly, Americans are loyal customers. Domestically produced cars represented almost 80% of total US purchases last year, compared to the roughly 10% of Canadian purchases which were domestically produced, suggesting that Americans are at least somewhat better prepared to deal with import tariffs on cars (Chart 5, right).

No Such Thing As A Free Lunch

All this is not to say that tariffs are some sort of free lunch for American businesses and households. The US auto industry is already dealing with the recently introduced

Chart 5

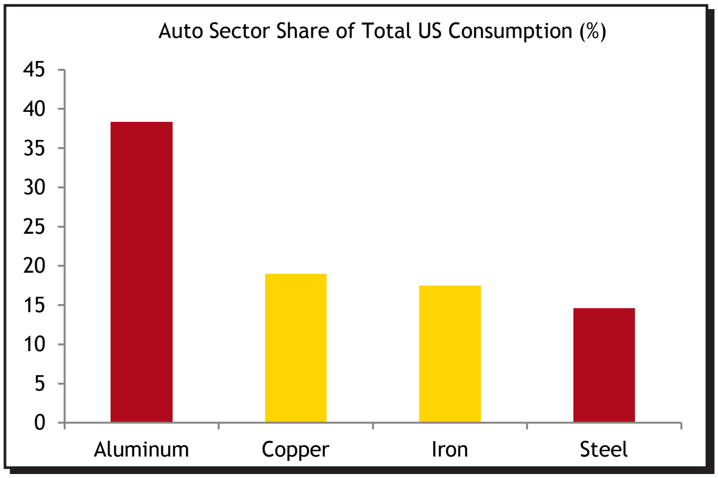
US Produces More Models (L) and Consumers Are More Loyal to Domestic Brands (R)



Source: Haver Analytics, APRC, CIBC

Chart 6

US Automakers Have Already Taken A Hit From Steel & Aluminum Tariffs



Source: Wards, CIBC

steel and aluminum tariffs, which make US producers less competitive (Chart 6).

Also, don't forget that US-made parts account for roughly 45% of vehicles assembled in Canada, so a reduction in Ontario activity would ripple across the border in the Great Lakes region. Import tariffs would raise domestic car prices too, as the industry is already facing near-term capacity constraints (Chart 7, left & right), not to mention hurting the American owners and employees of car dealerships involved in the sale of imported vehicles.

In the long-run, the US economy could reorient itself away from imported autos and further toward those produced domestically. But, in today's environment, when the economy is at full employment and capacity utilization rates are running high, it would require moving factory locations, reorganizing supply chains and pulling workers away from other industries, which could take years if not decades to fully work through the economy.

Retaliatory Tariffs Have a Blow-Back

Canada could respond to US auto tariffs with retaliatory duties on non-auto American-made goods. While that would be aimed at upping the pressure on the US side to reach a negotiated settlement, it would have some negative consequences for Canada's domestic economy.

The tariffs already applied in response to America's action on metals won't only lift prices for some consumer goods. Indeed, roughly half of those new tariffs are being applied to intermediate goods (Chart 8). That risks raising input costs for Canadian goods producers, a self-inflicted wound that could add to job losses and shuttered factories.

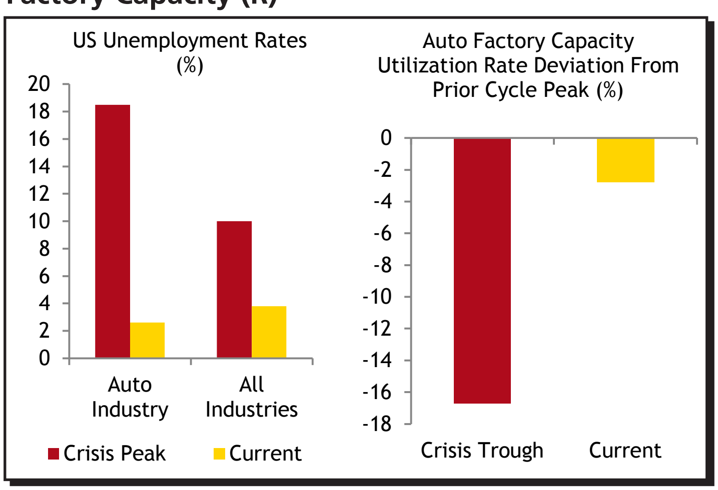
Policy Implications

It's clear then that even in our base-case scenario, in which auto tariffs are threatened but delayed, policymakers need to provide some support. For the Bank of Canada, a cautious approach to raising rates is warranted.

For the federal government, support for firms and workers adversely affected by tariffs, makes sense. But the negatives from the all out trade war that US auto tariffs would engender are too large to ignore. With a weaker negotiating hand, Canada may have to offer a few concessions in order to push NAFTA negotiations across the finish line before auto tariffs hit.

