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BMO CAPITAL MARKETS ECONOMICS

Focus

A weekly financial digest

Douglas Porter, CFA, Chief Economist, BMO Financial Group

October 12, 2018

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Okto-bear-fest

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Last week's focus on rising yields and a potential bear market in bonds morphed into an entirely different layer of concern this week. In an echo of February's swift correction, equities were pummelled by a rapid two-day descent, which hit almost all sectors and almost all major bourses. By Thursday's close, the S&P 500 found itself down 6.9% from the record high reached a mere three weeks earlier, while the Nasdaq was 9.6% below its late-August peak. Similarly, European markets ended the week down by almost 5%, even with a modest global bounce on Friday, while Asian markets took a bigger haircut—China's main index fell almost 8%, while the Nikkei sagged 5.3% on the week.

Naturally, **armchair detectives were out in force** after the hit, looking for who/what was responsible for the swift turn of events. The President seemed to have little doubt, railing against the Fed's tightening campaign over a 24-hour period. Running the gamut of calling the Fed *"crazy"*, *"loco"*, *"ridiculous"*, and *"wild"*, he also opined that *"I think they are making a big mistake"*. While far from a helpful intervention into the middle of a market maelstrom, most saw the rants as a continuation of earlier tirades in the summer and a fairly transparent effort to pin the blame elsewhere. Suffice it to say that it's a minority opinion in the markets that the Fed's rate hikes qualify as *"crazy"*—by the standards of any past tightening cycles, **this one stands out as particularly leisurely** at 200 bps spread over almost three years and starting at extremely low levels.

Still, while we have no quarrel with the Fed's moves so far, there is little doubt that **rising rates are making life less comfortable for markets**, in general, and equities, in particular. Recall that one of the smoking guns behind the February correction was also a rapid rise in long-term yields, which saw the 10-year Treasury surge 50 bps in a matter of weeks at the start of the year to nearly 3%. This latest episode saw 10s run more than 40 bps up from their late August lows to a peak on Tuesday of nearly 3.25%.

But that primary suspect was already backing away from the crime scene even before stocks began to swoon, as **yields dipped this week on calmer oil prices, a benign U.S. inflation result, and the market turmoil**. The September CPI printed just 0.1% on both headline and core, holding the latter steady at a 2.2% y/y pace and trimming the 3- and 6-month trend to just 1.8% annualized. We suspect core inflation will grind higher in the year ahead, but the recent mild results reinforce the view that the Fed will not need to go *"wild"* (i.e., crank up the pace of rate hikes). Having said that, **we remain quite comfortable looking for the Fed to continue bumping up rates by a quarter every quarter until the middle of next year.** A flurry of Fed speakers this week cast little doubt on that view, with even the normally dovish Charles Evans chiming in that rates needed to get back to neutral, and soon.

The other prime suspect for the market downdraft was the **rumbling trade battle with China**. Beyond Treasury yields, markets have also been warily eyeing the steady rise in the US$/yuan exchange rate in recent weeks. Matching bonds, it also peaked early this week at just over 6.93/US$, a rise of more than 10% from the lows in April—just as trade hostilities first broke into the open. News late last week that the U.S. bilateral trade deficit hit a new record high of $397 billion in the past 12 months piled on. However, there was a double-dose of late-week relief on this front.

News of a potential November meeting between Trump and Xi alongside indications that U.S. Treasury staff believe that China is not manipulating the yuan turned down the heat on the conflict.

A third factor weighing on markets was a **dimming global outlook for 2019** and any potential impact on earnings next year. The IMF's semi-annual global outlook saw a small trim to both this year's growth estimate and a shave to next year as well. The latest forecast was, in fact, unsurprising, given the strains in a variety of emerging markets, the weight of trade wars, and less-loose monetary policies globally. In that environment, the surprise would be if global growth did not cool over the next year. Following last year's synchronized and solid global GDP growth of 3.7%, we now look for 3.6% this year and another small step down to 3.5% in 2019. True, that's slower—but it's not slow.

Meantime, back at the U.S. economy, a sparse week for data (aside from CPI) left Treasuries largely driven by the air pocket in stocks. We continue to believe that the domestic growth outlook is firm, with Q3 GDP likely to come in at 3% and staying close to that mark over the next two quarters as well. Amid all the market noise, keep in mind that **we are looking for growth of 2.5% next year, inflation of little more than 2%, and a jobless rate of less than 4%**; true, some of the cheery news comes courtesy of a budget deficit of almost $1 trillion over the next year, but the overall economic backdrop remains highly favourable.

Proving the old saw that **the TSX has never met a crisis it didn't want to join**, Canadian equities were also slammed by the broad-based selling. After dipping 0.8% last week (despite the new USMCA deal), the TSX fell almost 4% in the first three sessions of this holiday-shortened week. A rebound on Friday contained the damage, but still left the index down almost 7% from its summer highs. The Toronto retreat was in spite of the fact that the TSX had never really joined in the tech-led S&P 500 party this year—the TSX is trailing the S&P 500 by 8 percentage points in 2019, and by almost 12 ppts when the currency change is taken into account. Prior to last week, some of the blame for this woeful relative performance was pinned on NAFTA uncertainty. With that handy excuse now eliminated, the focus fell squarely on the energy sector this week. As Robert highlights below, the latest deep dive in WCS was yet another thorn in Canadian markets this week (and would have been the big story of the week at almost any other time). With a pullback in global prices compounding the sector's woes, energy stocks fell 5% this week.

The **collapse in Canadian oil prices even raised some doubts on the upcoming Bank of Canada rate decision**. After all, the Bank was actually cutting rates last time WCS approached these levels in 2015. However, it is not just about WCS; WTI also matters for Canadian oil exports (in fact, according to the BoC commodity price index, it matters more than WCS). It also matters how long these low prices are sustained. We still look for the Bank to hike on October 24th, but the subsequent move expected in January may be in doubt if prices stay anywhere close to these levels. DoPoPo

'Bitumen Bubble' Blows Bigger

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A lot has been going right for Canada in recent weeks, but developments in the domestic oil market have not been one of them. WTI prices pushed north of $75 at one point earlier this month, but Western Canadian Select (WCS) sank below US$20, the lowest level since the depths of the oil shock, leaving the differential at the widest level in at least a decade, and making the infamous 'bitumen bubble' days of early-2013 look like a mild disturbance. Why is this happening?

