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Focus

A weekly financial digest

Douglas Porter, CFA, Chief Economist, BMO Financial Group

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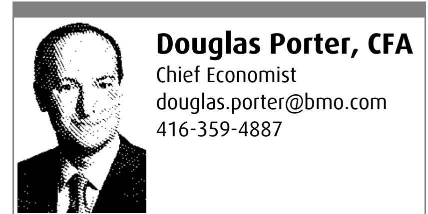
No Tariff Tantrum for Treasuries



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U.S. inflation is rising, the job market is tight, Q2 GDP may have approached 5%, the Fed is hiking remorselessly, the budget deficit is fattening fast, and bond yields are… falling? Benchmark 10-year Treasury yields dipped for the second week in a row, and are now probing the lower limits of the tight 2.8%-to-3.0% range that they have been stuck in for most of the past five months. The handy excuse for the latest move is “trade war fears”, what with the U.S. and China making good on their threats to hit $34 billion of products with tariffs and counter-tariffs today. Yet, U.S. equities managed to grind out decent gains this week (albeit after a bit of a pummelling the prior two weeks), and the U.S. dollar took a small step back, so other markets were not especially rattled by trade concerns.

While yields are no doubt being held back more broadly by **gnawing trade fears**, there are clearly other factors keeping a lid on long-term rates. We would point to: 1) fading non-energy commodity prices; and, 2) benign wage pressures. On the first point, while much of the attention has been focused this year on the blistering gains in oil—the President griped again this week about them—**non-oil prices have been going in reverse**. Copper, and its PhD in Economics, dropped heavily in the past month (-14%) and is now barely above a year ago, after posting gains of more than 20% y/y just this spring. Ag prices are also in full retreat again, with both livestock and crop futures down from a year ago. Arguably, some of this widespread commodity weakness can be traced directly back to the trade trauma—a) some specific commodities are being hit with tariffs (e.g., soybeans), b) the U.S. dollar is firming, dampening the US$ price of goods, and c) the trade cloud on global growth is weighing on cyclical commodities (e.g., copper).

Besides commodities, a **lack of serious wage pressure** in much of the developed world is also keeping broader inflation concerns at bay. While there are plenty of signs that wages are gradually responding to tight job markets across the OECD, the emphasis is on *gradual*. Today’s U.S. employment report is Exhibit A, with average hourly earnings rising a mild 0.2% in June and holding fast at a 2.7% y/y clip. True, that is slightly above last year’s average gain of 2.5%, but hardly the stuff to cause anyone serious inflation angst. It’s a broadly similar story for some of the other compensation measures, with wages & salaries from the ECI also up 2.7% y/y in the latest reading.

The moderate wage result, combined with a surprising 2-tick back-up in the jobless rate to 4.0%, was easily enough to offset yet another impressive gain in payrolls (+213,000 after the hefty 244,000 revised May gain). Earlier this year, we asked where would the workers come from to fuel the expansion? Well, a stabilization in the participation rate has helped drive a 1.2% y/y rise in the labour force, which works out to just over 160,000 per month, or just slightly below the recent underlying trend in job gains. Bigger picture, the fact is that **the job market will continue to tighten** with this kind of job growth and, yes, **wages will erratically grind higher**. So, even with the modest rally in Treasuries lately, **we are still looking for yields to push above 3% later this year**—presumably as trade tensions ease post mid-term elections.

Canada’s bond rally has been even more emphatic in recent months, with the trade concerns a much bigger deal for the domestic economy. But, Canada was not the star

of the tariff show this week, and the Canadian dollar managed to strengthen slightly on net after a comeback last week. **The local jobs report was almost the mirror image of the U.S. version**, replete with a 2-tick rise in the unemployment rate (to another round number of 6.0%), an above-expected headline jobs gain (+31,800), and somewhat milder-than-expected wages (but still strong at +3.6% y/y). In essence, it was a mixed bag and simply not enough to move the needle on the Bank of Canada outlook—even with all the trade noise, we and the market expect a 25 bp rate hike next Wednesday, which will take the overnight rate up to 1.50%.

We made two small tweaks to our forecast last week that are worth mentioning: First, we **trimmed this year's GDP outlook** by a tick to 1.9%, mostly on intensifying trade tensions but also due to the outage at Syncrude. A one-tick cut may not sound like a big deal, but it's firmly below consensus and it's the direction of the revisions that's important here. Along the same lines, **we have also taken out one of the expected BoC rate hikes over the next 18 months**, and now look for the overnight rate to finish next year at 2.25%, or still below what the Bank considers neutral. Again, while not a huge change, it's the direction of the revisions that matters.

Perhaps not realizing that South Park was being ironic with their *"Blame Canada"*, the Administration has taken up the cause with great gusto. White House Press Secretary Sanders said this week that *"We've been very nice to Canada for many years, and they've taken advantage of that",* echoing President Trump's comments from earlier this year: *"We lose a lot with Canada. People don't know it. Canada is very smooth."* Proving Canadians are smooth is far too daunting a task, so instead we will show just how they are indeed 'taking advantage' of the U.S., with *"A Day in the Life of Joe/Janet Canadian"*:

I saw a Hollywood film today, oh boy
The New England Patriots had just won the Bowl
A crowd of Teslas/F150s turned away
But I just had to go on Amazon and look
Having already at Walmart read the book
I'd love to turn CNBC on

Woke up, fell out of my Sealy/Serta bed,
Dragged a Dell mouse across Facebook/Instagram/Google's head
Found my way downstairs and drank a cup of Starbucks/Coke/Pepsi/Bud Light
And looking up at my Apple Watch I noticed I was late
Found my Abercrombie coat and grabbed my Nike hat
Made the Uber/Lyft in seconds flat
Made my way upstairs with Mickey Dees and had a Marlboro smoke
And Siri/Alexa spoke and I went into a Disney dream

I read the news in U.S. Today, oh boy
Four thousand folks in Blackberry's Waterloo
And though the folks were rather few
They wanted to boycott U.S. goods at the mall
Upon reading the list above, those folks decided after all
Nevermind, they'd still love to turn Netflix on

BoC Preview: Going for a Summer Hike

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The Bank of Canada is widely expected to hike rates 25 bps at the July 11 policy meeting. The uncertainty around the trade backdrop drove significant market volatility ahead of this meeting, but Governor Poloz reinforced the hawkish message from the May 30 policy statement last week, and the most recent data were better than expected. Note that this is an MPR meeting and Governor Poloz will hold a press conference as well.

