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Focus

A weekly financial digest

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June 22, 2018

Feature Article
Page 8

Autos: A Tariff Too Far

Cdn Retail Sales and CPI Disappoint

TSX Hits Record High; C$ Mines One-Year Low

Trump Vows More Tariffs on China

Powell Upbeat on Economy

OPEC to Raise Output

Hawkish BoE Still on Hold

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Trade: The Other Shoe Drops

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Trade war, huh, yeah, what is it good for? Absolutely nothing. Say it again, y'all… and again.

Don't you long for the good old days (i.e., two to three weeks ago), when the biggest thing we had to worry about was Italian politics? Market focus swivelled back to the trade front in a big way this week, with large-cap equities, emerging markets and the Canadian dollar having their own version of a tariff tantrum.

This week was headlined by a ramping up of the US/China threats (very much a louder replay of the initial instalment from two months ago). The wrinkle this time is that the **proposed U.S. countermove is now a tariff on up to *$400* billion of Chinese imports**. Not to be left out, **retaliatory tariffs from the EU** went into effect, India proposed to do likewise, and even **Japan and Korea** tussled over steel. Late in the week, President Trump threatened **European auto imports** with a 20% tariff, building on last week's more general threat at the sector (see this week's ***Feature*** on page 8). **Our view is that a broad-based auto tariff would be as unwise as chasing down an errant putt and hitting it before it stops rolling… in the U.S. Open, no less… but that doesn't mean it can't happen.**

While financial markets regained some equilibrium on Friday, this followed an extended period of softness, at least for the Dow. Bonds continue to struggle with the conflicting forces of a consistently hawkish Fed and extremely tight labour markets on one side, and the reality of open trade conflict and still-modest wage pressures on the other side. On balance, Treasury yields were virtually unchanged this week across the curve. But that's been the broader story for almost five months now, where 10s have barely strayed from a tight 2.8%-to-3.0% range, and are now right in the middle of that spread. Equities are grappling with the same contradictory forces, and that conflict is on full display in the diverging performances in 2018 between the Dow (now down on a year-to-date basis) and small caps (Russell 2000 at a record high and up more than 10% this year).

Not to be left out of the party, Canada was casually sideswiped by the President in a Tuesday press conference, decrying the time-honoured practice of cross-border shopping/scuffing/smuggling of Adidas and Nikes. Of course, he also suggested that Canada and the U.S. have "great relations", other than when calling the other leader weak and/or dishonest. Thankfully, NAFTA has subsided somewhat as the top-cited irritant, with the broadening volley of threats with China and Europe moving to centre-stage. Still, and not to be flippant, somehow Canada seems to be eventually drawn in to every U.S. trade action, in ways few could have conceivably imagined even a year ago.

Accordingly, the Canadian dollar took it on the chin again this week amid the deteriorating trade backdrop, sliding to a one-year low around 75 cents (or C$1.332/US$). That's a 1% drop from last Friday's close, following hard on the heels of a 2% slide last week. While some developing Asian currencies fell even harder this week—most notable the yuan—Canada is close to the back of the pack on the *"world's weakest currencies"* for all of 2018. Loaded on top of rising trade concerns, there is growing doubt on further Bank of Canada rate hikes. Friday's round of domestic data certainly didn't help the cause, with retail sales and CPI delivering a one-two punch of weakness. With the export and business investment outlooks already clouded by the fog of trade war, a dose of surprise weakness on the domestic front hardly helps the rate hike cause.

After appearing to be nearly a done deal, the market is now heavily questioning even the July 11 rate decision, assigning slightly less than 50:50 odds of a rate hike in the wake of this week's bevy of bad news. We have not yet shifted our call of a rate hike next month, but we eagerly await next week's trio of key events in Canada—Governor Poloz' speech in Victoria on Wednesday afternoon, and Friday's releases of April GDP (will struggle to stay flat) and the BoC's Business Outlook Survey for Q2 (how are businesses viewing the incessant trade noise?).

Meantime, the TSX is whistling past the proverbial trade graveyard. Even as the loonie lags, Canadian stocks are back in the green for the year, were heading for a record high finish to the week, and have quietly put in a fine performance so far in Q2 (currently up more than 7%). As Rob points out below, the gains have not been confined to one sector, with almost all areas joining in the rebound. But naturally the energy sector has played a big role in the comeback, thanks to a 40% rise in crude oil prices from year-ago levels, and no similar response from the Canadian dollar. In C$ terms, WTI now stands at slightly more than C$90/bbl, a level in the past that has been quite favourable for the domestic industry. Oil ended the week on a strong note, cheering the OPEC agreement to boost production quotas by 1 million bpd, with WTI popping more than 3% to back above US$68.

More broadly, while it seems counter-intuitive in the extreme that the TSX would be hitting record highs when trade tensions are also rising to 11 on the volume meter, some sense can be made of it by noting that the dominant equity sectors are not especially vulnerable to protectionism. After last year's frustration—when Canada led the G7 growth leagues, but trailed on stock returns—this year is one of those occasions where it's actually not a bad thing that the TSX is not particularly representative of the Canadian economy.

The non-stop flurry of trade rhetoric and threats has been bewildering for analysts and investors alike, as we all try to separate the noise from the facts. As an example, I was on a panel recently with a very senior economist at a big U.S. bank, and found myself explaining to said individual (patiently, of course) that, yes, the U.S. was already imposing tariffs on Canadian (and EU and Mexican) steel and aluminum, and that, no, it's not all bluster. The point is someone who should probably know this, didn't, and it gives you a sense of why markets are bouncing around on whether to be concerned about trade matters. And of course there's the bigger point that the U.S. economy is on track for its strongest year since 2005 (and a very strong Q2), and that the U.S. is less susceptible to trade weakness than most other major economies. **In that context, the global trade dispute still seems like a distant risk to many commentators, rather than the very real clear and present danger it has become.** PoPoPo

U.S. Economy and Interest Rates Headed In One Direction: Up

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Next week's data on personal and business spending should confirm how well the U.S. economy is still doing, despite a brewing trade war. The two sectors, weighing in at a combined 82% of GDP, look to anchor 3.2% or better growth in Q2. Barring a downside surprise, we would be inclined to mark-up our estimate (a few pundits are even calling for 4-handles).