Pipeline capacity: Alberta oilsands production continues to ramp up as a number of major projects started earlier in the cycle reach completion. But pipeline capacity is effectively full (and not increasing), so much of this new production is sloshing around in Alberta, depressing local prices. Rail shipments have surged above 200,000 bpd in response, but that is still a fraction of total Alberta oil exports. For perspective, the Trans Mountain expansion alone would add about 600,000 bpd of export capacity.

Temporary shutdowns: U.S. refineries are big users of Canadian crude, and a number of them have been offline simultaneously. Three refineries in Washington State were shut down this week after a natural gas fire, while a major BP operation in Indiana (the largest buyer of Canadian heavy crude) has been shut for maintenance. When Canadian crude is already flowing at capacity and has nowhere else to go, these closures lead to exacerbated price moves that are skewed only to the downside.

Fuel standards: Stricter rules by the International Marine Organization, taking effect in 2020, will reduce the amount of sulphur-rich oil used in ship fuel. This is probably having minimal impact today, but is an issue that could weigh on the differential.

Seasonality: The above issues come as we are already entering a weak period for heavy oil prices. Refineries typically run at peak levels during the summer to meet driving demand, which helps clear out Canadian crude—the opposite occurs through the fall and winter. Our estimates show a roughly $2-to-$3 seasonal swing in the WCS differential through the winter months. True, the recent move has been about 10x that, but seasonality is still a real factor.

So, what does this mean? For the **Bank of Canada**, it's probably premature to argue that the move in Canadian oil will alter the near-term policy course, but it's certainly not irrelevant. Of the four factors listed above, two are temporary and should reverse in due course, but the big one (pipeline capacity) is not going away. Also, keep in mind that only about half of Canadian oil production is exposed to WCS pricing. That said, an equal-weight price (i.e., 50% WCS and 50% WTI) is around $50, or right around levels seen when the Bank cut rates twice in 2015. For **government finances**, the **Province of Alberta** was careful not to upgrade its oil price assumptions too much in its most recent fiscal update, and that is looking like a wise move now. The Province is still only assuming $61 for WTI this fiscal year, which is conservative enough to roughly offset the impact of the lower differential, assuming it narrows again through March. The longer-term fiscal plan, however, could need a rethink given some of the more structural factors now pinning down WCS. From a **policy perspective** and with competiveness talk growing louder, the depressed Canadian price, at a time when there is global hunger, speaks louder than words. Rob K.

Letter from the Fed Chair to the White House

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Dear Mr. President

I read about your comments on my job performance. I sense you are unsatisfied. But let me explain.

I understand where you are coming from. You promised jobs, jobs, jobs, and higher wages to boot. A noble cause. But my job is more nuanced. I also need to keep an eye on the inflation ball. To be fair, it has shown little bounce of late. In fact, core consumer prices hardly budged in the past two months. But that is now, and my job is to anticipate the future. And decades of hard data suggest that when the economy creates too many jobs but not enough workers to fill them, inflation eventually rises. If past is prologue, we will end up with much higher interest rates and, eventually, fewer jobs. In my view, it would be "crazy" not to keep raising rates now to avoid a likely worse outcome later.

Let me remind you that core inflation has already returned to its target. The task now is to keep it there. But holding real policy rates close to zero when the economy is growing 3% is unlikely to accomplish this goal. True, there could be more "slack" in the economy than we think (the prime-age participation rate is below prior cycle peaks) and productivity could improve (partly in response to your tax reforms). Both would allow the economy to run faster than we think without overheating. At the same time, however, more companies are telling us that they can't find qualified workers to fill positions, while productivity growth, though improved, is trending little more than 1%. Given a modest increase in the working-age population, the economy's sustainable speed limit is likely stuck below 2%. I know that's a far cry from your ambitious goal of 3% or better, but I'm just stating facts. Given our outlook for continued robust growth, the jobless rate is likely headed toward its second lowest level in over six decades (3.5%).That would be a full percentage point below what we deem sustainable in the long run.

As for our interest rate policy being too "aggressive", let me remind you that my predecessors in the last cycle raised rates more than 4 percentage points within roughly 2 years, while, in the prior two cycles, rates jumped nearly 2 percentage points and 3 percentage points within about a year. By contrast, I, along with my immediate predecessor, have lifted rates 2 percentage points in just under 3 years. Yes, we intend to move an additional 1¼ percentage points in the next 2 years, but given the low starting point (almost zero), this would still leave rates tucked under 3½%, well below the peaks of 5¼% and 6½% in the previous two cycles. Remember, slowly dialling back our policy settings now should preclude the need for more heavy-handed action later, which, in the past, rarely ended well for workers.

Mr. President, although inflation has returned to target, policy rates have not. This means both levers of government policy, monetary and fiscal, are supporting the economy, at a time when such support is less welcome. I can't control the fiscal lever. That's your job. But I do intend to adjust the monetary dial based on what I believe is best for the economy and workers over the long run. That's why you hired me less than a year ago.

Signed, your faithful, but independently-minded, servant,

Jerome Powell

Do We Really Yuan To Go There?

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It was just under ten years ago that China became the world's top merchandise exporter, overtaking Germany. There was lots of buzz about how its economy was going to bypass Japan and become number two in the world, just behind the U.S.

