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BMO CAPITAL MARKETS ECONOMICS

Focus

A weekly financial digest

Douglas Porter, CFA, Chief Economist, BMO Financial Group

May 31, 2019

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Brave New Yield

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The market's wall of worry just turned into Mount Everest, amid climbing trade tensions. Mixing metaphors, President Trump flung **gasoline onto the protectionism inferno** with a Thursday threat to impose a 5% tariff on all Mexican imports on June 10, rising to 25% by October. Seemingly unafraid to further inflame markets, or to trample every conventional diplomatic norm, or to threaten the fragile path for USMCA approval, the President's tariff threat was aimed at border security—far removed from any trade issue. Having well learned not to dismiss the Administration's threats on trade—no matter how outlandish the bluster—markets are selling first, and will ask questions later. The peso has responded most forcefully, dropping 2.6% today, a move which would alone counter much of the first round of potential U.S. tariffs.

Equities were already under some serious pressure from the deepening U.S./China tussle, even before the latest threat aimed at Mexico. After reaching record highs just one short month ago, broad U.S. averages had already dropped nearly 6% from the apex, prior to Friday's tariff trauma (down roughly 1% as we speak). The Mexican melee sealed a tough month for stocks globally, with the MSCI headed for a 6% setback. That would mark the first drop of the year, and in the same league as 7%+ declines last October and December. While the TSX held up somewhat better, even it was on track for nearly a 4% pullback in May, weighed as well by a downbeat response to the run of Q2 bank earnings. A late-month retreat in crude oil prices also hurt, with WTI dropping almost 14% in May to end below $55.

Bonds, of course, are feasting on the equity markets' struggles, as well as the related sag in oil. For weeks, many commentators, including us, were highlighting the seeming disconnect between plunging bond yields and robust stocks. Well, it appears that the conundrum has been resolved, with the bond rally fuelled even further by the sag in stocks. After already falling 20 bps since the start of the month, ten-year Treasury yields almost doubled that with another 16 bp drop this week alone (to 2.16%). The 2-5 year portion of the curve gripped a 1-handle late in the week, a long, long way from the fed funds target of 2.25%-to-2.50%. Almost the entire Treasury curve has now seen yields drop by 100 bps or more from their peaks of little more than six months ago. It's almost redundant to note that the market is now priced for two Fed rate cuts by the end of this year. The fact that the Fed's Vice Chair, Richard Clarida, is now openly discussing the possibility of rate reductions is the potential smoke behind a very real fire.

The Bank of Canada has certainly taken note. Thursday's speech by Senior Deputy Governor Wilkins, while upbeat on business investment, also warned about the inverted yield curve. The BoC had earlier called it an "innocent inversion"—because it was due more to bonds rallying rather than short rates rising. But Wilkins' remarks betray a growing unease among central bankers surrounding the relentless drop in long-term yields. Canada is on the cusp of an extreme inversion, as the 30-year bond is now just 2 meagre basis points above the overnight target rate of 1.75%. We have long contended that the persistence of sub-2% yields at the very long end of the GoC curve is a strong signal from financial markets that "neutral" short-term interest rates in Canada are still much lower than the Bank's revised estimate of 2.25%-to-3.25%.

If the Fed was to succumb to mounting trade tensions and still-mild inflation with rate trims, **would the Bank follow?** Only **reluctantly.** This week's Statement after the rate decision carried a whiff of optimism on the economic outlook, with the Bank affirming that growth was picking up after a two-quarter struggle. Today's GDP release chimed in, as March powered up with a 0.5% m/m jump on broad-based gains, largely countering the measly 0.4% annualized growth for all of Q1 (after a revised 0.3% "advance" in Q4). Moreover, the starting point for the Bank is much lower, with the overnight rate below both inflation and neutral, neither of which is the case for the Fed. And, contrary to the U.S., the primary measure of Canadian core inflation is not obviously below target (at 1.9% in April, and 2.0% in March). Accordingly, the odds of a BoC rate cut this year are lower, although markets are currently pricing in about a 65% chance of one move by year-end.

Meanwhile, **back at the U.S. economy**… This week's releases actually suggested that **domestic growth is holding up well**. Consumer confidence snapped higher in May, with job prospects seen as the strongest of the cycle. Gains in April incomes and spending point to some consumer-related support for Q2 GDP growth. We are sticking to our call of 1.3% for the quarter, a big step down from the surprise 3.1% Q1 gain, but see a touch of upside for the spring period. However, given the swirling trade uncertainties, and the very clear risk of a big downward lurch in growth, there won't be any upward forecast revisions anytime soon.

Next week will bring a raft of early indications of how the North American economy fared in May, amid the escalating trade tensions and the de-escalating equity markets. Employment reports for both countries on Friday will grab the headlines, although even solid gains may be viewed by many as a lagging indicator. Perhaps more telling will be earlier reads from U.S. factories (Monday's ISM), consumers (auto sales for both countries), and Canadian home buyers (preliminary sales figures for the big cities will roll in throughout the week). We suspect that, aside from the ISM, the tone will remain solid, for now—but the big issue is how much damage will be inflicted on growth in the second half of the year from trade conflict and its market casualties.

Never one to jump on a crowded bandwagon, but it's Raptor time. We were asked at the start of the week if there would be an impact on Canada's economy from the deep Dino run in the playoffs. Beyond the direct impact of attendance at home games, there are also sales of jerseys and Drake paraphernalia, visitors, and the throngs watching at bars and restaurants. But our initial take was that, while there could indeed be a small impact, it's tough to see more than a 0.1 ppt bump to GDP, which would then be reversed the following month. Note that Q1 nominal GDP sported a $2.25 trillion annualized read. That translates into $188 billion of goods and services produced every single month, meaning it would take almost $200 million of net new activity to boost GDP even by one tick. I realize ticket prices are high for the finals… but not that high!