Chart 7

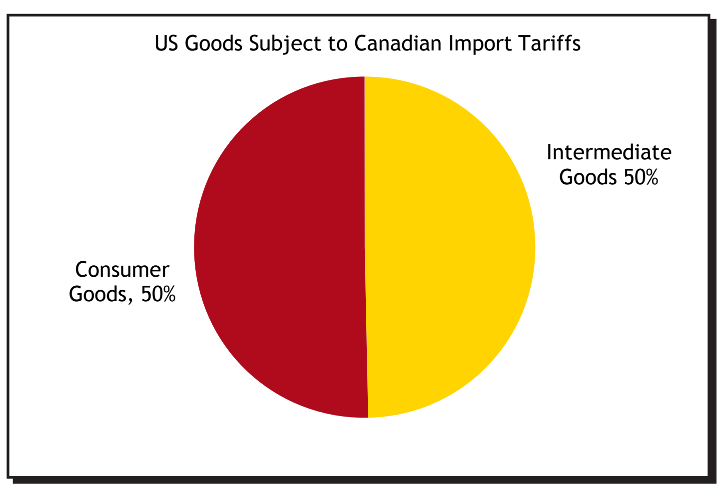
Dwindling Supply of US Auto Workers (L) and Factory Capacity (R)



Source: BLS, FRB, CIBC

Chart 8

Half of Canadian Retaliatory Tariffs on US Products Aimed at Intermediate Goods



Source: US Census Bureau, CIBC

What Pulls and Pushes Canadian Household Savings?

by Benjamin Tal and Andrew Grantham

The Canadian household savings rate can have major impacts on growth, as on the surface every dollar saved is a dollar not spent. But it's been a boring indicator nevertheless. It simply didn't move much over the past decade. However, that doesn't mean there aren't important trends occurring beneath the surface, with the impacts of rising house prices and demographics playing critical roles in determining aggregate savings.

And when comparing household savings in the US and Canada, something interesting happened in 2017. The savings rate in the US is now back to its pre-recession level, and for the first time in almost two decades it is lower than the Canadian savings rate, which is still notably higher than its pre-recession level (Chart 1). It's interesting, but how significant is it?

An Imprecise Indicator

First let's establish that the widely quoted savings rate is a poor indicator of the true saving behaviour of households. This ratio is calculated by subtracting total personal outlays from disposable income. As a result, savings are simply a residual—what's left from household disposable income after all spending is deducted.

That sounds reasonable, but it's not so simple. Since savings are calculated as a residual, they are subject to significant measurement errors, as reflected in the frequent revisions to the figures. More importantly, the savings rate focuses on the flow data associated with current production, so it gives an incomplete picture of household savings behaviour.

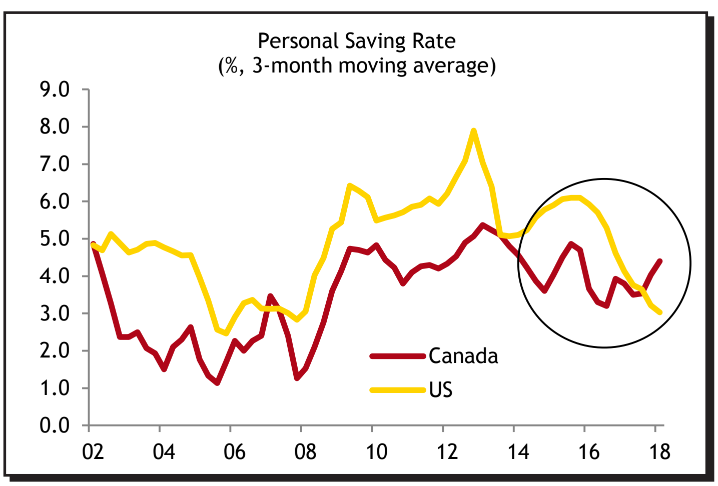
For example, the measurement of the savings rate excludes the sale, or change in the market value of existing assets. For financial assets, personal income includes dividends and interest income paid to an individual, but excludes capital gains and losses. For real estate assets, the measure of savings includes service flows from housing as consumption, but also treats expenditures (for example, renovations) as consumption. Similarly, personal expenditures on education and training are treated as consumption.

