Monthly Economic Monitor

Economics and Strategy

NATIONAL BANK OF CANADA FINANCIAL MARKETS

July/August 2018

Highlights

- While fundamentals remain good for the world economy, there are ominous signs that warrant caution from investors going forward. A commercial spat now threatens to evolve into a full blown trade war after the imposition of tariffs by the U.S. and retaliatory measures from affected trade partners. Even a small deceleration of trade flows could have negative repercussion on world GDP growth and hence raise the likelihood of financial stress and defaults, more so considering record levels of leverage. One source of encouragement, however, is policy stimulus which will continue to support growth. Enhanced uncertainties to the economic outlook and the persistence of low inflation should limit the extent of monetary policy tightening by central banks while governments could deliver additional fiscal stimulus to sustain growth.

- Thanks to a blistering second quarter, the U.S. economy now has a positive output gap for the first time since 2007. While consistent with a late cycle, that's not to say a downturn is imminent. Consumption spending, the main engine of the U.S. economy, is in excellent shape thanks to prior deleveraging and a solid labour market. Pro-cyclical fiscal stimulus from Washington should also help extend the expansion into 2019 and offset any drag from Fed interest rate hikes.

- Downside risks to the Canadian economy have arguably increased amidst an apparent deterioration in the trade relationship with the U.S., the latter not only imposing tariffs on steel and aluminium imports but also threatening to slap additional ones on the crucial auto sector. All in all, a deal to revamp NAFTA before year-end is becoming less likely. As a result, we have trimmed by two ticks our 2018 GDP growth forecast to just 2.0% and now expect just one additional rate hike from the Bank of Canada before year-end.

Krishen Rangasamy
514-879-3140

				Change from Previous Forecast	
	2017	**2018**	**2019**	**2018**	**2019**
United States					
GDP	2.3%	3.0%	2.3%	+0.2 pp	unch
CPI inflation	2.1%	2.5%	2.3%	unch	unch
Fed Fund Target Rate*	1.50%	2.25%	3.00%	unch	unch
Ten-year bond yield*	2.40%	3.14%	3.47%	-4 bp	unch
Canada					
GDP	3.0%	2.0%	1.9%	-0.2 pp	unch
CPI inflation	1.6%	2.2%	2.1%	-0.1 pp	unch
Overnight rate*	1.00%	1.50%	2.25%	-25 bp	unch
Ten-year bond yield*	2.04%	2.62%	3.09%	-1 bp	unch

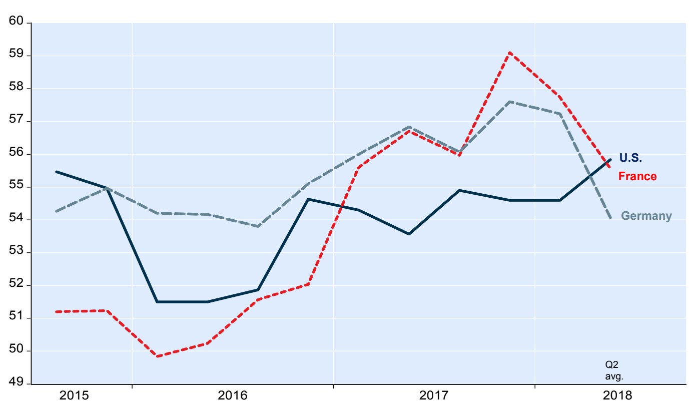
* end of period

World: The summer of tariffs

While fundamentals remain good for the world economy, there are ominous signs that warrant caution from investors going forward. A commercial spat now threatens to evolve into a full blown trade war after the imposition of tariffs by the U.S. and retaliatory measures from affected trade partners. Even a small deceleration of trade flows could have negative repercussion on world GDP growth and hence raise the likelihood of financial stress and defaults, more so considering record levels of leverage. One source of encouragement, however, is policy stimulus which will continue to support growth. Enhanced uncertainties to the economic outlook and the persistence of low inflation should limit the extent of monetary policy tightening by central banks while governments could deliver additional fiscal stimulus to sustain growth.

The world economy continued to expand in the second quarter of 2018, buoyed by a rampant U.S., the latter's growth likely accelerating at the fastest pace in years courtesy of fiscal stimulus (see U.S. section). That's good news in the sense it provides an offset to the apparent ramp down in the eurozone. Recall that the zone's real GDP grew just 1.6% annualized in Q1 as both France and Germany moved down a gear. And based on Markit's composite purchasing managers indices, the zone's growth remained soft in Q2.

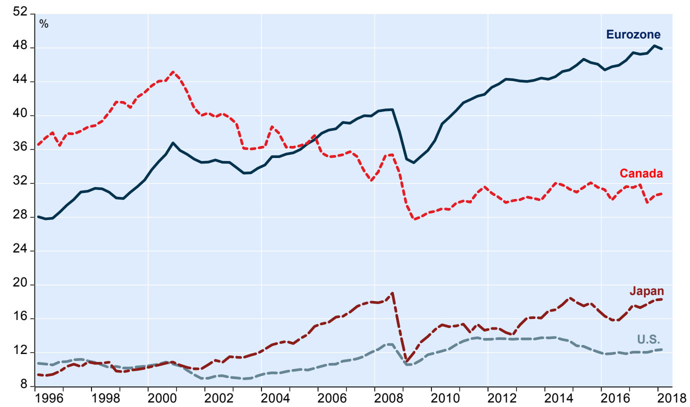
World: U.S. on the rise while Europe takes a breather
Markit composite purchasing managers index



NBF Economics and Strategy (data via Markit)

A moderation in trade flows seems to be hurting the eurozone where exports account for roughly 48% of GDP (contrasting with just 12% of GDP in the U.S.). The deceleration in the pace of growth explains the European Central Bank's downgrade of its 2018 GDP growth forecast to just 2.1% and its announcement that interest rates will remain unchanged until at least the summer of 2019.

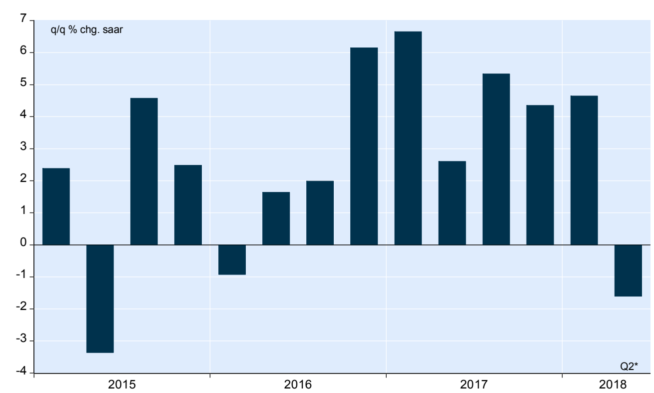
World: Eurozone highly dependent on exports
Share of exports in GDP



NBF Economics and Strategy (data via Datastream)

Latest data from the CPB suggests the world economy is on track to see a drop in trade volumes in Q2 for the first time in two years. Is this an indication that mounting trade protectionism is starting to bite?

