

Green Look

United States

- Tuning out a drumbeat of dreary data, equity bulls have stamped back, with the worst December since 1931 followed by the best January/February since 1987. Previous recession fears have ebbed as the Fed looks to have ended its tightening cycle, driving borrowing costs sharply lower.
- Also calming investor nerves was **progress on U.S./China trade talks**. The March 1 deadline for hiking the tariff on \$200 billion of China's goods was deferred indefinitely and, pending further progress on structural reforms and enforcement measures, the two countries aim to seal a deal by late April. This would remove one of the biggest thorns in the side of the global economy. Still, unresolved trade issues include USMCA ratification, metals tariffs, and a threatened U.S. duty on European autos.
- The trade skirmish with China has greased a record increase in the U.S. goods trade deficit. In fact, China, which accounts for over half of the shortfall, has all but stopped buying American oil after importing a record amount last summer. Fanned by soft global demand and a strong greenback, the trade gap is gnawing away at U.S. growth. It's one reason **real GDP slowed to a 2.2% (annualized) pace in Q4** from 3.4% in Q3. Residential construction was another weight, while the government shutdown shaved a tenth from growth. However, consumer spending rose a healthy 2.5% in the quarter, despite plunging in December. Even better was a **5.4% surge in nonresidential investment**, suggesting the trade war hasn't curbed spending plans. As a result, private domestic demand grew a sturdy 2.6% in Q4, only a modest step down from 3.0% in Q3.
- But **growth looks to ebb further to 1.2% in Q1**. The week year-end handoff from consumer spending, a likely inventory drawdown and lingering "residual seasonality" will weigh, while the longest-running government shutdown (which ended January 25th) will shave about 0.2 ppts from growth. Possible lighter tax refunds this year, due to less withholding tax, imply some downside risk.
- **Since some of the headwinds are temporary, growth should rebound to 2.5% in Q2**. A sharp rebound in home sales recently suggests housing markets are regaining a footing after the seven-year-long recovery stumbled badly last year, benefitting from the biggest decline in mortgage rates in a decade. Demographics also remain supportive, with the homeownership rate turning higher as more millennials take the plunge. Meantime, sturdy income growth, elevated

ECONOMIC RESEARCH

1-800-613-0205 • economics.bmocapitalmarkets.com

Sal Guatieri, Senior Economist

416-359-5295

sal.guatieri@bmo.com

KEY MESSAGES

- The Lazarus-like recovery in equity markets has calmed some of the economic headwinds, though both the U.S. and Canada will slow this year due to fading policy support
- Weaker global demand, tame inflation and uncertain trade policies will dissuade further rate hikes from the Fed and Bank of Canada
- An escalation of the trade war is the biggest threat to the North American expansion, though recent news from the U.S./China front is encouraging

wealth and a light debt-service load will underpin consumers. On the fiscal front, federal spending will enjoy a post-shutdown bounce in Q2, and many states plan to increase spending or cut taxes this year amid a surge in revenues.

- After growing 2.9% in 2018, the economy will moderate to **a more sustainable 2.3% rate this year** and to 1.7% in 2020 amid fading policy stimulus. The jobless rate should still slip to 3.5% later this year, the second lowest level since 1953. Payrolls have risen for a record 101 straight months, and, come July, the economic expansion will enter the history books as the longest-running since at least the mid-19th century.
- In a sea-change shift, the **Fed strongly signaled at its March 20 policy meeting that rate hikes are on hold this year**, while leaning toward just one move next year (down from a combined three moves expected in this period at the December meeting). It also announced a quicker end to paring its balance sheet (October 1). Combined with an expected slower economy, we **expect no further Fed rate hikes through the end of 2020**.
- With market expectations leaning toward a Fed rate cut, the **10-year Treasury yield has fallen almost 30 basis points this year** to 2.4%, below the 3-month rate. We expect it to increase modestly to 2.6% by year-end amid stable Fed policy and a mild rise in core inflation due to wage pressures.
- A **sustained inversion of the yield curve** could flag trouble for the economy. Long-term rates fell below short-term rates prior to each of the last seven recessions, with only one false alarm in the mid-60s. However, we suspect the curve will revert to a more normal positive slope when markets reassess the odds of an easing in monetary policy.
- Apart from concerns about trade policy, the economy faces a few **political land mines**. A divided Congress may not agree to suspend over \$120 billion in **automatic spending cuts** that are set to kick in on October 1st (a legacy of the 2011 congressional deal to raise the debt ceiling). As well, Congress could balk at lifting the recently-reinstated **debt ceiling** before the fall, at which time the Treasury will run out of shuffling measures to pay its bills, risking a rating downgrade.

