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BMO CAPITAL MARKETS ECONOMICS

Focus

A weekly financial digest

Douglas Porter, CFA, Chief Economist, BMO Financial Group

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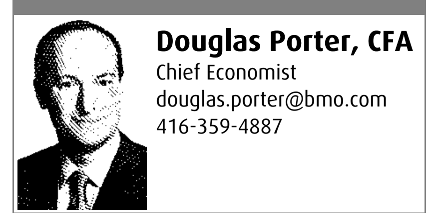
That Synching Feeling



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

The dawning realization that U.S./China trade tensions are not going to be resolved anytime soon continues to rattle markets. Major developments this week included U.S. restrictions on Chinese telecom companies (and then a small step back), and a hardening of rhetoric on both sides. Amid some back-and-forth, equities receded for the third week in a row, with the S&P 500 now down a little less than 4% over that period. While stocks are grappling for clear direction, bond yields aren't—they have been headed due south through the three weeks of open hostilities. Ten-year Treasury yields fell to 20-month lows of below 2.30%—gathering fuel from a deep slide in oil prices—before nudging up slightly on Friday. Since the trade war flickered back to life, Treasury yields have dropped roughly 20 bps across the curve, slicing all but the very longest bond to below the midpoint of the Fed's overnight target range (2.375%).

Effectively, **investors are still in the process of readjusting expectations on the trade war, shifting its probabilities from outside risk to base case in a matter of weeks**. And, given the tone from both sides—including Xi harkening back to The Long March—this seems to be a **prudent step**. We take a closer look at the impact on Canada of a full-blown trade war in this week's Feature (page 8), but it's difficult to put decimal points on this developing battle. Much depends on how markets, businesses, and even consumers respond to events. A variety of Fed speakers have noted recently that the uncertainty alone could chill business investment, which already had been a notable laggard for much of this cycle globally.

While most markets were busily pricing in deeper damage from the trade conflict, the **foreign exchange market was a notable bystander** this week. Most of the majors managed to hold their own against the U.S. dollar, if not even firm a tad, albeit reflecting a swathe of specific factors. A surprise election victory by the ruling coalition gave some mild support to the **Australian dollar**. The **U.K. pound** sagged early in the week, but revived a bit on Friday's announcement of Theresa May's resignation—presumably on the faint hope that her replacement may be able to reset Brexit proceedings (and good luck with that). And, **China's yuan** stabilized after it was allowed to weaken more than 3% over the past month.

The **Canadian dollar** also pulled a counter trend, rising marginally this week even as oil prices fell heavily. Notably, while WTI dropped 7% to $58, WCS was crushed by 11% to just over $42, with the differential moving back into the normally wide range. There were a few supportive factors for the loonie this week, even amid the deteriorating global trade backdrop and sagging crude. **First**, the currency was still basking in the warm glow of last Friday's sudden deal with the U.S. to remove the metals tariffs, and related prospects of the USMCA proceeding with some pace (well, at least until Donald met Nancy). **Second**, the wave of upbeat Canadian domestic data kept rolling, with both retail (+1.1%) and wholesale trade (+1.4%) coming in above expectations for March. Pretty much **since the day the Bank of Canada delivered a downbeat economic forecast at its April MPR, we have been fed a steady diet of strong Canadian data**. While we still believe Q1 GDP was quite sluggish, we did slightly revise up our call for next week's report (to 0.5% a.r.) on the latest strong indicators, and look for a significant improvement in Q2 (at just over 2% growth).

Finally, the loonie also was supported by **some surprisingly upbeat remarks by Governor Poloz** after the markets had packed it in last Friday. He both indicated that the underlying tendency is for rates to go higher, and that the recent massive job gains may, in fact, be a true indication of how the economy is faring. We have no significant quarrel with the view that job growth is robust—even this week's Economist magazine trumpets *'The Great Jobs Boom'* on its latest cover (and, no, they are not focusing on Canada… pity). However, it is highly debatable whether the gaudy headline job gains will translate into a meaningful pickup in broader activity, given that wage growth remains modest and the biggest increases are in part-time positions. Note that, even with the solid March advance, real retail sales were up a modest 1.2% y/y, not even matching Canada's (torrid 1.4%) population growth trends.

What do these many moving parts mean for the Bank of Canada's policy outlook? There's not much debate that the Bank is locked firmly on the sidelines for the time being (see Ben's Thought on page 5). Poloz's recent comments seem to lean to the side that the run of robust domestic data carry more weight than the flare-up in U.S./China trade tensions. And, the Governor has often noted the potential upside risks if and when said tensions recede. Suffice it to say that we take a more jaundiced view of the trade outlook and, instead, believe that the better domestic news will in fact soon be overshadowed by a more problematic external backdrop. The fact that even two-year GoC yields have cascaded 65 bps lower in the past six months to below 1.60% suggests that markets are very much of that view as well.

One of the most common questions we field these days is whether Canada's mortgage stress tests may be relaxed in the semi-near future. The short answer now seems to be "highly unlikely", after two key voices—Governor Poloz and the head of the CMHC—offered full support to the tests in the past week. Both suggested that the tests were part of a broader goal of averting a wider problem on the household debt front. And just since the latest round of tests came into effect at the start of last year, growth in overall household debt has cooled notably from more than 5% to just under 3%—taking it a bit below underlying personal income growth.