Leaving aside the trade rhetoric/uncertainty for a moment, **the Canadian economic backdrop is fully consistent with higher policy rates**. The output gap is closed, inflation is close to target and growth is projected to be at or above potential. April GDP was nicely better than expected keeping the April MPR forecast for Q2 GDP growth of 2.5% on track. And, perhaps more importantly, the BoC's Business Outlook Survey was exceptionally strong. The caveat is that much of the survey was done before the U.S. imposed tariffs on Canadian steel and aluminum, but it's clear there was solid momentum in the lead-up.

Unfortunately, we can't ignore the trade uncertainty even if much of it is Twitter driven. The U.S. tariffs and Canadian retaliation will dent growth, even if modestly, but more importantly reinforce that there's some risk of further U.S. action. Trump has frequently touted potential auto tariffs (mostly on Europe); and, even if the odds of such a move are small, the impact would be significant. Fortunately, there was no reaction (Twitter or otherwise) to the Canadian retaliatory tariffs, suggesting further escalation isn't likely in the near term. However, the U.S. is investigating whether auto imports are a national security threat, so we could still see the trade spat worsen.

From the BoC's perspective, Governor Poloz has made it clear that **policy will not be shaped by trade rhetoric**. Rather, the Bank will take concrete actions into account and make its best effort on assessing the impact of uncertainty. The Bank has already done the latter twice due to NAFTA uncertainty, but we could see another trade uncertainty-driven downgrade in this MPR. The latter would be in addition to the impact of tariffs already announced which will likely cut growth by a tick or two in 2018 and 2019.

The trade tensions are likely to be the main driver of forecast changes in the MPR. We're not expecting much change to Q2 after April's decent GDP print, though some oil sands shutdowns could trim 2018 an extra tick (and weigh heavily on Q3), with the rebound coming in 2019. Inflation could see a small downgrade after the soft May print, but nothing that would impact policy.

Meantime, the BoC's other notable risks—housing and household debt—have improved. The housing market continues to show signs of stabilizing after a very weak start to the year. And, household debt growth has slowed sharply (with housing), which should help bring debt ratios lower and improve the quality of the debt stock as incomes continue to rise.

Key Takeaway: All signs point to a July rate hike as the broader backdrop suggests the economy no longer needs the stimulus that's in place. Beyond next week, look for the BoC to keep a close eye on trade developments, but allow the data to determine the direction of rates absent another round of tariffs. *B.A.A.R.*

Fed Eyes Return to Neutral

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The U.S. economy continues to run at a strong pace, but some mixed messages on the capacity front continue to argue for gradual tightening. One of the key takeaways from the Minutes of the Federal Reserve's June policy meeting, released this week, was that further evolution in language is likely coming. Recall that the June meeting was famous not so much for an as-expected rate hike, but for removing the long-standing guidance (since March 2014) that pointed to the fed funds rate tracking below the longer-run neutral level, for some time. The Minutes also highlighted another looming language change, saying that *"a number of [participants] noted that it might soon be appropriate to modify the language in the postmeeting statement indicating that the stance of monetary policy remains accommodative"*. Indeed, assuming the quarter-per-quarter pace of rate hikes continues, the fed funds rate should reach a neutral level around the middle of 2019. And, given lingering uncertainty around precisely where that level is, the Fed could more or less view policy as no longer stimulative before then.

Given what we're seeing in the economy, a stimulative monetary policy stance is hardly in order any longer, but an overly restrictive one might still be premature. The manufacturing ISM rose back above the 60 level in June, with supplier delivery delays surging to the highest in 14 years. This at least partly reflects tightening capacity, particularly for transportation and some electronic components (trade concerns also appear to be at work). And, next week, core CPI inflation is expected to pick up again to 2.3% y/y, matching the highest level of the cycle. But, there appears to be some tolerance at the Fed to let inflation run modestly above 2% to help anchor expectations, given the prolonged undershoot. This week's payrolls report also highlighted solid growth but still-moderate inflation pressure. Headline job growth came in stronger than expected at 213k in June, with positive revisions to boot, while aggregate hours rose for a third straight month and were up 3.1% annualized for all of Q2—that's the strongest clip in four years. However, wage growth came in light at 2.7% y/y, and refuses to break out of its two-year range. This came alongside a 601k increase in the labour force, suggesting that there's still some pent-up slack sitting on the sidelines of the U.S. labour market.

The Bottom Line: The Fed is well on its way to returning to a neutral policy stance, and we judge it will effectively get there around the middle of next year. How restrictive policy needs to get from there remains to be seen—at this point, it doesn't look like there is a big hurry. Rob K.

Knowing When to Fold 'Em

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A**s much as I dislike changing a call on a central bank from A to B then back to A, this change was needed.** I am referring to our expectations for the next Bank of England rate hike. We reversed the change made six weeks ago, and now look for the next move to come in August, rather than November. Frankly, it has always been a close call between those two months.

It all goes back to what the MPC was looking for in May, and how things are developing compared to that month. The majority of the Committee wanted to wait and ensure that the weak start to the year (Q1 real GDP was up a mere 0.1% q/q) was indeed temporary. After all, it wouldn't hurt to do so, and *"discern"* and *"learn"* from the data. When the upward adjustment to the first quarter failed to materialize, we moved to November. In the six weeks since, the **data have improved** (services PMI hit an 8-month high in June). The June meeting saw a more hawkish tilt to the MPC—the two hawks had recruited an extra body over to the "let's hike NOW" side). The newest hawk, Chief Economist **Andrew Haldane**, warned recently that it was *"important to push inflation back to the target of 2% and not wait too long"*. One of the original hawks, Ian McCafferty, will be stepping down on August 31st and his replacement, **Jonathan Haskel**, is a dove. **BoE Governor Carney** also sounded upbeat on the economy in a speech this week, declaring that *"the incoming data have given me greater confidence that the softness of UK activity in the first quarter was largely due to the weather, not the economic climate"*. And, the **final kick at Q1 GDP** unexpectedly saw the upward revision that we had been waiting for (just a month late), to +0.2%.

