Trump Card

United States

- It’s still too early to tell which way the economic cards will fall in 2017. Will Congress approve tax cuts by mid-year or in 2018? Will tax reforms largely neutralize the impact on the budget and economy? Are Donald Trump’s protectionist threats merely a bargaining tool, and, if not, how would China, Mexico and others respond? Will the shovels to rebuild the nation’s infrastructure hit the ground this year or next? Will businesses use a repatriation tax holiday to boost investment, or will they continue to hoard cash in an uncertain climate? The President-elect’s picks for key cabinet posts suggest a strong pro-business thrust, but also a get-tough stance on trade and a hawkish eye on the budget deficit. The stimulus money promised during the election campaign could be neutralized or delayed. There is also a growing risk of a trade war with China amid recent saber-rattling.

- Although it could take a few months to get clarity on some of these issues, we have taken a small leap-of-faith and expect the new Administration’s policies to support the economy. We revised our growth outlook to 2.4% in 2017 and to 2.5% in 2018 (from 2.2% and 2.0% previously). The revision assumes that some fiscal stimulus will begin in the second half of 2017 and that lower taxes and deregulation will incent businesses to spend.

- The upgrade to the growth outlook in 2017 marks a material improvement from last year (around 1.6%) and the post-recession norm (2.1%). Although financial conditions have tightened post-election, they should remain supportive, as rising equity and house prices, narrowing credit spreads (nine-year low) and easier loan standards have offset higher interest rates and the dollar.

- Households are in excellent shape to keep spending at a near 3% rate, especially if disposable income gets a jolt from lower taxes and higher wages. They are sitting on a record amount of wealth and the lightest debt burden since 2002 (relative to income). Confidence is at 15-year highs. While auto sales look to have hit a speed-bump near the 18 million mark, the need to replace an aging fleet should keep demand historically high this year.

- In the housing market, rising owner equity bodes well for renovation spending. It will take a much larger jump in mortgage rates than 90 bps since last summer to cool sales, as affordability remains much better than normal in most regions. A tidal wave of millennials, now entering their prime home buying years, is about to wash over the housing landscape. According to...
one study, nearly 40% of young persons (age 18-34) live with a relative, the largest percentage since 1940. Easing mortgage standards will slowly open the housing door for this cohort, with an extra nudge from rising rents (and nagging parents). After leaping 15% in the past year, existing home sales should stay near 10-year highs. A lean supply of listings will keep homebuilders busy, while rising prices will draw more speculators into the market (the number of home “flippers” has returned to pre-crisis levels according to the Wall Street Journal).

- **Before the economic train can leave the station, however,** **businesses will need to hop on board.** They were the big disappointment in 2016, for largely unclear reasons, though election-related jitters didn’t help. Higher oil prices in the wake of OPEC’s agreement to curb supply have already spurred an upturn in U.S. drilling. A pro-business government pledging to cut taxes and regulations should spur investment spending this year.

- **Trade is the one sector likely to temper the expansion in 2017.** The dollar, already at 14-year highs, is expected to rise another 6% this year in response to diverging monetary policies between the Fed and global central banks. Unfortunately, the wider trade gap could fan protectionist moves from the new Administration.

- **For the first time in a decade, inflation is starting to creep back on the radar screen.** Faster wages likely explain the recent upturn in the core PCE rate to 1.6%. We expect core inflation to rise to 2.3% by 2018 as the unemployment rate slips toward 4¼%. Still, for most of the year, a sufficient number of job seekers (both inside and outside the labour force) should keep wage growth in check. Lingering “slack”, a rising greenback, low crop prices (after four years of bumper harvests) and aggressive retail competition should help contain inflation.

- Despite the brighter economic picture, we see the fed funds rate rising just twice this year (in June and December), before stepping up to three moves next year (revised up from two)—still one of the mildest tightening cycles on record. A more dovish rotation of voting members on the FOMC (assuming the President doesn’t fill two vacancies with hawks), and Yellen’s musings about the benefits of temporarily running a “high-pressure economy”, should keep the Fed on a patient normalization path.