Home-Made Savings

These accounting practices tend to overstate consumption and understate savings. In reality, saving is not only about putting money aside, it's also about capital appreciation. After all, if the existing investment pie is growing nicely, one is less motivated to compromise his/her current standard of living in order to save. Indeed, as illustrated in Chart 2 left, the ratio of the change in net worth to

Chart 1

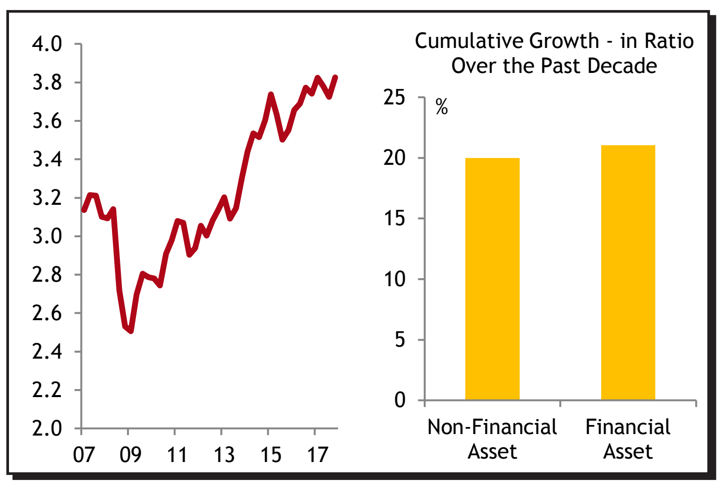
For the 1st Time in Two Decades, US Savings is Lower Than Canada



Source: Statistics Canada, BEA, CIBC

Chart 2

Net Financial Asset as a Share of Disposable Income



Source: Statistics Canada, CIBC

disposable income has risen dramatically in recent years reflecting gains in both financials and real estate values (Chart 2, right). That's a completely different picture than the relatively stable official saving rate.

Yet these two measures (net worth to disposable income and the savings rate) are related, in the sense that an increase in net worth can put downward pressure or limit the increase in the official savings rate as passive saving replaces active saving.

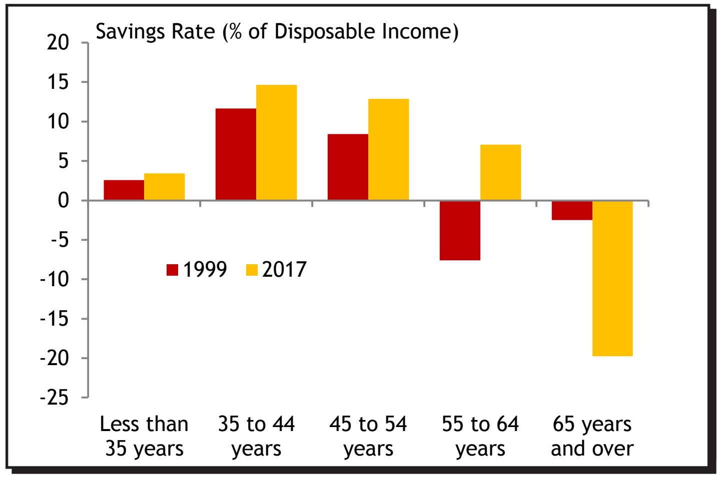
This type of passive savings has dominated the savings behaviour of Canadians for the past two decades. Based on the Bank of Canada's estimates, consumers spend 5.7 cents out of every dollar increase in the net value of their homes. Accordingly, the surge in real estate prices over the past decade alone has led (through the wealth effect) to a cumulative foregone savings of no less than $160 billion—chipping 1.5% , on average, off the annual savings rate during that period (Chart 3). Now that the housing market is cooling and price gains are harder to find, active savings should take over from passive savings.

A Demographic Drag

Whether the aggregate savings rate rises, and by how much, will also depend on demographic influences. Even though the Canadian household savings rate in 2017 was almost identical to where it stood at the start of the millennium, data by age group showed that despite lower interest rates, most have actually been saving more (Chart 4). This shows particular discipline in the case of those

Chart 4

Savings Rates Have Generally Risen Within Age Groups



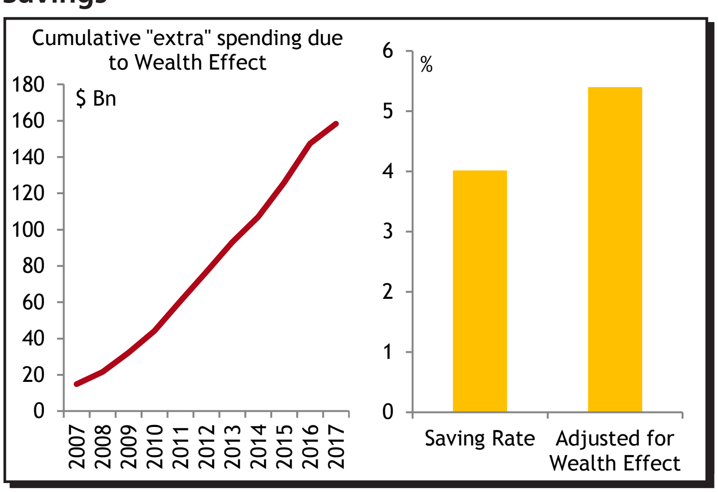
Source: Statistics Canada, CIBC

under 35 and between 35-45 who, presumably due to rapidly rising house prices, have had to spend more of their income on housing-related costs (Chart 5).

