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Focus

A weekly financial digest

Douglas Porter, CFA, Chief Economist, BMO Financial Group

January 25, 2019

Feature Article
Page 8

2% Yields Forever?

U.S. Government Reopens until Feb. 15

IMF Clips Global Growth Outlook

U.S./China "Miles" Apart on Trade

Run of Weak Canadian Data

ECB, BoJ on Hold

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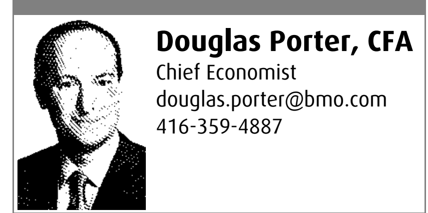
Building a Remedy, for Tariff Man and Mr. Xi…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…and for Wall Man and Pelosi.

After a powerful rally to start 2019, markets largely pulled a sideways shuffle this week, with stocks aiming for modest net gains, yields dipping, and currencies mostly flat. In a week dominated by the deep thinkers in Davos, a U.S. data void, and few shocks from Q4 earnings, **the focus fell on global growth** and **any new developments in the big three market irritants**. As we outlined last week, that Hall of Shame is occupied by **the U.S. government shutdown**, **Brexit**, and **the U.S./China trade battle.** On each front, this week brought a lot of heat, and only a little light. **The shutdown is seemingly ending until February 15 on a stop-gap funding bill**. But the battle on border security will rumble on, with both camps locked in position, seemingly unable to back down. The Brexit morass prompted some Royal intervention, while the pound rose more than 2% on rising hopes that a hard exit can be averted.

We continue to assert that, by far, the most important of the three market irritants is the U.S./China trade tiff. It is the one flashpoint that can rise to the level of causing some serious damage to the global economy if the talks founder. **In turn, even semi-success on this front could provide a meaningful boost to sentiment and the broader outlook.** The news flow was back and forth this week, ahead of the next set of meetings in Washington on January 30/31. While Treasury Secretary Mnuchin played good cop (*"a lot of progress"),* Commerce Secretary Ross was the bad cop ("*miles and miles"* from a resolution). In fact, both could be quite correct; trade deals can be extraordinarily complex, and perhaps there has been some real progress in recent weeks. Call us skeptical—no, highly skeptical—that a broad agreement can be reached anytime soon. But the generally positive tone does suggest that there might be just enough headway to extend negotiations well beyond the March 1 deadline.

While U.S. economic data—and trade figures specifically—have gone AWOL amid the shutdown, such was not the case in China. This week started with the entirely unsurprising **news that Q4 GDP in China cooled to 6.4% y/y, holding full-year growth to "just" 6.6%.** That's the slowest annual gain since 1990, and we're calling for 6.0% this year, even with some stimulus support. That calmer pace, along with a more modest U.S. advance, is a big reason why the global growth outlook is fading. Markets stumbled early this week on the IMF's downgraded forecast for world GDP, which they clipped to 3.5% for this year and next. **Spoiler alert:** That's not the last downgrade for 2019, as we are already pegging this year at 3¼%.

Besides the high-profile GDP figures, **China also quietly released the details of its 2018 trade flows. And the results amply reveal the law of unintended consequences.** For all of last year, China's trade surplus narrowed to US$367 billion (from $438 bln in 2017), as imports jumped 15.8%, while exports remained strong at up 9.7%. However, the bilateral gap with the U.S. actually widened to $325 bln (from $278 bln), as exports to the U.S. remained strong at +10.8%, while imports almost stagnated at up just 0.1% on the year. (Somewhat ironically, China's imports from Canada surged 39.4% last year, cutting the bilateral surplus to just $7 billion.) So, in a year when China was ramping up imports aggressively, thus cutting into its towering surplus, the U.S. was left out of the buying spree. In other words, stage one of the trade war completely backfired.

This is not to suggest U.S. policy is misguided on this issue; it's more that such a crucial file may require a defter touch and a bit more patience. After all, a strong case can be made that the biggest current threats to the cycle are all policy-driven and self-inflicted. At this stage, the goal should be to aim for small short-term wins in the trade talks, and keep the dialogue going. That's actually a more likely scenario than we may have guessed just a month ago.

Today is Robbie Burns Day *('Scots Wha Hae!');* besides being a poet and a connoisseur of fine Scotch and haggis, Burns also had a few great quotes on forecasting.

> *"There is no such uncertainty as a sure thing."*
>
> *"The best-laid plans of mice and men often go awry."*

Which naturally brings us to next week's FOMC meeting, as well as the Fed's reversal of QE, or quantitative tightening (QT). The process of gradually reducing the Fed's balance sheet, which was supposed to be a non-event for the market, has suddenly become a hot topic, especially for stocks (the best-laid plans, and all that). This week's Economist chimes in that the process is causing unexpected market volatility, while today's Wall Street Journal suggests that **the Fed may halt the QT program sooner than expected**. As a reminder, the Fed's balance sheet now stands at just over $4 trillion, down nearly 10% (or $420 billion) since QT began in 2017Q4, but still well up from pre-crisis levels of under $1 trillion.

So, is the possibility of an earlier end to QT bullish or bearish for Treasuries? Well, theory would suggest that since QE supposedly served to reduce long-term yields by up to 100 bps below where they otherwise would have been, then QT should have pushed up yields. Thus, halting QT early should be bullish (i.e., push yields down). But, since stocks have ostensibly been roiled by QT, then halting QT should be stock-supportive, so risk-on and, thus, bearish for Treasuries (i.e., push yields up). And, meantime, this is all complicated by the fact that yields are also being swayed by QE decisions at other central banks. On balance, we would land on the first line of reasoning—that, ultimately, bigger Fed holdings of Treasuries than initially expected will tend to keep a mild damper on yields. For the U.S. dollar, the impact of a less forceful QT seems unambiguous—it would be negative for the greenback.

As Burns may have also said, forecasting is hard, especially when it's about the future. (Actually, that was Niels Bohr, but who's counting?)