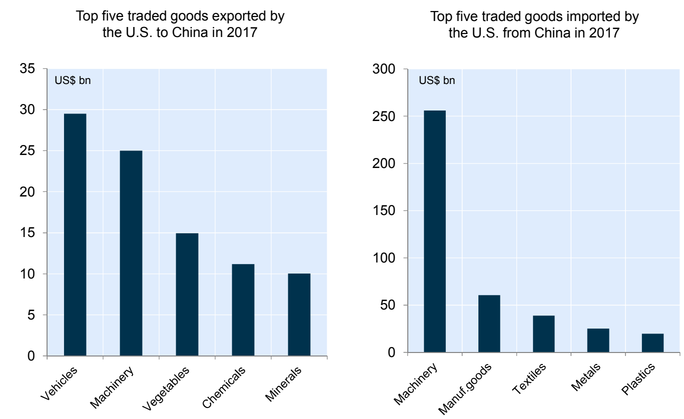
World: Are global trade flows already being affected by protectionism?
World trade volumes



* Assuming no change in May and June and no revisions to prior months
NBF Economics and Strategy (data via CPB)

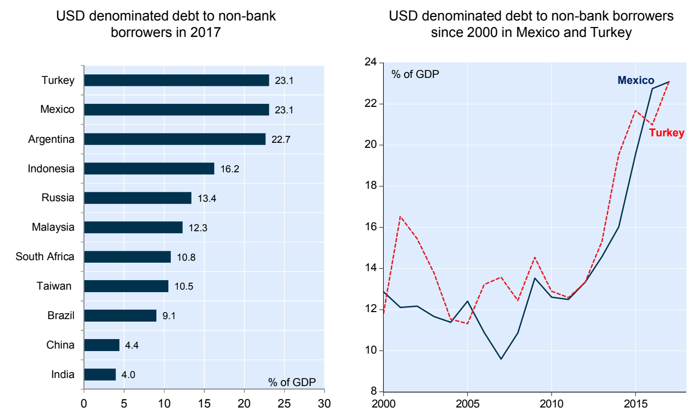
To be sure, the world economy seems to be moving towards a full blown trade war. The U.S. government, which had earlier imposed tariffs on a variety of imports including solar panels, washing machines, steel, and aluminium, upped the ante in June by announcing its intention of applying tariffs on an additional $200 bn of imports from China as well as threatening to slap tariffs on imports of autos and parts. The retaliation was swift as the European Union, Canada, Mexico and China all imposed tariffs of their own on imports from the U.S.. This escalation of the trade spat is concerning because a deceleration in trade flows has historically been associated with slower world GDP growth.

World: U.S.-China trade in jeopardy



NBF Economics and Strategy (data via U.S. Census Bureau)

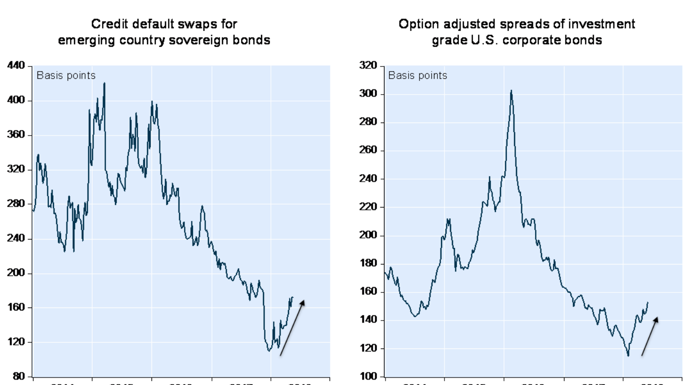
World: Dollar denominated debt high in some emerging economies



NBF Economics and Strategy (data via Bank of International Settlements, IMF)

Global financial markets not surprisingly reacted negatively to the apparent souring of trade relationships. The MSCI All-Country World index sank after the U.S. announcements. Investor concerns about emerging markets, where exports are a large share of the economy, were also reflected in rising costs of insurance against default on their sovereign bonds. But U.S. corporate bonds also struggled with rising spreads. A deceleration of trade flows and hence world GDP growth would indeed raise the likelihood of financial stress and defaults, more so considering record levels of leverage.

World: Investor concerns on the rise



NBF Economics and Strategy (data via Bloomberg)

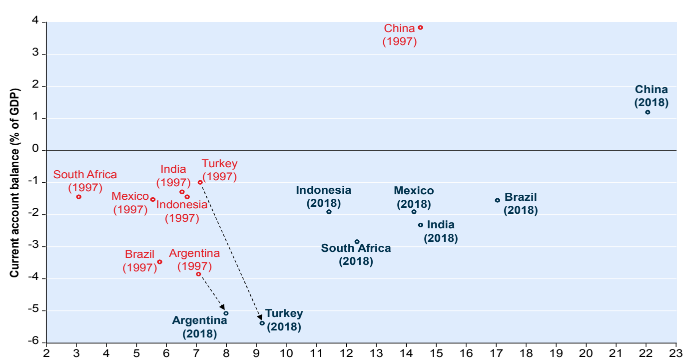
As we've shown before, credit intensity (i.e. credit relative to GDP) has risen dramatically over the past decade, particularly in emerging markets. While China usually makes headlines with regards to overleveraging, other emerging economies have also seen sharp increases in debt. More concerning is the fact that some of those economies have accumulated debt denominated in currencies other than their own. For instance, USD-denominated debt to non-bank borrowers now top 20% of GDP in places such as Turkey, Mexico and Argentina.

Could U.S. protectionism be the straw that breaks the back of indebted emerging economies? That possibility should not be underestimated given the resulting triple whammy of a subsequent growth slowdown, capital outflows, and an appreciating US dollar. Recall that the dollar's surge this year has been driven in part by risk-off sentiment, courtesy of U.S. protectionist measures, which prompted a selloff of stocks and currencies of several emerging economies. The dollar's appreciation is concerning in the sense that it can lead to a viscious cycle by making it harder for borrowers to service USD-denominated debt, reinforcing default risks and hence leading to more capital outflows from emerging markets.

Some emerging economies are better positioned than others to weather the current onslaught. Unlike Turkey and Argentina (whose currencies are the worse performing this year), several major emerging economies including China and India are in a much better economic situation than say 1997, when the Asian financial crisis started, thanks to sharp increases in foreign exchange reserves and manageable external deficits. But with foreign investors having a tendency of painting all emerging markets with the same brush, there's no guarantee even those economies with good fundamentals will remain unscathed.

World: Can emerging economies weather the current onslaught?

