BMO Capital Markets®
We're here to help.™

BMO CAPITAL MARKETS ECONOMICS

Focus

A weekly financial digest

Douglas Porter, CFA, Chief Economist, BMO Financial Group

December 14, 2018

2019 Outlook Edition

Feature Article
Page 10

China: Weathering the Trade Storm

Canada-China Tensions Increase

U.S.-China Trade Talks Progress

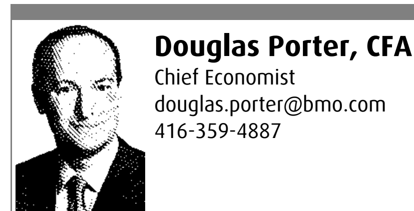
More Signs of China Slowdown

Dovish ECB Still Ends QE

PM May Survives Non-Confidence Vote

BMO Capital Markets Economics
economics.bmocapitalmarkets.com • 1-800-613-0205
Please refer to page 20 for important disclosures

Outlook 2019:
Will Winter of Discontent Make Summer of Slowdown?



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

One of the key features of this past year was the mismatch between challenging conditions for investors in almost all markets and all geographies, set against the backdrop of still-robust global growth. But that seeming conundrum can be largely explained away by noting that markets were consistently under pressure from a) trade tensions; b) a wave of geopolitical concerns (e.g., North Korea, Iran, Brexit, Italy); c) a variety of emerging market stumbles; and, d) steady Fed tightening. And, lurking beneath the surface of these, admittedly important, concerns is the broader context that global growth is grinding slower and markets are looking ahead to even cooler activity in 2019.

Following a mild slowdown year for both the global economy generally and Canada specifically, there are increasing signs that activity will indeed moderate further in 2019. We look for global GDP to dip a bit below 3½%, with China set to drift down to around a 6¼% pace, the Euro Area easing to just over 1½%, another sub-1% year for Japan, and the U.S. fiscal policy lift fading. This milder growth backdrop, along with the recent 30% correction in world oil prices, will relieve some of the pressure from still very tight labour markets around the industrialized world. Yet, OECD jobless rates at modern-day lows will continue to justify less-loose monetary policies. Significant divergences among the major central banks are likely to remain a key theme, with the Fed plowing ahead with three rate hikes over the next year (including next week's) and continuing to unwind QE, the ECB just ending QE this month, and the BOJ keeping its foot almost to the floor.

Wither financial markets, after this year's broadly weak performance, punctuated by spasms of volatility? With monetary policy snugging, global growth likely to moderate, and the cycle getting very long in the tooth (the U.S. expansion will become the longest on record by this summer), cyclical risks are mounting. A recent Blue Chip poll found that professional forecasters peg the odds of a U.S. recession in 2019 at 24% (and 35% in 2020), figures with which we wouldn't quarrel. Fundamentally, though, we expect growth to soldier on and inflation to remain contained. In bonds, the flat yield curve is likely to get even flatter as the Fed marches on and long yields only nudge up. But on both of these fronts, we would point to the second half of the 1990s cycle (which this version has many parallels with)—the curve was quite flat for years, and yet the U.S. economy forged ahead amid a tech boom, while the S&P 500 knocked down five consecutive years of returns of more than 20% (from 1995-99, inclusive). Meantime, the U.S. dollar is likely to be mixed, torn between the positive of the Fed at the very front of the rate-hike parade, and the negative of groaning twin deficits.

In normal times, it's Canada's turn to shine at this later stage in the cycle—typically benefitting from rising commodity prices and still-solid global growth. But the TSX was bludgeoned this year (down nearly 10% ytd) by trade tensions, a housing slowdown and weak domestic oil prices. Next year's growth outlook is dulled by oil production cuts, slower U.S. spending, slipping auto sales and the overhang of record consumer debt. Providing a mild offset will be the new LNG project, mildly stimulative fiscal policy in the lead-up to the October federal election, as well as

(presumably) some certainty on the North American trade front. But with the big interest-sensitive sectors still gearing lower, we look for 2019 Canadian GDP growth to simmer down to a 1.8% pace following this year's as-expected 2.1% advance. With population growth recently clocking in at 1.4% y/y, this points to quite modest per capita gains.

Even this more restrained GDP growth will tighten the labour market further, producing the lowest unemployment rate seen in Canada since the early 1970s. This will be the key ingredient convincing the Bank of Canada to tighten further in 2019, tempered somewhat by Governor Poloz's view that there is still some hidden slack in job markets—surprisingly sluggish wage growth recently lends serious credence to that opinion. Overall, we look for the Bank to hike rates two times (50 bps) in 2019, following a year when policy actually met expectations to a T. Curiously, 10- and 30-year Canadian bond yields are now only slightly above year-ago levels, and the GoC curve is even flatter than the flat Treasury curve; bonds clearly expect cooler Canadian growth next year as well. That view also appears to be built into the Canadian dollar, which spent most of the year on the defensive amid trade tensions and wobbly WCS prices. We look for only a mild recovery in 2019 for the loonie amid firmer oil prices and if/when the USMCA is ratified.

Fed Policy: When Neutral Becomes Normal

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

The FOMC is widely expected to raise the fed funds target range by 25 bps to 2.25%-to-2.50% (2.375% midpoint) on December 19th, marking the fifth consecutive quarterly move. However, this should herald a slower cadence ahead, with extra caution dictated by three factors. First, with the target range butting against the bottom of the FOMC's range of projections of the neutral rate (2.5%-to-3.5%), the next move starts taking the first steps into net restrictive territory. And, there's always a wide confidence interval around any estimate of the neutral rate.

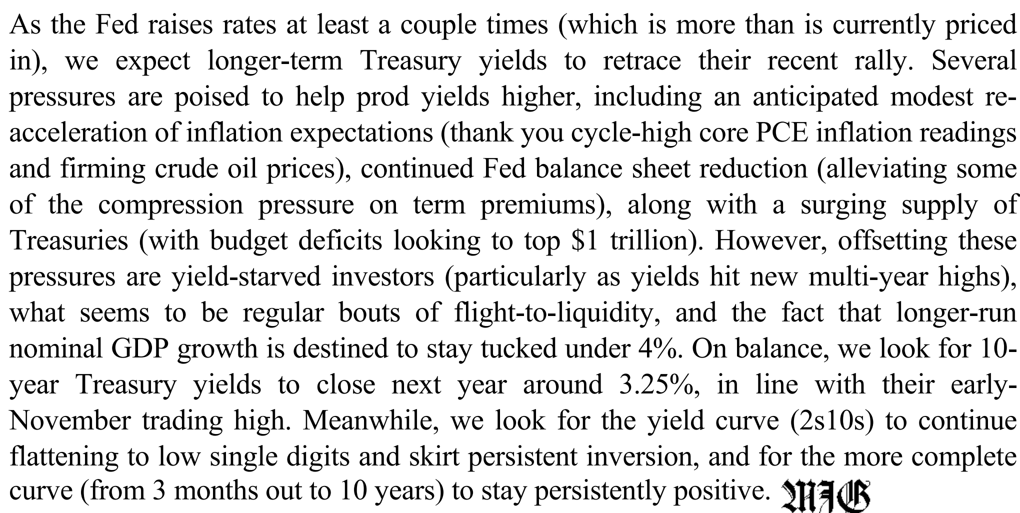
Second, the recent ebbing of core PCE inflation emphasized the risk the Fed still faces on the inflation front, in both hitting the 2% objective and having it temporarily run slightly above-target to provide comfort that 2% will stick. Core PCE inflation was 1.8% y/y in October with the shorter-term trends running even slower. Although November's report showed core CPI inflation and its shorter-term metrics turning up, with real GDP growth running above potential and the economy supposedly operating at full capacity/employment, the inability to maintain 2% inflation means there is more slack in the economy than estimated and/or the secular forces of disinflation are still exerting more pressure than the cyclical forces of inflation.

Third, the housing sector has recently weakened more than expected, hinting that the Fed's policy tightening is proving to be more potent for this critical sector, which could be the proverbial "canary in a coalmine" for the broader economy. Higher mortgage rates have definitely eroded affordability. However, with household balance sheets in good shape, sturdy income growth supported by job creation and rising wages, along with elevated consumer confidence, it's hard to explain why housing has weakened as much as it has. Perhaps the lingering psychological scars from the Great Recession and a larger-than-anticipated impact of tax reform (limitations on mortgage interest

deductibility, larger standard deduction) have made homebuyers more sensitive to higher mortgage rates and dimming price appreciation prospects.

