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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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## A Week at the Opera

**Douglas Porter, CFA**
Chief Economist
douglas.porter@bmo.com
416-359-4887

After a rough and tumble October—mostly tumble—markets steadied late in the month and carried that momentum into the start of November. Sentiment got another temporary pop Friday on a conveniently timed item that President Trump had instructed his Cabinet to draft up a possible trade deal with China, ahead of his meeting with President Xi a month from now at the G20 meetings. Many an eyebrow arched over this news, coming four days before the midterms, and it soon was denied. The trade spat remains arguably the single biggest tail risk to the outlook. Even with a retreat Friday morning, the broadest market averages finally broke a five-week losing streak, as the Wilshire 5000 managed to rise nearly 3% after a full-blown 10.6% correction (from the record close on Sep 20, to Monday's low). But the stock market's gains were the bond market's loss, as yields backed up across the curve amid the rally in risk assets and generally solid U.S. data.

Friday's rock-solid employment report capped off a string of strength, with the notable exception of a so-so ISM reading for manufacturing (57.7 in October). The latter was a theme globally, as the previously-expanding trade war was a key figure in dampening a variety of PMIs last month—notably in Asia, but also in Europe. On the domestic side of the ledger, U.S. growth is still quite clearly humming. Even amid the equity market correction, consumer confidence hit its highest level last month since the boom year 2000, at least according to the Conference Board (whose metric famously tends to be driven more by jobs than stocks). In a similar light, auto sales kept clicking at a 17.5 million pace in October, up both from the prior month and the lofty average of 17.3 million over the past three years.

With jobs behind us, and the markets seemingly steadying heading into a highly favourable seasonal period for stocks, the focus will now fall squarely on Tuesday's midterm elections. For our full review, see Key for Next Week (page 12), but, suffice it to say that the market has been largely building in a split-decision result for months now (House shifts to Democrats, Senate stays Republican—but neither is locked down). One intense area of concern for the neighbours is whether that at all imperils the fate of the USMCA—the risk is that the trade deal becomes a pawn in a much bigger chess war.

Beyond the midterms, it's a very sparse week for key economic data, although we *do* have a little-noted FOMC meeting on Thursday. While Chair Powell has tried to emphasize that every meeting is live, this one conjures memories of a particular parrot from Monty Python (i.e., most definitely not live). Nevertheless, in honour of today's movie release on the story of ***Freddie Mercury and Queen***, we consider on the next page how things could play out if the meeting actually were live…

As for the real Fed, the market has about as close to a zero chance for a rate hike next week as imaginable, but is almost fully locked in for a December hike, and two more next year. At this point, we concur on December, and are still leaning to three more moves in 2019, which would take rates to a 3.00%-to-3.25% range by end-19, listing a bit to the high side of neutral.

## Bankerian Rhapsody

*(Scene I: FOMC Meeting, November 8)*

Is this the real thing?
Is this just the economy?
Caught in a sell-off
No escape from reality
Open your eyes
Look up to the skies and see
I'm just a Fed Chair, I need no sympathy
Because rates should rise, growth should slow
The jobless rate, little low
Anyway the Dow goes,
doesn't really matter to me, to me

Markets, just hiked again
Put a press release to bed
Pulled the trigger, now it's read
Markets, my term had just begun
But now I've gone and thrown it all away
Markets, ooo, didn't mean to make you sigh
If I'm not back again this time next year
Carry on, carry on, as if nothing really matters

Too late, my time has come
Sends shivers down the dollar's spine
Bonds aching for some time
Goodbye everybody I've got to go
Gotta leave you all behind and face Congress
Markets, ooo (anyway the Dow goes)
I don't want to step down
I sometimes wish I'd never been nominated at all

*(Scene II: Testimony to Congress, December 5)*

I see a little silhouetto of wage growth
Scary markets, scary markets, will oil do the contango
Quantitative tightening, very very frightening me
Going Loco, Going Loco,
Going Loco, Going Loco,
Going Loco, Figured so—magnifico

But I'm just a Fed Chair and nobody loves me
He's just a Fed Chair from the FOMC
Spare him his job from this monstrosity
Rates can rise, rates can fall,
will you let me make the call
Businesses! No we will not let you hike—let him hike
Businesses! We will not let you hike—let him hike
Businesses! We will not let you hike—let me hike
Will not let you hike let me hike (never)
Never let you hike let me hike; never let me hike ooo
No, no, no, no, no, no, no
Oh mama mia, mama mia,
mama mia let me hike once more
Bernanke and Yellen would have had the same policy
Policy… Policy!!

*(Scene III: President enters, in high dudgeon, later that day)*

So you think you can tighten and spit in stocks' eye
So you think you can invert the curve and leave housing to die
Oh Jay P, can't do this to me Jay P
Just gotta get out just gotta get right outta here

Ooh yeah, ooh yeah, Rates must get to neutral
Anyone can see
Rates must get to neutral, not else really matters to me
Anyway the Dow goes

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Now that you have been subjected to that, and possibly left with an earworm for the day, here's some trivia on that 1975 classic piece of prog-rock/operetta. Bohemian Rhapsody, at almost 6 minutes in length, never did manage to make it to number 1 in the U.S., neither initially nor upon its revival in Wayne's World in 1992. However, it handily reached those ranks in Canada and the U.K. (where it did it both times, and is often rated as one of the most popular rock songs ever). Here's guessing that the song has another comeback alongside the new movie. Admittedly, I may be a tad biased, being a serious Queen fan all the way back to the days *before* this song was a twinkle in Freddie's eye.

## FOMC Preview:
## Last of the Presser-less Policy Pronouncements

**Michael Gregory, CFA**
Deputy Chief Economist
michael.gregory@bmo.com
416-359-4747

The data on the ground are compelling. Core PCE inflation has been running at the Fed's 2.0% y/y target for the past five consecutive months (ending September). The economy expanded at an above-potential pace in Q3 (3.5% annualized or 3.0% y/y), while 2.1% (1.8% median call) is the strongest projection for potential growth by any FOMC participant. The unemployment rate remained at 3.7% in October, the lowest level in nearly 49 years, while the lowest any FOMC participant projects the "natural rate" to be is 4.0% (4.5% median call). The jobless rate has been running below 4% for six of the past seven months.