As for a forecast, I will simply note that of the 14 NBA playoff series so far this year, 12 have been won by the higher seed (i.e., the team with home-court advantage, in this case the Raptors, of course). In staggering contrast, only 7 of the 14 NHL series have gone that way, and the Blues may keep it there.

This Town Ain't Big Enough for the Both of Us

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It's been a week of winners and losers. No, I'm not referring to shares of rare earth mineral companies, or China's supposed list of blacklisted companies; rather, government leaders in Europe. The 2019 European Parliament elections produced some **clear winners**, such as the Netherlands' Frans Timmermans, Spain's Pedro Sánchez, Britain's Nigel Farage, and Green Party members everywhere. There were **clear losers**, including Austria's Sebastian Kurz (though that wasn't election-related), Greece's Alexis Tsipras, Italy's Luigi Di Maio, and Germany's Annegret Kramp-Karrenbauer (no longer considered Angela Merkel's "mini-me" after the Chancellor pulled her support away, reportedly citing that, *"She's not ready for this job."*) There were **those who claimed to be winners**, even though it wasn't totally obvious, including France's Emmanuel Macron and Marine Le Pen.

But, if I had to select one, the **biggest winner** would have to be **Italy's Matteo Salvini**, whose Northern League emerged as the largest party in Italy with 34% of the vote (turnout was 56%), while the Five-Star Movement was pushed down to third place with only 17% of the vote. Although Deputy PM Salvini could have used this opportunity to call a general election in Italy and be rid of his coalition partner, he chose not to. Instead, he focused his energies on his main target: Brussels. Salvini wants to introduce *"fiscal shock"* tax cuts, because *"We need a Trump cure, an Orban cure, a positive fiscal shock to restart the country."* And yet, he claims that the economy is *"healthy"* and picking up, though the coalition's 0.2% GDP growth forecast is not what I would describe as healthy. And if it were, then why the need to boost spending and cut taxes? In fact, first quarter GDP was revised lower and now stands 0.1% below year-ago levels. The government will work on these new budget plans this summer and have it ready for the fall. Meantime, Brussels is not standing idly by. **Italy's deficit** (estimated at 2.4% of GDP this year) and **debt** (134% to GDP, more than double the EU's limit) continue to rise, so the European Commission served FM Tria with an official letter, requesting an explanation as to why its finances continue to deteriorate. Let's see what their response will be, but already Di Maio complained that he was not consulted. Although this week's BTP auctions were met with strong demand, the relief is likely temporary as the chances of Italy being punished with the Excessive Deficit Procedure are rising. Ten-year Italian spreads versus bunds widened to nearly 290 bps this week. The government was given a reprieve in December; but, Brussels' patience may be wearing a little thin.

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	Good News	Bad News
Canada ▪ Neutral BoC on hold for the foreseeable future ▪ Plans to ratify USMCA hang in the balance amid new U.S./Mexico battle	**Monthly Real GDP** +0.5% (Mar.) **SEPH Employment** +27,458 (Mar.) **Industrial Product Prices** +0.8%; **Raw Material Prices** +5.6% (Apr.) **Conference Board's Consumer Confidence Index** +8.4 pts to 120.4 (May)	**Quarterly Real GDP** +0.4% a.r. (Q1)—below expected **Current Account Deficit** widened to $69.4 bln a.r. (Q1) **Ottawa** posted an $11.8 bln deficit (Apr.-to-Mar.)—shifted from surplus the prior month
United States ▪ President Trump threatens 5% tariff on all Mexican products; could reach 25% if migrant issue unresolved ▪ Stocks slump, Treasury yields plunge on heightened global trade risks ▪ China's new tariffs on U.S. imports kick in on Saturday	**Real Personal Spending** unch (Apr.)—but prior month revised up **Personal Income** +0.5% (Apr.) **Core PCE Deflator** picked up to +1.6% y/y (Apr.) **Wholesale Inventories** +0.7%; **Retail Inventories** +0.5% (Apr. A) **S&P Case Shiller Home Prices** +2.7% y/y (Mar.) **FHFA House Prices** +5.0% y/y (Mar.) **Conference Board's Consumer Confidence Index** +4.9 pts to 134.1 (May) **Chicago PMI** +1.6 pts to 54.2 (May)	**Real GDP** revised down to +3.1% a.r. (Q1 P) **Goods Trade Deficit** widened to $72.1 bln (Apr. A) **Pre-Tax Corporate Profits** slowed to +3.1% y/y (Q1 P) **Pending Home Sales** -1.5% (Apr.) **U of M Consumer Sentiment** revised down to 100.0 (May) **Initial Claims** +3k to 215k (May 25 week)
Japan ▪ Little progress made on trade following President Trump's first visit	**Industrial Production** +0.6% (Apr. P) **Jobless Rate** -0.1 ppts to 2.4% (Apr.)	**Retail Sales** unch (Apr.) **Consumer Confidence** -1.0 pts to 39.4 (May)
Europe ▪ European Parliament elections over: pro-Europe centre still dominates, but lost seats to Greens and populists ▪ German bund yields fall to sub-zero record lows ▪ Italian fiscal picture under scrutiny	**Euro Area—Private Sector Credit Growth** +3.4% y/y (Apr.) **Euro Area—Economic Confidence** +1.2 pts to 105.1 (May) **France—Consumer Spending** +0.8% (Apr.) **France—Consumer Confidence** +3 pts to 99 (May) **Italy—Consumer Confidence** +1.2 pts to 111.8 (May) **U.K.—GfK Consumer Confidence** +3 pts to -10 (May)	**Germany—Retail Sales** -2.0% (Apr.) **Germany—Consumer Prices** slowed to +1.3% y/y (May P) **Germany—Unemployment** +60,000 (May) —biggest since 2009 **Germany—Jobless Rate** +0.1 ppts to 5.0% (May) **Germany—GfK Consumer Confidence** -0.1 pts to 10.1 (June)—2-yr low **France—Consumer Prices** slowed to +1.1% y/y (May P) **Italy—Real GDP** revised down to +0.1% q/q (Q1) **Italy—Consumer Prices** slowed to +0.9% y/y (May P) **U.K.—Nationwide House Prices** -0.2% (May)
Other ▪ China says *"necessary measures will be taken"* on blacklist of *"unreliable"* companies… and could use rare earth minerals as tool in trade war ▪ Mexican peso weakens on U.S. tariffs	**China—Non-manufacturing PMI** steady at 54.3 (May)	**China—Manufacturing PMI** -0.7 pts to 49.4 (May) **China—Composite PMI** -0.1 pts to 53.3 (May) **Australia—Building Approvals** -4.7% (Apr.) **Brazil—Real GDP** slowed to +0.5% y/y (Q1) **India—Real GDP** slowed to +5.8% y/y (Q1)