Reflecting these factors, and because variable intervals between Fed rate hikes becomes communicatively easier with pressers after each FOMC meeting, we expect rate hikes on May 1st and September 18th, with one further hike in early 2020. This results in a peak fed funds target range of 3.00%-to-3.25% with a 3.125% midpoint, which is slightly above the FOMC's median projection of neutral (which is currently 3.00%).

There are a couple of other factors that point to a more cautious Fed theme for 2019. The annual rotation of regional Fed presidents should take on a less hawkish tone. The outgoing group of Richmond's Barkin, Atlanta's Bostic, San Francisco's Daly and Cleveland's Mester will be replaced by the incoming group of St. Louis' Bullard, Chicago's Evans, Kansas City's George and Boston's Rosengren. Also, the FOMC will be keeping its eye on the ramifications of balance sheet reduction, on alert for any adverse reaction in financial markets. So far this year, the Fed's holdings of Treasuries and MBS have shrunk by $327 billion, and we estimate this could top $350 billion by year-end before exceeding $425 billion next year.



As the Fed raises rates at least a couple times (which is more than is currently priced in), we expect longer-term Treasury yields to retrace their recent rally. Several pressures are poised to help prod yields higher, including an anticipated modest re-acceleration of inflation expectations (thank you cycle-high core PCE inflation readings and firming crude oil prices), continued Fed balance sheet reduction (alleviating some of the compression pressure on term premiums), along with a surging supply of Treasuries (with budget deficits looking to top $1 trillion). However, offsetting these pressures are yield-starved investors (particularly as yields hit new multi-year highs), what seems to be regular bouts of flight-to-liquidity, and the fact that longer-run nominal GDP growth is destined to stay tucked under 4%. On balance, we look for 10-year Treasury yields to close next year around 3.25%, in line with their early-November trading high. Meanwhile, we look for the yield curve (2s10s) to continue flattening to low single digits and skirt persistent inversion, and for the more complete curve (from 3 months out to 10 years) to stay persistently positive. MJG

The Big Fade

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

The U.S. economy surprised to the upside in 2018 as businesses responded forcefully to tax reforms and deregulation. Barring a weak final quarter, growth looks to come in at 2.9%, the fastest since 2005. The burst of activity carved the jobless rate to 3.7%, the lowest since 1969, compelling the President to claim this is *"the greatest economy in the history of our country"*. Although the facts would beg to differ—growth was stronger (4.7%) and the jobless rate lower (2.5%) in 1953, to pick just one example—growth did surpass our call (2.6%) at the start of the year and marked a nice step-up from the post-recession mean of 2.3%.

Unfortunately, the economy won't repeat this stellar act in 2019. Annual growth is projected to slow to 2.4% (and more tellingly to 2.0% from 3.1% on a Q4/Q4 basis), two tenths below the Consensus Economics call. Highly expansionary fiscal/monetary policies and supportive wealth effects are fading, just when capacity constraints are becoming more binding and political instability is poised to ratchet higher.

The **trade war** is another headwind, especially if it opens on new fronts (Europe and Japan). While a strong dollar has largely shielded American businesses and households from the corrosive effects of import tariffs, the damage could mount quickly if trade talks between the U.S. and China fail. While the tariff toll on GDP is likely to be limited to 0.4%, this assumes no further escalation apart from the planned 15 ppts hike in the tariff rate on $200 billion worth of China's goods on March 1. Due to slower global demand and the trade-weighted dollar's 8% rise this year to 16-year highs, a further widening in the already decade-large U.S. trade deficit is expected to carve 0.5 ppts from growth in 2019.

The lift from tax cuts and new federal spending, which added a full percentage point to GDP growth in 2018, will fade to just 0.2 ppts in 2019. New fiscal stimulus is limited by a budget shortfall fast approaching $1 trillion. On the monetary side, the Fed has pushed real policy rates above zero for the first time in a decade, and will likely move twice more in 2019. The interest-sensitive housing market has already sagged in response, with no help from the past escalation in prices and lower limits on mortgage interest deductibility.

Along with nagging tariffs, slowing profits and growing labour shortages, **companies will need to contend with more political uncertainty**. A divided Congress and greater congressional zeal to investigate the Trump Administration ahead of the 2020 election can only dial up the drama in Washington, raising the risk of a government shutdown or credit event should Congress not agree to fund the various agencies or raise the debt ceiling.

Although the economy will slow in 2019, there's some reason for cheer. The jobless rate should ease to 3.5%, matching the second lowest level since 1953. **Recession odds next year are likely less than one in four,** meaning there's a good chance the expansion will become the longest on record at over ten years. Rising employment and incomes remain sturdy pillars for households, along with a record-low debt service burden. Businesses need to add capacity (largely via automation) to contend with worker shortages. Benign inflation means the Fed is closer to the end than the beginning of its tightening cycle.

So what could go wrong? A more heated trade war, a spark in inflation or a deeper dive in equities would pose headwinds. Fiscal policy could turn outright restrictive in the fourth quarter if Congress fails to pass legislation to avoid automatic spending cuts of about $100 billion (0.5% of GDP) starting in October 2019. Still, for now, the fundamentals look reasonably healthy, suggesting the economy will merely downshift to a more sustainable rate. And, if productivity churns higher, growth could exceed expectations… this time for a much sounder reason than simply spiking the fiscal punch bowl.

BoC to Stay Unpredictable in 2019

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

The last few months of 2018 have provided a stark reminder that the Bank of Canada can at times be as unpredictable as ever. October's vigorously upbeat tone gave way to a much more cautious one in December. That comes after NAFTA worries clouded the outlook for a large chunk of this past year and kept the BoC sidelined in Q2. Even so, there were three rate hikes in 2018, just as we forecasted at this time last year.

Oil is the big worry for the Bank at present; but, funnily enough, the discounts on heavy and light crude have fully retraced since the Alberta production cuts were announced and are sitting in historically normal ranges. WTI is still down $20 since September, and global prices are lower—an unambiguous negative for the outlook. However, the level of concern should have eased meaningfully. Even so, early 2019 growth will take a hit from lower Alberta production. The latter will likely be enough to prompt the BoC to stay on hold through Q1 barring a positive growth shock. Once it's clear that the broader economy is holding up in the face of the production cuts and that growth will rebound in Q2, the domestic coast should be clear for another rate hike. However, the global and financial backdrop could inject some uncertainty.

We are forecasting two 25 bp rate hikes from the BoC in 2019, in April and October. While the rationale behind the pause until April is outlined above, the move to the sidelines through mid-year is driven by a slowing North American growth profile. Indeed, we're looking for the Fed to be less mechanical in 2019, shifting from quarterly moves to a more data-dependent stance. Our call is for Fed hikes in May and September—broadly in line with the BoC—bringing policy rates to the mid-point of the Fed's neutral range. For the Bank, getting to neutral will likely take a bit longer, perhaps a 2020 story if the cycle can last that long.

Looking at the Canada curve, higher policy rates aren't going to mean materially higher yields. Indeed, the curve is likely to stay relatively flat through 2019, with the potential for inversion (in 2s10s) rising as we move through the year. Current outright yield levels are quite low, as the market has rallied significantly over the past three months amid global financial market pressure and the BoC's dovish turn. There's room for higher yields, with our forecast for the 10-year rate at 2.5% for the end of 2019, but the broader curve (think 2s10s) is unlikely to steepen meaningfully until rate *cuts* come into focus.

For the **loonie**, the struggle is expected to continue into the early portion of 2019. The Bank's move to the sidelines for now is expected to keep the currency on the defensive, though much of that shift is already priced in. We have the C$ little-changed through 2019, staying in a C$1.30-to-C$1.35 range, as the BoC matches the Fed's moves and amid a decelerating U.S. growth backdrop. An expected recovery in world oil prices should provide some support as we head toward mid-year, but that will rely on Canadian oil discounts remaining well behaved—never a sure thing. *B.A.A.R.*

Regional Outlook: Convergence Continues

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

The broad trend of **regional convergence** should remain in place in Canada in 2019, with two major themes to watch. First, oil prices have again thrown a wrench in the outlook for the three producing provinces. Elsewhere, most provinces are coming off very strong runs and are in the process of slowing toward potential growth, much like we're seeing at the national level. Scanning across the map, British Columbia is expected to remain at the front of the pack with 2.5% growth, receiving a boost as a major LNG project breaks ground. Alberta will see one of the more noteworthy slowdowns, slipping to 1.5% as oil production cuts weigh and capital spending plans pull back. Saskatchewan looks to be relatively stagnant as well in the mid-1% range. Manitoba, however, will likely continue its workmanlike performance, just below its steady 2.3% average pace so far this cycle.