- The Fed will avoid fanning the post-election rout in Treasuries, one of the worst in decades. After vaulting more than one percentage point since July’s record low (1.36%), the 10-year yield is expected to climb just modestly further to around 2.8% by late 2017, held back by easier monetary policies abroad.
Canada

- Canada’s economy is stuck in first gear, despite making some recent headway. After storming back in the fall from the wildfire-related contraction in the spring, real GDP looks to have slowed in the final quarter, capping a year of just 1.3% growth. Business investment likely contracted for a second straight year, largely due to weakness in energy, but with little offsetting strength elsewhere. The latter reflects weak non-energy exports, despite the loonie’s 13% depreciation in the past two years. Factories continue to spin their wheels amid declines in machinery, aerospace and metal fabrication, and stalled auto production. Consumer spending, though growing near 2%, is weighed down by elevated debts and slow-rising wages. However, recent strength in employment (202,000 new positions in the last five months of 2016), an upturn in business sentiment, and a jump in November exports suggest some momentum at year end.

- The economy is expected to shift into second gear in 2017, expanding 2.0% amid stronger U.S. demand. Firmer exports, alongside higher oil prices (averaging $55 in 2017 and $64 in 2018), should spur business investment. After contracting the past two years due to the downturn in oil drilling, Alberta and Newfoundland & Labrador should begin to emerge from recession. Expected growth will chip away at Alberta’s 8.5% jobless rate (a near two-decade high) and reduce the national rate slightly to 6.7% by year end.

- Canada’s housing market is sharply divided along regional lines. Vancouver has suddenly turned chilly, with sales down 37% y/y and benchmark prices falling in the past four months to December. Poor affordability and a property transfer tax on non-resident buyers are to blame. Conversely, Toronto is heating up, with sales rising 12% y/y and prices accelerating 21%. Supportive demand fundamentals, an apparent influx of foreign wealth, and lean inventories are all at play. Demand pressures have spilled into surrounding areas as first-time buyers “drive to qualify” for detached homes. Calgary’s downturn is steadying amid firmer oil prices. The new mortgage-insurance rules are expected to reduce sales and price growth, particularly in high-priced regions. The latest Financial System Review from the Bank of Canada found that over 40% of borrowers in Vancouver and Toronto in the past year to September would not have qualified for an insured mortgage under the tougher stress test.

- The Bank of Canada is firmly on hold. Weak growth, elevated unemployment and low inflation (regardless of which fancy new core measure you pick) preclude higher rates, while hopes of firmer growth argue against easing. We still see the Bank parked
on the side of the road this year, before merging into traffic in 
mid-2018, roughly when the economy will return to full 
employment.

- Fed tightening and weak exports have pulled the Canadian dollar 
to 76 cents US, down four cents since April. We expect the loonie 
to test 72 cents later this year partly owing to larger negative 
Canada-U.S. interest-rate spreads.

Risks
Along with possible protectionist moves in the U.S., several other 
potential developments could upset the economic apple-cart in 2017:

- **Rising U.S. inflation** in response to trade tariffs or aggressive 
fiscal stimulus could drive interest rates sharply higher. 
Immigration curbs could also awaken wage inflation.

- A **soaring U.S. dollar** would create financial stress for emerging 
market companies saddled with dollar-denominated debts.

- **Equity markets could correct** from recent elevated levels if 
investors doubt the effectiveness of the President-elect’s policies.

- Increased **global protectionism** could slow growth further. 
Euroskeptic parties might gain power in elections in Germany, 
France and the Netherlands this year.

- A bitter divorce during **Brexit negotiations** could hit business 
confidence in the U.K. and Europe, slowing their economies.

