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Friends With Fewer Benefits

by Avery Shenfeld

Rising oil prices are a friend of the Canadian economy, with lots of side benefits even for those not working on a drilling platform. But today's run to the $70/bbl range looks to be a friend with less generous benefits than usual.

For one, only some of this year's run is tied to healthy global growth and its attendant support for Canadian non-energy exports. Signals on both the US and Europe have been in line with our below-consensus global growth call. The upward revision to our Economic team's average WTI price to roughly $65/bbl this year is rooted in a supply collapse in Venezuela. We're assuming that sanctions are not reimposed on Iran, and are skeptical that OPEC will continue to squeeze its output and drive prices still higher, since we're now at levels where it opted not to do so back in 2014.

Higher oil prices come at a time at which the central bank of Canada's largest trading partner is judging just how much growth to sacrifice on the altar of higher interest rates to keep inflation at bay. The Fed can look past energy-triggered inflation when the economy is soft, but has more reason to fear that wages will chase higher fuel prices when labour markets are tight.

The lessons of doing otherwise were seen in the last major run-up in inflation in the late 1970s. But leaning against the wind has its growth risks, which will impact Canada's non-oil exports. The Fed's tightening response to what was partially oil-induced inflation in the last business cycle was a factor in triggering the housing and financial downturn, although we don't see that sort of overkill for now.

Some of the domestic economic benefits to Canada from firming energy prices also won't be as apparent as they were in that prior cycle. For an oil exporter like Canada, the hit to consumer spending power from higher pump prices is typically more than countered by the spending by oil and gas companies on exploration and development.

But we're much less likely to see those offsetting benefits, at least not as soon. Nat-gas prices remain weak. Crude producers are leery of expanding in Canada given pipeline uncertainties here, and a now-lighter tax and regulatory hand in competing US jurisdictions. For the oil sands segment, high up-front costs for greenfield projects imply the need for more certainty on just how long today's prices will persist.

While Statistics Canada's survey would not have picked up the latest price upswing, it reported weak intentions for energy capital spending in 2018. Canada's energy players will need more convincing that US shale is hitting lasting roadblocks to growth, or that current prices aren't reversed if the Iranian or Venezuelan uncertainties clear up favourably. A shiny new pipeline wouldn't hurt either.

Sure, we welcome a return to near-$70 WTI, and it feels better than $40. But this isn't the big win for the Canadian economy or our equities that it could be in other circumstances.

MARKET CALL

- Back in January, we warned that the Bank of Canada might have to wait until July to have evidence that the economy was picking up enough to justify the next hike. That still looks like the right call, and we're betting on another extended pause after that. This is a central bank that will err on the side of caution given various headwinds to growth.
- The Canadian dollar retrenched after what we thought was an excessive climb, but that pull back largely reflected a general weakening in the US$ globally. A monetary policy divergence with the US and lingering trade uncertainties will provide some made-in-Canada reasons for a further loonie slippage.
- We've modestly raised our long-term bond yield targets for the US and Canada. To the pressure we already had factored in from the combination of large US fiscal deficits and the unwinding of central bank balance sheets ahead, we added a touch more to allow for inflation expectations to nudge higher, as our forecast for oil prices made room for the disruption evident in Venezuela.

INTEREST & FOREIGN EXCHANGE RATES

		2018				2019			
END OF PERIOD:		**27-Apr**	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**
CDA	Overnight target rate	1.25	1.25	1.50	1.50	1.75	1.75	2.00	2.00
	98-Day Treasury Bills	1.19	1.25	1.45	1.45	1.75	1.70	1.95	2.00
	2-Year Gov't Bond	1.90	1.90	2.05	2.05	2.10	2.10	2.20	2.25
	10-Year Gov't Bond	2.32	2.50	2.50	2.50	2.60	2.65	2.65	2.60
	30-Year Gov't Bond	2.41	2.50	2.65	2.75	2.85	2.85	2.90	3.05
U.S.	Federal Funds Rate	1.625	1.875	2.125	2.125	2.375	2.625	2.625	2.875
	91-Day Treasury Bills	1.81	1.80	1.90	2.05	2.25	2.55	2.65	2.80
	2-Year Gov't Note	2.49	2.40	2.45	2.50	2.60	2.70	2.70	2.80
	10-Year Gov't Note	2.96	3.00	2.95	3.05	3.20	3.30	3.25	3.15
	30-Year Gov't Bond	3.13	3.25	3.35	3.45	3.50	3.50	3.55	3.60
Canada - US T-Bill Spread		-0.62	-0.55	-0.45	-0.60	-0.50	-0.85	-0.70	-0.80
Canada - US 10-Year Bond Spread		-0.64	-0.50	-0.45	-0.55	-0.60	-0.65	-0.60	-0.55
Canada Yield Curve (10-Year — 2-Year)		0.42	0.60	0.45	0.45	0.50	0.55	0.45	0.35
US Yield Curve (10-Year — 2-Year)		0.48	0.60	0.50	0.55	0.60	0.60	0.55	0.35
EXCHANGE RATES	CADUSD	0.78	0.77	0.76	0.76	0.78	0.78	0.76	0.77
	USDCAD	1.29	1.30	1.32	1.31	1.28	1.29	1.31	1.30
	USDJPY	109	105	103	102	102	102	101	100
	EURUSD	1.21	1.25	1.27	1.28	1.29	1.29	1.30	1.32
	GBPUSD	1.38	1.41	1.41	1.44	1.46	1.47	1.48	1.52
	AUDUSD	0.76	0.76	0.77	0.80	0.82	0.83	0.84	0.85
	USDCHF	0.99	0.94	0.93	0.93	0.92	0.93	0.93	0.92
	USDBRL	3.47	3.26	3.40	3.45	3.40	3.50	3.52	3.58
	USDMXN	18.7	20.1	19.5	19.0	18.8	18.8	18.5	19.0

To Spend or Not to Spend: The Question for Canadian Businesses

by Royce Mendes

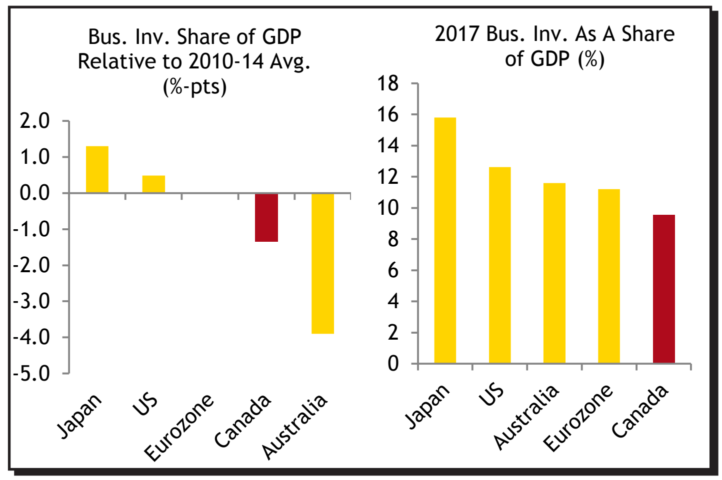
It's no longer simply a question of *when* businesses will splash out to respond to higher oil prices and narrowing capacity; it's now a question of *whether* they will at all. That's disturbing given that the Canadian economy's balancing act has relied on a two-legged stool of household spending and housing investment for some time now, both of which have looked shakier of late.