Well, China is there now (in the #2 spot) but instead of being one of the most popular kids in class, it is being shunned, in many respects. The latest move was the USMCA's ***"non-market economy"* clause**, which does not allow countries in the agreement to negotiate trade deals with such economies unless the others scrutinize the deal's fine print. There are concerns that the U.S. will use the USMCA as a blueprint for other trade pacts, making it very difficult for any of America's trading partners to cut a deal with China. Meantime, the tariffs slapped on $250 bln of Chinese goods going into the U.S. have had a negative impact on China's economy. To cushion the pain, **the PBoC lowered reserve requirements** for various lenders by 100 bps earlier this week. And, for those engaged in international trade, the government **raised export tax rebates** (effective November 1st) and promised a faster turnaround to receive the rebates. Concerns about growth cooling and trade tensions heating hit the yuan, which neared a 10½-year low of 7.00, prompting Treasury Secretary Mnuchin to warn China against competitive devaluations. This is all quite timely given that next week, the Treasury's ***Semiannual Report on International Economic and Exchange Rate Policies*** will be released. If Mr. Mnuchin wants to label China a currency manipulator, he may have to be a bit more creative as his staff reportedly advised him that China still hasn't met all three criteria for currency manipulation. Instead, China should just remain on the Monitoring List. Bear in mind the report covers the first six months of 2018 so if Treasury again fails to use the 'manipulator' label, it will be more likely to do so next April, as the yuan weakened more in the latter half of this year. In any event, it is rumoured that President Trump and President Xi will meet at the November 30th G20 summit in Argentina, which is a positive step. By then, China's just-announced record trade surplus with the U.S. in September will be old news (we will have October data by then). That's a good thing as it would have made for a more uncomfortable meeting, unless October trade is worse… JLee

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Canada

- WCS oil plunges to US$18
- Countries flooding Canada with steel imports will face 25% tariffs in new safeguard measure

Good News	Bad News
Building Permits +0.4% (Aug.)	**Housing Starts** -5.1% to 188,683 a.r. (Sep.)
New Housing Price Index unch (Aug.)	

United States

- Stocks sell off in worst rout since February
- Pres. Trump calls the Fed *"crazy"* and *"loco"*
- Sources say the Treasury Dept. will not label China a currency manipulator… but Secretary Mnuchin insists that any trade talks with China must include the currency
- Hurricane Michael slams Florida Panhandle

Good News	Bad News
Consumer Prices +0.1% (Sep.)	**Import Prices** +0.5% (Sep.)
Producer Prices +0.2% (Sep.)	**Initial Claims** +7k to 214k (Oct. 6 week)
Wholesale Inventories revised up to +1.0% (Aug.)	**U of M Consumer Sentiment** -1.1 pts to 99.0 (Oct.)
NFIB Small Business Optimism Index -0.9 pts to 107.9 (Sep.)	

Japan

- BoJ Kuroda says there's *"no change to the solid fundamentals of Japan"*

Good News	Bad News
Core Machine Orders +6.8% (Aug.)	**Current Account Surplus** narrowed to €1.8 trln (Aug.)
Machine Tool Orders +2.8% y/y (Sep. P)	
Producer Prices +0.3% (Sep.)	
Bank Lending Ex. Trusts +2.3% y/y (Sep.)	
Tertiary Industry Index +0.5% (Aug.)	

Europe

- ECB Minutes flag trade war as a risk to growth
- Brexit talks with EU progress but PM May faces concern from her Cabinet… GBP dips back below $1.32

Good News	Bad News
Euro Area—Industrial Production +1.0% (Aug.)	**Germany—Industrial Production** -0.3% (Aug.)
Germany—Trade Surplus widened to €18.3 bln (Aug.)	**U.K.—Trade Deficit** widened to £11.2 bln (Aug.)
France—Industrial Production +0.3% (Aug.)	
Italy—Industrial Production +1.7% (Aug.)	
U.K.—Real GDP +0.7% (3 mths to Aug.)	
U.K.—Industrial Production +0.2% (Aug.)	

Other

- China cuts reserve requirement ratio 100 bps
- IMF trims growth this year and next amid growing trade woes
- WTI drops below $72 as OPEC trims demand estimates
- Brazil's 1st round presidential election sees far-right's Jair Bolsonaro lead… on to round 2

Good News	Bad News
China—Exports +14.5% y/y; **Imports** +14.3% y/y% (Sep.)	**China—Foreign Reserves** $3.09 trln (Sep.) —below expected
China—Caixin Services PMI +1.6 pts to 53.1; **Composite PMI** +0.1 pts to 52.1 (Sep.)	
Australia—Westpac Consumer Confidence +1.0% (Oct.)	
Australia—NAB Business Confidence +1 pt to 6 (Sep.)	

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

Competitiveness: Your Move, Canada

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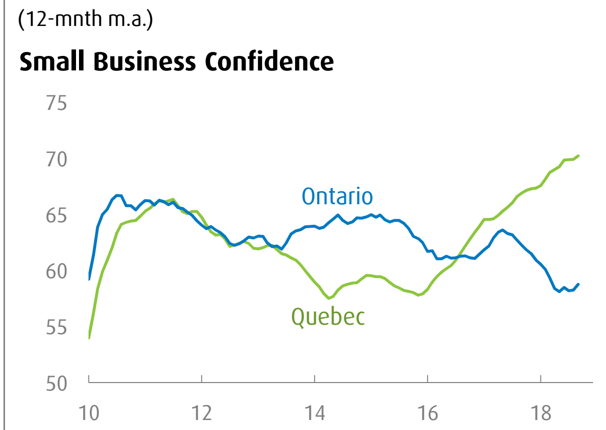
Positive economic news has been flowing for Canada recently. The ink is drying on the USMCA deal, a record infrastructure project has been announced in Western Canada, our growth forecast revisions have been consistently to the upside, and the Bank of Canada is only gradually normalizing interest rates. Against that backdrop, the federal and provincial governments will begin to roll out their mid-year fiscal updates in the coming weeks, and some meaningful policy moves could be on offer.

The **USMCA deal** removes a thick cloud of uncertainty from the Canadian business sector, particularly in Ontario where business confidence has been depressed (*Chart 1*). To be sure, some of the downdraft in Ontario reflects displeasure with prior-provincial-government policy (i.e., energy costs, minimum wages, etc.), which helps explain the divergence versus Quebec, where that (also now prior) government took a more pro-business approach. The wheels are already in motion for a shift in Ontario (e.g., scrapping of cap-and-trade, minimum wage freeze), and more moves could be coming in the next few months. Ontario was also by far the most heavily-exposed province to a negative trade outcome, so business confidence should get a natural lift from the USMCA.

Still, even with the uncertainty cleared, **competeviness issues remain for Canada broadly**. Last year's record FDI outflow has been well documented. Also, consider that M&E investment has been plumbing record lows as a share of GDP in recent years, in stark contrast to a record high for residential investment (*Chart 2*). With the latter likely to stagnate amid recent policy changes and higher interest rates, the former will be needed to pick up some of the slack. This is set against a backdrop of U.S. tax relief that has only further eroded Canada's relative position, with the 2018 round of provincial and federal budgets doing little to address competeviness—perhaps policy will now shift in this direction.

