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BMO CAPITAL MARKETS ECONOMICS

Focus

A weekly financial digest

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January 4, 2019

Blowout U.S. Jobs Report; Canada Decent

More Signs of Slowing in China

Fed Chair Powell Upbeat on Growth But Preaches Patience

Oil Prices Rise, Lifting Loonie

10-year Treasury Yield Mines One-year Low

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Snappy New Fear

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If you had been fortunate enough to have packed it in after the Fed hiked on December 19 and just returned to your desk today (and somehow managed to avoid all forms of communication, whilst luxuriating in Antarctica), it would superficially appear that not much happened. After all, the S&P 500 is up a tad from that day's close, oil is slightly lower at just below $48, the euro and Canadian dollar are modestly firmer and even the 30-year Treasury yield is flat at just below 3%. Then, however, you might suddenly realize that the yen has mysteriously popped almost 4% in barely two weeks, that gold is up almost 3%, and that two-year Treasury yields have dropped a hefty 15 bps—all despite some big reversals today. Of course, lurking below the mostly calm net moves in many markets has been unusually high volatility in thin trading conditions. To cite just one example, the Dow has seen moves of more than 400 points in fully 6 of the past 10 trading days, with some wild intraday shifts to boot.

Effectively, we are witnessing in real time markets grappling with the question of just how deep the slowdown in global growth will be in 2019. That growth will be slower this year is not really a question, not with tighter central bank liquidity, not with less U.S. fiscal policy juice, and not with the ongoing China/U.S. trade tussle. The broad slide in equities in Q4 of 2018, along with a deep dive in cyclically-sensitive commodities (notably copper), has even got some whispering the "R-word". Not helping matters was the widespread drop in purchasing managers indexes in December, with global measures falling back to 2016 levels, and thus erasing the so-called Trump Bump. This pullback was highlighted by the swoon in the U.S. ISM, which saw its largest month-to-month slide in a decade, with particular weakness in new orders. Coming on the heels of a big downward revision in Apple's sales forecasts, this simply ramped up the slowdown chatter another notch. Conditions suddenly looked so soft that not only were markets discounting any further rate hikes by the Fed, but even rate *cut* speculation was in the air, at least at some point later in 2019.

And then, just as the outlook appeared very bleak indeed, the cavalry came riding over the hill. First, it was announced that China/U.S. trade talks would resume in earnest next week, and China cut its reserve requirements for banks. As well, oil prices continued to forcefully recover on supply restraint from OPEC, rebounding 15% from last week's depths. Next, the always important U.S. jobs report calmed growth concerns with an emphatic show of strength in December, replete with a 312,000 payroll gain and a cycle-high 3.2% y/y wage gain. Finally, Fed Chair Powell suggested on Friday that the Fed is indeed sensitive to the market's message, that rate hikes are not pre-set, and that they could adjust the balance sheet unwind if it truly is causing the market stress. This well-timed combination acted as just the tonic to counter the sour start to the year, and leaves markets now broadly unchanged early in 2019.

Looking past the recent market volatility and some of the more extreme views on the outlook, we remain comfortable with the broad strokes of our forecast. To wit, that U.S. growth will simmer down from last year's 3.1% surge to roughly 2% in 2019 (on a Q4-to-Q4 basis), that this will be enough to clip the jobless rate a bit further and put slightly more upward pressure on wages and core prices, and that the Fed will eventually raise rates a bit further. But, the unusual political backdrop does offer

some serious event risk to this forecast—between the uncertain outlook for trade (even on the unresolved USMCA file, let alone on the U.S./China front), as well as for government funding, and fiscal policy more generally. Along with the fragility in financial markets, the Fed thus will certainly be patient before taking any further steps, and a mild inflation backdrop offers it plenty of leeway to be flexible. Tellingly, Powell indicated on Friday that the Fed will be prepared to possibly adjust policy as it did in 2016, when it paused until the very end of the year.

Canada has been a bit of a bystander amid the wild swings in sentiment on the global outlook in recent weeks, with the TSX seeing more muted moves than the S&P 500. However, the Canadian dollar had been hammered by the combination of lower commodity prices and global growth fears, ending 2018 at barely above 73 cents ($1.365/US$) and down 7.8% for the year. The loonie has started this year on a better footing, supported by the comeback in oil and a broader retreat in the U.S. dollar. Even with a lacklustre domestic jobs report (employment up 9,300 in December and a flat jobless rate at 5.6%), the currency still managed to snap back 1.8% this week to 74.6 cents ($1.340), after a tough Q4.