Also of note has been the swing from net spender to saving in the 55- to 64-year age group, as people are generally working to older ages now, compared to the start of the millennium. The main swing in the opposite direction comes from the older 65+ age group, which has a much larger negative savings rate potentially, as these people monetize and spend some of the gains in asset prices that aren't included within the income figures.

Chart 3

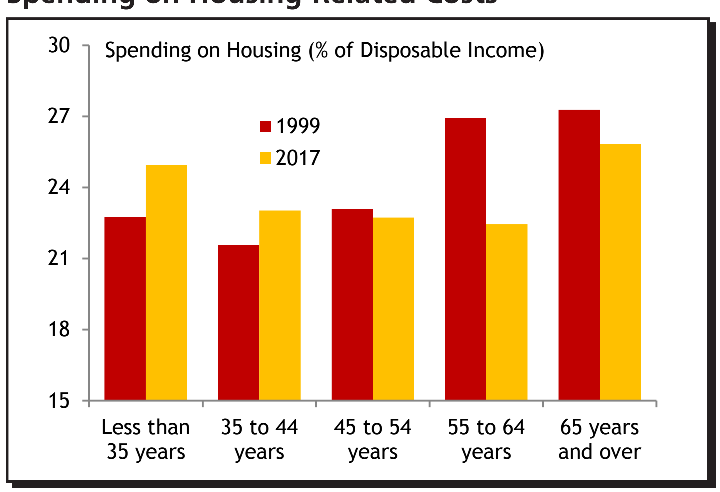
Wealth Effect Was Acting as a Negative For Savings



Source: Statistics Canada, CIBC

Chart 5

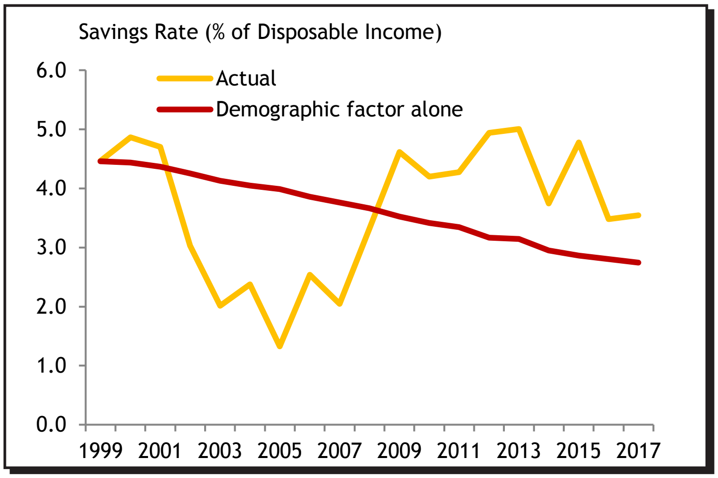
Spending on Housing-Related Costs



Source: Statistics Canada, CIBC

Chart 6

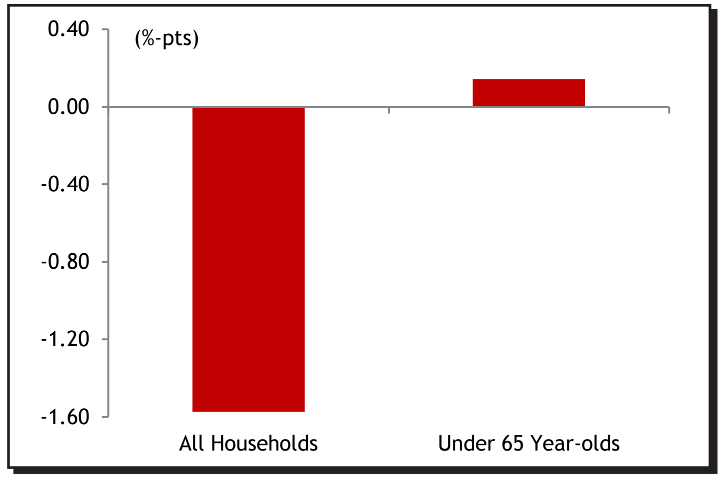
Households Saving Rate Slightly High When Adjusted For Demographics



Source: Statistics Canada, CIBC

Chart 7

Demographic Impact on Aggregate Household Savings Rate in Next 10 Years



Source: Statistics Canada, CIBC

Even with that big shift in the 65+ age range, the aggregate savings rate is still actually a little higher than it would have been based on demographic influences alone. In other words, if savings rates within individual groups had stayed constant, the aggregate would be about 1% below its current level and 2% below where it stood at the start of the millennium (Chart 6).