These results all but seal the deal on additional Fed rate hikes, up to at least where the preponderance of participants peg the real neutral rate (1.0% median or 0.9% mean assuming 2.0% inflation; the range is 0.5% to 1.5%). But, getting there will still be done "gradually", which has come to mean with one meeting spaced between moves. Next week's FOMC meeting is one of the "in-betweeners".

It's noteworthy that this will be the last FOMC meeting without a press conference by the Chairman. Beginning in January, there will be pressers after each meeting. This should afford the Fed more flexibility to skip more than one meeting between moves (and conveniently explain why), which we suspect they'll likely need next year. The road to neutral real policy rates is paved with uncertainty over timing and terminus.

Indeed, the need for more nimbleness going forward should result in some wording changes to the Fed's policy statement, but perhaps not as early as next week. Nevertheless, by next month, we expect the word *"gradual"* to be dropped from the rote phrase, *"the Committee expects that further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term"*. The word has become synonymous with "quarterly". However, there is a chance next week that the previously mentioned *"for now"* moniker could be inserted, as a precursor to the removal of *"gradual"*.

With a rate hike looming for December, and given the economic performance described above, there's also a chance that another rote phrase, *"risks to the economic outlook appear roughly balanced"*, could be tweaked next week, with the word *"roughly"* being dropped.

Interestingly, we suspect a chunk of the discussion will revolve around dynamics in the money market, in particular the up-drift in the effective fed funds rate. It's currently 7½ bps above the midpoint of the range again, up from a more "normal" 3½ bps, which also happened this summer and led the Fed to raise the interest paid on excess reserves (IOER) by only 20 bps when the fed funds target was lifted by 25 bps. Back then, two forces were driving this phenomenon. First, hefty Treasury issuance was increasing the demand for repo financing and thus the level of repo rates—diverting some investment flows to the repo market at the expense of fed funds. Second, the repatriation of corporate profits reduced the demand for the money market instruments that these offshore funds had previously invested in, applying upward pressure on their rates (relative to fed funds). While we expect another 5-bps-less move in IOER next month, the "scarcity" of reserves is being bandied about as yet another factor. With $1.7 trillion of excess reserves currently in the system, and even acknowledging that the demand for reserves has skyrocketed owing to regulatory changes and market pressures, we judge that trotting this out as a factor is premature. Recent pressures in the fed funds market might simply reflect the fact that banks can make more money keeping their excess reserves in their Fed accounts (earning IOER) than lending them to other banks. As such, we suspect next month's adjustment in the relative IOER will not be its last. MJG

## Who Wants To Be a Central Banker These Days? Anyone? Anyone?

**Jennifer Lee**
Senior Economist
jennifer.lee@bmo.com
416-359-4092

It was steady as she goes on the central bank front this week, with the BoJ and the BoE pulling no surprises. The **Bank of Japan** kept rates at record lows, remained on its QE path; and once again, dashed rumours that its target for 10-year yields would be adjusted (I gave up on that earlier this year). It is evident that there is no appetite to think too much about exiting, as the Policy Board also trimmed its inflation forecasts. Then there was the **Bank of England**, which also stayed on hold (as expected) as the MPC navigated the rocky waters of the Brexit negotiations. Governor Carney raised a few eyebrows when he warned that, even if the U.K. ends up with no deal (which he emphasized repeatedly was not the most likely outcome), he could see a situation where the Bank would still raise rates. In any event, we continue to look for one hike a year over the next couple of years.

The **ECB** was on hold last week, and not due to meet again for six weeks, but the Governing Council certainly has its work cut out. There's the **political landscape**, which cannot be ignored. The Euro Area's largest and strongest economy has just embarked on a huge wave of political turmoil and change. After the painful weekend election in the State of Hesse, **Chancellor Merkel** announced that she will not seek re-election as CDU party chairwoman on December 7/8, and will not run for re-election in 2021. Although it is still very early in her fourth term, she will likely not last until 2021 as her grip on the German leadership and, in many ways, all of Europe, has weakened considerably. Her successor is not anticipated to have as much of a Euro-unifying mindset. Then there is **Italy**, where the government managed to stay under the radar this week as it mulls over the European Commission's demand for a revised budget by November 13th. But Luigi Di Maio set the tone for a likely clash with Brussels when he defiantly declared on Friday that the government will approve the plan for pension reform and the citizens' income around Christmas. **Then there's the economy**. **Euro Area real GDP** rose just 0.2% in Q3, the slowest increase in four years. Although some of that weakness was temporary (German auto production slumped in the summer as automakers dealt with new emissions tests), it confirms that growth has slowed from 2017's strong pace. **Italy's economy** stagnated in Q3, which will make it more difficult to come close to the government's 1.5% growth forecast for 2019. But **Euro Area inflation** rose 2.2% y/y in October, the fastest rate in six years. It is at this point that we are reminded of the **ECB's mandate**: to maintain price stability, defined as inflation below, but close to, 2%

over the medium term. With inflation heading higher, how can the ECB not stick to its plan to stop asset purchases by the end of December? In fact, a few of the (albeit hawkish) policymakers made their views known this week. One was particularly quote-worthy: *"It would take a lot more than this to change monetary policy… We have a super-easy monetary policy and it would take a lot to make it easier, especially when there is inflation momentum."* The December 13th ECB meeting will be super-important. We will stick to our view that the bond buying will end this year, as scheduled, but President Draghi may waffle on the rate hike. JLee

## CPTPP: Victory from the Jaws of Defeat

**Aaron Goertzen, CFA**
Senior Economist
aaron.goertzen@bmo.com
416-359-8229

On October 31st, Australia became the sixth country to ratify the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership* (CPTPP), following closely on the heels of Canada. With enabling legislation in place across a majority of the agreement's 11 signatories, the CPTPP is now slated to take effect on December 30th (i.e.; 60 days after majority ratification). This represents a dramatic reversal of fortune for the deal, which appeared to be dead in the water after the U.S. withdrew from the original TPP in early 2016. Against the odds, remaining members resurrected the agreement earlier this year and have moved quickly on ratification.

