# ECONOMIC UPDATE

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What a difference a year makes. By the end of 2019, the global economic uncertainty that weighed heavily on investor sentiment in the fourth quarter of 2018 had been replaced by optimism. A gradual de-escalation of the global trade conflict between the U.S. and China that began 18 months ago helped ease investor concerns. This change bolstered returns for markets – equities in particular – which were being supported by central bank stimulus, notably three interest rate cuts by the U.S. Federal Reserve (the Fed).

## Some progress, but geopolitical uncertainty lingers in 2020

Despite ending the year (and decade) on a positive tone, the economic outlook remains somewhat murky. While progress has been made on several big issues faced by financial markets in 2019, loose ends which could unravel in 2020 remain. Of note:

• **U.S. - China Trade** • The most important economic story of 2019 was the trade relationship between the world's two largest economies, the U.S. and China. This relationship was the key reason that led the Fed to its trio of interest rate cuts in its effort to bolster spending amid global economic uncertainty. Although a phase one agreement between the two countries has been reached, few details have been released and 90% of the existing tariffs remain in place. With a deal yet to be signed, trade relations remain the primary risk to our 2020 outlook.

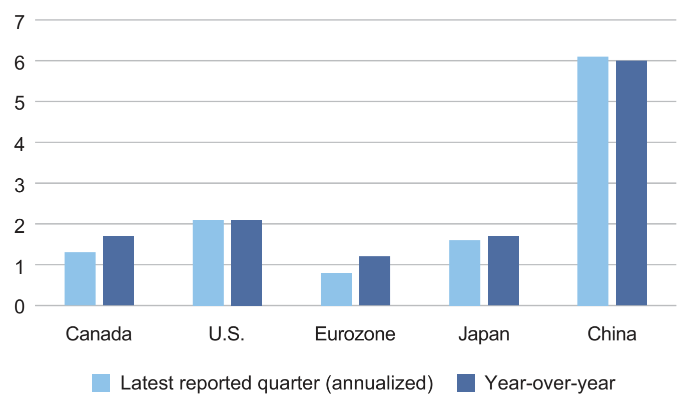
• **World War III** • Tensions between the U.S. and the Middle East are once again heightened after U.S. President Trump ordered the killing of an Iranian military leader on January 3, 2020. This event comes on the heels of the drone attack in the heart of Saudi Arabia's oil producing complex in September. This recent event is likely to keep Iranian oil production levels low, which should provide ongoing support to oil prices in 2020 from a supply perspective.

• **Brexit** • Across the pond, British Prime Minister Boris Johnson – after claiming a strong majority election victory and calming markets – promptly set an aggressive new deadline (year-end 2020) for a trade deal with the European Union. Furthermore, Scotland appears ready to initiate another independence referendum. The British Pound ended the year below its pre-election level amid renewed uncertainty.

• **Impeachment** • It came as no surprise to global markets when the Democrat-led House of Representatives voted along party lines to impeach U.S. President Donald Trump. However, while the market has long assumed that the Republican-led Senate would quickly quash an impeachment, the timing has become uncertain. House Speaker Nancy Pelosi appears to be in no rush to send the articles of impeachment to the Senate, and as such, this issue will linger.

• **USMCA** • As the year ended the U.S. House of Representatives overwhelmingly voted to approve the free trade agreement between the U.S., Mexico and Canada (USMCA). The Senate, however, appears willing to delay its review until the impeachment trial is over. Adding to the uncertainty is pushback on some of the details of the agreement from the opposition parties in Canada who gained strength at the expense of the Liberal Party in the recent election. Trade flows between the U.S., Mexico and Canada are more than double trade flows between the U.S. and China, so a final resolution is important.

**Real GDP Growth (%)**




Source: Bloomberg

## U.S. economic data resilient, interest rates likely on hold

Taking a closer look at the U.S., fourth quarter growth should be adequate following a decent 2.1% advance in the third quarter. Housing has become a bright spot with building permits at a 12-year high. Consumer spending is still strong with solid income growth and an improved savings rate. A recent spending deal agreed on by Congress means that government spending could add to growth in 2020. Given these factors, the market is projecting little chance of Fed activity in 2020, pricing in less than one interest rate cut during the year.

### Canadian housing firmer, balances out moderation in GDP growth

The situation in Canada looks similar in that markets expect little activity from the Bank of Canada (BoC) in 2020 even though the economy experienced some weakness to end the year. Manufacturing, wholesale and retail trade all reported declining activity in December, causing forecasts for fourth quarter GDP growth to drop below 1%. A surprise drop in employment has added to the negative tone.

Offsetting these concerns, and perhaps keeping the BoC on hold, is the fact that core inflation remains above the BoC's 2% target and that the housing market is firming, with sales up 11% year-over-year in November and inventories running low. An ongoing concern is the effect a rate cut would have on domestic borrowing given the high levels of personal debt currently outstanding: there is a record high debt-service ratio and insolvencies rose 10% in 2019.

Finally, fiscal policy looks set to support growth in the coming year as more new spending and even bigger deficits should be expected in the 2020 budget, giving the BoC enough reasons to keep interest rates on hold in 2020.