Current account balance versus FX reserves in 1997 and 2018

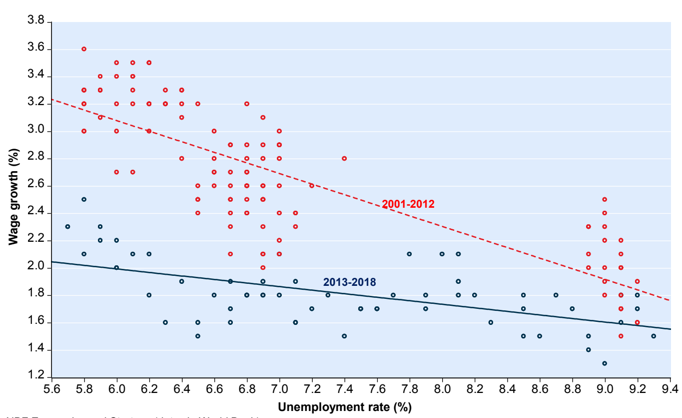


NBF Economics and Strategy (data via IMF, Bloomberg)

While protectionism looms large, there's still hope policymakers will recognize the threat and eventually veer away from mutually destructive tariffs. It's possible U.S. tariffs are just political posturing to garner voter support for Congressional Republicans ahead of November's mid-term elections and hence could be subsequently reversed, as was done during George W.Bush's first term as President.

Regardless, monetary and fiscal policy are likely to remain growth-friendly. Enhanced uncertainties to the economic outlook and the persistence of low inflation should limit the extent of monetary policy tightening by major central banks. While stronger growth in the OECD has allowed the jobless rate to drop towards pre-recession levels, inflation has not picked up as central banks would have liked. In other words, the Phillips curve has become flatter, something that allows central bankers to be patient in normalizing policy.

World: Phillips curve has flattened in major developed economies
Wage growth versus Unemployment rate in G4 (Eurozone, Japan, UK and U.S.)



NBF Economics and Strategy (data via World Bank)

And according to the International Monetary Fund's last World Economic Outlook, advanced economies will see more fiscal stimulus in 2018 and 2019 than previously forecast. Ditto for emerging economies whose fiscal policy is expected to be more stimulative than first thought especially in 2019. All told, we continue to call for global GDP growth of around 4% this year and next, under the assumption that world policymakers step back from mutually destructive protectionist policies.

World Economic Outlook

	Forecast		
	2017	2018	2019
Advanced countries	***2.3***	***2.4***	***2.0***
United States	2.3	3.0	2.3
Euroland	2.5	2.3	1.9
Japan	1.7	1.1	1.1
UK	1.8	1.4	1.5
Canada	3.0	2.0	1.9
Australia	2.3	2.7	2.8
New Zealand	3.0	2.8	2.6
Hong Kong	3.8	3.4	2.8
Korea	3.1	2.9	2.8
Taiwan	2.8	2.7	2.4
Singapore	3.6	3.2	2.8
Emerging Asia	***6.5***	***6.5***	***6.4***
China	6.9	6.6	6.4
India	6.7	7.4	7.6
Indonesia	5.1	5.3	5.4
Malaysia	5.9	5.4	5.1
Philippines	6.7	6.6	6.5
Thailand	3.9	4.0	3.7
Latin America	***1.3***	***2.2***	***2.7***
Mexico	2.0	2.2	2.3
Brazil	1.0	2.5	2.9
Argentina	2.9	1.7	2.5
Venezuela	-14.0	-11.0	-2.9
Colombia	1.8	3.6	3.5
Eastern Europe and CIS	***3.8***	***3.2***	***3.0***
Russia	1.5	1.8	1.9
Czech Rep.	4.3	3.5	3.0
Poland	4.6	4.2	3.5
Turkey	7.0	4.5	3.9
Middle East and N. Africa	***2.2***	***3.2***	***3.6***
Sub-Saharan Africa	***2.9***	***3.4***	***3.7***
Advanced economies	***2.3***	***2.4***	***2.0***
Emerging economies	***4.7***	***5.0***	***5.0***
World	***3.8***	***3.9***	***3.8***

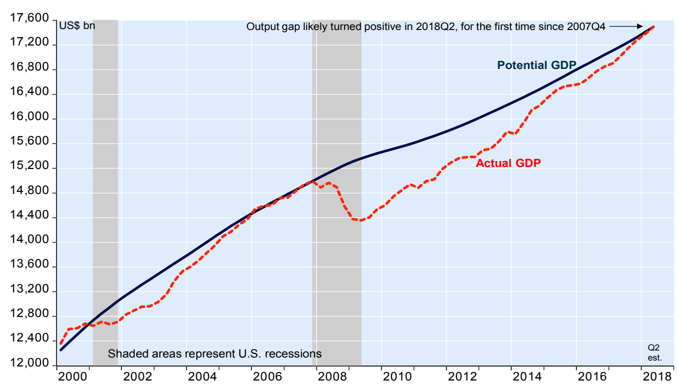
Source: NBF Economics and Strategy

U.S.: What's a late cycle?

Thanks to a blistering second quarter, the U.S. economy now has a positive output gap for the first time since 2007. While consistent with a late cycle, that's not to say a downturn is imminent. Consumption spending, the main engine of the U.S. economy, is in excellent shape thanks to prior deleveraging and a solid labour market. Pro-cyclical fiscal stimulus from Washington should also help extend the expansion into 2019 and offset any drag from Fed interest rate hikes.

The U.S. economy is firing from all cylinders. At least that's the message from solid monthly reports which point to annualized real GDP growth above 4% in the second quarter of 2018. That would mean, for the first time since 2007, the U.S. economy now has a positive output gap, i.e. actual output higher than potential output as measured by the Congressional Budget Office.

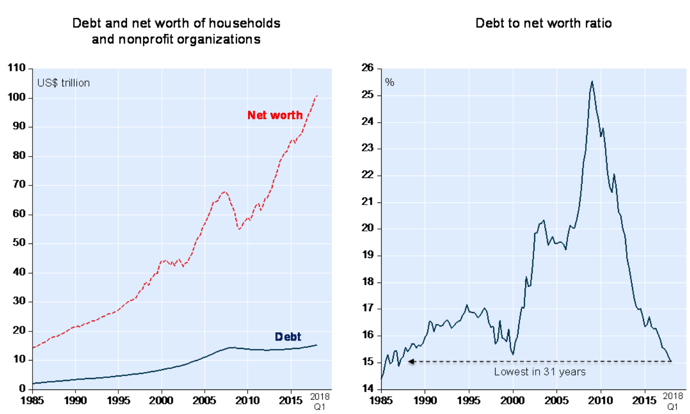
U.S.: Output gap turns positive for the first time since late 2007
Actual real GDP versus potential (as estimated by Congressional Budget Office)



NBF Economics and Strategy (data via Datastream, CBO)

Historically, such occurrence had signalled the expansion was about to end. But being in a "late cycle" does not mean a recession is imminent. We suspect the U.S. economy has at least a few more quarters to run before going into an inevitable downturn.