Canada

- Canadian stocks also bolted out of the gates this year, racking up their best two-month start in three decades, and both global and Canadian oil prices have reversed a good chunk of earlier declines. But this **welcome news pales against a backdrop of a weak economy**. Real GDP rose just 0.4% in Q4 after expanding 2.0% in Q3. Unlike U.S. companies feasting on lower taxes and a lighter regulatory touch, Canadian businesses have slashed spending by double-digit rates in the past two

quarters, with notable weakness in the energy sector. As well, consumers are spending at the slowest pace since the recession (1.3% y/y in real terms), as higher interest rates and elevated debts have sown the weakest household credit growth in 35 years (3.1% y/y in January). Despite a welcome rebound in January GDP, oil output cuts will **keep growth weak at 0.7% in Q1**.

- While the **housing market is finding a steadier footing** after last year's slide, activity and prices continue to sag in Vancouver and the oil-producing provinces. However, the fastest population gains in 28 years (1.4%) should provide support, and we look for steadier sales and prices across the nation this year.
- After slowing to 1.8% last year from 3.0% in 2017, the **economy is projected to grow just 1.5% in 2019**. Planned layoffs totaling more than 4,000 auto workers at GM in Oshawa and Fiat-Chrysler in Windsor this year won't help the economy, and neither will China's decision to stop buying Canadian canola. However, extra spending announced in the March federal budget could add 0.2 ppts to growth. The jobless rate should hold near a four-decade low (averaging 5.7%), though further slippage in growth would send it marching higher.
- Amid a cooling economy, below-target inflation and unresolved trade issues, we now expect **the Bank of Canada to stand pat on rates rather than hike later this year**. Meantime, the 10-year Canada rate has fallen to 1.5%, below the policy rate of 1.75%. We see it rising to just 1.6% at year-end, not far from the record low (0.95%) reached in 2016.
- The **Canadian dollar remains flightless**, as support from firmer oil prices has been offset by a weaker economy and near-record trade deficit. The currency will struggle to make any headway, given chronic competitiveness issues, including the uncertain and lengthy approval process for launching major construction projects, such as much-needed pipelines.
- Legislative failure to ratify the USMCA, weaker growth in China (the world's largest commodities consumer), and a slower U.S. economy are potential **risks** facing the Canadian economy.