Oil Not Greasing the Wheels of CAPEX

Things had been looking up a few years ago. Heading into the end of 2014, capital investment reached a cyclical high as a share of the Canadian economy, leaving a more balanced-looking outlook. However, the ensuing oil price crash changed that narrative completely. Business investment as a share of GDP plunged to its lowest level since the 2008/09 financial crisis, and we've been relying on consumption and a hot real estate market for growth ever since (Chart 1). While Canada was never a leader in terms of investment's share of GDP, the oil price crash saw us slip even further in global standings (Chart 2).

Chart 2

Bus. Inv. as Share of GDP Has Fallen in Canada (L), Leaving Us Even Further Behind Others (R)

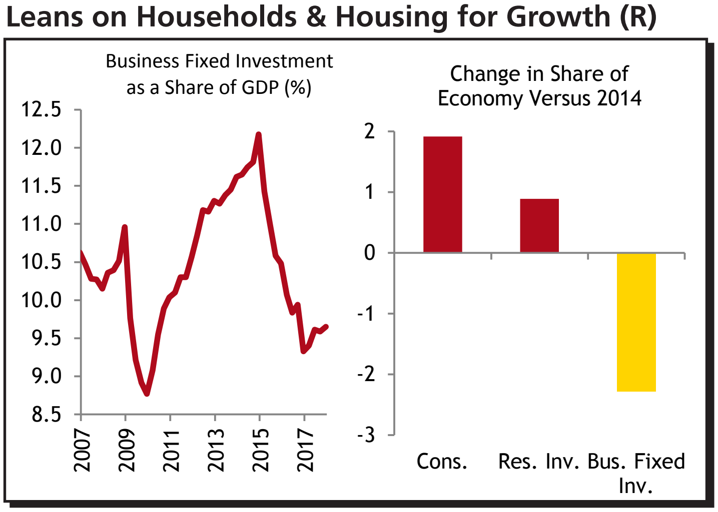


Source: Bloomberg, BEA, Statistics Canada, CIBC

But now that oil prices are back on the rise, should we expect a commensurate pick-up in oil patch capital spending? We're not optimistic. Statistics Canada conducts an annual survey on investment intentions and oil and gas companies gave some of the most dour responses (Chart 3, left). It's true that survey was conducted before the most recent run-up in Canadian crude prices, but major extraction projects, like those recently completed, generally have one- to two-year lead times before shovels hit the ground.

Chart 1

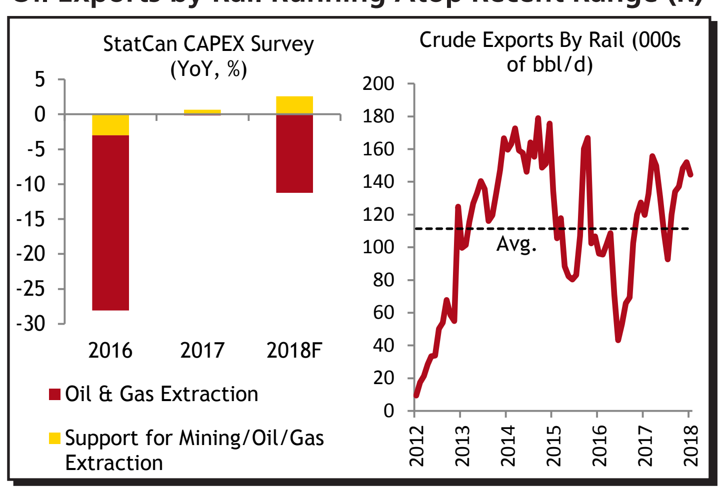
Bus. Inv. a Smaller Share of GDP (L), as Canada Leans on Households & Housing for Growth (R)



Source: Statistics Canada, CIBC

Chart 3

Oil Firms Signaling Lean Year for CAPEX (L), Oil Exports by Rail Running Atop Recent Range (R)



Source: Bloomberg, BEA Statistics Canada, CIBC

Furthermore, the tax changes in the US allowing for immediate expensing of machinery and equipment could have oil companies seeing a more favourable environment south of the border. That's in addition to the regulatory rollback and perception of fewer political hurdles. So, if anything, we shouldn't be hanging onto much hope that the energy sector will pull us out of this slump anytime soon.

There are, of course, other reasons to believe the response to higher oil prices won't look particularly robust this time around. Pipeline capacity is maxed out and crude-by-rail exports are already hovering near historical peaks (Chart 3, right).

Sure, the prospect of additional rail cars will help, but remember that crude production is also set to increase this year, leaving capacity constraints a nagging issue with no near-term solution. Elevated uncertainty about additional pipeline construction will cut the same way.

And the Survey Says…

While it's a major swing factor for capital spending in Canada, the oil sector represents less than 10% of the overall economy. So what about non-energy capital spending? Capacity utilization across industries looks stretched, something that has spurred investment in the past. The Bank of Canada's latest Business Outlook Survey also showed that industry was, by and large, confident about the outlook (Chart 4, left). The so-called BOS Indicator contained in that report has historically been a relatively reliable guide to capital spending.

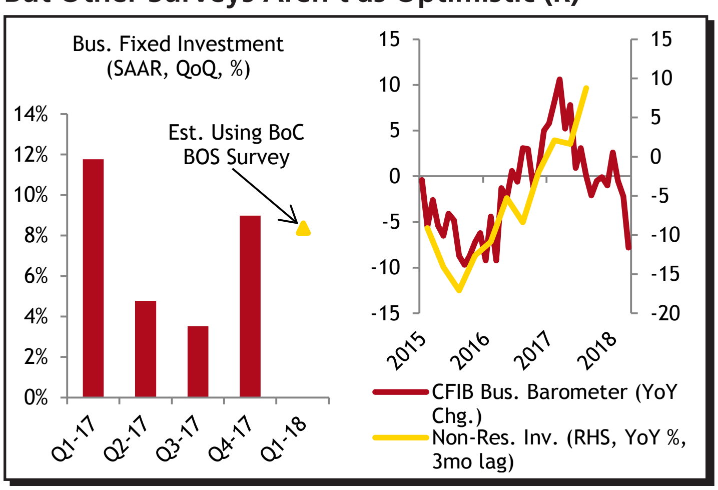
But we'd caution reading too much into those conclusions. Remember it's just a survey, and it happens to be one of a number of surveys pointing in a different direction. Indeed, the Canadian Federation of Independent Business' barometer suggests a weak year for capital spending (Chart 4, right). Similarly, the aforementioned Statistics Canada CAPEX survey suggested we should be looking for an only modest track for nominal investment growth this year. Merely one-third of the industries replying said that they were going to increase nominal spending by more than 2% in 2018 (Chart 5), an even more stark number when taken in the context of an average 2½% Canadian inflation rate.