- The emergence of **anti-Euro parties in Italy** could upset the 
nation’s fragile banks and fracture the single currency union.

- Rising debt and **capital outflows in China** could put further 
downward pressure on the yuan and strain its financial system.

- A sharp **slide in oil prices** if OPEC nations renege on their recent 
deal could lead to a third straight year of subpar growth for 
Canada’s economy.

- **Escalating house prices in Toronto** could encourage households 
to take on even more debt. According to the latest Financial 
System Review from the Bank of Canada, the proportion of 
highly-indebted households is rising quickly in the GTA and 
surrounding areas.
## Forecasts

### CANADA

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP (q/q % chng : a.r.)</td>
<td>2.7</td>
<td>-1.3</td>
<td>3.5</td>
<td>2.0</td>
<td>1.8</td>
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<tr>
<td>Consumer Spending</td>
<td>2.5</td>
<td>1.8</td>
<td>2.6</td>
<td>1.7</td>
<td>1.4</td>
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<tr>
<td>Business Investment (non-residential)</td>
<td>-8.5</td>
<td>-0.9</td>
<td>3.5</td>
<td>-9.7</td>
<td>1.2</td>
</tr>
<tr>
<td>Consumer Price Index (y/y % chng)</td>
<td>1.5</td>
<td>1.6</td>
<td>1.2</td>
<td>1.4</td>
<td>2.2</td>
</tr>
<tr>
<td>Unemployment Rate (%)</td>
<td>7.2</td>
<td>7.0</td>
<td>7.0</td>
<td>6.9</td>
<td>6.9</td>
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<tr>
<td>Housing Starts (000s : a.r.)</td>
<td>199</td>
<td>198</td>
<td>199</td>
<td>197</td>
<td>190</td>
</tr>
<tr>
<td>Current Account Balance ($blns : a.r.)</td>
<td>-68.2</td>
<td>-76.1</td>
<td>-73.2</td>
<td>-60.5</td>
<td>-54.9</td>
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### UNITED STATES

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP (q/q % chng : a.r.)</td>
<td>0.8</td>
<td>1.4</td>
<td>3.5</td>
<td>2.1</td>
<td>2.2</td>
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<tr>
<td>Consumer Spending</td>
<td>1.6</td>
<td>4.3</td>
<td>3.0</td>
<td>2.4</td>
<td>2.6</td>
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<tr>
<td>Business Investment (non-residential)</td>
<td>-3.4</td>
<td>1.0</td>
<td>1.4</td>
<td>1.5</td>
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<tr>
<td>Consumer Price Index (y/y % chng)</td>
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<td>1.1</td>
<td>1.1</td>
<td>1.8</td>
<td>2.7</td>
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<tr>
<td>Unemployment Rate (%)</td>
<td>5.0</td>
<td>4.9</td>
<td>4.9</td>
<td>4.7</td>
<td>4.6</td>
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<tr>
<td>Housing Starts (mlns : a.r.)</td>
<td>1.15</td>
<td>1.16</td>
<td>1.14</td>
<td>1.22</td>
<td>1.24</td>
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<tr>
<td>Current Account Balance ($blns : a.r.)</td>
<td>-527</td>
<td>-473</td>
<td>-452</td>
<td>-508</td>
<td>-564</td>
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### Interest Rates

#### (average for the quarter : %)

<table>
<thead>
<tr>
<th>Rate</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
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</thead>
<tbody>
<tr>
<td>Overnight Rate</td>
<td>0.50</td>
<td>0.50</td>
<td>0.50</td>
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<tr>
<td>3-month Treasury Bill</td>
<td>0.45</td>
<td>0.51</td>
<td>0.50</td>
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<tr>
<td>10-year Bond</td>
<td>1.22</td>
<td>1.29</td>
<td>1.06</td>
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### Canada/U.S. Interest Rate Spreads