Forecasts

CANADA	2018				2019				ANNUAL		
	I	II	III	IV	I	II	III	IV	2017	2018	2019
Real GDP (q/q % chng : a.r.)	1.3	2.6	2.0	0.4	0.7	2.3	2.2	1.5	3.0	1.8	1.5
Consumer Spending	1.5	1.7	1.3	0.7	2.1	1.6	1.6	1.4	3.6	2.1	1.5
Business Investment (non-residential)	7.0	-1.4	-10.8	-10.9	4.5	3.8	3.2	2.9	2.5	1.7	-1.3
Consumer Price Index (y/y % chng)	2.1	2.3	2.7	2.0	1.5	1.8	1.7	1.9	1.6	2.3	1.7
Unemployment Rate (%)	5.8	5.9	5.9	5.7	5.8	5.8	5.7	5.7	6.3	5.8	5.7
Housing Starts (000s : a.r.)	224	218	197	217	202	211	206	200	220	214	205
Current Account Balance (\$blns : a.r.)	-69.0	-63.4	-40.4	-61.9	-56.8	-57.0	-58.2	-60.0	-60.1	-58.7	-58.0
Interest Rates (average for the quarter : %)											
Overnight Rate	1.25	1.25	1.50	1.75	1.75	1.75	1.75	1.75	0.71	1.44	1.75
3-month Treasury Bill	1.14	1.21	1.47	1.66	1.65	1.65	1.65	1.65	0.69	1.37	1.65
10-year Bond	2.24	2.28	2.28	2.32	1.85	1.60	1.70	1.80	1.78	2.28	1.75
Canada/U.S. Interest Rate Spreads (average for the quarter : bps)											
90-day	-44	-67	-61	-70	-79	-76	-76	-76	-26	-60	-77
10-year	-52	-64	-65	-71	-80	-83	-82	-80	-55	-63	-81
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	4.2	3.4	2.2	1.2	2.5	2.1	1.9	2.2	2.9	2.3
Consumer Spending	0.5	3.8	3.5	2.5	0.9	2.7	2.1	2.0	2.5	2.6	2.2
Business Investment (non-residential)	11.5	8.7	2.5	5.4	2.3	3.0	2.1	2.0	5.3	6.9	3.4
Consumer Price Index (y/y % chng)	2.2	2.7	2.6	2.2	1.6	1.6	1.7	1.8	2.1	2.4	1.7
Unemployment Rate (%)	4.1	3.9	3.8	3.8	3.9	3.7	3.5	3.5	4.4	3.9	3.6
Housing Starts (mlns : a.r.)	1.32	1.26	1.23	1.19	1.21	1.24	1.24	1.22	1.21	1.25	1.23
Current Account Balance (\$blns : a.r.)	-496	-414	-506	-538	-506	-526	-538	-548	-449	-488	-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	1.00	1.83	2.38
3-month Treasury Bill	1.58	1.87	2.08	2.36	2.45	2.45	2.45	2.45	0.95	1.97	2.45
10-year Note	2.76	2.92	2.93	3.03	2.65	2.40	2.50	2.60	2.33	2.91	2.55
EXCHANGE RATES (average for the quarter)											
US¢/C\$	79.1	77.5	76.5	75.7	75.2	74.8	75.1	75.4	77.1	77.2	75.1
C\$/US\$	1.265	1.291	1.307	1.322	1.330	1.337	1.332	1.327	1.298	1.296	1.331
¥/US\$	108	109	112	113	110	111	110	110	112	110	110
US\$/Euro	1.23	1.19	1.16	1.14	1.14	1.13	1.14	1.15	1.13	1.18	1.14
US\$/£	1.39	1.36	1.30	1.29	1.30	1.31	1.31	1.30	1.29	1.34	1.31

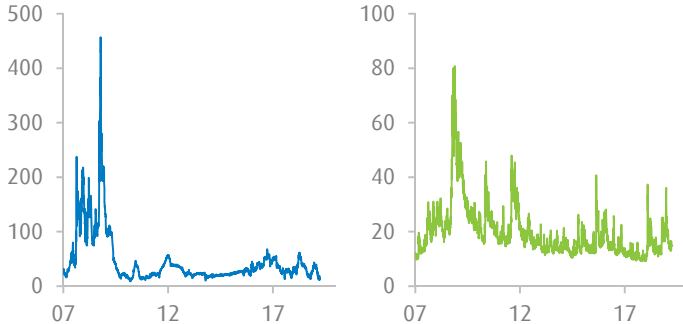
Note: Shaded areas represent BMO Capital Markets forecasts

VOLATILITY EBBS

United States (as of March 28, 2019)

Ted Spread¹

VIX²

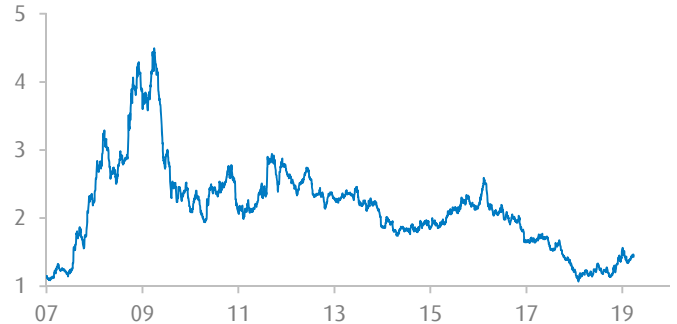


¹ 3-mnth Eurodollar minus 3-mnth T-bills (bps) ² CBOE market volatility index

CREDIT SPREADS STABILIZE

United States (ppts)

Corporate Bond Spreads¹



¹ 15-year BoA Merrill Lynch AA Corporate Yield less 10-year Treasury Yield

EQUITIES REBOUND

(indices : as of March 28, 2019)