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

U.S. Economy: Little Potential to Exceed Speed Limit

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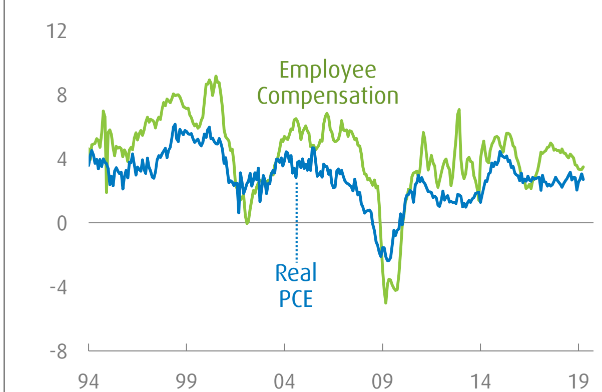
As it enters the record books for longevity, the U.S. expansion seems to be losing steam. Trade policy headwinds are mounting just as the tailwind from past policy stimulus has ebbed. The economy's big engines—consumer spending and fixed investment, accounting for 85% of GDP—sputtered at the turn of the year, weighed down by the stock market scare, government shutdown and wicked weather. Private final domestic demand grew only 1.3% annualized in the first quarter, half the prior quarter's pace and the weakest in 6½ years. Previously, we thought that, as the above-mentioned temporary factors ended, consumer and business spending would rebound and eventually lift growth modestly above potential (which the FOMC pegs around 1.9%). However, we now believe that just getting back to this long-run speed limit will be a challenge. Below we survey the key components of GDP, assessing which can propel it forward and which are more apt to hold it back.

Consumer Spending: Weighing in at two-thirds of the economy, consumers are well positioned to extend the expansion. Despite stalling in April, real consumer spending still rose 2.7% in the past year. Near-record high household wealth and low debt-service costs have shoppers in a good mood, with confidence near multi-decade highs. Consumer credit rose 5% y/y in Q1. But the main driver of spending, typically, is income. And here, sturdy job gains and rising wages are providing support (*Chart 1*). If companies continue to hire, households should keep spending at a solid rate for the rest of the year.

Chart 1
Compensating Factor
United States (y/y % chng)



Sources: BMO Economics, Haver Analytics

Housing Market: Residential investment contracted 3.5% annualized in Q1, decreasing for the fifth straight quarter. The slide reflects several factors. Mortgage rates spent most of 2018 on the rise; 30-year tenors peaked at near 8-year highs in November, or 95 bps above where they began the year. Meanwhile, last year's tax changes reduced the tax-savings from mortgage interest deductibility and the attractiveness of ownership. Unfortunately, the stock market's autumn retreat, along with extreme winter and spring weather, kept a housing rebound at bay. However, borrowing costs have fallen almost one percentage point from their apex against a background of strong job creation, sturdy income growth, healthy household balance sheets, easing mortgage lending standards, and improving consumer confidence. This flags some rebound in housing activity.

So far in Q2, however, housing indicators have been mixed. While starts hit a seven-month high in April and building permits are even loftier, existing, pending and new home sales all slipped in April (*Chart 2*), though the latter should find support from the homebuilders' sales activity index hitting eight-month highs in May. We expect positive readings for residential investment in Q2 and beyond. However, a sustained above-potential pace would likely require more millennials to jump off the fence.

Chart 2
Home Sales Cresting
United States (mlns)
New and Existing Home Sales

Sources: BMO Economics, Haver Analytics

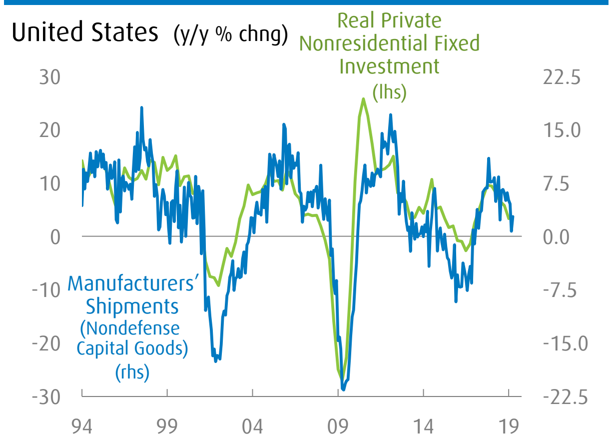
Business Fixed Investment: As the trade war heats up, the risk grows that businesses will curb spending. After responding with gusto in response to tax reforms last year, business spending on structures and equipment has downshifted. Even demand for information processing gear has slowed from double-digit rates, despite the ongoing need to automate to expand capacity. A big downshift in capital goods orders in April suggests the retreat extended into Q2 (*Chart 3*). However, one area that breeds optimism is intellectual property products, namely software and R&D, which are still up a strong 8% y/y to Q1. Moreover, most surveys of business leaders suggest confidence remains above normal. Overall, fixed investment looks to grow at least near potential this year, though the trade war is a huge wild card.

