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BMO CAPITAL MARKETS ECONOMICS

Focus

A weekly financial digest

Douglas Porter, CFA, Chief Economist, BMO Financial Group

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All about NAFTA for the BoC

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There was little intrigue around this week's BoC decision, with nearly everyone anticipating no move in rates. The question was around the tone and language the BoC would use. The statement was pretty much in-line with our expectations. NAFTA worries received a specific mention, while trade worries in general loom large. Other uncertainties, such as housing and household debt, appear to be improving and are somewhat less of a concern. EM stresses were noted as well, but lack of contagion will keep those worries on the back burner. And, the *"gradual approach"* to tightening was reiterated.

The **bigger market mover was BoC Sr. Deputy Governor Wilkins' speech** on Thursday. Markets latched on to the comment that the *"Governing Council also discussed whether the gradual approach to raising rates that we have been taking over the past year remains appropriate."* Dropping *"gradual"* would be a big deal, suggesting that rate hikes could come quicker. But hold on…didn't Governor Poloz just provide another reason to be gradual in his Jackson Hole speech? So, let's put Wilkins' comments in context.

There are three things to note. **First**, the policy statement opened with comments on **inflation**. That hasn't happened since April, which was the end of a period of low headline inflation. Clearly, the Bank wants to highlight that July's 3% CPI print is transitory and inflation is not expected to accelerate. **Second**, the above sentence from Wilkins' speech was followed by a similar discussion on inflation. **Third**, when asked about the comment during the press conference, her focus was also on inflation. All of this suggests that the comment was intended to make absolutely clear that **the BoC is not willing to fall behind the curve on inflation**. It's not ignoring the big headline print, but rather believes it's transitory. But, if that's not the case, it is signalling that it will take action. Also note that, from a bigger picture perspective, just talking about potentially dropping *"gradual"* suggests that the option for more aggressive hikes is there, even if conditions aren't appropriate for a shift at the moment.

The other major talking point was around **trade uncertainty**. NAFTA is issue #1 at the moment. The BoC, like all market participants, is waiting for the results of the NAFTA talks. Assuming a deal gets done, an October rate hike seems likely. If there's no deal, don't expect immediate rate cuts (according to Wilkins), but a rate hike would be off the table.

Key Takeaway: The BoC delivered largely what was expected. There was particular emphasis on CPI and not falling behind the curve, but it all comes down to NAFTA at the moment. Deal or no deal determines hike or no hike. And so, we wait. *B.A.A.R.*

Wage Warming

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The U.S. labour market has come a long way since Lehman's collapse a decade ago. Back then, the fear was all about millions of job losses, rising unemployment and soaring foreclosures. Today, a net 12.5 million new jobs later, the lowest jobless rate in nearly 18 years (3.9%), and the lowest early-stage mortgage delinquency rate on record back to 1972, the concern is that too much of a good thing will sow the inflation seeds of the next downturn.

The August jobs report confirmed that labour market conditions remain healthy, even if the trend has softened from early this year. The three-month average payroll gain of 185,000 is down from the 220,000 pace in the first five months of the year, though it's still parked slightly above last year's norm (182,000). The slowing likely reflects some moderation in economic activity, with an estimated 2.8% annual pace for Q3 GDP marking a modest downshift from the first-half average (3.2%). Rising trade tensions, no doubt, are causing some companies to delay investments and hiring.

Not helping is the increased difficulty in finding workers, any workers. The all-inclusive U6 unemployment rate, which adjusts the headline rate for part-time workers seeking full-time work and for persons who are not actively seeking a job but want to work, probed new 17-year lows. High school dropouts are enjoying the best prospects since record-keeping began in 1992, with their jobless rate trending around 5½%. A rising participation rate would help alleviate the shortages, but it has held to a tight 0.3-percentage-point range for two years, as returning discouraged workers fill the shoes of retiring baby boomers.

Emboldened by still-robust hiring and less competition, more workers are leaving their current jobs (14% of those unemployed in August left their jobs, the most in nearly 18 years), many for higher-paying positions. That's putting the heat on wages. Average hourly earnings popped 0.4% in August, lifting the yearly rate to a nine-year high of 2.9%. The latter corroborates modest upward trends in the employment cost index (2.8%) and in hourly compensation (3.2%). So far, none signal much upward pressure on inflation. Dampened by a modest improvement in productivity, unit labour costs are rising about 2%, precisely in-line with core inflation and the Fed's target. But history suggests **the longer that job markets heat up, the greater the chance that inflation will boil over**. The Fed has little reason not to extend the tightening cycle in three weeks… especially since the target fed funds rate is lower today than when Lehman went bust. Sal