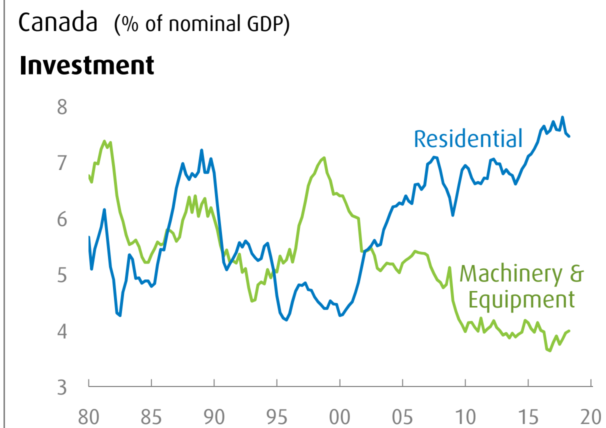
Accelerated depreciation (or full expensing) of capital investment is one idea that has been floated and could be implemented almost immediately to match the U.S. move, though this could be costly and somewhat narrow (i.e., benefiting capital-intensive businesses that are mature enough to have a heavy tax burden). More broadly, Canada's corporate tax rate advantage has effectively eroded versus the U.S. in one fell swoop. Recall that Canada had been cutting corporate tax rates steadily since the early-2000s, with many provinces taking additional steps to harmonize taxes. At one point, Canada had a 13 ppt gap on combined corporate tax rates—that is now fully gone (*Chart 3*). At the personal level, while relatively competitive through the low and middle income brackets, Canada

Chart 1
Better Business Confidence Ahead?



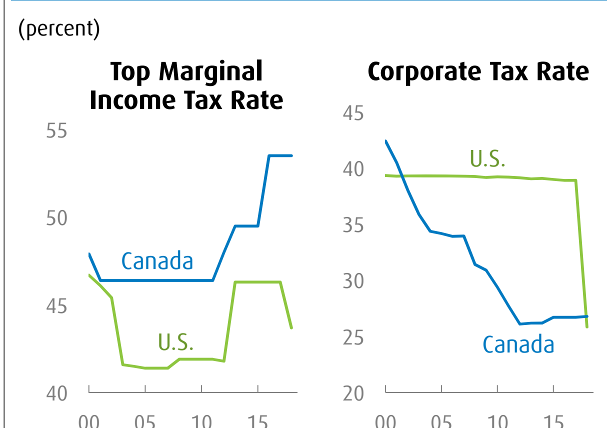
Sources: BMO Economics, CFIB

Chart 2
Rotation Coming?



Sources: BMO Economics, Haver Analytics

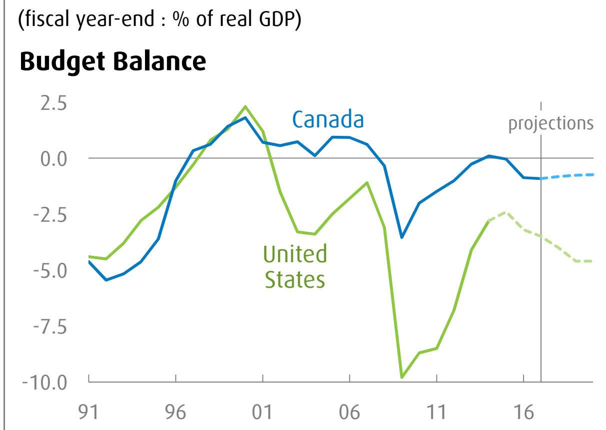
Chart 3
Competitiveness Challenged



Sources: BMO Economics, OECD

loses competiveness quickly as incomes push higher up the scale. Indeed, Canada still suffers one of the highest top marginal income tax rates in the OECD (6th highest, with 7 of 10 provinces above 50%), it has seen that position deteriorate steadily versus the U.S., and the top rate kicks in at a relatively low income threshold. This could pose a much bigger longer-term issue as the economy evolves to one driven more by innovation, technology and services, requiring talent and skilled labour.

Chart 4
The Deficit: It's All Relative



Sources: BMO Economics, Cdn federal budget; CBO

With that in mind, we've consistently made two major arguments with respect to **fiscal policy in Canada**. First, fiscal stimulus is not ideal near the peak of the business cycle, when the economy is rolling on its own and governments could be shoring up fiscal capacity. Second, if such a move is absolutely necessary, tax relief to address some of the above issues would provide a more lasting benefit than ramped-up government spending—to date, we've mostly seen the latter. Keep in mind, too, that 2019 is an election year, so the Fall update and Budget 2019 will serve as important blueprints. And, some meaningful policy could be prodded by the fact that **a wave of change is well underway at the provincial level**—three prominent Liberal governments have fallen in Ontario, Quebec and New Brunswick, with voters in each case shifting to the right.

At any rate, **Ottawa likely has sufficient wiggle room in its fiscal plan to accommodate some new policy measures** in the Fall update and/or Budget 2019. The FY17/18 deficit looks to come in roughly in-line with the $19.4 billion estimate after accounting for some benefit programs. Year-to-date through July 2018, the bottom line is running about $4.5 billion better than a year ago, and our current economic outlook suggests that FY18/19 is, at a minimum, tracking in-line with Ottawa's estimate, leaving the $3 billion contingency free (though dairy compensation could eat up some). Additionally, next fiscal year could see that room doubled (i.e., roughly $6 billion including the contingency) with our 2.1% 2019 real GDP growth forecast now fully 0.5 ppts above Ottawa's budget assumption. For argument's sake, a 1 ppt reduction in the corporate tax rate (closing the U.S. gap) would cost roughly $1.7 billion per year according to the PBO; a 4 ppt reduction in the top marginal income tax rate (bringing all provinces at or below 50%, as they were in 2014) would cost just under $2 billion. **On a relative basis, Canada's fiscal position looks even better**. Although many have scoffed at the move back into deficit, the shortfall this year, at 1% of GDP, pales in comparison to the $1 trillion (4.7% of GDP) U.S. gap expected in the fiscal year that began this week (*Chart 4*). While we wouldn't recommend Washington as a blueprint for fiscal responsibility, the point is that Canada is still in a position of strength at the federal level.