Ontario and Quebec have been growth drivers recently, but both have shown signs of moderating. Growth in these two is expected to ease to 2.0% and 1.9%, respectively, in 2019. Still, external conditions—solid U.S. growth, still-low interest rates, and demographic momentum—remain favourable. Also, trade risks have faded with the USMCA and, along with a pro-business policy shift, should support confidence in 2019. This could counter some softness in housing and consumer spending.

Finally, a population boost has lifted growth in much of Atlantic Canada well above potential over the past two years. While that could persist into 2019, we believe the process of gradually returning to trend will play out in this part of the country as well—we peg average growth in the region at just over 1%. One challenge will be retaining recent immigrants in a relatively weak (albeit tightening) labour market, which would buck the trend of population flows to stronger regional economies. Some provinces in the region are also starting to feel a hangover after a number of major private- and public-sector capital spending projects reached completion.

From a **fiscal perspective**, 2019 will be dominated by the looming federal election. Given the recent trend of forecast revisions (i.e., softer growth and deflators), Ottawa could finally face a year that is not characterized by upside revenue surprises. To be sure, the 2019 budget will deliver some pre-election goodies, but the attached dollar amount will be the big question. Provincially, the biggest uncertainty surrounds Ontario, which has yet to table a plan beyond FY18/19. We believe the Province has set the deficit bar low to start the mandate, but we've already seen some negative credit action, and the market would like some clarity on how quickly the $14.5 billion shortfall will be closed. Alberta is another one to watch, as the 2019 budget comes against a less favourable oil price backdrop and ahead of a spring election.

In the U.S., most **states in the BMO footprint** are expected to see growth soften in 2019, consistent with the national average—especially true in the Midwest. Business investment is expected to moderate as the impact of fiscal stimulus fades; higher interest rates have softened housing across much of the country, with the Midwest no exception; and trade tensions with China arguably pose the largest risk to outlook, though clarity on USMCA is certainly a win for the trade-intensive region. That said, most of these states are still expected to see growth slightly above potential for 2019. Rob K.

Venturing Into the Great Unknown That Is 2019

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

I don't remember being so apprehensive for a year-ahead piece in years, given the many sources of uncertainty as 2019 fast approaches…

Politics will take centre stage again. The **European parliamentary elections**, minus the U.K., will have all 705 seats up for grabs in May. Some key figures, including the ECB's Mario Draghi, as well as Jean-Claude Juncker and Donald Tusk, will be replaced. The new group could steer to the right, as the undercurrents of populism are bubbling again, though to a lesser degree than in 2017. In **Germany**, Angela Merkel's influence will wane as politicians count down her remaining months as Chancellor (her term actually ends in 2021). New CDU Chair Annegret Kramp-Karrenbauer is regarded as Merkel's heir-apparent but she will likely put her personal stamp on key issues, such as immigration, in order to appease the increasingly influential non-traditional parties such as the Greens and the AfD. In **France**, 2019 will mark President Macron's second year as leader. The past year was spent marketing himself as Europe's new leader, but 2019 will be focused on issues closer to home, to change his reputation as being out of touch. Recent budgetary tweaks come at a cost (~€10 bln), and France's fiscal health will return to the spotlight. It was just last year that the deficit ratio fell below the EU's 3% limit for the first time in a decade; it looks to deteriorate to around 3.3% in 2019. Meantime, **Italy** will temporarily avoid penalties for its new budget, but the cost to its planned measures may rise as the economy struggles, bringing back the threat of the Excessive Deficit Procedure. In this environment, we expect **the ECB** to revise its rate guidance, from a rate hike in 'the summer' to 'later in the year' (perhaps even 2020).

The biggest unknown is **Brexit**. The U.K. Parliamentary vote will be held in January and this could play out in many ways. MPs could vote in favour of the agreement, paving the way for a 21-month transition period and trade deals to be ironed out. If it is voted down, there could be an extension of Article 50, an election, and/or another referendum. But, the EU could refuse to negotiate again, repeating the line that "*this is the best deal*". That would mean a hard Brexit, bringing the U.K. economy to a halt. Our base case is that the U.K. will manage to avoid a hard Brexit, but it will require support from the EU to pass the deal.

In **Japan**, the economy has struggled to post meaningful growth over the past decade. Real GDP grew under 1% in 2018, with some of the blame falling on a series of natural disasters. There is, however, some potential upside for 2019. Although trade talks with the U.S. (its biggest trading partner) are ongoing, the trade agreement with the EU (destination for about 10% of Japan's exports) will take provisional effect on February 1st. Then there is immigration. The aging population is weighing heavily on the economy, so Japan is widening the doorway to welcome more newcomers (interestingly, at a time when other countries are closing them) with a new immigration law that will take effect in April. And, consumers have had plenty of time to prepare for the 2 ppt hike in the sales tax to 10% in October, after a 4-year postponement. The BoJ will likely stay gun-shy about tightening monetary policy but Governor Kuroda should start to communicate a move to tweak the 0% target for 10-year JGB yields. JLee

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

	Good News	Bad News
Canada ▪ Canadian oil prices hold ▪ Detainment of Huawei CFO heightens tensions with China	**Housing Starts** +4.4% to 215,941 a.r. (Nov.)	**Capacity Utilization** -1.5 ppts to 82.6% (Q3) **Household Debt-to-Income** +0.6 ppts to 173.8% (Q3)—near all-time high **Building Permits** -0.2% (Oct.) **New Housing Price Index** unch (Oct.) **New Motor Vehicle Sales** -1.4% y/y (Oct.) **Manpower Survey—Net Outlook** -2 ppts to +12% (Q1)
United States ▪ Some progress in U.S.-China trade talks	**Retail Sales** +0.2% (Nov.) **Industrial Production** +0.6% (Nov.)—and **Capacity Utilization** +0.4 ppts to 78.5% **Consumer Prices** unch (Nov.) **Producer Prices** +0.1% (Nov.) **Job Openings** climbed to 7,079k (Oct.) **Manpower Survey—Net Outlook** +1 ppt to +20% (Q1) **Initial Claims** -27k to 206k (Dec. 8 week)	**Import Prices** -1.6% (Nov.) **NFIB Small Business Optimism** -2.6 pts to 104.8 (Nov.) **Budget Deficit** widened to $204.9 bln (Nov.)
Japan ▪ Q3 economy shrinks more than expected	**Manufacturing PMI** +0.2 pts to 52.4 (Dec. P) **Bank Lending Ex-Trusts** +2.2% y/y (Nov.) **Core Machine Orders** +7.6% (Oct.) **Tertiary Industry Index** +1.9% (Oct.) **Tankan Large Mfg Index** steady at 19 (Q4)	**Real GDP** revised down to -0.6% q/q (Q3) **Producer Prices** -0.3% (Nov.)
Europe ▪ Dovish ECB to end QE at month-end ▪ France's 2019 spending plans could breach EU budget rules ▪ Italy tweaks spending costs to lower expected budget deficit/GDP ▪ PM May survives a non-confidence vote following tumultuous week but Brexit risks remain	**Euro Area—Industrial Production** +0.2% (Oct.) **Germany—ZEW Survey** +6.6 pts to -17.5 (Dec.) **Italy—Industrial Production** +0.1% (Oct.) **Italy—Industrial Orders** +2.0% (Oct.) **U.K.—Employment** +79,000 (3 mths to Oct.) **U.K.—Jobless Rate** steady at 4.1% (3 mths to Oct.) **U.K.—Average Hourly Earnings ex. Bonus** +3.3% y/y (3 mths to Oct.)—fastest since Dec. '08	**Euro Area—Manufacturing PMI** -0.4 pts to 51.4; **Services PMI** -2 pts to 51.4; **Composite PMI** -1.4 pts to 51.3 (Dec. P) **Euro Area—Labour Costs** +2.5% y/y (Q3) **Germany—Trade Surplus** narrowed to €17.3 bln (Oct.) **U.K.—Real GDP** eased to +0.4% (3 mths to Oct.) **U.K.—Industrial Production** -0.6% (Oct.) **U.K.—Trade Deficit** widened to £11.9 bln (Oct.)
Other ▪ China agrees to cut tariffs on imported U.S. autos amid more signs of slowdown ▪ India's PM Modi loses votes in key states ahead of next year's election; RBI governor unexpectedly quits ▪ Brazil on hold	**China—Consumer Prices** +2.2% y/y; **Producer Prices** +2.7% y/y (Nov.) **China—Aggregate Yuan Financing** 1.5 trln (Nov.)—and **New Yuan Loans** 1.3 trln **China—M2 Money Supply** +8.0% y/y (Nov.) **China—Fixed Asset Investment** +5.9% y/y (Jan.-to-Nov.)	**China—Exports** slowed to +5.4% y/y; **Imports** slowed to +3.0% y/y (Nov.) **China—Retail Sales** slowed to +8.1% y/y; **Industrial Production** +5.4% y/y (Nov.) **China—Foreign Direct Investment** -26.3% y/y (Nov.) **Australia—Westpac Consumer Confidence** down to +0.1% (Dec.) **Australia—NAB Business Confidence** -2 pts to 3 (Nov.)