That demographic influence on aggregate savings will continue as the population ages, moves into the 65+ bracket and starts drawing down on savings and accumulated wealth. Indeed, assuming again that savings rates within age groups remain constant, the aggregate savings rate will fall by around 1½% over the coming decade, entirely due to the growth of the 65+ population (Chart 7). That would almost entirely counteract the other large impact of households having to undertake more active savings now that asset prices aren't inflating wealth as much.

Through the relative stability of the household savings rate, some big and important trends are occurring. The reliance of older age groups on rising asset prices to fund spending on retirement will have to revert into greater active savings in the years ahead, which would normally boost the aggregate savings rate. However, with retirees becoming a larger part of the population and drawing down on their savings/accumulated wealth, we may actually be in for another period of relative stability on aggregate, with all of the interesting trends occurring beneath the surface.

Midwest vs. the Rest: How the Heartland is Faring

by Katherine Judge and Avery Shenfeld

America's heartland isn't typically a growth leader, but the Midwest economy stacks up very well in terms of where it sits today. The expansion has been brisk enough to bring the region back to full employment, and although growth ahead could somewhat lag the national economy, that's a reflection of the lack of idle labor supply rather than a signpost of trouble ahead.

The movement of US population to the south and west, as well as the competitive challenges posed by industrial growth in emerging markets, has generally seen the Midwest trail national growth in recent decades. From 1998 to 2008, the annual growth gap was roughly a full percent point. But since 2010, that gap has been virtually eliminated (Chart 1).

A Victim of Its Own Success

The result of that success, and its translation into jobs, has meant that Midwest labor markets are now drum tight. Unemployment is lower than other regions, a reversal of fortune since the previous cycle's peak, when the Midwest suffered from the highest regional jobless rate (Chart 2 left). The scarcity of available labor has helped stoke more meaningful wage growth (Chart 2, right), a challenge for employers, but a support for consumer spending ahead. The labor force participation rate in the Midwest surpasses the rest of the nation by a wide margin, something that will leave producers hard pressed to expand production going forward.

Some of the labor market tightness appears to stem from out-migration of workers. While working age population growth is under pressure nationwide as a result of an aging demographic, the Midwest has experienced an outright contraction in this segment of the population, contributing to labor scarcity in the region. This effect is being exacerbated by experienced workers retiring and leaving the workforce.

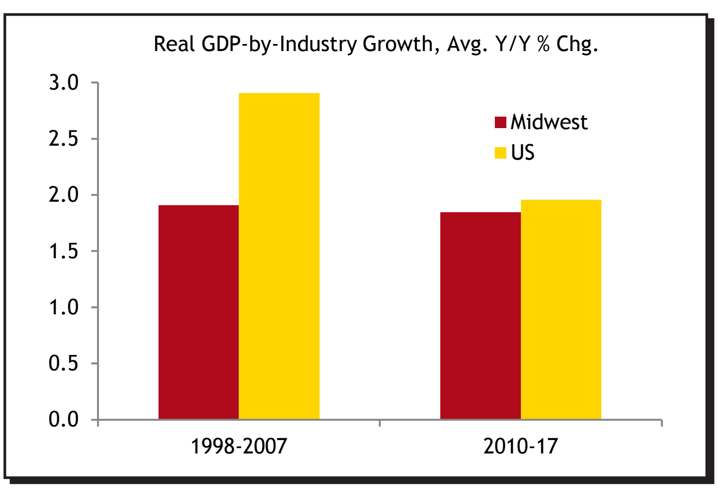
Until wage gains become strong enough to entice workers back to the Midwest, these factors will put a cap on growth. As a result, we look for real GDP growth in 2018, at a still healthy 2.1%, to trail the national 2.9% pace, with both growth rates settling to just under 2% come 2019 as other regions also hit the barrier of full employment.

Recent Indicators Paint a Mixed Picture

Consistent with a region that is seeing moderate growth, current and forward looking indicators present a mixed

Chart 1

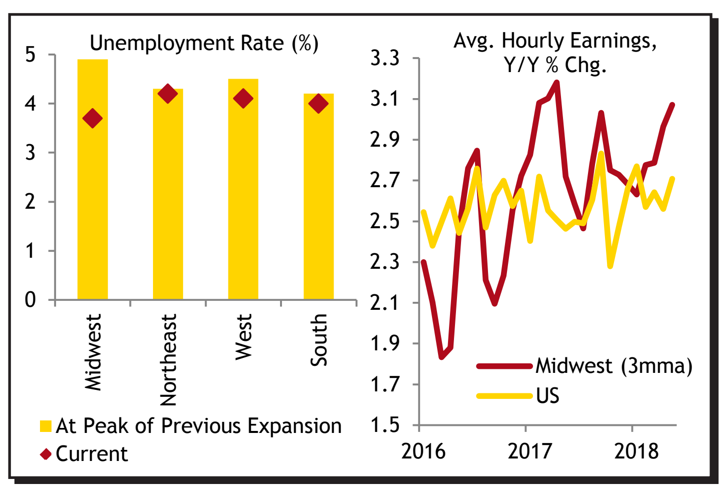
Midwest Has Closed Its Growth Gap



Source: BEA, BLS, FRED, CIBC

Chart 2

Midwest Labor Market is Drum Tight (L); Stoking Stronger Wage Growth (R)