Fed Preview: Powell to Preach Patience

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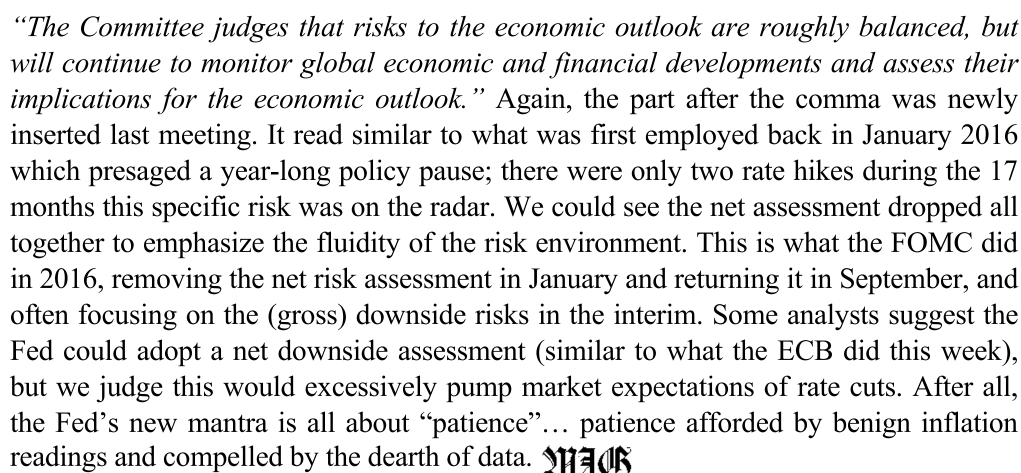
In the December 19th press conference after the FOMC's rate-hiking confab, Chairman Powell acknowledged that some *"crosscurrents"* had emerged since the September 26th meeting (the S&P 500 peaked the week before). However, Powell still indicated that rate hikes would likely continue, albeit at a slower pace than posited previously (two moves in 2019 vs. three before); and, importantly, that balance sheet reduction would continue according to script (*"I don't see us changing that"*). The market-perceived cavalier hawkishness exacerbated volatility. By Christmas Eve, the S&P 500 had fallen 19.8% from September's peak, on its way to recording the worst December since 1931. Meanwhile, the yield curve (3 months, 10 years) continued

flattening to its lowest level since before the Great Recession and was dangerously close to inverting—just 16 bps shy on the day before Powell spoke again.

In a panel session with his two predecessors (Yellen and Bernanke) on January 4th, Powell said the Fed was *"listening very carefully"* to markets. He said *"if we came to the view that the balance sheet normalization plan, or any other aspect of normalization, was part of the problem, we wouldn't hesitate to make a change."* There was *"no preset path for policy. And particularly with muted inflation readings that we've seen coming in, we will be patient as we watch to see how the economy evolves."* Indeed, in a follow-up event (January 10), Powell reiterated: *"We're in a place where we can be patient and flexible and wait and see what does evolve, and I think for the meantime we're waiting and watching."* In the press conference following next week's FOMC meeting (January 29-30), we look for the Chairman to repeat these comments, formally walking back from the previous presser's messaging. And, perhaps providing a clue or two on prospective balance sheet paring.

In the FOMC statement, we could also see some modification to key phrases, with even the most hawkish members (such as Kansas City President George) now preaching patience.

"The Committee judges that some further gradual increases in the target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term." The word *"some"* was newly inserted last meeting to signal a slower, more occasional rate hike cadence ahead. We could see the inclusion of "over time" to convey an even greater sense of timing ambiguity (similar to what the Bank of Canada did recently).



"The Committee judges that risks to the economic outlook are roughly balanced, but will continue to monitor global economic and financial developments and assess their implications for the economic outlook." Again, the part after the comma was newly inserted last meeting. It read similar to what was first employed back in January 2016 which presaged a year-long policy pause; there were only two rate hikes during the 17 months this specific risk was on the radar. We could see the net assessment dropped all together to emphasize the fluidity of the risk environment. This is what the FOMC did in 2016, removing the net risk assessment in January and returning it in September, and often focusing on the (gross) downside risks in the interim. Some analysts suggest the Fed could adopt a net downside assessment (similar to what the ECB did this week), but we judge this would excessively pump market expectations of rate cuts. After all, the Fed's new mantra is all about "patience"… patience afforded by benign inflation readings and compelled by the dearth of data. MJG

A November to Forget

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The theme permeating financial markets in recent months has been slowing global growth. The story wasn't any different in Canada at the tail end of 2018. This week's data showed wholesale, retail and manufacturing activity all contracted in November. That comes after home sales and exports were reported down earlier this month. All those soft data points set the stage for what is expected to be a drop in November GDP due out next week (see Key for Next Week). **The poor run of data**

prompted us to downgrade our Q4 growth forecast by three-tenths to 1.2%. That's a bit below the BoC's 1.3% call, and it looks like there are further downside risks.

Looking back to November, it shouldn't be a surprise that the economy hit a rough patch. Recall that Canadian oil prices hit rock-bottom in the month, driven by pipeline worries and falling global prices. Prices started to recover by month end, but the damage was done. Meantime, the U.S./China trade war continued and global equity markets were trending lower. And, you can add the Bank of Canada's fifth 25 bp rate hike (which came in late October) putting increasing pressure on heavily indebted households (see Sal's Thought for more on the consumer).

The Bank of Canada has made it clear it's going to be patient, even though it wants to get rates to neutral eventually. Governor Poloz reiterated his caution in an interview from Davos this week. Housing was once again highlighted as something the BoC is watching. Home sales fell in four straight months to December, with the declines accelerating. For all of 2018, they dropped in eight of twelve months, with the annual tally down 11%, cutting sales back to 2013 levels. We'll likely start to get some January figures late next week, and we'll be watching closely to see if the negative momentum persisted. Beyond housing, the Bank is watching how the non-energy sector holds up through the early part of the year as the oil production cuts will hit GDP growth hard. And, they'll be headline watching just like everyone else with respect to U.S./China trade.

Key Takeaway: It's a waiting game for policymakers. The uncertainty surrounding housing, trade and oil will take at least a few months to clear up. And, given the Q1 data will likely remain weak, expect the near-term to be somewhat nerve-wracking for the BoC and Canadian markets. *B.A.A.R.*

Nay Big Spender

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Canadian consumers were hit with a double dose of bad news this week. First, an Ipsos poll reported that almost half of households would struggle to manage a $200 increase in monthly bills or credit payments. The only good news is that the figure (46%), though up from the prior quarter (40%), is down slightly from two years ago (48%). Second, StatsCan reported that retail sales plunged 0.9% in November, a decidedly Grinch-like start to the holiday season. Retail volumes fell modestly in the past year amid lower sales of autos, home furnishings, gasoline and even groceries.