Business Inventories: A hefty recent build in inventories—the Q1 addition was more than double the past quarter-century norm—will undercut production and GDP in Q2 (*Chart 4*). The increase was partly unintentional as consumers retrenched in the face of temporary factors, but it also reflected a prior surge in imports ahead of feared new tariffs. Auto inventories are notably elevated. Historically, large inventory builds are often followed by weaker GDP growth the next quarter. However, the current drag should wane in Q3 if consumers bounce back. While inventories have piled up recently, this followed a period of modest gains that left the ratio to sales in line with the four-year norm. All in, inventories look to make little impression in the second half of the year.

Net Exports: Real imports dropped 2.5% annualized in Q1, the second largest decline since the recession. Imports were boosted previously by stockpiling ahead of feared tariff hikes. So, Q1 was payback and Q2 should see imports rebound, particularly as domestic demand improves during the period. Apart from this technicality, the trend for both exports and imports is weakening, as tit-for-tat tariffs and other trade barriers are mounting, while domestic and global growth trends are slowing (only partly due to the trade restrictions). For example, in 2017Q4, just before U.S. tariffs were deployed as a trade policy tool for the first time in many years, U.S. real exports and imports were expanding in the 4½%-to-5½% y/y range. But growth in trade volumes has since slowed to just 1½%-to-2½% y/y.

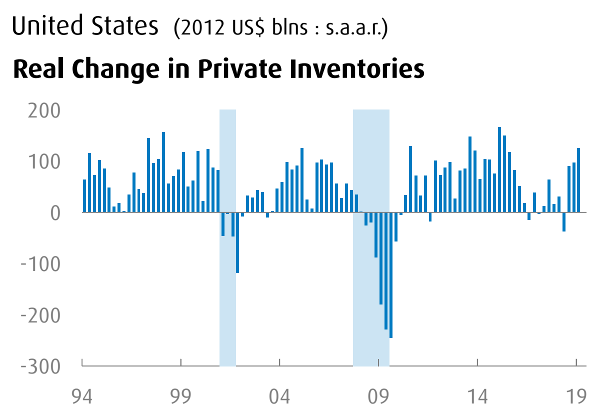
With real import levels about 35% above exports, import surges to get in front of tariffs on washing machines, solar panels, steel, aluminum, and $250 billion of Chinese goods have been whipsawing net exports. The underlying trend has deteriorated in the past year (*Chart 5*) and we expect this to continue, acting as a drag on GDP growth. Meanwhile, the U.S. dollar has appreciated 9.0% since early-2018's nadir (about when tariffs started), diminishing the impact of tariff-boosted import prices, while

Chart 3
Investment Cools



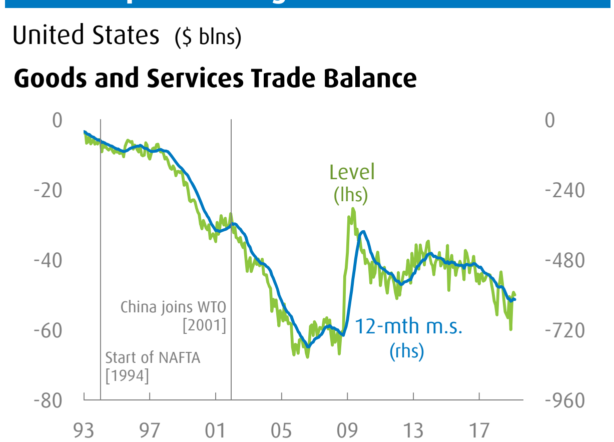
Sources: BMO Economics, Haver Analytics

Chart 4
Stocking Up



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

Chart 5
Trade Gap Widens Again



Sources: BMO Economics, Haver Analytics

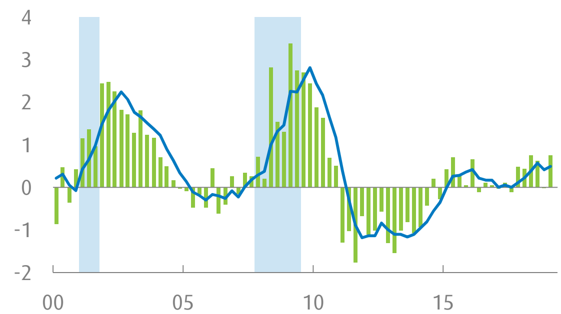
augmenting the impact of retaliatory-tariff-boosted export prices, and impeding any net export gains.

Government Spending: In Q1, the construction of highways and streets paved a large gain in state and local government investment outlays (an 18-year high of 21.2%), driving a 2.5% increase in total government spending. However, such outlays ramp up very quickly, and eventually steer growth rates into negative territory as construction is completed. At the federal level, last year's increase in defence spending continued (up 4.0% in Q1), but total federal outlays were flat as non-defence spending recorded a back-to-back decline. The latter will likely recover, but we judge that sub-potential-growing real federal government spending will emerge as the norm with trillion-dollar budget deficits looming (*Chart 6*). State and local governments are relatively less constrained, so total government spending could manage to keep pace with the economy.