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

China: Weathering the Trade Storm

Art Woo
Senior Economist
art.woo@bmo.com
416-359-4525

While there has been some calming in the U.S.-China trade war recently, it is far from over. In turn, some 'China Bears' are doubling-down on their long-held view that the Middle Kingdom is on the brink of disaster (e.g., hard landing, banking crisis or bursting of housing bubble). Though not impossible, we continue to see this as too extreme and not reflective of Beijing's recent strides to tackle financial stability risks emanating from the economy's heavy reliance on leverage[1] (*Chart 1*).

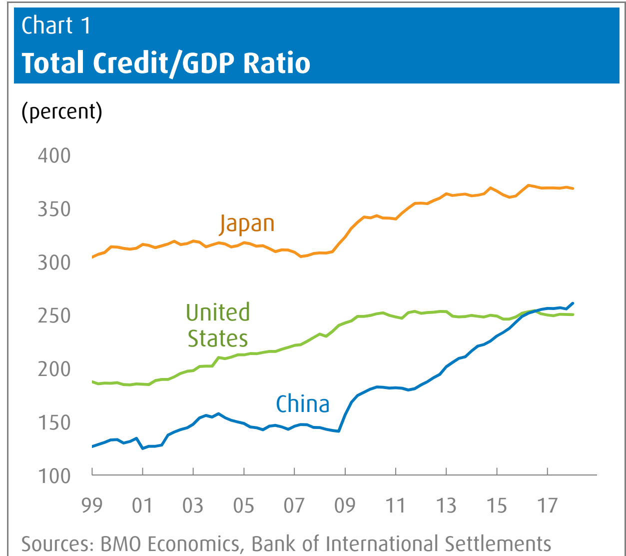
Even if the tensions flare again, the trade war is unlikely to tip China's economy into recession. But it has further complicated Beijing's goal of transitioning its economy from rapid credit-fuelled growth to a higher-quality, sustainable expansion. This drive is underscored by President Xi's 'Three Critical Battles' of preventing and resolving the major risks, conducting targeted poverty reduction, and controlling pollution. Thus, rather than undermine financial stability, the trade war is more likely to place downward pressure on China's growth trajectory, which was already facing pressure from an increasingly challenging global economic backdrop of rising interest rates and slower growth.

A Long Battle Ahead

Although Washington and Beijing have set March 1, 2019 as the deadline to resolve the trade dispute, a comprehensive deal is likely to remain elusive. Instead, there is still a meaningful risk that the trade war escalates with the Trump Administration moving to increase/expand tariffs. It is evident that Trump is not merely focused on reducing the size of the bilateral merchandise trade deficit, but also concerned about altering China's economic model. The core of Trump's complaints revolve around China's heavily managed/state-driven economy, which he argues is too reliant on: (1) excessive state subsidies/control, (2) forced/illegal technology transfer from foreign companies; and, (3) market access restrictions for foreign operators in key domestic industries.

However, forcing Beijing to overhaul its economic model in one fell swoop will not be easy, especially since it has not only served the country quite well the past two decades but also because it is supported by a different political structure. These fundamental differences explain why most China watchers, including ourselves, believe the dispute won't end quickly, perhaps lasting in some form until the next U.S. presidential election in 2020.

Chart 1
Total Credit/GDP Ratio



Sources: BMO Economics, Bank of International Settlements

The Economy Remains on Firm Footing For Now...

In the short-term, the knock-on effects of higher U.S. tariffs should be fairly manageable as (1) Beijing is letting its currency depreciate

[1] Although many economies display similar or even higher degrees of leverage, concerns over China largely revolve around: (1) its total credit/GDP ratio, estimated at 261% of GDP in Q1/18 by the Bank of International Settlements (BIS), is high for an economy of its relatively low income level (Chart 1); (2) the rise in credit/GDP took place over a relatively short period; and, (3) a significant portion of new credit extended could have been misallocated to unproductive/unprofitable infrastructure projects and companies.

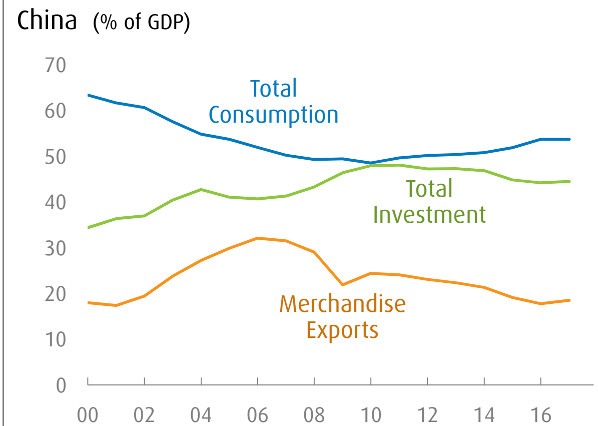
to help offset some of the impact of higher tariffs and (2) the drivers of China's economic growth have broadened in recent years with consumption playing an increasing role (*Chart 2*). In turn, the ratio of merchandise exports-to-GDP fell to 18.4% in 2017 versus a peak of 32.0% in 2006. Our base-case scenario factors in U.S. tariffs being raised to 25% on the additional US$200 billion of imports announced in September and a modest easing in both fiscal and monetary policies in China. The combined effects are expected to lower headline real GDP growth to 6.2% in 2019, compared to around 6.6% in 2018. If the trade war escalates (tariffs placed on all of China's exports to the U.S.) then real GDP growth could decline by another 0.25-0.50 percentage points depending on the magnitude of Beijing's fiscal and monetary policy responses.

Financial markets are likely to remain heavily focused on the path of the renminbi against the U.S. dollar, particularly whether the exchange rate (currently 6.9/US$) breaches the 7.0 mark (*Chart 3*). In our view, it is reasonable to believe that Beijing will let the renminbi do so, especially if the Trump Administration increases/expands tariffs. Beyond helping to offset the impact of higher tariffs from a China export/U.S. import perspective, we believe Beijing would rather protect its stock of foreign exchange reserves (US$3.2 trillion in November) rather than deplete them by intervening in the forex market to manage the renminbi's depreciation (*Chart 4*). It bears mentioning that one of the key metrics of reserve adequacy—the forex reserves/M2 money supply ratio[2]—has continued to fall, which is why Beijing chose to significantly tighten capital controls back in 2016. At 11.5% in Q3/18, it is well below what is considered to be the minimum threshold of 20%.

Moreover, Beijing's long-term objective to curb leverage and enhance financial transparency remains largely intact. The financial deleveraging campaign—composed of an array of measures that includes increasing regulatory oversight, improving financial transparency, strengthening banks' balance sheets, reducing moral hazard risks, eliminating inefficient infrastructure, removing excess industrial capacity and cooling the housing market—has not reversed course, despite pre-emptive measures introduced to help cushion the economy (*Chart 5*). Of note, Beijing just announced plans to designate at least 50 banks, securities firms and insurance companies as domestic systemically important financial institutions (i.e., too big to fail), which will not only force these entities to increase their capital requirements but also enhance financial disclosure to guard against potential systemic distress.

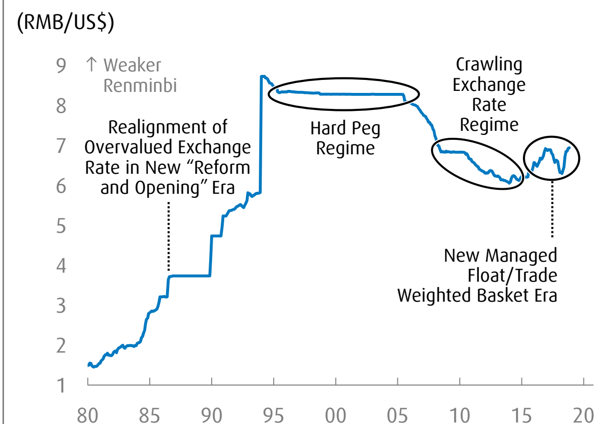
[2] This ratio is used to gauge the risk of capital flight (e.g., potential bank runs).