Rebranding aside, the CPTPP is remarkably similar to the original TPP, with the exception of certain provisions that had been included mainly at the behest of the U.S. In particular, the new agreement provides less in the way of intellectual property protection for pharmaceuticals and technology, and places somewhat tighter limits on investors' ability to litigate against governments. It will liberalize trade in nearly all goods and services, while also making progress on issues like regulation, labour, and the environment.

Although the withdrawal of the U.S. has been a blow for the pact as a whole, this represents a windfall for Canada, which will now enjoy a competitive edge over the U.S. in CPTPP markets. Just as importantly, Canadian firms will maintain their current advantage over those from other CPTPP countries (aside from Mexico) in America—an edge reaffirmed by the USMCA. Following U.S. withdrawal, Ottawa raised its estimate of the deal's long-run impact on GDP from $3.4 bln to $4.2 bln, which equates to between 5,000-to-10,000 jobs.

At the industry level, the CPTPP will benefit much of Canada's agri-food sector by providing preferential access for crops, meat, alcohol, and processed foods, most notably in the large and (until now) tightly-protected Japanese market. The forest products sector will also see reduced tariffs, especially in Australia and Japan, which are already important destinations for Canadian wood products. In the manufacturing sector, Canadian industrial goods will enjoy substantially lower tariffs in Japan, Malaysia, and Vietnam, where current levies run well into the double digits. Meantime, the services sector will benefit from temporary-entry provisions and restrictions on the preferential treatment of state-owned enterprises.

Of course, trade deals are always a matter of give and take. Various Canadian industries will face greater competition for the domestic market under the CPTPP—to the benefit of Canadian consumers. Most controversially, Canada will cede around

3% of its supply-managed market for dairy, poultry, and eggs to imports from elsewhere in the bloc. Not only will this add to the market concessions made under CETA (Canada's recent trade deal with the EU), but those made more recently as part of the USMCA will be stacked on top. The government is adamant that it will fully compensate supply-managed farmers, but has provided little in the way of specifics.

Even once the CPTPP has entered into force, it will take time for Canadian consumers and businesses to realize its full benefits, as some provisions are subject to lengthy phase-in periods spanning up to 20 years. But, over time, the deal should boost Canada's presence in the fast-growing Asia-Pacific region and, in doing so, should reduce economic reliance on the U.S.—an attractive prospect after the recent NAFTA scare. The agreement also has value in its symbolism, serving as a potent reminder that many countries still see value in working cooperatively across borders.

**Priscilla Thiagamoorthy**
Economic Analyst
priscilla.thiagamoorthy@bmo.com
416-359-6229

| | Good News | Bad News |
|---|---|---|
| **Canada**<br>▪ BoC. Gov. Poloz sticks to the script as rates head to neutral<br>▪ Ontario and Saskatchewan team up to remove trade barriers | **Real GDP at Basic Prices** +0.1% (Aug.)<br>**Employment** +11,200 (Oct.)<br>**Jobless Rate** -0.1 ppts to 5.8% (Oct.)<br>**Industrial Product Prices** +0.1% (Sep.)<br>**Conference Board Consumer Confidence Index** +4.3 pts to 119.6 (Oct.) | **Average Hourly Wages** slowed to +2.2% y/y (Oct.)<br>**Merchandise Trade Deficit** $416 mln (Sep.)—and prior month swung back to deficit<br>**Auto Sales** -1.9% y/y (Oct.)<br>**Raw Material Prices** -0.9% (Sep.)<br>**Markit Manufacturing PMI** -0.9 pts to 53.9 (Oct.) |
| **United States**<br>▪ October goes down as worst month for stocks in 7 years<br>▪ President Trump says trade talks with China are *"moving along nicely"* | **Nonfarm Payrolls** +250,000 (Oct.)<br>**Jobless Rate** steady at 3.7% (Oct.)<br>**Average Hourly Earnings** +3.1% y/y (Oct.)<br>**Real Personal Spending** +0.3% (Sep.)<br>**Personal Income** +0.2% (Sep.)<br>**Core PCE Deflator** +2.0% y/y (Sep.)<br>**Auto Sales** 17.5 mln a.r. (Oct.)<br>**Unit Labour Costs** +1.2% a.r. (Q3)<br>**Employment Cost Index** +0.8% (Q3)<br>**Conference Board Consumer Confidence Index** +2.6 pts to 137.9 (Oct.)<br>**Initial Claims** -2k to 214k (Oct. 27 week) | **Productivity** slowed to +2.2% a.r. (Q3)<br>**Construction Spending** unch (Sep.)<br>**Manufacturing ISM** -2.1 pts to 57.7 (Oct.)<br>**Goods & Services Trade Deficit** widened to $54.0 bln (Sep.)<br>**S&P Case-Shiller Home Prices** slowed to +5.5% y/y (Aug.)<br>**Homeowner Vacancy Rate** +0.1 ppts to 1.6% (Q3) |
| **Japan**<br>▪ BoJ on hold and lowers inflation outlook again | **Jobless Rate** -0.1 ppts to 2.3% (Sep.) | **Retail Sales** -0.2% (Sep.)<br>**Industrial Production** -1.1% (Sep. P)<br>**Consumer Confidence** -0.4 pts to 43.0 (Oct.) |
| **Europe**<br>▪ German Chancellor Merkel will not seek re-election as party chair<br>▪ BoE on hold, keeping options open for post-Brexit<br>▪ U.K. Brexit Secretary Raab upbeat on a deal by Nov. 21<br>▪ U.K. budget introduces digital tax on tech firms | **Euro Area—Consumer Prices** +2.2% y/y (Oct. A)<br>**Euro Area—Jobless Rate** steady at 8.1% (Sep.)<br>**Germany—Unemployment** -11,000 (Oct.)—and **Jobless Rate** steady at 5.1%<br>**France—Real GDP** +0.4% q/q (Q3 A)<br>**France—Jobless Rate** steady at 9.3% (Sep. P)<br>**Italy—Consumer Confidence** +0.5 pts to 116.6 (Oct.)<br>**U.K.—Construction PMI** +1.1 pts to 53.2 (Oct.) | **Euro Area—Real GDP** +0.2% (Q3 A) —4-yr low<br>**Euro Area—Economic Confidence** -1.1 pts to 109.8 (Oct.)<br>**Euro Area—Manufacturing PMI** revised lower to 52.0 (Oct.)<br>**Germany—Retail Sales** +0.1% (Sep.) —below expected<br>**France—Consumer Spending** -1.7% (Sep.)<br>**Italy—Real GDP** unch q/q (Q3 P)<br>**Italy—Jobless Rate** +0.3 ppts to 10.1% (Sep. P)<br>**U.K.—Manufacturing PMI** -2.5 pts to 51.1 (Oct.) |
| **Other**<br>▪ China's yuan flirts with 7/dollar before strengthening on upbeat trade news<br>▪ Brazil's central bank on hold after far-right Jair Bolsonaro elected new president | **China—Caixin Manufacturing PMI** +0.1 pts to 50.1 (Oct.)<br>**Australia—Trade Surplus** widened to A$3.0 bln (Sep.)<br>**Australia—Building Approvals** +3.3% (Sep.)<br>**Mexico—Real GDP** +2.6% y/y (Q3 P) | **China—Manufacturing PMI** -0.6 pts to 50.2; **Non-manufacturing PMI** -1 pt to 53.9 (Oct.)<br>**Australia—Consumer Prices** +0.4% (Q3)<br>**Australia—Retail Sales** slowed to +0.2% (Sep.) |