Source: FRED, BEA, BLS, CIBC

picture for how the Midwest is stacking up against the rest this year. As elsewhere, helped by tax cuts and a firming national picture, business confidence is robust, captured in survey results from the Mid-America Business Conditions index which is hovering around the 14-year high hit in May (Chart 3, left).

That's in line with the healthy start we appear to have had this year in manufacturing, a sector much more heavily weighted in this industrial heartland region than in the national economy as a whole. The Chicago Fed's Relative Index for manufacturing, which indicates how the region is faring relative to elsewhere, soared early in the year, as did the overall MEI that covers all sectors (Chart 3, right). Of late however, we're seeing both of these indicators retreat, perhaps a sign that labor market tightness is starting to bite in terms of the room for growth.

Indeed, a scarce supply of construction workers is likely limiting the pace of homebuilding, with housing starts growing but at less than the national pace. Although existing home sales activity has weakened this year, that aligns to national trends and is likely partially attributable to a lack of inventory on the market. Rising land and construction costs have added to robust price growth and impinged on affordability along with rising mortgage rates, offsetting some of the benefits of improving wages. Permitting activity has fallen on an annual basis this year, hinting at a deceleration in housing construction ahead.

Midwest Sensitive to Trade Issues

In addition to demographics, the medium term picture for the Midwest region will also be colored by developments on the trade front. That is inherent, of course, in its relatively larger weighting in manufacturing, but extends to agriculture as well. Although, as in the rest of the US, services growth ran ahead of the goods sector last year, and past decades have seen a shift in manufacturing to lower wage states, the factory sector still retains a larger share of Midwest GDP and employment than it does for America as a whole.

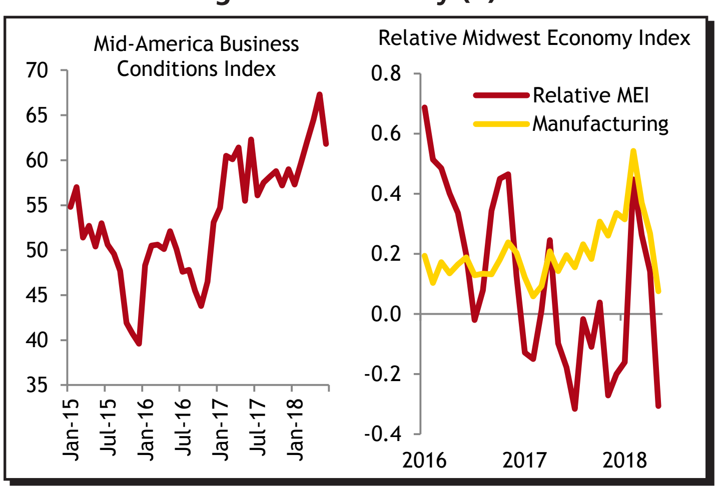
In recent years, the Midwest's economic performance featured a lift from manufacturing, including sectors like primary metals that benefitted from an upturn in global growth. Should a trade war dampen two way goods flows, the only plus for the region would be that a greater share of Midwest manufacturing output remains with in the US borders than is the case for the national factory sector (Chart 4, left). As a result, despite its manufacturing orientation, the Midwest isn't more dependent on exports than other regions (Chart 4, right).

The recent political trend towards protectionism, both threatened and actual, is still a significant issue for the region. Although US policy is aimed at protecting some sectors, including some of interest to the Midwest, from import competition, it also poses a potential roadblock to low cost inputs used by manufacturers, in addition to the threat associated with retaliatory tariffs by America's trading partners.