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	Good News	Bad News
Canada ▪ BoC on hold; decides gradual rate hike approach still appropriate ▪ NAFTA talks continue… ▪ …but PM Trudeau says Ch. 19 is non-negotiable with a president who *"doesn't always follow the rules"*	**Merchandise Trade Deficit** narrowed to $114 mln (July) **Labour Productivity** +0.7% (Q2) **Ivey PMI** +0.1 pts to 61.9 (Aug.)	**Employment** -51,600 (Aug.) **Jobless Rate** +0.2 ppts to 6.0% (Aug.) **Average Hourly Wages** slowed to +2.9% y/y (Aug.) **Manufacturing PMI** -0.1 pts to 56.8 (Aug.) **Auto Sales** -1.6% y/y (Aug.) **Building Permits** -0.1% (July)
United States ▪ President Trump *"ready to go"* with tariffs on $267 billion of Chinese imports… if he wants ▪ President Trump doesn't rule out a government shutdown	**Nonfarm Payrolls** +201,000 (Aug.) **Jobless Rate** steady at 3.9% (Aug.) **Average Hourly Earnings** +2.9% y/y (Aug.)—fastest pace since June '09 **Manufacturing ISM** +3.2 pts to 61.3 (Aug.)—highest since May '04 **Non-manufacturing ISM** +2.8 pts to 58.5 (Aug.) **Initial Claims** -10k to 203k (Sep. 1 week)—lowest since Dec. '69	**Construction Spending** +0.1% (July)—below expected **Factory Orders** -0.8% (July) **Auto Sales** fell to 16.6 mln a.r. (Aug.) **Goods & Services Trade Deficit** widened to $50.1 bln (July)
Japan ▪ President Trump says Japan could be next target in trade war	**Household Spending** +0.1% y/y (July) **Services PMI** +0.2 pts to 51.5 (Aug.) **Composite PMI** +0.2 pts to 52.0 (Aug.) **Capital Spending** +12.8% y/y (Q2)	
Europe ▪ GBP gyrates on false news that Germany would soften Brexit stance ▪ BoE's Gov. Carney willing to stay beyond June 2019 to guide a *"smooth"* Brexit	**France—Industrial Production** +0.7% (July) **France—Trade Deficit** narrowed to €3.5 bln (July) **U.K.—Services PMI** +0.8 pts to 54.3; **Composite PMI** +0.7 pts to 54.2 (Aug.)	**Euro Area—Retail Sales** -0.2% (July) **Germany—Factory Orders** -0.9% (July) **Germany—Industrial Production** -1.1% (July) **Germany—Trade Surplus** narrowed to €15.8 bln (July) **Italy—Retail Sales** -0.1% (July) **U.K.—Manufacturing PMI** -1.0 pts to 52.8; **Construction PMI** -2.9 pts to 52.9 (Aug.)
Other ▪ RBA on hold as household risks remain elevated ▪ Emerging market turmoil continues with stocks sliding into bear territory	**Australia—Real GDP** +0.9% (Q2)—above expected	**China—Caixin Manufacturing PMI** -0.2 pts to 50.6; **Services PMI** -1.3 pts to 51.5; **Composite PMI** -0.3 pts to 52.0 (Aug.) **China—Foreign Reserves** fell to $3.11 trln (Aug.) **Australia—Retail Sales** unch (July) **Australia—Trade Surplus** narrowed to A$1.6 bln (July)

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

The Fed's "New Normal" Balance Sheet

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The Fed's balance sheet paring will soon hit its maximum pace. Beginning October, the first $30 billion of maturing Treasury securities will not be reinvested each month along with the first $20 billion of redeeming MBS. A year ago, these thresholds were initially set at $6 billion and $4 billion, respectively, and they've been lifted each quarter by $6 billion and $4 billion (respectively). Permissible balance sheet reduction is about to shift into its fastest gear, an annualized $600 billion[1]. When the normalization process began in October 2017, the Fed's balance sheet stood at $4.46 trillion; it now stands at $4.22 trillion (*Chart 1*). **How big (or small) will it be when the process ends?**

A decade ago (2008 Q2), before the Fed's alphabet soup of liquidity measures and large-scale asset purchases inflated the figures, the **Fed's balance sheet averaged $891 billion, or 6.0% of nominal GDP**. The ratio was relatively stable up to that point, averaging 5.7% since 1975 with a 0.5% standard deviation (*Chart 2*). It **subsequently surged more than four times** this level by the end of 2014, to a record 25.1%. As the economy continued to grow and maturing/redeeming securities in the system open market account (SOMA) were fully reinvested, the ratio started to slip. The slippage picked up as SOMA holdings were permitted to shrink starting October 2017; assets are currently 21.3% of GDP. Turning to the liabilities side of the ledger as a guide (*Table 1*), **we reckon the relative size of the "new normal" balance sheet will be at least twice as large as its pre-crisis range**.

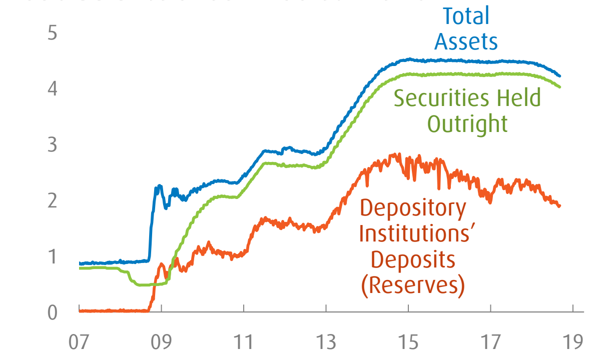
From one perspective, the **Fed has been quietly growing into its over-sized balance sheet**, partly mitigating the requirement to reduce it. Federal Reserve notes, currently $1.63 trillion outstanding, have been outpacing nominal GDP growth for most of the past decade (*Chart 3*), despite the shift to electronic payments and the emergence of cryptocurrencies. For several years prior to the Global Financial Crisis and Great Recession, the growth in greenbacks-in-print lagged GDP. However, these events, along with subsequent economic, financial market, policy and political uncertainty—both at home and abroad—seemingly boosted, and continue to boost, the demand for physical dollars. Global dollar demand was also prodded by historically low (and, in some jurisdictions, negative) interest rates. In modelling the Fed's balance

[1] Our Fixed Income Strategy team estimates Treasury maturities and MBS redemptions will total more than $350 billion this year, around $480 billion next year, and about $400 billion in 2020.