While Chair Powell had to toe a very fine line in his remarks on Friday, so too will Governor Poloz in his full meal rate decision next Wednesday (i.e., including the MPR and a press conference). The Bank will most likely cut its GDP forecast for 2019 (it was last at 2.1%, while consensus is probably now more in line with our call of 1.8%), but do so in a way that doesn't further ding confidence. Somewhat overshadowed amid the big-time rally in Treasuries recently, and the flat yield curve, has been an even flatter curve in Canada and sub-2% yields right out to the 10-year area in GoCs. Remarkably, 10-year yields dipped 8 bps for all of 2018, even with 75 bps of BoC tightening, and are down another 5 bps so far this year to little more than 1.9%. Not only does that offer nothing above current core inflation, it's also far below the Bank's official view on neutral overnight rates (somewhere between 2.5% and 3.5%). If, like his Fed counterpart, Governor Poloz is sensitive to the market's message, he would be hearing loud and clear that it's time to again hit the snooze button.

Adding to the sense that the Bank can now take its sweet time before hiking rates further is mounting evidence that past rate increases are already having an outsized impact. This week brought a blizzard of indicators showing that interest-sensitive sectors are struggling in Canada. After years of knocking down much bigger gains in vehicle sales than stateside, the opposite was the case in 2018. Canadian auto sales ended last year with a dull thud, falling 8% y/y in December and down 2.6% for the full year, the first annual decline since 2009. Meantime, home sales were downright weak in December, even accounting for a tough year-on-year comparison. Vancouver sales plunged 47% y/y, while each of Toronto, Edmonton and Calgary saw sales slide by roughly 20%, with prices showing little move in any of the four cities. With the two big engines of housing and consumer spending cooling before our eyes, the economy is now heavily dependent on exports, business investment and infrastructure spending for growth in 2019. With those thin supports, we look for a further cooling in GDP this year to just 1.8%, with risks leaning to the downside of that modest call.

Fed Policy: A Green Light amid Lots of Yellows and Reds

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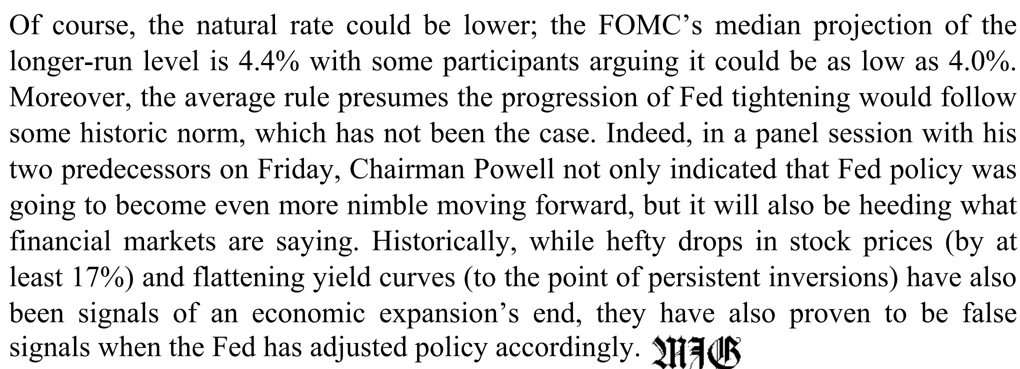
Increasingly, there seems to be more lights flashing yellow and red along the policy road these days, signalling the Fed to either slow down rate hikes or stop them altogether. However, the labour market continues to flash green. December's employment report was stellar. Payroll jobs increased 312k, which, with 58k in net upward revisions to the two prior months, more than doubled the consensus call. The result pulled the underlying growth trends all back above the 200k mark to post their strongest gains since the autumn of 2016 (average growth was 254k over the past three months, 222k over the past six months and 220k over the past year).

Average hourly earnings increased 0.4%, lifting the annual change a tenth to 3.2% y/y and matching (along with October's reading) the fastest pace in more than 9½ years. Wage growth is picking up, albeit still too slowly for complete comfort. Meanwhile, the unemployment rate rose a couple tenths to 3.9% but this was owing to a comparable increase in the participation rate to 63.1%. The latter has been bouncing in the 62.7%-to-63.1% range for more than the past three years—stabilization being a sign of strength given the demographic downward pressure.

Interestingly, the jobless rate averaged 3.8% in Q4, putting it 0.8 ppts below the CBO's estimate of the natural rate (4.6%). Historically, the point in the business cycle when the current unemployment rate falls below the natural rate has been a very early signal of the cycle's end. Looking back at the past 10 recessions, the crossover occurred an average of 12 quarters before the onset of recession, reflecting the progression of Fed tightening during the interim to counter wage growth and inflation pressures. This cycle, the crossover occurred in 2017 Q2, with the historic average pointing to a potential recession starting in 2020 Q2.