U.S.: Debt to net worth ratio lowest since 1987

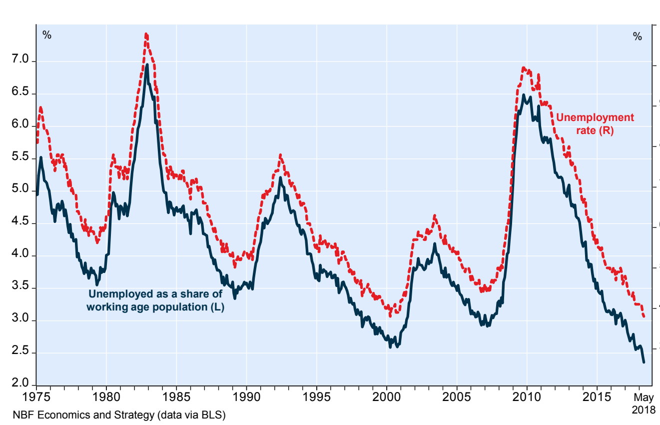


NBF Economics and Strategy (data via Federal Reserve)

For starters, the outlook for consumption spending, which accounts for nearly 70% of U.S. GDP, is arguably the best in years. According to the Federal Reserve's latest Financial Accounts the net worth of American households and non-profit organizations climbed to a record US$100.8 trillion in the first quarter of 2018. While the stock market rout lowered the value of corporate equities held, that was more than offset by increases in the value of real estate and other assets which pushed up net worth by a little more than US$1 trillion during Q1. Household debt also rose, but at a much slower pace. So much so that the household debt to net worth ratio plunged to a 31-year low in Q1. The best household balance sheet in decades, coupled with federal personal income tax cuts, still-low interest rates and easy access to credit explain why consumer confidence remains high.

A buoyant labour market is also positive for consumption spending. According to the establishment survey, non-farm payrolls grew by about 1 million over the January-May period, the best start of the year since 2015. The household survey also paints a positive picture of the U.S. labour market with the lowest unemployment ever recorded as a share of the working age population. Also encouraging is the fact that the jobs created have tilted towards full-time positions, the latter rising this year at the fastest pace since 2010, and pushing up its share of total employment to a decade-high of 82.7%.

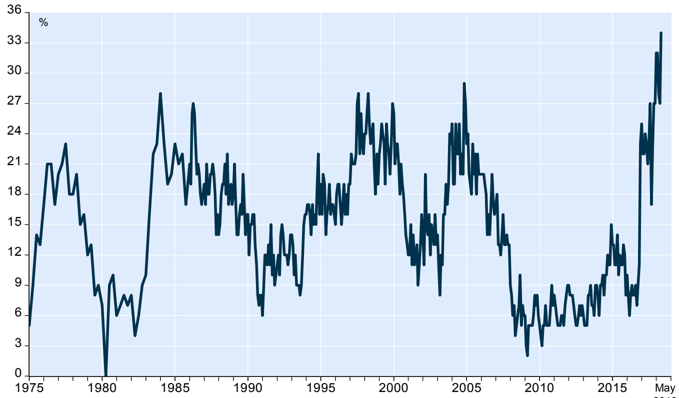
U.S.: Jobs are plentiful
Unemployment rate and Share of unemployed in non-institutional civilian working age population



NBF Economics and Strategy (data via BLS)

Sky-high business optimism also suggests the expansion has legs and hence could extend through next year. Solid corporate profits bode well for investment outlays at large firms. But even small businesses, which account for the bulk of employment creation in the U.S., plan to expand and invest. The latest NFIB small business survey indeed showed that more than a third of respondents feel now is a good time to expand.

U.S.: Small business owners want to expand
NFIB small business optimism index, Share of respondents saying that now is a good time to expand

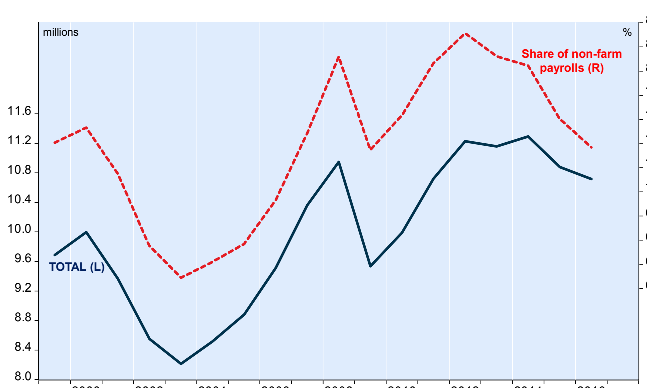


NBF Economics and Strategy (data via Datastream)

All in all, the U.S. economic outlook is largely positive, with 2018 real GDP growth expected to come in around 3%. Momentum from this year could spill over to 2019, which is why we expect a healthy performance for next year as well, although a moderation in growth is in the cards after this year's red hot pace. But there are risks that could bring the current expansion to an earlier end.

And here we're thinking of tariffs imposed by the U.S. government on imports which not only raise prices and hence lower real disposable incomes for consumers, but also put in jeopardy the livelihood of American workers. Millions of jobs that directly depend on imports are now threatened after U.S. tariffs were imposed on a range of goods. Ditto for the nearly 11 million jobs that are supported by exports and which are now vulnerable to a drop in foreign demand for American-made goods courtesy of retaliatory tariffs from trade partners.

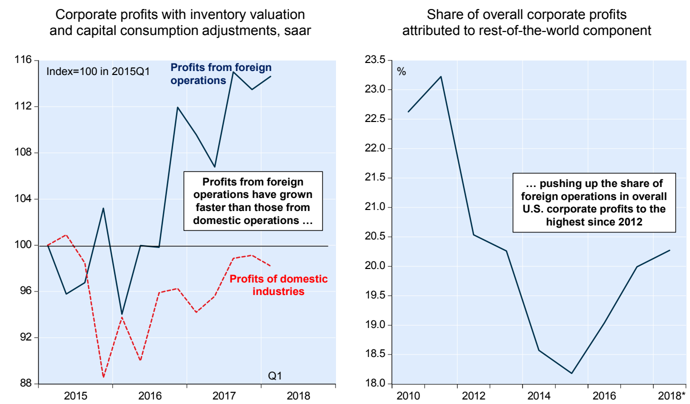
U.S.: Trade protectionism could backfire
Jobs supported by exports of goods and services



NBF Economics and Strategy (data via International Trade Administration)

Corporate profits could also take a hit from protectionism. For the past few years, U.S. profit growth has been driven by the "rest-of-the-world" component. The latter has increased its share of overall U.S. corporate profits to reach a four-year high of 20.3% in Q1 this year. So, growing protectionism from Washington has potential to hurt the bottom line of corporate America and hence offset some of the benefits obtained through tax cuts.