Chart 1
Starting to Shrink

United States (US$ trlns)

Fed's Balance Sheet — Select Items

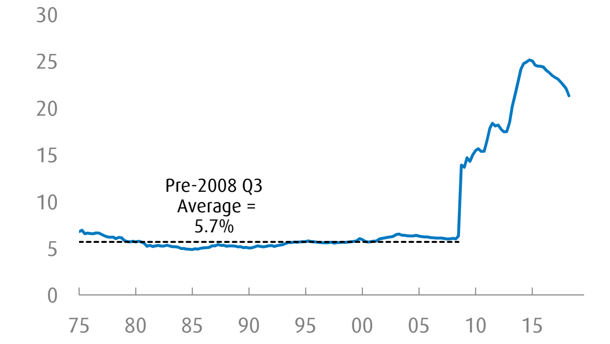


Sources: BMO Economics, Haver Analytics

Chart 2
Quadruple

United States (% of nominal GDP)

Fed's Balance Sheet



Sources: BMO Economics, Haver Analytics

Table 1
Fed's Balance Sheet: By the Numbers

($ blns : as of August 29, 2018)*

Total assets	**4,219**	**Total liabilities**	**4,219**
Securities held outright	**4,024**	**Federal Reserve notes**	**1,633**
Treasuries	2,325	**Reverse repos**	**232**
MBS	1,697	Foreign official & int'l accounts	232
Agencies	2	Other (incl. ON RPP program)	1
All other assets	**195**	**Deposits**	**2,308**
		Depository institutions (reserves)	1,881
		Treasury	345
		Other	82
		All other liabilities (incl. capital)	**45**

* figures might not add up due to rounding
Sources: BMO Economics, Haver Analytics

sheet, we assume the current growth gap between Federal Reserve notes and GDP will only gradually converge to zero, with a nod to the numerous issues lingering on the uncertainty front.[2]

Three other items constitute a permanently larger balance sheet than before. First, **the U.S. Treasury now holds much larger account balances at the Fed**. Before 2008 Q4, balances always averaged less than $15 billion per quarter (*Chart 4*). Currently, primarily for prudential purposes, Treasury has a policy of maintaining the higher of $150 billion or five days' worth of payments in its account, and the latter tends to be more binding. Amid the implementation of money market reform in October 2016, the 13-week average topped $375 billion at one point as large amounts of T-bills were issued to accommodate the increased demand for these securities. Although balances were subsequently drawn down sharply owing to repeated debt ceiling constraints, they are trending above $300 billion again. Looking ahead, with budget outlays projected to expand faster than GDP (according to the CBO's baseline) and Treasury's cybersecurity concerns likely escalating, Treasury balances should remain at least at $300 billion.

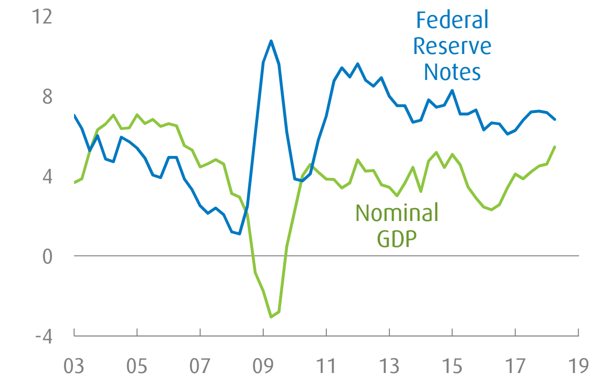
Second, since early 2015, more foreign official and international account holders (e.g., other central banks) have been **taking advantage of the foreign reverse repo pool** (*Chart 5*), as the NY Fed relaxed its rules to afford customers more flexibility. Recently, these overnight transactions have been running around $245 billion, on a 13-week average basis. They hovered around $100 billion before the rules changed and under $50 billion pre-crisis. The NY Fed relaxed its rules because reserves in the banking system had become so abundant that large unplanned customer reverse repo swings could be easily absorbed. It's possible that, as reserves become less abundant, the rules could be tweaked tighter; but, as we discuss below, **normalized levels of reserves will still likely be very large from an historical perspective**. As such, going forward, we judge activity here will be comparable to current levels.

Third, depository institutions' deposits at the Fed, a.k.a. **bank reserves, are currently $1.88 trillion**, down from the record high of $2.82 trillion hit in October 2014 when the FOMC's third round of large-scale asset purchases (QE3) ended (*see Chart 1 again*). It's noteworthy that reserves have fallen by $940 billion since then, while SOMA securities have decreased by $229 billion (or $216 billion since balance sheet normalization began). As money market interest rates have risen, in some cases relative to the interest rate

Chart 3

Gaining Currency

United States (y/y % chng)



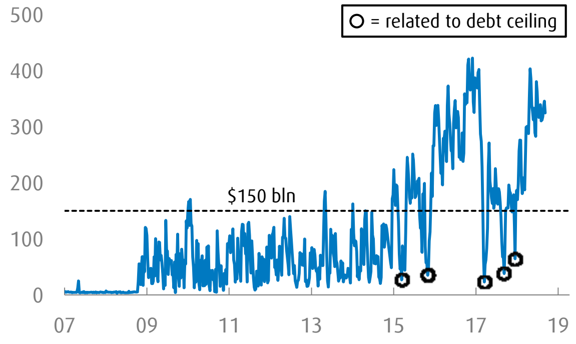
Sources: BMO Economics, Haver Analytics

Chart 4

Big Bank Account

United States (US$ blns)