Of course, the natural rate could be lower; the FOMC's median projection of the longer-run level is 4.4% with some participants arguing it could be as low as 4.0%. Moreover, the average rule presumes the progression of Fed tightening would follow some historic norm, which has not been the case. Indeed, in a panel session with his two predecessors on Friday, Chairman Powell not only indicated that Fed policy was going to become even more nimble moving forward, but it will also be heeding what financial markets are saying. Historically, while hefty drops in stock prices (by at least 17%) and flattening yield curves (to the point of persistent inversions) have also been signals of an economic expansion's end, they have also proven to be false signals when the Fed has adjusted policy accordingly. MJG

Shutdown Showdown Stirs Slowdown

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A new U.S. Congress convened this week and the **first priority of business was to reopen the one-quarter of the government affected by the two-week shutdown**. The Democrat-led House passed a spending package and proposes about $1.3 billion for border fencing, but Senate Majority Leader McConnell says the Senate won't approve the bill unless it contains the $5 billion requested by the President for his wall. As of Friday, there was little sign of progress at a meeting between Trump and congressional leaders. The President says the shutdown will last "*as long as it takes*" to get a deal. The best hope is for Congress to pass another continuing resolution to

provide temporary funding for the nine agencies. The shutdown will have only a modest slowing effect on the economy, but this is likely just a prelude to more political instability ahead that could have more damaging effects on both growth and markets.

Around 800,000 federal employees (or one in five) are affected by the shutdown, about half of whom are deemed essential and still working while the other half is furloughed. None will be paid until the closure ends and Congress approves a bill to compensate workers, as per past shutdowns. Assuming the closure lasts until mid-month, **the direct impact on annualized GDP growth from the loss of government services is on the order of 0.1 ppts** in each of Q4 and Q1, while Q2 could see a 0.2-ppt lift. There is also a smaller indirect effect from the loss of consumer spending, which will worsen if the shutdown extends into February and the IRS delays income tax refunds. In the first quarter of last year, households received more than $200 billion in refunds, about 1% of GDP, and could receive even more this year due to tax reform.

Still, even an extended shutdown won't have a particularly large effect on the economy. More concerning, the **shutdown foreshadows greater political uncertainty**, which could slow business investment and growth. It has already delayed key data releases from the Bureau of Economic Analysis and the Census Bureau, clouding the Fed's reading of the tea leaves, which risks delaying new stimulus should the economy warrant such action.

Reopening the government is just one of three hurdles Congress will need to jump over. The second is the **debt ceiling** which will be re-instated on March 1 after being suspended for more than a year. Given the ballooning deficit, Uncle Sam's $20.5 trillion credit-card limit will need to be raised by more than $1½ trillion by then, or suspended again, to avoid a possible payment default and credit-rating downgrade. While the Treasury Department can take "extraordinary measures" to avoid a default through the summer, the heat will be on come the fall. Recall, *"political brinkmanship"* over the debt ceiling led S&P to pull its triple-A rating on U.S. debt in 2011. On the bright side, the House is trying to change the rules so that a vote for an appropriations bill to increase spending would also mark a vote to raise the debt ceiling. Hopefully, the Senate will pass a similar bill.

The third challenge is that **Congress will need to approve a budget for next fiscal year** to avoid a possibly larger shutdown on October 1. Given political jockeying ahead of next year's election, simply passing legislation to avoid automatic spending cuts from kicking in could be a challenge. Since 2013, Congress has voted roughly every two years to temporarily raise the spending caps that were required under the Budget Control Act of 2011. Failure to raise the limits by October 1 could lead to the automatic reduction in federal spending of more than $100 billion, slicing 0.5 ppts from FY 2020 growth, which starts in Q4 of this year.

The upshot is that, while the shutdown and political instability are unlikely to cause a recession, they could **aggravate the expected slowdown in growth** to 2.4% this year from an estimated 2.9% in 2018. Both will heighten the already sour mood in equity markets, and more so if the Democrats launch numerous investigations against the administration. Perhaps the only good thing is that much of the political drama is likely priced into markets following the midterm elections, so even a modest move toward reconciliation by the two parties could imply some upside potential. But until proven otherwise, I'll take the under on that bet.

BoC Preview: New Year, Same Story

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The Bank of Canada is widely expected to hold policy rates steady at 1.75% for a second consecutive meeting. It's been only just over a month since the last policy announcement when the BoC surprised markets with a more dovish-than-expected turn. There's been precious little positive news since then: risk sentiment has soured further (e.g. the S&P 500 is down about 8% since Dec. 7th), there's been little concrete news on the global trade front (Trump tweets don't count), WTI oil prices are down another 10% (though Canadian light and heavy crude prices are up modestly). The domestic data have been mixed, with October GDP and November jobs coming in surprisingly perky, while the CPI slowed, the Business Outlook Survey softened and December jobs were underwhelming.

Oil was the big story at the December meeting, with the steep drop in prices and just-announced Government of Alberta mandated production cuts weighing heavily on the outlook. The domestic oil backdrop has improved as the announced production cuts narrowed the discount on Canadian crude varieties sharply which should provide the BoC some comfort, though the global picture has worsened with WTI touching a one-year low. Despite the improvement, the sector is going to be a key reason behind expected downgrades to the growth forecast. Look for 2018Q4 GDP to be cut nearly 1 ppt to around 1.5%, while 2019Q1 will be introduced at about 1%. Those figures would cut the annual pace of growth at least a tick, with a larger impact if the rest of 2019 isn't upgraded. On the CPI front, the weaker starting point for headline CPI will cut the 2018Q4 forecast a snick below 2%, while 2019Q1 will be rolled out in the mid-to-high 1% level as well. Given the Bank is an inflation targeter, the softness in the core CPIs might have a bigger weight for policymakers.