The data out this week were largely housing related, the one sector showing more mixed than sturdy activity but, importantly, accounts for just 4% of GDP. Existing home sales, building permits and homebuilder confidence all took a step back from elevated levels, while still-brisk house prices (FHFA's measure) slowed for a third successive month to +6.4% y/y. On a more constructive note, housing starts jumped 5% in May to 11-year highs. The new supply will help ease the shortage of resale homes that is crimping affordability and demand.

Citing a *"strong"* economy, **Fed Chair Powell** said *"the case for continued gradual increases in the federal funds rate remains strong"*. This fits with our view, and that of the median FOMC member, that policy rates are likely to increase two more times this year. Still, Powell showed no inclination to ramp up the pace of tightening, noting that inflation is likely less responsive to joblessness today due to firmly anchored expectations. He sees few signs of financial imbalances stemming from below-neutral rates. The Chair also seems willing, within reason, to run the economy a little hotter than the Fed's models recommend, given possible benefits for labour force participation and productivity.

All in, barring a further escalation in the trade war, it's **onwards and upwards for the U.S. economy and interest rates this year**. According to Powell, while some businesses are considering delaying investments and hiring due to *"rising"* concerns about tariffs, the impact has yet to show up in the data and is likely not slowing the economy. Fear that it might, ahead of congressional elections in November and the presidential election in 2020, is one reason to believe that cooler heads will ultimately prevail.

Sal

Taking a Step Back

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Government of Canada bonds have rallied hard over the past two weeks, driven by a combination of trade fears and poor positioning. Two-year yields are down about 10 bps since last week, while 10-year yields are nearly 20 bps lower. Before getting caught up in the move, let's consider what's actually happened in Canada over the past two weeks. Going into Friday's data, nothing concrete had happened to change the economic backdrop. Admittedly, the risks around the outlook for trade have increased, but that's been driven more by U.S.-China turbulence. A **potential auto tariff** continues to be bandied about by Trump (see this week's ***Feature***, page 8), but again, nothing has actually happened. Friday's poor CPI and retail data changed the picture a little bit, as April GDP could come in negative, but weather appears to have weighed on the month. And with respect to the CPI, the core measures were weak in May, but +1.9% y/y is pretty much at target. So, there's no need to panic, but it does mean there's a bit less urgency to tighten in July.

So where does that leave the Bank of Canada? Governor Poloz is in a bit of a tough spot. With the backdrop of an economy operating around potential, inflation close to target, and nothing concrete on the trade front since May 30, Poloz will likely be reluctant to do a 180 and turn dovish after signalling that a July hike was a strong possibility. Also notable is that the C$ has weakened sharply in recent days, providing a bit more room for a rate hike next month. However, we've seen the BoC make sharp turns before and no one would be shocked.

Key Takeaway: Fundamentally, very little has changed for Canada. Q2 is tracking only a bit weaker. The risks around trade have risen; but, until today, this was primarily a sentiment/positioning-driven market move. Governor Poloz's speech next week just got a lot more interesting. The BoC's view that the economy no longer needs stimulus isn't likely to have changed so quickly, but expect some more cautious talk around trade and an acknowledgment that risks to the outlook have risen. *B.A.A.R.*

Canadian Stocks Bucking the Bearishness

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The **TSX hit a record high this week**, pushing above levels last seen at the start of the year. This is all the more impressive given that it comes alongside news flow that reads anything but bullish for the Canadian economy (see the weakening loonie) and equity market. First, the very real **escalation in trade tensions** would hit Canada disproportionately hard, given its status as a small open economy tied strongly to the U.S. market. We look in detail at the potential impact of tariffs on the auto sector in this week's ***Feature*** on page 8 (hint: it could be pretty bad, especially for industrials). Also, we see continued evidence that soft housing market conditions are **slowing credit growth** more meaningfully, with even the closely-scrutinized debt-to-disposable income ratio suggesting the era of household leveraging could well be behind us. To boot, the yield curve has flattened again over the past month, with the 10s-minus-2s spread nearing cycle lows—this combination does not, in theory, ring bullish for the banks. Finally, **oil prices have been consolidating** after a strong run, on surging U.S. output and word that OPEC supply will get a 1 mln bpd bump—though price action was positive on Friday.

Yet the TSX marches upward. Since bottoming in early April, the index has jumped more than 7%, a rare bout of outperformance, however modest, versus the S&P 500. **Gains have been widespread**, with all sectors but utilities in the black. Half of the group—health care, technology, industrials, consumer discretionary and energy—has posted double-digit gains over that period. And, at the individual level, the move has not been driven by any one particular company as is often the case in Canada—Suncor, TD, CN Rail and Shopify top a diverse list of biggest index-point drivers. One could argue that Canadian equity **valuations** had simply become too depressed heading into the spring, especially on a relative basis versus those in the U.S. The **forward earnings yield** on the TSX currently sits at roughly 6.7% based on Bloomberg's forward earnings estimate, a full percentage point above recent lows. And, the **earnings yield** in Canada recently sat a full percentage point above that of the S&P 500, the juiciest spread in almost a decade. So, it may simply be that Canadian stocks were already on guard for cloudier economic news coming into the year. Rob K.

What a Difference a Year Makes!

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At **last year's ECB Forum in Sintra, Portugal**, the major central bankers suddenly came across as being very hawkish. **BoC Governor Poloz** was very explicit, and his comments put a rate hike the following month squarely on the table. *"It does look as though those cuts have done their job. We're just approaching a new interest rate decision, so I don't want to prejudge that, but certainly we need to be at least considering that whole situation now that capacity—excess capacity—is being used up steadily."* And sure enough, the BoC raised rates at the July meeting. **ECB President Draghi's** *"deflationary forces have been replaced by reflationary ones"* quip caused the euro to soar on expectations of stimulus paring; but alas, markets had to wait until October for it to be official. Then, there was **BoE Governor Carney's** famous 180 when he mused that *"some removal of monetary stimulus is likely to become necessary"*, after stating that *"now is not yet the time"* just one week prior. Markets ended up being disappointed in August but were gifted a rate hike in November.

