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Focus

A weekly financial digest

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August 3, 2018

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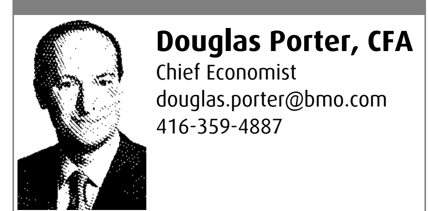

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In a chock-a-block week of economic news, events, and earnings—and yet strangely precious little net move in most markets—the $1 trillion figure rose above the din. In fact, that big round number arguably was the centre-piece of every major economic storyline this week. Here are six of the biggest:

1) As you may have heard, **Apple** rather famously became the first listed company to grip the $1 trillion market-cap handle, with Amazon and Alphabet in hot pursuit (giving a whole new meaning to AAA rating). But while that impressive feat hogged the headlines, perhaps the more pertinent story was the broader strength in U.S. Q2 earnings (well above 20% y/y), and the growing divide with much of the rest of the world (barely above 5% y/y in other developed markets). This wedge partly reflects the impact of U.S. corporate tax relief. But it also **partly reflects the growing divide in underlying economic growth between the U.S. and the rest of the industrialized world.** This week saw more Q2 GDP releases; and, contrary to the U.S. pick-up (to a 2.8% y/y clip), the trend is to slower growth. Prime example: Euro area GDP cooled to a 1.4% a.r. last quarter, shaving the annual gain to 2.1%. Next week's report on Japan is expected to show GDP growth running at less than 1% y/y. Even Canada, which knocked down a hearty 0.5% gain in May and is on track for a 3.3% advance for all of Q2, will see its y/y pace decelerate to around 2.0% (due to even stronger gains a year ago).

2) One of the main reasons that equities barely benefitted from the solid earnings is **gnawing trade war concerns**. After a tantalizing hint of a reprieve, the U.S. quickly reverted to the Bad Cop routine, threatening a painful 25% tariff on $200 billion of imports from China. By week's end, China in turn warned of tariffs up to 25% on $60 billion of U.S. imports, triggering yet another blast of rhetoric from the U.S. side. Not helping matters was the U.S. trade release on Friday—overshadowed by the largely on-consensus employment report—which showed the deficit on goods and services gapping up to $46.3 billion in June, and nudging up to $33.5 billion on goods trade with China alone. The ongoing tensions sent the yuan skidding further to a 14-month low, until the PBoC stepped in late in the week with a 20% reserve requirement on foreign exchange forwards, halting the slide. The currency is still down more than 8% from its April high. The $1 trillion figure involved here? **China's holdings of U.S. Treasuries** stand at a cool $1.176 trillion, and may prove to be the ultimate hammer in a true trade war.

3) Treasuries also went on a small ride to nowhere this week, with **10-year yields** temporarily punching above the 3% level, before receding back to about where they started (2.96%). Yields were given a push last week on speculation that the Bank of Japan was preparing to back off slightly on its ultra-loose policy, but instead they only tweaked policy. Undaunted, yields still forged higher on news that the U.S. Treasury will ramp up H2 borrowing in order to fund **the groaning budget deficit**—which is headed for the $1 trillion mark next year (up from "only" $750 billion in the past 12 months). Yields backed off on Friday amid the non-threatening jobs data (wages steady at 2.7% y/y) and the gathering storm clouds around trade. Notably, Canadian yields held on to increases of 4-5 bps across the curve on the week due to the strong GDP report, surprisingly robust trade results spurring upward growth revisions, and even some chatter of a September rate hike (we're sticking with October).

4) One of the reasons we would stay a tad cautious on the next BoC rate hike is the **ongoing uncertainty around NAFTA**. While Governor Poloz has been extraordinarily clear that policy will be dictated by economic facts and not lurid headlines, it would seem extremely risky to be rushing rate hikes in the face of very real trade threats. This week saw some classic good news/bad news on the NAFTA front, with all reports suggesting a deal on auto content is achingly close. That's the good news. The bad news is that Canada is outside looking in, at this particular part of the deal. It's not entirely clear how important that exclusion really is, and may just be another part of the unusual U.S. negotiating style; moreover, many of the latest U.S. proposals on the auto front for NAFTA could actually be a mild positive for Canada. Meantime, the U.S. continues to suddenly make nice with the EU (at least in relative terms), reducing the risk of broader auto tariffs. Overall **U.S. trade flows with both the EU and with NAFTA partners** are above the $1 trillion mark, although we would note that the gap with Europe is much bigger than with Canada and Mexico combined—for those keeping score at home.

5) Another reason we would argue for some caution on BoC rate hikes is that there are growing **signs that past rate moves are starting to bite**. The 100 bp rise in overnight rates since the start of last July appears to be weighing on spending, housing, and borrowing. The early return for July home sales suggests that activity is still moderating in much of the country from the 1-2 hit of rising mortgage rates and a tighter regulatory backdrop. While Toronto bucked that trend with an 18% y/y rise in sales, this was from very low levels a year ago, and they are still down 30% from two years ago. At the same time, auto sales sagged 3.6% y/y in July and are now down 0.7% so far this year—suggesting Canadian vehicle sales are poised to report their first annual setback this year since 2009. The BoC has often suggested that they are watching with a hawk eye on how sensitive the consumer is to rate hikes. Adding it up, overall household borrowing is showing distinct signs of cooling, easing from a 5.8% clip a year ago to just below 4.1% y/y in June—matching the slowest pace since 2001. Okay, this one is a stretch, but total household borrowing is now up almost One Trillion Canadian Dollars this cycle (to a bit above $2 trillion).