Bottom Line: We are now looking for the BoE to raise rates 25 bps to 0.75% on August 2nd. And that will likely be it, until sometime after Brexit Day on March 29, 2019. JLee

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	Good News	Bad News
Canada ▪ Counter-tariffs on U.S. goods kick in ▪ C$ strengthens to three-week high ▪ Toronto home sales stabilize… Vancouver continues to sag	**Employment** +31,800 (June)—but mostly part-time **Manufacturing PMI** +0.9 pts to survey record high 57.1 (June) **Ivey PMI** +0.6 pts to 63.1 (June)	**Jobless Rate** +0.2 ppts to 6.0% (June) **Average Hourly Wages** slowed to +3.6% y/y (June) **Merchandise Trade Deficit** widened to $2.8 bln (May) **Auto Sales** -1.6% y/y (June)
United States ▪ U.S.-China tariffs officially triggered and President Trump threatens tariffs on all Chinese imports ▪ A NAFTA deal could be stalled until mid-term elections ▪ FOMC Minutes show gradual rate hikes still *"appropriate"*	**Nonfarm Payrolls** +213,000 (June) **Average Hourly Earnings** +0.2% (June) **Goods & Services Trade Deficit** narrowed to $43.1 bln (May) **Auto Sales** climbed to 17.5 mln a.r. (June) **Factory Orders** +0.4% (May) **Manufacturing ISM** +1.5 pts to 60.2; **Non-manufacturing ISM** +0.5 pts to 59.1 (June)	**Jobless Rate** +0.2 ppts to 4.0% (June) **Construction Spending** +0.4% (May)—hefty downward revision to April **Initial Claims** +3k to 231k (June 30 week)
Japan ▪ Yen advances amid market gyrations	**Services PMI** +0.4 pts to 51.4; **Composite PMI** +0.4 pts to 52.1 (June)	**Household Spending** -3.9% y/y (May) **Tankan Large Mfg Index** -3 pts to 21 (Q2)
Europe ▪ Reports that U.S.-EU willing to compromise on auto tariffs ▪ BoE Gov. Carney upbeat on growth; sets the stage for August hike ▪ PM May fights to hash out Brexit agreement in critical Cabinet meeting	**Euro Area—Services PMI** revised higher to 55.2; **Retail PMI** +0.1 pts to 51.8; **Composite PMI** revised higher to 54.9 (June) **Euro Area—Jobless Rate** steady at 8.4% (May) **Germany—Industrial Production** +2.6% (May) **Germany—Factory Orders** +2.6% (May) **France—Jobless Rate** steady at 9.2% (May P) **Italy—Jobless Rate** -0.3 ppts to 10.7% (May P) **Italy—Retail Sales** +0.8% (May) **U.K.—Manufacturing PMI** +0.1 pts to 54.4; **Services PMI** +1.1 pts to 55.1; **Construction PMI** +0.6 pts to 53.1; **Composite PMI** +0.7 pts to 55.2 (June)	**Euro Area—Manufacturing PMI** revised down to 54.9 (June)—a 20-mth low **Euro Area—Retail Sales** unch (May) **France—Trade Deficit** widened to €6.0 bln (May) **U.K.—Unit Labour Costs** +3.1% y/y (Q1)—fastest since 2013Q4
Other ▪ Stocks in China drop to lowest in more than 2 years; yuan weakens further ▪ Leftist Lopez Obrador wins big in Mexico's presidential election ▪ Mexico triggers 2nd wave of tariffs and Russia slaps more duties on U.S. imports ▪ RBA on hold	**China—Non-manufacturing PMI** +0.1 pts to 55.0 (June) **China—Caixin Services PMI** +1.0 pt to 53.9 (June) **Australia—Trade Surplus** widened to A$827 mln (May)—but prior month revised down **Australia—Retail Sales** +0.4% (May)	**China—Manufacturing PMI** -0.4 pts to 51.5 (June) **China—Caixin Manufacturing PMI** -0.1 pts to 51.0 (June) **China—Exports to U.S.** +5.4% y/y (Jan.-to-June)—sharp slowdown from same period last year **Australia—Building Approvals** -3.2% (May)

Indications of stronger growth and a move toward price stability are good news for the economy.

Mexico's Macro Matters

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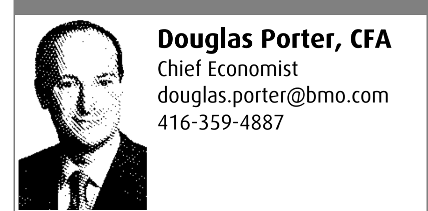
Mexico's underlying economic performance has been overshadowed in the past year by the NAFTA negotiations and by the July 1 elections. With the latter now out of the way, here's a look at what incoming President Lopez Obrador will be dealing with on the economic front, along with the mounting trade uncertainties. In a nutshell, it's a backdrop of cooling growth, high (but moderating) inflation, rising interest rates, a volatile/weak peso, and auto production that has doubled in a decade. Combined with the messy trade outlook, it's fair to conclude that for the Mexican economy: It's complicated.



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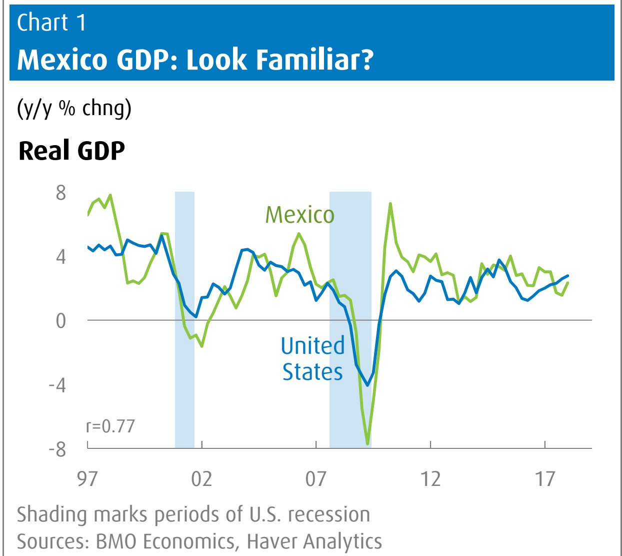
Growth: Real GDP rose at a 2.3% y/y pace in Q1 (on a seasonally adjusted basis), versus a recent peak of just over 3% in late 2016. Rising interest rates and NAFTA uncertainty have dulled growth, although domestic demand remains solid. In particular, real consumer spending is clicking along at a 3.5% y/y pace. Private capital spending popped in Q1, but this followed an outright decline (-0.5%) for all of 2017 amid the trade talks. From a big-picture view, the Mexican economy tends to track the U.S. very closely *(Chart 1)*—the high correlation between the two countries' GDP growth rate over the past 20 years (0.77) is eerily similar to the figure between the U.S. and Canada. This is a relatively new development, as there was almost zero correlation between U.S. and Mexican GDP prior to the 1994 NAFTA deal. However, given the uncertain near-term future for trade, we are likely to see a notable divergence over the next year, with Mexico expected to underperform U.S. growth by at least half a point.