The sag in sales is not hard to fathom. Consumer spending was juiced in 2017 by enhanced child-benefit payments and rock-bottom interest rates, and dutifully jumped 3.6% in real terms that year, by far the most since emerging from recession. Some payback was due. Interest rates have risen since mid-2017, with the BoC hiking 125 bps and mortgage rates rising 70 bps. There's no doubt that households have become more sensitive to credit costs due to elevated debt and a near-record debt-service burden, with payments gobbling 14.5% of disposable income in Q3, up 0.4 ppts from mid-2017. (In sharp contrast, American households enjoy a record-low debt-service ratio of less than 10%. While the two measures are not wholly comparable, it is worth noting that the U.S. ratio is little changed since the Fed began hiking rates in late

2015.) Compounding the pain is that tougher mortgage rules and provincial policy measures have slammed the brakes on the once high-flying Vancouver and Toronto housing markets, and the stress tests have also weighed on the already depressed oil-producing regions. Consequently, household credit is now rising the least in 35 years at 3.2% y/y. And, incomes aren't picking up the slack, as both employment and wage growth have faded.

The upshot is that **consumer spending growth looks to moderate further to 1.6% this year** and 1.4% next year from an estimated 2.2% in 2018. The economy will need to get its mojo from the other 44% of spenders.

Is Draghi Too Patient?

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It was understandable that the ECB stuck to its guns on December 13th and ended its asset buying program. Yes, the economic outlook was not as rosy as it once was, but the data were still holding up. The various PMI surveys had slowed, but they were still expanding (over 50). The Euro Area economy had eased but it was still growing (real GDP was up 1.6% y/y in Q3). Sure there was some weaker data out of Germany, but the auto industry was dealing with new emissions rules and should get back on track. Euro Area inflation was also right on target at 2.0%. Yes, there were worries about how Italy would play out, but these were not reasons to call off the well-telegraphed and anticipated end of QE.

Fast forward about six weeks to January 24th. Something is amiss. The Euro Area's manufacturing PMI is at its lowest level in over four years, and the services measure is at a 5-year low. The sluggishness in Germany doesn't seem temporary after all: the manufacturing PMI contracted for the first time in four years, although services held up. Business confidence is at a 2-year low. The VDMA is seeing weaker foreign and domestic demand for machine orders. There is also uncertainty about whether or not the U.S. will introduce higher import taxes on European cars. And, although it appears that Germany just managed to skirt a recession, the fact that the "R" word is even entering the conversation is astonishing. Finally, the German government reportedly slashed its growth forecast this year by 0.8 ppts to 1.0%. In France, President Macron has reluctantly pulled his attention away from the world stage and is focused on taming the Yellow Vest protests, which are damaging service sector growth.

This casts a **cloud over the 2019 outlook** and how the ECB responds. At the January 24th meeting, President Draghi repeated that they will continue the reinvestment plan for an *"extended period of time"* beyond the first rate hike. But the central bank did not change its rate guidance: rates are expected to stay low *"at least through the summer of 2019"*. That it wasn't pushed out even further was surprising, given the landscape that has unfolded since the last meeting. Yes, it is still early but the weakness in the data has been unsettling, and the U.S./China trade war has yet to be resolved. And, trade talks between the U.S. and the Euro Area are on the horizon and no one is expecting a smooth process when they finally begin later this year. All of this suggests that the **any ECB rate hike will likely be delayed until 2020, at the earliest**.

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	Good News	Bad News
Canada ▪ Economy may have contracted in November ▪ BoC Governor Poloz sticks to his data-dependent stance	**Ottawa** posted a $2.1 bln deficit (Apr.-to-Nov.)—narrowed from a $9.5 bln deficit last year	**Retail Sales Volumes** -0.4% (Nov.) **Manufacturing Sales Volumes** -0.9% (Nov.) **Manufacturing New Orders** -2.9% (Nov.) **Wholesale Trade Volumes** -1.2% (Nov.)
United States ▪ Commerce Secretary Ross: still *"miles and miles"* away from China trade deal ▪ Government to reopen temporarily (until Feb. 15)	**FHFA House Price Index** +0.4% (Nov.) **Initial Claims** -13k to 199k (Jan. 19 week)—near 50-yr low	**Existing Home Sales** -6.4% to 4.99 mln a.r. (Dec.) **Leading Indicator** -0.1% (Dec.)
Japan ▪ BoJ on hold, lowers inflation forecast again		**Exports** -3.8% y/y (Dec.) **Department Store Sales** -0.7% y/y (Dec.) **Manufacturing PMI** -2.6 pts to 50.0 (Jan. P)—lowest since Aug. '16 **All-Industry Activity Index** -0.3% (Nov.)
Europe ▪ ECB on hold as growth risks tilt to the downside ▪ PM May's Plan B looks very similar to Plan A ▪ Possibility of a delayed Brexit grows	**Euro Area—Consumer Confidence** +0.4 pts to -7.9 (Jan. A) **Germany—ZEW Survey** +2.5 pts to -15.0 (Jan.) **France—Business Confidence** steady at 102 (Jan.) **U.K.—Employment** +141,000 (3 mths to Nov.) **U.K.—Jobless Rate** -0.1 ppts to 4.0% (3 mths to Nov.) **U.K.—Average Weekly Earnings ex. Bonus** steady at +3.3% y/y (3 mths to Nov.) **U.K.—Rightmove House Prices** +0.4% (Jan.)	**Euro Area—Manufacturing PMI** -0.9 pts to 50.5 (Jan. P)—lowest since Nov. '14 **Euro Area—Services PMI** -0.4 pts to 50.8 (Jan. P)—lowest since Aug. '13 **Euro Area—Composite PMI** -0.4 pts to 50.7 (Jan. P)—lowest since July '13 **Germany—Ifo Business Climate** -1.9 pts to 99.1 (Jan.)
Other ▪ IMF lowers global growth outlook amid trade fears ▪ Oil steadies despite U.S. sanction threats on Venezuela	**China—Industrial Production** +5.7% y/y (Dec.) **China—Retail Sales** +8.2% y/y (Dec.) **Australia—Employment** +21,600 (Dec.) —but all part-time **Australia—Jobless Rate** -0.1 ppts to 5.0% (Dec.)	**China—Real GDP** +6.4% y/y (Q4)—slowest pace since 2009Q1 **China—Fixed Asset Investment** +5.9% y/y (Jan-to-Dec.)

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

2% Yields Forever?