6) Finally, a number of countries have found themselves on the receiving end of U.S. trade threats and/or sanctions recently, and their respective markets have felt the pain. The **latest target is Turkey**, which was hit with sanctions this week after not releasing a U.S. pastor (arrested after the 2016 coup attempt). Already under pressure from President Erdogan's foray into monetary policy advice, the Turkish lira was slammed some more this week. The cost of the U.S. dollar jumped almost 5% from last Friday alone to 5.07 lira; in perspective, the currency was barely above par as recently as a decade ago. It's now depreciated more than 30% in the past year alone, rivalling Argentina for the weakest major currency in the world. As a result, Turkey has seen its **nominal GDP sag in U.S. dollar terms** from a peak five years ago of nearly $1 trillion to below $900 billion now, even with robust volume growth.

One notable feature in July payrolls was that U.S. factories added a cool 37,000 jobs, the 11th time in 12 months with a gain of at least 20,000. In the past year, U.S. manufacturing jobs are now up 327,000 or more than 2.6% y/y. That's the largest yearly percent gain in factory payrolls since the boom year of 1984.

There has been a lot of inflation since 1967—the year that Dr. Evil was reportedly frozen, along with Austin Powers. But, even accounting for the average 4.0%

U.S. CPI inflation rate over that period of 51 years, that would still mean that prices are up "just" a bit more than 7.5 times over that stretch. In other words, even now his One Million Dollar demand would be just $7.51 million in today's dollars—arguably a still laughably low figure to ransom the world. Keeping the demand steady as a share of U.S. national income would still produce a figure a bit below $24 million in today's dollars, or less than what last night's starting pitcher for the Seattle Mariners (Felix Hernandez) makes in a year. Think bigger, Dr. Evil.

Thoughts on a "Terrific" Quarter

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The President was right: Q2 was a *"terrific"* quarter. But the question is whether the burst of activity, the most in nearly four years, has legs, or whether it will die out when the fiscal fillip fades? We lean toward the latter outcome given usual late-cycle restraints, in particular higher rates and scarcer labour. Still, we are keeping an open mind in the event that productivity improves.

One view that most economists, including us, can agree on (according to Consensus Economics) is that growth will remain solid at a shade below **3% in the second half of the year.** This implies little slowing from the 3.1% average in the first half, and a pace that is well above potential, pegged at 1.8% by the FOMC. The rosy outlook is reinforced by positive trends in three areas: investment, savings and income.

First, sparked by tax cuts and full expensing, business investment is simply on fire with no signs of flaming out. While a good chunk of the double-digit advance in structures spending in the first half of the year can be laid at the doorstep of the oil boom, spending on IT gear and software also gushed higher. Nonresidential investment rose 6.7% y/y in H1, while spending on information processing equipment jumped 11.2% and software purchases vaulted 9.0%. Upward trending core capital goods orders (7.8% y/y in June) flags continued capex strength ahead.

Second, the personal savings rate was revised sharply higher to 7.0% in the first half of the year from the low-3s. It even picked up from last year (6.7%), suggesting households banked some of the tax cuts, which should support spending in the second half.

Third, personal disposable incomes are rising the fastest in three years, up 5.1% y/y in Q2. Sure, tax cuts are a factor, but wages and salaries rose 4.9% y/y, matching the best gain in nearly three years. Amid improving job prospects—including for part-timers and discouraged workers as the more comprehensive U6 rate mines 17-year lows of 7.5%—wages can only head higher, supporting spending.

True, the **third quarter is off to a so-so start** due to some slippage in payrolls, work hours, autos and the ISMs in July. However, it's early days; and, barring an escalation in the trade war, we remain comfortable with our call for 2.8% growth, followed by 2.9% in Q4.

If we are right, the U.S. economy will have grown at an average rate of 2.9% between Donald Trump's first full quarter in office and the end of this year, just a tad shy of the trumpeted 3% or better claim. But this pace won't last next year unless productivity picks up or Congress digs a deeper hole in the budget balance. Most economists can also agree that only the former is sustainable in the long run.

Don't Get Too Excited on Canada

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We're two-thirds through second quarter data and GDP growth is looking good. That's particularly true compared to the 1.6% average growth rate of the prior three quarters. The 0.5% surge in May GDP and Friday's strong trade figures put Q2 on pace for above 3% growth even if June is merely flat. (The Q2 report is out August 30.) The solid May was broad-based, but there were some one-time factors. Most notably, a number of sectors rebounded from the terrible weather that weighed heavily on April. There was also a big increase in oil & gas production, which has its limits. Indeed, the Syncrude shutdown in mid-June will hit the sector hard as it accounts for about 10% of total crude production. We'll see a further negative impact in July with just about 1/3 of production restarted, while there should be some positive offsets in August and September. That suggests **monthly GDP will struggle in June and July** after the huge May. Also note that the seasonality around July employment, out next Friday, is quite negative (see Key for Next Week on page 12).

The potential bad news flow is set to arrive just as markets are finally pricing in higher odds of Bank of Canada rate hikes. We continue to expect the next rate hike will come in October, assuming nothing negative develops on trade. It's possible that a very solid Q2 GDP print (we're at 3.3% versus the BoC's 2.8%) could spark speculation of a September move, but Governor Poloz has emphasized gradual hikes and back-to-back moves would not be gradual. Memories of last September's hike might suggest otherwise, but that was a different dynamic as the Bank was still undoing the 50 bps in emergency cuts from 2015. Never say never, but September would take a strong run of data and probably positive NAFTA news as well.

On the NAFTA front, it seems like there is progress at last. When talks stalled in early summer, it was U.S./Mexico disagreements about autos and wages that held things up. The new Mexican administration appears to be more amenable to pushing wages higher, making a breakthrough on that front possible. Canada being left out of the discussion makes for great headlines, but there's little for Canada to do on this front. We're largely on board with the U.S. on autos and improving competitiveness relative to Mexico. If Canada is left out of talks after the auto issues are solved, then there might be something deeper going on. But until then, ignore the dire headlines.