The global trade front hasn't budged much either, with no real progress in the U.S.-China trade war. It's worth noting that the BoC stressed that the risks around trade are two-sided. So any good news here would be viewed as a positive for Canada. For now, we mostly just have tweets, but if the stock market keeps tumbling, we wouldn't be shocked to see some meaningful progress. Trade representatives meet early next week; we'll see if that yields anything.

Meantime, household debt burdens remain an issue for the BoC. While debt ratios have largely stabilized, the debt-service ratio pushed materially higher in Q3. Higher interest rates are clearly having an impact, and that's before the full impact of past hikes has been felt. Just one more reason for Governor Poloz to remain sidelined.

Finally, in the December statement the BoC said that *"there may be additional room for non-inflationary growth"* due to downward GDP revisions and *"recent macroeconomic developments."* This will be revisited at this meeting, and any confirmation of more room for non-inflationary growth would be yet another reason for dovishness.

Key Takeaway: The Bank of Canada is going to sound dovish again, but the question is how dovish? Markets have all but priced out any odds of a hike in 2019, with some inversion creeping up in 2020. Outside of a couple of decent domestic data points, the policy backdrop has deteriorated, driven largely by global economic and financial conditions. Accordingly, expect more caution from Governor Poloz and the Bank to stay on the sidelines for at least the next couple of months. *B.A.A.R.*

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	Good News	Bad News
Canada ▪ In 2018, Vancouver home sales lowest in nearly two decades and Toronto sales lowest in a decade ▪ C$ lifted on higher oil prices	**Employment** +9,300 (Dec.) **Jobless Rate** steady at 5.6% (Dec.) **Average Hourly Wages** +2.0% y/y (Dec.)	**Auto Sales** -8.0% y/y (Dec.) **Industrial Product Prices** -0.8%; **Raw Materials Prices** -11.7% (Nov.) **Markit Manufacturing PMI** -1.3 pts to 53.6 (Dec.)
United States ▪ Trade talks with China resume next week with President Trump upbeat on progress ▪ Fed Chair Powell still sees solid economic momentum ▪ House Dems pass bills to end government shutdown… and work to change debt ceiling rules ▪ Wall Street starts the year with more volatility	**Nonfarm Payrolls** +312,000 (Dec.) **Average Hourly Earnings** +0.4% (Dec.) **Auto Sales** 17.55 mln units a.r. (Dec.) **Chicago Fed National Activity Index** +0.22 (Nov.)	**Jobless Rate** +0.2 ppts to 3.9% (Dec.) **Manufacturing ISM** -5.2 pts to 54.1 (Dec.)—biggest drop since Oct. '08 **S&P Case-Shiller Home Prices** eased to +5.0% y/y (Oct.) **FHFA House Prices** slowed to +5.7% y/y (Oct.) **Pending Home Sales** -0.7% (Nov.) **Conference Board Consumer Confidence Index** -8.3 pts to 128.1 (Dec.)—biggest drop since July '15 **Conference Board CEO Confidence Index** -13 pts to 42 (Q4)—biggest drop since 2012Q2 **Initial Claims** +10k to 231k (Dec. 29 week)
Japan ▪ JPY skyrockets on safe-haven flows, before stabilizing	**Manufacturing PMI** revised up to 52.6 (Dec.)	**Retail Sales** -1.0% (Nov.) **Industrial Production** -1.1% (Nov. P) **Jobless Rate** +0.1 ppts to 2.5% (Nov.)
Europe ▪ PM May seeks more concessions with EU leaders as Brexit parliamentary vote looms	**Euro Area—Private Sector Credit** steady at +3.3% y/y (Nov.) **Germany—Unemployment** -14,000 (Dec.)—and **Jobless rate** steady at 5.0% **U.K.—Manufacturing PMI** +0.6 pts to 54.2; **Services PMI** +0.8 pts to 51.2; **Composite PMI** +0.6 pts to 51.4 (Dec.)	**Euro Area—Consumer Prices** slowed to +1.6% y/y (Dec. A)—but **core** steady at +1.0% y/y **Euro Area—Services PMI** revised down to 51.2; **Composite PMI** revised down to 51.1 (Dec.) **U.K.—Construction PMI** -0.6 pts to 52.8 (Dec.) **U.K.—Nationwide House Prices** -0.7% (Dec.)
Other ▪ Slowing demand in China prompts PBoC to cut RRR by 1 ppt	**China—Non-manufacturing PMI** +0.4 pts to 53.8 (Dec.) **China—Caixin Services PMI** +0.1 pts to 53.9; **Composite PMI** +0.3 pts to 52.2 (Dec.)	**China—Manufacturing PMI** -0.6 pts to 49.4 (Dec.) **China—Caixin Manufacturing PMI** -0.5 pts to 49.7 (Dec.)