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A funny thing happened on the way to higher interest rates—they started moving in reverse three months ago. For instance, Canadian 10-year GoC yields dropped back below the 2% threshold this week, down from the short-lived peak of 2.60% reached in early October. Some retreat is understandable given the broader financial market volatility in late 2018, a more subdued outlook for Fed and BoC tightening, and the pullback in oil prices over that period. But, it is remarkable that the level of long-term yields has again careened to sub-2% terrain. After all, the Bank of Canada's longstanding official view on neutral overnight interest rates is in a range of 2.5%-to-3.5%, and yet even the longest-term interest rate seemingly cannot break into that zone *(Chart 1)*. This, at a time when both headline and core inflation are basically right on top of the Bank's 2% target, budget deficits remain meaty, oil prices are close to long-run norms, the output gap is essentially closed, and the unemployment rate is probing its lowest level in almost 50 years. **If long-term yields can't stick above 2% in this environment, it raises two fundamental questions:**

1. **What will it take to get yields to move much higher?**
2. **Is the Bank's estimate of "neutral" still too high?**

Deconstructing the recent slide in nominal long-term rates reveals that most of the drop has been driven by the inflation outlook implicitly built into yields *(Chart 2)*. In other words, **real bond yields have only slipped slightly in recent weeks**. In turn, much of the steep slide in the inflation component can be traced back to the sudden reversal in global oil prices late last year, when the market decided that the U.S. sanctions on Iranian oil lacked bite, and as U.S. production continued to soar.

But looking beyond that short-term swing in oil prices, the latest pullback in yields is just part of a bigger pattern that has been unfolding for years, nay decades. **Economists, forecasters, pundits**—of which we stand accused on at least two fronts—**have consistently overestimated long-term interest rates for a seeming eternity.** Take, as just one example, the relentless drop in expectations for bond yields among private sector forecasts in the official survey that the Department of Finance conducts a few times a year. (Since the mid-90s, this forecast has been used in Ottawa's budget plans, in part to ensure that the underlying economic assumptions are in no way politically motivated.) Two major points stand out in *Chart 3*: 1) the forecast for yields five years out has plunged 400 bps in past 25 years; and 2) every single one of those forecasts was far too high on the bond yield call. Even the most recent forecast of 3.3% for 10-year yields (five years hence) looks in danger given today's sub-2% reality.

Chart 1
Canadian Yields: Stuck below Neutral

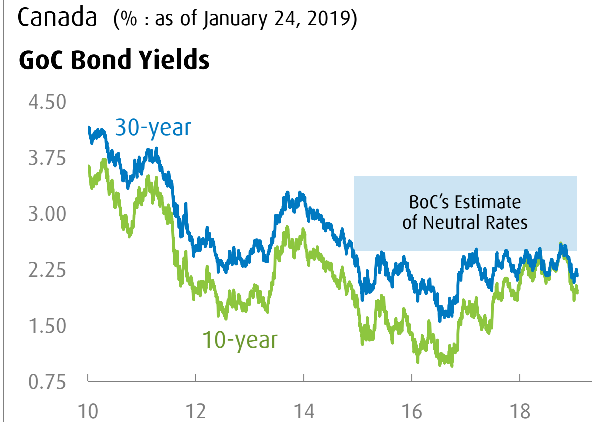


Chart 2
Deconstructing the Drop

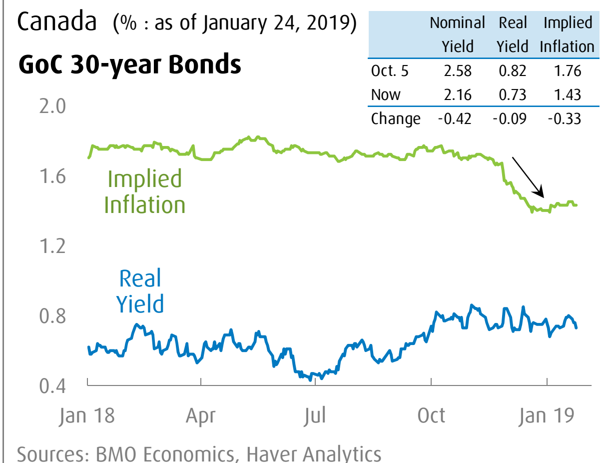
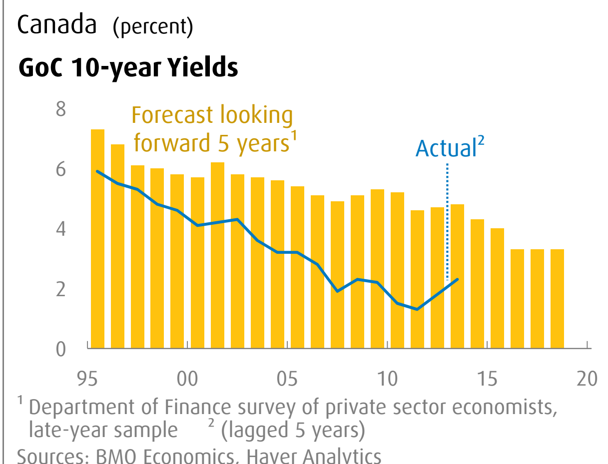


Chart 3
Consensus Forecasts Down, Down, Down

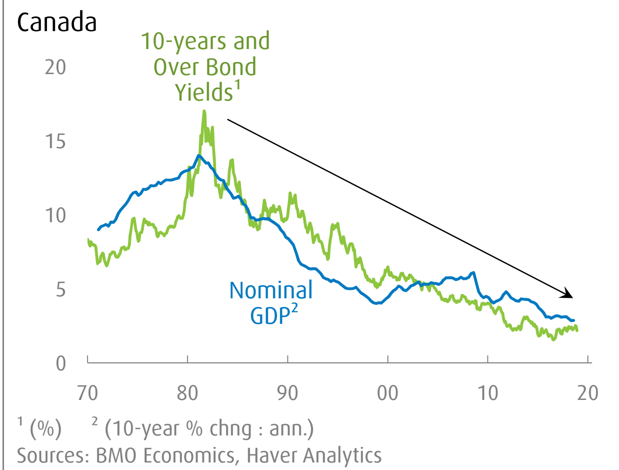


There's not too much mystery behind why yields have been on a long-term slide. At least, in part, the relentless move has been related to **a long-term slide in nominal GDP growth** *(Chart 4)*. In the early stages of the four-decade bull market, the slide in nominal GDP growth was first pulled down by lower inflation. More recently, the descent has been led more by **much slower real GDP growth**. The current consensus assumes that nominal GDP growth will settle into a 3.5%-to-4.0% range in the medium term. Suffice it to say that the bond market, with yields struggling to hold onto the 2% handle, is saying *"I will take the under on that range"*.