Equities



LOONIE LANGUISHES

(US¢ : as of March 28, 2019)

Canadian Dollar

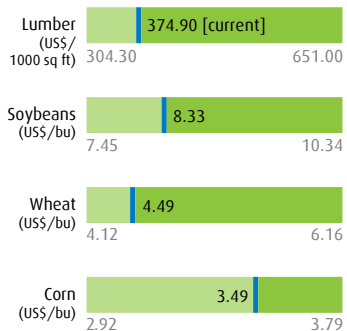


NATURAL GAS FIZZLES

Commodity price range since start of 2018

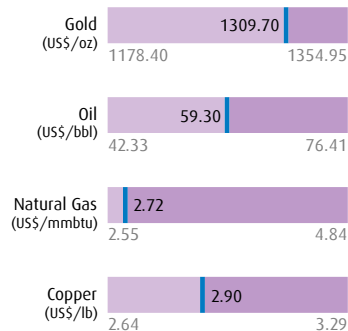
Materials & Foodstuffs

(as of March 28, 2019)



Metals & Energy

(as of March 28, 2019)



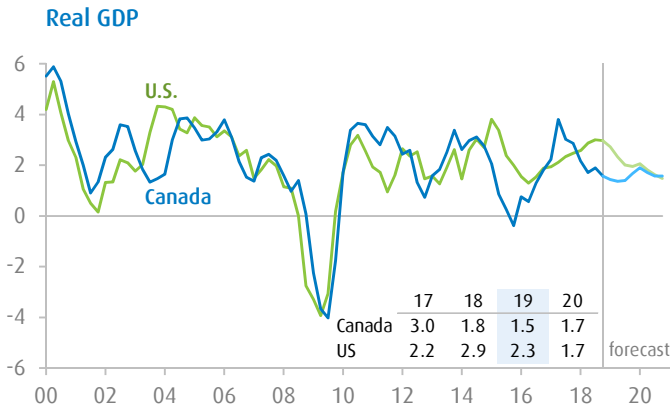
OIL PRICES FIRM

(US\$/bbl : as of March 29, 2019)

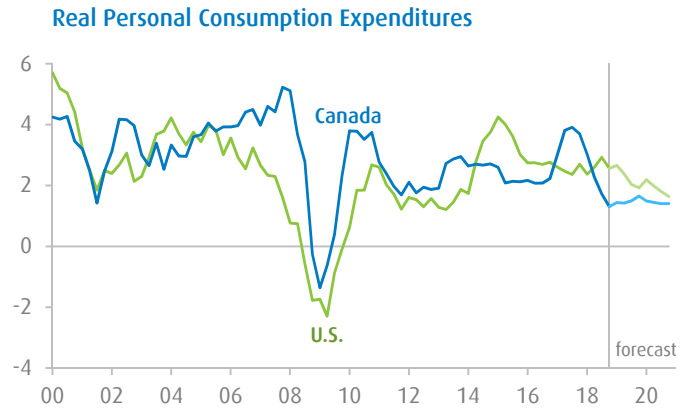
WTI Crude Oil



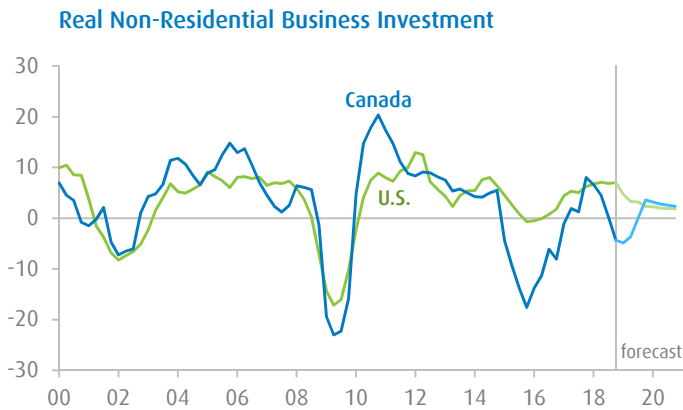
GROWTH MODERATES (y/y % change)