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

Economic Forecast Summary for January 4, 2019

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	1.9	1.4	1.7	1.6	2.0	1.6	2.2	1.7
Unemployment Rate (percent)	5.8	5.9	5.9	5.7	5.6 ↓	5.7 ↑	5.7 ↑	5.7 ↑	6.3	5.8	5.7 ↑
Housing Starts (000s : a.r.)	225	219	197	211	210	207	204	200	220	213	205
Current Account Balance ($blns : a.r.)	-69.3	-66.7	-41.4	-56.7	-56.3	-56.7	-58.0	-58.9	-60.1	-58.5	-57.5
Interest Rates (average for the quarter : %)											
Overnight Rate	1.25	1.25	1.50	1.75	1.75	2.00	2.00	2.25	0.71	1.44	2.00
3-month Treasury Bill	1.14	1.21	1.47	1.66	1.70	1.90	2.00	2.15	0.69	1.37	1.95
10-year Bond	2.24	2.28	2.28	2.32	1.95 ↓	2.05 ↓	2.20 ↓	2.30 ↓	1.78	2.28	2.10 ↓
Canada-U.S. Interest Rate Spreads (average for the quarter : bps)											
90-day	-44	-66	-61	-70	-73 ↓	-77 ↑	-87 ↑	-85 ↑	-26	-60	-81 ↑
10-year	-52	-64	-65	-72	-73 ↑	-72 ↑	-70 ↑	-69 ↑	-55	-63	-71 ↑
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	4.2	3.4	2.6	1.9	2.4	2.0	1.9	2.2	2.9	2.4
Consumer Price Index (y/y % chng)	2.3	2.6	2.6	2.2	1.8	2.0	2.0	2.1	2.1	2.4	2.0
Unemployment Rate (percent)	4.1	3.9	3.8	3.8	3.7 ↑	3.6 ↑	3.5	3.5	4.4	3.9	3.6 ↑
Housing Starts (mlns : a.r.)	1.32	1.26	1.23	1.24	1.26	1.24	1.23	1.21	1.21	1.26	1.24
Current Account Balance ($blns : a.r.)	-487	-405	-499	-509	-535	-547	-563	-573	-449	-475	-555
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	2.36	2.45	2.65 ↓	2.85 ↓	3.00 ↓	0.95	1.97	2.75
10-year Note	2.76	2.92	2.93	3.03	2.65 ↓	2.80 ↓	2.90 ↓	3.00 ↓	2.33	2.91	2.85 ↓
EXCHANGE RATES (average for the quarter)											
US¢/C$	79.1	77.5	76.5	75.7	74.2 ↓	74.2	74.5	74.7	77.1	77.2	74.4
C$/US$	1.27	1.29	1.31	1.32	1.35	1.35	1.34	1.34	1.30	1.30	1.34
¥/US$	108	109	112	113	112 ↓	111 ↓	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	1.29	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

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Merchandise Trade Deficit

Tuesday, 8:30 am

Nov. (e)	**$2.5 bln**
Consensus	*$1.9 bln*
Oct.	$1.2 bln

The November trade picture is all about energy, as oil prices had fallen sharply by the start of the month. While the discount on Canadian oil (both heavy and light) started to narrow around mid-month, prices didn't begin to recover until month end. Canada's trade deficit is expected to more than double to $2.5 bln in November. Note that the modest recovery in energy prices in December suggests we'll get some bounceback in next month's report; but, given current price levels, sizeable deficits are expected to persist. Non-energy commodity prices were down in November as well, a fifth straight monthly drop, which will also weigh on exports (and imports to a lesser extent). Real trade volumes started Q4 off on a solid footing; we'll be watching to see if that was maintained.

Housing Starts

Wednesday, 8:15 am

Dec. (e)	**210,000 a.r. (-2.8%)**
Consensus	*210,000 a.r. (-2.8%)*
Nov.	216,000 a.r. (+4.4%)

Building Permits, New Housing Price Index

Thursday, 8:30 am

	Building Permits
Nov. (e)	**+1.0%**
Oct.	-0.2%

	New Housing Price Index	
Nov. (e)	**unch**	**unch y/y**
Oct.	unch	+0.1% y/y

Building permits are expected to climb 1% in November, after a couple of relatively tame months for what tends to be a volatile series. The gain looks to be driven by the non-residential sector as a chunky drop in the prior month is reversed. Residential permits have been heavy in recent months, but bounced in October and look to be little changed in this report. The number of residential permits has remained elevated and that should keep housing starts running north of 200k units annualized. Lastly, new home prices are expected to be flat in November for the ninth time in twelve months, leaving prices unchanged from a year ago, the slowest pace since January 2010.

BoC Policy Announcement and Monetary Policy Report

Wednesday, 10:00 am
Press conference at 11:15 am

See Benjamin Reitzes' Thought on page 6.