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

# Sizing Up Provincial Trade Barriers

**Douglas Porter, CFA**
Chief Economist
douglas.porter@bmo.com
416-359-4887

**Robert Kavcic**
Senior Economist
robert.kavcic@bmo.com
416-359-8329

There has been intense focus on international trade developments recently, but another significant trade issue warrants continued vigilance in Canada—**freeing interprovincial trade**. Canada has long struggled with various impediments to trade within its own borders that are widely believed to impede growth and productivity. The following is a brief look at this issue and potential positive economic benefits of knocking down some of these internal barriers.

## The Importance of Interprovincial Trade

**Canadian interprovincial exports of goods and services are now nearly $400 billion per year, or almost 20% of GDP.** While trailing international exports ($630 billion in the same period), it is clearly a major portion of total economic activity.

Interprovincial trade also acts as an important buffer. Ontario and Quebec, the two provinces usually deemed most exposed to international trade, are currently running meaningful trade deficits with partners outside Canada—in Ontario's case, that was $33 billion in 2017, according to the provincial GDP accounts. That was entirely offset by a similar-sized trade surplus with Canada's other provinces.

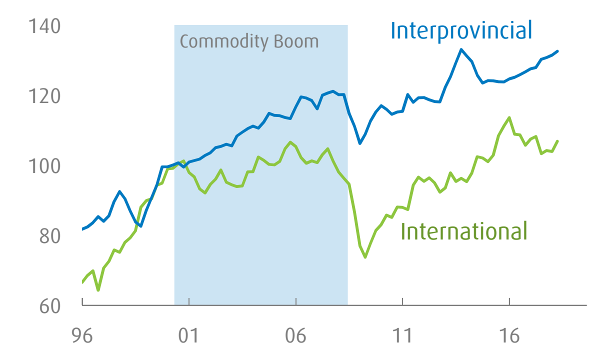
Additionally, provincial exports were a valuable hedge during the 2000-to-2008 commodity boom, when Ontario's international exports were crowded out by the strong Canadian dollar (*Chart 1*). During that period, Ontario's real international exports slipped a cumulative 6%, while real interprovincial exports rose nearly 20%.

Given Canada's highly regional specialization of economic activity (i.e., manufactured goods in Central Canada, energy in Alberta and various commodities in Atlantic Canada), the free-flow of goods across provincial borders is important to support consumer choice, productivity and output through the production chain.

## Economic Impact

Estimating the economic impact of fully free interprovincial trade is hardly a precise science. In 2016, the Senate Committee on Banking, Trade and Commerce examined the available research on this front[1] in advance of the 2017 Canadian Free Trade Agreement (CFTA). While estimated impacts ranged from very small (adding less than 1% of GDP) to very large (7% of GDP with all barriers removed), the findings across various modelling methods were unanimous in concluding that **free provincial trade would be a net positive for the Canadian economy**. An alternative approach from Statistics Canada found that **interprovincial trade barriers amounted to the equivalent of a 6.9% tariff** between 2004 and 2012[2]. And, the Bank of Canada

Chart 1
**Provincial Trade Buffer**
Ontario (2000 = 100)
**Real Exports of Goods and Services**




Sources: BMO Economics, Haver Analytics

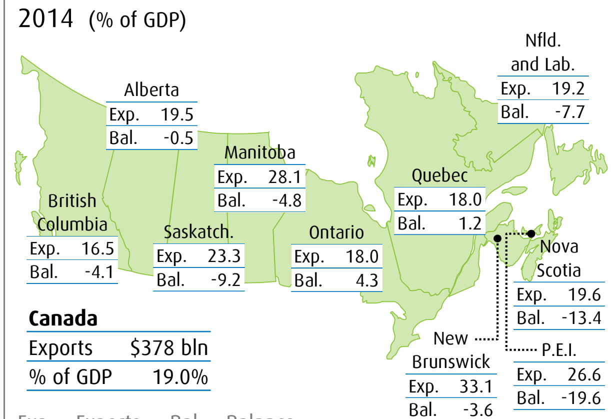
[1] *Tear Down These Walls: Dismantling Canada's Infernal Trade Barriers*. Report of the Standing Senate Committee on Banking, Trade and Commerce. June, 2016.

[2] *Going the Distance: Estimating the Effect of Provincial Borders on Trade when Geography Matters*. Statistics Canada. Robby K. Bemrose, W. Mark Brown and Jesse Tweedle. September, 2017.

finds that removing interprovincial trade barriers could add 0.1-to-0.2 percentage points to potential output annually[3].