In the meantime, the record $40 billion **LNG Canada** announcement has provided a ray of optimism that private-sector capital spending can pick up some of the slack. With pipeline construction expected to begin in 2019, we've revised up our real GDP forecast by a tick, and the boost could rise to two-ticks as construction ramps up further in 2020. The massive discount for **Canadian oil prices** versus WTI, however, suggests there is much work to be done in the energy sector. We now await the next steps for fiscal policy.

Economic Forecast Summary for October 12, 2018

BMO Capital Markets Economic Research

	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3	2019 Q4	Annual 2017	Annual 2018	Annual 2019
CANADA											
Real GDP (q/q % chng : a.r.)	1.4	2.9	2.0	2.7	2.0	1.8	1.8	1.7	3.0	2.1	2.1
Consumer Price Index (y/y % chng)	2.1	2.3	2.7	2.5	2.2	2.4	2.2	2.1	1.6	2.4	2.2
Unemployment Rate (percent)	5.8	5.9	5.9	5.8	5.7	5.7	5.6	5.6	6.3	5.9	5.6
Housing Starts (000s : a.r.)	225	219	196	202 ↓	208	207	204	200	220	210 ↓	205
Current Account Balance ($blns : a.r.)	-69.9	-63.5	-53.4	-53.3	-53.7	-54.6	-55.6	-56.1	-63.3	-60.0	-55.0
Interest Rates (average for the quarter : %)											
Overnight Rate	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.50	0.71	1.44	2.31
3-month Treasury Bill	1.14	1.21	1.47	1.80	2.00	2.20	2.40	2.40	0.69	1.40	2.25
10-year Bond	2.24	2.28	2.28	2.45	2.55	2.65	2.80	2.90	1.78	2.30	2.70
Canada-U.S. Interest Rate Spreads (average for the quarter : bps)											
90-day	-44	-66	-61	-49	-49	-49	-41	-52	-26	-55	-48
10-year	-52	-64	-65	-62	-58	-53	-49	-45	-55	-61	-51
UNITED STATES											
Real GDP (q/q % chng : a.r.)	2.2	4.2	3.0	2.7	2.6	2.2	2.0	1.9	2.2	2.8	2.5
Consumer Price Index (y/y % chng)	2.3	2.6	2.6	2.3 ↓	2.1 ↓	2.2	2.1 ↓	2.1	2.1	2.5	2.1 ↓
Unemployment Rate (percent)	4.1	3.9	3.8	3.7	3.6	3.6	3.5	3.5	4.4	3.9	3.6
Housing Starts (mlns : a.r.)	1.32	1.26	1.24	1.30	1.31	1.32	1.33	1.33	1.21	1.28	1.32
Current Account Balance ($blns : a.r.)	-487	-406	-512	-516	-528	-541	-550	-560	-449	-480	-545
Interest Rates (average for the quarter : %)											
Fed Funds Target Rate	1.46	1.71	1.96	2.21	2.46	2.71	2.88	2.96	1.00	1.83	2.75
3-month Treasury Bill	1.58	1.87	2.08	2.25	2.50	2.70	2.80	2.90	0.95	1.95	2.70
10-year Note	2.76	2.92	2.93	3.05	3.15	3.20	3.25	3.35	2.33	2.90	3.25
EXCHANGE RATES (average for the quarter)											
US¢/C$	79.1	77.5	76.5	77.9	78.7	79.1	79.5	79.9	77.1	77.7	79.3
C$/US$	1.27	1.29	1.31	1.28	1.27	1.26	1.26	1.25	1.30	1.29	1.26
¥/US$	108	109	112	112	112	111	111	110	112	110	111
US$/Euro	1.23	1.19	1.16	1.18	1.17	1.19	1.22	1.24	1.13	1.19	1.20
US$/£	1.39	1.36	1.30	1.28	1.23	1.27	1.33	1.38	1.29	1.33	1.31

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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Existing Home Sales, MLS Home Price Index

Monday, 9:00 am (expected)

	Existing Home Sales	Average Prices
Sep. (e)	**-6.5% y/y**	**-1.0% y/y**
Aug.	-3.8% y/y	+1.0% y/y
	MLS Home Price Index	
Sep. (e)	**+2.5% y/y**	
Aug.	+2.5% y/y	

CREA will release the full suite of September housing market data, and the overall picture will continue to look subdued. National sales were likely down 6.5% y/y in the month, slightly weaker than the 3.8% y/y decline seen in August. The average price was likely down 1% from a year ago, partly reflecting a massive sales decline in the pricier Vancouver market (the MLS benchmark was likely clinging to positive territory). Indeed, Vancouver is the major weak spot currently, with sales down 43.5% y/y and prices for both detached homes and condos correcting. Toronto is much more stable, but still subdued, while Ottawa and Montreal remain the most solid performers.

BoC Business Outlook Survey and Senior Loan Officer Survey (Q3)

Monday, 10:30 am

The Q3 version of the Business Outlook Survey will cover the late-August to mid-September period, and therefore could be weighed down by uncertainty (at that time) on the North American trade front. While this is a key piece of information for the Bank of Canada, it might need to be taken with a grain of salt ahead of the October 24th meeting, when a rate hike is fully expected. Still, the prior edition of this survey flashed the second strongest overall reading of the cycle, and the Bank will be eyeing measures of capacity constraints. Labour shortages hit a cycle high in the Q2 report, as did the share of firms having 'some' or 'significant' difficulty meeting demand. All told, this is the stuff of interest rates on their way back to neutral levels.