Fast forward one year to the **2018 ECB Forum**. This time, all of the major central bankers who spoke came across as being very cautious (dovish is too strong). **ECB President Draghi**, a week after announcing that monthly bond buying will come to a close by the end of December, stressed the need to be *"prudent"* and that rate hikes will be *"gradual"*. That wasn't new. But, his view that it was *"undeniable"* that *"uncertainty surrounding the growth outlook has recently increased"* and that the various rounds of tariff retaliation are *"very worrisome and again, I can't see any positive"* underscores his worry. **BoJ Governor Kuroda**, who is not even contemplating an end to the BoJ's highly accommodative posture, admitted that, if the tariffs escalate between the U.S. and China, the indirect impact on Japan's economy *"could be quite significant"*. **Fed Chair Powell** said that *"for the first time, we are hearing about decisions to postpone investment, postpone hiring, postpone making decisions"*. Although these are not in the Fed's outlook, he admitted that *"in principle changes in trade policy could cause us to have to question the outlook"*. Although **BoE Governor Carney** presided over the BoE meeting this week and sounded hawkish, the MPC, too, warned that *"A major increase in protectionism worldwide could have a significant negative impact on global growth"*.

Bottom Line: While most of the major central banks are tightening in some form or another, plans can be easily derailed by the tariff war. JLee

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	Good News	Bad News
Canada ▪ C$ weakens to a one-year low on trade concerns ▪ TSX hits record high		**Consumer Prices** steady at +2.2% y/y (May) —below expected **Retail Sales Volumes** -1.4% (Apr.) **Wholesale Trade Volumes** unch (Apr.) **ADP Employment** slowed to +2,905 (May)—and prior month revised lower
United States ▪ President Trump threatens tariffs on almost all Chinese imports… and 20% on EU cars ▪ Commerce Secretary Ross: NAFTA deal would remove metals tariffs on partners ▪ Big banks pass Fed's stress test	**Housing Starts** +5.0% to 1.35 mln a.r. (May) —11-yr high **Initial Claims** -3k to 218k (June 16 week) **FHFA House Prices** +6.4% y/y (Apr.) **Leading Indicator** +0.2% (May)	**Existing Home Sales** -0.4% to 5.43 mln a.r. (May) **Building Permits** -4.6% to 1.30 mln a.r. (May) **NAHB Housing Market Index** -2 pts to 68 (June) **Current Account Deficit** widened to $124.1 bln (Q1) **Philly Fed Index** -2.7 pts to an ISM-adjusted 58.9 (June)—but still high
Japan ▪ Japan files WTO complaint against South Korea steel duties	**Consumer Prices** +0.7% y/y (May) **Manufacturing PMI** +0.3 pts to 53.1 (June P) **All-Industry Activity Index** +1.0% (Apr.)	**Department Store Sales** -2.0% y/y (May) **Trade Deficit** widened to ¥578.3 bln (May)
Europe ▪ EU's 25% tariffs on U.S. products take effect ▪ BoE on hold in 6-3 vote; tilts hawkish with stock of purchased assets steady until Bank Rate hits 1.5% (was 2.0%) ▪ Markets uneasy as early German elections possible, and two Eurosceptics tapped for key posts in Italy ▪ Greece's creditors agree on bailout exit deal ▪ A win for PM May after Brexit Bill to be passed into law	**Euro Area—Services PMI** +1.2 pts to 55.0; **Composite PMI** +0.7 pts to 54.8 (June P) **Germany—Producer Prices** +2.7% y/y (May) **France—Business Confidence** steady at 106 (June) **U.K.—Rightmove House Prices** +0.4% (June)	**Euro Area—Manufacturing PMI** -0.5 pts to 55.0 (June P) **Euro Area—Consumer Confidence** -0.7 pts to -0.5 (June A)
Other ▪ China vows to take further trade action against the U.S. ▪ RBA more upbeat on growth ▪ Brazil on hold; Mexico hikes ▪ OPEC to raise output July 1		**New Zealand—Real GDP** slowed to +0.5% q/q (Q1)—held back by **Household Spending**

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

Autos: A Tariff Too Far

Douglas Porter, Robert Kavcic, and Alex Koustas

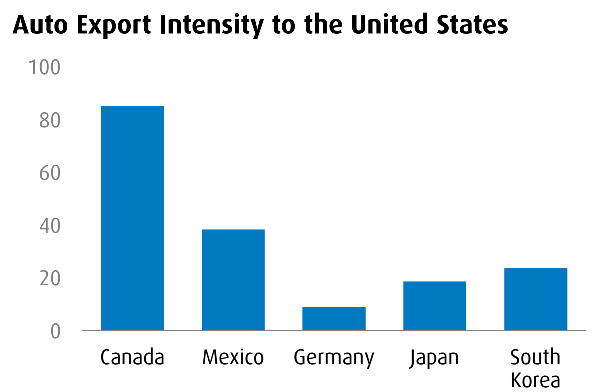
For much of the past 18 months, the conventional wisdom on the trade front has been that President Trump's protectionist bark is worse than his bite; that trade threats are bluster and/or a negotiating tactic; and that cooler heads will prevail. Wrong, wrong, and wrong. Instead, we have a very real trade tussle between the U.S. and China, tariffs on Canadian steel, aluminum, lumber, and newsprint, and NAFTA negotiations which face U.S. demands that are simply unacceptable to Canada and Mexico. Accordingly, there is the dawning realization among investors and analysts to not dismiss any trade threat, and that includes the possibility of a 25% tariff on imported autos. While we doubt that the U.S. would go as far as to impose a permanent, broad-based tariff on auto imports of that magnitude—partly because of the damage it would do to the U.S. economy, and the pain it would inflict on middle class American consumers (*see last week's Focus*)—we simply can't rule out the possibility. With that background, we delve deeper into the Canadian auto sector, and how it could potentially be affected by U.S. tariffs.