What's fascinating about this whole episode is how it has now become almost conventional wisdom that the housing market had indeed been in bubble-like conditions in 2016 and early 2017. Oh, and that, yes, non-resident investors were indeed a significant factor fuelling those unsustainable trends—the BoC has released a paper that gives some academic heft to something that was evident to anyone who cared to look at that issue. We would *never* stoop so low as to say "we told you so", but there are always times for exceptions…

Don't Forget U.S. Fiscal Hurdles

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

With trade war fears flaring, it's easy to forget that the U.S. economy also faces looming fiscal risks, as we were reminded of this week when the President stormed out of a meeting with congressional Democrats. The meeting was supposed to move the infrastructure spending ball downfield, one area where the administration and Democrats (though not most Republicans) actually see eye to eye in budget talks and, one would think, would be a relatively easy first down to achieve. Instead, they

fumbled badly, with the President warning he wouldn't work with Democratic leaders until they stop investigating him and seeking testimony from administration officials. The breakdown in budget talks and heightened animosity between the White House and House Democrats poses serious challenges in overcoming a number of major fiscal hurdles this year. It also injects new doubts into USMCA ratification, which only last week received a Hail Mary pass from the end of metals tariffs on partner nations Canada and Mexico. While the White House was quick to add that it still seeks a budget deal (and a two-year version to get past the presidential election), and Democrats said they would still try to pass legislation with the Republicans, the latest blowup raises doubts on *any* legislation getting passed in the next 17 months.

The **first hurdle**, of course, is for Congress to actually pass a budget that sets total funding levels for next fiscal year starting October 1. Without one, it will need to pass a continuing resolution to fund government departments at current spending levels beyond September 30. And without a continuing resolution, parts of the government would shut down, resulting in delayed salaries for federal workers and an even bigger headache for businesses and the economy than what happened at the turn of this year. The President has veto power over a bill to pass a continuing resolution, so hopefully he will be in a better mood by then. The **second hurdle** is that deep spending cuts are scheduled to kick in starting October 1 unless Congress votes to suspend the caps on spending that were imposed by the 2011 debt-ceiling compromise known as the "sequester". This would result in $126 billion of less discretionary and defense expenditures relative to fiscal 2019 levels, gouging full-year GDP by 0.6%. The **third hurdle** is the government's borrowing limit, which was suspended in February 2018 but reinstated on March 1, 2019 at the level of public debt outstanding on that day ($22.0 trillion). Unless the debt ceiling is lifted or suspended again, investors will start feeling antsy around late summer. That's when Treasury Secretary Mnuchin says he will run out of juggling room, such as borrowing from retirement funds or withdrawing from federal accounts held at the Fed, to prevent a possible debt payment default.

It's hard to place odds on a scenario in which all three fiscal shocks *and* an escalation in the trade war occur simultaneously. But it's not hard to imagine the serious damage to investor confidence, financial markets and the economy that would ensue. We can only hope cooler political heads will prevail by then.

U.S. Housing's Rebound Hasn't Found a Home... Yet

New and existing home sales slipped 1.2% to 5.86 million (annualized) in April, after falling 3.5% in March. Monthly figures can be quite volatile, but even the 12-month average has continued to drift down. The latter trend peaked in December 2017 at the highest level in more than a decade (since before the Great Recession) and has been sliding since, reflecting a sequence of overlapping factors. Mortgage rates spent most of 2018 on the rise; 30-year tenors peaked at 7¾-year highs in November at 95 bps above where they began the year. Although mortgage rates have dropped more than 85 bps from their apex, the sales trend has yet to even stabilize.

Just as mortgage rates began dropping, households were battening down the spending hatches amid a near-20% plummet in the S&P 500. We suspect the shock to home-

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

buying confidence required a complete stock market recovery in order to be forgotten, and we only hit a new record high in late April. Meantime, the weather hasn't helped. The winter months were the wettest in recorded history and even April punched in among the top 10% of Aprils over the past 125 years of data. Finally, April was the deadline for filing 2018 income taxes, which likely emphasized for many filers how last year's tax changes reduced the tax-attractiveness of mortgage interest payments and home ownership. These were likely negatives for home sales since the start of 2018.

However, with mortgage rates low, and heading even lower given the recent reductions in longer-term Treasury yields, the home sales trend could soon stabilize and turn up. The stock market has already hit the requisite new record high, and April showers will presumably bring May flowers (and better home-buying weather). Meantime, strong job creation and moderate wage growth are supporting incomes. Household balance sheets are very healthy, for example, they sport an 18-year low debt-to-income ratio, near-record-high net worth relative to income, and a near-record-low debt service ratio. In other words, consumers have the capacity to borrow more, and more banks were easing mortgage lending standards in the Fed's Q2 survey. If there's a lingering constraint for home sales, it's likely the availability of homes for sale. After hitting record lows in December 2017 (just in time for the sales downturn), they have risen around 4% over the past 16 months. But, these lean inventories bode well for home prices and new home construction. MJG

BoC Preview… Patience Paying Off

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

The **Bank of Canada** is universally expected to hold policy rates steady at 1.75% at the May 29 announcement. At the last meeting in April, the BoC stressed patience and set a high bar to move policy rates. We've heard from Governor Poloz a couple of times since then and he has not deviated one iota. It's clear that, given the current backdrop, the BoC has no interest in moving rates (either way) anytime soon.