A failure to reach a NAFTA agreement, or at least a bilateral deal with America's northern neighbor, would be a risk to Midwest growth. Shipments to Canada from the Midwest account for more than twice the amount of GDP than for the rest of the country. Vehicles, machinery

Chart 3

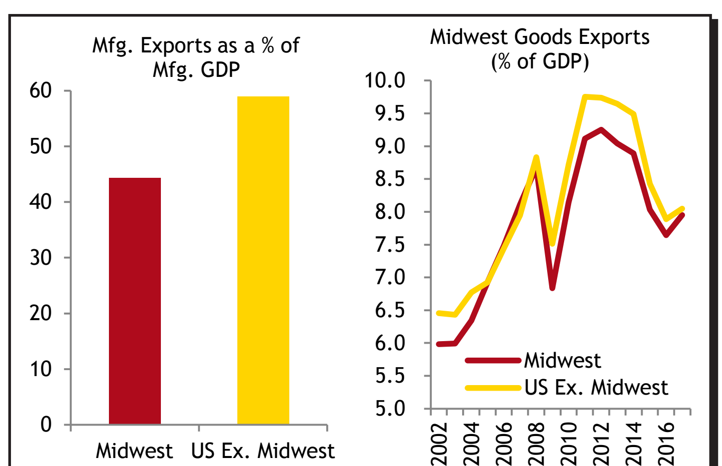
Business Survey Data Remains Robust (L), Despite Growth Tracking Lower Recently (R)



Source: Bloomberg, Chicago Fed, CIBC

Chart 4

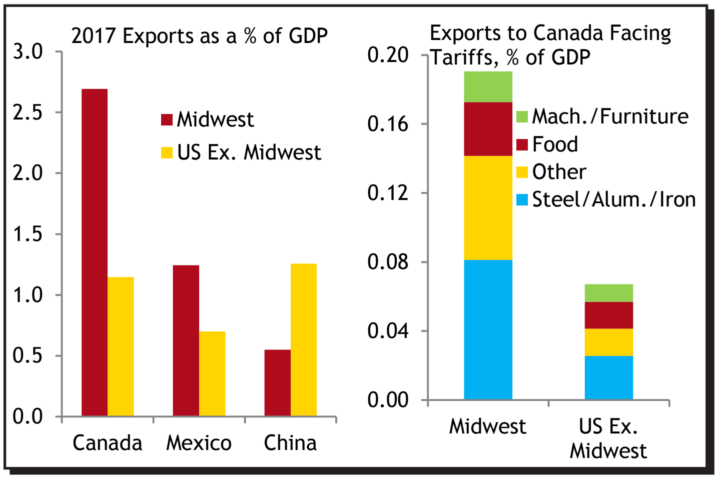
Midwest Manufacturing Titled To US Demand (L); Economy Still Export Exposed (R)



Source: Census Bureau, BEA, CIBC

Chart 5

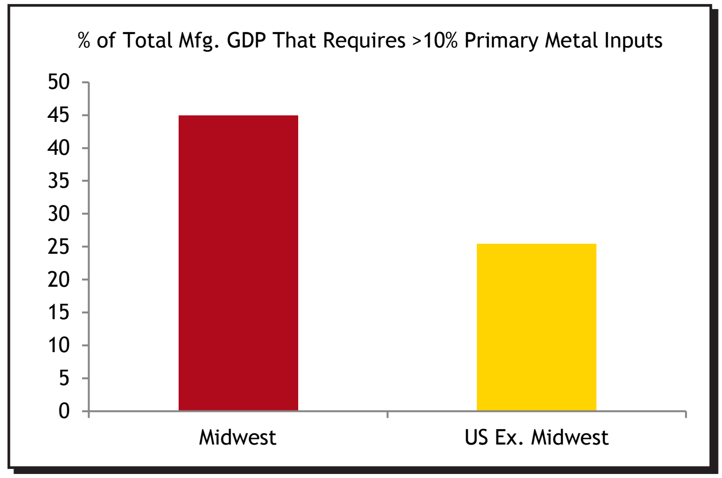
Midwest has High Exposure to NAFTA (L), Facing More Significant Retaliatory Tariffs (R)



Source: Census Bureau, BEA, Finance Canada, CIBC

Chart 6

Midwest Producers Use More Metal Inputs in Manufacturing



Source: Census Bureau, BEA, CIBC

and mineral fuel and oil represent roughly half of Midwest exports to Canada and Mexico, leaving manufacturers highly sensitive to recently imposed retaliatory tariffs.

Indeed, an examination of exports to Canada indicates that the Midwest has more than twice the exposure in terms of GDP to tariffs that were imposed by Canada effective July 1st (Chart 5, left). Metal suppliers will bear the brunt of these effects, with iron, steel and aluminum being the main targets amongst other goods including food, machinery and furniture (Chart 5, right). That threatens roughly 3% of total Midwest exports, compared to only 1% of the rest of the country. In GDP terms, that puts 0.2%-pts of output at risk, a modest hit at this point.