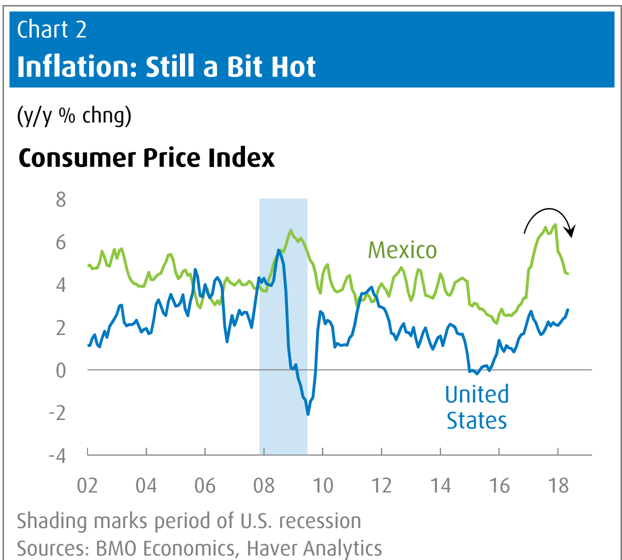
Chart 1
Mexico GDP: Look Familiar?



Shading marks periods of U.S. recession
Sources: BMO Economics, Haver Analytics

Inflation: After peaking at almost 7% late last year, Mexico's headline inflation rate has eased to a still-meaty 4.5% y/y pace (and 3.7% for core CPI). Given that the Bank of Mexico aims to keep inflation within 1 point of a 3% target, these trends are still on the uncomfortably high side. After staying nicely within the target zone for years, inflation punched higher in late 2016 and early 2017 as the peso swooned and as gasoline prices spiked when government subsidies were cut *(Chart 2)*. With those factors largely falling away, both headline and core inflation have receded markedly in 2018. From a big-picture view, inflation is now close to its 4% average over the past 15 years—a period that has seen Mexico's CPI running roughly 2 percentage points faster than the U.S. rate. Still, that's a massive improvement from earlier decades, when Mexican inflation topped 50% as recently as 1996, and peaked at 180% in 1988, aka the bad old days.

Chart 2
Inflation: Still a Bit Hot



Shading marks period of U.S. recession
Sources: BMO Economics, Haver Analytics

Interest Rates: The high-side inflation readings in recent years have prompted the Bank of Mexico to aggressively tighten, more so even than the Fed. From a low of 3.0% in 2015, the Bank has cranked its overnight rate by a cumulative 475 bps. While the Bank initially matched the first rate hike of the cycle by the Fed, it has since acted much more forcefully in the face of the deep drop in the peso and the ensuing inflation jump, especially through 2016.

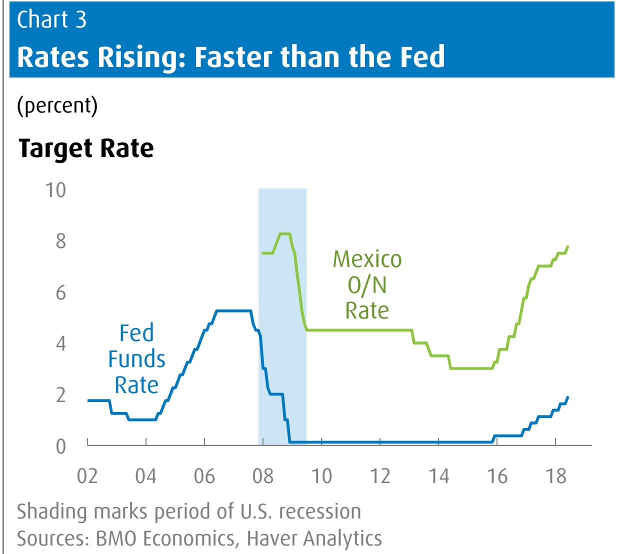
However, over the past year, Banxico has essentially matched the FOMC step-for-step, including a 25 bp hike in June *(Chart 3)*. Still, similar to the inflation story, the rate environment is in a different world from 20 or 30 years ago, when rates peaked as high as 50% in the 1990s or more than 100% in the 1980s.

Exchange Rate: The big-time tightening by the Bank of Mexico has helped support the peso, after it fell heavily through the 2015-16 period. The peso hit rock bottom shortly after the 2016 U.S. election, at one point almost touching 22 pesos/US$—a 40% depreciation in under three years *(Chart 4)*. Since 2017, the currency has swung violently on shifting NAFTA tides and in the lead-up to the July 1 elections. As it became increasingly clear that Lopez Obrador would win, and as NAFTA prospects dimmed, the peso sank heavily through the spring. However, the market reaction to Obrador's post-election comments on the economy and trade was one of relief, and the peso has recouped half of those spring losses. The *big-picture view* is that the currency remains nearly 40% weaker than just five years ago against the U.S. dollar. On a real trade-weighted basis, it stands roughly 20% below its long-run average. (For comparison, the Canadian dollar is now about 5% below its long-run mean on the real effective exchange rate.)

Trade: In a classic case of unintended consequences, the highly competitive level for the peso has further supported Mexico's trade position. In other words, Trump's tough trade rhetoric, much of which has been trained on Mexico, has played a big role in pounding the peso in recent years, which in turn has aggravated the underlying trade irritant. Mexico's bilateral trade surplus on goods with the U.S. has widened above US$71 billion in the past 12 months *(Chart 5)*, about $10 billion more than during the 2016 U.S. election campaign (when Trump threatened a 35% tariff on Mexico). Note that including services doesn't change the picture in a big way, as the gap is still close to $70 billion (whereas the U.S. now runs a small surplus with Canada on goods and services). As an aside, Mexico also runs a large trade surplus with Canada—it hit a record C$12 billion in the past 12 months (or more than 0.5% of Canadian GDP, versus Mexico's imbalance with the U.S. which clocks in at 0.4% of U.S. GDP.) But from a *big-picture view*, even with the hefty trade surpluses with its NAFTA partners, Mexico still runs a moderate current account deficit overall (1.3% of GDP in the past four quarters).