The BoC's patient stance is driven by a couple of key pillars. There's no urgency to hike—though the Governor continues to note that rates should tend to move higher—as the weakness in Q4 and likely Q1 GDP have opened up an output gap that will take at least a few quarters to close. Indeed, the April MPR said the output gap was estimated at about -0.75% (+/-0.5 ppts). And, the BoC is forecasting just 1.3% in Q2, suggesting the gap will widen a bit further. Unless growth is well above potential in H2, the output gap won't close until 2020. Since inflation dynamics show little sign of heating up, there's clearly no rush at all to push rates higher. All this ignores the issue of high household debt ratios, which is yet another reason rates shouldn't be moving up anytime soon.

At the same time, there's been exactly ZERO discussion of easing. That's despite the Fed openly musing about potential cuts, even if it isn't ready to pull the trigger at present. The BoC is in a very different place than the Fed. First, Canadian policy rates remain below neutral and are negative in real terms, while it can be reasonably argued that fed funds are around neutral and positive in real terms. Next, the April MPR's Q1 and Q2 GDP forecasts were conservative… at least initially. For Q1, we've since brought our call down to just +0.5% (two ticks above the BoC) as trade is expected to subtract heavily. That's in contrast with the consensus which is looking for something closer to 1%, in line with what the sindustry data show. While the Q1 data will be out

on Friday (post-BoC), the governing council will likely have the number in hand for its deliberations, so any big surprises might be betrayed in the statement. For Q2, the MPR was conservative again at only 1.3%—we're 1 ppt higher. The few data points we have so far for Q2 have been quite positive and we're expecting a solid handoff from March. Housing is particularly important here, with general stability in the April figures easing the BoC's concerns. It's early but all signs point to a much better Q2. Trade could be the real key though after the putrid Q1.

Some other factors that the Bank will consider this month include the U.S./China trade war escalation and the removal of U.S. steel/aluminum tariffs on Canada & Mexico. Both might just offset each other. The risks around U.S./China are two sided, but lean negative (at least in our view) and the latest round of tariffs will be unambiguously negative for growth. Conversely, the end of metals tariffs should be a plus for GDP, but perhaps the more important aspect is that the door appears to be cracked open for the USMCA to be ratified maybe as soon as this year (though here, too, we have doubts).

Bottom Line: Expect the policy statement to walk the neutral line, showing no desire to move on rates anytime soon. The usual reference to the forecast will likely note that things are evolving as anticipated in the April MPR. Given the market's persistent dovish lean, don't be shocked if a neutral statement is viewed as somewhat hawkish. *B.A.A.R.*

Different Face, Same Problems

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

It was only a matter of time before Theresa May would admit that she was unable to deliver Brexit and step down (on June 7th). Now, the question is who will be the next Tory leader? **Boris Johnson** is the favourite right now, but he has some competition, including **Michael Gove**. Note that both contenders changed their minds earlier this year and backed PM May's Brexit deal, which could come back to haunt them. There is also former Brexit Minister Dominic Raab. And, **Graham Brady** just announced that he would stand down as Chair of the 1922 Committee (backbenchers), so add him to the list. In any event, the new resident of Number 10 Downing Street will be more of a hard Brexiteer than the outgoing leader, but will face the **same issues**; that is, a weak minority government, a reliance on the DUP for support, and a very divided Parliament on this highly charged issue that has torn Britain apart for nearly three years. There will be plenty of troop-rallying about how he/she will get a better deal for the U.K. than Mrs. May ever could. However, that would be a very ambitious message given that once the new leader is in Brussels, he/she will be confronted with a very different audience. Those on the other side of the table have already gone through months/years of detailed negotiations that resulted in what is deemed the best deal for both sides. Their message will likely be take it or leave it. It is also possible that the new PM may want his/her own mandate and ask the House for a general election, but there is a risk that the Brexit Party will gain ground. PM Farage, anyone?

Bottom Line: The uncertainty continues, but there are two growing possibilities playing out now… a no-deal Brexit, even though the British Parliament does not want it, and… sorry, I have to say this… another extension of the Brexit date. Instead of Halloween, we could be talking about New Year's Eve. *JLee*

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

	Good News	Bad News
Canada ▪ Ottawa lifts retaliatory tariffs on U.S. imports ▪ C$ range bound despite drop in oil	**Retail Sales Volumes** +0.3% (Mar.) **Wholesale Trade Volumes** +1.0% (Mar.)	
United States ▪ Pres. Trump sees a *"good possibility"* for China trade deal even as tensions flare ▪ Washington unveils $16 bln plan to help hurting farmers ▪ FOMC Minutes suggest patience for *"some time"*	**Initial Claims** -1k to 211k (May 18 week)	**Durable Goods Orders** -2.1% (Apr.) —and **core** -0.9% **Existing Home Sales** -0.4% to 5.19 mln a.r. (Apr.) **New Home Sales** -6.9% to 673,000 a.r. (Apr.)—but prior months revised up **Chicago Fed National Activity Index** -0.45 (Apr.)
Japan ▪ Strong GDP result masks underlying weakness	**Real GDP** +0.5% q/q (Q1 P)—but exports drop **Consumer Prices** +0.9% y/y (Apr.) **Core Machine Orders** +3.8% (Mar.) **Imports** +6.4% y/y (Apr.) **Industrial Production** revised up to -0.6% (Mar.)	**Exports** -2.4% y/y (Apr.) **Department Store Sales** -1.1% y/y (Apr.) **Manufacturing PMI** -0.6 pts to 49.6 (May P)
Europe ▪ U.K. PM May to resign as party leader June 7 after *"new and improved"* deal backfires ▪ EU elections under way with polls suggesting Brexit Party poised for major win	**Euro Area—Consumer Confidence** +0.8 pts to -6.5 (May A) **Euro Area—Composite PMI** +0.1 pts to 51.6 (May P) **Germany—Producer Prices** +2.5% y/y (Apr.) **France—Business Confidence** steady at 106 (May) **U.K.—Retail Sales (incl. Fuel)** unch (Apr.) —above expected **U.K.—Core Consumer Prices** +1.8% y/y (Apr.) **U.K.—Producer Prices (Output)** +2.1% y/y (Apr.) **U.K.—Rightmove House Prices** +0.9% (May)	**Euro Area—Manufacturing PMI** -0.2 pts to 47.7 (May P) **Euro Area—Services PMI** -0.3 pts to 52.5 (May P) **Germany—ifo Business Climate** -1.3 pts to 97.9 (May)
Other ▪ Australian PM Morrison beats the odds with majority win ▪ Indian PM Modi re-elected in landslide victory		**Mexico—Real GDP** revised down to +1.2% y/y (Q1)