Chart 2
Drivers of Economic Growth Shifting



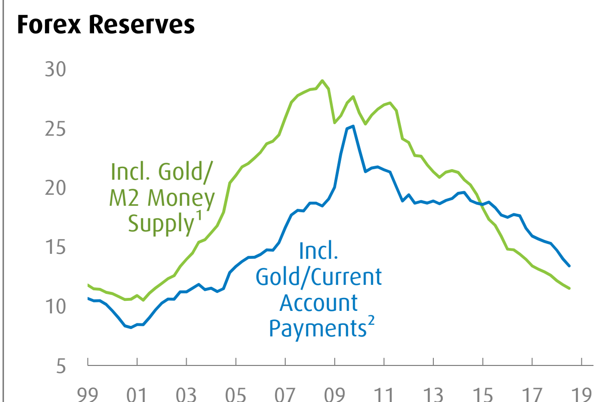
Sources: BMO Economics, Haver Analytics

Chart 3
Recent Exchange Rate Regime Transitions



Sources: BMO Economics, Haver Analytics

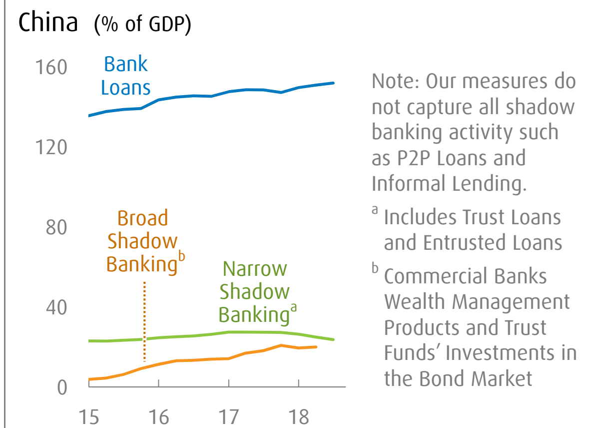
Chart 4
Forex Reserve Coverage Ratios Declining



[1] (percent) [2] (months)
Sources: BMO Economics, Haver Analytics

...But the Medium-to-Longer-Term Outlook Could Become Cloudier

Chart 5
Shadow Banking Activity has been Curtailed



Sources: BMO Economics, Haver Analytics

If it becomes clear that the trade war will not be resolved over the next year, the risks to China's medium-to-long-term growth prospects would gradually increase. Beyond a potential loss of exports to the U.S., the bigger risk is that domestic investment in manufacturing facilities could be curtailed, which could reduce China's productive capacity and potential growth rate. This is magnified by the fact that the country's merchandise exports feed large globally-integrated supply/value chains, which are not effectively controlled by Mainland Chinese-owned corporations. Put another way, a foreign multinational that relies on Chinese-owned factories to produce/assemble products could begin to relocate production outside of China. Equally vital, a more fractured economic relationship with the U.S. and other countries/regions such as Europe could inhibit China's technological progress and productivity growth.

On the flipside, China is not likely to stand still if the trade war becomes protracted. We suspect that Beijing would likely increase its efforts to close the gap between the country's capabilities and that of the global technology frontier. Rather than dismantle its high-profile *Made in China 2025* plan—which is focused on developing new technologies in 10 strategic sectors—as Trump is reportedly demanding, Beijing may feel emboldened and allocate more (financial and non-financial) resources to ensure it achieves its objective. At the same time, this may prompt Beijing to accelerate some key structural reforms, namely improving the efficiency of the large number of state-owned enterprises (SOEs) or ending the preferential treatment they receive. The latter development would benefit the private sector, which has been largely responsible for leading China's recent innovation successes, despite ongoing difficulties in accessing bank credit due to the large share taken up by SOEs.

Key Takeaways

China's policymakers are unlikely to abandon their focus on stability and return to their prior 'growth at all costs' strategy. As a result, Beijing is likely to continue tweaking its fiscal and monetary policies to address the trade war's impact on the economy rather than introduce a massive fiscal stimulus program as it did in 2008[3] when the Great Recession erupted.

---

[3] The State Council introduced a fiscal stimulus program, largely focused on infrastructure (e.g., high speed railways, roads, airports, water) and housing, amounting to RMB4.0 trillion (12.5% of 2008 GDP) on November 9, 2008.

Economic Forecast

BMO Capital Markets

Economic Forecast Summary for December 14, 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.)	1.7	2.9	2.0	1.5 ↓	1.0 ↑	2.5	2.2	1.9	3.0	2.1	1.8
Consumer Price Index (y/y % chng)	2.1	2.3	2.7	2.0	1.6	1.8	1.7	2.1	1.6	2.2	1.8
Unemployment Rate (percent)	5.8	5.9	5.9	5.7	5.7	5.6	5.6	5.5	6.3	5.8	5.6
Housing Starts (000s : a.r.)	225	219	197	211 ↑	210 ↑	207	204	200	220	213 ↑	205
Current Account Balance ($blns : a.r.)	-69.3	-66.7	-41.4	-56.7	-56.3 ↑	-56.7 ↑	-58.0 ↑	-58.9 ↑	-60.1	-58.5	-57.5 ↑
Interest Rates					(average for the quarter : %)						
Overnight Rate	1.25	1.25	1.50	1.75	1.75	2.00	2.00	2.25	0.71	1.44	2.00
3-month Treasury Bill	1.14	1.21	1.47	1.65	1.75 ↑	1.90 ↓	2.00 ↑	2.15 ↓	0.69	1.35	1.95
10-year Bond	2.24	2.28	2.28	2.35	2.20	2.30	2.45	2.55	1.78	2.30	2.35
Canada-U.S. Interest Rate Spreads					(average for the quarter : bps)						
90-day	-44	-66	-61	-70 ↑	-73 ↑	-78 ↑	-90 ↓	-88 ↓	-26	-60 ↑	-82 ↑
10-year	-52	-64	-65	-71	-75	-74 ↓	-72	-70	-55	-63	-73 ↓
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	4.2	3.5	2.6	1.9 ↓	2.4 ↑	2.0	1.9	2.2	2.9	2.4 ↓
Consumer Price Index (y/y % chng)	2.3	2.6	2.6	2.2	1.8 ↓	2.0 ↓	2.0 ↓	2.1	2.1	2.4	2.0 ↓
Unemployment Rate (percent)	4.1	3.9	3.8	3.7	3.6	3.5	3.5	3.5	4.4	3.9	3.5
Housing Starts (mlns : a.r.)	1.32	1.26	1.22	1.24	1.26 ↓	1.24 ↓	1.23 ↓	1.21 ↓	1.21	1.26	1.24 ↓
Current Account Balance ($blns : a.r.)	-487	-406	-530	-495 ↑	-521	-537 ↓	-553 ↓	-567 ↓	-449	-480	-545 ↓
Interest Rates					(average for the quarter : %)						
Fed Funds Target Rate	1.46	1.71	1.96	2.21	2.38	2.54	2.71	2.88	1.00	1.83	2.63
3-month Treasury Bill	1.58	1.87	2.08	2.35 ↓	2.45 ↓	2.70	2.90	3.05	0.95	1.95 ↓	2.75
10-year Note	2.76	2.92	2.93	3.05	2.95	3.05	3.15	3.25	2.33	2.90	3.10
EXCHANGE RATES					(average for the quarter)						
US¢/C$	79.1	77.5	76.5	75.9	74.4 ↓	74.2 ↓	74.5 ↓	74.7 ↓	77.1	77.3	74.5 ↓
C$/US$	1.27	1.29	1.31	1.32	1.34 ↑	1.35 ↑	1.34 ↑	1.34 ↑	1.30	1.29	1.34 ↑
¥/US$	108	109	112	113	113	112	111	110	112	110	111
US$/Euro	1.23	1.19	1.16	1.14	1.14 ↑	1.13 ↑	1.14	1.16 ↓	1.13	1.18	1.14
US$/£	1.39	1.36	1.30	1.28	1.24	1.23 ↓	1.26 ↓	1.29 ↓	1.29	1.34	1.26 ↓

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

Existing Home Sales

Monday, 9:00 am (expected)

		Avg. Prices
Nov. (e)	**-12.0% y/y**	**-2.5% y/y**
Oct.	-3.7% y/y	-1.5% y/y
	MLS Home Price Index	
Nov. (e)	**+2.4% y/y**	
Oct.	+2.3% y/y	

CREA will release the full set of November housing market data, and the overall picture will continue to look stable/subdued. National sales were likely down 12% y/y in the month, but keep in mind that sales were ramping up this time last year ahead of the January OSFI rule change. The average price was likely down 2.5% from a year ago, partly dampened by a hefty sales decline in the pricier Vancouver market (the MLS benchmark was likely relatively steady at 2.4% y/y). Recall that in the prior month, the median average price gain across the 26 markets tracked was just under 3% y/y, confirming the relative home-price stability across most of the country. Still, there are clear pockets of strength and weakness, as well as a pretty stark East (stronger)-West (weaker) divide in place. On the strong side, Ottawa and Montreal continue to churn out near-7% y/y price gains amid tight conditions. On the weak side, Vancouver sales were down 43% y/y, with prices for both detached homes and condos correcting. Toronto has seen prices stabilize overall, but sales were down 15% from a strong month last year.