In our view, the real-world economic impact would likely run at the lower end of this range given that (and as we have already seen) provinces will likely remain reluctant to free up all regulations and barriers. But freer interprovincial trade would still be clearly a net positive: Largely concurring with the Bank of Canada's estimates on the growth impact, we **judge that the positive impact from free interprovincial trade would cumulate over a decade to add as much as 2% to national GDP, or nearly $50 billion**. **For Ontario alone, we judge that the net positive addition to output would build to a range of $15 billion-to-$20 billion over ten years**.

Chart 2
**Interprovincial Trade Comparison**




Sources: BMO Economics, Statistics Canada

There are many channels through which benefits would flow. Seamless transport regulations that don't change at provincial borders would reduce shipping times and costs; consistent packaging requirements would improve productivity and reduce costs; nationwide recognition of professional licenses would improve labour mobility at times when there are large regional market disparities—this would reduce capacity constraints, ease pockets of labour shortages and trim unemployment in weaker regions; and, consumer welfare would improve through increased choice and/or lower prices.

At the regional level, **all provinces would benefit** to some degree from free interprovincial trade. Ontario and Quebec are by far the largest trading partners given their relative size and proximity. But, as a share of GDP, interprovincial exports from those provinces are comparatively low, and thus the impact might be somewhat smaller (*Chart 2*). Freer trade for the remaining eight net provincial importers would likely mean a more streamlined supply chain (e.g., manufactured products moving from Ontario into Alberta's energy sector) and better/cheaper consumer choice.

## Why Act?

There are two main reasons why moving to reduce interprovincial trade barriers is a proverbial slam-dunk decision from a policy perspective—the cost-benefit tradeoff and the external environment.

Given that most barriers to provincial trade are largely related to regulation and red tape, the **cost of removing such barriers should be relatively low**. The benefits, however, are substantial, as discussed. And, with Ottawa already running a large budget deficit (and mulling various pro-business policy options that could carry a large price tag), this policy prescription is among the lowest-hanging fruit.

Meantime, while Canada has secured a trade agreement with the U.S. and Mexico, the protectionist agenda carried by Canada's largest trading partner only amplifies the **need to seek alternative growth opportunities**. Canada has made moves to diversify trade in recent years, and improved flows within its own border should be right at the very top of the agenda.

[3] *Living with Lower for Longer*. Remarks by Stephen S. Poloz. September, 2016.

# Economic Forecast Summary for November 2, 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 | 2.0 | 2.5 | 2.0 | 1.8 | 1.8 | 1.7 | 3.0 | 2.1 | 2.1 |
| Consumer Price Index (y/y % chng) | 2.1 | 2.3 | 2.7 | 2.0 | 1.8 | 2.0 | 1.8 | 2.2 | 1.6 | 2.2 | 2.0 |
| 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 | 196 | 202 | 208 | 207 | 204 | 200 | 220 | 210 | 205 |
| Current Account Balance ($blns : a.r.) | -69.9 | -63.5 | -45.2 ↑ | -49.3 ↑ | -49.6 ↑ | -50.6 ↑ | -51.7 ↑ | -52.1 ↑ | -63.3 | -57.0 ↑ | -51.0 ↑ |
| **Interest Rates** | (average for the quarter : %) | | | | | | | | | | |
| Overnight Rate | 1.25 | 1.25 | 1.50 | 1.75 | 2.00 | 2.25 | 2.50 | 2.50 | 0.71 | 1.44 | 2.31 |
| 3-month Treasury Bill | 1.14 | 1.21 | 1.47 | 1.75 | 2.00 | 2.20 | 2.40 | 2.40 | 0.69 | 1.40 | 2.25 |
| 10-year Bond | 2.24 | 2.28 | 2.28 | 2.50 | 2.55 | 2.65 | 2.80 | 2.90 | 1.78 | 2.30 | 2.70 |
| **Canada-U.S. Interest Rate Spreads** | (average for the quarter : bps) | | | | | | | | | | |
| 90-day | -44 | -66 | -61 | -57 | -49 | -49 | -41 | -52 | -26 | -57 | -48 |
| 10-year | -52 | -64 | -65 | -63 | -58 | -53 | -49 | -45 | -55 | -61 | -51 |
| **UNITED STATES** | | | | | | | | | | | |
| Real GDP (q/q % chng : a.r.) | 2.2 | 4.2 | 3.5 | 2.6 | 2.4 | 2.2 | 2.0 | 1.9 | 2.2 | 2.9 | 2.5 |
| Consumer Price Index (y/y % chng) | 2.3 | 2.6 | 2.6 | 2.3 | 2.1 | 2.2 | 2.1 | 2.1 | 2.1 | 2.5 | 2.1 |
| Unemployment Rate (percent) | 4.1 | 3.9 | 3.8 | 3.7 | 3.6 | 3.6 | 3.5 | 3.5 | 4.4 | 3.9 | 3.5 |
| Housing Starts (mlns : a.r.) | 1.32 | 1.26 | 1.22 | 1.24 | 1.30 | 1.31 | 1.31 | 1.32 | 1.21 | 1.26 | 1.31 |
| Current Account Balance ($blns : a.r.) | -487 | -406 | -517 | -530 | -534 | -547 | -555 | -565 | -449 | -485 | -550 |
| **Interest Rates** | (average for the quarter : %) | | | | | | | | | | |
| Fed Funds Target Rate | 1.46 | 1.71 | 1.96 | 2.21 | 2.46 | 2.71 | 2.88 | 2.96 | 1.00 | 1.83 | 2.75 |
| 3-month Treasury Bill | 1.58 | 1.87 | 2.08 | 2.30 | 2.50 | 2.70 | 2.80 | 2.90 | 0.95 | 1.95 | 2.70 |
| 10-year Note | 2.76 | 2.92 | 2.93 | 3.10 | 3.15 | 3.20 | 3.25 | 3.35 | 2.33 | 2.95 | 3.25 |
| **EXCHANGE RATES** | (average for the quarter) | | | | | | | | | | |
| US¢/C$ | 79.1 | 77.5 | 76.5 | 76.9 ↓ | 77.4 ↓ | 78.2 ↓ | 78.9 ↓ | 79.7 ↓ | 77.1 | 77.5 ↓ | 78.6 ↓ |
| C$/US$ | 1.27 | 1.29 | 1.31 | 1.30 ↑ | 1.29 ↑ | 1.28 ↑ | 1.27 ↑ | 1.25 | 1.30 | 1.29 | 1.27 ↑ |
| ¥/US$ | 108 | 109 | 112 | 112 | 112 | 111 | 111 | 110 | 112 | 110 | 111 |
| US$/Euro | 1.23 | 1.19 | 1.16 | 1.15 ↓ | 1.16 ↓ | 1.19 | 1.22 | 1.24 | 1.13 | 1.18 ↓ | 1.20 |
| US$/£ | 1.39 | 1.36 | 1.30 | 1.28 | 1.23 | 1.27 | 1.33 | 1.38 | 1.29 | 1.33 | 1.31 |