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Non-manufacturing ISM (NMI)

Monday, 10:00 am

Dec. (e)	**59.0**
Consensus	*59.5*
Nov.	60.7

Sharply lower service-sector activity in the Dallas and Philadelphia Fed Districts suggest the ISM index reversed to 59.0 in December from 60.7 in November. The index is trending at the highest levels since 2005, but it's likely all downhill from here. After hitting fresh highs in November, oil production retreated in the face of lower prices, while residential construction has stalled amid ebbing affordability. Still, consumer services spending remains healthy (volumes rose 2.6% y/y in November), which should keep the index at levels consistent with growth comfortably above potential. Warning: markets will be on high-alert following the biggest dive in the ISM manufacturing index since the 2008 recession.

Key for Next Week

BMO Capital Markets

Goods & Services Trade Deficit

Tuesday, 8:30 am

(This report will likely be delayed by the government shutdown)

Nov. (e)	**$54.0 bln**
Consensus	*$54.0 bln*
Oct.	$55.5 bln

Without the advance report on goods trade (due to the shutdown), we are almost flying blind here. However, the dive in oil prices suggests some room for improvement following five straight monthly increases in the deficit to nine-year highs, as the nation remains a net importer of oil despite record production. Exports have gone sideways since the summer and likely stayed soft in November due to the strong dollar, slower global demand and China's retaliatory tariffs. After rising 8.5% y/y in October, imports likely slowed amid watered-down fiscal juice, though a sturdy holiday shopping season provided some lift. Amid official trade talks with China, the record $93 billion bilateral deficit in Q3—up 18% since the President took office—will draw close scrutiny.

FOMC Minutes from the December 18-19 meeting

Wednesday, 2:00 pm

Back on December 19, the FOMC raised the fed funds target range by 25 bps to 2.25%-to-2.50% (a 2.375% midpoint), marking the fifth consecutive quarterly move, and also signaled a slower, more occasional rate-hike cadence ahead. Apart from modifying its forward-looking language (the word *"some"* was inserted in front of *"further gradual increases"*) and participants lowering their (median) policy rate expectations by 25 bps (including the longer-run), the most notable aspect of the signal was including "global economic and financial developments" in the risk assessment for the first time in more than 1½ years. Indeed, the phrase that it will *"monitor global economic and financial developments and assess their implications for the economic outlook"* was eerily similar to what was newly inserted back in January 2016, which presaged a year-long policy pause. With policy rates now on the edge of the neutral range (normalization had only started in early 2016), and balance sheet reduction in full swing with some $378 billion already in the bag, we'll be scouring the Minutes for clues on how readily (and for how long) the Fed might shift into pause mode again.

Consumer Prices

Friday, 8:30 am

Dec. (e)	**-0.2%**	**+1.8% y/y**
Consensus	*-0.1%*	*+1.9% y/y*
Nov.	unch	+2.2% y/y
	CPI Ex. Food & Energy	
Dec. (e)	**+0.2%**	**+2.2% y/y**
Consensus	*+0.2%*	*+2.2% y/y*
Nov.	+0.2%	+2.2% y/y

A double-digit decline in gasoline prices should fuel a 0.2% drop in the CPI, slicing headline inflation to 1.8% y/y in December. Excluding food and energy prices, the CPI should rise 0.2% to also keep core inflation unchanged at 2.2% y/y, amid steadfast annual gains in housing and medical care costs. However, the monthly move should still be sufficient to turn up the shorter-term core trends (the 3-month change to 2.4% annualized from 2.1%, the 6-month change to 2.1% from 2.0% annualized). It's noteworthy that core goods inflation has managed to move back into positive territory (+0.2% y/y in November), after a 30-month run on the other side, which is the fastest pace in more than 5½ years. Tariffs are having an impact here, although the bulk of the impact has been offset by gains in the greenback. Since U.S. tariffs were dusted off in January 2018, the trade-weighted dollar has appreciated for 11 consecutive months (on average) and a cumulative 9.7%.