Consumer Price Index

Wednesday, 8:30 am

Nov. (e)	**-0.4% (-0.3% sa)**	**+1.8% y/y**
Consensus	*-0.1%*	*+2.1% y/y*
Oct.	+0.3%	+2.4% y/y

	Core CPI Measures (% y/y)		
	Trimmed Mean	**Weighted Median**	**Common Comp.**
Nov.			
Oct.	+2.1%	+2.0%	+1.9%

Consumer prices likely fell heavily for the second time in three months in November. Gasoline prices dropped 10%, alone subtracting 0.3 ppts from the headline. CPI is seasonally weak in the final two months of the year, but our call is well below the norm for November, leaving the seasonally adjusted decline at 0.3%. Mortgage interest costs will likely continue to be an upside for CPI, though slowing home price gains will be a bit of an offset. There remains significant uncertainty around airfares as we have yet to get a full year of data to have a better idea of the new seasonal pattern after the methodology change in March. This month, Statscan will change its methodology on calculating smartphone prices; and, while we'd lean toward that being disinflationary, we'll have to wait and see. Our call for CPI will trim annual inflation to 1.8% y/y. The Bank of Canada's core CPI measures have hovered around 2% over the past seven months, consistent with its target. We're looking for the core measures to hold steady, with the risks tilted to the downside due to strong year-ago increases.

Real GDP at Basic Prices

Friday, 8:30 am

Oct. (e)	**+0.2%**
Consensus	*+0.2%*
Sep.	-0.1%

Our early read on October real GDP is for a 0.2% gain, but this is very crude given that key data on manufacturing, wholesale and retail sales are still pending—all will be released next week. Here's what we *do* know: Auto sales were solid in the month, and production ticked higher. Cannabis legalization also began around mid-month, which could provide a modest boost. And, oil production cuts were not in play yet (could actually see a modest rebound from September's decline). All told, this would set up growth in all of Q4 for something around 1.5% annualized, a sluggish finish to the year.

Retail Sales

Friday, 8:30 am

		Ex. Autos
Oct. (e)	**+0.6%**	**+0.2%**
Consensus	*+0.6%*	*+0.4%*
Sep.	+0.2%	+0.1%

Canadian retail sales are expected to rise 0.6% in October, led by a solid gain in autos. Excluding autos, look for a more modest 0.2% gain as gas prices were lower in the month. Also keep an eye on building materials stores, which have seen sales fall more than 1% in each of the past three months alongside weaker housing activity. An expected small volume gain will help monthly GDP, along with pending manufacturing and wholesale data. The bigger picture is that Canadian consumer spending has mellowed alongside higher interest rates and softer housing activity.

BoC Business Outlook Survey & Senior Loan Officer Survey (Q4)
Friday, 10:00 am

The Bank of Canada's winter Business Outlook Survey (BOS), likely compiled in late October and early November, will likely remain in decent shape, but could show signs of jitters about the economic outlook. The volatility in markets, uncertainty around the U.S.-China trade war, lingering USMCA uncertainty, and falling oil prices likely drove a bit more caution than in the previous survey. The BOS indicator (a summary measure for the survey) was not far from historical highs in the prior two surveys, and would do well to hold steady in this survey, though a modest decline seems more likely.

Employment and investment expectations were well above the long-term average in the prior survey, leaving room for a pullback while continuing to point to solid growth in both. Future sales growth was about average last quarter, and is expected to be little changed. The timing of the survey encompasses falling oil prices, so there could be some regional divergence, as the commodity producing regions will likely see broadly softer sentiment. Meantime, the rest of the country looks to be in decent shape, though trade uncertainty and the BoC's October rate hike could weigh a bit. The latter could also mean tighter credit conditions in the BOS and Senior Loan Officer Survey.

Capacity pressures are a key barometer for the BoC to assess where the economy is operating relative to potential. Downward revisions to GDP are driving a rethink at the BoC, which we'll only get the result of in January. We'll be watching to see if capacity pressures retreated after printing very high levels in Q2 and Q3. With respect to the labour market, shortages rose in recent quarters, and we look for more of the same even if wage growth hasn't really reflected a tightening market.

The inflation questions (input and output) could show some easing pressures. Falling energy prices are the key driver here, even as the weaker C$ is lifting import costs. And, inflation expectations aren't expected to move much, holding around 2%. Overall, the tone of the survey is expected to be more cautious than in the fall, but still positive. Even so, we're not expecting anything that will alter the BoC's bias to hold rates steady in January.

United States

Michael Gregory, CFA
Deputy Chief Economist
michael.gregory@bmo.com
416-359-4747
Sal Guatieri
Senior Economist
sal.guatieri@bmo.com
416-359-5295

Housing Starts
Tuesday, 8:30 am

Nov. (e)	**1.230 mln a.r. (+0.2%)**
Consensus	*1.230 mln a.r. (+0.2%)*
Oct.	1.228 mln a.r. (+1.5%)
	Building Permits
Nov. (e)	**1.250 mln a.r. (-1.2%)**
Consensus	*1.270 mln a.r. (+0.4%)*
Oct.	1.265 mln a.r. (-0.4%)

Amid worsening affordability, housing starts are expected to see only the tiniest of rebounds in November after a horrid hurricane season. Recall, this is the month the NAHB homebuilders index plunged by the third most on record. Heavy snowfall piled on. While loftier permits suggest some increase in starts to 1.23 million annualized, this would still leave the level below the year-to-date average (1.26 million). It looks to be a clean sweep of quarterly declines for residential construction this year.

Existing Home Sales
Wednesday, 10:00 am

Nov. (e)	**5.20 mln a.r. (-0.4%)**
Consensus	*5.20 mln a.r. (-0.4%)*
Oct.	5.22 mln a.r. (+1.4%)

Large declines in pending home sales and new mortgage applications in October suggest existing home sales (which track closings) fell for the seventh time in eight months in November. A 0.4% dip to 5.20 million annualized would reduce the recent trend to two-year lows. While the supply of resale homes has not risen as fast as new homes, prices have still lost their zing. The yearly rate for median prices has slipped below 4% from above 6% in mid-2017.

FOMC Announcement and Summary of Economic Projections

Wednesday, 2:00 pm
Press conference at 2:30 pm

The FOMC is widely expected to raise the fed funds target range by 25 bps to 2.25%-to-2.50%, with a 2.375% midpoint, marking the fifth consecutive quarterly move. And, to signal a slower rate hike cadence ahead, we look for the Fed to modify its forward-looking language by dropping the reference to *"gradual"* actions, which has become synonymous with quarterly moves (the Bank of Canada also did this recently). Other things to watch for in the statement, Summary of Economic Projections and press conference:

- The statement's economic assessment should mention recent weakness in the housing market. In the presser, Chairman Powell will likely emphasize that such developments are a key reason why the Fed must tread more carefully moving forward.
- Governor Michelle Bowman will cast a vote and plot a "dot" for the first time. We reckon she'll come in at the median or possibly a bit below. If the former, it will take two currently-at-the-median calls to change in order to dial down the median projection in any year (and only one if Bowman comes in below). As such, we anticipate the number of rate hikes in 2019's new median projection will drop from three to two.
- The median projection of the longer-run fed funds rate (currently 3.00%) is likely to drop back down to 2.875% with a chance it could be 2.75%. And, at some point, the median forecast of the longer-run unemployment rate will ratchet down from 4.5%.
- We also look for Powell to emphasize that with pressers after each FOMC confab beginning in January, every meeting is now truly "live".

Durable Goods Orders

Friday, 8:30 am

		Ex. Transport
Nov. (e)	**+2.0%**	**+0.3%**
Consensus	*+2.0%*	*+0.3%*
Oct.	-4.3%	+0.2%
	Nondef. Capital Goods ex. Air	
Nov. (e)	**+0.3%**	
Consensus	*+0.1%*	
Oct.	unch	

Higher Boeing sales should see durable goods orders lift-off 2.0% in November, retracing nearly half of October's nosedive. Core capital goods orders, which have struggled to leave the tarmac recently after surging an annualized 16% in the four months to July on tax cuts, are expected to rise 0.3%. While the fiscal jolt is fading, there is enough pep in consumer spending to keep factory order-books fully stocked for a while. Non-residential investment likely picked up in Q4 after slowing in Q3, though its average 10% annualized gain in the first half of the year almost surely marks the high-point for the rest of the cycle.