Key Takeaway: The Canadian economy remains in decent shape, with underlying growth trending around the 2% mark. For better or worse, there's nothing exciting at the moment, despite the big moves in rates. The backdrop hasn't fundamentally changed, even if Q2 GDP growth looks like it will have a 3-handle. Barring another surprisingly strong month of data, look for the BoC to remain patient and wait until October for their next hike. *B.A.A.R.*

"Calm Down": Central Banks Aren't Making Drastic Changes

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It's been a very active week for central bankers. In a nutshell, tucked in the "We'll take a pass this time!" corner were the FOMC, the BoJ, Brazil and Mexico. In the "We'd like to tighten!" corner was the RBI and BoE. But each central bank had some unique intentions behind their decision, and some sort of plan in the works. Let's focus specifically on the BoJ and the BoE:

The **BoJ** continues to push its massive easing program, and throws out all expectations for any changes to policy. After all, inflation remains stubbornly low at 0.7% (down from nearly 1% earlier this year), and the central bank won't even put a timeframe on when it expects the 2% target to be reached. It only admitted that *"it will take more time than expected"*. Forward guidance was also used this week—rates would stay *"very low"* for an *"extended period of time"*. However, some hope was raised that tweaks would eventually be made. After all, the BoJ said some deviation for yields would be tolerated: 10-year yields can fluctuate as much as 0.2% from the 0% target, compared to 0.1% moves previously. More flexibility is not a bad thing. But later in the week, the BoJ stepped in and bought 5-to-10 year bonds to stem some of the increase in yields. Um, what happened to that flexibility? The **BoJ will keep rates low for a very long time.**

The **BoE** raised rates 25 bps to 0.75% on Thursday, to the surprise of almost no one. What did come as a shock was the vote itself. All nine members of the Committee raised their hand when asked "Who's down for a rate hike today?" That is a huge difference from the 2-to-3 members who've pushed for a rate hike for the last four meetings. The other six changed their vote as, given the *"luxury"* of time, it was confirmed that the Q1 softness was temporary. Although GDP growth projections were little-changed, inflation forecasts were raised moderately for 2018 and 2019. In fact, CPI is expected to stay over the 2% target over the 3-year forecast period before settling in on target at the end of 2020. Given the vote and the new forecasts, it seemed that, barring some big setback in economic activity and the Brexit process, the BoE may actually hike again, possibly in November! Besides, Governor Carney said it would be a *"mistake to wait, wait, wait for perfect certainty"* on Brexit as they don't know when that higher degree of certainty will transpire. Then, 3½ hours later, the Governor gave a little more clarification to Mr. Market via the BBC. In a nutshell, he said *"If you take what financial markets think which is about one interest rate increase a year of a quarter of a percent per year for the next few years, you more or less get inflation back to target over the right horizon… It's actually a little too little but not much too little. If people want a rule of thumb for now I would use that with the caveat… (that) it will depend on what happens with the Brexit discussions."* Ok then. **We will stick to our call that the BoE will next raise rates in May 2019.** JLee

Supply and Demands: Assessing U.S. Auto Market Security

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Hopes are high that the threat of a tariff war on autos is subsiding after last week's rapprochement between the U.S. and the EU on trade. However, the Department of Commerce's investigation into the automotive industry will still continue as the negotiations take place, casting a shadow on the talks as well as presenting a real and present threat to ongoing NAFTA negotiations. For a quick refresher, the Department of Commerce launched an investigation into Section 232 of the Trade Expansion Act of 1962 to impose tariffs of up to 25% on imported vehicles and parts in May. Although Section 232 relates to threats to national security, the definition is rather vague, allowing for the investigation to instead focus on "*whether*

the decline of domestic automobile and automotive parts production threatens to weaken the internal economy of the United States."

Under this lens, it's relevant to **consider what may happen to the American worker and the broader economy if import volumes were stressed**. We use an extreme example, where all imports, including those from NAFTA partners, cease to flow to the U.S. Under such a scenario, the U.S. market would see domestic supply cut to roughly 12 million new vehicles per year with U.S. plants ramping up to full capacity and halting exports; well below the current selling rate of just under 17 million units. Would the American economy be able to function under such a scenario? The evidence suggests that yes, it could.

Our first assumption is that no **new domestic plants can come online for 4 years** (the length of a very long international conflict or impasse), as it takes at least 2.5 years for a greenfield auto plant to begin production after planning, design and a site selection. Second, we assume that the **scrappage rate** (the percentage of the domestic vehicle fleet taken off the road each year) **edges up to 5.0%**. This is a fairly conservative assumption, as a shortage of new vehicles would surely compel many Americans to keep their cars running longer. Finally, we use population estimates from the Census Bureau to forecast the number of driving-age individuals in the United States.

Under such conditions, the **vehicle ownership rate** (measured as registered vehicles per driving-age American) **would decline from an estimated level of 1.05 in 2018** (an all-time high) **to 0.99 over the four-year forecast horizon**, after which new production would be ready to come online. For context, this would entail an ownership rate marginally below what was observed from 2011-2013 and roughly in line with 2003's figure. While both of these periods were post-recession recovery phases, it could hardly be said that productivity was gridlocked by a shortage of vehicles at any point. Disregarding the broader economic effects (a large loss in consumer surplus due to price increases and decreased selection would be largely offset by a decline in the trade deficit), a far-fetched scenario in which the domestic market is deprived of all imports would not result in a major interruption of the daily functions of most American workers.

Bottom Line: Understanding that the definition of Section 232 can be significantly broad (the Commerce Department has pinpointed technology as a concern, despite the U.S. being a clear leader), America has sufficient capacity to bridge a prolonged interruption in foreign vehicle supply.