When yields were scraping bottom in 2016, many resources were poured into exploring the implications of Low for Long. The Bank of Canada, for one, delivered two key speeches on that very subject at the time, after having earlier openly mused about the possibility of negative interest rates. As a brief recap, here are some of the biggest implications of the possibility of 2% yields forever:

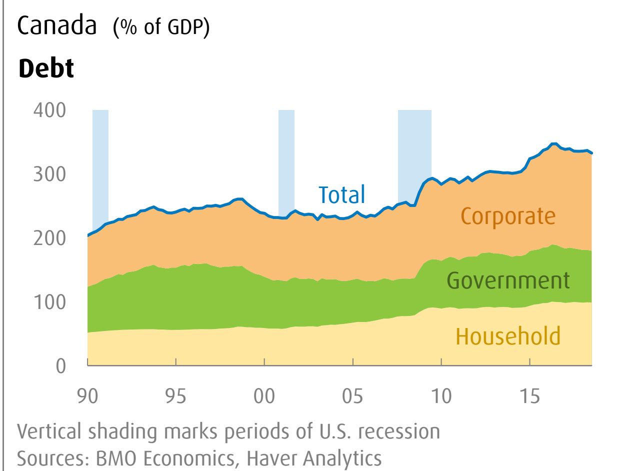
Winners: Borrowers, obviously. And for Canada, where the system-wide debt has risen to a towering 330% of GDP *(Chart 5)*, the economy is indeed more rate-sensitive than in the past. That sensitivity could partly cut the other way as well—i.e., even small rate cuts would bring some relief in the next downturn. The **housing market** will find support, with long-term mortgage rates starting to ebb. **Interest-sensitive sectors** in equity markets have benefitted, with utilities, telecom and REITs rare stand-outs in a challenged TSX over the past three months. Finally, **government budgets** benefit. Simply, debt dynamics become much more friendly when *"g is greater than r"* (i.e., when real growth at about 1.5%-to-2.0% is much higher than real interest rates of nearly nil). At those estimates, Ottawa has room to run primary deficits of around 0.5% of GDP and still keep the debt/GDP ratio steady (versus a small projected non-interest surplus this year). That's not a prescription, but just the math.

Chart 4
Yields Just Following the GDP Leader



¹ (%) ² (10-year % chng : ann.)
Sources: BMO Economics, Haver Analytics

Chart 5
Debt Dynamo



Vertical shading marks periods of U.S. recession
Sources: BMO Economics, Haver Analytics

Losers: Savers, obviously. With almost all yields now again negative in real terms, even before taking taxes into account, it's readily apparent that there's not much incentive to save. And Canadians are clearly responding to that negative incentive. While we are no fans of the official savings rate, it is notable that it drooped to an average of just 1.0% in the first three quarters of 2018, on course to hit its lowest annual tally in almost 60 years of records. In a similar vein, **pension funds** will come under renewed pressure from sustained ultra-low bond yields, given that the liability side is discounted by long-term rates.

Circling back to the initial two questions: **What will it take to seriously lift yields?** Less QE globally, firmer inflation (perhaps driven by faster wages), and/or firmer real GDP gains (perhaps supported by higher infrastructure spending or productivity). Are those likely? Not really. So, **is the Bank's official estimate of neutral too high?** Most probably, and even Governor Poloz hinted at such in a remark in December that the new normal may in fact be around 2%. The implication for BoC policy is that at 1.75%, the overnight rate is already pretty close to home.

Economic Forecast Summary for January 25, 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	1.2 ↓	1.0	2.5	2.2	1.9	3.0	2.0 ↓	1.8
Consumer Price Index (y/y % chng)	2.1	2.3	2.7	2.0	1.5	1.8	1.7	2.0	1.6	2.3	1.8
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.)	224	218	197	217	210	207	204	200	220	214	205
Current Account Balance ($blns : a.r.)	-69.3	-66.7	-41.4	-56.4 ↓	-55.8 ↓	-56.2 ↓	-57.5 ↓	-58.4 ↓	-60.1	-58.5 ↓	-57.0 ↓
Interest Rates (average for the quarter : %)											
Overnight Rate	1.25	1.25	1.50	1.75	1.75	1.75	2.00	2.08	0.71	1.44	1.90
3-month Treasury Bill	1.14	1.21	1.47	1.66	1.65	1.70	1.90	2.05	0.69	1.37	1.85
10-year Bond	2.24	2.28	2.28	2.32	2.00	2.05	2.15	2.20	1.78	2.28	2.10
Canada-U.S. Interest Rate Spreads (average for the quarter : bps)											
90-day	-44	-66	-61	-70	-81	-91	-83	-83	-26	-60	-85
10-year	-52	-64	-65	-72	-75	-74	-74	-73	-55	-63	-74
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	4.2	3.4	2.6	1.6 ↓	2.5 ↑	2.0	1.9	2.2	2.9	2.4
Consumer Price Index (y/y % chng)	2.3	2.6	2.6	2.2	1.8	2.0	2.0	2.1	2.1	2.4	2.0
Unemployment Rate (percent)	4.1	3.9	3.8	3.8	3.8 ↑	3.6	3.5	3.5	4.4	3.9	3.6
Housing Starts (mlns : a.r.)	1.32	1.26	1.23	1.24	1.26	1.24	1.23	1.21	1.21	1.26	1.24
Current Account Balance ($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	2.46	2.63	2.71	1.00	1.83	2.54
3-month Treasury Bill	1.58	1.87	2.08	2.36	2.45	2.65	2.70	2.90	0.95	1.97	2.65
10-year Note	2.76	2.92	2.93	3.03	2.75	2.80	2.90	2.95	2.33	2.91	2.85
EXCHANGE RATES (average for the quarter)											
US¢/C$	79.1	77.5	76.5	75.7	75.1	75.2	75.3	75.4	77.1	77.2	75.2
C$/US$	1.27	1.29	1.31	1.32	1.33	1.33	1.33	1.33	1.30	1.30	1.33
¥/US$	108	109	112	113	109	109	110	110	112	110	110
US$/Euro	1.23	1.19	1.16	1.14	1.15	1.15	1.16	1.17	1.13	1.18	1.15
US$/£	1.39	1.36	1.30	1.29	1.30	1.33	1.32	1.31	1.29	1.34	1.31

Blocked areas represent BMO Capital Markets forecasts

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

Canada

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Real GDP at Basic Prices

Thursday, 8:30 am

Nov. (e)	**-0.1%**
Consensus	*-0.2%*
Oct.	+0.3%

November was an ugly month for the Canadian economy, with weakness almost across the board. Manufacturing, wholesale and retail activity contracted in the month, while international trade flows were down as well. And, existing home sales dropped for a third straight month. One bright spot was that housing starts picked up, but that's hardly enough to offset the negatives. Indeed, all that weakness is even before accounting for potential voluntary oil production cuts (recall some producers announced cuts before the Province of Alberta mandated them). Those negatives peg our November GDP call at -0.1%, with some downside risk. That, in turn, has prompted us to cut our Q4 GDP growth forecast three ticks to 1.2%.