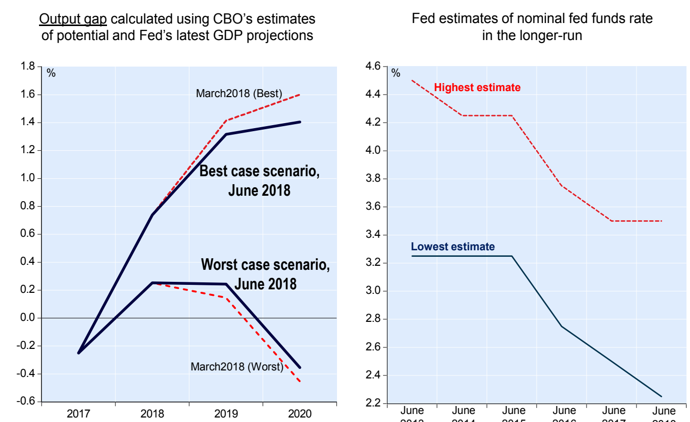
U.S.: Increasing share of corporate profits coming from abroad



* 2018 estimate is based on Q1 results only
NBF Economics and Strategy (data via Bureau of Economic Analysis)

Can the Federal Reserve carry on with policy normalisation amidst downside risks related to trade? At its June meeting, the Fed shrugged off those risks and not only raised the fed funds rate to 2.00% but hinted at two more rate hikes (of 25 bps each) before year-end and three more in 2019 amidst rising inflation pressures. Revisions to the Fed's forecasts showed a narrower band than before for GDP projections, highlighting growing confidence within the FOMC about the economic outlook.

U.S.: Fed still expects healthy growth ahead



NBF Economics and Strategy (data via Federal Reserve, Congressional Budget Office)

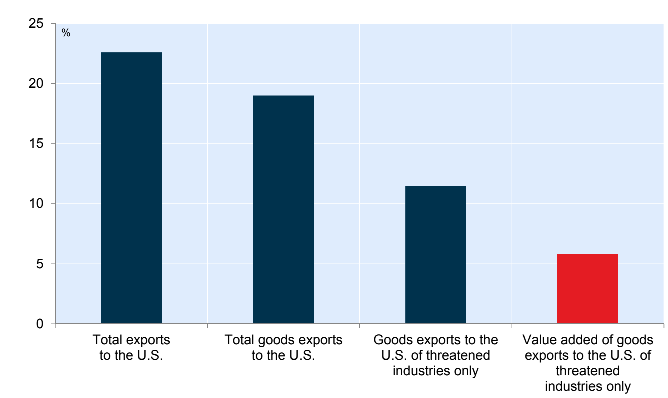
But with the fed funds rate already close to what the Fed estimates as the longer-run equilibrium (or neutral), and the yield curve at its flattest since 2007, it's unclear if the FOMC can be as aggressive. Concerns about protectionism have pushed down Treasury yields and given a boost to the U.S. dollar, the latter likely to act as a drag on the economy and hence inflation. As such, we expect no more than one additional Fed rate hike before year-end.

Canada: Deal or no deal?

Downside risks to the Canadian economy have arguably increased amidst an apparent deterioration in the trade relationship with the U.S., the latter not only imposing tariffs on steel and aluminium imports but also threatening to slap additional ones on the crucial auto sector. All in all, a deal to revamp NAFTA before year-end is becoming less likely. As a result, we have trimmed by two ticks our 2018 GDP growth forecast to just 2.0% and now expect just one additional rate hike from the Bank of Canada before year-end.

Canadian hopes for a quick deal on a revamped NAFTA were dealt a blow in June as an increasingly belligerent U.S. government moved beyond rhetoric and into action, imposing tariffs on some imports from Canada. Not surprisingly, investor sentiment about economic prospects seems to have worsened, at least based on the Canadian dollar's slump. To be sure, 75% of Canada's goods exports goes to the U.S., and the latter's protectionism will have negative impacts this side of the border. But not all exporting industries are threatened. In a *Special Report* last March entitled "Reality check: Canadian exposure to U.S. protectionism", we estimated that the value added of goods exports of threatened industries to the U.S. amount to about 6% of nominal GDP. In other words, should the U.S. stop importing those goods from Canada, nominal GDP would be about 6% less than what would otherwise be the case.

Share of Canadian economy vulnerable to U.S. protectionist policies
Goods exports to the U.S. as a share of GDP

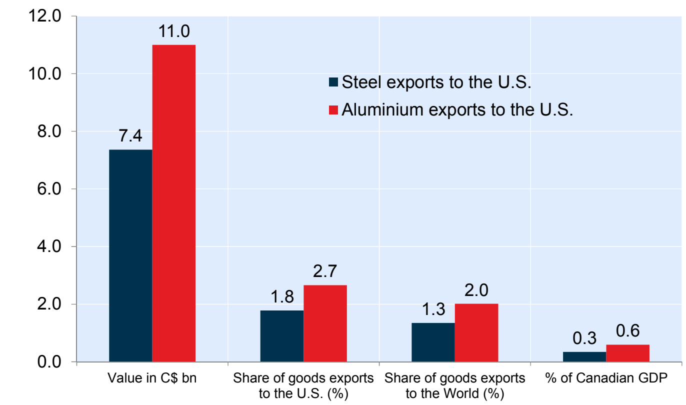


NBF Economics and Strategy (data via Statistics Canada, NBF calculations)

With more than 80% of their exports going to the U.S., Canadian producers of steel and aluminium will take a major hit from the tariffs imposed in June as their products become more expensive and hence less appealing to American buyers. But the Canadian economy as a whole can weather this storm assuming nothing else changes. In the 12 months to March 2018, Canadian exports of steel products to the U.S. amounted to C$7.4 bn and those of aluminium products totalled C$11 bn.

Taken together, those represent less than 5% of Canadian goods exports to the U.S. and less than 1% of Canadian GDP. In other words, this latest stunt from the U.S. will hardly break the Canadian economy.

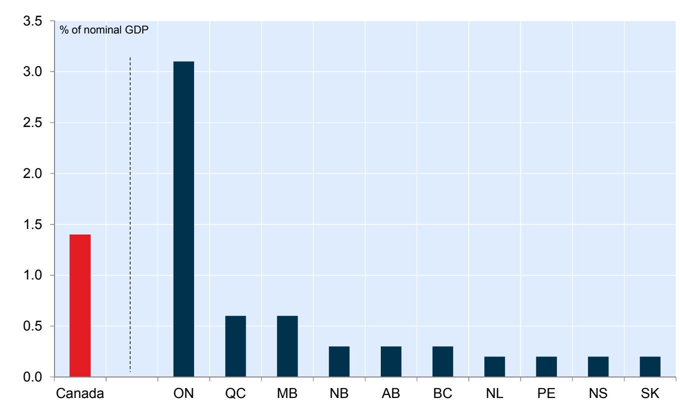
Canada: Tariffs on steel and aluminium unlikely to break the economy ...
Canadian exports of steel and aluminium products to the U.S. (April 2017-March 2018)



NBF Economics and Strategy (data via Industry Canada)

That said, those trade barriers are still concerning because they open the door for a broadening of tariffs to include more goods. Tariffs on autos for example, which are now being considered by the U.S. government, would have more devastating impacts on Canada, particularly in Ontario.