Furthermore, while firms were more upbeat according to the BOS Indicator, a separate question in that publication asked how much effect US policy changes were having on outlooks for Canadian firms. According to that survey question, the negative implications are clearly growing (Chart 6, left). The Bank of Canada estimates that by 2020 uncertainty surrounding US trade policy and the competitiveness issues created by the recent US tax cut will see business investment in this country 3% lower than what would otherwise have been the case (Chart 6, right).

Even that, however, seems like a conservative bet. The Trump administration has been trying to roll back regulations across a number of industries and in some cases has succeeded, adding to the reasons companies have to boost capacity in the US at the expense of Canada.

Chart 4

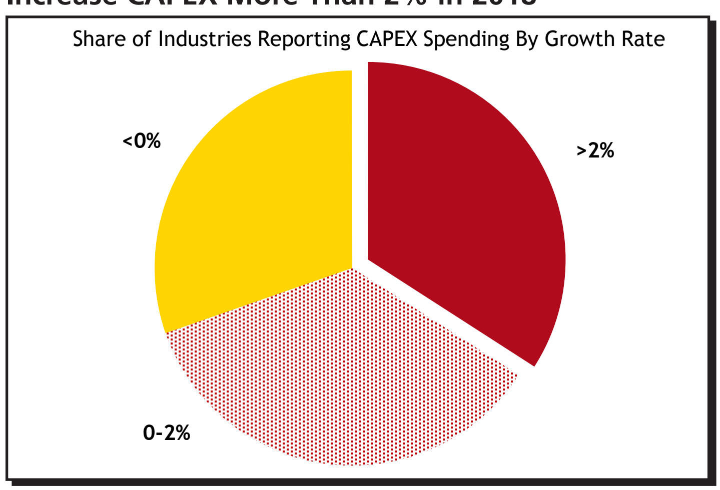
BoC BOS Suggests Healthy Inv. to Continue (L), But Other Surveys Aren't as Optimistic (R)



Source: Bank of Canada, CFIB, Statistics Canada, CIBC

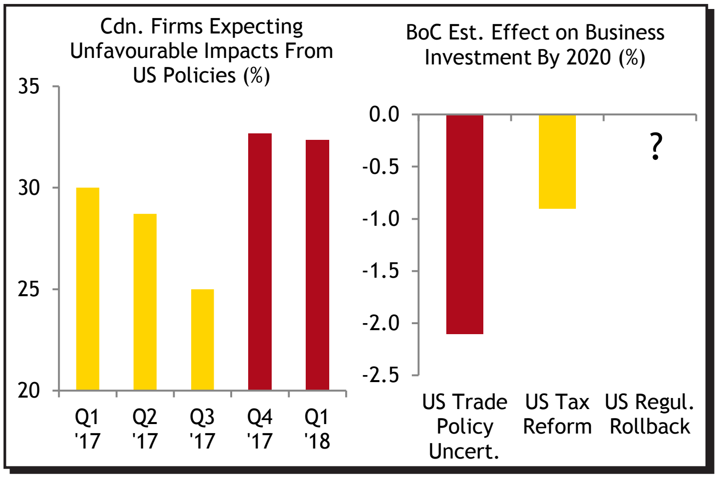
Chart 5

Only One-third of Industries Surveyed Plan to Increase CAPEX More Than 2% in 2018



Source: Statistics Canada, CIBC

Chart 6
Concerns Re US Policy May Bring Headwinds (L), BoC Estimates a Noticeable Drag (R)



Source: Bank of Canada, CIBC

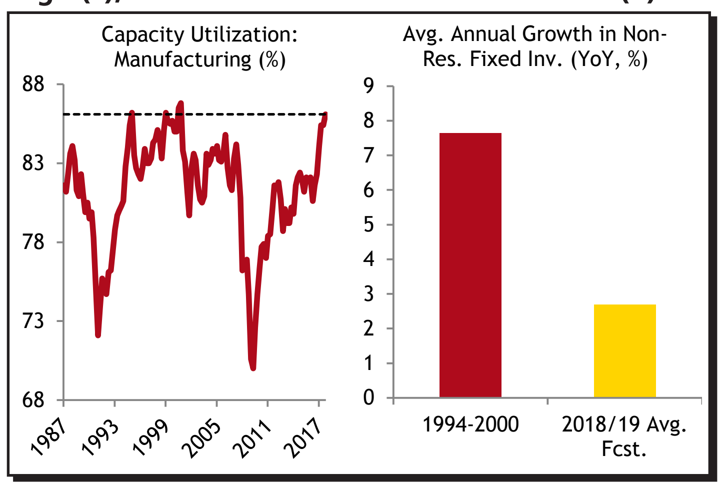
Competing Forces

An economy's competitiveness is difficult to measure, and judged on almost an unlimited number of factors. But clearly, in the past twelve months Canada has lost an edge against the US. So far the federal government plans on taking a wait-and-see approach to the potential loss of corporate investment. However, there is a silver lining in the fact that infrastructure spending was delayed and could help cushion some of the blow.

The Bank of Canada is not just an observer here. It has an important role to play in supporting competitiveness. The more difficult it is to attract business spending, the lower both interest and exchange rates need to be. That's one reason we expect central bankers to remove stimulus at a very gradual pace, and dollar-Canada to remain roughly ten cents weaker than its long-term average over the next couple of years.

Even that, however, won't be able to offset all of the challenges facing business fixed investment. So, we're not expecting capital formation to repeat the run we saw last time capacity was this tight (Chart 7).

Chart 7
Manufacturing Capacity Utilization Historically High (L), But This Time Won't Look Like Last (R)



Source: Statistics Canada, Bank of Canada, CIBC

Trade ~~War~~ ... Scuffle

by Benjamin Tal and Katherine Judge

China is less vulnerable to a trade war than it was a decade ago. But it is still no match for the US. Regardless of how you look at it, China will be the biggest loser. It still relies heavily on US demand while its retaliation arsenal is light. And with the US directly targeting China's soft spot—its aspiration to become a dominant high-value-added manufacturer—the Middle Kingdom will have little choice but to return to the negotiation table. So our base case scenario is that we will end up with only a trade scuffle as opposed to a full-blown trade war. The global economy and Canada can live with such a scenario. The alternative, however, is not so pretty.

A Trade War—A Bad Idea

First let's establish that trade wars are not bullish for global growth. There is ample evidence in the literature for the growth benefits of enhanced trade, and numerous studies showing that rampant protectionism served to deepen the Great Depression.