Blocked areas represent BMO Capital Markets forecasts

Up and down arrows indicate changes to the forecast ↑↓ Spreads may differ due to rounding

# Canada

**Benjamin Reitzes**
Canadian Rates & Macro Strategist
benjamin.reitzes@bmo.com
416-359-5628

Building permits are expected to rise 0.5% in September, building on the prior month's gain. Residential permits have been heavy in recent months, so some reprieve is expected, while buoyant business investment intentions should support non-residential activity. Despite the pullback in the value of residential permits, the number of permits has held well over 200k, pointing to a rebound in starts. We're calling for a 6% increase to 200k units annualized for October. Lastly, new home prices are expected to be flat in September for the sixth time this year, trimming the annual rate another couple of ticks to 0.2% and catching up to the sharp slowdown in existing home prices.

### Building Permits
Tuesday, 8:30 am

| | |
|---|---|
| **Sep. (e)** | **+0.5%** |
| Aug. | +0.4% |

### Housing Starts
Thursday, 8:15 am

| | |
|---|---|
| **Oct. (e)** | **200,000 a.r. (+6.0%)** |
| Sep. | 188,683 a.r. (-5.1%) |

### New Housing Price Index
Thursday, 8:30 am

| | | |
|---|---|---|
| **Sep. (e)** | **unch** | **+0.2% y/y** |
| Aug. | unch | +0.4% y/y |

# United States

**Sal Guatieri**
Senior Economist
sal.guatieri@bmo.com
416-359-5295

### Non-manufacturing ISM (NMI)
Monday, 10:00 am

| | |
|---|---|
| **Oct. (e)** | **60.0** |
| *Consensus* | *59.2* |
| Sep. | 61.6 |

After hitting 21-year highs in September, the ISM non-manufacturing index is expected to stage a modest retreat to 60 in October, partly due to Hurricane Michael. Several regional surveys suggest the service sector eased back from robust levels in the month. All but one of 18 industries reported growth in the prior month's survey, and most purchasing managers expressed confidence that demand and business conditions would stay strong, despite nagging concerns about cost increases arising from worker shortages and tariffs. Vendor deliveries continue to lengthen, and the prices-paid index is near the highest levels in six years.

### U.S. Midterm Elections
Tuesday

There's a lot at stake in Tuesday's elections, as noted in our September 14 Focus Feature. Besides races for state governorships and legislatures, all 435 seats in the House of Representatives and 35 of 100 seats in the Senate will be contested. The outlook for fiscal policy, the economy, the USMCA, and markets could hinge on whether the congressional races result in split chambers, the status quo or a Democrat sweep. The latest polls point to a split Congress with the Democrats winning the House and the Republicans hanging on to the Senate. RealClearPolitics judges the Republicans have 50 safe/likely/leaning seats in the Senate, the Democrats have 44 seats, while six races are too close to call. In the House, the Democrats are likely/leaning to take 204 seats, the Republicans 197 seats and 34 are toss-ups. FiveThirtyEight places 6-in-7 odds of the Republicans retaining the Senate, but just a 1-in-7 chance of them keeping control of the House.

If the Democrats win the House—as generally expected at this point—the net risks to the U.S. economy would shift given the potential for increased political uncertainty that could dampen business and investor confidence. There would be a greater chance of a government shutdown over funding and a credit event over the debt ceiling. The Democrats could gain sway over committee priorities and more boldly investigate allegations about the Administration, heightening chances of a confrontation.

The fiscal policy risks for the economy and budget deficit are less clear. A Democrat-led House would reduce the GOP's legislative ability, thereby delaying or derailing its agenda of deregulation and possible new tax cuts. (The President and the GOP have floated additional middle-class tax cuts as well as making current reductions for individuals permanent after 2025.) This could preclude potential new stimulus that supports growth. At the same time, the Democrats could push for more government spending, notably on infrastructure which the President also supports. However, a Republican-led Senate is unlikely to pass new spending that boosts an already large deficit.

In the less likely event that Democrats sweep Congress, policy gridlock would dominate and the push for further tax cuts and deregulation would come to a screeching halt. It's not clear how much resistance Congress would provide to the President's trade war, and there's no guarantee it would ratify the USMCA. If the Republicans retain control of Congress, an extension of business-friendly policies could support growth, at the risk of pushing interest rates and the dollar higher.