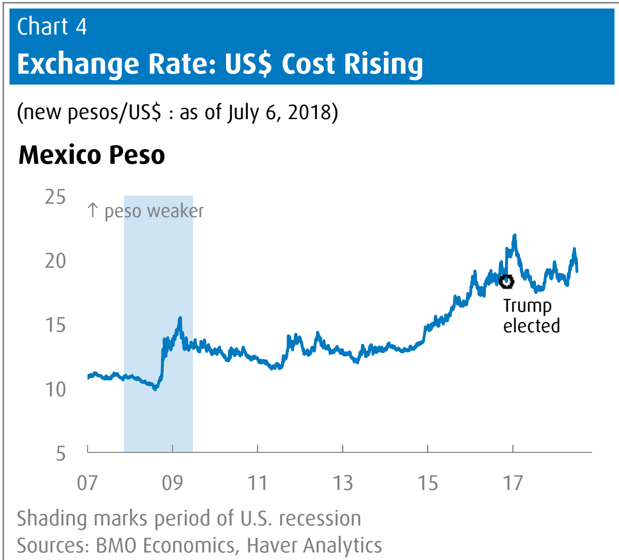
Auto Production: There is zero doubt or debate about what generates Mexico's sizeable trade surplus with the U.S. (and Canada)—the auto industry. Over the past 12 months, Mexico has run a US$83 billion surplus with the U.S. in cars, trucks, and parts, split almost evenly between those three categories. Autos & parts alone account for more than the entire bilateral trade imbalance, as the U.S. runs a $14 billion surplus on other goods and services. This reflects the dramatic ramping up of the Mexican auto sector, which

Chart 3
Rates Rising: Faster than the Fed



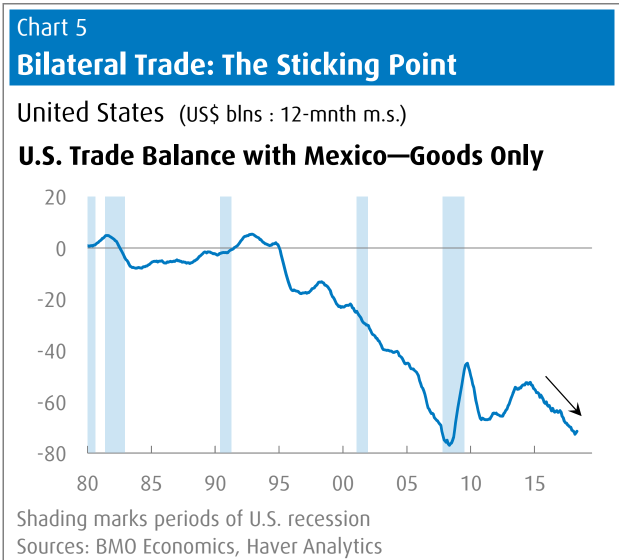
Shading marks period of U.S. recession
Sources: BMO Economics, Haver Analytics

Chart 4
Exchange Rate: US$ Cost Rising



Shading marks period of U.S. recession
Sources: BMO Economics, Haver Analytics

Chart 5
Bilateral Trade: The Sticking Point

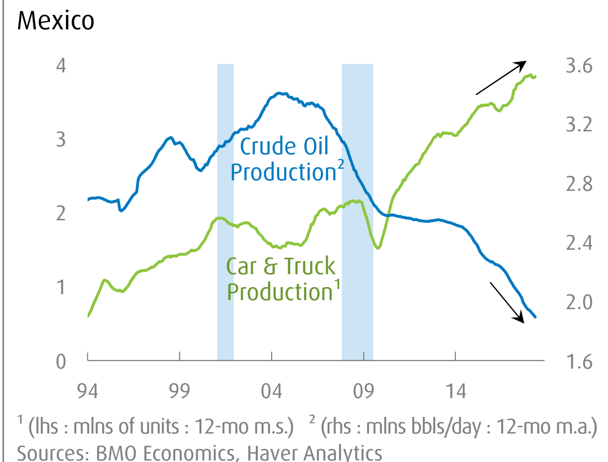


Shading marks periods of U.S. recession
Sources: BMO Economics, Haver Analytics

has seen production triple in the past two decades—from roughly 1 million vehicles per year in the mid-1990s to more than 3.8 million now. In a sense, autos have supplanted petroleum as Mexico's chief industry and export, as oil production has plunged by more than 40% from its 2004 peak of 3.4 million bpd to less than 1.9 million today *(Chart 6)*. Curiously, that drop in oil production has been almost offset barrel-for-barrel by rising Canadian production, even as Mexican auto production has more than offset falling Canadian assemblies.

Bottom Line: It would be overly dramatic to conclude with *"Live by NAFTA, die by NAFTA"*, and too trite to say *"Ob-la-di, Obrador, life goes on"*. But there's no doubt that the Mexican economy has become much more tightly integrated with the U.S. economy—and thus much more stable—in the wake of NAFTA, largely thanks to a thriving auto sector. But that very success has fuelled the U.S. Administration's key gripe with the 25-year old trade deal, and is clearly at risk in a world threatened by U.S. auto tariffs.

Chart 6
Oil Change for Mexican Economy



[1] (lhs : mlns of units : 12-mo m.s.) [2] (rhs : mlns bbls/day : 12-mo m.a.)
Sources: BMO Economics, Haver Analytics

Lopez Obrador's Nationalist Agenda

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Lopez Obrador achieved the biggest margin of victory in a Mexican presidential election in recent history. More importantly, the better-than-expected results for his coalition in the Congressional elections—61% in the Chamber of Deputies and 53% in the Senate—indicate a very strong mandate for the incoming administration and significant leeway to implement its policy agenda. The new president may even be able to muster support for Constitutional reforms, which require a two-thirds majority in both houses, from smaller left-wing opposition parties. Such amendments also require the approval of half the state legislatures, of which Lopez Obrador's party is now expected to control 19 of 32, having won five of the nine simultaneous gubernatorial elections. While policy details are scant at this point and economic conditions could change before the new administration takes office in December, Lopez Obrador has pledged to:

- Reduce poverty and inequality by increasing spending on social programs (targeting pensions, higher education) and infrastructure and raising the minimum wage.
- Find savings worth some 2% of GDP by reducing public sector inefficiencies and fighting corruption, and avoid raising taxes or the debt burden.
- Revitalize the state oil company Pemex, build oil refinery capacity, intervene more heavily in the financial sector and provide support for the agricultural sector through farming subsidies.
- Review existing contracts awarded to private/foreign oil and gas firms amid corruption concerns and freeze new offshore exploration auctions. However, he is unlikely to pursue a full-scale reversal of the 2014 energy sector reform given the expected hit to investment.
- Uphold NAFTA and remain consistent with the current administration's negotiating stance, though he may seek to shift focus and bring new issues to the discussion table (i.e., labour, agriculture).
- Respect the independence and integrity of the central bank and the rule of law.