We also should establish that trade wars make little sense in a world in which the largest and fastest growing stage of processing in global trade is intermediate goods (Chart 1). Higher tariffs interfere with smoothly running supply chains and exacerbate the damage of protectionism on global growth.

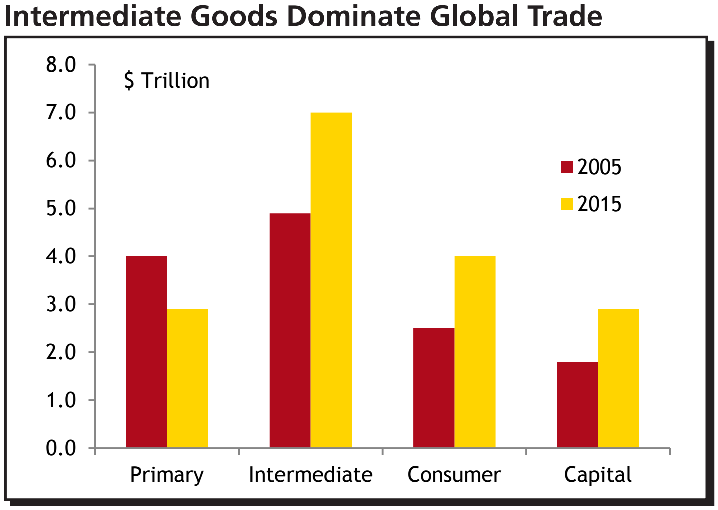
One more thing to establish is that when it comes to trade with China, Trump is right. There are legitimate grounds for questioning aspects of Chinese policy. The issue is not only a lack of reciprocity and market access, but also the absence of a level playing field in China for American investors and allegations of intellectual property rights violations. Some examples: China imposes a 25% tariff on new car imports from the US while facing only a 2.5% tariff. A US company offering cloud services to Chinese users must store the data in China and use a Chinese partner to operate the servers. And China's main sectors such as cars, telecoms, IT and healthcare are basically off limits to any US company.

Damage Assessment

The impacts of a tit-for-tat tariff war would be asymmetrical, with China more vulnerable than the US. Yes, China's economy is now much more domestically oriented, with exports accounting for close to 20% of GDP—almost half the share seen a decade ago. But that's still high when compared to the 12% level seen in the US. What's more, the US accounts for 19% of China's exports while China accounts for only 8% of US exports (Chart 2). Furthermore, the composition of trade surplus appears to show that recently, China's dependency on

Chart 1

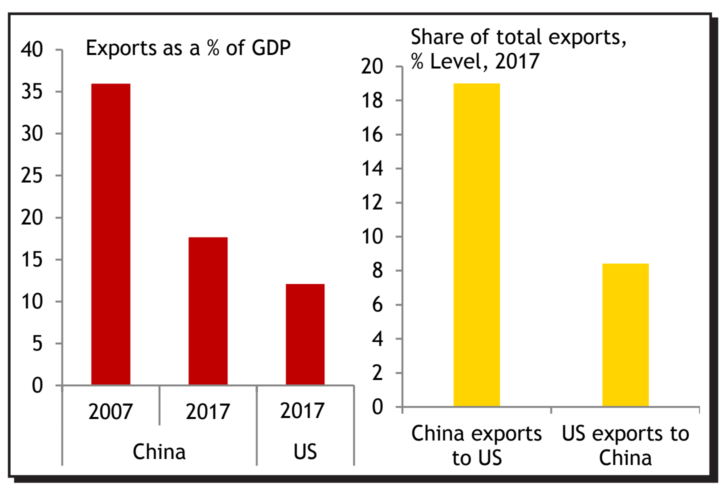
Intermediate Goods Dominate Global Trade



Source: World Bank, CIBC

Chart 2

China is Less Export Dependant But is Still No Match for US



Source: ITC, World Bank, CIBC

the US has been on the rise, as the US was the only major region seeing an increase in net imports from China in 2017.

Another dimension of Chinese vulnerability is that corporate China, facing heightened domestic competition, has been relying more heavily on foreign revenue. By some estimates, foreign income now stands at close to 10% of total revenue—almost double the share seen a decade ago.

Retaliation

China of course can retaliate, but the more you look at it, the more you realize that Beijing does not have many options. To be an effective retaliatory weapon, the targeted US export products should be those that rely heavily on Chinese demand, and at the same time, are easy enough for China to replace with other markets. That's a tough combination. For the vast majority of products, the US has a broad destination base, making it very difficult for China to find products that can notably damage the US (Chart 3, left).

The combined value of US export products that rely on China for more than 20% of its shipments amount to less than 3% of total US exports (Chart 3, right), and a much lower share of that already tiny segment have reliable substitutes elsewhere.

Aviation is of course a candidate for retaliation, with China accounting for no less than 12% of US exports in that sector, but there could be issues with delivery times. Agriculture, where China accounts for 23% of US exports is another choice—and it's no surprise then that those products dominate China's retaliation list. But by doing so, the Middle Kingdom may have fired its last bullets.

China will be in an even more precarious position if other countries joined forces with the US against its practices. That motivation is mostly behind the US Administration's official complaint to the WTO, accusing China of IP theft and blocking US companies from competing in its market. The EU and Japan made their support conditional on the US including the WTO in its trade dispute strategy.

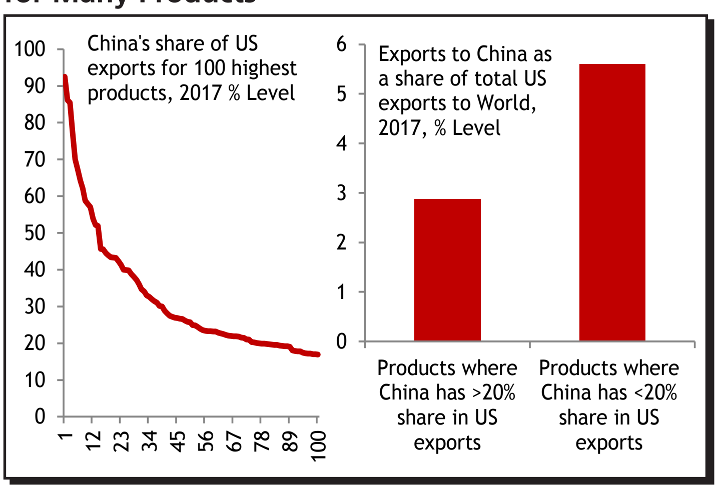
Beyond tariffs, China can make it difficult for US businesses operating in China by tightening regulations. But pushing too hard here will lead to a similar move by the US, as well as encourage US multinationals to accelerate the process of migrating to other lower cost countries. China is not ready for that. It would work to undermine its domestic financial stability and challenge growth targets, in turn jeopardizing commitments to structural reforms and economic rebalancing.