The Canadian automotive industry possesses many unique characteristics that only exist in the context of the tight political and economic partnership between Canada and the U.S. It is a prime example of the application of comparative advantage. Beginning with the Auto Pact of 1965, operations have been refined over 50 years through supply chain optimization and strong supplier relationships. Canada's annual auto manufacturing capacity stands at just above 2 million units, with the U.S. closer to 12 million units and Mexico approaching 4 million. Auto and parts manufacturing directly account for 1% of Canadian GDP, down from pre-financial crisis levels of 1.5%, following the closure of several facilities. Direct employment in auto and parts manufacturing currently stands at over 130,000 workers (0.8% of total payrolls), down from a peak of 170,000 in the early 2000s, but up 10% over the past three years.

Of the 2 million vehicles manufactured in Canada, 85% are exported to the United States, up from 65% in the early 1990s. For context, the country with the next largest U.S.-export intensity is Mexico, whose ratio stands at just 38% (*Chart 1*). Such dependency can only be formed after decades of trust, which appears to be fraying. This is particularly concerning given the trade relationship extends both ways, with Canada the destination for roughly 40% of total U.S. autos and parts exports. Two-way auto and parts trade accounts for over US$110 billion, with Canada acting as a net exporter of finished vehicles and a net importer of parts. Combined, **the well-oiled relationship resulted in a modest $2.5 billion net autos surplus for the U.S. in 2017, which is remarkably balanced** given more than $500 billion of overall trade flows between the two countries (*Chart 2*). Tariffs in the range proposed by the Department

Chart 1
High Reliance on U.S. Trade

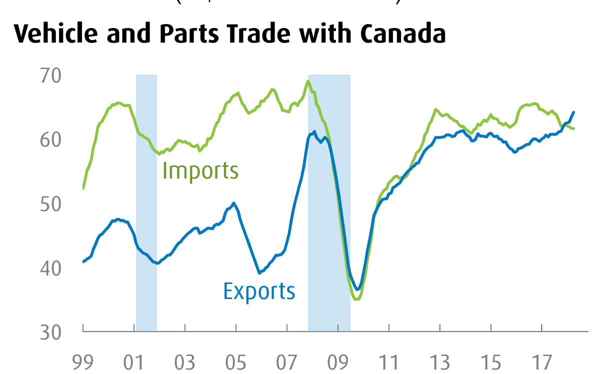
2016 (% of auto production exported to the U.S.)



Source: BMO Economics

Chart 2
Auto Trade is Balanced

United States (US$ blns : 12-mnth m.s.)



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

of Commerce risk fracturing this relationship and, more seriously, risk damaging the effectiveness and competitiveness of the North American production chain in the face of steadily growing international competition.

Focusing on finished cars and trucks, 44% of all vehicles purchased in the U.S. are imported, meaning nearly half of the market could be subjected to tariffs of up to 25%. **The ability of U.S. production to capitalize on the price distortions caused by the tariffs in the near term is extremely limited given plants are operating at 97% capacity**. Even if all U.S. auto exports were redirected to the domestic market, worsening the trade deficit, it would only add 2.8 million units of supply (16% of domestic demand), and this ignores that the vehicles in question would be imperfect substitutes (implying a loss of consumer welfare).

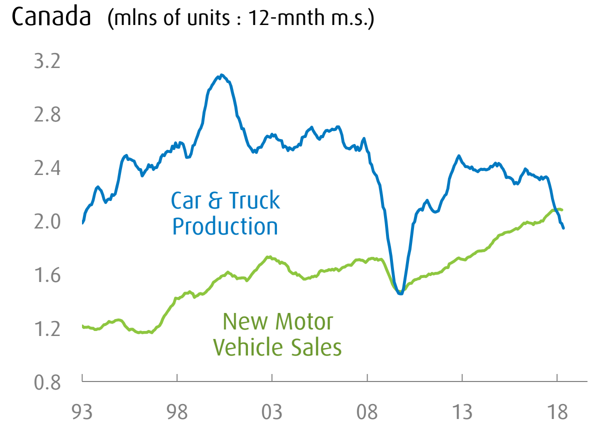
Industry commentary suggests that a tariff of 25% would be met with a 15%-to-20% increase in the wholesale price of a vehicle. Making a generous assumption on the price elasticity of demand, **we assume a 10% decline in U.S. sales from our baseline forecast**, to just over 15 million units. Despite punitive tariffs, nearly 5 million imported vehicles would still be required to satisfy domestic demand even if U.S. plants ramped up to full capacity. In the extreme case where the U.S. ceased all exports, 3 million import units would still be needed. These outcomes would entail a 35%-to-60% drop in import volumes from current levels of around 7.5 million units, which would hit Canadian production disproportionately hard. Of course, the consequences would be magnified if the tariffs are extended to parts.

The **impact on Canada's economy would be significant**, and possibly large enough to pull Ontario specifically down to near recession territory. Given the above range of U.S. import volume changes resulting from the tariff, Canadian auto production could be cut by somewhere in the 600k-to-1 million unit range. Assuming a similar impact through the parts supply chain, **this would directly carve roughly 0.3-to-0.6 ppts from Canadian GDP, and could put at least 40k factory jobs at risk**. Of course, the impact wouldn't stop at the factory gate. Income losses would flow through to lower consumer spending; sectors that derive business from autos, such as transportation & warehousing, would see activity decline; the impact would likely disrupt the wholesale and retail networks, which employ twice as many people as parts and production; and the broader hit to business confidence would certainly dent capital spending in other sectors. Tempering the decline somewhat would be a weaker Canadian dollar, a potential response from the Bank of Canada and any government support measures (for which there is precedent). While measuring the impact of such spillover effects is far from precise, our analysis suggests that **the broader impact on GDP could run in the 0.6-to-1.2 ppt range** after a year.