Economic Forecast Summary for July 6, 2018

BMO Capital Markets Economic Research

	2018				2019				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2017	2018	2019
CANADA											
Real GDP (q/q % chng : a.r.)	1.3	2.4	1.5	2.2	1.8	1.7	1.7	1.6	3.0	1.9	1.8
Consumer Price Index (y/y % chng)	2.1	2.3	2.3	2.1	1.9	2.1	2.2	2.1	1.6	2.2	2.1
Unemployment Rate (percent)	5.8	5.9	5.9 ↑	5.7 ↑	5.7 ↑	5.7 ↑	5.6 ↑	5.6 ↑	6.3	5.8 ↑	5.6 ↑
Housing Starts (000s : a.r.)	223	209	215	213	211	207	204	200	220	215	205
Current Account Balance ($blns : a.r.)	-78.0	-68.5 ↓	-69.6 ↓	-67.9 ↓	-66.4 ↓	-66.1 ↓	-65.9 ↓	-65.5 ↓	-63.3	-71.0 ↓	-66.0 ↓
Interest Rates	(average for the quarter : %)										
Overnight Rate	1.25	1.25	1.50	1.75	1.75	2.00	2.25	2.25	0.71	1.44	2.06
3-month Treasury Bill	1.14	1.21	1.50	1.70	1.70	1.95	2.15	2.15	0.69	1.40	2.00
10-year Bond	2.24	2.28	2.30	2.50	2.60	2.65	2.75	2.80	1.78	2.35	2.70
Canada-U.S. Interest Rate Spreads	(average for the quarter : bps)										
90-day	-44	-66	-53	-54	-71	-68	-60	-60	-26	-55	-64
10-year	-52	-64	-62	-58	-54	-51	-47	-44	-55	-59	-49
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.0	3.7	2.8	2.9	2.7	2.2	2.0	1.8	2.3	2.8	2.5
Consumer Price Index (y/y % chng)	2.3	2.7	2.7	2.5	2.2	2.2	2.2	2.1	2.1	2.5	2.2
Unemployment Rate (percent)	4.1	3.9	3.9 ↑	3.8 ↑	3.7 ↑	3.7 ↑	3.6 ↑	3.6 ↑	4.4	3.9 ↑	3.6 ↑
Housing Starts (mlns : a.r.)	1.32	1.32	1.31	1.28	1.27	1.28	1.28	1.28	1.21	1.31	1.28
Current Account Balance ($blns : a.r.)	-496	-466	-492	-506	-520	-533	-546	-560	-449	-490	-540
Interest Rates	(average for the quarter : %)										
Fed Funds Target Rate	1.46	1.71	1.96	2.21	2.46	2.71	2.88	2.88	1.00	1.83	2.73
3-month Treasury Bill	1.58	1.88	2.05	2.25	2.45	2.65	2.75	2.75	0.95	1.95	2.65
10-year Note	2.76	2.92	2.95	3.05	3.15	3.20	3.20	3.25	2.33	2.90	3.20
EXCHANGE RATES	(average for the quarter)										
US¢/C$	79.1	77.5	76.9	78.1	78.7	79.1	79.5	79.9	77.1	77.9	79.3
C$/US$	1.27	1.29	1.30	1.28	1.27	1.26	1.26	1.25	1.30	1.28	1.26
¥/US$	108	109	109	108	108	107	106	105	112	109	106
US$/Euro	1.23	1.19	1.19 ↑	1.21	1.23	1.23	1.24	1.25	1.13	1.20	1.24
US$/£	1.39	1.36	1.34 ↓	1.36 ↓	1.38 ↓	1.40	1.41	1.43	1.29	1.36 ↓	1.40 ↓

Blocked areas represent BMO Capital Markets forecasts
Up and down arrows indicate changes to the forecast ↑↓
Spreads may differ due to rounding

Canada

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Housing Starts
Tuesday, 8:15 am

June (e)	**210,000 a.r. (+7.4%)**
May	195,613 a.r. (-9.8%)

Building permits are expected to rise 4% in May, reversing the prior month's partially weather-driven decline. Both residential and non-residential permits are expected to climb. June housing starts also look to rebound 7.4% to 210,000 units annualized, after falling below the 200k threshold for the first time in a year. Note that last May saw a similar drop, only to rebound sharply, and we suspect a similar outcome this year. Lastly, new home prices are expected to rise 0.1% in May, slicing the annual rate to 1%, as prices continue to decelerate from the mid-2017 nine-year high.

Building Permits
Tuesday, 8:30 am

May (e)	**+4.0%**
Apr.	-4.6%

New Housing Price Index
Thursday, 8:30 am

May (e)	**+0.1%**	**+1.0% y/y**
Apr.	unch	+1.6% y/y

BoC Policy Announcement and Monetary Policy Report
Wednesday, 10:00 am
Press conference at 11:15 am

See Benjamin Reitzes' Thought on page 4.

Existing Home Sales, MLS Home Price Index
Friday, 9:00 am (expected)

	Existing Home Sales	Average Prices
June (e)	**-10.0% y/y**	**-2.0% y/y**
May	-16.2% y/y	-6.4% y/y
	MLS Home Price Index	
June (e)	**+1.0% y/y**	
May	+1.0% y/y	

After a difficult start to the year, the housing market is showing signs that conditions are broadly stabilizing. Despite the less negative overall picture, the market remains highly segmented. Vancouver (and B.C. in general) continues to struggle, adjusting to the new mortgage regulations and tightened foreign buyer rules. The Prairies are also struggling to gain any traction despite oil prices sitting at very high levels in C$ terms. However, if oil stays here, it's reasonable to expect some improvement through the back half of the year. Toronto is right in the middle, with sales and prices stabilizing after a big early-year pullback. And, Montreal and Ottawa, which have been particularly strong this year, cooled a bit as well in June. Overall, sales are expected to fall 10% y/y, a solid improvement over May. Average prices look to be down 2% y/y (also less bad), while the quality-adjusted MLS HPI is expected to hold steady around 1% y/y, as B.C. weakness offsets Toronto improvement.