The Real Agenda

And those structural reforms are America's prime target. Out of the 1,333 products that are subject to a tariff increase as announced by the US Administration, close to 70% are high-end exports. Those are directly related to China's grand project "Made in China 2025", aimed at moving the country's manufacturing base up on the value-added ladder by becoming dominant in 10 advanced industries by 2025 (Chart 4).

Chart 3

China Doesn't Dominate US Exports for Many Products



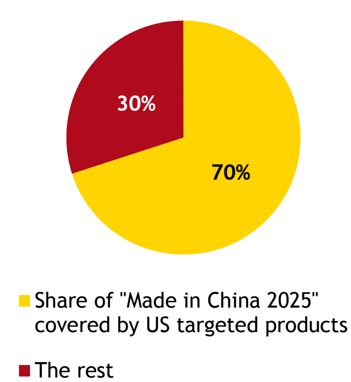
Source: ITC, CIBC

Chart 4

US Targeting Made in China 2025

Made in China 2025

1	Next-generation information technology (IT)
2	High-end numerical control tolls and robotics
3	Aerospace equipment
4	Ocean engineering equipment and high-tech ships
5	Advanced railway equipment
6	Energy saving and new energy vehicles
7	Power equipment
8	Agricultural machinery
9	New materials
10	Biomedicine and high-performance medical devices



Source: USTR, CIBC

But reaching that ultimate goal still requires a high volume of Western technology exports (China imports north of $200 billion in semiconductors and integrated circuit boards while 75% of global industrial robot shipments go to China), suggesting little ability to retaliate in that space.

A big part of China's high-value-added aspiration also calls for a large-scale purchase of foreign companies. No surprise then that the US Administration is making it increasingly more difficult to make US acquisitions. The US Committee on Foreign Investment, with its recently enhanced power, has already blocked north of six billion dollars worth of takeover proposals over the past year alone.

And a side bonus of such a targeted approach is that the US can avoid a broadly based tariff increase, thus limiting the damage of such a move on American consumers. Of course, China can always use its US treasury holdings as a weapon but as we outlined in our March 9th issue of The Week Ahead, that treasury holding is not an act of charity, but an element of exchange rate policy.

So when Wilbur Ross stated recently that he perceived the strong stance on trade as a pressure tactic on China to bring concession without escalating into a broader conflict, surely he had China's limited ability to retaliate without inflicting notable damage to its own economy in mind.

Protectionism is No Zero-sum Game for Canada

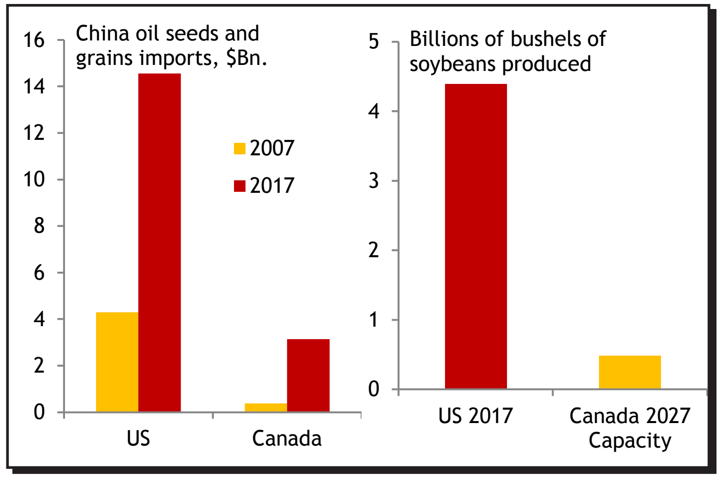
Yes, the US far surpasses China in terms of its share of Canadian exports, but the Chinese market has accounted for a growing share of Canadian goods. And while the implementation of tariffs on American goods in China could divert demand towards Canadian goods in theory, displaced American exports could result in increased competition for Canadian goods elsewhere. But the negative impact on consumption in the US is muted as the goods facing tariffs are less than 1% of GDP.

Agricultural Exports Have Little Room for Expansion

Canada has gained market share in Chinese imports of agricultural goods, one of China's prime tariff targets, at the expense of the US. Any price increase in American seeds and grains could cause substitution towards Canadian goods. But even when accounting for industry estimates of soybean production capacity, which is expected to double over the next decade, Canadian production won't even come close to replacing American grown soybeans (Chart 5). And, American soybeans could be diverted to the Canadian market, harming domestic soybean production.

Chart 5

Canada Has Little Room to Ramp Up Soybean Exports to China

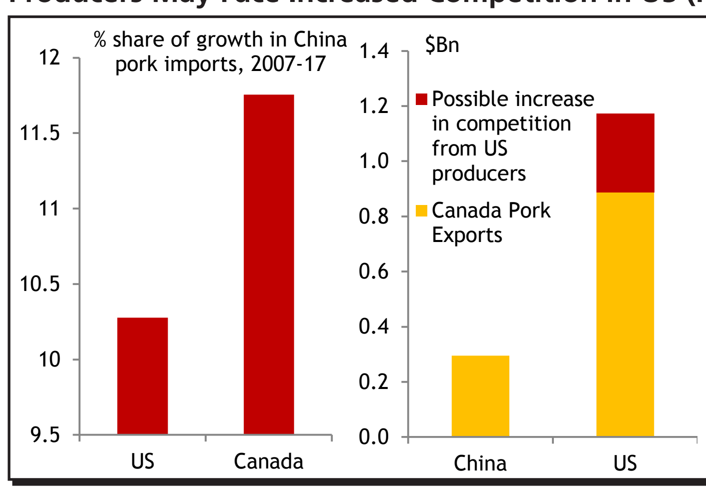


Source: ITC, Statistics Canada, USDA, Soy Canada, CIBC

In the same vein, tariffs on American pork also present limited upside potential for Canadian producers, given their outsized reliance on the US market for demand. Over one-third of Canadian pork exports are US-bound. If American pork floods the US market, 32% of Canadian pork exports could face increased competition in the US (Chart 6).