		Jan 4 [1]	Dec 28	Week Ago	4 Weeks Ago	Dec. 31, 2018
					(basis point change)	
Canadian Money Market	Call Money	1.75	1.75	0	0	0
	Prime Rate	3.95	3.95	0	0	0
U.S. Money Market	Fed Funds (effective)	2.50	2.50	0	25	0
	Prime Rate	5.50	5.50	0	25	0
3-Month Rates	Canada	1.63	1.64	-1	0	-1
	United States	2.41	2.37	4	3	6
	Japan	-0.19	-0.15	-4	1	-4
	Eurozone	-0.31	-0.31	0	1	0
	United Kingdom	0.91	0.91	0	0	-1
	Australia	2.06	2.09	-3	7	-3
2-Year Bonds	Canada	1.84	1.86	-2	-16	-2
	United States	2.49	2.52	-2	-22	0
10-Year Bonds	Canada	1.91	1.95	-4	-16	-5
	United States	2.65	2.72	-7	-20	-3
	Japan	-0.04	-0.01	-4	-10	-4
	Germany	0.21	0.24	-3	-4	-3
	United Kingdom	1.27	1.27	1	1	0
	Australia	2.23	2.36	-13	-21	-8
Risk Indicators	VIX	23.4	28.3	-4.9 pts	0.2 pts	-2.0 pts
	TED Spread	39	43	-4	0	-6
	Inv. Grade CDS Spread [2]	89	89	0	9	1
	High Yield CDS Spread [2]	460	452	8	49	10
					(percent change)	
Currencies	US¢/C$	74.68	73.32	1.8	-0.5	1.8
	C$/US$	1.339	1.364	—	—	—
	¥/US$	108.32	110.27	-1.8	-3.9	-1.2
	US$/€	1.1404	1.1444	-0.3	0.2	-0.5
	US$/£	1.269	1.270	-0.1	-0.3	-0.5
	US¢/A$	70.96	70.47	0.7	-1.6	0.7
Commodities	CRB Futures Index	173.15	170.97	1.3	-6.0	2.0
	Oil (generic contract)	48.94	45.33	8.0	-7.0	7.8
	Natural Gas (generic contract)	2.98	3.30	-9.8	-33.6	1.3
	Gold (spot price)	1,284.00	1,281.10	0.2	2.9	0.1
Equities	S&P/TSX Composite	14,346	14,222	0.9	-3.0	0.2
	S&P 500	2,488	2,486	0.1	-5.5	-0.7
	Nasdaq	6,671	6,585	1.3	-4.3	0.5
	Dow Jones Industrial	23,290	23,062	1.0	-4.5	-0.2
	Nikkei	19,562	20,015	-2.3	-9.8	-2.3
	Frankfurt DAX	10,669	10,559	1.0	-1.1	1.0
	London FT100	6,809	6,734	1.1	0.5	1.2
	France CAC40	4,699	4,679	0.4	-2.4	-0.7
	S&P ASX 200	5,619	5,654	-0.6	-1.1	-0.5

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

Global Calendar
January 7 – January 11

BMO Capital Markets®

	Monday January 7	Tuesday January 8	Wednesday January 9	Thursday January 10	Friday January 11
Japan	**Services PMI** **Dec.** Nov. 52.3 **Composite PMI** **Dec.** Nov. 52.4	**Consumer Confidence Index** **Dec. (e) 42.8** Nov. 42.9			**Household Spending** **Nov.** Oct. -0.3% y/y **Current Account Surplus** **Nov. '18 (e) ¥560.2 bln** Nov. '17 ¥1340.7 bln **Bank Lending Ex-Trusts** **Dec.** Nov. +2.2% y/y
Euro Area	EURO AREA **Retail Sales** **Nov. (e) +0.2% +0.4% y/y** Oct. +0.3% +1.7% y/y GERMANY **Retail Sales** **Nov. (e) +0.4% -0.4% y/y** Oct. +0.1% +5.0% y/y **Factory Orders** **Nov. (e) -0.1% -2.6% y/y** Oct. +0.3% -2.7% y/y	EURO AREA **Consumer Confidence** **Dec. F (e) -6.2** Nov. -3.9 **Economic Confidence** **Dec. (e) 108.3** Nov. 109.5 GERMANY **Industrial Production** **Nov. (e) +0.3% -0.8% y/y** Oct. -0.5% +1.6% y/y FRANCE **Trade Deficit** **Nov. (e) €5.0 bln** Oct. €4.1 bln	EURO AREA **Jobless Rate** **Nov. (e) 8.1%** Oct. 8.1% GERMANY **Trade Surplus** **Nov.** Oct. €17.3 bln FRANCE **Jobless Rate** [D] **Nov. P** Oct. 8.9% **Consumer Confidence** **Dec. (e) 90** Nov. 92 ITALY **Jobless Rate** **Nov. P (e) 10.5%** Oct. 10.6%	EURO AREA ECB Minutes from Dec. 12-13 meeting FRANCE **Industrial Production** **Nov. (e) +0.2% -0.2% y/y** Oct. +1.2% -0.7% y/y **Manufacturing Production** **Nov.** Oct. +1.4% -1.3% y/y ITALY **Retail Sales** **Nov.** Oct. +0.1% +1.5% y/y	ITALY **Industrial Production** **Nov. (e) -0.3% +0.4% y/y** Oct. +0.1% +1.0% y/y
U.K.					**Monthly Real GDP 3m/3m** **Nov. (e) +0.2% n.a.** Oct. +0.1% +0.4% **Industrial Production** **Nov. (e) +0.4% -0.6% y/y** Oct. -0.6% -0.8% y/y **Manufacturing Production** **Nov. (e) +0.5% -0.7% y/y** Oct. -0.9% -1.0% y/y **Trade Deficit Non-EU** **Nov. (e) £11.4 bln £3.4 bln** Oct. £11.9 bln £4.3 bln
Other	CHINA **Foreign Reserves** [D] **Dec. (e) $3.1 trln** Nov. $3.1 trln	AUSTRALIA **Trade Surplus** **Nov. (e) A$2.8 bln** Oct. A$2.3 bln	CHINA **Aggregate Yuan Financing** [D] **Dec. (e) 1.25 trln** Nov. 1.52 trln **New Yuan Loans** [D] **Dec. (e) 0.83 trln** Nov. 1.25 trln **M2 Money Supply** [D] **Dec. (e) +8.1% y/y** Nov. +8.0% y/y AUSTRALIA **Building Approvals** **Nov. (e) -0.3% -24.6% y/y** Oct. -1.5% -13.4% y/y	CHINA **CPI PPI** **Dec. (e) +2.1% y/y +1.6% y/y** Nov. +2.2% y/y +2.7% y/y **Foreign Direct Investment** [D] **Dec.** Nov. -26.3% y/y	AUSTRALIA **Retail Sales** **Nov. (e) +0.4%** Oct. +0.3%