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

Crossfire Hurricane: Canada in a Time of Trade War

Douglas Porter, Robert Kavcic, Benjamin Reitzes

We have long been sceptical that the U.S./China trade negotiations would end well, owing to the extremely high bar for change that the U.S. was demanding of China. The positive tone surrounding the talks in the first four months of the year gave way to the cold hard reality of open hostilities in the past three weeks, which are much more in line with our initial impressions. Looking ahead, we are not optimistic, and suspect the best that we can realistically hope for is a tempering of the rhetoric, with perhaps a narrow deal possible at some point, at least on the trade front. Our FX Strategy group provides some guidance on the odds of various scenarios by the middle and end of this year in the attached table (*Table 1*). But, the main message is that there is better than a 50-50 chance of an unfavourable outcome—in contrast, financial markets were likely assuming roughly 90% odds of a favourable outcome as recently as late April.

What are the implications for Canada if U.S./China relations sour further? In a nutshell: not good. Some have made the case that Canada could potentially see some benefits from a prolonged battle, based on possible long-term trade diversion (likely coming from the U.S. sourcing imports from anywhere but China). While that may provide a partial offset, we suspect the obvious negatives would far outweigh any support on this front.

In our estimates of the trade war **impact on the U.S. economy**, we've considered the loss of real consumer purchasing power, retaliatory actions by China hitting U.S. exports (see the farm sector) and less confidence. All told, we judge that the U.S. economy could be hit by roughly 0.6 ppts, all else equal, from the current and threatened action between the two countries. While there's always debate about who 'wins' in such a dispute, the reality is that a negative supply shock (as the textbook would characterize it) is bad for growth and inflation, while leaving both trading partners worse off overall. True, the U.S. arguably has less to lose, with shipments to China coming in at less than 1% of GDP, while China's shipments to the U.S. add up to more than 3% of the economy (*Table 2*). But, the U.S. imports more than 20% of its goods from China, leaving the consumer on the hook—substitution is possible, but unlikely at current prices.

Table 1
Trade War Scenarios

(% probability of each outcome)	
Before G20 on June 28-29:	
Additional tariffs imposed	30
No new tariffs imposed	65
Grand bargain	5
By year's end:	
Not even talking	20
Still talking, new tariffs imposed	35
Still talking, no new tariffs	15
Small deal, talks for more	20
Grand bargain	10

Source: Greg Anderson, Head BMO FX Strategy

Table 2
The Trade Picture — 2018

			(US$ blns)	(% of total)	(% of GDP)		(US$ blns)	(% of total)	(% of GDP)
Imports	**Canada**	with United States	301.5	64.9	17.6	with China	35.8	7.6	2.1
Exports			334.0	73.9	19.5		22.4	5.0	1.3
Balance			32.4	n.m.	1.9		-13.4	79.5	-0.8
Imports	**United States**	with Canada	318.5	12.5	1.6	with China	539.5	21.2	2.6
Exports			298.7	18.0	1.5		120.3	7.2	0.6
Balance			-19.8	2.3	-0.1		-419.2	47.7	-2.0
Imports	**China**	with Canada	28.4	1.3	0.2	with United States	115.1	7.3	1.1
Exports			35.2	1.4	0.3		478.4	19.2	3.5
Balance			6.8	1.9	0.0		323.3	91.9	2.4

n.m. = not meaningful

Sources: national statistical agencies

Canada is largely an observer for now, but it's often the case that as goes the U.S., so goes Canada. We've estimated that a 0.6 ppt dip in U.S. growth could ultimately pull down **Canadian growth** by about 0.3 ppts, all else equal, especially if it is business confidence and real consumer spending that take the brunt of the impact. Overall, the U.S. still accounts for almost three-quarters of Canadian exports versus just 5% for China. From a regional perspective, Central Canada is most exposed to trade flows with the U.S. and most closely correlated to U.S. real GDP growth. But, commodity-heavy regions of the country would certainly feel the hit if the trade war triggers a broader slowdown in global growth, resource demand and prices. And, while we are largely ignoring the current state of affairs directly between Canada and China for now, consider that British Columbia sends almost as much to Asia as it does to the United States, with 15% of its exports flowing directly to China.

