Economic outlook: 
Spring back

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Bull market back on

(as of April 25, 2019)

Stocks

Worst December since 1931

1 (lhs); 2 (rhs)

10-year government bond yields (%)

Curves flirted with inversion

Source: BMO Economics

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Wicked weather

America’s wettest winter on record
(February particularly bad)

Record snowfall in many parts of Canada
(cumulatively for the winter or for specific storms)

Late January-February polar vortex impacted both sides of the border

Record spring flooding in the US Midwest
(intense flooding in other areas on both sides of the border)

Stock market drop + extreme weather = dismal turn-of-the-year economic performance
Global growth slowing

2018:Q4 (y/y % chng)

Real GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>6.6</td>
</tr>
<tr>
<td>China¹</td>
<td>6.4</td>
</tr>
<tr>
<td>World</td>
<td>3.4</td>
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<tr>
<td>US¹</td>
<td>3.2</td>
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<tr>
<td>Russia</td>
<td>2.9</td>
</tr>
<tr>
<td>Australia</td>
<td>2.3</td>
</tr>
<tr>
<td>South Korea¹</td>
<td>1.8</td>
</tr>
<tr>
<td>Mexico</td>
<td>1.7</td>
</tr>
<tr>
<td>Canada</td>
<td>1.6</td>
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<td>UK</td>
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<td>Eurozone</td>
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</tr>
<tr>
<td>Brazil</td>
<td>1.1</td>
</tr>
<tr>
<td>Japan</td>
<td>0.3</td>
</tr>
</tbody>
</table>

Source: BMO Economics

Trade restrictions rising... Trade volumes shrinking

Sorted by current; World GDP based on 72 of 75 countries that regularly report GDP growth, weighted by GDP shares (converted via IMF’s PPP estimates); ¹ 2019-Q1
Divergent growth trends

Real GDP (% chng)

United States

Quarter/quarter (ar) Year/year

Q1 helped by transitory factors

Canada

Quarter/quarter (ar) Year/year

Oil output cuts to impact Q1

Source: BMO Economics

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Looking under the hood...

Contributions to real GDP growth  (y/y % chng)

**United States**
- Real GDP
- Consumer spending
- Fixed investment
- Net exports
- Government spending
- Housing

**Canada**
- Real GDP
- Consumer spending
- Fixed investment
- Net exports
- Government spending
- Housing

**Sturdy consumer spending, capex**

**Dampened domestic spending**

Source: BMO Economics

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Household debt: Bank of Canada’s “#1 domestic financial vulnerability”

Households

Debt ratio
(ratio to personal disposable income)

Debt growth
(y/y % chng)

1 Households, nonprofits and unincorporated businesses; 2 Consumer credit and residential mortgages only

Source: BMO Economics
Canadian house prices: East hot, West not

Canada (y/y % chng: nsa: as of March 2019)

Existing home prices

- Ottawa: 7.6% increase, average price $423,000
- Montreal: 6.3% increase, average price $387,000
- Hamilton-Burlington: 3.8% increase, average price $564,000
- Toronto: 2.6% increase, average price $776,000
- Winnipeg: 0.2% decrease, average price $297,000
- Canada: -0.5% decrease, average price $470,000
- Saskatoon: -2.7% decrease, average price $311,000
- Edmonton: -4.4% decrease, average price $355,000
- Regina: -4.7% decrease, average price $294,000
- Calgary: -4.9% decrease, average price $443,000
- Vancouver: -7.7% decrease, average price $972,000

1 HPI composite benchmark where available; 2 Average price (y-t-d avg)

Source: BMO Economics
A decade of housing policy changes

Canada

2008–2015:
- Shortening amortizations (40 yrs → 35 → 30 → 25)
- Raising down payments (0% → 5%, 5%-7.5% on $500k-$1 mln, 20% on $1 mln+)
- Increasing constraints on availability of mortgage insurance
- Increasing credit adjudication stringency

2016–2018:
- Tax on nonresident buyers (BC, ON)
- Vacancy tax (BC)
- Stress tests on insured mortgages
- Stress tests on uninsured mortgages

2019 Federal budget: CMHC First-Time Home Buyers Incentive introduced, Home Buyers’ Plan boosted
Housing reacting to new rules... and higher rates

Canada (y/y % chng)

MLS Home Price Index

Supported by population growth

Source: BMO Economics

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Canadian capex challenges and opportunities

Real business fixed investment  \( (y/y \% \text{ chng}) \)

Opportunities:
- New accelerated depreciation rates (some 100%, all at least tripled)
- LNG Canada
- CUSMA (NAFTA uncertainty lifted)
- Late-cycle capacity constraints

Challenges:
- Regulatory environment vs US
- Corporate tax advantage vs US eroded...
- Personal tax disadvantage worsened
- Oil pipeline uncertainty
- US trade policy uncertainty

Source: BMO Economics

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Non-commodity export prospects dimmed by capacity/competitiveness issues

Canada

Non-energy export volumes  (January 2000 = 100)

US trade policy uncertainty:

Will CUSMA get passed?

Will steel/aluminum tariffs be lifted for Canada and Mexico?

Will trade wars with China and EU escalate?