Chart 6

China a Crucial Market for Canada's Pork (L), Producers May Face Increased Competition in US (R)



Source: ITC, CIBC

Production Capacity Constraints Are a Concern

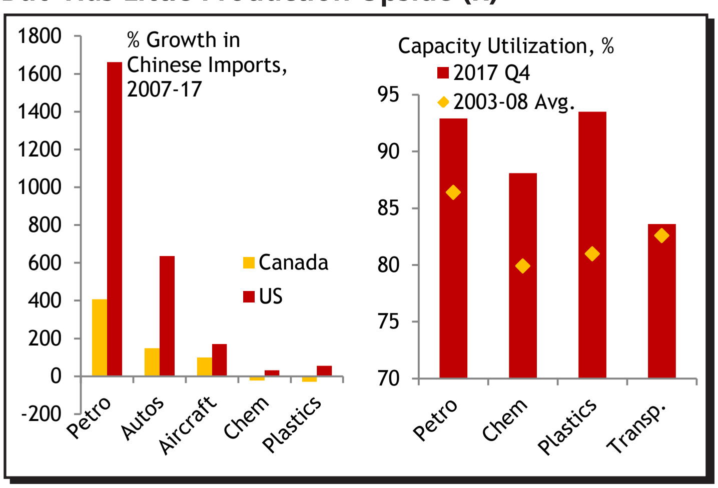
Even if China were to levy tariffs on other American goods that overlap with Canadian exports there, Canada would stand to gain little due to a lack of available production capacity (Chart 7). Specifically, Canada has lost market share to American producers of plastics, autos and aircraft. Even if the tariffs are high enough to cause substitution toward Canadian goods, subdued business investment prospects would limit any near-term response by producers.

Limited Exposure in the EU

The US may divert exports to the EU, where over three-quarters of Canadian exports compete directly with the US, but the effects on Canada would be minimal because agriculture and aerospace products destined for the EU make up less than 1% of Canada's overall exports. Indeed, Canada has been sending a smaller share of goods to the EU since 2011, and the newly minted CETA deal with the EU will enhance our competitive advantage in that market.

Chart 7

Canada Competes With the US in China (L), But Has Little Production Upside (R)



Source: ITC, Statistics Canada, CIBC

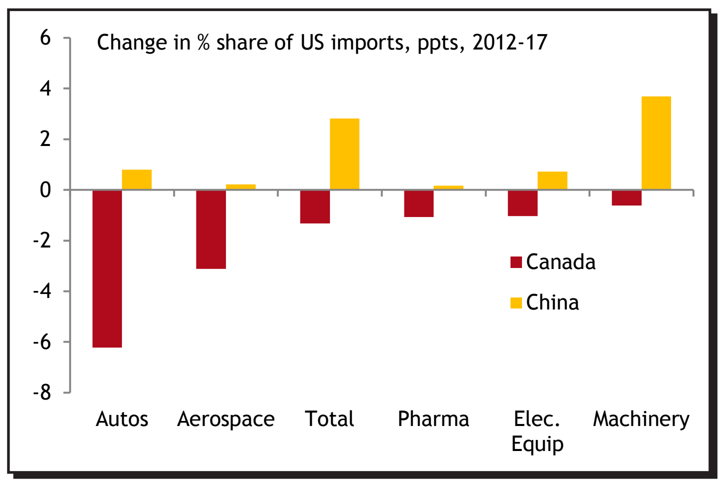
There May Be Some Wins in the US

Canadian producers could stand to gain market share in industries that have dealt with increasing Chinese competition in the US. Much of the trade that Canada conducts with the US deals with intermediate and capital goods, but in recent years, China has gained notable market share in US imports of capital goods, at the expense of Canada. This is true in both the machinery and electrical equipment industries, which face potential tariffs (Chart 8). Although capacity utilization remains strained in the former industry, electrical equipment producers have room to ramp up production by 9% relative to the previous expansionary peak capacity utilization level.

Still, our discussion of the impacts of a lasting trade war looks at what we see as a less-than-likely scenario. With China vulnerable to such a trade war expect Beijing to ultimately seek a mediated truce with the US on some of America's most pressing concerns.

Chart 8

Canada's Exports to the US Have Suffered From Chinese Competition



Source: Census Bureau, CIBC

US Recovery: Slow, Yes, But Too Slow...?

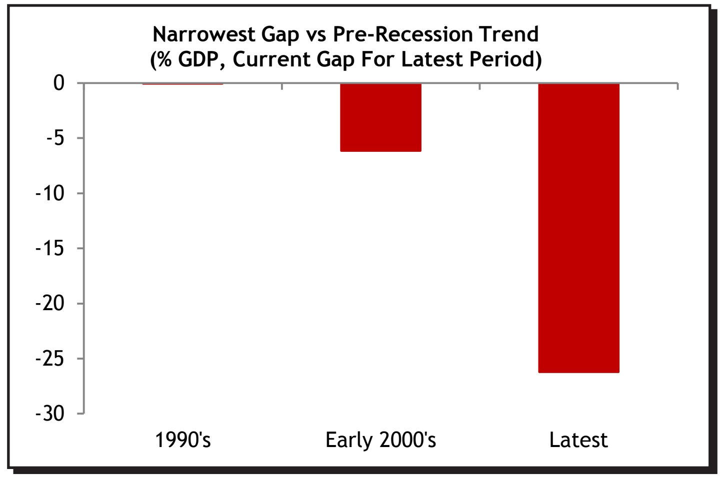
by Andrew Grantham

Warning! The following article makes no mention of President Trump, tariffs or trade wars. As such, it may not have big implications for near-term trading ideas. However, the long-term analysis undertaken here hopefully gives us a better understanding of why the US economic recovery has apparently been so slow, and what we should expect not just from the remainder of this cycle but also future ones.

Most are aware that real GDP in the US is still well below its pre-financial crisis trend. The fact that it is actually getting further away from that trend, however, is a little more interesting (Chart 1). And while it's not uncommon for the economy to fail in trying to return to its previous trend after recessions, in past cycles a full recovery has been a lot closer than in the current one (Chart 2).

Chart 2

Full Recoveries Rare, But Generally Closer



Source: BEA, CIBC

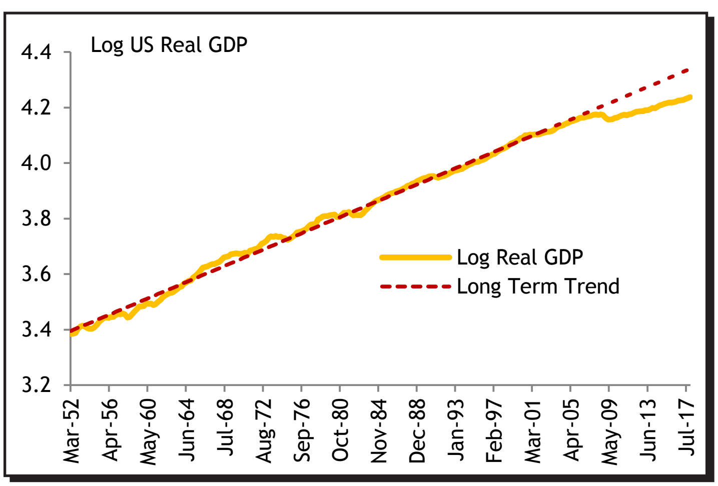
Comparing Apples to…

One complicating factor this time around is the large demographic change occurring within the US economy as it was trying to make its comeback from the last recession. The slowing growth and ageing of the population made it that much more difficult for real GDP to get back its pre-recession trend.