Of course, there are potential **offsetting factors** beyond just trade diversion. First, as we've seen in recent days, it appears that the U.S. setting its sights more squarely on China has allowed progress on the all-important North American trade relationship. Steel/aluminum tariffs, a key holdup to USMCA ratification, were removed this week, which is an encouraging step. (Arguably, removal of the metals tariffs more than offsets the hit from China's recent restrictions on Canadian goods (e.g., canola).) Meantime, any economic shock of such magnitude will also impact interest rates and the currency, providing some further buffer.

The **Bank of Canada** has viewed the U.S./China trade spat as a two-sided risk. If the downside is realized, it's hard to see the BoC not seriously contemplating rate cuts. The April MPR estimated that the economy already has a 0.25% to 1.25% output gap, and a further hit to growth would widen that more. The disinflationary pressure suggests the next move for the BoC would be a rate cut. However, Governor Poloz has discussed the trade-war scenario in the past and noted that, due to the potential inflationary impact of higher tariffs, he might not be inclined to cut rates at all. While that might be possible for a few months, we believe the BoC would ultimately capitulate, especially if the Fed were leading the way down the easing path.

Lower policy rates amid a weaker growth backdrop likely won't be friendly to the **Canadian dollar**, even if the Fed is cutting as well. As we have long contended, the loonie has never met an international crisis that it didn't want to join. So far this year, oil prices have risen and, more recently, Canada-U.S. rate spreads have moved in Canada's favour, yet the currency has barely benefitted. That suggests sentiment toward the loonie is quite bearish. A full-blown trade war would be a negative for risk assets, commodities and likely positive for the U.S. dollar. That combination would hit the loonie hard and a move toward C$1.40 (or 70 U.S. cents) would not be unreasonable.

The Bottom Line: Despite being largely a spectator to the U.S./China trade war, the collateral damage to Canada could be meaningful. And, that's before considering the impact of Canada's running spat with China. Trade wars drag on global growth and this episode is no different. Fortunately, unlike some other regions, Canada has some leeway to cushion the blow with monetary policy and a potentially weaker currency, as well as a solid fiscal position should a policy response be needed on that front.

Economic Forecast Summary for May 24, 2019

BMO Capital Markets Economic Research

	2018				2019				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2018	2019	2020
CANADA											
Real GDP (q/q % chng : a.r.)	1.3	2.6	2.0	0.4	0.5 ↑	2.3	2.2	1.5	1.8	1.4	1.7
Consumer Price Index (y/y % chng)	2.1	2.3	2.7	2.0	1.6	2.2	2.0	2.3	2.3	2.0	2.1
Unemployment Rate (percent)	5.8	5.9	5.9	5.7	5.8	5.7	5.7	5.7	5.8	5.7	5.7 ↑
Housing Starts (000s : a.r.)	224	218	197	217	188	218	209	208	214	205	200
Current Account Balance ($blns : a.r.)	-69.0	-63.4	-40.4	-61.9	-73.2 ↓	-62.0 ↓	-59.4 ↑	-61.2 ↑	-58.7	-64.0 ↑	-59.0 ↑
Interest Rates					(average for the quarter : %)						
Overnight Rate	1.25	1.25	1.50	1.75	1.75	1.75	1.75	1.75	1.44	1.75	1.75
3-month Treasury Bill	1.14	1.21	1.47	1.66	1.65	1.70	1.70	1.70	1.37	1.65	1.70
10-year Bond	2.24	2.28	2.28	2.32	1.86	1.70	1.75	1.90 ↑	2.28	1.80	1.80 ↑
Canada-U.S. Interest Rate Spreads					(average for the quarter : bps)						
90-day	-44	-66	-61	-70	-79	-72 ↑	-71 ↑	-71 ↑	-60	-73 ↑	-70 ↑
10-year	-52	-64	-65	-72	-80	-73 ↑	-67 ↑	-67 ↑	-63	-72 ↑	-67 ↑
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	4.2	3.4	2.2	3.2	1.3 ↓	1.8 ↓	1.9	2.9	2.5	1.7
Consumer Price Index (y/y % chng)	2.2	2.7	2.6	2.2	1.6	2.0	2.1	2.3	2.4	2.0	2.2
Unemployment Rate (percent)	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.5	3.9	3.6	3.6
Housing Starts (mlns : a.r.)	1.32	1.26	1.23	1.19	1.20	1.23	1.24	1.22	1.25	1.22	1.23
Current Account Balance ($blns : a.r.)	-496	-414	-506	-538	-468	-483	-498 ↑	-511 ↑	-488	-490	-530 ↑
Interest Rates					(average for the quarter : %)						
Fed Funds Target Rate	1.46	1.71	1.96	2.21	2.38	2.38	2.38	2.38	1.83	2.38	2.38
3-month Treasury Bill	1.58	1.87	2.08	2.36	2.44	2.40	2.40	2.40	1.97	2.40 ↓	2.40
10-year Note	2.76	2.92	2.93	3.03	2.65	2.40 ↓	2.40 ↓	2.55 ↓	2.91	2.50 ↓	2.50
EXCHANGE RATES					(average for the quarter)						
US¢/C$	79.1	77.5	76.5	75.7	75.2	74.5	74.5 ↓	74.6 ↓	77.2	74.7 ↓	75.1 ↓
C$/US$	1.27	1.29	1.31	1.32	1.33	1.34	1.34	1.34 ↑	1.30	1.34 ↑	1.33 ↑
¥/US$	108	109	112	113	110	110	109	108	110	110	109
US$/Euro	1.23	1.19	1.16	1.14	1.14	1.11 ↓	1.11 ↓	1.12	1.18	1.12	1.13
US$/£	1.39	1.36	1.30	1.29	1.30	1.29 ↓	1.24 ↓	1.25 ↓	1.34	1.27 ↓	1.28 ↓

Blocked areas represent BMO Capital Markets forecasts

Up and down arrows indicate changes to the forecast ↑↓

Spreads may differ due to rounding

Canada

See Benjamin Reitzes' Thought on page 5.