Section 232 tariffs on imported vehicles and parts decision due May 17th
(Canada & Mexico exempt)

Source: BMO Economics
Ottawa’s deficits linger; infrastructure sags

Canada

Federal government budget balance

Net debt (% of GDP): 30.7% (FY19/20) → 28.6% (FY23/24)

General government real investment

Combined federal/provincial/local pullback

Sources: BMO Economics; 1 2019 federal budget
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http://economics.bmocapitalmarkets.com
Provincial finances: Mixed bag

Canada – FY19/20 (% of GDP)

Budget balance

-3

-2

-1

0 surplus
deficit

British Columbia

Saskatchewan

Alberta

Federal

Ontario

Newfoundland & Labrador

Manitoba

New Brunswick

Prince Edward Island

Nova Scotia

Quebec

Net debt

Sources: BMO Economics; Federal and provincial budgets/fiscal updates
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Growth to slow... Canada to lag

(y/y % chng)

Real GDP

Both economies:

Labour shortages and other capacity constraints
Slower global growth
Trade restrictions
Less accommodative financial conditions

US:
Fading fiscal stimulus

Canada:
Higher household debt levels

<table>
<thead>
<tr>
<th></th>
<th>17</th>
<th>18</th>
<th>19</th>
<th>20</th>
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<tbody>
<tr>
<td>Canada</td>
<td>3.0</td>
<td>1.8</td>
<td>1.5</td>
<td>1.7</td>
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<tr>
<td>US</td>
<td>2.2</td>
<td>2.9</td>
<td>2.5</td>
<td>1.7</td>
</tr>
</tbody>
</table>

Canada: [2019:Q1] BMO Economics estimate

Source: BMO Economics
Regional outlook: Tight race

Canada

Real GDP (y/y % chng)

<table>
<thead>
<tr>
<th>Province</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>NL(^1)</td>
<td>-2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>BC</td>
<td>1.8</td>
<td>1.8</td>
</tr>
<tr>
<td>QC</td>
<td>2.1</td>
<td>1.7</td>
</tr>
<tr>
<td>ON</td>
<td>2.1</td>
<td>1.7</td>
</tr>
<tr>
<td>MB</td>
<td>1.9</td>
<td>1.6</td>
</tr>
<tr>
<td>AB(^1)</td>
<td>2.0</td>
<td>1.3</td>
</tr>
<tr>
<td>PE</td>
<td>2.0</td>
<td>1.2</td>
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<tr>
<td>SK(^1)</td>
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<td>0.9</td>
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<td>0.7</td>
</tr>
<tr>
<td>NB</td>
<td>0.9</td>
<td>0.6</td>
</tr>
</tbody>
</table>

Sorted by 2019; \(^1\) Oil producers: Alberta, Saskatchewan, Newfoundland and Labrador; \(^2\) estimate; \(^3\) forecast

Source: BMO Economics

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Labour markets to tighten a bit more... but only modest acceleration in wage growth

Unemployment rate  (percent)

Saskatchewan’s jobless rate should stay under Canada’s

Forecast

Source: BMO Economics

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Core inflation to creep up

Consumer price index (y/y % chng)

United States

Total  2.0%
Core  1.9%

Canada

Total  2.0%
Core  1.9%

Not fast or persistent enough to elicit central bank action

1 Average of three new core inflation measures

Source: BMO Economics

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Interest rates: The world is flat

(%: as of April 25, 2019)

**Overnight rate**

<table>
<thead>
<tr>
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<th>US</th>
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<tbody>
<tr>
<td>Current</td>
<td>1.75</td>
<td>2.25-2.50</td>
</tr>
<tr>
<td>End-2019</td>
<td>1.75</td>
<td>2.25-2.50</td>
</tr>
<tr>
<td>End-2020</td>
<td>1.75</td>
<td>2.25-2.50</td>
</tr>
</tbody>
</table>

**10-year bonds**

<table>
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<tr>
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</thead>
<tbody>
<tr>
<td>Current</td>
<td>1.70</td>
<td>2.54</td>
</tr>
<tr>
<td>End-2019</td>
<td>1.85</td>
<td>2.65</td>
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<tr>
<td>End-2020</td>
<td>1.65</td>
<td>2.40</td>
</tr>
</tbody>
</table>

Net downside risk

Fed balance sheet shrinking ends September

Source: BMO Economics

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Canadian dollar: Where next?

Canada

Canadian dollar (US¢ : as of April 25, 2019)

Bank of Canada Governor Stephen Poloz

[Line] weekly averages; [dots] daily closes; [forecasts] BMO Economics

Source: BMO Economics

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http://economics.bmocapitalmarkets.com
Bottom line: Economic expansion and bull market should continue, but with net downside risks

Downside:
- US/global trade protectionism increases further
- Wage growth and inflation accelerate too quickly, forcing central banks’ hands
- In Canada, a larger consumer spending pullback and deeper housing sector correction due to high debt/new regs

Upside:
- US productivity gain in wake of sturdy capex pace
- Economic bounce from recent bond yield declines
- CUSMA gets passed quickly

Wild cards:
- Brexit, Iran, US politics, elections (EU, Canada)