[D] = date approximate

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

North American Calendar
January 7 – January 11

BMO Capital Markets®

Canada

Monday January 7

10:00 am **Ivey Purchasing Managers Index (s.a.)**
Dec.
Nov. 57.2

Conference Board Consumer Confidence Index[D]
Dec.
Nov. 114.2

Tuesday January 8

8:30 am **Merchandise Trade Deficit**
Nov. (e) **$2.5 bln**
Consensus *$1.9 bln*
Oct. $1.2 bln

10:30 am 3-, 6- & 12-month bill auction $8.5 bln (new cash -$2.4 bln)

Wednesday January 9

8:15 am **Housing Starts**
Dec. (e) **210,000 a.r. (-2.8%)**
Consensus *210,000 a.r. (-2.8%)*
Nov. 215,954 a.r. (+4.4%)

10:00 am **BoC Policy Announcement and Monetary Policy Report; press conference at 11:15 am**

Thursday January 10

8:30 am **Building Permits**
Nov. (e) **+1.0%**
Oct. -0.2%

8:30 am **New Housing Price Index**
Nov. (e) **unch** **unch y/y**
Oct. unch +0.1% y/y

Noon 2-year bond auction $3.0 bln
5-year bond auction announcement

Friday January 11

United States

Monday January 7

Releases marked by * will be delayed by the U.S. government shutdown

10:00 am **Factory Orders***
Nov. (e) **+0.4%**
Oct. -2.1%

10:00 am **Non-manufacturing ISM (NMI)**
Dec. (e) **59.0**
Consensus *59.5*
Nov. 60.7

Fed Speaker: Atlanta's Bostic (12:40 pm)

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

◀ Saturday January 5

Fed Speakers: New York's Williams (8:00 am); Atlanta's Bostic (10:15 am); San Francisco's Daly (12:30 pm)

Tuesday January 8

6:00 am **NFIB Small Business Economic Trends Survey**
Dec. (e) **104.0**
Consensus *103.5*
Nov. 104.8

8:30 am **Goods & Services Trade Deficit***
Nov. (e) **$54.0 bln**
Consensus *$54.0 bln*
Oct. $55.5 bln

10:00 am **Job Openings & Labor Turnover Survey (Nov.)**

3:00 pm **Consumer Credit**
Nov. (e) **+$15.0 bln**
Consensus *+$14.3 bln*
Oct. +$25.4 bln

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

1:00 pm 3-year note auction $38 bln

Wednesday January 9

7:00 am **MBA Mortgage Apps**
Jan. 4
Dec. 28 -8.5%

2:00 pm **FOMC Minutes from the December 18-19 meeting**

Fed Speakers: Atlanta's Bostic (8:20 am); Chicago's Evans (9:00 am); Boston's Rosengren (11:30 am)

1:00 pm 10[R]-year note auction $24 bln

Thursday January 10

8:30 am **Initial Claims**
Jan. 5
Dec. 29 231k (+10k)

8:30 am **Continuing Claims**
Dec. 29
Dec. 22 1,740k (+32k)

10:00 am **Wholesale Inventories***
Nov. F (e) **+0.2%**
Consensus *+0.5%*
Oct. +0.8%

12:45 pm **Fed Chair Powell speaks to the Economic Club of Washington**

Fed Speakers: Richmond's Barkin (8:35 am); St. Louis' Bullard (12:40 pm); Chicago's Evans (1:00 pm); Vice Chair Clarida (7:00 pm, event starts at 5:30 pm)

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

11:30 am 4- & 8-week bill auction

1:00 pm 30[R]-year bond auction $16 bln

Friday January 11

8:30 am **Consumer Prices**
Dec. (e) **-0.2%** **+1.8% y/y**
Consensus *-0.1%* *+1.9% y/y*
Nov. unch +2.2% y/y

8:30 am **CPI Ex. Food & Energy**
Dec. (e) **+0.2%** **+2.2% y/y**
Consensus *+0.2%* *+2.2% y/y*
Nov. +0.2% +2.2% y/y

2:00 pm **Budget Balance**
Dec. '18
Dec. '17 -$23.2 bln

[D] = date approximate [R] = reopening

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

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