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

BoC Policy Announcement
Wednesday, 10:00 am

Current Account Deficit
Thursday, 8:30 am

Q1 (e)	**$18.3 bln ($73.0 bln a.r.)**
Consensus	*$17.9 bln ($71.6 bln a.r.)*
Q4	$15.5 bln ($61.9 bln a.r.)

Canada's current account deficit likely widened big time in Q1 to $18.3 bln (or $73 bln annualized) which would be the largest gap since 2016. Our call would mark the fifth-largest shortfall on record. The deterioration came despite a sharp rebound in oil prices that unfolded over the quarter: Non-energy trade was hit hard as imports jumped while exports sagged. The goods deficit could be the biggest on record, challenging 2016Q2 (not coincidentally when wildfires hit oil production). The non-merchandise deficit is expected to be little changed, consistent with the experimental monthly services trade data from StatsCan. Our estimate would peg the current account shortfall at around 3.2% of GDP, a bit wide for comfort but an expected rebound in goods trade would close the gap slightly in Q2.

Real GDP
Friday, 8:30 am

		Chain Prices
Q1 (e)	**+0.5% a.r.**	**+3.6% a.r.**
Consensus	*+0.9% a.r.*	*n.a.*
Q4	+0.4% a.r.	-3.3% a.r.
	Real GDP at Basic Prices	
Mar. (e)	**+0.3%**	
Consensus	*+0.3%*	
Feb.	-0.1%	

Out like a lamb, in like a lamb; that looks to be the story for the Canadian economy with growth stumbling in 2018Q4 and likely faring no better to start 2019. A weak handoff, some bad weather, and an absolutely horrendous performance for net exports likely drove the softness in Q1 GDP. The latter is the key cog in our forecast for a mere 0.5% annualized rate in the quarter, with trade expected to subtract about 3.5 ppts from the headline. Prior episodes when trade dragged significantly in recent years saw the economy buoyed by strong consumption and housing. That's no longer the case as high debt levels and tighter mortgage regulations have dampened those two sectors. And, the uncertainty surrounding global trade—U.S./China, USMCA, until recently the steel/aluminum tariffs—has been a consistent weight on business investment, and Q1 was no different. Government spending is expected to rebound after capital spending fell heavily in Q4. Inventories will likely add strongly to growth as well, and are partially the result of the surge in imports. Before getting too downbeat on the economy, we're forecasting a solid rebound in Q2, and the early April returns are pointing in that direction.

March GDP is expected to rise 0.3%, bouncing back from the prior month's contraction. Manufacturing, wholesale and retail trade look to have contributed to growth in the month, while an increase in crude-by-rail shipments is expected to reverse a chunk of February's record decline in rail transportation. Home sales bounced back as well, while finance looks to rebound, too. While the monthly (industry level) figures for all of Q1 suggest growth closer to 1%, the huge drag from trade drives the difference between our call for the monthly and quarterly figures. Note that our call for March would provide a solid handoff for Q2.

United States

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

Personal Spending and Income

Friday, 8:30 am

	Personal Spending	Personal Income
Apr. (e)	**+0.2%**	**+0.3%**
Consensus	*+0.2%*	*+0.3%*
Mar.	+0.9%	+0.1%
	Core PCE Price Index	
Apr. (e)	**+0.2%**	**+1.6% y/y**
Consensus	*+0.2%*	*+1.6% y/y*
Mar.	unch	+1.6% y/y

An abrupt reversal in auto sales and a flat tire in broader retail outlets suggest personal spending decelerated to a 0.2% rate in April from 0.9% in March. Siphoning out higher gas prices, volumes likely stalled. Still, thanks to the prior snappy gain (0.7%), real consumer spending likely upshifted to 2.6% (annualized) in Q2 from 1.2% in Q1. Meantime, strong job growth should fuel a 0.3% advance in personal income after little change in March, keeping the yearly rate near 4%. The Fed will have both eyes on annual core PCE inflation after it stumbled to a 19-month low of 1.6% (actually 1.55%) in March. An expected 0.2% monthly increase would hold it steady in April. Other measures of trend inflation compiled by regional Fed Districts suggest core inflation is still near the 2.0% target, a key reason many FOMC members, including the Chair, believe most of the recent decline in the core PCE rate is temporary. If this view is proven wrong in the months ahead, rate-cut chatter will build, though the bar seems high at the moment.