In Ontario, the consequences would be more severe given that the province accounts for nearly all of Canada's auto and parts production, and U.S.-bound autos and parts account for 30% of the province's total exports. In fact, we estimate that the direct impact of lower production could alone cut almost a percentage point from growth, leaving the broader impact closer to 2 ppts. In a nutshell, the hit to production and auto-sector employment would not be far behind that experienced during the financial crisis in 2009. While the broader impact would be tempered by still-solid economic fundamentals in other sectors, **Ontario could very well see a modest recession** versus our baseline forecast of around 2% growth in 2019. Another key concern is that, given the highly localized nature of the auto sector, specific **communities in Southwestern Ontario could see an impact far beyond that for Ontario or Canada overall**, and an acceleration of the hollowing out process that has been underway for more than decade (*Table 1*). Moreover, the economic impacts could be more severe than suggested given the attendant risks of plants operating at low capacity and unprofitable levels.

Canada does have one notable advantage: Domestic capacity of over 2 million units can still meet domestic demand (*Chart 3*). Should Canada apply a 25% countervailing tariff on U.S. imports (and potentially other imports to protect domestic assemblies), it **could see demand shift to Canadian-produced vehicles and maintain production at higher levels than otherwise would be the case**. Unfortunately, for this strategy to have maximum impact, duties would also need to be levied to all trading partners to prevent a re-routing of once-U.S. bound vehicles into the Canadian market to fill the void left by U.S imports. This would have separate ramifications, including a breach of Canada's CETA commitments, break in solidarity with Mexico with regards to NAFTA negotiations, not to mention a limited selection of available vehicles for consumers and higher prices biting purchasing power.

Chart 3
Production and Domestic Demand



Sources: BMO Economics, Haver Analytics

Bottom Line: The auto industry remains one of the most important sectors in the Canadian economy—acutely so for Ontario—even with its relative downsizing over the past two decades. Potential U.S. tariffs would land a heavy blow on the economy, but would also inflict serious pain on U.S. consumers and workers. Given that the U.S. industry doesn't have the capacity to meet domestic demand for the foreseeable future, any tariffs are likely to be either temporary, and/or less than 25%, or ultimately exempt Canada. Still, even the threat of tariffs can chill capital spending decisions, and cannot be lightly dismissed as a key risk.

Table 1
Vehicle Production in Canada

Company	Vehicle Production —12 months through May— (units) 2018	2017	Volume (% chng)	Share of Company's NAFTA Production (percent) Current	Year-ago	Models Produced
FCA	**497,850**	**529,112**	**-5.9**	**21.3**	**22.9**	
Brampton	216,904	220,949	-1.8	8.3	9.4	300, Challenger, Charger
Windsor	280,946	308,163	-8.8	13.0	13.6	Caravan, Pacifica
Ford	**233,236**	**265,604**	**-12.2**	**8.5**	**8.1**	
Oakville	233,236	265,604	-12.2	8.5	8.1	Edge, Flex, MKT, MKX
GM	**289,627**	**506,609**	**-42.8**	**9.4**	**13.9**	
Ingersoll	205,691	399,799	-48.6	6.8	7.7	Equinox
Oshawa 1	65,039	65,850	-1.2	1.8	2.8	Impala
Oshawa 2	18,897	40,960	-53.9	0.8	3.3	Regal, XTS
Honda	**392,828**	**417,137**	**-5.8**	**22.4**	**23.8**	
Alliston 1	192,791	205,085	-6.0	10.9	11.4	Civic
Alliston 2	200,037	212,052	-5.7	11.5	12.4	CR-V
Toyota	**488,666**	**604,575**	**-19.2**	**26.6**	**30.0**	
Cambridge	269,538	352,540	-23.5	14.7	17.5	Corolla, RX350
Woodstock	219,128	252,035	-13.1	11.9	12.5	RAV-4
Total	**1,902,207**	**2,323,037**	**-18.1**	—	—	

Source: BMO Economics

Economic Forecast Summary for June 22, 2018

BMO Capital Markets Economic Research

	2018				2019				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2017	2018	2019
CANADA											
Real GDP (q/q % chng : a.r.)	1.3	2.5	2.1	1.9	1.8	1.7	1.7	1.6	3.0	2.0	1.8
Consumer Price Index (y/y % chng)	2.1	2.3 ↓	2.3 ↓	2.1 ↓	1.9	2.1	2.2	2.1	1.6	2.2 ↓	2.1
Unemployment Rate (percent)	5.8	5.8	5.7	5.6	5.6	5.5	5.5	5.5	6.3	5.7	5.5
Housing Starts (000s : a.r.)	223	209	215	213	211	207	204	200	220	215	205
Current Account Balance ($blns : a.r.)	-78.0	-68.9	-67.2	-65.8	-65.3	-65.1	-64.9	-64.5	-63.3	-70.0	-65.0
Interest Rates					(average for the quarter : %)						
Overnight Rate	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.50	0.71	1.44	2.31
3-month Treasury Bill	1.14	1.25	1.50	1.70	1.95	2.15	2.35	2.35	0.69	1.40	2.20
10-year Bond	2.24	2.30	2.40	2.60	2.75	2.85	2.95	3.05	1.78	2.40	2.90
Canada-U.S. Interest Rate Spreads					(average for the quarter : bps)						
90-day	-44	-62	-53	-51	-49	-46	-38	-38	-26	-53	-42
10-year	-52	-63	-64	-60	-56	-53	-49	-46	-55	-60	-51
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	3.2	2.9	2.9	2.7	2.2	2.0	1.8	2.3	2.8	2.5
Consumer Price Index (y/y % chng)	2.3	2.7	2.7	2.5	2.2	2.2	2.2	2.1	2.1	2.5	2.2
Unemployment Rate (percent)	4.1	3.8	3.7	3.6	3.5	3.5	3.5	3.5	4.4	3.8	3.5
Housing Starts (mlns : a.r.)	1.32	1.32 ↑	1.31 ↑	1.28	1.27	1.28	1.28	1.28	1.21	1.31 ↑	1.28
Current Account Balance ($blns : a.r.)	-496	-482 ↑	-501 ↑	-520 ↑	-534	-547	-564	-574	-449	-500 ↑	-555 ↑
Interest Rates					(average for the quarter : %)						
Fed Funds Target Rate	1.46	1.71	1.96	2.21	2.46	2.71	2.88	2.88	1.00	1.83	2.73
3-month Treasury Bill	1.58	1.90	2.05	2.25	2.45	2.65	2.75	2.75	0.95	1.95	2.65
10-year Note	2.76	2.95	3.05	3.20	3.30	3.40	3.45	3.50	2.33	3.00	3.40
EXCHANGE RATES					(average for the quarter)						
US¢/C$	79.1	77.6 ↓	77.2 ↓	78.1 ↓	78.7	79.1	79.5	79.9	77.1	78.0 ↓	79.3
C$/US$	1.27	1.29 ↑	1.30 ↑	1.28	1.27	1.26	1.26	1.25	1.30	1.28	1.26
¥/US$	108	109	109	108	108	107	106	105	112	109	106
US$/Euro	1.23	1.19	1.18	1.21	1.23	1.23	1.24	1.25	1.13	1.20	1.24
US$/£	1.39	1.36	1.35	1.37	1.39	1.40	1.41	1.43	1.29	1.37	1.41