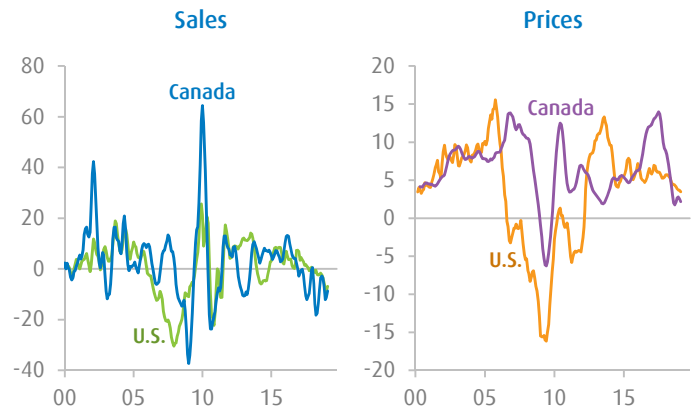
CONSUMER SPENDING DOWNSHIFTS (y/y % change)



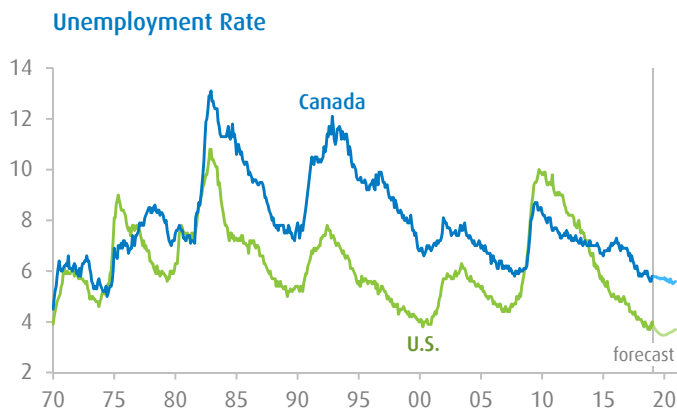
CANADIAN INVESTMENT WEAK (y/y % change)



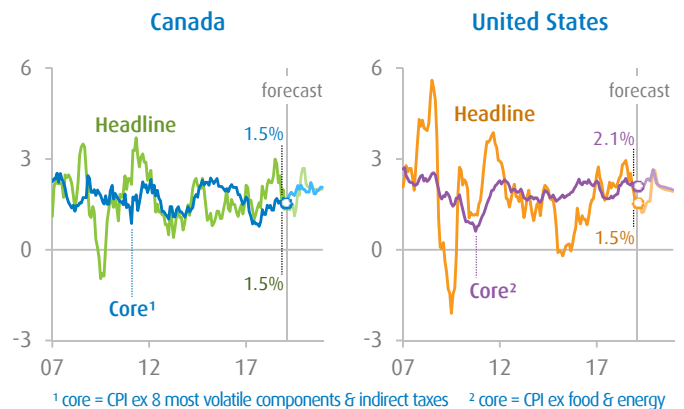
HOUSING COOLS Existing Homes (y/y % change : 3-month m.a.)



FULLY EMPLOYED (percent)

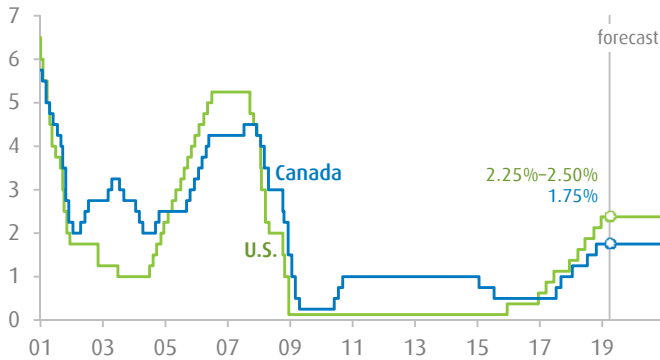


INFLATION MUTED Consumer Price Index (y/y % change)



THAT'S ALL FOLKS (% : as of March 28, 2019)

Overnight Rate



RATES PEAKING (% : as of March 28, 2019)

10-Year Bonds



General Disclosure

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

Dissemination of Research

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

Conflict Statement

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

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

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

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

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

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

© COPYRIGHT 2019 BMO CAPITAL MARKETS CORP.

A member of BMO Financial Group