		May 24 [1]	May 17	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	1.68	1.68	0	1	4
	United States	2.35	2.37	-2	-6	0
	Japan	-0.15	-0.16	0	2	0
	Eurozone	-0.31	-0.31	0	0	0
	United Kingdom	0.80	0.80	-1	-3	-12
	Australia	1.43	1.55	-12	-14	-66
2-Year Bonds	Canada	1.57	1.61	-3	3	-29
	United States	2.15	2.20	-5	-13	-34
10-Year Bonds	Canada	1.63	1.69	-5	-5	-33
	United States	2.32	2.39	-7	-18	-37
	Japan	-0.08	-0.06	-2	-3	-7
	Germany	-0.12	-0.11	-1	-9	-36
	United Kingdom	0.95	1.03	-8	-19	-32
	Australia	1.52	1.64	-12	-26	-80
Risk Indicators	VIX	16.4	16.0	0.4 pts	3.6 pts	-9.1 pts
	TED Spread	17	15	3	0	-28
	Inv. Grade CDS Spread [2]	66	62	3	8	-22
	High Yield CDS Spread [2]	366	349	17	39	-85
					(percent change)	
Currencies	US¢/C$	74.33	74.31	0.0	0.0	1.4
	C$/US$	1.345	1.346	—	—	—
	¥/US$	109.34	110.08	-0.7	-2.0	-0.3
	US$/€	1.1204	1.1158	0.4	0.5	-2.3
	US$/£	1.269	1.272	-0.3	-1.8	-0.5
	US¢/A$	69.16	68.68	0.7	-1.8	-1.9
Commodities	CRB Futures Index	177.60	180.99	-1.9	-3.8	4.6
	Oil (generic contract)	57.75	62.92	-8.2	-8.8	27.2
	Natural Gas (generic contract)	2.57	2.63	-2.2	0.3	-12.4
	Gold (spot price)	1,283.98	1,277.55	0.5	-0.2	0.1
Equities	S&P/TSX Composite	16,191	16,402	-1.3	-2.5	13.0
	S&P 500	2,823	2,860	-1.3	-4.0	12.6
	Nasdaq	7,647	7,816	-2.2	-6.0	15.2
	Dow Jones Industrial	25,554	25,764	-0.8	-3.7	9.5
	Nikkei	21,117	21,250	-0.6	-5.1	5.5
	Frankfurt DAX	11,998	12,239	-2.0	-2.6	13.6
	London FT100	7,272	7,349	-1.0	-2.1	8.1
	France CAC40	5,311	5,438	-2.3	-4.6	12.3
	S&P ASX 200	6,456	6,365	1.4	1.1	14.3

[1] = as of 11:40 am [2] = One day delay

Global Calendar
May 27 – May 31

BMO Capital Markets

Japan

Monday May 27 – Tuesday May 28: President Trump visits Japan (May 25-28)

Friday May 31

Jobless Rate		
Apr. (e)	**2.4%**	
Mar.	2.5%	

Industrial Production		
Apr. P (e)	**+0.2%**	**-1.4% y/y**
Mar.	-0.6%	-4.3% y/y

Retail Sales		
Apr. (e)	**+0.6%**	**+1.0% y/y**
Mar.	+0.2%	+1.0% y/y

Consumer Confidence Index		
May		
Apr.	40.4	

Euro Area

Monday May 27

SPAIN

Local Elections (May 26)

BELGIUM

Federal Election (May 26)

Tuesday May 28

EURO AREA

M3 Money Supply		
Apr. (e)	**+4.4% y/y**	
Mar.	+4.5% y/y	

Economic Confidence	
May (e)	**103.9**
Apr.	104.0

Consumer Confidence	
May F (e)	**-6.5**
Apr.	-7.3

GERMANY

GfK Consumer Confidence	
June (e)	**10.4**
May	10.4

FRANCE

Consumer Confidence	
May (e)	**97**
Apr.	96

Wednesday May 29

GERMANY

	Unemploy.	Jobless Rate
May (e)	**-7,000**	**4.9%**
Apr.	-12,000	4.9%

FRANCE

Real GDP		
Q1 F (e)	**+0.3%**	**+1.1% y/y**
Q1 P	+0.3%	+1.1% y/y
Q4	+0.3%	+1.0% y/y

Consumer Spending		
Apr. (e)	**+0.4%**	**+0.6% y/y**
Mar.	-0.1%	-1.9% y/y

Producer Price Index		
Apr.		
Mar.	unch	+1.9% y/y

ITALY

Consumer Confidence Index	
May (e)	**110.0**
Apr.	110.5

Friday May 31

GERMANY

Retail Sales		
Apr. (e)	**+0.4%**	**+1.2% y/y**
Mar.	unch	-2.1% y/y

Consumer Price Index		
May P (e)	**+0.3%**	**+1.4% y/y**
Apr.	+1.0%	+2.1% y/y

ITALY

Real GDP		
Q1 F (e)	**+0.2%**	**+0.1% y/y**
Q1 P	+0.2%	+0.1% y/y
Q4	-0.1%	unch y/y

Consumer Price Index		
May P (e)	**+0.2%**	**+1.0% y/y**
Apr.	+0.5%	+1.1% y/y

Producer Price Index		
Apr.		
Mar.	unch	+3.7% y/y

U.K.