To account for this, a better measure of the economy would be real GDP per capita or, better still, GDP per working-age population. Examining the level of these versus the pre-recession trend does show a smaller gap than just looking at real GDP. However, the more-than-10% undershoot even in real GDP per working-age population still highlights an economy running well below its previous trend (Chart 3).

Chart 1

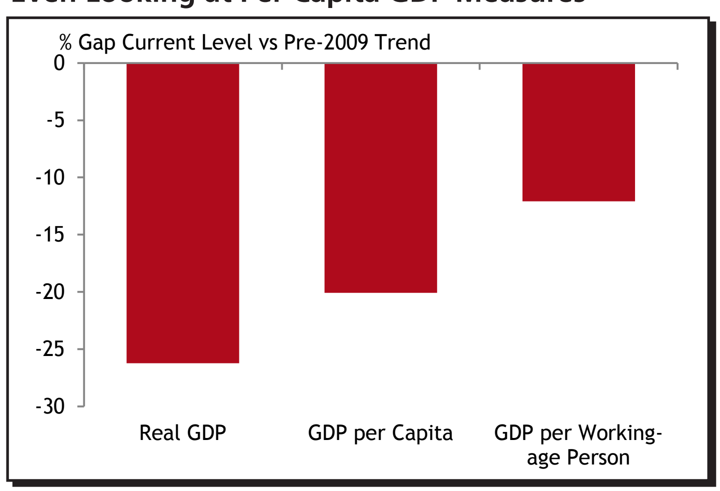
US GDP Still Well Below Previous Trend



Source: BEA, CIBC

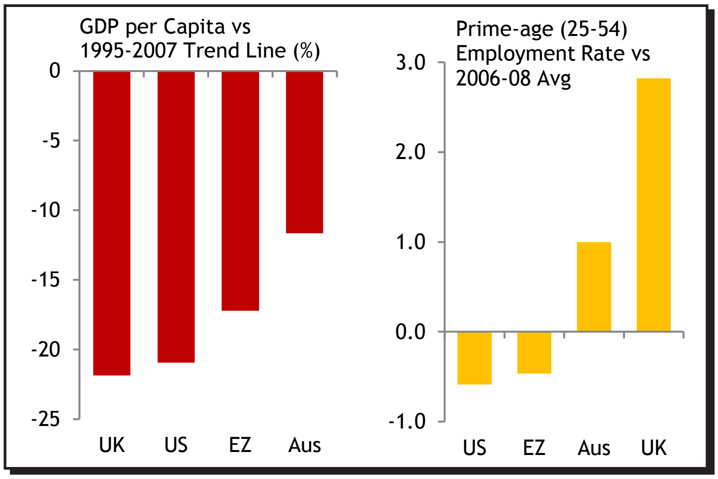
Chart 3

Still Fairly Sizeable Gaps Even Looking at Per Capita GDP Measures



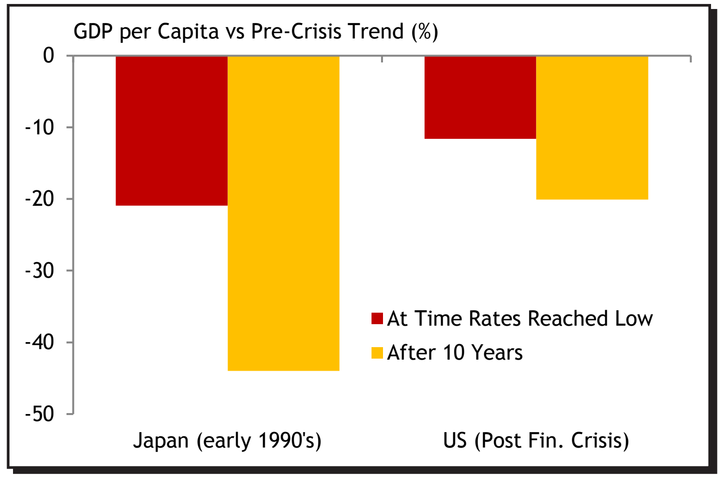
Source: BEA, BLS, CIBC

Chart 4
US Bodes Poorly on Global Comparisons for Per Capita GDP (L) and Labour Market Tightness (R)



Source: OECD, CIBC

Chart 5
US Failure to Get Back to Trend Not a Japan-like Mistake



Source: OECD, BEA, CIBC

Of course, the US is not alone in seeing a very slow recovery from the financial crisis. Other economies on a per capita basis are also well below the previous trend (Chart 4, left). However, these regions are also not raising interest rates, either at all or at least not as quickly as rates are going up in the US. And even though in Europe there's still clearly slack in the labour market, the same could be said of the US if we examine the widest measure of employment (Chart 4, right).

So is the US making a mistake raising interest rates? Well, if it is, it's nowhere near as obvious a mistake as was made in Japan prior to its lost decade, where the delay in cutting rates initially contributed to a much larger undershoot versus the prior trend and then a bigger widening of that gap. But even in the US, the more moderate undershoot in per capita GDP versus the prior trend as interest rates reached their low has grown a little larger in subsequent years (Chart 5).

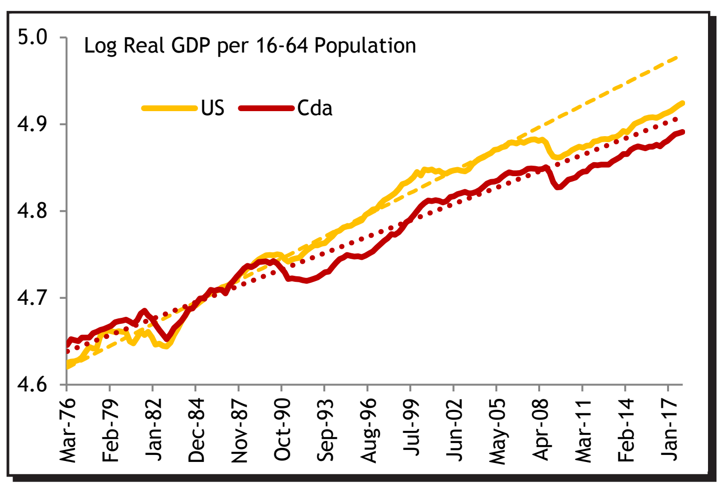
Leader Pulled Back into the Pack

All of this analysis of how countries are faring versus previous trends depends greatly on the start and end date of those prior trend lines. In the previous example, there's little doubt that Japan's lost decade was worsened by policy mistakes. Yet at the same time the previous trend was clearly unsustainable.

Comparisons between the US and Canada for the most recent period could highlight that the previous trend stateside was similarly unsustainable (albeit less dramatically so than 1990s' Japan). Even using real GDP per working age population, it is clear that the US economy not only suffered a larger downturn but has also seen that shortfall versus the prior trend widen slightly, as opposed to the narrowing seen in Canada (Chart 6 and Chart 7, left).