Consumer Price Index

Friday, 8:30 am

Sep. (e)	**+0.1% (+0.1% sa)**	**+2.7% y/y**
Consensus	*+0.1%*	*+2.7% y/y*
Aug.	-0.1%	+2.8% y/y

	Core CPI Measures (% y/y) Trimmed Mean	Weighted Median	Common Comp.
Sep.			
Aug.	+2.2%	+2.1%	+2.0%

Canada's headline inflation rate likely cooled to a still-chunky 2.7% y/y in September, just a few ticks off the 3% high set in July. A few areas were percolating a bit in the month. Mortgage interest costs have been consistently pushing higher, and we're pencilling in a similar move in September, but a small drop in new home prices last month could offset that underlying pressure. Meantime, tuition fees were up 3% overall (and a firm 3.4% for undergrads), which is a few ticks firmer than the average of the past five years. That said, last September saw a sufficiently firm seasonally-adjusted increase (0.23%) to pull the expected headline rate down a tenth. On the core inflation front, the average of the Bank of Canada's measures touched 2.1% in August for the first time since February 2012. If that holds steady in September (a reasonable call given that the traditional core measure could rise a tick, but to a lower 1.8% y/y), it would mark 7 of the past 8 months at 2% or higher. That would just reinforce October rate hike expectations and the eventual move back to neutral.

Retail Sales

Friday, 8:30 am

		Ex. Autos
Aug. (e)	**+0.4%**	**+0.2%**
Consensus	*+0.5%*	*+0.2%*
July	+0.3%	+0.9%

Canadian retail sales are expected to rise 0.4% in August, led by autos. Excluding autos, look for a more modest 0.2% increase as gas prices were slightly lower in the month. An expected small volume gain will help shape the monthly GDP call, along with pending manufacturing and wholesale data. The bigger picture is that Canadian consumer spending has mellowed alongside higher interest rates and softer housing activity.

United States

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Retail Sales
Monday, 8:30 am

		Ex. Autos
Sep. (e)	**+0.6%**	**+0.4%**
Consensus	*+0.7%*	*+0.4%*
Aug.	+0.1%	+0.3%
	Ex. Autos/Gas	
Sep. (e)	**+0.4%**	
Consensus	*+0.4%*	
Aug.	+0.2%	

Accelerating auto sales (4.3% m/m) and strong chain-store receipts (Johnson Redbook index 5.8% y/y, the most in 14 years) suggest retail sales rose 0.6% in September, and 0.4% excluding autos. Hurricane Florence, which struck mid-month, might have a small dampening effect, though rebuilding activity could provide an offset. Still, retail sales look to return to the strong growth track prevailing before autos backfired and shoppers caught their breath in August. Lower taxes, rising income, record equity values, 49-year low joblessness and 18-year high confidence have lit a fire under spending. After splurging 3.8% (a.r.) in Q2, households spent almost as freely in Q3, powering the economy to another quarter of 3% or better growth.

Industrial Production, Capacity Utilization
Tuesday, 9:15 am

	Industrial Production	Capacity Utilization
Sep. (e)	**+0.3%**	**78.2%**
Consensus	*+0.2%*	*78.2%*
Aug.	+0.4%	78.1%

Industrial production likely rose 0.3% in September, subdued in part by Hurricane Florence. Manufacturing should rise only moderately, as an increase in the ISM production index contrasts with a retreat in aggregate work hours. Utilities could sag as warmer-than-usual weather likely clipped heating use. Record oil production, however, should keep the mining sector on a steep upward track (August’s 14.2% y/y print was the fastest in six decades). The capacity utilization rate is expected to reach 3½-year highs of 78.3%, edging closer to the 80% level that presaged an upturn in inflation in the last cycle.

Housing Starts
Wednesday, 8:30 am

Sep. (e)	**1.200 mln a.r. (-6.4%)**
Consensus	*1.210 mln a.r. (-5.6%)*
Aug.	1.282 mln a.r. (+9.2%)

Existing Home Sales
Friday, 10:00 am

Sep. (e)	**5.31 mln a.r. (-0.6%)**
Consensus	*5.30 mln a.r. (-0.8%)*
Aug.	5.34 mln a.r. (unch)

Housing activity appears to be downshifting to a lower gear, one that no longer adds more than its fair share to real GDP growth, but also one that doesn’t act as a drag. The demand for homes has been dampened by deteriorating affordability and dwindling pent-up demand. For the former, NAR’s metric is now only 9% above its long-run average versus almost 70% at the wide (in early 2013). This reflects the combination of continued price appreciation and rising mortgage rates. Countering these two forces are solid job and income growth, elevated consumer confidence, healthy household balance sheets and easing mortgage lending standards, resulting in faint underlying growth in the sector.

After surging 9.2% in August, which was partly payback for a 11.7% decrease in June-July, we look for housing starts to slip 6.4% to 1.20 million units (annualized) in September. Last month posted the most precipitation for a September in 32 years (partly owing to Hurricane Florence), and the third-highest rain reading in 97 years of data. Housing starts should rebound in October (Hurricane Michael aside), with the trend continuing to push up to the longer-run rate of household formation (just under 1.4 million).

Existing home sales were exactly unchanged in August, at 5.34 million units (annualized), holding to their lowest level in 2½ years. They have not registered a gain for the past five months (for a cumulative 4.6% decline). Although mortgage originations for purchases rose in September, pending home sales slipped in August and sales will continue to be constrained by historically-low (though no longer record-low) listings. We look for existing home sales to record another mild decline (-0.6%) in the month.

FOMC Minutes from September 25-26 meeting
Wednesday, 2:00 pm

Last month, as was completely expected, the FOMC hiked the target range for the fed funds rate by 25 bps (to 2.00%-to-2.25%) repeating, verbatim, the prior meeting's *"strong"* assessment of the economy. The only significant change to the statement was the removal of the phrase: *"the stance of monetary policy remains accommodative"*. We judge this was nothing more than a nod to the fact that the midpoint of the funds range (2.125%) is now above core PCE inflation (2.0% y/y) for the first time since March 2008. Real policy rates are no longer negative, and, thus, no longer overtly accommodative. Chairman Powell said: *"This change does not signal any change in the likely path of policy; instead, it is a sign that policy is proceeding in line with our expectations"*. We'll be reading the Minutes for insights on what it would take for the FOMC to depart from its current quarterly rate hike cadence (now 4-for-4).