#### (average for the quarter : bps)

<table>
<thead>
<tr>
<th>Spread</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
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<tbody>
<tr>
<td>90-day</td>
<td>16</td>
<td>25</td>
<td>20</td>
</tr>
<tr>
<td>10-year</td>
<td>-70</td>
<td>-47</td>
<td>-50</td>
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### Exchange Rates

#### (average for the quarter)

<table>
<thead>
<tr>
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<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>USD/C$</td>
<td>72.8</td>
<td>77.6</td>
<td>76.6</td>
<td>75.0</td>
<td>75.0</td>
<td>72.8</td>
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<tr>
<td>C$/US$</td>
<td>1.374</td>
<td>1.289</td>
<td>1.305</td>
<td>1.334</td>
<td>1.333</td>
<td>1.355</td>
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<tr>
<td>¥/US$</td>
<td>115</td>
<td>108</td>
<td>102</td>
<td>109</td>
<td>117</td>
<td>118</td>
</tr>
<tr>
<td>US$/Euro</td>
<td>1.10</td>
<td>1.13</td>
<td>1.12</td>
<td>1.08</td>
<td>1.05</td>
<td>1.03</td>
</tr>
<tr>
<td>US$/£</td>
<td>1.43</td>
<td>1.43</td>
<td>1.31</td>
<td>1.24</td>
<td>1.22</td>
<td>1.17</td>
</tr>
</tbody>
</table>

Note: Shaded areas represent BMO Capital Markets forecasts.
MARKET VOLATILITY NORMAL
United States (as of January 13, 2017)

Ted Spread 1

VIX 2

Credit spreads at nine-year low
United States (ppts)

Corporate Bond Spreads 1

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

All eyes on the new U.S. government

CANADIAN DOLLAR SAGS
(US¢ : as of January 13, 2017)

Canadian Dollar

Parity 76.18¢

OIL PRICES FIND HIGHER RANGE
Commodity price range since start of 2016

Materials & Foodstuffs
(as of January 13, 2017)

Lumber (US$/1000 fg)

Soybeans (US$/bu)

Wheat (US$/bu)

Corn (US$/bu)

4.19 2.88 3.42 3.84

343.10 233.30 8.40 3.10

Gold (US$/oz)

Oil (US$/bb)

Natural Gas (US$/mmbtu)

Copper (US$/lb)

110 100 90 80 70 60 50 40 30 20 10 0

03 05 07 09 11 13 15 17

Gold losing glitter as dollar rises

U.S. ECONOMY SHOULD GET FISCAL LIFT
(y/y % change)

Real GDP

Canada 0.9 1.3 2.0 1.8

US 2.6 1.6 2.4 2.5

00 02 04 06 08 10 12 14 16 18

Canada 15 16 17 18

forecast

AMERICAN CONSUMERS LEAD THE WAY
(y/y % change)

Real Personal Consumption Expenditures

Canada 0.9 1.3 2.0 1.8

U.S. 2.6 1.6 2.4 2.5

00 02 04 06 08 10 12 14 16 18

Canada 15 16 17 18

forecast
OIL-LED DOWNTURN IN INVESTMENT WILL EBB
(y/y % change)

Real Non-Residential Business Investment

TORONTO NOW LEADING CANADIAN HOME PRICES
Existing Homes (y/y % change : 3-month m.a.)

Sales

Prices

U.S. prices rising more than 5%

U.S. LABOUR MARKET NEAR FULL EMPLOYMENT
(percent)

Unemployment Rate

INFLATION HAS BOTTOMED
Consumer Price Index (y/y % change)

Canada

United States

FED TO SLOWLY LIFT RATES IN 2017
(% : as of January 13, 2017)

Overnight Rate

LONG BOND RATES TO RISE ONLY MODESTLY
(% : as of January 13, 2017)

10-Year Bonds

But upside risk

Canadian jobless rate closer to 7%

Headline

Core

Headline

Core

Bank of Canada on hold until mid-2018