... but auto tariffs could have more devastating impacts
Value added dependent on exports of autos and parts to the U.S.



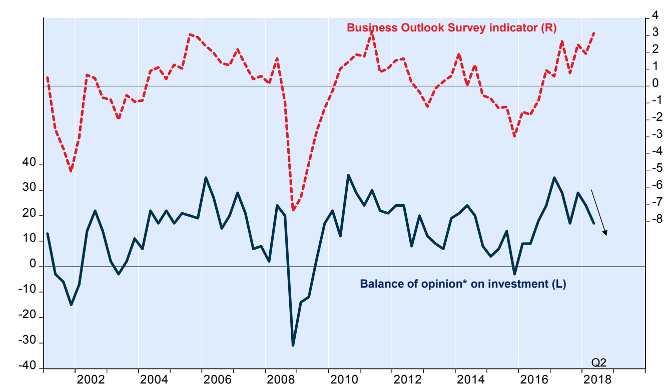
NBF Economics and Strategy (data via Statistics Canada)

But given how integrated North American auto production is — auto bodies and parts actually cross the border several times before final assembly —, tariffs are set to be costly even for U.S. based auto plants. Given the prohibitive costs of such trade barriers, the assumption behind our base case scenario (which calls for real GDP growth of 2% this year) is that auto tariffs are not imposed and that an eventual trade deal is reached with the U.S..

Monthly Economic Monitor

But until that happens, expect the uncertain business environment to restrain economic activity. The Bank of Canada's latest Business Outlook Survey was generally positive albeit with one blemish, namely investment intentions which fell for the second consecutive quarter. Things likely worsened on the investment front after the disastrous G7 meeting of June 8th/9th (i.e. after the survey was carried out) when Canada-U.S. trade relations soured. So, barring a positive development with regards to NAFTA negotiations, investment spending may be a drag on the economy in the second half of the year.

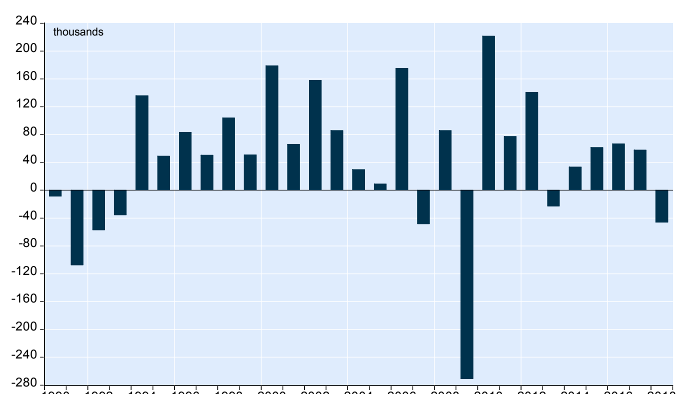
Canada: Despite high business optimism, investment intentions fell in Q2
Business Outlook Survey indicator versus Balance of opinion* on investment



** Percentage of firms expecting higher investment minus the percentage expecting lower investment*
NBF Economics and Strategy (data via Bank of Canada)

Trade-related uncertainties could also be restraining the labour market. According to the Labour Force Survey, Canada has lost nearly 50,000 jobs since the start of the year as declines in the private sector (the worst since the 2009 recession) and in self-employment dwarfed increases in government positions.

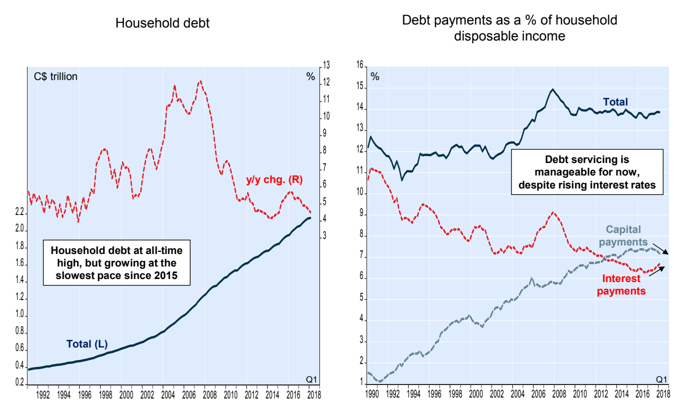
Canada: Private sector employment down so far this year
Change in private sector employment in the first five months of every year according to Labour Force Survey



NBF Economics and Strategy (data via Statistics Canada)

As such, the Bank of Canada, which had signalled a July rate hike at its last meeting, may now be more cautious in its approach to monetary policy normalisation. Earlier rate hikes and enhanced macro prudential measures seem to be delivering intended results. While household debt reached a record C$2.2 trillion at the end of the first quarter, the pace of growth (year-on-year) softened to just 4.5%, the slowest in three years. Those concerned about financial stability will also be encouraged by household debt servicing which remains stable and manageable at less than 14% of household disposable income. While interest payments are now taking an increasing share of disposable incomes, courtesy of rising borrowing costs, the share of capital repayments is falling and providing an offset.

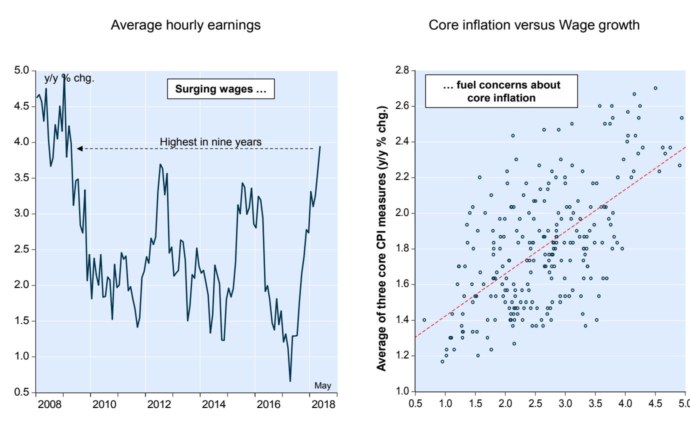
Canada: Household debt servicing manageable for now



NBF Economics and Strategy (data via Statistics Canada)

That's not to say the Bank of Canada's job is done. The correction in resale home prices, in the aftermath of OSFI's B20 regulations, now seems to be over according to the Teranet-National Bank index which show prices heating up again in Vancouver and Toronto. More generally, inflation pressures continue to build. Despite challenges in the labour market, average hourly earnings are now growing 3.9% year-on-year, the highest in nine years. And accelerating wages have typically been associated with upward pressures on core inflation, the latter already near the central bank's 2% target — the average of the three core measures was 1.9% in May. But amidst the deterioration in the Canada-U.S. trade relationship, we now expect just one additional rate hike from the Bank of Canada before year-end.