U.S. Treasury's General Account



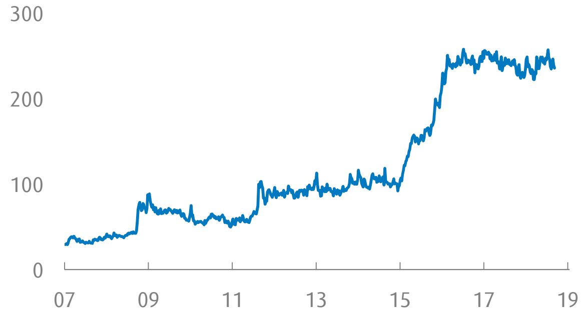
Sources: BMO Economics, Haver Analytics

Chart 5

Jumping in the Foreign Repo Pool

United States (US$ blns)

Overnight Reverse Repos with Foreign Official and International Accounts



Sources: BMO Economics, Haver Analytics

[2] In 2018 Q2, nominal GDP growth was 5.4% y/y, the strongest in nearly a dozen years and we look for this pace to persist through the turn of the year, before embarking on a gradual slowing trend to its longer-run rate just under 4%. In 2018 Q2, average Federal Reserve notes were up 6.8% y/y, and we project the gap to close by 0.1 % per quarter.

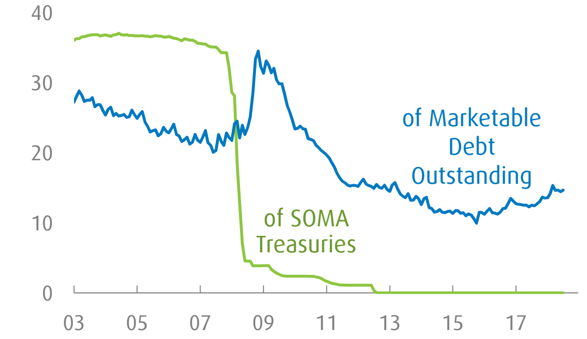
paid on excess reserves (IOER), banks have redeployed some of these funds. Also, during money market reform (and to some degree since), the demand for bank-issued paper was (is being) dampened, prodding banks to tap another source of funding, their reserves.

Chart 6

Got Bills?

United States (percent)

Treasury Bill Shares



Sources: BMO Economics, Haver Analytics

These developments illustrate that the current **demand for reserves is being driven by factors not present before the financial crisis, and thus, reserve levels are unlikely to return to where they were before**. In the pre-2008 period, and since 1980, reserves ran at less than $50 billion, apart from a brief episode around 9/11 when they were lifted above $100 billion. This amount was mostly to meet reserve requirements and facilitate interbank settlements. And, while these reasons still exist, the demand for reserves is now being driven more by a crowd of new factors including *"the Liquidity Coverage Ratio (LCR), banks' internal stress tests of their liquidity adequacy, supervisory expectations related to banks' ability to monetize their liquidity portfolios during periods of financial stress, and the incorporation of liquidity into resolution planning. Other important factors include increased bank aversion to incurring intraday overdrafts, higher bank investor and creditor expectations for liquidity, and a lower opportunity cost of holding reserves relative to before the crisis"*.[3] Of course, many of these factors reflect an increased demand for liquidity, but reserves are the most liquid asset; they don't have to be sold or financed (potentially during a period of financial market stress). Our **working assumption is for normalized reserves of at least $500 billion**.[4]

If we set Treasury balances, foreign client reverse repos and bank reserves at the above-mentioned amounts, allow for GDP-exceeding growth in Federal Reserve notes and assume all other balance sheet items grow in line with the economy, shrinking SOMA balances will intersect with these normalized net liabilities by 2021 Q2 (or sooner). At this time, the **Fed's balance sheet should be above $3.04 trillion, or above 13.3% of GDP**. After this point, the FOMC will have to start buying Treasury securities to grow the balance sheet and replace redeeming MBS (with the eventual goal of holding only Treasuries).

When it comes to the Fed's balance sheet, it's important to keep in mind that, although the size of assets should be normalized by 2021 Q2, **the mix of assets will not be normalized**. Three rounds of longer-term-skewed asset purchases and an Operation Twist (switching shorter-term for longer-term tenors) left a legacy of an above-market weight of longer-term maturities in the SOMA. Other things equal, this should continue to impart some flattening pressure on the yield curve. And, by 2021 Q2, the Fed will still probably own more than $1 trillion of MBS. Other things equal, this should continue to impart some narrowing pressure on mortgage spreads. **We suspect the Fed's attention will turn to asset mix normalization once the balance sheet has been right-sized** (if not sooner).

Note that the FOMC has already indicated that it could resort to *"limited sales"* of MBS to expedite the drawdown in the longer run. Depending on the health of housing and mortgage markets, the Fed could entertain earlier (and larger) outright MBS sales. Next, when the Fed starts buying Treasuries again to grow the balance sheet and replace redeeming MBS, the focus will probably be solely on bills. Currently the Fed owns none, when the SOMA used to hold an above-market weight (*Chart 6*). Moving to just a market weight would require $480 billion in initial bill purchases. Finally, given that attrition alone won't readily address the above-market weight of longer-term coupons in the SOMA, the **Fed could also entertain outright sales of longer-term maturities for short-term tenors—or a "reverse" Operation Twist**. This option could gain some currency if the yield curve actually inverts.