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	Good News	Bad News
Canada ▪ BMO Q2 GDP forecast upgraded to 3.3% on solid data	**Real GDP at Basic Prices** +0.5% (May) **Merchandise Trade Deficit** shrank to $626 mln (June)—smallest since January 2017 **Industrial Product Prices** +0.5%; **Raw Material Prices** +0.5% (June)	**Auto Sales** -3.6% y/y (July) **Manufacturing PMI** -0.2 pts to 56.9 (July) **Conference Board's Consumer Confidence Index** -0.1 pts to 116.2 (July)
United States ▪ FOMC on hold, but upbeat… sets stage for September hike ▪ White House threatens to raise tariffs on Chinese imports to 25% from 10% ▪ Government shutdown fears resurface	**Nonfarm Payrolls** +157,000 (July)—upward revisions of 59,000 in prior two months **Jobless Rate** -0.1 ppts to 3.9% (July) **Average Hourly Earnings** +0.3% (July) **Real Personal Spending** +0.3% (June)—supported by 0.4% rise in **incomes** **Core PCE Price Index** steady at +1.9% y/y (June) **Pending Home Sales** +0.9% (June) **S&P Case-Shiller Home Prices** +6.5% y/y (May) **Conference Board's Consumer Confidence Index** +0.3 pts to 127.4 (July) **Employment Cost Index** +0.6% q/q (Q2) **Continuing Claims** -23k to 1,724k (July 21 week)	**Goods & Services Trade Deficit** widened to $46.3 bln (June) **Construction Spending** -1.1% (June) **Core Durable Goods Orders** revised down to +0.2% (June)—initially reported as +0.6% **Manufacturing ISM** -2.1 pts to a 3-month low 58.1; **Nonmanufacturing ISM** -3.4 pts to 55.7 (July) **Auto Sales** slowed to 16.77 mln a.r. (July)
Japan ▪ BoJ on hold, but indicates more flexibility on 10-year yields	**Retail Sales** +1.5% (June)	**Services PMI** -0.1 pts to 51.3; **Composite PMI** -0.3 pts to 51.8 (July) **Industrial Production** -2.1% (June P) **Jobless Rate** +0.2 ppts to 2.4% (June)
Europe ▪ BoE unanimously votes to raise rates 25 bps to 0.75% ▪ Governor Carney tells BBC that one rate hike per year is a good rule of thumb	**Euro Area—Consumer Prices** +2.1% y/y (July A)—fastest in five years **Euro Area—Jobless Rate** steady at 8.3% (June) **Euro Area—Retail Sales** +0.3% (June) **Germany—Retail Sales** +1.2% (June) **Germany—Jobless Rate** unch at 5.2% (July) **France—Jobless Rate** unch at 9.2% (June) **Italy—Industrial Production** +0.5% (June) **U.K.—Construction PMI** +2.7 pts to 14-month high 55.8 (July)	**Euro Area—Real GDP** slowed +0.3% q/q (Q2 A) **Euro Area—Economic Confidence** slid to 112.1 (July) **Italy—Real GDP** +0.2% q/q (Q2 P) **Italy—Jobless Rate** +0.2 ppts to 10.9% (June P) **Italy—Retail Sales** -0.2% (June) **U.K.—Manufacturing PMI** -0.3 pts to 54.0; **Services PMI** -1.6 pts to 3-month low 53.5; **Composite PMI** -1.6 pts to 53.6 (July) **U.K.—GfK Consumer Confidence** -1 pt to -10 (July)
Other ▪ China threatens tariffs on $60 bln of U.S. imports subject to U.S. actions; PBoC lifts RRR for banks selling offshore forward CNY positions ▪ RBI +25 bps to 6.5% ▪ Mexico and Brazil on hold	**Australia—Trade Surplus** rose to A$1.9 bln (June) **Australia—Retail Sales** +0.4% (June) **Australia—Building Approvals** +6.4% (June)	**China—Manufacturing PMI** -0.3 pts to 51.2; **Non-manufacturing PMI** -1.0 pts to 54.0; **Composite PMI** -0.8 pts to 53.6 (July) **China—Caixin Manufacturing PMI** -0.2 pts to 50.8; **Services PMI** -1.1 pts to 4-month low 52.8; **Composite PMI** -0.7 pts to 52.3 (July) **Mexico—Real GDP** -0.1% q/q (Q2 P)

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

U.S. Regional Economy:
A Western Swath of Strength

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The U.S. economy expanded at a 4.1% annual rate in 2018Q2, the strongest gain in nearly four years, as federal fiscal stimulus started to kick in. With such vigour at the national level, we again ask the question: What's the state of the states? Before answering, keep in mind that the economy's current major tailwind—fiscal policy—and current minor (but could become major) headwind—trade policy—will impact individual states differentially. Although the benefits of federal fiscal stimulus are ubiquitous, some states will reap proportionately more than others given, for example, their relative exposure to business equipment manufacturing that is benefitting from corporate tax cuts (and late-cycle capacity constraints), or companies with federal contracts. By the same token, although the costs of trade restrictions are also ubiquitous, some states stand to be hit proportionately harder given their relative export exposure. Consequently, comparative state economic performance is currently in a state of flux.

Nevertheless, on the ground now, our State Economic Scorecard reveals a swath of economic strength stretching from Washington to Texas (*Chart 1, next page*). In our ranking of overall economic performance[1] (*Table 1*), 10 of the 12 states in the top quartile are found in the western half of the continent. Indeed, the U.S. economy is on a Rocky Mountain high, with Utah sitting at the top of the table, followed by Idaho and Colorado (and Wyoming coming in at #7). The Southeast is the most eclectic region, home to the remaining states in the top quartile (Florida and Tennessee), but also home to a cluster of states in the bottom quartile (Mississippi, Alabama and Louisiana). Another cluster in the bottom quartile is the contiguous grouping of New York, New Jersey, Connecticut, Vermont and Delaware. The Midwest is awash with rankings in the two middle quartiles, apart from Illinois at the bottom and Nebraska at the top.