Blocked areas represent BMO Capital Markets forecasts

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

Canada

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Real GDP at Basic Prices

Friday, 8:30 am
Apr. (e) **-0.1%**
Mar. +0.3%

After a sluggish start to the year, Canadian economic activity roared back in February and March. The economy likely stumbled again in April, with poor weather playing a role. We're looking for a 0.1% drop in monthly GDP, with retail activity down sharply and manufacturing falling, while wholesale volumes stalled. Home sales were down modestly in April, but look for some bounce in finance after the biggest drop since November 2008. Transportation has the potential to push higher as well, with activity ramping up after winter-weather related issues in Q1. Oil production was up sharply in the prior two months, though some of that was a reversal of January maintenance, suggesting that the sector could struggle to gain further ground. Hours worked were down very slightly in the month, supporting our call for a modest contraction. The expected small drop puts Q2 on track for about 2% growth thanks to a solid handoff, but that assumes decent gains in May and June.

BoC Business Outlook Survey and Senior Loan Officer Survey (Q2)

Friday, 10:30 am

The Bank of Canada's summer Business Outlook Survey (BOS), compiled between early-May and early-June, is expected to show the economy continues to grow at a decent pace, while operating close to capacity. The BOS indicator (a summary measure for the survey) was not far from historical highs in the prior survey, and would do well to hold steady during this round.

The broad-based strength in the spring BOS suggests that most indicators will struggle to gain any ground. Employment and investment expectations were well above the mean and median in the prior survey, leaving room for a pullback while continuing to point to solid growth in both. Future sales growth is one question where there's room for improvement, but ongoing uncertainty around NAFTA likely isn't helping. Note that the timing of the survey means only respondents in the back half of the survey period will have been impacted by U.S. steel/aluminum tariffs and the accompanying heightened trade risk. In the spring issue, there was a box on *"The impact of US policy changes or associated uncertainty: views from BOS firms"*, we'll see if there's an update this time around.

Look for regional commentary to be a bit more balanced, with rising oil prices lifting sentiment in commodity-producing regions, while trade uncertainty weighs a bit on Central Canada. Meantime, credit conditions in the BOS and Senior Loan Officer Survey were likely little changed.

Capacity pressures are a key barometer for the BoC to assess where the economy is operating relative to potential. In Q1, capacity pressures retreated from a 10-year high and likely held around the 50 level (some or significant difficulty to meet an unexpected increase in demand), suggesting the economy continues to operate around capacity. While capacity is tight, labour shortages have remained relatively subdued. Look for some increase in this measure, consistent with the upward pressure on wages.

The inflation questions (input and output) could show some brewing pressures. Wage growth has picked up, energy prices are higher, tariffs are driving some prices up, and the weaker C$ is lifting import costs (though that's probably more a Q3 issue). But, inflation expectations aren't expected to move much, holding around 2%, though more in the 2%-3% range than 1%-2%. Overall, the tone of the survey is expected to be generally positive, though not as upbeat as in the spring. Even so, we're not expecting the BOS to alter the BoC's bias to tighten on July 11. Risks around trade and tariffs appear to be the main stumbling block to a move.

United States

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New Home Sales

Monday, 10:00 am

May (e)	**669,000 a.r. (+1.0%)**
Consensus	*666,000 a.r. (+0.6%)*
Apr.	662,000 a.r. (-1.5%)

New home sales likely rose 1.0% to 669,000 units annualized in May after retreating in April. While mortgage applications slipped last month, homebuilder confidence held aloft (before dipping in June) and housing starts jumped 5% to new cycle highs. Resale shortages have more buyers eyeing the new home market, despite escalating prices due to rising labour and material costs. After a soft start to the year, residential construction looks to have rebounded a bit in Q2.

Durable Goods Orders

Wednesday, 8:30 am

		Ex. Transport
May (e)	**-1.0%**	**-0.1%**
Consensus	*-0.8%*	*+0.5%*
Apr.	-1.6%	+0.9%

	Nondef. Capital Goods ex. Air
May (e)	**-0.2%**
Consensus	*+0.5%*
Apr.	+1.0%

Durable goods orders are expected to fall 1.0% in May, dragged down by fewer aircraft and automobile bookings. Excluding aircraft and defence items, orders for capital goods should post a modest decline after April's 1% spike, continuing this year's seesaw pattern. Tax cuts and full expensing are supporting business spending, while growing concerns about a trade war are giving reason for pause. A deceleration in machinery and equipment orders would signal somewhat slower capex in Q2 after a hefty 9.2% annual advance in Q1.