[3] Simon Potter, "Confidence in the Implementation of U.S. Monetary Policy Normalization", Federal Reserve Bank of New York, August 2018 https://www.newyorkfed.org/newsevents/speeches/2018/pot180803

[4] Given this elevated level and the potential volatility imparted by the mentioned factors, a return to point-targeting of the fed funds rate, rather than range-targeting, appears unlikely. The ON RPP program and interest being paid on reserves are going to continue, although we assume ON RPP balances will be relatively small for the most part.

Economic Forecast Summary for September 7, 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.)	1.4	2.9	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	2.7	2.5	2.2	2.4	2.2	2.1	1.6	2.4	2.2
Unemployment Rate (percent)	5.8	5.9	5.9 ↑	5.8 ↑	5.7	5.7 ↑	5.6	5.6 ↑	6.3	5.9 ↑	5.6
Housing Starts (000s : a.r.)	225	219	209	208	208	207	204	200	220	215	205
Current Account Balance ($blns : a.r.)	-69.9	-63.5	-65.8	-64.8	-64.2	-64.4	-64.7	-64.7	-63.3	-66.0	-64.5
Interest Rates					(average for the quarter : %)						
Overnight Rate	1.25	1.25	1.50	1.75	1.75	2.00	2.25	2.25	0.71	1.44	2.06
3-month Treasury Bill	1.14	1.21	1.50 ↑	1.70	1.75 ↑	1.95	2.15	2.15	0.69	1.40 ↑	2.00
10-year Bond	2.24	2.28	2.30	2.50	2.60	2.70	2.75	2.80	1.78	2.30	2.70
Canada-U.S. Interest Rate Spreads					(average for the quarter : bps)						
90-day	-44	-66	-59 ↑	-57 ↑	-71 ↑	-68 ↑	-59 ↑	-59 ↑	-26	-57 ↑	-64 ↑
10-year	-52	-64	-63 ↑	-56 ↑	-53 ↑	-49 ↑	-46 ↑	-43	-55	-59	-48 ↑
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	4.2	2.8	2.9	2.6	2.2	2.0	1.8	2.2	2.8	2.5
Consumer Price Index (y/y % chng)	2.3	2.6	2.6	2.4	2.2	2.2	2.2	2.1	2.1	2.5	2.2
Unemployment Rate (percent)	4.1	3.9	3.8	3.7	3.7	3.6	3.6	3.5	4.4	3.9	3.6
Housing Starts (mlns : a.r.)	1.32	1.25	1.22	1.30	1.31	1.32	1.33	1.33	1.21	1.27	1.32
Current Account Balance ($blns : a.r.)	-496	-391	-468	-483	-496	-509	-521	-533	-449	-460	-515
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	1.87	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	2.90 ↓	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	76.6	78.0	78.7	79.1	79.5	79.9	77.1	77.8	79.3
C$/US$	1.27	1.29	1.30	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$/Euro	1.23	1.19	1.16	1.17	1.18	1.20	1.22	1.24	1.13	1.19	1.21
US$/£	1.39	1.36	1.30 ↑	1.28	1.26	1.30	1.34	1.39	1.29	1.33	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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Housing Starts

Tuesday, 8:15 am

Aug. (e)	**210,000 a.r. (+1.2%)**
July	206,314 a.r. (-16.2%)

New Housing Price Index

Thursday, 8:30 am

July (e)	**+0.1%**	**+0.5% y/y**
June	+0.1%	+0.8% y/y

Housing starts are expected to rise 1.2% to 210,000 units annualized in August. Our call would still be 10k below the year-to-date average of 220k, with the solid pace driven by record immigration flows. The week's other housing release is expected to show new home prices rose 0.1% in July, slowing the yearly increase to 0.5%, the lowest since January 2010.

National Balance Sheet and Financial Flow Accounts (Q2)

Friday, 8:30 am

Canada's household debt ratio likely moved modestly higher in Q2, as housing activity (not seasonally adjusted) picked up despite being relatively softer than the usual spring buying season. Income growth slowed sharply compared to a year ago, which won't help the income side of the equation. Note that debt ratios have risen in every Q2 on record (starting in 1990) and this quarter will be no different, with the only question being the extent of the increase. So, don't be surprised to see the ratio perk up after Q1's record drop, but look for the rise to be very modest compared to the average Q2 increase of 1.4 ppts. This release also includes details on household assets. Net worth as a share of disposable income saw its largest decline in nearly seven years in Q1 thanks to a drop in home prices, but Q2 should be better with equities up, the C$ weaker and home prices stabilizing. Overall, Canadian balance sheets are in decent shape, but don't be shocked if debt ratios deteriorated a bit in Q2.

United States

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Beige Book

Wednesday, 2:00 pm

In preparation for the next FOMC meeting, the Fed's regional report card should reinforce expectations of a rate hike by confirming that most Districts are growing at least moderately (code for above potential) and that wage pressures, though contained, could fan inflation. The report will likely confirm that tariff angst is spreading, and delaying investment and hiring decisions. Still, any hint that businesses are readily passing the tariff bill on to customers could reinforce expectations of another rate hike at year-end.