Chart 6
Fiscal Stimulus to Fade

United States (ppts)

Contribution of Fiscal Policy to Real GDP Growth[1]



[1] Hutchins Center Fiscal Impact Measure
Sources: BMO Economics, Brookings, Hutchins Center

Bottom Line: Of the key economic drivers, only consumers look to have enough fuel in the tank to propel the economy at an above-potential rate this year. The rest of the economy will likely prevent GDP from reaching its long-run speed limit, and we expect growth to average a modest 1.6% to the end of 2020. While this is still an OK performance in the late stages of a cycle when supply issues are also applying a brake, it comes with a big warning label: a further escalation in trade tensions would grind down this modest pace, pushing the jobless rate higher.

Economic Forecast Summary for May 31, 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.)	1.5	2.5	2.1	0.3	0.4	2.3	2.1 ↓	1.4 ↓	1.9	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 ($blns : a.r.)	-65.5	-61.5	-40.6	-66.5	-69.4	-59.3 ↑	-56.8 ↑	-58.6 ↑	-58.5	-61.0 ↑	-57.0 ↑
Interest Rates					(average for the quarter : %)						
Overnight Rate	1.25	1.25	1.50	1.75	1.75	1.75	1.75	1.75	1.44	1.75	1.75
3-month Treasury Bill	1.14	1.21	1.47	1.66	1.65	1.65 ↓	1.65 ↓	1.65 ↓	1.37	1.65	1.65 ↓
10-year Bond	2.24	2.28	2.28	2.32	1.86	1.65 ↓	1.65 ↓	1.80 ↓	2.28	1.75 ↓	1.80
Canada-U.S. Interest Rate Spreads					(average for the quarter : bps)						
90-day	-44	-66	-61	-70	-79	-73 ↓	-71	-71	-60	-74 ↓	-71 ↓
10-year	-52	-64	-65	-72	-80	-73	-67	-66 ↑	-63	-72	-65 ↑
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	4.2	3.4	2.2	3.1	1.3	1.8	1.9	2.9	2.5	1.7
Consumer Price Index (y/y % chng)	2.2	2.7	2.6	2.2	1.6	1.9 ↓	2.0 ↓	2.2 ↓	2.4	1.9 ↓	2.2
Unemployment Rate (percent)	4.1	3.9	3.8	3.8	3.9	3.6	3.6	3.5	3.9	3.6	3.6
Housing Starts (mlns : a.r.)	1.32	1.26	1.23	1.19	1.20	1.23	1.24	1.22	1.25	1.22	1.23
Current Account Balance ($blns : a.r.)	-496	-414	-506	-538	-472 ↓	-496 ↓	-500 ↓	-513 ↓	-488	-495 ↓	-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	2.30 ↓	2.45 ↓	2.91	2.45 ↓	2.45 ↓
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	1.28 ↓	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

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Merchandise Trade Deficit
Thursday, 8:30 am

Apr. (e)	**$2.5 bln**
Consensus	*$2.8 bln*
Mar.	$3.2 bln

The trade deficit has remained stubbornly wide this year, averaging the largest gap on record over the past four months. The drop in oil prices late last year was a big factor, but the **deficit is still quite wide** despite the rebound in prices. We look for oil exports to rise a bit further in April which should help the headline. Imports are expected to pull back modestly, as chunky increases in consumer goods and special transactions retrace. All told, we're looking for the trade deficit to narrow to $2.5 bln. Despite the anticipated improvement, the gap remains relatively wide, reflecting global trade uncertainty and a relatively weak Canadian competitive backdrop.

Employment
Friday, 8:30 am

	Employment
May (e)	**+0.1% (+20,000)**
Consensus	*-0.03% (-5,000)*
Apr.	+0.6% (+106,500)
	Unemployment Rate
May (e)	**5.7%**
Consensus	*5.7%*
Apr.	5.7%
	Average Hourly Wages
May (e)	**+2.4% y/y**
Apr.	+2.5% y/y

April saw a record job gain, but that doesn't necessarily mean we'll get payback in May. The Canadian labour market has been impressively strong over the past year, adding an average 35,500 jobs per month. However, that's been matched by labour force growth, keeping the jobless rate steady. Population growth doesn't seem likely to slow near-term, so we could see a continued run in employment. From a sector perspective, none seem ripe to retrace April's gain—manufacturing's surge just made up for softness in prior months, and retail/wholesale trade is bouncing back from last year's decline. Our call for a 20,000 job gain is expected to keep the jobless rate steady at 5.7%. And, strong wage growth in May 2018 makes for a tough comparable. Average hourly wages would do well to hold steady at 2.5% y/y, though risks are to the downside. Still, note that wage growth has been strong for five straight months, we'll see if that trend persists.

United States

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Manufacturing ISM (PMI)
Monday, 10:00 am

May (e)	**52.8**
Consensus	*53.2*
Apr.	52.8

The regional factory surveys were mixed in May, suggesting the national ISM index held steady after retreating to 2½-year lows in April. This would suggest little expansion in the sector, which would mark some improvement, as actual production has yet to post an increase in the first four months of the year. Export orders have been notably weak amid a slower global economy and China's retaliation. Survey respondents have expressed growing concerns about tariffs as well as supply issues arising from delays at the Mexican border. The former concerns look to ratchet higher after the recent breakdown of U.S./China trade talks and new tariffs on Mexican goods.

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

May (e)	**55.5**
Consensus	*56.0*
Apr.	55.5

The Fed's regional services indexes suggest the non-manufacturing sector grew at a steady, moderate pace in May. The ISM index should hold at 55.5 after falling the prior two months to the lowest level since August 2017. Unlike the manufacturing sector, companies are more worried about finding workers than addressing tariffs, suggesting the trade war has yet to seriously damage the broader economy. Record oil production, improved housing starts, and steady gains in personal spending on services should provide support. However, a downside miss would raise doubts about the economy's momentum heading into the spring.

