Nightmares on *Eluminam* Street

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Cry tariff, and let slip the dogs of trade war. That slightly adopted phrase, from Shakespeare's Julius Caesar, dates back more than 400 years to 1601, but is somehow appropriate for this very eventful week. It seemed like each day brought a new round of havoc, in a completely different realm, resurrected from a different era. To wit…

Monday: Like a bad dream from the early 2010s, **Italian bond yields** blew higher (and then really spiked on Tuesday) after the right-left coalition's first attempt at a government was rejected. By week's end, a new government was in place, yields had done a 360, and the euro was back to levels prevailing a week ago. Still, the brief flare-up served as a reminder of the euro area's fragility, and the lingering threat posed by the massive debt loads of many of its members.

Tuesday: Like a throwback to the early 1980s, Ottawa shocked many by deciding to effectively nationalize the **Trans Mountain pipeline project**, at the cool price tag of $4.5 billion (plus construction costs). While the tough decision was met by strong responses on all sides, many likely allowed that it may have been the only realistic option to get the pipeline built. On that same day, and in another echo of the 1980s, the U.S. announced it was moving forward with potential tariffs on $50 billion of Chinese imports by mid-June.

Wednesday: Like a flashback to the early 1990s, the **Bank of Canada** caught the market somewhat unawares with its hawkish (albeit terse) Statement at its rate decision. Dropping references to being cautious and/or the need for stimulus, the Bank all but set the table for a July rate hike. The loonie dutifully popped 1.3% on the day. While those gains were handed back the very next day on a soft Q1 GDP report (and the steel tariffs), a follow-up speech by Deputy Governor Leduc reinforced the message that the Bank is prepping for second-half rate hikes.

Thursday: Like an extremely bad dream from the early 1930s, the U.S. Administration—in all its collective wisdom—decided to **impose tariffs on steel and aluminum imports from Canada, Mexico and the EU**. That is, on some of its best friends, neighbours, and allies… on security grounds. Not surprisingly, the capricious decision was met with fury and fire, including an aggressive list of retaliatory tariffs by Canada, on such sundry items as playing cards, sleeping bags, beer kegs, and inflatable boats (summer vacay just got a lot more expensive). We take a closer look at the economic impact of the steel tariffs in this week's Focus; we judge the direct economic hit to Canada will be a moderate 0.1% from GDP.

Friday: Like a hazy memory from the early 2000s, the **U.S. jobless rate fell to 3.8% in May**, matching the lowest reported level since the 1960s. Putting it more precisely, there has been only one other month since 1969 when the unemployment rate was as low as 3.8% (April 2000). Almost all aspects of the release landed on the strong side (as the President so helpfully presaged in a tweet), with wages slowly grinding higher to a 2.7% y/y pace. While the participation rate slipped slightly in

May, the measure for those 16-64 has been steadily moving higher since bottoming in 2015.

The extreme tightness in the U.S. job market, highlighted in Friday's release, sent a stark message about the folly of trade protectionist measures. Earlier in the week, the Conference Board reported that 42.4% of Americans consider jobs to be "plentiful", up from less than 10% just five short years ago and the highest reading since the tech boom. And tight labour market conditions are not just a U.S. story, with each of Canada, Germany, Japan and the U.K. boasting their lowest jobless rates in decades. While we have all seen and read the articles about robots and AI stealing our jobs, **the reality in the here and now is that we have a shortage of workers, not work.**

Moreover, the protectionist wave lands like a thud just as inflation pressures are starting to show a flicker of life. Inflation across the OECD has crept up to 2.3% y/y and core trends are now just a touch below 2%. While oil prices have simmered down in the past two weeks, note that the relief for much of the world has been modest. The differential between Brent (at $77) and WTI (at $66) is abnormally wide, with the former only slightly below its recent peaks. The point is that many consumers are still facing oil price increases of more than 50% in the past year. **Loaded on top of that are the various new tariffs, which ultimately act as a tax on consumers and producers.** If implemented, we judge that the new measures by Ottawa would add 0.1-to-0.2 ppts to Canadian CPI for instance.

> **Brief sidebar rant:** The President was busy railing about Canada yet again on Friday, tweeting about our "highly restrictive" trade practices. Why, yes, we are only the world's single biggest market for U.S goods and services (with Mexico in a strong second position). With a population of less than 37 million, Canada buys more from the U.S. than Japan, Germany and Korea combined, and almost twice that of China. In addition, bilateral trade between the U.S. and Canada is much more closely balanced than against any other major nation the U.S. deals with. It continues to be baffling beyond words how Canada has ended up being among the Administration's "most wanted" trade villains. All I can say is WTF… Why Tariffs For us?

Of all the many moving parts from this week, **the key takeaway is the highly unfortunate lurch towards protectionism, at a time when job markets are moving back to full capacity and price pressures are heating up.** As Jamie Dimon succinctly put it on Friday, *"this trade stuff is a negative"*. Yet note that despite all this week's drama, U.S. bond yields ended almost exactly where they left off last Friday, the Canadian dollar was unchanged on net, gold and WTI slipped only slightly, and stocks were fighting to get out of the red. It appears that amid a still-solid global growth backdrop, investors are keeping their collective calm even if the same can't be said for some of the political leaders.

Next week is highly unlikely to be as eventful as this past week, although there are a few items worth highlighting. The **G7 meeting to be held right here in Canada** (Charlevoix, Quebec, to be precise) should at least make for some trade drama, if no real policy proposals. Along the same lines, U.S. Commerce Secretary **Ross travels to China** over the weekend to discuss trade—why does the phrase *"bull in a China shop"* so readily spring to mind?

Finally, the **Ontario election is on Thursday, June 7**, and, if the polls are to be believed, it's come down to a dead-heat battle between the two main opposition parties. Typically occupying the opposite ends of the political spectrum, the two favourites promise very different economic visions. Maintaining strict neutrality, and providing just the facts, the NDP looks to ramp up spending above and beyond current Liberal pledges, with the extra paid for by a 1.5 ppt hike in the corporate income tax rate and a 1-to-2 ppt personal rate hike on (relatively) high-income earners. In complete contrast, the Progressive Conservatives look to trim corporate rates by 1 ppt and to slice middle-income tax rates. Suffice it to say, **it's a big election for Canada's biggest province**, although from a credit standpoint we could end up in a similar deficit position regardless of which stripe wins. Ironically, game 5 of the Stanley Cup playoffs just happens to land on that very date, so we could see a new NHL champ and a new Ontario government a week from today.