Consumer Prices

Thursday, 8:30 am

Aug. (e)	**+0.2%**	**+2.7% y/y**
Consensus	*+0.3%*	*+2.8% y/y*
July	+0.2%	+2.9% y/y
	Ex. Food & Energy	
Aug. (e)	**+0.2%**	**+2.3% y/y**
Consensus	*+0.2%*	*+2.4% y/y*
July	+0.2%	+2.4% y/y

Steady gas prices should limit CPI prices to a 0.2% advance in August, allowing the yearly rate to retreat from 6½-year highs to 2.7%. A similar monthly advance in core prices would trim its yearly rate from a near decade-high to 2.3%. Still, this could prove a brief reprieve for core inflation. Tariffs on steel and aluminum have contributed to the fastest three-month upturn in new vehicle prices in seven years, and the tariff tally will only mount as new duties on China's goods kick in. Rising rent and hospital fees are also warming the inflation pot. While a firmer dollar has lowered the heat slightly (and might explain a recent decline in clothing prices), it's no match for an economy that's bursting at the seams to keep up with robust demand.

Retail Sales

Friday, 8:30 am

		Ex. Autos
Aug. (e)	**+0.4%**	**+0.5%**
Consensus	*+0.5%*	*+0.6%*
July	+0.5%	+0.6%

	Ex. Autos/Gas
Aug. (e)	**+0.5%**
Consensus	*+0.5%*
July	+0.6%

Rising chain-store receipts suggest retail sales rose 0.4% in August after a solid 0.5% advance in July. Excluding a mild dip in autos, sales likely increased 0.5%. Tax cuts, job growth and record equity values mean households have little reason to retrench. One of the fastest growing expenditure areas is restaurants and bars, up 10% y/y. It's also one of the most discretionary, and speaks to the lofty level of confidence. After splurging 3.8% annualized in Q2, consumers look to retain a healthy 2.6% pace of spending in Q3.

Industrial Production

Friday, 9:15 am

		Capacity Utilization
Aug. (e)	**+0.4%**	**78.3%**
Consensus	*+0.3%*	*78.2%*
July	+0.1%	78.1%

Following a lukewarm gain, industrial production likely fired on all cylinders in August, cranking out a 0.4% advance. Manufacturing looks to upshift on increased auto assemblies and strong business investment, with the ISM index popping to 14-year highs. After a rare dip in July, mining looks to rebound on record oil production. Meantime, strong AC demand should fan the first advance in utilities output in four months. Look for the capacity utilization rate to hit 3½-year highs of 78.3%, edging toward the 80% level that foreshadowed inflation pressures in the last cycle.

Central Banks

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BoE Monetary Policy Announcement and Minutes

Thursday, 7:00 am ET

ECB Monetary Policy Announcement

Thursday, 7:45 am ET
Press conference 8:30 am ET

It is rare, but not unheard of, for the BoE and the ECB to have their monetary policy meetings on the same day. It last occurred on December 14, 2017, and it will happen again next week, on September 13th. Both central banks are expected to leave policy unchanged. After all, it was just last month that the **BoE** raised the Bank Rate 25 bps to an 8-year high of 0.75%. We do not look for another hike by Carney et al until the spring of 2019, after Brexit Day has passed. Until then, the Bank will be parked on the sidelines as Brexit talks heat up ahead of the October EU Summit. The data have been mixed but the economy looks to have softened in the second half of 2018, partly on Brexit uncertainty. Look for how policymakers voted… did the regular hawks push for another hike? Look for references to the weaker British pound, and its potential impact on inflation, in the Monetary Policy Summary and Minutes, as well as the view of trade tensions. There will be no press conference next week, so Governor Carney can avoid questions about his willingness to stay at the BoE beyond his previously planned end date of June 2019.

The **ECB** is expected to maintain the refi rate at 0%, and not veer from its already carefully laid out plans for asset purchases, which are to chop the monthly bond buying in half to €15 bln starting in October and, assuming the inflation outlook remains the same, wrap up QE by the end of this year. We do not expect these plans to change, but the Governing Council will be keeping a watchful eye on Italy as the populist government prepares to introduce a budget for the coming year. If the deficit blows past the 3% of GDP target, the central bank may have to rejig its plans to end QE. Watch for any change to the key line on interest rates, which is that they will *"remain at their present levels at least through the summer of 2019"*, and for plenty of questions on what could stop the ECB from its plans to end QE and start tightening. Look for President Draghi to address questions (again) on his potential replacement when his term ends in October 2019. The ECB will also release its latest growth and inflation forecasts, which we expect to be little changed. It was just in June that the outlook for CPI was raised in 2018 and 2019, while GDP was trimmed for this year.