Beige Book
Wednesday, 2:00 pm

The Beige Book is for the June 18-19 FOMC meeting. The prior report, covering March and early April, saw economic activity expanding at a "slight-to-moderate" rate, with many Districts noting "trade-related uncertainty" among manufacturers. It also mentioned "moderate" wage growth amid tight labour markets that were "restraining the rate of growth", along with "modestly" rising prices. Tariffs, freight costs and wages were causing input costs to increase at a "modest-to-moderate" pace, but with mixed ability to pass the costs onto consumers. We'll be on the watch for adjective adjustments. Perhaps more interesting will be the **Fed's Conference on Monetary Policy Strategy, Tools and Communication Practices** held at the Chicago Fed starting Tuesday. Chair Powell will deliver opening remarks. Much of the market focus will be on the papers and pronouncements dealing with different forms of inflation targeting and methods of anchoring inflation expectations.

Goods & Services Trade Deficit
Thursday, 8:30 am (including revisions)

Apr. (e)	**$51.3 bln**
Consensus	*$50.8 bln*
Mar.	$50.0 bln

The goods and services trade deficit will likely widen by $1.3 billion to $51.3 in April, registering the largest shortfall so far this year. Both goods exports and imports are expected to decline, with the former outpacing the later. Partly contributing to this, U.S. dollar appreciation (6.4% y/y) is diminishing the effect of tariffs on import prices but augmenting the effect of retaliatory tariffs on export prices. The services surplus should remain unchanged. With crude oil prices up in the month, the march of the petroleum goods balance to surplus territory for the first time ever will probably step back (it was a puny $1.8 billion shortfall in March). With the escalation of the U.S./China trade war, the bilateral trade balance should garner increased scrutiny. The 12-month cumulative deficit hit a record high $419 billion in December but has since slipped to $408 billion.

Nonfarm Payrolls
Friday, 8:30 am

	Nonfarm Payrolls	
May (e)	**+180,000**	
Consensus	*+185,000*	
Apr.	+263,000	
	Unemployment Rate	
May (e)	**3.7%**	
Consensus	*3.6%*	
Apr.	3.6%	
	Average Hourly Earnings	
May (e)	**+0.3%**	**+3.2% y/y**
Consensus	*+0.3%*	*+3.2% y/y*
Apr.	+0.2%	+3.2% y/y

Hiring looks to have stayed solid in the spring, as initial jobless claims remained low and the Conference Board's survey reported improved job prospects in May. So, even after a sizeable advance the prior month (263,000), nonfarm payrolls should rise another 180,000 in May. This would keep the 3-month mean close to the 12-month trend, indicating little let up in hiring, raising hopes that the recent loss of steam in the economy is temporary. Keep an eye on federal jobs, which have held steady in the past year but could get a jolt from early staffing for the 2020 Census. On the downside, companies concerned about the recent breakdown in U.S./China trade talks might have hit the pause button. The record-long expansion in payrolls (103 months) has pulled the jobless rate to 49-year lows (3.6%), but some backup is expected in May given a likely rebound in the participation rate. The tight labour market and firmer productivity are expected to lift average hourly earnings 0.3%, holding the yearly rate near cycle-highs of 3.2%. While that's far from inflation-threatening levels, the potential for further increases is a key reason the Fed expects inflation to remain on target and doesn't see a pressing need (yet) to ease policy.

Central Banks

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ECB Policy Announcement
Thursday, 7:45 am

The June 6th ECB monetary policy meeting, the third final meeting under President Draghi, will be closely watched. **Key interest rates are expected to be untouched:** the main refi rate (0.00%), the marginal lending facility (0.25%), and the deposit facility (-0.40%). There is a **slight possibility** that the **forward guidance may be adjusted**… dropping the timing for rates to stay where they are *"at least through the end of 2019"*… but it may be too soon for some of the hawks to give in, even though we're already halfway through the year. Indeed, the views aired by various policymakers have been mixed; most recently, the Bundesbank's Weidmann said (not surprisingly) that he sees signs of price pressures, suggesting that he is not willing to add any extra stimulus to the Eurozone. The central bank has not *"discussed the merits or the cons"* of a tiering system (allowing some reserves to be exempt from the deposit rate), though some feel it would make things more *"complicated"*.

The ECB staff will have **new GDP and CPI forecasts** prepped for this meeting. And, although President Draghi will continue to point to the **positives**… favourable financing conditions, expanding employment and rising wages, no one should be the slightest bit surprised if the 2019 growth forecast (currently pegged at 1.1%) is trimmed for the fourth time in a row. After all, the latest ECB Minutes stated that some recent data were weaker than expected and that, even though the baseline scenario was for more solid growth in the second half of 2019, *"there was now somewhat less confidence in this baseline scenario and that the range of other possible outcomes had widened"*. This would keep the **risks** surrounding the growth outlook *"tilted to the downside"*. Plus, the U.S./China trade war has taken a bad turn; and, though auto tariffs on European and Japanese cars were delayed, they could very well be imposed later. We also expect to be fed details on the new TLTRO-III… President Draghi said during the April meeting that the precise terms will be communicated at one of our *"forthcoming meetings"* and the June meeting is as good as any to do so. This new round of cheap loans will be launched this September and run till March 2021.

This will also be the first meeting with Ireland's Philip Lane as the ECB's Chief Economist, replacing Peter Praet who spent eight years in that capacity. Mr. Lane is seen as a centrist, which will be needed to balance out both sides of the ECB's spectrum (pushing for more or less stimulus).