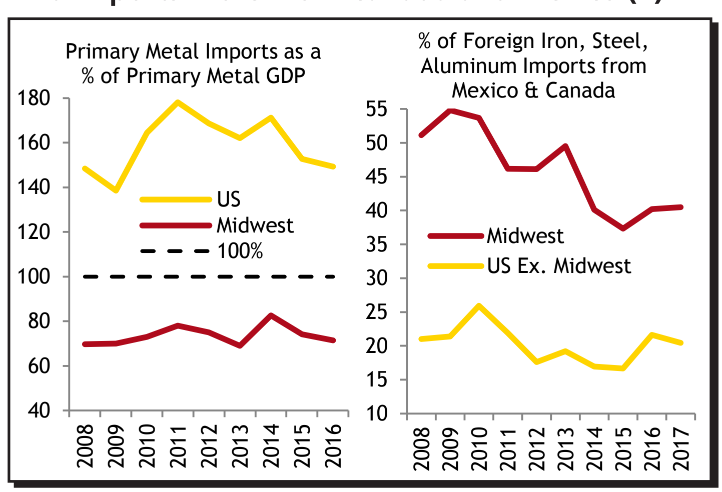
New US tariffs on imports of steel, iron and aluminum will raise production costs more significantly for the Midwest. Indeed, primary metals are inputs to just under half of production activity that takes place there, meaning that producers' margins will be squeezed to a greater extent than those elsewhere in the country (Chart 6). And the industries affected aren't limited to vehicles and metal components either, as primary metal inputs for miscellaneous goods and electrical equipment production represent over 20% of manufactured goods consumed in production.

Still, these negatives have to be balanced out against the lift to the region's own metals sector, as the tariff wall elevates US domestic prices. In contrast to other areas of the US, the Midwest produces more primary metals than it imports (Chart 7, left). If a new NAFTA deal provided exemptions for Canada and Mexico, that would also eliminate tariffs on more than 40% of the Midwest's imported steel (Chart 7, right).

Looming on the horizon are threatened US and retaliatory global tariffs on automotive products. US industry leaders have made it clear that they much prefer to avoid such an outcome, as it would be disruptive for their existing supply chains. On autos, the Trump Administration's goal appears to be to use the threat of such tariffs as a way of opening up greater access to American vehicles abroad, rather than a long lasting shuttering of US borders to two-way trade. It will be of importance to this region that this tactic achieves that goal.

Chart 7

Midwest Produces More Metal Than It Imports (L); And Imports More From Canada and Mexico (R)



Source: Census Bureau, BEA, CIBC

ECONOMIC UPDATE

CANADA	17Q4A	18Q1A	18Q2F	18Q3F	18Q4F	19Q1F	19Q2F	2017F	2018F	2019F
Real GDP Growth (AR)	1.7	1.3	2.4	2.0	1.9	1.4	1.5	3.0	2.0	1.6
Real Final Domestic Demand (AR)	4.1	2.1	2.5	2.3	1.9	1.6	1.2	3.0	2.8	1.6
Household Consumption (AR)	2.2	1.1	2.2	2.6	2.2	1.7	1.3	3.5	2.2	1.8
All Items CPI Inflation (Y/Y)	1.8	2.1	2.3	2.4	2.2	1.9	1.9	1.6	2.3	2.0
Unemployment Rate (%)	6.0	5.8	5.8	5.8	5.7	5.7	5.8	6.3	5.8	5.7

U.S.	17Q4A	18Q1A	18Q2F	18Q3F	18Q4F	19Q1F	19Q2F	2017A	2018F	2019F
Real GDP Growth (AR)	2.9	2.0	4.1	2.6	2.1	1.3	1.7	2.3	2.9	1.9
Real Final Sales (AR)	3.4	2.0	4.1	2.6	2.0	1.3	1.7	2.4	2.8	1.9
All Items CPI Inflation (Y/Y)	2.1	2.2	2.7	2.9	2.9	2.7	2.6	2.1	2.7	2.5
Core CPI Inflation (Y/Y)	1.8	1.9	2.2	2.4	2.5	2.3	2.4	1.8	2.3	2.4
Unemployment Rate (%)	4.1	4.1	3.8	3.6	3.5	3.5	3.4	4.4	3.8	3.4

CANADA

In Canada, the latest monthly GDP print was enough to keep the economy tracking a 2.4% growth rate over the second quarter, a solid rebound from the subdued reading in Q1. However, the pace is set to cool over the second half as housing and consumption feel the effects of tighter financial conditions and business investment is muted by trade uncertainty. Outside of higher gas prices, inflation hasn't looked particularly strong. But ex-energy prices should firm as tightness in the labour market leads to higher wages.

UNITED STATES

Tailwinds from tax cuts and additional government spending now have the US economy looking like it exceeded a 4% growth rate in Q2. While the remainder of the year won't look as hot, expected strength in business capital spending will be enough to propel 2018 just under 3% growth. The rise in headline inflation hasn't been mirrored in core measures as gasoline prices have done much of the work, support that will fade in 2019.