Personal Spending and Income

Friday, 10:00 am

	Personal Spending	Personal Income
Nov. (e)	**+0.3%**	**+0.3%**
Consensus	*+0.3%*	*+0.3%*
Oct.	+0.6%	+0.5%
	Core PCE Price Index	
Nov. (e)	**+0.2%**	**+1.9% y/y**
Consensus	*+0.2%*	*+1.9% y/y*
Oct.	+0.1%	+1.8% y/y

Strong core retail sales should offset lower gas station receipts to lift personal spending 0.3% in November. A similar-sized gain in volumes following a hearty 0.4% advance in October should anchor a 3.2% annualized increase in real consumer spending in Q4. While this would mark some slowing from the average 3.7% pace of the prior two tax-cut-stoked quarters, it would still imply a merry holiday shopping season. Despite fading wealth and credit trends, household spending remains supported by lofty confidence amid the best job prospects in nearly half a century and by solid income growth due to steady hiring and rising wages. Personal income is expected to increase 0.3% in November and 4.3% y/y. Mild inflation has also greased spending power. While an expected 0.2% increase in core PCE prices (matching the core CPI) would lift the yearly rate to 1.9%, this is still shy of the Fed's target.

		Dec 14 [1]	Dec 7	Week Ago	4 Weeks Ago	Dec. 31, 2017
					(basis point change)	
Canadian Money Market	Call Money	1.75	1.75	0	0	75
	Prime Rate	3.95	3.95	0	0	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	1.63	1.63	0	-7	57
	United States	2.41	2.39	2	6	103
	Japan	-0.25	-0.20	-5	4	-9
	Eurozone	-0.31	-0.32	0	1	2
	United Kingdom	0.90	0.91	-1	1	38
	Australia	2.02	1.99	3	8	24
2-Year Bonds	Canada	2.04	2.00	4	-18	35
	United States	2.73	2.71	2	-7	84
10-Year Bonds	Canada	2.11	2.07	4	-25	7
	United States	2.88	2.85	4	-18	48
	Japan	0.03	0.05	-3	-7	-2
	Germany	0.25	0.25	0	-12	-17
	United Kingdom	1.26	1.26	0	-15	8
	Australia	2.46	2.45	2	-22	-17
Risk Indicators	VIX	21.2	23.2	-2.1 pts	3.0 pts	10.1 pts
	TED Spread	39	39	1	9	8
	Inv. Grade CDS Spread [2]	77	80	-4	2	27
	High Yield CDS Spread [2]	406	411	-5	6	99
					(percent change)	
Currencies	US¢/C$	74.71	75.06	-0.5	-1.8	-6.1
	C$/US$	1.339	1.332	—	—	—
	¥/US$	113.55	112.69	0.8	0.6	0.8
	US$/€	1.1289	1.1379	-0.8	-1.1	-6.0
	US$/£	1.255	1.273	-1.4	-2.2	-7.1
	US¢/A$	71.68	72.08	-0.6	-2.2	-8.2
Commodities	CRB Futures Index	181.42	184.15	-1.5	-3.1	-6.4
	Oil (generic contract)	51.64	52.61	-1.8	-8.5	-14.5
	Natural Gas (generic contract)	3.91	4.49	-12.8	-8.4	32.5
	Gold (spot price)	1,236.35	1,248.35	-1.0	1.2	-5.1
Equities	S&P/TSX Composite	14,709	14,795	-0.6	-2.9	-9.3
	S&P 500	2,630	2,633	-0.1	-3.9	-1.6
	Nasdaq	7,000	6,969	0.4	-3.4	1.4
	Dow Jones Industrial	24,347	24,389	-0.2	-4.2	-1.5
	Nikkei	21,375	21,679	-1.4	-1.4	-6.1
	Frankfurt DAX	10,879	10,788	0.8	-4.1	-15.8
	London FT100	6,858	6,778	1.2	-2.2	-10.8
	France CAC40	4,864	4,813	1.1	-3.2	-8.4
	S&P ASX 200	5,602	5,681	-1.4	-2.2	-7.6

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

Global Calendar
December 17 – December 21

BMO Capital Markets®

	Monday December 17	Tuesday December 18	Wednesday December 19	Thursday December 20	Friday December 21
Japan			**Trade Balance** **Nov. '18 (e) -¥630.b bln** Nov. '17 +¥105.2 bln BoJ Monetary Policy Meeting (Dec. 19-20)	**All-Industry Activity Index** **Oct. (e) +2.0%** Sep. -0.9% **Machine Tool Orders** **Nov. F (e) -16.8% y/y** Oct. -0.7% y/y	**CPI / Core CPI** **Nov. (e) +0.8% y/y +1.0% y/y** Oct. +1.4% y/y +1.0% y/y **CPI ex. Fresh Food & Energy** **Nov. (e) +0.4% y/y** Oct. +0.4% y/y **Department Store Sales** **Nov.** Oct. +1.6% y/y
Euro Area	EURO AREA **Trade Surplus** **Oct. (e) €14.0 bln** Sep. €13.4 bln **Consumer Price Index** **Nov. F (e) -0.2% +2.0% y/y** Oct. +0.2% +2.2% y/y **Core CPI** **Nov. F (e) +1.0% y/y** Oct. +1.1% y/y	GERMANY **Ifo Business Climate** **Dec. (e) 101.6** Nov. 102.0			EURO AREA **Consumer Confidence** **Dec. A (e) -4.3** Nov. -3.9 GERMANY **GfK Consumer Confidence** **Jan. (e) 10.3** Dec. 10.4 FRANCE **Consumer Spending** **Nov. (e) unch -1.8% y/y** Oct. +0.8% +0.9% y/y **Real GDP** **Q3 F (e) +0.4% +1.4% y/y** Q3 P +0.4% +1.4% y/y Q2 +0.2% +1.6% y/y ITALY **Consumer Confidence Index** **Dec. (e) 114.0** Nov. 114.8
U.K.	**Rightmove House Prices** **Dec.** Nov. -1.7% -0.2% y/y		**Consumer Price Index** **Nov. (e) +0.2% +2.3% y/y** Oct. +0.1% +2.4% y/y **Core CPI** **Nov. (e) +1.8% y/y** Oct. +1.9% y/y **Producer Price Index—Output** **Nov. (e) -0.1% +3.0% y/y** Oct. +0.3% +3.3% y/y	**Retail Sales (incl. Fuel)** **Nov. (e) +0.3% +2.0% y/y** Oct. -0.5% +2.2% y/y 7:00 am ET BoE Monetary Policy Meeting and Minutes	**Real GDP** **Q3 F (e) +0.6% +1.5% y/y** Q3 P +0.6% +1.5% y/y Q2 +0.4% +1.2% y/y **GfK Consumer Confidence** **Dec. (e) -14** Nov. -13
Other		AUSTRALIA RBA Minutes from Dec. 4 meeting	CHINA: Annual Central Economic Work Conference (December 19-21) NEW ZEALAND **Real GDP** **Q3 (e) +0.6% +2.8% y/y** Q2 +1.0% +2.8% y/y	AUSTRALIA **Employment** **Nov. (e) +20,000** Oct. +32,800 **Jobless Rate** **Nov. (e) 5.0%** Oct. 5.0%	

Upcoming Policy Meetings | BoE: Feb. 7, Mar. 21, May 2 | ECB: Jan. 24, Mar. 7, Apr. 10

North American Calendar
December 17 – December 21

BMO Capital Markets®

Monday December 17

Canada

8:30 am	Int'l Securities Transactions Inflows	Outflows
Oct.		
Sep.	$7.7 bln	$10.6 bln

9:00 am	Existing Home Sales[D]	Average Prices
Nov. (e)	**-12.0% y/y**	**-2.5% y/y**
Oct.	-3.7% y/y	-1.5% y/y

9:00 am	MLS Home Price Index[D]
Nov. (e)	**+2.4% y/y**
Oct.	+2.3% y/y

United States

8:30 am	Empire State Manufacturing Survey
Dec. (e)	**21.0**
Consensus	*20.0*
Nov.	23.3

10:00 am	NAHB Housing Market Index
Dec. (e)	**61**
Consensus	*60*
Nov.	60

4:00 pm	Net TIC Flows Total	Long Term
Oct.		
Sep.	-$29.1 bln	$30.8 bln

Business Roundtable CEO Economic Outlook Survey (Q4)[D]

11:30 am — 13- & 26-week bill auction $75 bln

Tuesday December 18

Canada

8:30 am	Mfg. Sales	Mfg. New Orders
Oct. (e)	**+0.7%**	**+0.5%**
Consensus	*+0.3%*	*n.a.*
Sep.	+0.2%	-0.4%