## FOMC Announcement
Thursday, 2:00 pm

See Michael Gregory's Thought on page 4.

| | | Nov 2 [1] | Oct 26 | Week Ago | 4 Weeks Ago | Dec. 31, 2017 |
|---|---|---|---|---|---|---|
| | | | | | (basis point change) | |
| Canadian Money Market | Call Money | 1.75 | 1.75 | 0 | 25 | 75 |
| | Prime Rate | 3.95 | 3.95 | 0 | 25 | 75 |
| U.S. Money Market | Fed Funds (effective) | 2.25 | 2.25 | 0 | 0 | 75 |
| | Prime Rate | 5.25 | 5.25 | 0 | 0 | 75 |
| 3-Month Rates | Canada | 1.73 | 1.72 | 1 | 13 | 67 |
| | United States | 2.32 | 2.32 | 1 | 12 | 95 |
| | Japan | -0.32 | -0.31 | -1 | -3 | -15 |
| | Eurozone | -0.32 | -0.32 | 0 | 0 | 1 |
| | United Kingdom | 0.83 | 0.81 | 2 | 3 | 31 |
| | Australia | 1.93 | 1.92 | 1 | 0 | 15 |
| 2-Year Bonds | Canada | 2.33 | 2.26 | 7 | 1 | 65 |
| | United States | 2.88 | 2.81 | 7 | -1 | 99 |
| 10-Year Bonds | Canada | 2.51 | 2.39 | 12 | -9 | 47 |
| | United States | 3.17 | 3.08 | 10 | -6 | 77 |
| | Japan | 0.12 | 0.11 | 2 | -3 | 8 |
| | Germany | 0.42 | 0.35 | 7 | -15 | 0 |
| | United Kingdom | 1.48 | 1.38 | 10 | -24 | 29 |
| | Australia | 2.69 | 2.60 | 10 | -2 | 6 |
| Risk Indicators | VIX | 19.2 | 24.2 | -4.9 pts | 4.4 pts | 8.2 pts |
| | TED Spread | 27 | 20 | 7 | 7 | -5 |
| | Inv. Grade CDS Spread [2] | 68 | 70 | -2 | 7 | 19 |
| | High Yield CDS Spread [2] | 370 | 382 | -12 | 29 | 64 |
| | | | | | (percent change) | |
| Currencies | US¢/C$ | 76.31 | 76.30 | 0.0 | -1.3 | -4.1 |
| | C$/US$ | 1.311 | 1.311 | — | — | — |
| | ¥/US$ | 112.82 | 111.91 | 0.8 | -0.8 | 0.1 |
| | US$/€ | 1.1430 | 1.1403 | 0.2 | -0.8 | -4.8 |
| | US$/£ | 1.300 | 1.283 | 1.3 | -0.9 | -3.8 |
| | US¢/A$ | 72.18 | 70.90 | 1.8 | 2.4 | -7.6 |
| Commodities | CRB Futures Index | 192.28 | 195.51 | -1.7 | -3.4 | -0.8 |
| | Oil (generic contract) | 63.67 | 67.59 | -5.8 | -14.4 | 5.4 |
| | Natural Gas (generic contract) | 3.21 | 3.23 | -0.5 | 2.1 | 8.7 |
| | Gold (spot price) | 1,235.80 | 1,233.13 | 0.2 | 2.7 | -5.2 |
| Equities | S&P/TSX Composite | 15,179 | 14,888 | 2.0 | -4.8 | -6.4 |
| | S&P 500 | 2,742 | 2,659 | 3.1 | -5.0 | 2.5 |
| | Nasdaq | 7,357 | 7,167 | 2.7 | -5.5 | 6.6 |
| | Dow Jones Industrial | 25,334 | 24,688 | 2.6 | -4.2 | 2.5 |
| | Nikkei | 22,244 | 21,185 | 5.0 | -6.5 | -2.3 |
| | Frankfurt DAX | 11,612 | 11,201 | 3.7 | -4.1 | -10.1 |
| | London FT100 | 7,151 | 6,940 | 3.1 | -2.3 | -7.0 |
| | France CAC40 | 5,137 | 4,967 | 3.4 | -4.1 | -3.3 |
| | S&P ASX 200 | 5,849 | 5,665 | 3.2 | -5.4 | -3.6 |

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

# Global Calendar
# November 5 – November 9

BMO Capital Markets

## Monday November 5

### Japan

**Services PMI**
**Oct.**
Sep. 50.2

**Composite PMI**
**Oct.**
Sep. 50.7

**BoJ Minutes from Sep. 18-19 meeting**

### U.K.

**Services PMI**
**Oct. (e) 53.3**
Sep. 53.9

**Composite PMI**
**Oct. (e) 53.4**
Sep. 54.1

### Other

**CHINA**

**Caixin Services PMI**
**Oct. (e) 52.8**
Sep. 53.1

**Caixin Composite PMI**
**Oct.**
Sep. 52.1

## Tuesday November 6

### Japan

**Household Spending**
**Sep. (e) +1.5% y/y**
Aug. +2.8% y/y

### Euro Area

**EURO AREA**

**Services PMI**
**Oct. F (e) 53.3**
Sep. 54.7

**Composite PMI**
**Oct. F (e) 52.7**
Sep. 54.1

**Producer Price Index**
**Sep. (e) +0.4% +4.3% y/y**
Aug. +0.3% +4.2% y/y

**GERMANY**

**Factory Orders**
**Sep. (e) -0.5% -3.0% y/y**
Aug. +2.0% -2.1% y/y

### Other

**CHINA**

**Foreign Reserves** [D]
**Oct.**
Sep. $3.1 trln

**AUSTRALIA**

**RBA Monetary Policy Meeting**

## Wednesday November 7

### Euro Area

**EURO AREA**

**Retail Sales**
**Sep. (e) +0.1% +0.9% y/y**
Aug. -0.2% +1.8% y/y

**GERMANY**

**Industrial Orders**
**Sep. (e) -0.1% +0.5% y/y**
Aug. -0.3% -0.1% y/y

**ITALY**

**Retail Sales**
**Sep.**
Aug. +0.7% +2.2% y/y

### Other

**CHINA**

**Trade Surplus** [D]

| | in USD | in CNY |
|---|---|---|
| **Oct.** | | |
| Sep. | $31.7 bln | 213.2 bln |