Monday May 27: Markets Closed

Tuesday May 28

Nationwide House Prices [D]		
May (e)	**unch**	**+1.2% y/y**
Apr.	+0.4%	+0.9% y/y

Friday May 31

GfK Consumer Confidence	
May (e)	**-12**
Apr.	-13

Other

Thursday May 30

AUSTRALIA

Building Approvals		
Apr. (e)	**unch**	**-22.4% y/y**
Mar.	-15.5%	-27.3% y/y

BRAZIL

Real GDP		
Q1 (e)	**+0.2%**	**+0.6% y/y**
Q4	+0.1%	+1.1% y/y

Friday May 31

CHINA

	Mfg. PMI	Nonmfg. PMI
May (e)	**49.9**	**54.3**
Apr.	50.1	54.3

Composite PMI	
May	
Apr.	53.4

INDIA

Real GDP	
Q1 (e)	**+6.2% y/y**
Q4	+6.6% y/y

[D] = date approximate

Upcoming Policy Meetings | BoE: June 20, Aug. 1, Sep. 19 | ECB: June 6, July 25, Sep. 12

North American Calendar
May 27 – May 31

BMO Capital Markets

Canada

Monday May 27

Tuesday May 28

10:30 am — 3-, 6- & 12-month bill auction $14.0 bln (new cash -$2.8 bln)

Wednesday May 29

10:00 am — BoC Policy Announcement

Thursday May 30

8:30 am — Current Account Deficit

Q1 (e)	**$18.3 bln ($73.0 bln a.r.)**
Consensus	*$17.9 bln ($71.6 bln a.r.)*
Q4	$15.5 bln ($61.9 bln a.r.)

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

2:15 pm — BoC Senior Deputy Governor Wilkins gives the Economic Progress Report at the Calgary Chamber of Commerce

2-year bond auction announcement

Friday May 31

8:30 am

	Real GDP	Chain Prices
Q1 (e)	**+0.5% a.r.**	**+3.6% a.r.**
Consensus	*+0.9% a.r.*	*n.a.*
Q4	+0.4% a.r.	-3.3% a.r.

8:30 am — Real GDP at Basic Prices

Mar. (e)	**+0.3%**
Consensus	*+0.3%*
Feb.	-0.1%

8:30 am

	Industrial Product Price Index	Raw Materials Price Index
Apr. (e)	**unch**	**+2.5%**
Mar.	+1.3%	+2.8%

United States

Monday May 27

Memorial Day (markets closed)

Tuesday May 28

9:00 am — S&P Case-Shiller Home Price Index (20 city)

Mar. (e)	**+0.2%**	**+2.4% y/y**
Consensus	*+0.2%*	*+2.5% y/y*
Feb.	+0.2%	+3.0% y/y

9:00 am — FHFA House Price Index

Mar. (e)	**+0.2%**	**+4.9% y/y**
Consensus	*+0.2%*	*+4.9% y/y*
Feb.	+0.3%	+4.9% y/y

10:00 am — Conference Board Consumer Confidence Index

May (e)	**130.0**
Consensus	*130.0*
Apr.	129.2

10:30 am — Dallas Fed Mfg. Activity

May (e)	**5.0**
Apr.	2.0

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

11:30 am — 26-week bill auction $36 bln

11:30 am — 2-year note auction $40 bln

1:00 pm — 13-week bill auction $36 bln

1:00 pm — 5-year note auction $41 bln

Wednesday May 29

7:00 am — MBA Mortgage Apps

May 24	
May 17	+2.4%

10:00 am — Richmond Fed Manufacturing Index

May (e)	**5**
Apr.	3

11:30 am — 2[R]-year FRN auction $18 bln

1:00 pm — 7-year note auction $32 bln

Thursday May 30

8:30 am — Initial Claims

May 25 (e)	**214k (+3k)[C]**
May 18	211k (-1k)

8:30 am — Continuing Claims

May 18	
May 11	1,676k (+12k)

8:30 am

	Real GDP	GDP Deflator
Q1 P (e)	**+3.0% a.r.**	**+0.9% a.r.**
Consensus	*+3.1% a.r.*	*+0.9% a.r.*
Q1 A	+3.2% a.r.	+0.9% a.r.
Q4	+2.2% a.r.	+1.7% a.r.

8:30 am — Pre-Tax Corporate Profits

Q1 P (e)	**+7.1% y/y**
Q4	+7.4% y/y

8:30 am — Goods Trade Deficit

Apr. A (e)	**$72.0 bln**
Consensus	*$72.5 bln*
Mar.	$71.3 bln

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

10:00 am — Pending Home Sales

Apr. (e)	**+0.5%**
Consensus	*+0.5%*
Mar.	+3.8%

Vice President Pence meets with Prime Minister Trudeau in Ottawa to discuss advancing USMCA approval

Fed Speaker: Vice Chair Clarida (noon)

11:00 am — 13- & 26-week bill auction announcements

11:30 am — 4- & 8-week bill auction

Friday May 31

Ottawa's Budget Balance[D]

Mar. '19	
Mar. '18	-$10.6 bln

8:30 am

	Personal Spending	Personal Income
Apr. (e)	**+0.2%**	**+0.3%**
Consensus	*+0.2%*	*+0.3%*
Mar.	+0.9%	+0.1%

8:30 am — Core PCE Price Index

Apr. (e)	**+0.2%**	**+1.6% y/y**
Consensus	*+0.2%*	*+1.6% y/y*
Mar.	unch	+1.6% y/y

9:45 am — Chicago PMI

May (e)	**53.0**
Consensus	*54.0*
Apr.	52.6

10:00 am — University of Michigan Consumer Sentiment

May F (e)	**101.0**
Consensus	*102.0*
May P	102.4
Apr.	97.2

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

Upcoming Policy Meetings | Bank of Canada: July 10, Sep. 4, Oct. 30 | FOMC: June 18-19, July 30-31, Sep. 17-18

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