		Oct 12 [1]	Oct 5	Week Ago	4 Weeks Ago	Dec. 31, 2017
					(basis point change)	
Canadian Money Market	Call Money	1.50	1.50	0	0	50
	Prime Rate	3.70	3.70	0	0	50
U.S. Money Market	Fed Funds (effective)	2.25	2.25	0	25	75
	Prime Rate	5.25	5.25	0	25	75
3-Month Rates	Canada	1.54	1.60	-6	2	48
	United States	2.26	2.21	5	12	89
	Japan	-0.31	-0.28	-3	-18	-15
	Eurozone	-0.32	-0.32	0	0	1
	United Kingdom	0.81	0.80	1	1	29
	Australia	1.94	1.93	1	2	16
2-Year Bonds	Canada	2.27	2.32	-5	14	59
	United States	2.85	2.89	-4	7	97
10-Year Bonds	Canada	2.50	2.60	-10	15	46
	United States	3.16	3.23	-8	16	75
	Japan	0.14	0.15	-1	3	10
	Germany	0.50	0.57	-7	5	8
	United Kingdom	1.63	1.72	-9	10	44
	Australia	2.75	2.71	4	15	12
Risk Indicators	VIX	22.1	14.8	7.3 pts	10.1 pts	11.1 pts
	TED Spread	17	20	-3	-2	-15
	Inv. Grade CDS Spread [2]	65	61	4	10	16
	High Yield CDS Spread [2]	358	341	16	39	52
					(percent change)	
Currencies	US¢/C$	76.72	77.29	-0.7	0.0	-3.6
	C$/US$	1.303	1.294	—	—	—
	¥/US$	112.14	113.72	-1.4	0.1	-0.5
	US$/€	1.1547	1.1524	0.2	-0.7	-3.8
	US$/£	1.318	1.312	0.4	0.8	-2.5
	US¢/A$	71.22	70.52	1.0	-0.4	-8.8
Commodities	CRB Futures Index	197.60	199.04	-0.7	3.7	1.9
	Oil (generic contract)	71.38	74.34	-4.0	3.5	18.1
	Natural Gas (generic contract)	3.16	3.14	0.5	14.1	6.9
	Gold (spot price)	1,219.65	1,202.95	1.4	2.2	-6.4
Equities	S&P/TSX Composite	15,440	15,946	-3.2	-3.6	-4.7
	S&P 500	2,763	2,886	-4.2	-4.9	3.4
	Nasdaq	7,469	7,788	-4.1	-6.8	8.2
	Dow Jones Industrial	25,256	26,447	-4.5	-3.4	2.2
	Nikkei	22,695	23,784	-4.6	-1.7	-0.3
	Frankfurt DAX	11,559	12,112	-4.6	-4.7	-10.5
	London FT100	7,024	7,319	-4.0	-3.8	-8.6
	France CAC40	5,119	5,359	-4.5	-4.4	-3.6
	S&P ASX 200	5,896	6,185	-4.7	-4.4	-2.8

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

Global Calendar
October 15 – October 19

BMO Capital Markets®

	Monday October 15	Tuesday October 16	Wednesday October 17	Thursday October 18	Friday October 19
Japan	**Industrial Production** **Aug. F (e) +0.7% +0.6% y/y** July -0.1% +2.2% y/y			**Trade Balance** **Sep. '18 (e) -¥43 bln** Sep. '17 +¥653 bln	**CPI / Core CPI** **Sep. (e) +1.3% y/y +1.0% y/y** Aug. +1.3% y/y +0.9% y/y **CPI ex. Food & Energy** **Sep. (e) +0.4% y/y** Aug. +0.4% y/y BoJ Gov. Kuroda speaks in Tokyo
Euro Area	**ITALY** Draft budget plan submitted to EC Sunday October 14 **GERMANY** Regional elections in Bavaria	**EURO AREA** **Trade Surplus** **Aug. (e) €14.4 bln** July €12.8 bln **GERMANY** **ZEW Survey—Expectations** **Oct. (e) -12.0** Sep. -10.6 **ITALY** **Industrial Orders** **Aug.** July -2.3% +2.8% y/y **Consumer Price Index** **Sep. F (e) +1.8% +1.6% y/y** Aug. -0.2% +1.6% y/y	**EURO AREA** **Consumer Price Index** **Sep. F (e) +0.5% +2.1% y/y** Aug. +0.2% +2.0% y/y **Core CPI** **Sep. F (e) +0.9% y/y** Aug. +1.0% y/y	**EURO AREA** EU Summit in Brussels (Oct. 18-19)	
U.K.	**Rightmove House Prices** **Oct.** Sep. +0.7% +1.2% y/y	**Jobless Claims / Claimant Count Rate** **Sep.** Aug. +8,700 2.6% **Avg. Wkly Earnings Ex. Bonus (3 mma)** **Aug. (e) +2.9% y/y** July +2.9% y/y **Jobless Rate (3 mma)** **Aug. (e) 4.0%** July 4.0%	**Consumer Price Index** **Sep. (e) +0.2% +2.5% y/y** Aug. +0.7% +2.7% y/y **Core CPI** **Sep. (e) +2.0% y/y** Aug. +2.1% y/y **Producer Price Index (Output)** **Sep. (e) +0.2% +2.9% y/y** Aug. +0.2% +2.9% y/y	**Retail Sales (incl. Fuel)** **Sep. (e) -0.4% +3.6% y/y** Aug. +0.3% +3.3% y/y	BoE Gov. Carney speaks in New York
Other	**CHINA** **Foreign Direct Investment [D]** **Sep.** Aug. +1.9% y/y **Aggregate Yuan Financing [D]** **Sep.** Aug. 1.55 trln **New Yuan Loans [D]** **Sep. (e) 1.36 trln** Aug. 1.28 trln **M2 Money Supply [D]** **Sep. (e) +8.3% y/y** Aug. +8.2% y/y	**CHINA** **CPI / PPI** **Sep. (e) +2.5% y/y +3.6% y/y** Aug. +2.3% y/y +4.1% y/y **AUSTRALIA** RBA Minutes from Oct. 2 meeting		**AUSTRALIA** **Employment** **Sep. (e) +20,000** Aug. +44,000 **Jobless Rate** **Sep. (e) 5.3%** Aug. 5.3%	**CHINA** **Real GDP** **Q3 (e) +1.6% +6.6% y/y** Q2 +1.8% +6.7% y/y **Industrial Production** **Sep. (e) +6.0% y/y (+6.4% YTD)** Aug. +6.1% y/y (+6.5% YTD) **Retail Sales** **Sep. (e) +9.0% (+9.3% YTD)** Aug. +9.0% (+9.3% YTD) **Fixed Asset Investment (YTD)** **Sep. (e) +5.4% y/y** Aug. +5.3% y/y