United States

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Real GDP

Wednesday, 8:30 am
(This report likely rescheduled as U.S. government reopens for 3 weeks)

		GDP Deflator
Q4 A (e)	**+2.6% a.r.**	**+2.4% a.r.**
Consensus	*+2.6% a.r.*	*+1.7% a.r.*
Q3	+3.4% a.r.	+1.8% a.r.

GDP growth likely slowed to 2.6% annualized in Q4 from 3.4% in Q3 as a result of a wider trade deficit, smaller inventory build and weaker residential investment. The partial government shutdown that started on December 22 will hive off 0.1 ppts from growth. Still, consumer and business spending likely stayed strong, with the former matching the prior quarter's 3.5% rate and the latter picking up after fading in Q3. On a fourth quarter-over-fourth quarter basis, the economy's estimated 3.1% expansion in 2018 will mark the best performance since 2005, with fiscal stimulus accounting for a third of the gain.

FOMC Announcement

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

See Michael Gregory's Thought on page 3.

Personal Spending

Thursday, 8:30 am
(This report likely rescheduled as U.S. government reopens for 3 weeks)

	Personal Spending	Personal Income
Dec. (e)	**+0.2%**	**+0.5%**
Consensus	*+0.3%*	*+0.5%*
Nov.	+0.4%	+0.2%
	Core PCE Price Index	
Dec. (e)	**+0.2%**	**+1.9% y/y**
Consensus	*+0.2%*	*+1.9% y/y*
Nov.	+0.1%	+1.9% y/y

Plunging service-station receipts should hold personal spending to a modest 0.2% advance in December. However, the headline figure will mask a strong holiday season as chain-store receipts strengthened and new vehicle sales found a higher gear. A 0.2% increase in real spending would cap a quarterly gain of 3.5% (annualized), mirroring the strong pace of the prior two quarters that benefitted from tax cuts. A late-year surge in employment should pump personal income 0.5% in the month. Meantime, the mighty dollar has helped shield households from tariffs. Core PCE prices are expected to rise a moderate 0.2%, keeping the annual rate below the Fed's target and in line with the six-month mean of 1.9%. Placid prices promise to prod Powell's patience.

Nonfarm Payrolls
Friday, 8:30 am

	Nonfarm Payrolls	
Jan. (e)	**+160,000**	
Consensus	*+160,000*	
Dec.	+312,000	
	Unemployment Rate	
Jan. (e)	**3.9%**	
Consensus	*3.9%*	
Dec.	3.9%	
	Average Hourly Earnings	
Jan. (e)	**+0.2%**	**+3.1% y/y**
Consensus	*+0.3%*	*+3.2% y/y*
Dec.	+0.4%	+3.2% y/y

It should be a happy 100th birthday (in months) for the longest-running payrolls expansion on record dating back to 1939. Legislation providing back pay to 380,000 furloughed federal employees means they will be counted on payrolls. We expect the nonfarm tally to increase 160,000, while falling short of last year's monthly average (220,000) due to slower economic growth, laid-off federal contract workers and payback from December's outsized 312,000 print. As well, the pool of available workers is now just ankle deep after last year's 2.6 million net hiring spree. The furloughed workers, however, will carve 0.2% from jobs in the household survey, while adding 0.2 ppts to the unemployment rate, likely keeping it steady at 3.9% and up from November's 49-year low of 3.7%. Average hourly earnings should rise a modest 0.2% following the largest increase in more than a year, shaving the yearly rate to 3.1%. Wages are running fast enough to fan spending but not inflation.

Manufacturing ISM (PMI)
Friday, 10:00 am

Jan. (e)	**54.3**
Consensus	*54.3*
Dec.	54.3

The ISM manufacturing index plummeted 4.5 points to 54.3 in December, the worst one-month move since the Great Recession. This followed a prolonged period (16 months) of stability at a relatively high level (range of 57.5 to 60.8). Unfortunately, the January regional factory metrics released so far indicate that a new, lower range is likely being established. Recast on an ISM basis, the New York, Philadelphia and Kansas City Fed indices all declined again, although the as-reported Richmond Fed index improved. But domestic demand growth is ebbing in the face of fading fiscal stimulus and tightening financial conditions, for factories, the tipping point has probably been the trifecta of tariffs (U.S. tariffs on imported intermediate and raw inputs along with retaliatory tariffs on U.S. finished goods), a strengthening U.S. dollar and slowing global growth. The sheer magnitude of December's drop points to the potential for a technical rebound and we judge the ISM index will do well just to stay flat.

Euro Area

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Real GDP
Thursday

Q4 A (e)	**+0.2%**	**+1.2% y/y**
Q3	+0.2%	+1.6% y/y

The coming week will bring what is expected to be weak Q4 GDP figures from the Euro Area. The Yellow Vest protests hammered France at the end of the year, and Italy likely contracted. Although Germany's GDP report is not out yet, a technical recession was just avoided, according to the Federal Statistics Office. All of this does not bode well for the Euro Area, where the economy likely slowed to a 1.2% y/y rate in Q4. January isn't starting off on a jaunty foot either, with the composite PMI at the lowest level since July 2013. No wonder the ECB now sees that the balance of risks has moved to the downside.