Looking at the categories that comprise our ranking, the business conditions metric has the largest weight, with state GDP growth one of its major elements (the others are the growth rates of population, the Coincident Economic Activity Index, and nominal exports). Note that state GDP is calculated on an industry basis, which can often paint an incomplete picture of a sub-national or regional economy. This is why we don't use GDP as the sole barometer of

Table 1
State Economic Scorecard Summary

(as of August 3, 2018)

State	Rank	Business Conditions	Labour Market	Housing Market	State Finances
Weight:		35%	30%	20%	15%
Utah	**1**	4	3	3	4
Idaho	**2**	7	1	1	7
Colorado	**3**	1	2	4	14
Nevada	**4**	6	15	2	15
Texas	**5**	5	5	10	16
Washington	**6**	2	9	5	32
Wyoming	**7**	13	7	33	1
Florida	**8**	15	6	15	6
Arizona	**9**	3	19	8	42
Tennessee	**10**	14	11	9	10
Nebraska	**11**	28	18	11	5
Oregon	**12**	8	25	25	20
North Carolina	**13**	16	12	14	22
California	**14**	21	24	6	37
Georgia	**15**	22	20	12	24
Rhode Island	**16**	12	23	18	36
Wisconsin	**17**	27	14	16	27
Virginia	**18**	17	13	39	18
South Carolina	**19**	20	22	23	30
South Dakota	**20**	37	26	27	3
Michigan	**21**	9	40	19	29
Montana	**22**	26	31	21	11
Missouri	**23**	19	28	28	13
New Hampshire	**24**	29	21	22	19
Kansas	**25**	42	8	24	25
Indiana	**26**	31	30	17	17
Minnesota	**27**	46	29	7	12
Maryland	**28**	10	43	35	35
Ohio	**29**	30	37	20	26
Massachusetts	**30**	32	17	31	43
West Virginia	**31**	18	41	29	41
Maine	**32**	40	10	40	34
Hawaii	**33**	50	4	42	23
Iowa	**34**	49	16	30	21
Pennsylvania	**35**	24	34	43	44
Kentucky	**36**	33	49	13	49
Arkansas	**37**	34	38	37	38
Oklahoma	**38**	39	27	48	8
North Dakota	**39**	35	42	50	2
Louisiana	**40**	38	32	41	48
Alabama	**41**	48	33	32	31
Delaware	**42**	44	36	36	33
Illinois	**43**	36	39	38	47
Vermont	**44**	41	35	44	28
Connecticut	**45**	23	47	49	40
New Jersey	**46**	25	44	47	50
Mississippi	**47**	43	48	34	45
Alaska	**48**	11	50	26	9
New York	**49**	45	45	45	39
New Mexico	**50**	47	46	46	46

[1] State rankings are derived from the weighted average number of standard deviations away from the 50-state average, across four indicators in each of four categories. For the complete report, see State Economic Scorecard, https://economics.bmocapitalmarkets.com/economics/score/20180803/sr201808.pdf.

state economic conditions (besides, the vast majority of the other indicators we track are more timely).

In 2018Q1, real GDP growth was positive for all 50 states, ranging from 4.9% y/y in Wyoming to 0.4% y/y in Minnesota (the comparable U.S. figure was 2.6% y/y). Note that fastest-growing Wyoming scored 7th in overall economic performance, partly owing to a poorly ranked housing market. Slowest-growing Minnesota scored 27th, reflecting relatively high rankings for its housing market and state finances. Utah was #1 in overall economic performance, despite sporting the 7th fastest-growing GDP, because of its high-ranked labour and housing markets, and state finances. It's interesting that, despite some dissimilarity between rankings of overall economic performance and GDP growth, the theme revealed in the former is also revealed in the latter. For example, the 10 fastest-growing states corroborate the western swath of strength running from Washington to Texas, and led by the Rocky Mountain region (*Chart 2*).

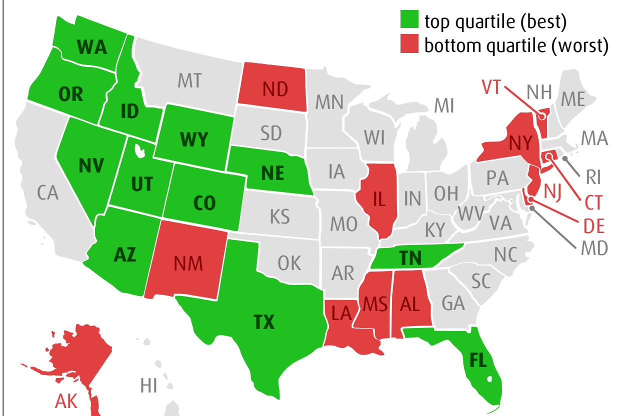
The labour market metric has the second largest weight in our scoring, with the jobless rate and increase in nonfarm payrolls two major elements (the others are the growth in average weekly earnings and hours). While U.S. labour market conditions were strong in June (jobless rate 4.0%, payrolls 1.7% y/y), they were uneven across the nation. The growth in nonfarm payrolls ranged from 3.0% y/y in Utah and Idaho to a contraction of 1.0% in Alaska (North Dakota was also in the red). Again, the 10 fastest-growing job markets corroborate the western swath of strength, although North Carolina and Florida managed to crack the top 10 (*Chart 3*).

Meantime, unemployment rates ranged from a low of 2.1% in Hawaii to a high of 7.1% in Alaska. In total, 16 states fell below the U.S. figure and six were higher (the remaining 28 were at, or relatively close to, the national average). Interestingly, the six states with statistically higher jobless rates also included Arizona, Nevada, and Washington (all at 4.7%). Job gains in these hot economies are simply not keeping up with even stronger labour force gains.

Looking at employment on a sectoral basis, manufacturing picked up everywhere in the past year except in New York, Kentucky and Vermont. American factories are benefitting as business investment is improving, reflecting the rebound in oil- and agriculture-related capex along with the response to late-cycle capacity constraints; and, of course, tax cuts. Meanwhile, record oil production provided a boost for mining jobs too—a stark turnaround from early last year. And, after one of the toughest years, ever, for U.S. brick and mortar retailers, jobs in this sector are beginning to see a mild pickup, although not in all states.