What's also clear is that the slope of the prior trend line was a lot steeper in the US than Canada, hence setting a higher bar to return to. And it's possible that the prior period of strong growth was the outlier, rather than the current recovery. Looking simply at the average growth rates in GDP per working-age person in the US prior to the financial crisis, it was almost ½% a year faster than in

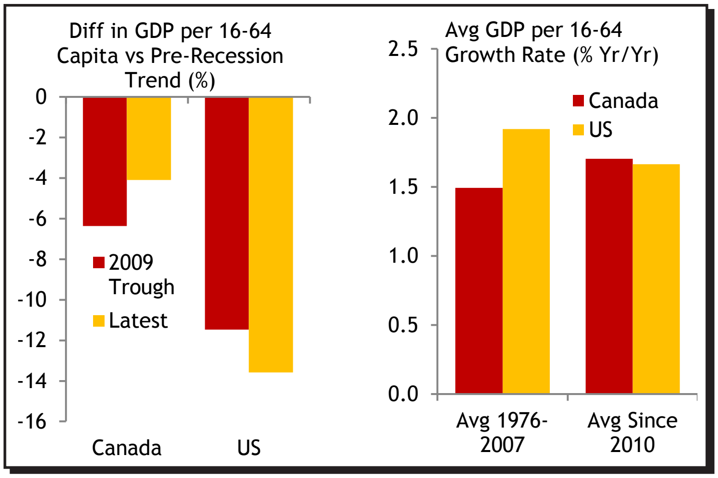
Chart 6
Real GDP Per Working-age Person in US vs Canada



Source: BEA, Statistics Canada, CIBC

Chart 7

US Shortfall Larger and Rising (L), As Strong Past Growth Set a Higher Bar for Recovery (R)



Source: BEA, Statistics Canada, CIBC

Canada. In the current decade, the US isn't lagging, but has simply returned to growth rates only in-line with its Northern neighbour (Chart 7, right).

As mentioned previously, if and by how much an economy is below its previous trend also depends greatly on the starting point for the trend line. To push that to the extreme, we sourced US GDP per capita data dating back to 1790 and plotted a long-run trend line. As opposed to the common chart plotting figures from 1950 onwards (as in Chart 1), using this as a starting point shows GDP per capita to be above its very, very long-term trend.

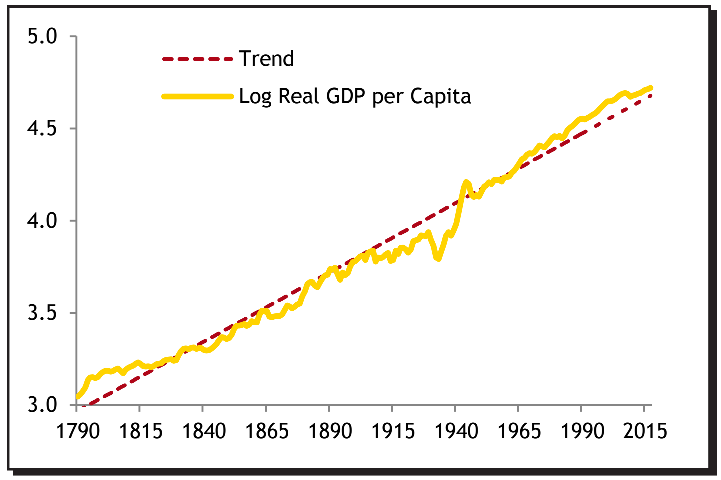
In no way are we suggesting that the US economy is reverting back to where its growth rate stood in the 19th century. But this analysis also seems to support the suggestion above, that the period from about 1960-2000 could just have been a particularly strong one for the US economy, and shouldn't be blindly used as a barometer for what can be achieved in the future.

The US economy is certainly underperforming its pre-financial crisis trend, even adjusted for the working-age population. However, that trend may have been unsustainable. Comparisons between the US and Canada, as well as a longer-term view of the economy stateside, suggests that former growth rates might not be so easy to reattain without triggering inflation.

The recent pick-up in core PCE prices might be telling us just that. If so, what looks like a disappointing failure to live up to the growth trends of the last few cycles may be something we'll have to live with.

Chart 8

A *Very* Long-run View of US Paints a Different Picture



Source: Samuel H. Williamson, "What Was the U.S. GDP Then?" MeasuringWorth, 2018, CIBC, BEA, CIBC

ECONOMIC UPDATE

CANADA	17Q4A	18Q1F	18Q2F	18Q3F	18Q4F	19Q1F	19Q2F	2017F	2018F	2019F
Real GDP Growth (AR)	1.7	1.7	2.4	1.6	2.0	1.6	1.4	3.0	2.0	1.6
Real Final Domestic Demand (AR)	3.9	2.0	2.6	1.3	2.0	1.7	1.2	3.0	2.7	1.5
Household Consumption (AR)	2.1	1.8	3.1	1.5	2.3	1.9	1.3	3.5	2.5	1.8
All Items CPI Inflation (Y/Y)	1.8	2.1	2.5	2.7	2.5	2.0	1.8	1.6	2.4	2.0
Unemployment Rate (%)	6.0	5.8	5.8	5.8	5.7	5.7	5.7	6.3	5.8	5.7

U.S.	17Q4A	18Q1A	18Q2F	18Q3F	18Q4F	19Q1F	19Q2F	2017A	2018F	2019F
Real GDP Growth (AR)	2.9	2.3	2.8	2.9	2.4	1.3	1.4	2.3	2.7	1.9
Real Final Sales (AR)	3.4	1.9	3.1	2.9	2.3	1.3	1.5	2.4	2.7	1.9
All Items CPI Inflation (Y/Y)	2.1	2.2	2.5	2.7	2.7	2.5	2.5	2.1	2.5	2.4
Core CPI Inflation (Y/Y)	1.8	1.9	2.3	2.5	2.6	2.4	2.4	1.8	2.3	2.4
Unemployment Rate (%)	4.1	4.1	4.0	3.9	3.9	3.8	3.8	4.4	4.0	3.8

CANADA

The housing market and oil industry volumes have weighed on the Q1 outlook somewhat more than we expected, so we're nudging our tracking forecast a couple of ticks to 1.7%. Housing market activity, however, was pulled forward into Q4 to avoid the B20 rules, and thus should rebound as the year progresses. Similarly, oil production and exports were temporarily weaker as a result of earlier than usual shutdowns and acute non-energy transportation issues, both of which should clear up a bit in the months ahead. As a result, we're only downgrading our full-year forecast 0.1%-pt to 2% for the Canadian economy.

UNITED STATES

First-quarter growth was a little stronger than we were expecting, however with much of the surprise coming from inventories we've shaved a little from Q2 and still see 2018 growth as a whole tracking 2.7%. A higher oil price assumption has seen us add a little to our projection for headline CPI this year.