United States

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Consumer Prices
Thursday, 8:30 am

June (e)	**+0.2%**	**+2.9% y/y**
Consensus	*+0.2%*	*+2.9% y/y*
May	+0.2%	+2.8% y/y
	Ex. Food & Energy	
June (e)	**+0.2%**	**+2.3% y/y**
Consensus	*+0.2%*	*+2.3% y/y*
May	+0.2%	+2.2% y/y

We look for core CPI to increase 0.2% in June, lifting the annual change a tenth to 2.3% y/y. This will match the fastest pace in 9¾ years; it was 2.5% on September 2008, when Lehman Brothers declared bankruptcy. Core CPI inflation has hit 2.3% six times in the interim (the last time being in January 2017). And, pushing it back to the top of its near-decade-long range should be rents (both actual and owners' equivalent) and medical care costs, along with broad pressure coming from an economy operating at full employment and with no output gap. However U.S. dollar strength should counter some of the pressure by restraining import prices. The broad, trade-weighted dollar index was up 1.6% in June and a cumulative 5.3% since it started appreciating five months ago. Elsewhere, continued modest food price increases should offset a decrease in gasoline prices, resulting in a 0.2% increase in the total CPI. This will also lift headline inflation a tenth to 2.9% y/y, hitting its highest level in 7½ years.

		Jul 6 [1]	Jun 29	Week Ago	4 Weeks Ago	Dec. 31, 2017
					(basis point change)	
Canadian Money Market	Call Money	1.25	1.25	0	0	25
	Prime Rate	3.45	3.45	0	0	25
U.S. Money Market	Fed Funds (effective)	2.00	2.00	0	25	50
	Prime Rate	5.00	5.00	0	25	50
3-Month Rates	Canada	1.21	1.26	-5	-2	15
	United States	1.95	1.91	3	4	57
	Japan	-0.14	-0.14	0	-1	2
	Eurozone	-0.32	-0.32	0	0	1
	United Kingdom	0.71	0.67	4	9	19
	Australia	2.06	2.10	-4	1	28
2-Year Bonds	Canada	1.92	1.91	1	0	24
	United States	2.54	2.53	1	4	66
10-Year Bonds	Canada	2.14	2.17	-3	-18	9
	United States	2.82	2.86	-5	-13	41
	Japan	0.03	0.03	0	-1	-2
	Germany	0.29	0.30	-1	-16	-14
	United Kingdom	1.25	1.28	-3	-14	6
	Australia	2.62	2.63	-1	-15	-1
Risk Indicators	VIX	14.2	16.1	-1.9 pts	2.0 pts	3.2 pts
	TED Spread	39	42	-4	-3	7
	Inv. Grade CDS Spread [2]	67	67	0	0	18
	High Yield CDS Spread [2]	356	357	-1	10	50
					(percent change)	
Currencies	US¢/C$	76.33	76.14	0.2	-1.3	-4.0
	C$/US$	1.310	1.313	—	—	—
	¥/US$	110.44	110.76	-0.3	0.8	-2.0
	US$/€	1.1762	1.1684	0.7	-0.1	-2.0
	US$/£	1.327	1.321	0.5	-1.0	-1.8
	US¢/A$	74.26	74.05	0.3	-2.3	-4.9
Commodities	CRB Futures Index	196.81	200.39	-1.8	-1.6	1.5
	Oil (generic contract)	73.29	74.15	-1.2	11.5	21.3
	Natural Gas (generic contract)	2.84	2.92	-2.8	-1.7	-3.8
	Gold (spot price)	1,256.05	1,253.16	0.2	-3.3	-3.6
Equities	S&P/TSX Composite	16,293	16,278	0.1	0.6	0.5
	S&P 500	2,744	2,718	1.0	-1.2	2.7
	Nasdaq	7,632	7,510	1.6	-0.2	10.6
	Dow Jones Industrial	24,378	24,271	0.4	-3.7	-1.4
	Nikkei	21,788	22,305	-2.3	-4.0	-4.3
	Frankfurt DAX	12,441	12,306	1.1	-2.5	-3.7
	London FT100	7,586	7,637	-0.7	-1.2	-1.3
	France CAC40	5,354	5,324	0.6	-1.8	0.8
	S&P ASX 200	6,272	6,195	1.3	3.8	3.4

[1] = as of 10:30 am [2] = One day delay

Global Calendar
July 9 – July 13

BMO Capital Markets

Japan

Monday July 9

Current Account Surplus
May '18 (e) ¥1.3 trln
May '17 ¥1.7 trln

Bank Lending Ex-Trusts
June
May +1.9% y/y

Wednesday July 11

Producer Price Index

June (e)	**+0.2%**	**+2.8% y/y**
May	+0.6%	+2.7% y/y

Tertiary Industry Index

May (e)	**-0.3%**
Apr.	+1.0%

Friday July 13

Industrial Production

May F (e)	**-0.2%**	**+4.2% y/y**
Apr.	+0.5%	+2.6% y/y

Euro Area

Monday July 9

GERMANY

Trade Surplus
May
Apr. €19.4 bln

Tuesday July 10

GERMANY

ZEW Survey—Expectations

July (e)	**-18.5**
June	-16.1

FRANCE

Industrial Production

May (e)	**+0.7%**	**+0.5% y/y**
Apr.	-0.5%	+2.1% y/y

Manufacturing Production

May (e)	**+0.5%**	**+0.9% y/y**
Apr.	+0.4%	+3.0% y/y

ITALY

Industrial Production

May (e)	**+0.8%**	**+2.7% y/y**
Apr.	-1.2%	+1.9% y/y

Wednesday July 11 – Thursday July 12

GERMANY

NATO Summit July 11-12

Thursday July 12

EURO AREA

Industrial Production

May (e)	**+1.2%**	**+2.3% y/y**
Apr.	-0.9%	+1.7% y/y

ECB Minutes from June 14 meeting

GERMANY

Consumer Price Index

June F (e)	**+0.1%**	**+2.1% y/y**
May	+0.6%	+2.2% y/y

FRANCE

Consumer Price Index

June F (e)	**+0.1%**	**+2.4% y/y**
May	+0.5%	+2.3% y/y

U.K.