Chart 1

Overall State Economic Performance



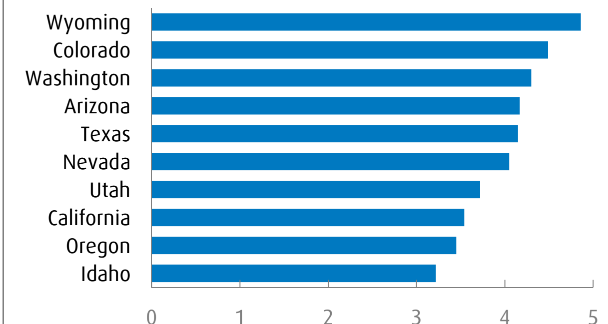
Sources: BMO Economics, Haver Analytics

Chart 2

Rocky Mountain High

2018:Q1 (y/y % chng : s.a.)

Real GDP — Top 10 States



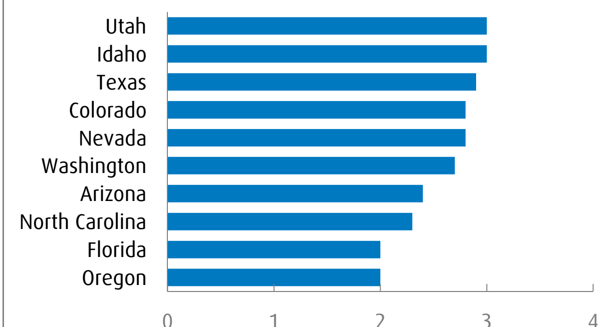
Sources: BMO Economics, Haver Analytics

Chart 3

West is the Best for Job Growth

June 2018 (y/y % chng : s.a.)

Nonfarm Employment — Top 10 States



Sources: BMO Economics, Haver Analytics

Economic Forecast Summary for August 3, 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	3.3 ↑	1.3 ↓	2.2	1.8	1.7	1.7	1.6	3.0	2.0 ↑	1.8
Consumer Price Index (y/y % chng)	2.1	2.3	2.3	2.1	1.8	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.)	225	219	210	208	208	207	204	200	220	215	205
Current Account Balance ($blns : a.r.)	-78.0	-62.5 ↑	-64.3 ↑	-63.2 ↑	-62.8 ↑	-62.9 ↑	-63.1 ↑	-63.2 ↑	-63.3	-67.0 ↑	-63.0 ↑
Interest Rates	(average for the quarter : %)										
Overnight Rate	1.25	1.25	1.50	1.75	1.75	2.00	2.25	2.25	0.71	1.44	2.06
3-month Treasury Bill	1.14	1.21	1.45	1.70	1.70	1.95	2.15	2.15	0.69	1.35	2.00
10-year Bond	2.24	2.28	2.35 ↑	2.50 ↑	2.60 ↑	2.65	2.75 ↑	2.80	1.78	2.35 ↑	2.70 ↑
Canada-U.S. Interest Rate Spreads	(average for the quarter : bps)										
90-day	-44	-66	-62 ↓	-59 ↓	-74 ↓	-70 ↓	-60	-60	-26	-58 ↓	-66
10-year	-52	-64	-64 ↑	-58 ↑	-55 ↑	-51 ↑	-47 ↑	-44 ↑	-55	-60 ↑	-49 ↑
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	4.1	2.8	2.9	2.6	2.2	2.0	1.8	2.2	2.8	2.5
Consumer Price Index (y/y % chng)	2.3	2.6	2.7	2.4	2.2	2.2	2.2	2.1	2.1	2.5	2.2
Unemployment Rate (percent)	4.1	3.9	3.8 ↓	3.7 ↓	3.7	3.6 ↓	3.6	3.5 ↓	4.4	3.9	3.6
Housing Starts (mlns : a.r.)	1.32	1.26	1.29	1.28	1.27	1.28	1.28	1.28	1.21	1.29	1.28
Current Account Balance ($blns : a.r.)	-496	-391	-448	-467	-476	-488	-502	-514	-449	-450	-495
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	2.10 ↑	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	3.10 ↑	3.15	3.20	3.20	3.25	2.33	2.95 ↑	3.20
EXCHANGE RATES	(average for the quarter)										
US¢/C$	79.1	77.5	76.6 ↓	78.0 ↓	78.7	79.1	79.5	79.9	77.1	77.8 ↓	79.3
C$/US$	1.27	1.29	1.31 ↑	1.28	1.27	1.26	1.26	1.25	1.30	1.29 ↑	1.26
¥/US$	108	109	111 ↑	110 ↑	110 ↑	109 ↑	109 ↑	108 ↑	112	110 ↑	109 ↑
US$/Euro	1.23	1.19	1.17 ↓	1.18 ↓	1.18 ↓	1.20 ↓	1.22 ↓	1.24 ↓	1.13	1.19 ↓	1.21 ↓
US$/£	1.39	1.36	1.31 ↓	1.29 ↓	1.26 ↓	1.30 ↓	1.34 ↓	1.39 ↓	1.29	1.34 ↓	1.32 ↓

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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Building Permits
Wednesday, 8:30 am

June (e)	**-2.0%**
May	+4.7%

Housing Starts
Thursday, 8:15 am

July (e)	**215,000 a.r. (-13.4%)**
June	248,138 a.r. (+28.0%)

New Housing Price Index
Thursday, 8:30 am

June (e)	**unch**	**+0.7% y/y**
May	unch	+0.9% y/y

Building permits are expected to fall 2% in June, continuing the up-down monthly pattern in place this year. After a strong residential gain in May, some pullback is expected, while non-residential permits have room to climb after falling in three of the prior four months. Housing starts look to slide 13.4% to 215,000 units annualized, retracing much of June's massive and temporary surge. Lastly, new home prices are expected to be flat in June, trimming the annual rate another couple of ticks to 0.7%, as prices continue to decelerate from mid-2017's nine-year high.