		Jan 25 [1]	Jan 18	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	0	0
	Prime Rate	5.50	5.50	0	0	0
3-Month Rates	Canada	1.63	1.62	1	-1	-1
	United States	2.37	2.39	-2	0	2
	Japan	-0.21	-0.21	0	-6	-6
	Eurozone	-0.31	-0.31	0	0	0
	United Kingdom	0.92	0.93	-1	1	1
	Australia	2.08	2.07	1	-1	-1
2-Year Bonds	Canada	1.88	1.94	-7	2	2
	United States	2.59	2.62	-2	8	10
10-Year Bonds	Canada	1.97	2.04	-6	2	1
	United States	2.75	2.79	-3	3	7
	Japan	-0.01	0.01	-2	0	0
	Germany	0.19	0.26	-7	-5	-5
	United Kingdom	1.30	1.35	-5	4	3
	Australia	2.21	2.32	-10	-15	-11
Risk Indicators	VIX	17.8	17.8	0.0 pts	-10.6 pts	-7.7 pts
	TED Spread	38	37	1	-5	-7
	Inv. Grade CDS Spread [2]	75	73	2	-14	-13
	High Yield CDS Spread [2]	386	381	4	-66	-65
					(percent change)	
Currencies	US¢/C$	75.56	75.41	0.2	3.0	3.0
	C$/US$	1.324	1.326	—	—	—
	¥/US$	109.65	109.78	-0.1	-0.6	0.0
	US$/€	1.1405	1.1363	0.4	-0.3	-0.5
	US$/£	1.319	1.287	2.5	3.9	3.4
	US¢/A$	71.78	71.68	0.1	1.9	1.8
Commodities	CRB Futures Index	180.73	182.21	-0.8	5.7	6.4
	Oil (generic contract)	53.61	54.04	-0.8	18.3	18.1
	Natural Gas (generic contract)	3.18	3.48	-8.6	-3.6	8.3
	Gold (spot price)	1,298.50	1,281.75	1.3	1.4	1.3
Equities	S&P/TSX Composite	15,360	15,304	0.4	8.0	7.2
	S&P 500	2,663	2,671	-0.3	7.1	6.2
	Nasdaq	7,159	7,157	0.0	8.7	7.9
	Dow Jones Industrial	24,726	24,706	0.1	7.2	6.0
	Nikkei	20,774	20,666	0.5	3.8	3.8
	Frankfurt DAX	11,282	11,206	0.7	6.8	6.8
	London FT100	6,809	6,968	-2.3	1.1	1.2
	France CAC40	4,926	4,876	1.0	5.3	4.1
	S&P ASX 200	5,906	5,880	0.4	4.4	4.6

[1] = as of 2:40 pm   [2] = One day delay

Global Calendar
January 28 – February 1

BMO Capital Markets®

	Monday January 28	Tuesday January 29	Wednesday January 30	Thursday January 31	Friday February 1
Japan	**BoJ Minutes from Dec. 19-20 meeting**		**Retail Sales** **Dec. P (e) +0.4% +0.8% y/y** Nov. -1.1% +1.4% y/y **Consumer Confidence** **Jan. (e) 42.4** Dec. 42.7	**Industrial Production** **Dec. P (e) -0.5% -2.3% y/y** Nov. -1.0% +1.5% y/y **BoJ Summary of Opinions from Jan. 22-23 meeting**	**Jobless Rate** **Dec. (e) 2.5%** Nov. 2.5% **Manufacturing PMI** **Jan. F (e) 50.0** Dec. 52.6
Euro Area	**EURO AREA** **M3 Money Supply** **Dec. (e) +3.8% y/y** Nov. +3.7% y/y	**FRANCE** **Consumer Confidence** **Jan. (e) 88** Dec. 87	**EURO AREA** **Economic Confidence** **Jan. (e) 106.9** Dec. 107.3 **Consumer Confidence** **Jan. F (e) -7.9** Dec. -8.3 **GERMANY** **GfK Consumer Confidence** **Feb. (e) 10.3** Jan. 10.4 **Consumer Price Index** **Jan. P (e) -0.9% +1.8% y/y** Dec. +0.3% +1.7% y/y **FRANCE** **Real GDP** **Q4 A (e) +0.2% +0.9% y/y** Q3 +0.3% +1.4% y/y **Consumer Spending** **Dec. (e) -0.2% -0.7% y/y** Nov. -0.3% -2.0% y/y **ITALY** **Consumer Confidence** **Jan. (e) 112.6** Dec. 113.1	**EURO AREA** **Real GDP** **Q4 A (e) +0.2% +1.2% y/y** Q3 +0.2% +1.6% y/y **Jobless Rate** **Dec. (e) 7.9%** Nov. 7.9% **GERMANY** **Unemploy. Jobless Rate** **Jan. (e) -11,000 5.0%** Dec. -14,000 5.0% **Retail Sales** **Dec. (e) -0.4% +1.7% y/y** Nov. +1.6% +1.1% y/y **FRANCE** **Consumer Price Index** **Jan. P (e) -0.6% +1.5% y/y** Dec. +0.1% +1.9% y/y **ITALY** **Real GDP** **Q4 A (e) -0.1% +0.4% y/y** Q3 -0.1% +0.7% y/y **Jobless Rate** **Dec. P (e) 10.6%** Nov. 10.5%	**EURO AREA** **Consumer Price Index** **Jan. A (e) +1.4% y/y** Dec. +1.6% y/y **Core CPI** **Jan. A (e) +1.0% y/y** Dec. +1.0% y/y **Manufacturing PMI** **Jan. F (e) 50.5** Dec. 51.4
U.K.		**Parliament debates and votes on Brexit amendments**		**GfK Consumer Confidence** **Jan. (e) -14** Dec. -14 **Nationwide House Prices** **Jan. (e) +0.2% unch y/y** Dec. -0.7% +0.5% y/y	**Manufacturing PMI** **Jan. (e) 53.5** Dec. 54.2
Other	**AUSTRALIA** **Markets Closed**	**AUSTRALIA** **NAB Business Confidence** **Jan.** Dec. 3	**U.S./China Trade Talks in Washington D.C. (Jan. 30-31)** **AUSTRALIA** **Consumer Price Index** **Q4 (e) +0.4% +1.7% y/y** Q3 +0.4% +1.9% y/y **MEXICO** **Real GDP** **Q4 P (e) +2.0% y/y** Q3 +2.5% y/y	**CHINA** **Mfg PMI Nonmfg PMI** **Jan. (e) 49.3 53.9** Dec. 49.4 53.8 **Composite PMI** **Jan.** Dec. 52.6	**CHINA** **Caixin Mfg PMI** **Jan. (e) 49.7** Dec. 49.7

Upcoming Policy Meetings | BoE: Feb. 7, Mar. 21, May 2 | ECB: Mar. 7, Apr. 10, June 6