Canada: Surging wages fuel inflation concerns



NBF Economics and Strategy (data via Datastream)

NATIONAL BANK OF CANADA FINANCIAL MARKETS

United States
Economic Forecast

*(Annual % change)**	*2015*	*2016*	*2017*	*2018*	*2019*	*Q4/Q4 2017*	*Q4/Q4 2018*	*Q4/Q4 2019*
Gross domestic product (2009 $)	2.9	1.5	2.3	3.0	2.3	2.6	2.9	2.1
Consumption	3.6	2.7	2.8	2.6	2.1	2.8	2.3	2.0
Residential construction	10.2	5.5	1.8	3.1	2.3	2.6	3.1	2.0
Business investment	2.3	(0.6)	4.7	6.1	2.7	6.3	5.1	2.0
Government expenditures	1.4	0.8	0.1	1.4	1.8	0.7	1.3	2.0
Exports	0.4	(0.3)	3.4	4.4	1.6	5.0	3.6	1.0
Imports	5.0	1.3	4.0	4.0	1.4	4.7	2.0	1.2
Change in inventories (bil. $)	100.5	33.4	15.2	25.6	27.8	15.6	29.0	27.0
Domestic demand	3.3	2.1	2.5	2.8	2.2	2.9	2.5	2.0
Real disposable income	4.2	1.4	1.2	2.0	1.7	1.9	2.2	1.7
Household employment	1.7	1.7	1.3	1.5	1.1	1.2	1.6	1.0
Unemployment rate	5.3	4.9	4.4	3.9	3.6	4.1	3.7	3.6
Inflation	0.1	1.3	2.1	2.5	2.3	2.1	2.4	2.4
Before-tax profits	(1.1)	(2.1)	4.4	7.0	5.6	2.7	7.6	4.5
Federal balance (unified budget, bil. $)	(438.0)	(586.0)	(666.0)	(804.0)	(981.0)	...	...	...
Current account (bil. $)	(407.8)	(432.9)	(449.1)	(503.9)	(516.4)	...	...	...

** or as noted*

Financial Forecast**

	Current 6-28-18	*Q3 2018*	*Q4 2018*	*Q1 2019*	*Q2 2019*	*2017*	*2018*	*2019*
Fed Fund Target Rate	2.00	2.25	2.25	2.50	2.50	1.50	2.25	3.00
3 month Treasury bills	1.89	2.13	2.08	2.25	2.37	1.37	2.08	2.83
Treasury yield curve								
2-Year	2.52	2.58	2.71	2.81	2.98	1.89	2.71	3.20
5-Year	2.73	2.76	3.00	3.06	3.13	2.20	3.00	3.32
10-Year	2.84	2.99	3.14	3.26	3.33	2.40	3.14	3.47
30-Year	2.97	3.12	3.26	3.37	3.43	2.74	3.26	3.55
Exchange rates								
U.S.$/Euro	1.16	1.15	1.19	1.20	1.21	1.20	1.19	1.25
YEN/U.S.$	110	107	109	110	112	113	109	114

*** end of period*

Quarterly pattern

	Q3 2017 actual	*Q4 2017 actual*	*Q1 2018 actual*	*Q2 2018 forecast*	*Q3 2018 forecast*	*Q4 2018 forecast*	*Q1 2019 forecast*	*Q2 2019 forecast*
Real GDP growth (q/q % chg. saar)	3.2	2.9	2.0	4.7	2.4	2.5	1.8	2.5
CPI (y/y % chg.)	2.0	2.1	2.3	2.7	2.7	2.4	2.1	2.2
CPI ex. food and energy (y/y % chg.)	1.7	1.7	1.9	2.2	2.3	2.4	2.3	2.5
Unemployment rate (%)	4.3	4.1	4.1	3.9	3.8	3.7	3.7	3.7

National Bank Financial

Canada
Economic Forecast

(Annual % change)*	2015	2016	2017	2018	2019	Q4/Q4 2017	Q4/Q4 2018	Q4/Q4 2019
Gross domestic product (2007 $)	1.0	1.4	3.0	2.0	1.9	3.0	2.0	1.7
Consumption	2.1	2.4	3.5	2.0	1.7	3.4	1.7	1.6
Residential construction	3.8	3.3	2.9	(0.5)	(2.3)	4.6	(3.2)	(3.0)
Business investment	(11.3)	(9.4)	2.8	4.8	2.4	8.9	1.8	4.2
Government expenditures	1.4	2.7	2.6	3.2	2.2	3.3	2.6	2.0
Exports	3.5	1.0	1.1	3.0	3.5	0.5	4.8	3.0
Imports	0.7	(1.0)	3.6	4.6	2.6	6.9	3.5	2.7
Change in inventories (millions $)	4,711	978	13,921	12,935	8,435	15,759	9,393	7,353
Domestic demand	0.3	1.1	3.0	2.4	1.6	4.0	1.6	1.7
Real disposable income	3.5	1.3	3.7	2.4	1.6	3.3	1.5	1.5
Employment	0.9	0.7	1.9	1.2	0.9	2.1	0.7	0.8
Unemployment rate	6.9	7.0	6.3	5.7	5.6	6.0	5.6	5.5
Inflation	1.1	1.4	1.6	2.2	2.1	1.8	2.0	2.5
Before-tax profits	(19.8)	(1.9)	19.9	6.0	6.3	7.9	8.3	5.0
Current account (bil. $)	(71.5)	(65.4)	(63.3)	(72.0)	(59.0)	....	....	....

** or as noted*

Financial Forecast**

	Current 6-28-18	Q3 2018	Q4 2018	Q1 2019	Q2 2019	2017	2018	2019
Overnight rate	1.25	1.25	1.50	1.75	2.00	1.00	1.50	2.25
3 month T-Bills	1.25	1.39	1.63	1.88	2.18	1.06	1.63	2.21
Treasury yield curve								
2-Year	1.85	1.85	2.14	2.31	2.38	1.69	2.14	2.55
5-Year	2.02	2.17	2.34	2.50	2.63	1.87	2.34	2.78
10-Year	2.13	2.48	2.62	2.82	2.93	2.04	2.62	3.09
30-Year	2.20	2.54	2.67	2.86	2.97	2.26	2.67	3.14
CAD per USD	1.33	1.33	1.28	1.28	1.27	1.25	1.28	1.25
Oil price (WTI), U.S.$	73	70	73	71	70	60	73	69

*** end of period*

Quarterly pattern

	Q3 2017 actual	Q4 2017 actual	Q1 2018 actual	Q2 2018 forecast	Q3 2018 forecast	Q4 2018 forecast	Q1 2019 forecast	Q2 2019 forecast
Real GDP growth (q/q % chg. saar)	1.7	1.7	1.3	2.5	1.8	2.2	1.7	1.8
CPI (y/y % chg.)	1.4	1.8	2.1	2.2	2.3	2.0	1.6	2.0
CPI ex. food and energy (y/y % chg.)	1.4	1.6	1.8	1.7	1.8	1.9	1.5	2.1
Unemployment rate (%)	6.2	6.0	5.8	5.8	5.7	5.6	5.6	5.5