Employment
Friday, 8:30 am

July (e)	**+5,000 (+0.03%)**
June	+31,800 (+0.2%)
	Unemployment Rate
July (e)	**6.0%**
June	6.0%
	Average Hourly Wages
July (e)	**+3.6% y/y**
June	+3.6% y/y

Employment is expected to rise a modest 5,000 in July, consistent with historical weakness in the month. July has tended to see a chunky drop in education, which is later revised away, but that hasn't stopped the initial print from being soft. Indeed, July employment has come in below expectations in 15 of the past 18 years. That's by far the worst for any month. Indeed, our call is driven entirely by this seeming seasonality issue and does NOT reflect underlying economic fundamentals. Moreover, given that job growth was actually negative through the first six months of 2018, there's likely room for positive surprises in the back half of the year. Assuming July is a dud as usual, don't be shocked if the rest of the year is abnormally strong. Moving back to July, look for goods-producing sectors to be more subdued after a huge June. And, services are expected to recover after June's pullback. Despite our call for a tiny headline gain, the jobless rate looks to hold steady and a decline wouldn't be shocking after June's two-notch increase. The labour force saw its biggest gain in over six years last month, which could mean some softer months ahead. Wage growth looks to hold steady at 3.6%, though there's some upside risk here as the labour market continues to tighten.

United States

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Consumer Prices
Friday, 8:30 am

July (e)	**+0.2%**	**+3.0% y/y**
Consensus	*+0.2%*	*+3.0% y/y*
June	+0.1%	+2.9% y/y
	Ex. Food & Energy	
July (e)	**+0.2%**	**+2.3% y/y**
Consensus	*+0.2%*	*+2.3% y/y*
June	+0.2%	+2.3% y/y

Inflation is drifting higher in response to labour shortages, tariffs and rising fuel costs. The annual CPI hit a 6½-year high in June, and looks to nudge up to 3.0% in July. The core rate should stay at 2.3%, matching earlier peaks reached in the past decade (rounded to one decimal place). Core prices likely rose 0.2% m/m assuming some reversal in June's sharp drop in clothing prices and record decline in hotel rates (thanks Airbnb). Providing a booster shot, hospital service fees are running near 5% y/y due to higher costs of serving more uninsured patients. Steel and aluminum tariffs are also starting to grease new vehicle prices, which rose for a second straight month after backtracking last year. Laundry equipment prices have also been put through the tariff wringer, jumping 20% in the past three months due to a hefty duty on washing machines. Despite the upward drift in core inflation in the past year, some recent deceleration is notable, with the annualized rate slowing to 1.7% in the past three months from 2.9% in the prior three. Still, barring a downside miss, the CPI report should keep the Fed eyeing another rate hike in September given the *"strong"* economy and labour market conditions.

		Aug 3 [1]	Jul 27	Week Ago	4 Weeks Ago	Dec. 31, 2017
					(basis point change)	
Canadian Money Market	Call Money	1.50	1.50	0	25	50
	Prime Rate	3.70	3.70	0	25	50
U.S. Money Market	Fed Funds (effective)	2.00	2.00	0	0	50
	Prime Rate	5.00	5.00	0	0	50
3-Month Rates	Canada	1.45	1.41	4	17	39
	United States	2.00	1.98	2	6	62
	Japan	-0.17	-0.16	-1	-3	-1
	Eurozone	-0.32	-0.32	0	0	1
	United Kingdom	0.81	0.79	2	10	29
	Australia	1.97	1.96	1	-9	19
2-Year Bonds	Canada	2.10	2.06	4	19	41
	United States	2.67	2.67	0	13	78
10-Year Bonds	Canada	2.35	2.29	6	22	31
	United States	2.98	2.96	2	15	57
	Japan	0.10	0.10	0	8	6
	Germany	0.41	0.40	1	12	-1
	United Kingdom	1.36	1.28	8	10	17
	Australia	2.73	2.64	8	10	10
Risk Indicators	VIX	12.0	13.0	-1.0 pts	-1.3 pts	1.0 pts
	TED Spread	34	36	-2	-5	3
	Inv. Grade CDS Spread [2]	59	59	0	-6	10
	High Yield CDS Spread [2]	329	332	-3	-18	22
					(percent change)	
Currencies	US¢/C$	77.02	76.60	0.6	0.8	-3.2
	C$/US$	1.298	1.306	—	—	—
	¥/US$	111.23	111.05	0.2	0.7	-1.3
	US$/€	1.1578	1.1657	-0.7	-1.4	-3.6
	US$/£	1.300	1.311	-0.8	-2.1	-3.8
	US¢/A$	73.96	74.00	-0.1	-0.5	-5.3
Commodities	CRB Futures Index	193.23	194.16	-0.5	-2.4	-0.3
	Oil (generic contract)	68.62	68.69	-0.1	-7.0	13.6
	Natural Gas (generic contract)	2.85	2.78	2.4	-0.3	-3.5
	Gold (spot price)	1,218.40	1,223.26	-0.4	-2.9	-6.5
Equities	S&P/TSX Composite	16,392	16,394	0.0	0.1	1.1
	S&P 500	2,831	2,819	0.4	2.6	5.9
	Nasdaq	7,810	7,737	0.9	1.6	13.1
	Dow Jones Industrial	25,388	25,451	-0.2	3.8	2.7
	Nikkei	22,525	22,713	-0.8	3.4	-1.1
	Frankfurt DAX	12,599	12,860	-2.0	0.8	-2.5
	London FT100	7,643	7,701	-0.8	0.3	-0.6
	France CAC40	5,471	5,512	-0.7	1.8	3.0
	S&P ASX 200	6,235	6,300	-1.0	-0.6	2.8

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

Global Calendar
August 6 – August 10

BMO Capital Markets®

Japan

Tuesday August 7
Household Spending
June (e) -1.3% y/y
May -3.9% y/y

Wednesday August 8
Bank Lending Ex. Trusts
July
June +2.1% y/y

Current Account Surplus
June '18 (e) ¥1.2 trln
June '17 ¥0.9 trln

BoJ Summary of Opinions from July 30-31 meeting

Thursday August 9
Machine Tool Orders
July P
June +11.4% y/y

Friday August 10
Real GDP
Q2 P (e) +0.3% +0.9% y/y
Q1 -0.2% +1.1% y/y

Tertiary Index
June (e) -0.3%
May +0.1%

Euro Area

Monday August 6
GERMANY
Factory Orders
June (e) -0.4% +3.4% y/y
May +2.6% +4.4% y/y

Tuesday August 7
GERMANY
Trade Surplus
June
May €20.3 bln

Industrial Production
June (e) -0.5% +3.0% y/y
May +2.6% +3.1% y/y

FRANCE
Trade Deficit
June (e) €5.6 bln
May €6.0 bln

Friday August 10
FRANCE
Industrial Production
June (e) +0.5% +1.5% y/y
May -0.2% -0.9% y/y

Manufacturing Production
June (e) +0.5% +0.3% y/y
May -0.6% -0.7% y/y

ITALY
Trade Surplus
June
May €3.4 bln

U.K.