Tuesday July 10

	Trade Deficit	Non-EU
May (e)	**£12.0 bln**	**£4.0 bln**
Apr.	£14.0 bln	£5.3 bln

Industrial Production

May (e)	**+0.5%**	**+1.9% y/y**
Apr.	-0.8%	+1.8% y/y

Manufacturing Production

May (e)	**+0.8%**	**+1.9% y/y**
Apr.	-1.4%	+1.4% y/y

Wednesday July 11

BoE Governor Carney speaks in Boston, Massachusetts

Thursday July 12

RICS House Price Balance

June (e)	**-2%**
May	-3%

Other

Monday July 9

CHINA

Foreign Direct Investment [D]
June
May +7.6% y/y

Foreign Reserves [D]

June (e)	**$3.1 trln**
May	$3.1 trln

Aggregate Yuan Financing [D]

June (e)	**1.4 trln**
May	0.8 trln

New Yuan Loans [D]

June (e)	**1.5 trln**
May	1.2 trln

M2 Money Supply [D]

June (e)	**+8.4% y/y**
May	+8.3% y/y

Tuesday July 10

CHINA

	CPI	PPI
June (e)	**+1.9% y/y**	**+4.5% y/y**
May	+1.8% y/y	+4.1% y/y

AUSTRALIA

NAB Business Confidence
June
May 6

Wednesday July 11

AUSTRALIA

Westpac Consumer Confidence
July
June +0.3%

Thursday July 12

CHINA

Trade Surplus [D]

	in USD	in CNY
June (e)	**$27.2 bln**	**182.5 bln**
May	$24.9 bln	156.5 bln

[D] = date approximate

Upcoming Policy Meetings | BoE: Aug. 2, Sep. 13, Nov. 1 | ECB: Sep. 13, Oct. 25, Dec. 13

North American Calendar
July 9 – July 13

BMO Capital Markets®

Canada

Monday July 9

(no releases)

Tuesday July 10

8:15 am — **Housing Starts**
June (e) — **210,000 a.r. (+7.4%)**
May — 195,613 a.r. (-9.8%)

8:30 am — **Building Permits**
May (e) — **+4.0%**
Apr. — -4.6%

10:30 am — 3-, 6- & 12-month bill auction $9.0 bln (new cash $0.4 bln)

Wednesday July 11

10:00 am — **BoC Policy Announcement and Monetary Policy Report; Press Conference at 11:15 am**

Thursday July 12

8:30 am — **New Housing Price Index**
May (e) — **+0.1%** — **+1.0% y/y**
Apr. — unch — +1.6% y/y

2-year bond auction announcement

Friday July 13

9:00 am — **Existing Home Sales**[D] — **Average Prices**
June (e) — **-10.0% y/y** — **-2.0% y/y**
May — -16.2% y/y — -6.4% y/y

9:00 am — **MLS Home Price Index**[D]
June (e) — **+1.0% y/y**
May — +1.0% y/y

United States

Monday July 9

3:00 pm — **Consumer Credit**
May (e) — **+$12.7 bln**
Consensus — *+$12.0 bln*
Apr. — +$9.3 bln

11:00 am — 4-week bill auction announcement

11:30 am — 13- & 26-week bill auction $90 bln

Tuesday July 10

6:00 am — **NFIB Small Business Economic Trends Survey**
June (e) — **106.9 (-0.9 pts)**
Consensus — *105.5 (-2.3 pts)*
May — 107.8 (+3.0 pts)

10:00 am — **Job Openings & Labor Turnover Survey (May)**

11:30 am — 4-week bill auction

1:00 pm — 3-year note auction $33 bln

Wednesday July 11

7:00 am — **MBA Mortgage Apps**
July 6
June 29 — -0.5%

8:30 am — **PPI Final Demand**
June (e) — **+0.2%** — **+3.2% y/y**
Consensus — *+0.2%* — *+3.1% y/y*
May — +0.5% — +3.1% y/y

8:30 am — **PPI Final Demand ex. F&E**
June (e) — **+0.3%** — **+2.6% y/y**
Consensus — *+0.2%* — *+2.6% y/y*
May — +0.3% — +2.4 y/y

10:00 am — **Wholesale Inventories**
May F (e) — **+0.6%**
Apr. — +0.5%

Fed Speaker: New York's Williams (4:30 pm)

1:00 pm — 10[R]-year note auction $22 bln

Thursday July 12

8:30 am — **Initial Claims**
July 7 (e) — **226k (-5k)**[C]
June 30 — 231k (+3k)

8:30 am — **Continuing Claims**
June 30
June 23 — 1,739k (+32k)

8:30 am — **Consumer Prices**
June (e) — **+0.2%** — **+2.9% y/y**
Consensus — *+0.2%* — *+2.9% y/y*
May — +0.2% — +2.8% y/y

8:30 am — **CPI Ex. Food & Energy**
June (e) — **+0.2%** — **+2.3% y/y**
Consensus — *+0.2%* — *+2.3% y/y*
May — +0.2% — +2.2% y/y

2:00 pm — **Budget Balance**
June '18 (e) — **-$80.0 bln**[C]
June '17 — -$90.2 bln

Fed Speakers: Minneapolis' Kashkari (8:30 am); Philadelphia's Harker (12:15 pm)

11:00 am — 13-, 26- & 52-week bill, 10-year TIPS auction announcements

1:00 pm — 30[R]-year bond auction $14 bln

Friday July 13

8:30 am — **Import Prices**
June (e) — **-0.1%** — **+4.5% y/y**
Consensus — *+0.1%* — *+4.7% y/y*
May — +0.6% — +4.3% y/y

10:00 am — **University of Michigan Consumer Sentiment**
July P (e) — **98.2**
Consensus — *98.2*
June — 98.2

11:00 am — **Fed releases Monetary Policy Report to Congress**

Fed Speaker: Atlanta's Bostic (12:30 pm)

[C] = consensus [D] = date approximate [R] = reopening

Upcoming Policy Meetings | Bank of Canada: Sep. 5, Oct. 24, Dec. 5 | FOMC: July 31-Aug. 1, Sep. 25-26, Nov. 7-8

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