Personal Spending and Income

Friday, 8:30 am

	Personal Spending	**Personal Income**
May (e)	**+0.5%**	**+0.4%**
Consensus	*+0.4%*	*+0.4%*
Apr.	+0.6%	+0.3%

	Core PCE Price Index	
May (e)	**+0.2%**	**+1.9% y/y**
Consensus	*+0.2%*	*+1.9% y/y*
Apr.	+0.2%	+1.8% y/y

Despite a further downshift in autos, personal spending is expected to rise 0.5% in May on strong retail sales. Volumes likely rose 0.3%, adding to earlier gains and indicating a 3.5% annualized rebound in Q2 consumer spending after Q1's breather. Personal income should ratchet 0.4% higher amid a pickup in employment and wage growth. The latter is filtering into prices. Core PCE prices likely rose 0.2% for a fourth straight month, lifting the annual rate to 1.9%, the highest since early last year and within a hair of the Fed's target. A solid spending report may warrant an upgrade to our 3.2% call for Q2 GDP growth.

		Jun 22 [1]	Jun 15	Week Ago	4 Weeks Ago	Dec. 31, 2017
					(basis point change)	
Canadian Money Market	Call Money	1.25	1.25	0	0	25
	Prime Rate	3.45	3.45	0	0	25
U.S. Money Market	Fed Funds (effective)	2.00	2.00	0	25	50
	Prime Rate	5.00	5.00	0	25	50
3-Month Rates	Canada	1.21	1.22	-1	-7	15
	United States	1.92	1.92	0	3	54
	Japan	-0.14	-0.12	-2	0	2
	Eurozone	-0.32	-0.32	0	0	1
	United Kingdom	0.66	0.63	3	5	14
	Australia	2.09	2.07	2	15	31
2-Year Bonds	Canada	1.79	1.89	-10	-17	11
	United States	2.54	2.55	-1	6	66
10-Year Bonds	Canada	2.12	2.22	-10	-23	8
	United States	2.90	2.92	-2	-3	50
	Japan	0.03	0.03	0	-1	-1
	Germany	0.33	0.40	-7	-7	-9
	United Kingdom	1.30	1.33	-3	-2	11
	Australia	2.65	2.69	-4	-14	2
Risk Indicators	VIX	13.5	12.0	1.5 pts	0.2 pts	2.4 pts
	TED Spread	42	41	1	-1	10
	Inv. Grade CDS Spread [2]	65	61	3	2	16
	High Yield CDS Spread [2]	344	336	8	0	37
					(percent change)	
Currencies	US¢/C$	74.97	75.85	-1.2	-2.7	-5.8
	C$/US$	1.334	1.318	—	—	—
	¥/US$	109.92	110.66	-0.7	0.5	-2.5
	US$/€	1.1626	1.1610	0.1	-0.2	-3.2
	US$/£	1.326	1.328	-0.1	-0.4	-1.9
	US¢/A$	74.23	74.42	-0.3	-1.7	-4.9
Commodities	CRB Futures Index	196.61	196.24	0.2	-3.3	1.4
	Oil (generic contract)	67.66	64.85	4.3	-0.3	12.0
	Natural Gas (generic contract)	2.96	3.02	-2.1	0.7	0.2
	Gold (spot price)	1,269.57	1,279.55	-0.8	-2.5	-2.6
Equities	S&P/TSX Composite	16,459	16,314	0.9	2.4	1.5
	S&P 500	2,763	2,780	-0.6	1.5	3.4
	Nasdaq	7,683	7,746	-0.8	3.3	11.3
	Dow Jones Industrial	24,580	25,090	-2.0	-0.7	-0.6
	Nikkei	22,517	22,852	-1.5	0.3	-1.1
	Frankfurt DAX	12,569	13,011	-3.4	-2.8	-2.7
	London FT100	7,686	7,634	0.7	-0.6	0.0
	France CAC40	5,387	5,502	-2.1	-2.8	1.4
	S&P ASX 200	6,225	6,094	2.2	3.2	2.6

[1] = as of 10:30 am   [2] = One day delay

Global Calendar
June 25 – June 29

BMO Capital Markets®

Japan

Monday June 25

BoJ Summary of Opinions from June 14-15 meeting

Thursday June 28

Retail Sales

May P (e)	**-0.9%**	**+1.2% y/y**
Apr.	+1.3%	+1.5% y/y

Friday June 29

Jobless Rate

May (e)	**2.5%**
Apr.	2.5%

Industrial Production

May P (e)	**-1.0%**	**+3.4% y/y**
Apr.	+0.5%	+2.6% y/y

Consumer Confidence Index

June (e)	**43.8**
May	43.8

Euro Area

Monday June 25

GERMANY

Ifo Business Climate

June (e)	**101.8**
May	102.2

Wednesday June 27

EURO AREA

M3 Money Supply

May (e)	**+3.8% y/y**
Apr.	+3.9% y/y

FRANCE

Consumer Confidence Index

June (e)	**100**
May	100

ITALY

Consumer Confidence Index

June (e)	**113.2**
May	113.7

Producer Price Index

May		
Apr.	-0.7%	+1.4% y/y

Thursday June 28

EURO AREA

Economic Confidence

June (e)	**112.0**
May	112.5

Consumer Confidence

June F (e)	**-0.5**
May	+0.2

ECB Economic Bulletin

EU Summit (June 28-29)

GERMANY

GfK Consumer Confidence

July (e)	**10.6**
June	10.7

Consumer Price Index

June P (e)	**+0.2%**	**+2.1% y/y**
May	+0.6%	+2.2% y/y

ITALY

Consumer Price Index

June P (e)	**+0.2%**	**+1.4% y/y**
May	+0.3%	+1.0% y/y

Friday June 29

EURO AREA

Consumer Price Index

June A (e)	**+2.0% y/y**
May	+1.9% y/y

Core CPI

June A (e)	**+1.0% y/y**
May	+1.1% y/y

GERMANY

Retail Sales

May (e)	**-0.6%**	**+1.8% y/y**
Apr.	+1.6%	+1.2% y/y

	Unemploy.	**Jobless Rate**
June (e)	**-8,000**	**5.2%**
May	-12,000	5.2%

FRANCE

Consumer Spending

May (e)	**+0.9%**	**+0.3% y/y**
Apr.	-1.5%	+0.2% y/y

Consumer Price Index

June P (e)	**+0.1%**	**+2.4% y/y**
May	+0.5%	+2.3% y/y

Producer Price Index

May		
Apr.	-0.7%	+2.3% y/y

U.K.