North American Calendar
January 28 – February 1

BMO Capital Markets®

Monday January 28

United States

8:30 am — **Chicago Fed National Activity Index**
Dec. (e) **unch**
Nov. +0.22

10:30 am — **Dallas Fed Mfg. Activity**
Jan. (e) **-4.0**
Consensus *-2.1*
Dec. -5.1

11:30 am 26-week bill auction $39 bln
11:30 am 2-year note auction $40 bln
1:00 pm 13-week bill auction $42 bln
1:00 pm 5-year note auction $41 bln

Releases marked by * likely rescheduled as U.S. government reopens for 3 weeks

Previously delayed data likely rescheduled as U.S. government reopens for 3 weeks:
- Construction Spending (Nov.)
- Factory Orders (Nov.)
- Goods & Services Trade Deficit (Nov.)
- Wholesale Inventories (Nov. F)
- Budget Balance (Dec.)
- Retail Sales (Dec.)
- Business Inventories (Nov.)
- Net TIC Flows (Nov.)
- Housing Starts (Dec.)
- Building Permits (Dec.)
- Real GDP by Industry (Q3)
- Durable Goods Orders (Dec.)
- New Home Sales (Nov., Dec.)

Tuesday January 29

United States

8:30 am — **Goods Trade Deficit***
Dec. A (e) **$76.0 bln**
Nov. A (e) **$76.0 bln**
Consensus *$76.1 bln*
Oct. $77.0 bln

8:30 am — **Wholesale and Retail Inventories (Dec. A)***

9:00 am — **S&P Case-Shiller Home Price Index (20 city)**
Nov. (e) **+0.3%** **+4.6% y/y**
Consensus *+0.4%* *+4.7% y/y*
Oct. +0.4% +5.0% y/y

10:00 am — **Homeowner Vacancy Rate***
Q4 (e) **1.6%**
Q3 1.6%

10:00 am — **Conference Board Consumer Confidence Index**
Jan. (e) **122.0**
Consensus *124.0*
Dec. 128.1

FOMC Meeting Begins

State of the Union Address (9:00 pm) likely rescheduled as U.S. government reopens for 3 weeks

11:00 am 4- & 8-week bill auction announcements
11:30 am 52-week bill auction $26 bln
11:30 am 2-year FRN auction $20 bln
1:00 pm 7-year note auction $32 bln

Wednesday January 30

Canada

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

United States

7:00 am — **MBA Mortgage Apps**
Jan. 25
Jan. 18 -2.7%

8:15 am — **ADP National Employment Report**
Jan. (e) **+160,000**
Consensus *+178,000*
Dec. +271,000

8:30 am — **Real GDP*** / **GDP Deflator***
Q4 A (e) **+2.6% a.r.** **+2.4% a.r.**
Consensus *+2.6% a.r.* *+1.7% a.r.*
Q3 +3.4% a.r. +1.8% a.r.

10:00 am — **Pending Home Sales**
Dec. (e) **-0.2%**
Consensus *+0.5%*
Nov. -0.7%

2:00 pm — **FOMC Announcement**
2:30 pm — **Fed Chair Powell's Press Briefing**

U.S./China Trade Talks in Washington D.C. (Jan. 30-31)

8:30 am 3- & 10-year note, 30-year bond auction and other quarterly refinancing announcements

Thursday January 31

Canada

8:30 am — **Real GDP at Basic Prices**
Nov. (e) **-0.1%**
Consensus *-0.2%*
Oct. +0.3%

8:30 am — **Industrial Product Price Index** / **Raw Materials Price Index**
Dec. (e) **+0.5%** **+5.0%**
Consensus *+0.2%* *+4.0%*
Nov. -0.8% -11.7%

12:30 pm — **BoC Senior Deputy Governor Wilkins speaks to the Toronto Board of Trade on the changing job market and the impact on monetary policy**

2-year bond auction announcement

United States

7:30 am — **Challenger Layoff Report**
Jan.
Dec. +35.3% y/y

8:30 am — **Initial Claims**
Jan. 26 (e) **216k (+17k)[c]**
Jan. 19 199k (-13k)

8:30 am — **Continuing Claims**
Jan. 19
Jan. 12 1,713k (-24k)

8:30 am — **Employment Cost Index**
Q4 (e) **+0.8%** **+3.0% y/y**
Consensus *+0.7%* *+2.9% y/y*
Q3 +0.8% +2.8% y/y

8:30 am — **Personal Spending*** / **Personal Income***
Dec. (e) **+0.2%** **+0.5%**
Consensus *+0.3%* *+0.5%*
Nov. +0.4% +0.2%

8:30 am — **Core PCE Price Index***
Dec. (e) **+0.2%** **+1.9% y/y**
Consensus *+0.2%* *+1.9% y/y*
Nov. +0.1% +1.9% y/y

9:45 am — **Chicago PMI**
Jan. (e) **59.0**
Consensus *62.0*
Dec. 65.4

11:30 am 4- & 8-week bill auction
11:00 am 13- & 26-week bill auction announcements

Friday February 1

Canada

9:30 am — **Markit Manufacturing PMI**
Jan.
Dec. 53.6

Auto Sales[D]
Jan.
Dec. -8.0% y/y

United States

8:30 am — **Nonfarm Payrolls**
Jan. (e) **+160,000**
Consensus *+160,000*
Dec. +312,000

8:30 am — **Unemployment Rate**
Jan. (e) **3.9%**
Consensus *3.9%*
Dec. 3.9%

8:30 am — **Average Hourly Earnings**
Jan. (e) **+0.2%** **+3.1% y/y**
Consensus *+0.3%* *+3.2% y/y*
Dec. +0.4% +3.2% y/y

9:45 am — **Markit Manufacturing PMI (Jan. F)**

10:00 am — **Manufacturing ISM (PMI)**
Jan. (e) **54.3**
Consensus *54.3*
Dec. 54.3

10:00 am — **Construction Spending***
Dec. (e) **-0.5%**
Nov. (e) **+0.4%**
Oct. -0.1%

10:00 am — **University of Michigan Consumer Sentiment**
Jan. F (e) **90.5**
Consensus *90.9*
Jan. P 90.7
Dec. 98.3

Ward's Total Vehicle Sales[D]
Jan. (e) **17.1 mln a.r.**
Consensus *17.2 mln a.r.*
Dec. 17.5 mln a.r.

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[c] = consensus   [D] = date approximate

Upcoming Policy Meetings | Bank of Canada: Mar. 6, Apr. 24, May 29 | FOMC: Mar. 19-20, Apr. 30-May 1, June 18-19

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