National Bank Financial

Provincial economic forecast

	Real GDP (% growth)					Nominal GDP (% growth)				
	2015	2016	2017e	2018f	2019f	2015	2016	2017e	2018f	2019f
Newfoundland & Labrador	-1.7	1.9	2.1	1.9	3.0	-11.5	2.6	8.6	8.3	3.1
Prince Edward Island	1.3	2.3	3.2	2.5	2.0	3.9	4.0	5.4	4.3	4.5
Nova Scotia	1.4	0.8	1.2	0.7	1.0	2.1	2.8	2.8	3.5	3.0
New Brunswick	2.4	1.2	1.9	1.2	1.3	2.0	3.6	5.4	5.3	3.7
Quebec	1.0	1.4	3.1	2.1	1.8	2.4	2.7	5.3	3.1	3.3
Ontario	2.9	2.6	2.7	2.1	1.8	5.0	4.3	4.5	3.2	3.6
Manitoba	1.3	2.2	2.8	2.0	1.5	3.3	2.3	4.9	4.4	3.6
Saskatchewan	-1.0	-0.5	2.9	1.5	2.5	-5.4	-4.0	6.4	6.9	3.8
Alberta	-3.7	-3.7	4.9	2.2	1.9	-12.0	-4.9	7.2	6.7	3.9
British Columbia	3.5	3.5	3.9	2.3	2.0	4.0	4.8	7.1	5.5	3.8
Canada	1.0	1.4	3.0	2.0	1.9	0.2	2.0	5.4	3.8	3.7

	Employment (% growth)					Unemployment rate (%)				
	2015	2016	2017e	2018f	2019f	2015	2016	2017e	2018f	2019f
Newfoundland & Labrador	-1.0	-1.5	-3.7	-0.2	-0.5	12.8	13.4	14.8	14.2	13.7
Prince Edward Island	-1.1	-2.3	3.1	2.4	0.7	10.4	10.7	9.8	10.3	9.9
Nova Scotia	0.1	-0.4	0.6	1.8	0.2	8.6	8.3	8.4	6.8	7.1
New Brunswick	-0.6	-0.1	0.4	0.4	0.2	9.8	9.5	8.1	8.1	8.2
Quebec	0.9	0.9	2.3	1.1	0.7	7.6	7.1	6.1	5.4	5.3
Ontario	0.7	1.1	1.8	1.4	1.0	6.8	6.5	6.0	5.5	5.4
Manitoba	1.5	-0.4	1.6	0.3	0.4	5.6	6.1	5.4	6.1	6.1
Saskatchewan	0.5	-0.9	0.0	0.2	0.7	5.0	6.3	6.3	5.8	5.6
Alberta	1.2	-1.6	1.1	1.7	1.2	6.0	8.1	7.8	6.4	6.2
British Columbia	1.2	3.2	3.7	0.7	1.1	6.2	6.0	5.1	4.6	4.7
Canada	0.8	0.7	1.9	1.2	0.9	6.9	7.0	6.3	5.7	5.6

	Housing starts (000)					Consumer Price Index (% growth)				
	2015	2016	2017e	2018f	2019f	2015	2016	2017e	2018f	2019f
Newfoundland & Labrador	1.7	1.4	1.4	1.6	1.3	0.4	2.7	2.3	1.9	2.0
Prince Edward Island	0.6	0.6	0.9	1.0	0.6	-0.6	1.2	1.8	2.2	2.0
Nova Scotia	3.8	3.8	4.0	3.7	3.4	0.4	1.2	1.1	2.2	2.0
New Brunswick	2.0	1.8	2.3	1.7	1.6	0.5	2.2	2.3	2.3	2.0
Quebec	37.9	38.9	46.5	52.0	40.0	1.1	0.7	1.1	1.8	1.9
Ontario	70.2	75.0	79.0	74.6	69.0	1.2	1.8	1.7	2.3	2.2
Manitoba	5.5	5.3	7.5	6.2	5.0	1.2	1.3	1.6	2.4	2.1
Saskatchewan	5.1	4.8	4.9	3.2	4.0	1.6	1.1	1.7	2.5	2.0
Alberta	37.3	24.5	29.5	26.2	24.0	1.1	1.1	1.5	2.2	2.1
British Columbia	31.4	41.8	43.7	42.8	35.0	1.1	1.8	2.1	2.3	2.2
Canada	195.5	197.9	219.7	213.0	183.9	1.1	1.4	1.6	2.2	2.1

e: estimate f: forecast

Historical data from Statistics Canada and CMHC, National Bank of Canada's forecast.

Monthly Economic Monitor

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Marc Pinsonneault
Senior Economist
marc.pinsonneault@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Paul-André Pinsonnault
Senior Fixed Income Economist
paulandre.pinsonnault@nbc.ca

Matthieu Arseneau
Senior Economist
matthieu.arseneau@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Krishen Rangasamy
Senior Economist
krishen.rangasamy@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
MD, Public Sector Research and Strategy
warren.lovely@nbc.ca

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 71 Fenchurch Street, London, EC3M 4HD.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

National Bank of Canada Financial Inc. (NBCFI), a broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority (FINRA), and a member of the Securities Investor Protection Corporation (SIPC), is distributing this Report in the United States. NBCFI operates pursuant to a 15 a-6 Agreement with its Canadian affiliate, NBF Inc.

This Report has been prepared in whole or in part by personnel employed by non-US affiliates of NBCFI that are not registered as broker/dealers in the US. These non-US personnel are not registered as associated persons of NBCFI and are not licensed or qualified as research analysts with FINRA or any other US regulatory authority and, accordingly, may not be subject (among other things) to FINRA restrictions regarding communications by a research analyst with the subject company, public appearances by research analysts and trading securities held in a research analyst account.

The author(s) who prepared these Reports certify that this Report accurately reflects his or her personal opinions and views about the subject company or companies and its or their securities, and that no part of his/her compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this Report as to the securities or companies.

NBF compensates the authors of this Report from a variety of sources, and such compensation is funded by the business activities of NBF including, Institutional Equity and Fixed Income Sales and Trading, Retail Sales, the correspondent clearing business and Corporate and Investment Banking.

Because the views of its personnel may differ, members of the National Bank Financial Group may have or may in the future issue Reports that are inconsistent with this Report, or that reach conclusions different from those in this Report. To make further inquiry related to this Report, United States residents should contact their NBCFI registered representative.

This document is intended for institutional investors and is not subject to all of the independence and disclosure standards under FINRA rules applicable to debt research Reports prepared for retail investors. This Report may not be independent of the proprietary interests of NBF, NBCFI, or their affiliates. NBF, NBCFI, or their affiliates may trade the securities covered in this Report for their own account and on a discretionary basis on behalf of certain clients. Such trading interests may be contrary to the recommendation(s) offered in this Report.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA")which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.