United States

8:30 am	Housing Starts
Nov. (e)	**1.230 mln a.r. (+0.2%)**
Consensus	*1.230 mln a.r. (+0.2%)*
Oct.	1.228 mln a.r. (+1.5%)

8:30 am	Building Permits
Nov. (e)	**1.250 mln a.r. (-1.2%)**
Consensus	*1.270 mln a.r. (+0.4%)*
Oct.	1.265 mln a.r. (-0.4%)

FOMC Meeting Begins

11:00 am — 4- & 8-week bill auction announcements

Wednesday December 19

Canada

8:30 am	Consumer Price Index	
Nov. (e)	**-0.4% (-0.3% sa)**	**+1.8% y/y**
Consensus	*-0.1%*	*+2.1% y/y*
Oct.	+0.3%	+2.4% y/y

8:30 am	Trimmed Mean Core CPI
Nov.	
Oct.	+2.1% y/y

8:30 am	Weighted Median Core CPI
Nov.	
Oct.	+2.0% y/y

8:30 am	Common Component Core CPI
Nov.	
Oct.	+1.9% y/y

United States

7:00 am	MBA Mortgage Apps
Dec. 14	
Dec. 7	+1.6%

8:30 am	Current Account Deficit
Q3 (e)	**$132.6 bln**
Consensus	*$124.5 bln*
Q2	$101.5 bln

10:00 am	Existing Home Sales
Nov. (e)	**5.20 mln a.r. (-0.4%)**
Consensus	*5.20 mln a.r. (-0.4%)*
Oct.	5.22 mln a.r. (+1.4%)

2:00 pm — FOMC Announcement and Summary of Economic Projections

2:30 pm — Fed Chair Powell's Press Briefing

Thursday December 20

Canada

8:30 am — Survey of Employment, Payrolls, and Hours (Oct.)

8:30 am	ADP Employment Report
Nov.	
Oct.	-22,970

8:30 am	Wholesale Trade
Oct. (e)	**+0.4%**
Sep.	+0.5%

Noon — 3-year bond auction $2.0 bln

United States

8:30 am	Initial Claims
Dec. 15 (e)	**222k (+16k)[C]**
Dec. 8	206k (-27k)

8:30 am	Continuing Claims
Dec. 8	
Dec. 1	1,661k (+25k)

8:30 am	Philadelphia Fed Index
Dec. (e)	**14.0**
Consensus	*15.0*
Nov.	12.9

10:00 am	Leading Indicator
Nov. (e)	**unch**
Consensus	*unch*
Oct.	+0.1%

11:00 am — 13- & 26-week bill, 2-, 5- & 7-year note, 2[R]-year FRN auction announcements

11:30 am — 4- & 8-week bill auction

1:00 pm — 5[R]-year TIPS auction $14 bln

Friday December 21

Canada

8:30 am	Real GDP at Basic Prices
Oct. (e)	**+0.2%**
Consensus	*+0.2%*
Sep.	-0.1%

8:30 am	Retail Sales	Ex. Autos
Oct. (e)	**+0.6%**	**+0.2%**
Consensus	*+0.6%*	*+0.4%*
Sep.	+0.2%	+0.1%

10:00 am — BoC Business Outlook Survey and Senior Loan Officer Survey (Q4)

Ottawa's Budget Balance[D]	
Oct. '18	
Oct. '17	-$0.3 bln

10:30 am — 3-, 6- & 12-month bill auction $6.0 bln (new cash -$3.9 bln)

United States

8:30 am	Real GDP	GDP Deflator
Q3 F (e)	**+3.5% a.r.**	**+1.7% a.r.**
Consensus	*+3.5% a.r.*	*+1.7% a.r.*
Q3 P	+3.5% a.r.	+1.7% a.r.
Q2	+4.2% a.r.	+3.0% a.r.

8:30 am	Pre-Tax Corporate Profits
Q3 F (e)	**+10.3% y/y**
Q3 P	+10.3% y/y
Q2	+7.3% y/y

8:30 am	Durable Goods Orders	Ex. Transport
Nov. (e)	**+2.0%**	**+0.3%**
Consensus	*+1.8%*	*+0.3%*
Oct.	-4.3%	+0.2%

8:30 am	Nondef. Capital Goods ex. Air
Nov. (e)	**+0.3%**
Consensus	*+0.2%*
Oct.	unch

10:00 am	Personal Spending	Personal Income
Nov. (e)	**+0.3%**	**+0.3%**
Consensus	*+0.3%*	*+0.3%*
Oct.	+0.6%	+0.5%

10:00 am	Core PCE Price Index	
Nov. (e)	**+0.2%**	**+1.9% y/y**
Consensus	*+0.2%*	*+1.9% y/y*
Oct.	+0.1%	+1.8% y/y

10:00 am	University of Michigan Consumer Sentiment
Dec. F (e)	**97.0**
Consensus	*97.5*
Dec. P	97.5
Nov.	97.5

11:00 am	Kansas City Fed Manufacturing Activity
Dec. (e)	**16**
Nov.	15

Federal Government funding expires

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

Upcoming Policy Meetings | Bank of Canada: Jan. 9, Mar. 6, Apr. 24 | FOMC: Jan. 29-30, Mar. 19-20, Apr. 30-May 1

General Disclosure

"BMO Capital Markets" is a trade name used by the BMO Financial Group for the wholesale banking businesses of Bank of Montreal and its subsidiaries BMO Nesbitt Burns Inc., BMO Capital Markets Limited in the U.K. and BMO Capital Markets Corp. in the U.S. BMO Nesbitt Burns Inc., BMO Capital Markets Limited and BMO Capital Markets Corp are affiliates. This document is issued and distributed in Hong Kong by Bank of Montreal ("BMO"). BMO is an authorized institution under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) and a registered institution with the Securities and Futures Commission (CE No. AAK809) under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong). BMO does not represent that this document may be lawfully distributed, or that any financial products may be lawfully offered or dealt with, in compliance with any regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder. This document is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Their contents have not been reviewed by any regulatory authority. Bank of Montreal or its subsidiaries ("BMO Financial Group") has lending arrangements with, or provide other remunerated services to, many issuers covered by BMO Capital Markets. The opinions, estimates and projections contained in this report are those of BMO Capital Markets as of the date of this report and are subject to change without notice. BMO Capital Markets endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO Capital Markets makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO Capital Markets or its affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This document is not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such Information be considered as investment advice or as a recommendation to enter into any transaction. Each investor should consider obtaining independent advice before making any financial decisions. This document is provided for general information only and does not take into account any investor's particular needs, financial status or investment objectives. BMO Capital Markets or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO Capital Markets or its affiliates, officers, directors or employees have a long or short position in many of the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should assume that BMO Capital Markets or its affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein.

Dissemination of Research

Our publications are disseminated via email and may also be available via our web site http://economics.bmocapitalmarkets.com. Please contact your BMO Financial Group Representative for more information.

Conflict Statement

A general description of how BMO Financial Group identifies and manages conflicts of interest is contained in our public facing policy for managing conflicts of interest in connection with investment research which is available at http://researchglobal.bmocapitalmarkets.com/Public/Conflict_Statement_Public.aspx.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

BMO Financial Group (NYSE, TSX: BMO) is an integrated financial services provider offering a range of retail banking, wealth management, and investment and corporate banking products. BMO serves Canadian retail clients through BMO Bank of Montreal and BMO Nesbitt Burns. In the United States, personal and commercial banking clients are served by BMO Harris Bank N.A., Member FDIC. Investment and corporate banking services are provided in Canada and the US through BMO Capital Markets. BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A, BMO Ireland Plc, and Bank of Montreal (China) Co. Ltd. and the institutional broker dealer businesses of BMO Capital Markets Corp. (Member SIPC), BMO Nesbitt Burns Securities Limited (Member SIPC) in the U.S., BMO Nesbitt Burns Inc. (Member Canadian Investor Protection Fund) in Canada, Europe and Asia, BMO Capital Markets Limited in Europe, Asia and Australia and BMO Advisors Private Limited in India.

"Nesbitt Burns" is a registered trademark of BMO Nesbitt Burns Inc., used under license. "BMO Capital Markets" is a trademark of Bank of Montreal, used under license. "BMO (M-Bar roundel symbol)" is a registered trademark of Bank of Montreal, used under license.

® Registered trademark of Bank of Montreal in the United States, Canada and elsewhere.

™ Trademark Bank of Montreal in the United States and Canada.

© COPYRIGHT 2018 BMO CAPITAL MARKETS CORP.

A member of BMO Financial Group