**Foreign Direct Investment** [D]
**Oct.**
Sep. +8.0% y/y

**NEW ZEALAND**

**RBNZ Monetary Policy Meeting**

## Thursday November 8

### Japan

**Core Machine Orders**
**Sep. (e) -9.0% +7.6% y/y**
Aug. +6.8% +12.6% y/y

**Current Account Surplus**
**Sep. '18 (e) ¥1.8 bln**
Sep. '17 ¥2.3 bln

**Bank Lending Ex-Trusts**
**Oct.**
Sep. +2.3% y/y

**BoJ Summary of Opinions from Oct. 30-31 meeting**

### Euro Area

**EURO AREA**

**ECB Economic Bulletin**

**EC Publishes Economic Forecasts**

**GERMANY**

**Trade Surplus**
**Sep.**
Aug. €18.3 bln

**FRANCE**

**Trade Deficit**
**Sep. (e) €6.1 bln**
Aug. €5.6 bln

### U.K.

**RICS House Price Balance**
**Oct. (e) -2%**
Sep. -2%

## Friday November 9

**FRANCE**

**Industrial Production**
**Sep. (e) -0.3% +1.1% y/y**
Aug. +0.3% +1.6% y/y

**Manufacturing Production**
**Sep. (e) +0.1% +1.8% y/y**
Aug. +0.6% +1.9% y/y

**Real GDP**
**Q3 P (e) +0.6% +1.5% y/y**
Q2 +0.4% +1.2% y/y

**Monthly Real GDP**
**Sep. (e) +0.1%**
Aug. unch

| **Trade Deficit** | | **Non-EU** |
|---|---|---|
| **Sep. (e)** | **£11.4 bln** | **£3.9 bln** |
| Aug. | £11.2 bln | £4.2 bln |

**Industrial Production**
**Sep. (e) -0.1% +0.5% y/y**
Aug. +0.2% +1.3% y/y

**Manufacturing Production**
**Sep. (e) +0.1% +0.4% y/y**
Aug. -0.2% +1.3% y/y

**CHINA**

| | **CPI** | **PPI** |
|---|---|---|
| **Oct.** | | |
| Sep. | +2.5% y/y | +3.6% y/y |

**Aggregate Yuan Financing** [D]
**Oct.**
Sep. 2.2 trln

**New Yuan Loans** [D]
**Oct.**
Sep. 1.4 trln

**M2 Money Supply** [D]
**Oct.**
Sep. +8.3% y/y

**AUSTRALIA**

**RBA Statement on Monetary Policy**

[D] = date approximate

Upcoming Policy Meetings | BoE: Dec. 20, Feb. 7, Mar. 21 | ECB: Dec. 13, Jan. 24, Mar. 7

# North American Calendar
# November 5 – November 9

BMO Capital Markets®

| | Monday November 5 | Tuesday November 6 | Wednesday November 7 | Thursday November 8 | Friday November 9 |
|---|---|---|---|---|---|
| **Canada** | **8:10 am** **BoC Governor Poloz speaks in London, UK to Canada-UK Chamber of Commerce; press conference at 9:30 am** | **8:30 am** **Building Permits**<br>**Sep. (e)** **+0.5%**<br>Aug. +0.4% | **10:00 am** **Ivey Purchasing Managers Index (s.a.)**<br>**Oct.**<br>Sep. 50.4<br><br>Noon 2-year bond auction $3.0 bln | **8:15 am** **Housing Starts**<br>**Oct. (e)** **200,000 a.r. (+6.0%)**<br>Sep. 188,683 a.r. (-5.1%)<br><br>**8:30 am** **New Housing Price Index**<br>**Sep. (e)** **unch** **+0.2% y/y**<br>Aug. unch +0.4% y/y<br><br>**8:30 am** **Provincial GDP (2015-17)**<br><br>5-year bond auction announcement | |
| **United States** | **9:45 am** **Markit Services/Composite PMI (Oct. F)**<br><br>**10:00 am** **Non-manufacturing ISM (NMI)**<br>**Oct. (e)** **60.0**<br>*Consensus* *59.0*<br>Sep. 61.6<br><br>11:00 am 4- & 8-week bill auction announcements<br>11:30 am 13- & 26-week bill auction $84 bln<br>1:00 pm 3-year note auction $37 bln | **10:00 am** **Job Openings & Labor Turnover Survey (Sep.)**<br>**U.S. Midterm Elections**<br><br>11:30 am 4- & 8-week bill auction<br>1:00 pm 52-week bill auction $26 bln<br>1:00 pm 10-year note auction $27 bln | **7:00 am** **MBA Mortgage Apps**<br>**Nov. 2**<br>Oct. 26 -2.5%<br><br>**3:00 pm** **Consumer Credit**<br>**Sep. (e)** **+$17.0 bln**<br>*Consensus* *+$15.0 bln*<br>Aug. +$20.1 bln<br>**FOMC Meeting Begins**<br><br>1:00 pm 30-year bond auction $19 bln | **8:30 am** **Initial Claims**<br>**Nov. 3 (e)** **214k (unch)** [c]<br>Oct. 27 214k (-2k)<br><br>**8:30 am** **Continuing Claims**<br>**Oct. 27**<br>Oct. 20 1,631k (-7k)<br><br>**10:00 am** **MBA Mortgage Delinquencies (Q3)** [D]<br><br>**2:00 pm** **FOMC Announcement**<br><br>11:00 am 4-, 8-, 13- & 26-week bill auction announcements | **8:30 am** **PPI Final Demand**<br>**Oct. (e)** **+0.2%** **+2.4% y/y**<br>*Consensus* *+0.3%* *+2.6% y/y*<br>Sep. +0.2% +2.6% y/y<br><br>**8:30 am** **PPI Final Demand ex. F&E**<br>**Oct. (e)** **+0.2%** **+2.3% y/y**<br>*Consensus* *+0.2%* *+2.4% y/y*<br>Sep. +0.2% +2.5% y/y<br><br>**10:00 am** **Wholesale Inventories**<br>**Sep. F (e)** **+0.3%**<br>*Consensus* *+0.3%*<br>Aug. +0.9%<br><br>**10:00 am** **University of Michigan Consumer Sentiment**<br>**Nov. P (e)** **98.0**<br>*Consensus* *97.9*<br>Oct. 98.6<br><br>Fed Speaker: Gov. Quarles (9:00 am) |

[c] = consensus [D] = date approximate

Upcoming Policy Meetings | Bank of Canada: Dec. 5, Jan. 9, Mar. 6 | FOMC: Dec. 18-19, Jan. 29-30, Mar. 19-20

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