		Sep 7 [1]	Aug 31	Week Ago	4 Weeks Ago	Dec. 31, 2017
					(basis point change)	
Canadian Money Market	Call Money	1.50	1.50	0	0	50
	Prime Rate	3.70	3.70	0	0	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	1.50	1.53	-3	5	44
	United States	2.13	2.09	3	8	75
	Japan	-0.14	-0.16	2	2	2
	Eurozone	-0.32	-0.32	0	0	1
	United Kingdom	0.80	0.80	0	0	28
	Australia	1.93	1.95	-2	-3	15
2-Year Bonds	Canada	2.10	2.07	4	0	42
	United States	2.70	2.63	7	9	82
10-Year Bonds	Canada	2.28	2.23	5	-2	24
	United States	2.95	2.86	9	7	54
	Japan	0.11	0.10	0	1	6
	Germany	0.39	0.33	6	7	-4
	United Kingdom	1.46	1.43	4	22	27
	Australia	2.55	2.52	3	-4	-8
Risk Indicators	VIX	14.7	12.9	1.9 pts	1.6 pts	3.7 pts
	TED Spread	20	23	-2	-7	-11
	Inv. Grade CDS Spread [2]	60	61	0	-1	11
	High Yield CDS Spread [2]	331	333	-1	-4	25
					(percent change)	
Currencies	US¢/C$	76.07	76.69	-0.8	0.0	-4.4
	C$/US$	1.315	1.304	—	—	—
	¥/US$	111.19	111.03	0.1	0.3	-1.3
	US$/€	1.1578	1.1602	-0.2	1.4	-3.6
	US$/£	1.297	1.296	0.1	1.7	-4.0
	US¢/A$	71.44	71.89	-0.6	-2.2	-8.5
Commodities	CRB Futures Index	189.62	192.96	-1.7	-1.1	-2.2
	Oil (generic contract)	67.24	69.80	-3.7	-0.6	11.3
	Natural Gas (generic contract)	2.77	2.92	-5.1	-6.0	-6.3
	Gold (spot price)	1,197.41	1,201.40	-0.3	-1.2	-8.1
Equities	S&P/TSX Composite	16,038	16,263	-1.4	-1.8	-1.1
	S&P 500	2,877	2,902	-0.8	1.6	7.6
	Nasdaq	7,947	8,110	-2.0	1.4	15.1
	Dow Jones Industrial	25,950	25,965	-0.1	2.5	5.0
	Nikkei	22,307	22,865	-2.4	0.0	-2.0
	Frankfurt DAX	11,950	12,364	-3.3	-3.8	-7.5
	London FT100	7,269	7,432	-2.2	-5.2	-5.4
	France CAC40	5,249	5,407	-2.9	-3.1	-1.2
	S&P ASX 200	6,144	6,319	-2.8	-2.1	1.3

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

Global Calendar
September 10 – September 14

BMO Capital Markets®

	Monday September 10	Tuesday September 11	Wednesday September 12	Thursday September 13	Friday September 14
Japan	**Real GDP** **Q2 F (e) +0.7% +1.1% y/y** Q2 P +0.5% +1.0% y/y Q1 -0.2% +1.0% y/y **Current Account Surplus** **July ’18 (e) ¥1.9 trln** July ’17 ¥2.4 trln **Bank Lending Ex-Trusts** **Aug.** July +2.0% y/y	**Tertiary Industry Index** **July (e) +0.1%** June -0.5% **Machine Tool Orders** **Aug. P** July +13.1% y/y		**Producer Price Index** **Aug. (e) +0.1% +3.1% y/y** July +0.5% +3.1% y/y **Core Machine Orders** **July (e) +5.7% +4.5% y/y** June -8.8% +0.3% y/y	**Industrial Production** **July F (e) -0.1% +2.3% y/y** June -1.8% -0.9% y/y
Euro Area		GERMANY **ZEW Survey—Expectations** **Sep. (e) -14.0** Aug. -13.7	EURO AREA **Industrial Production** **July (e) -0.4% +1.0% y/y** June -0.7% +2.5% y/y ITALY **Industrial Production** **July (e) -0.4% +1.6% y/y** June +0.5% +1.7% y/y	EURO AREA **ECB Monetary Policy Meeting** GERMANY **Consumer Price Index** **Aug. F (e) unch +1.9% y/y** July +0.4% +2.1% y/y FRANCE **Consumer Price Index** **Aug. F (e) +0.6% +2.6% y/y** July -0.1% +2.6% y/y	EURO AREA **Trade Surplus** **July (e) €16.2 bln** June €16.7 bln **Labour Costs** **Q2** Q1 +2.0% y/y ITALY **Consumer Price Index** **Aug. F (e) -0.1% +1.7% y/y** July -1.4% +1.9% y/y
U.K.	**Monthly Real GDP 3m/3m** **July (e) +0.1% +0.5%** June +0.1% +0.4% **Industrial Production** **July (e) +0.2% +1.1% y/y** June +0.4% +1.1% y/y **Manufacturing Production** **July (e) +0.1% +1.4% y/y** June +0.4% +1.5% y/y **Trade Deficit Non-EU** **July (e) £11.8 bln £3.3 bln** June £11.4 bln £2.9 bln	**Jobless Claims Claimant Count Rate** **Aug.** July +6,200 2.5% **Avg. Wkly Earnings Ex. Bonus (3 mma)** **July (e) +2.8% y/y** June +2.7% y/y **Jobless Rate (3 mma)** **July (e) 4.0%** June 4.0%		**RICS House Price Balance** **Aug. (e) +2%** July +4% **7:00 am ET BoE Monetary Policy Meeting and Minutes**	
Other	CHINA **CPI PPI** **Aug. (e) +2.1% y/y +4.0% y/y** July +2.1% y/y +4.6% y/y **Foreign Direct Investment [D]** **Aug.** July +14.9% y/y **Trade Surplus [D]** **in USD in CNY** **Aug. (e) $31.0 bln 205.0 bln** July $28.1 bln 177.0 bln **Aggregate Yuan Financing [D]** **Aug. (e) 1.30 trln** July 1.04 trln **New Yuan Loans [D]** **Aug. (e) 1.37 trln** July 1.45 trln **M2 Money Supply [D]** **Aug. (e) +8.6% y/y** July +8.5% y/y	AUSTRALIA **NAB Business Confidence** **Aug.** July 7	AUSTRALIA **Westpac Consumer Confidence** **Sep.** Aug. -2.3%	AUSTRALIA **Employment** **Aug. (e) +18,000** July -3,900 **Jobless Rate** **Aug. (e) 5.4%** July 5.3%	CHINA **Industrial Production** **Aug. (e) +6.2% y/y (+6.6% YTD)** July +6.0% y/y (+6.6% YTD) **Retail Sales** **Aug. (e) +8.8% y/y (+9.3% YTD)** July +8.8% y/y (+9.3% YTD) **Fixed Asset Investment (YTD)** **Aug. (e) +5.7% y/y** July +5.5% y/y