Wednesday August 8
RICS House Price Balance
July P (e) +3%
June +2%

Friday August 10
Real GDP
Q2 P (e) +0.4% +1.3% y/y
Q1 +0.2% +1.2% y/y

Monthly Real GDP 3m/3m
June (e) +0.2% n.a.
May +0.3% +0.2%

Industrial Production
June (e) +0.4% +0.7% y/y
May -0.4% +0.8% y/y

Manufacturing Production
June (e) +0.3% +1.0% y/y
May +0.4% +1.1% y/y

Trade Deficit Non-EU
June (e) £12.5 bln £3.6 bln
May £12.4 bln £3.5 bln

Other

Monday August 6
CHINA
Foreign Reserves [D]
July (e) $3.1 trln
June $3.1 trln

Tuesday August 7
CHINA
Trade Surplus [D]
in USD in CNY
July (e) $39.1 bln n.a.
June $41.5 bln 262 bln

Foreign Direct Investment [D]
July
June +0.3% y/y

AUSTRALIA
RBA Monetary Policy Meeting

Thursday August 9
CHINA
CPI PPI
July (e) +2.0% y/y +4.5% y/y
June +1.9% y/y +4.7% y/y

Aggregate Yuan Financing [D]
July (e) 1.10 trln
June 1.18 trln

New Yuan Loans [D]
July (e) 1.20 trln
June 1.84 trln

M2 Money Supply [D]
July (e) +8.2% y/y
June +8.0% y/y

NEW ZEALAND
RBNZ Monetary Policy Meeting

Friday August 10
AUSTRALIA
RBA Statement on Monetary Policy

RUSSIA
Real GDP [D]
Q2 A (e) +1.8% y/y
Q1 +1.3% y/y

[D] = date approximate

Upcoming Policy Meetings | BoE: Sep. 13, Nov. 1, Dec. 20 | ECB: Sep. 13, Oct. 25, Dec. 13

North American Calendar
August 6 – August 10

BMO Capital Markets®

Canada

Monday August 6

Civic Holiday (markets closed)

Tuesday August 7

10:00 am	**Ivey Purchasing Managers' Index (s.a.)**
July	
June	63.1

10:30 am — 3-, 6- & 12-month bill auction $12.0 bln (new cash $1.3 bln)

Wednesday August 8

8:30 am	**Building Permits**
June (e)	**-2.0%**
May	+4.7%

Noon — 2-year bond auction $3.0 bln

Thursday August 9

8:15 am	**Housing Starts**	
July (e)	**215,000 a.r. (-13.4%)**	
June	248,138 a.r. (+28.0%)	
8:30 am	**New Housing Price Index**	
June (e)	**unch**	**+0.7% y/y**
May	unch	+0.9% y/y

30-year bond auction announcement

Friday August 10

8:30 am	**Employment**
July (e)	**+5,000 (+0.03%)**
June	+31,800 (+0.2%)
8:30 am	**Unemployment Rate**
July (e)	**6.0%**
June	6.0%
8:30 am	**Average Hourly Wages**
July (e)	**+3.6% y/y**
June	+3.6% y/y

United States

Monday August 6

11:00 am — 4-week bill auction announcement

11:30 am — 13- & 26-week bill auction $96 bln

Tuesday August 7

10:00 am	**Job Openings & Labor Turnover Survey (June)**
3:00 pm	**Consumer Credit**
June (e)	**+$16.0 bln**
Consensus	*+$16.0 bln*
May	+$24.6 bln

11:30 am — 4-week bill auction

1:00 pm — 3-year note auction $34 bln

Wednesday August 8

7:00 am	**MBA Mortgage Apps**
Aug. 3	
July 27	-2.6%

Fed Speaker: Richmond's Barkin (8:45 am)

1:00 pm — 10-year note auction $26 bln

Thursday August 9

8:30 am	**Initial Claims**	
Aug. 4 (e)	**220k (+2k)**[c]	
July 28	218k (+1k)	
8:30 am	**Continuing Claims**	
July 28		
July 21	1,724k (-23k)	
8:30 am	**PPI Final Demand**	
July (e)	**+0.2%**	**+3.3% y/y**
Consensus	*+0.2%*	*+3.3% y/y*
June	+0.3%	+3.4% y/y
8:30 am	**PPI Final Demand ex. F&E**	
July (e)	**+0.3%**	**+2.9% y/y**
Consensus	*+0.3%*	*+2.9% y/y*
June	+0.3%	+2.8% y/y
10:00 am	**Wholesale Inventories**	
June F (e)	**unch**	
Consensus	*unch*	
May	+0.4%	

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

1:00 pm — 30-year bond auction $18 bln

Friday August 10

8:30 am	**Consumer Prices**	
July (e)	**+0.2%**	**+3.0% y/y**
Consensus	*+0.2%*	*+3.0% y/y*
June	+0.1%	+2.9% y/y
8:30 am	**CPI Ex. Food & Energy**	
July (e)	**+0.2%**	**+2.3% y/y**
Consensus	*+0.2%*	*+2.3% y/y*
June	+0.2%	+2.3% y/y
2:00 pm	**Budget Balance**	
July '18		
July '17	-$42.9 bln	

[c] = consensus

Upcoming Policy Meetings | Bank of Canada: Sep. 5, Oct. 24, Dec. 5 | FOMC: Sep. 25-26, Nov. 7-8, Dec. 18-19

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