		May 31 [1]	May 24	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	1.67	1.69	-2	0	3
	United States	2.34	2.34	0	-8	-1
	Japan	-0.16	-0.15	0	1	-1
	Eurozone	-0.32	-0.31	-1	-1	-1
	United Kingdom	0.80	0.80	0	-2	-12
	Australia	1.42	1.43	-1	-12	-67
2-Year Bonds	Canada	1.48	1.56	-8	-16	-38
	United States	2.00	2.17	-16	-33	-49
10-Year Bonds	Canada	1.51	1.61	-10	-25	-45
	United States	2.17	2.32	-15	-36	-52
	Japan	-0.10	-0.08	-2	-5	-9
	Germany	-0.20	-0.12	-8	-22	-44
	United Kingdom	0.87	0.96	-8	-35	-40
	Australia	1.46	1.52	-6	-33	-86
Risk Indicators	VIX	18.4	15.9	2.5 pts	5.5 pts	-7.1 pts
	TED Spread	16	19	-3	2	-29
	Inv. Grade CDS Spread [2]	67	65	2	9	-21
	High Yield CDS Spread [2]	376	364	12	52	-74
					(percent change)	
Currencies	US¢/C$	73.91	74.42	-0.7	-0.8	0.8
	C$/US$	1.353	1.344	—	—	—
	¥/US$	108.65	109.31	-0.6	-2.2	-0.9
	US$/€	1.1145	1.1203	-0.5	-0.5	-2.8
	US$/£	1.261	1.271	-0.8	-4.3	-1.1
	US¢/A$	69.29	69.27	0.0	-1.3	-1.7
Commodities	CRB Futures Index	177.04	178.63	-0.9	-2.6	4.3
	Oil (generic contract)	55.01	58.63	-6.2	-11.2	21.1
	Natural Gas (generic contract)	2.48	2.61	-4.9	-3.2	-15.5
	Gold (spot price)	1,300.53	1,284.75	1.2	1.7	1.4
Equities	S&P/TSX Composite	16,018	16,230	-1.3	-2.9	11.8
	S&P 500	2,763	2,826	-2.2	-6.2	10.2
	Nasdaq	7,498	7,637	-1.8	-8.2	13.0
	Dow Jones Industrial	24,935	25,586	-2.5	-5.9	6.9
	Nikkei	20,601	21,117	-2.4	-7.4	2.9
	Frankfurt DAX	11,728	12,011	-2.4	-5.5	11.1
	London FT100	7,166	7,278	-1.5	-2.9	6.5
	France CAC40	5,196	5,317	-2.3	-6.4	9.8
	S&P ASX 200	6,397	6,456	-0.9	1.0	13.3

[1] = as of 11:20 am [2] = One day delay

Global Calendar
June 3 – June 7

BMO Capital Markets®

	Monday June 3	Tuesday June 4	Wednesday June 5	Thursday June 6	Friday June 7
Japan	**Capital Spending** **Q1 (e) +2.6% y/y** Q4 +5.7% y/y **Manufacturing PMI** **May F (e) 49.6** Apr. 50.2		**Services PMI** **May** Apr. 51.8 **Composite PMI** **May** Apr. 50.8		**Household Spending** **Apr. (e) +2.7% y/y** Mar. +2.1% y/y
Euro Area	EURO AREA **Manufacturing PMI** **May F (e) 47.7** Apr. 47.9	EURO AREA **Consumer Price Index** **May A (e) +1.3% y/y** Apr. +1.7% y/y **Core CPI** **May A (e) +1.0% y/y** Apr. +1.3% y/y **Jobless Rate** **Apr. (e) 7.7%** Mar. 7.7% FRANCE **Jobless Rate** [D] **Apr. P** Mar. 8.8% ITALY **Jobless Rate** **Apr. P (e) 10.3%** Mar. 10.2%	EURO AREA **Retail Sales** **Apr. (e) -0.4% +1.5% y/y** Mar. unch +1.9% y/y **Services PMI** **May F (e) 52.5** Apr. 52.8 **Composite PMI** **May F (e) 51.6** Apr. 51.8 **Producer Price Index** **Apr. (e) +0.3% +3.2% y/y** Mar. -0.1% +2.9% y/y	EURO AREA **Real GDP** **Q1 F (e) +0.4% +1.2% y/y** Q1 P +0.4% +1.2% y/y Q4 +0.2% +1.2% y/y ECB Monetary Policy Meeting GERMANY **Factory Orders** **Apr. (e) unch -5.6% y/y** Mar. +0.6% -6.0% y/y	GERMANY **Industrial Production** **Apr. (e) -0.5% -0.3% y/y** Mar. +0.5% -0.9% y/y **Trade Surplus** **Apr.** Mar. €20.0 bln FRANCE **Industrial Production** **Apr. (e) +0.4% +1.0% y/y** Mar. -0.9% -0.9% y/y **Manufacturing Production** **Apr.** Mar. -1.0% +0.5% y/y **Trade Deficit** **Apr. (e) €4.8 bln** Mar. €5.3 bln ITALY **Retail Sales** **Apr.** Mar. -0.3% -3.3% y/y
U.K.	**Manufacturing PMI** **May (e) 52.0** Apr. 53.1 President Trump visits U.K. (June 3-5)	**Construction PMI** **May (e) 50.6** Apr. 50.5	**Services PMI** **May (e) 50.6** Apr. 50.4 **Composite PMI** **May (e) 50.7** Apr. 50.9	BoE Gov. Carney speaks in Tokyo	PM May steps down as Conservative Party Leader
Other	CHINA **Caixin Manufacturing PMI** **May (e) 50.0** Apr. 50.2	AUSTRALIA **Retail Sales** **Apr. (e) +0.2%** Mar. +0.3% RBA Monetary Policy Meeting	CHINA **Caixin Services PMI** **May (e) 54.2** Apr. 54.5 **Caixin Composite PMI** **May** Apr. 52.7 AUSTRALIA **Real GDP** **Q1 (e) +0.4% +1.8% y/y** Q4 +0.2% +2.3% y/y	CHINA **Foreign Reserves** [D] **May (e) \$3.1 trln** Apr. \$3.1 trln AUSTRALIA **Trade Surplus** **Apr. (e) A\$5.0 bln** Mar. A\$4.9 bln INDIA RBI Monetary Policy Meeting	G20 Finance Ministers and Central Bank Governors meeting in Fukuoka, Japan (June 8-9) CHINA Markets Closed