[D] = date approximate

Upcoming Policy Meetings | BoE: Nov. 1, Dec. 20, Feb. 7 | ECB: Oct. 25, Dec. 13, Jan. 24

North American Calendar
September 10 – September 14

BMO Capital Markets®

	Monday September 10	Tuesday September 11	Wednesday September 12	Thursday September 13	Friday September 14
Canada		8:15 am **Housing Starts** **Aug. (e) 210,000 a.r. (+1.2%)** July 206,314 a.r. (-16.2%) **Manpower Survey—Net Outlook** **Q4 (e) 13%** Q3 13%	8:30 am **Capacity Utilization** **Q2 (e) 87.3%** Q1 86.1% Noon 30-year real return bond auction $0.4 bln	8:30 am **New Housing Price Index** **July (e) +0.1% +0.5% y/y** June +0.1% +0.8% y/y 2-year bond auction announcement	8:30 am **National Balance Sheet and Financial Flow Accounts (Q2)**
United States	3:00 pm **Consumer Credit** **July (e) +$15.0 bln** *Consensus +$14.1 bln* June +$10.2 bln Fed Speaker: Atlanta's Bostic (noon) 11:00 am 4-week bill auction announcement 11:30 am 13- & 26-week bill auction $90 bln	6:00 am **NFIB Small Business Economic Trends Survey** **Aug. (e) 108.0 (+0.1 pts)** *Consensus 108.2 (+0.3 pts)* July 107.9 (+0.7 pts) 10:00 am **Wholesale Inventories** **July F (e) +0.7%** *Consensus +0.5%* June +0.1% 10:00 am **Job Openings & Labor Turnover Survey (July)** **Manpower Survey—Net Outlook** **Q4 (e) 18%** Q3 18% 11:30 am 4-week bill auction 11:30 am 52-week bill auction $26 bln 1:00 pm 3-year note auction $35 bln	7:00 am **MBA Mortgage Apps** **Sep. 7** Aug. 31 -0.1% 8:30 am **PPI Final Demand** **Aug. (e) +0.2% +3.2% y/y** *Consensus +0.2% +3.2% y/y* July unch +3.3% y/y 8:30 am **PPI Final Demand ex. F&E** **Aug. (e) +0.2% +2.7% y/y** *Consensus +0.2% +2.7% y/y* July +0.1% +2.7% y/y **2:00 pm Beige Book** Fed Speakers: St. Louis' Bullard (9:30 am); Gov. Brainard (12:45 pm) 1:00 pm 10^{R}-year note auction $23 bln	8:30 am **Initial Claims** **Sep. 8 (e) 210k (+7k)^{C}** Sep. 1 203k (-10k) 8:30 am **Continuing Claims** **Sep. 1** Aug. 25 1,707k (-3k) 8:30 am **Consumer Prices** **Aug. (e) +0.2% +2.7% y/y** *Consensus +0.3% +2.8% y/y* July +0.2% +2.9% y/y 8:30 am **CPI Ex. Food & Energy** **Aug. (e) +0.2% +2.3% y/y** *Consensus +0.2% +2.4% y/y* July +0.2% +2.4% y/y **10:00 am Fed Vice Chair for Supervision Quarles speaks before the Senate on the Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act** 2:00 pm **Budget Balance** **Aug. '18 (e) -$183.0 bln** July '17 -$107.7 bln Fed Speaker: Atlanta's Bostic (1:15 pm) 11:00 am 13- & 26-week bill, 10^{R}-year TIPS auction announcements 1:00 pm 30^{R}-year bond auction $15 bln	8:30 am **Retail Sales Ex. Autos** **Aug. (e) +0.4% +0.5%** *Consensus +0.5% +0.6%* July +0.5% +0.6% 8:30 am **Retail Sales ex. Autos/Gas** **Aug. (e) +0.5%** *Consensus +0.5%* July +0.6% 8:30 am **Import Prices** **Aug. (e) -0.1% +4.1% y/y** *Consensus -0.3% +3.9% y/y* July unch +4.8% y/y 9:15 am **Industrial Production Capacity Utilization** **Aug. (e) +0.4% 78.3%** *Consensus +0.3% 78.2%* July +0.1% 78.1% 10:00 am **Business Inventories** **July (e) +0.6%** *Consensus +0.4%* June +0.1% 10:00 am **University of Michigan Consumer Sentiment** **Sep. P (e) 97.0** *Consensus 96.2* Aug. 96.2 Fed Speakers: Chicago's Evans (9:00 am); Boston's Rosengren (10:00 am)

^{C} = consensus ^{R} = reopening

Upcoming Policy Meetings | Bank of Canada: Oct. 24, Dec. 5, Jan. 9 | FOMC: Sep. 25-26, Nov. 7-8, Dec. 18-19

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