Thursday June 28

Nationwide House Prices [D]

June (e)	**+0.3%**	**+1.7% y/y**
May	-0.2%	+2.4% y/y

Friday June 29

GfK Consumer Confidence

June (e)	**-7**
May	-7

Real GDP

Q1 F (e)	**+0.1%**	**+1.2% y/y**
Q1 P	+0.1%	+1.2% y/y
Q4	+0.4%	+1.4% y/y

Other

Monday June 25

TURKEY

Presidential Election (June 24)

Wednesday June 27

NEW ZEALAND

RBNZ Monetary Policy Meeting

Friday June 29

MEXICO

General Election (July 1)

[D] = date approximate

Upcoming Policy Meetings | BoE: Aug. 2, Sep. 13, Nov. 1 | ECB: Sep. 13, Oct. 25, Dec. 13

North American Calendar
June 25 – June 29

BMO Capital Markets®

Canada

Monday June 25

Tuesday June 26

10:30 am	3-, 6- & 12-month bill auction $9.0 bln (new cash $0.5 bln)

Wednesday June 27

3:00 pm	BoC Governor Poloz speaks at the Greater Victoria Chamber of Commerce, Victoria, BC; press conference at 4:30 pm

Thursday June 28

8:30 am	Survey of Employment, Payrolls, and Hours (Apr.)
Noon	2-year bond auction $3.0 bln

Friday June 29

8:30 am	Real GDP at Basic Prices	
Apr. (e)	-0.1%	
Mar.	+0.3%	
8:30 am	Industrial Product Price Index	Raw Materials Price Index
May (e)	+1.0%	+4.5%
Apr.	+0.5%	+0.7%
10:30 am	BoC Business Outlook Survey and Senior Loan Officer Survey (Q2)	

United States

Monday June 25

8:30 am	Chicago Fed National Activity Index
May (e)	+0.30
Apr.	+0.34
10:00 am	New Home Sales
May (e)	669,000 a.r. (+1.0%)
Consensus	*666,000 a.r. (+0.6%)*
Apr.	662,000 a.r. (-1.5%)
10:30 am	Dallas Fed Mfg. Activity
June (e)	27.0
May	26.8
11:00 am	4-week bill auction announcement
11:30 am	13- & 26-week bill auction $90 bln

Tuesday June 26

9:00 am	S&P Case-Shiller Home Price Index (20 city)	
Apr. (e)	+0.5%	+6.8% y/y
Consensus	*+0.4%*	*+6.7% y/y*
Mar.	+0.4%	+6.8% y/y
10:00 am	Conference Board Consumer Confidence Index	
June (e)	127.0	
Consensus	*128.0*	
May	128.0	
10:00 am	Richmond Fed Manufacturing Index	
June (e)	16	
May	16	

Fed Speakers: Atlanta's Bostic (1:15 pm); Dallas' Kaplan (1:45 pm)

11:30 am	4-week bill auction
1:00 pm	2-year note auction $34 bln

Wednesday June 27

7:00 am	MBA Mortgage Apps	
June 22		
June 15	+5.1%	
8:30 am	Goods Trade Deficit	
May A (e)	$69.0 bln	
Consensus	*$68.5 bln*	
Apr.	$67.3 bln	
8:30 am	Wholesale and Retail Inventories (May A)	
8:30 am	Durable Goods Orders	Ex. Transport
May (e)	-1.0%	-0.1%
Consensus	*-0.8%*	*+0.5%*
Apr.	-1.6%	+0.9%
8:30 am	Nondef. Capital Goods ex. Air	
May (e)	-0.2%	
Consensus	*+0.5%*	
Apr.	+1.0%	
10:00 am	Pending Home Sales	
May (e)	+0.5%	
Consensus	*+1.0%*	
Apr.	-1.3%	

Fed Speakers: Gov. Quarles (11:00 am); Boston's Rosengren (12:15 pm)

11:30 am	2[R]-year FRN auction $16 bln
1:00 pm	5-year note auction $36 bln

Thursday June 28

8:30 am	Initial Claims	
June 23 (e)	220k (+2k)[c]	
June 16	218k (-3k)	
8:30 am	Continuing Claims	
June 16		
June 9	1,723k (+22k)	
8:30 am	Real GDP	GDP Deflator
Q1 F (e)	+2.3% a.r.	+1.9% a.r.
Consensus	*+2.2% a.r.*	*+1.9% a.r.*
Q1 P	+2.2% a.r.	+1.9% a.r.
Q4	+2.9% a.r.	+2.3% a.r.
8:30 am	Pre-Tax Corporate Profits	
Q1 F (e)	+4.3% y/y	
Q1 P	+4.3% y/y	
Q4	+2.7% y/y	
11:00 am	Kansas City Fed Manufacturing Activity	
June (e)	26	
May	29	

Fed releases results of 2018 bank stress tests (second release)

Fed Speakers: St. Louis' Bullard (10:45 am); Atlanta's Bostic (noon)

11:00 am	4-, 13- & 26-week bill auction announcements
1:00 pm	7-year note auction $30 bln

Friday June 29

8:30 am	Personal Spending	Personal Income
May (e)	+0.5%	+0.4%
Consensus	*+0.4%*	*+0.4%*
Apr.	+0.6%	+0.3%
8:30 am	Core PCE Price Index	
May (e)	+0.2%	+1.9% y/y
Consensus	*+0.2%*	*+1.9% y/y*
Apr.	+0.2%	+1.8% y/y
9:45 am	Chicago PMI	
June (e)	61.0	
Consensus	*60.7*	
May	62.7	
10:00 am	University of Michigan Consumer Sentiment	
June F (e)	99.0	
Consensus	*99.3*	
June P	99.3	
May	98.0	

[c] = consensus [R] = reopening

Upcoming Policy Meetings | Bank of Canada: July 11, Sep. 5, Oct. 24 | FOMC: July 31-Aug. 1, Sep. 25-26, Nov. 7-8

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