[D] = date approximate

Upcoming Policy Meetings | BoE: June 20, Aug. 1, Sep. 19 | ECB: July 25, Sep. 12, Oct. 24

North American Calendar
June 3 – June 7

BMO Capital Markets®

Canada

Monday June 3

9:30 am **Markit Manufacturing PMI**
May
Apr. 49.7

Auto Sales[D]
May
Apr. -3.5% y/y

Tuesday June 4

Wednesday June 5

8:30 am **Labour Productivity**
Q1 (e) **+0.3%**
Consensus *+0.4%*
Q4 -0.4%

Noon 2-year bond auction $3.0 bln

Thursday June 6

8:30 am **Merchandise Trade Deficit**
Apr. (e) **$2.5 bln**
Consensus *$2.8 bln*
Mar. $3.2 bln

10:00 am **Ivey Purchasing Managers Index (s.a.)**
May
Apr. 55.9

3-year bond auction announcement

Friday June 7

8:30 am **Employment**
May (e) **+0.1% (+20,000)**
Consensus *-0.03% (-5,000)*
Apr. +0.6% (+106,500)

8:30 am **Unemployment Rate**
May (e) **5.7%**
Consensus *5.7%*
Apr. 5.7%

8:30 am **Average Hourly Wages**
May (e) **+2.4% y/y**
Apr. +2.5% y/y

8:30 am **Capacity Utilization**
Q1 (e) **81.0%**
Consensus *81.3%*
Q4 81.7%

United States

Monday June 3

9:45 am **Markit Manufacturing PMI (May F)**

10:00 am **Manufacturing ISM (PMI)**
May (e) **52.8**
Consensus *53.2*
Apr. 52.8

10:00 am **Construction Spending**
Apr. (e) **+0.4%**
Consensus *+0.5%*
Mar. -0.9%

Ward's Total Vehicle Sales[D]
May (e) **16.8 mln a.r.**
Consensus *16.8 mln a.r.*
Apr. 16.4 mln a.r.

Fed Speakers: Gov. Quarles (9:10 am); Richmond's Barkin (12:40 pm); St. Louis' Bullard (1:25 pm)

11:30 am 13- & 26-week bill auction $72 bln

Sunday June 2

Fed Speaker: San Francisco's Daly (9:45 pm)

Tuesday June 4

9:55 am **Fed Chair Powell speaks at the Chicago Fed Conference**

10:00 am **Factory Orders**
Apr. (e) **-1.0%**
Consensus *-0.8%*
Mar. +1.4%

Fed Speaker: New York's Williams (8:30 am)

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

Wednesday June 5

7:00 am **MBA Mortgage Apps**
May 31
May 24 -3.3%

8:15 am **ADP National Employment Report**
May (e) **+160,000**
Consensus *+175,000*
Apr. +275,000

9:45 am **Markit Services/Composite PMI (May F)**

10:00 am **Non-manufacturing ISM (NMI)**
May (e) **55.5**
Consensus *56.0*
Apr. 55.5

2:00 pm **Beige Book**

Fed Speakers: Vice Chair Clarida (9:45 am); Gov. Bowman (10:00 am); Atlanta's Bostic (11:00 am)

Thursday June 6

7:30 am **Challenger Layoff Report**
May
Apr. +10.9% y/y

8:30 am **Initial Claims**
June 1 (e) **215k (unch)**[c]
May 25 215k (+3k)

8:30 am **Continuing Claims**
May 25
May 18 1,657k (-26k)

8:30 am	**Productivity**	**Unit Labour Costs**
Q1 F (e)	**+3.4% a.r.**	**-0.7% a.r.**
Consensus	*+3.6% a.r.*	*-0.9% a.r.*
Q1 P	+3.6% a.r.	-0.9% a.r.
Q4	+1.3% a.r.	+2.5% a.r.

8:30 am **Goods & Services Trade Deficit (and revisions)**
Apr. (e) **$51.3 bln**
Consensus *$50.8 bln*
Mar. $50.0 bln

10:00 am **Quarterly Services Survey (Q1 F)**

12:00 pm **Flow of Funds (Q1)**

Fed Speakers: Dallas' Kaplan (8:40 am); New York's Williams (1:00 pm)

11:00 am 13- & 26-week bill, 3- & 10[R]-year note, 30[R]-year bond auction announcements

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

Friday June 7

8:30 am **Nonfarm Payrolls**
May (e) **+180,000**
Consensus *+185,000*
Apr. +263,000

8:30 am **Unemployment Rate**
May (e) **3.7%**
Consensus *3.6%*
Apr. 3.6%

8:30 am	**Average Hourly Earnings**	
May (e)	**+0.3%**	**+3.2% y/y**
Consensus	*+0.3%*	*+3.2% y/y*
Apr.	+0.2%	+3.2% y/y

10:00 am **Wholesale Inventories**
Apr. F (e) **+0.7%**
Consensus *+0.2%*
Mar. unch

3:00 pm **Consumer Credit**
Apr. (e) **+$13.0 bln**
Consensus *+$12.0 bln*
Mar. +$10.3 bln

Fed Speaker: San Francisco's Daly (midnight)

[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