[D] = date approximate

Upcoming Policy Meetings | BoE: Nov. 1, Dec. 20, Feb. 7 | ECB: Oct. 25, Dec. 13, Jan. 24

North American Calendar
October 15 – October 19

BMO Capital Markets®

Canada

Monday October 15

8:30 am — **New Motor Vehicle Sales**[D]
Aug.
July: -2.8% y/y

9:00 am — **Existing Home Sales**[D] | **Average Prices**
Sep. (e): **-6.5% y/y** | **-1.0% y/y**
Aug.: -3.8% y/y | +1.0% y/y

9:00 am — **MLS Home Price Index**[D]
Sep. (e): **+2.5% y/y**
Aug.: +2.5% y/y

10:30 am — **BoC Business Outlook Survey and Senior Loan Officer Survey (Q3)**

Tuesday October 16

8:30 am — **Int'l Securities Transactions** — **Inflows** | **Outflows**
Aug.
July: $12.7 bln | $13.1 bln

10:30 am — 3-, 6- & 12-month bill auction $9.0 bln (new cash -$0.3 bln)

Wednesday October 17

8:30 am — **Mfg. Sales** | **Mfg. New Orders**
Aug. (e): **-0.7%** | **+2.0%**
Consensus: *-0.7%* | *n.a.*
July: +0.9% | -1.8%

Noon — 10-year bond auction $3.0 bln

Thursday October 18

8:30 am — **ADP Employment Report**
Sep.
Aug.: +13,600

Friday October 19

8:30 am — **Consumer Price Index**
Sep. (e): **+0.1%** | **+2.7% y/y** | **(+0.1% sa)**
Consensus: *+0.1%* | *+2.7% y/y*
Aug.: -0.1% | +2.8% y/y

8:30 am — **Trimmed Mean Core CPI**
Sep.
Aug.: +2.2% y/y

8:30 am — **Weighted Median Core CPI**
Sep.
Aug.: +2.1% y/y

8:30 am — **Common Component Core CPI**
Sep.
Aug.: +2.0% y/y

8:30 am — **Retail Sales** | **Ex. Autos**
Aug. (e): **+0.4%** | **+0.2%**
Consensus: *+0.5%* | *+0.2%*
July: +0.3% | +0.9%

United States

Monday October 15

8:30 am — **Retail Sales** | **Ex. Autos**
Sep. (e): **+0.6%** | **+0.4%**
Consensus: *+0.7%* | *+0.4%*
Aug.: +0.1% | +0.3%

8:30 am — **Retail Sales ex. Autos/Gas**
Sep. (e): **+0.4%**
Consensus: *+0.4%*
Aug.: +0.2%

8:30 am — **Empire State Manufacturing Survey**
Oct. (e): **20.5**
Consensus: *20.5*
Sep.: 19.0

10:00 am — **Business Inventories**
Aug. (e) F: **+0.5%**
Consensus: *+0.5%*
July: +0.7%

2:00 pm — **Budget Balance**[D]
Sep. '18
CBO: *+$116 bln*
Sep. '17: +$8 bln

This Week: U.S. Treasury expected to release biannual report on "Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States"

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

11:30 am — 13- & 26-week bill auction $84 bln

Tuesday October 16

9:15 am — **Industrial Production** | **Capacity Utilization**
Sep. (e): **+0.3%** | **78.2%**
Consensus: *+0.2%* | *78.2%*
Aug.: +0.4% | 78.1%

10:00 am — **NAHB Housing Market Index**
Oct. (e): **67**
Consensus: *67*
Sep.: 67

10:00 am — **Job Openings & Labor Turnover Survey (Aug.)**

4:00 pm — **Net TIC Flows** — **Total** | **Long Term**
Aug.
July: $52.2 bln | $74.8 bln

11:30 am — 4- & 8-week bill auction

Wednesday October 17

7:00 am — **MBA Mortgage Apps**
Oct. 12
Oct. 5: -1.7%

8:30 am — **Housing Starts**
Sep. (e): **1.200 mln a.r. (-6.4%)**
Consensus: *1.210 mln a.r. (-5.6%)*
Aug.: 1.282 mln a.r. (+9.2%)

8:30 am — **Building Permits**
Sep. (e): **1.276 mln a.r. (+2.2%)**
Consensus: *1.280 mln a.r. (+2.5%)*
Aug.: 1.249 mln a.r. (-4.1%)

2:00 pm — **FOMC Minutes from September 25-26 meeting**

Fed Speaker: Gov. Brainard (12:10 pm)

Thursday October 18

8:30 am — **Initial Claims**
Oct. 13
Oct. 6: 214k (+7k)

8:30 am — **Continuing Claims**
Oct. 6
Sep. 29: 1,660k (+4k)

8:30 am — **Philadelphia Fed Index**
Oct. (e): **21.0**
Consensus: *21.0*
Sep.: 22.9

10:00 am — **Leading Indicator**
Sep. (e): **+0.5%**
Consensus: *+0.5%*
Aug.: +0.4%

Fed Speaker: St Louis' Bullard (9:05 am); Gov. Quarles (12:15 pm)

11:00 am — 13- & 26-week bill, 2-, 5- & 7-year note, 2-year FRN auction announcements

1:00 pm — 30[R]-year TIPS auction $5 bln

Friday October 19

10:00 am — **Existing Home Sales**
Sep. (e): **5.31 mln a.r. (-0.6%)**
Consensus: *5.30 mln a.r. (-0.8%)*
Aug.: 5.34 mln a.r. (unch)

Fed Speakers: Dallas' Kaplan (9:00 am); Atlanta's Bostic (noon)

Saturday October 20

Fed Speaker: Atlanta's Bostic (noon)

[D] = date approximate [R] = reopening

Upcoming Policy Meetings | Bank of Canada: Oct. 24, Dec. 5, Jan. 9 | FOMC: Nov. 7-8, Dec. 18-19, Jan. 29-30