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BMO CAPITAL MARKETS ECONOMICS

Focus

A weekly financial digest

Douglas Porter, CFA, Chief Economist, BMO Financial Group

May 30, 2014

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For Whom the Yield Falls

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Bond yields dropped this week. Again. To their lowest level of 2014. And, to their lowest level since last June. The 10-year Treasury is now down 55 bps since the start of the year. Many other borrowers have seen even bigger declines. This was not supposed to happen. Most looked for yields to march higher this year. Now the rush is on to explain what has happened. And there has been much hand-wringing.

Dispensing with the faux Hemingway, market watchers have been struggling to pinpoint the cause of this year's biggest slow-motion surprise for markets. There is no shortage of suspects, with Europe near the top of the list. The ECB appears poised to do something relatively aggressive at next week's monthly meeting, as inflation continues to wallow at just 0.7% and GDP growth is also stuck below 1%. While the ECB may not dip into the QE pool just yet, European bonds have still been on fire, with the peripherals leading the charge. Ten-year yields in Italy and Spain have collapsed this year, both plunging by more than 100 bps, while German yields have dropped to a microscopic 1.35% (testing record lows). In this environment, the near-2.5% yield on offer from the U.S. looks almost generous.

Besides Europe, the soggy start to the year for the U.S. economy and sluggish results from many emerging markets have also played a role in the bond rally. The second estimate of U.S. Q1 GDP growth put an exclamation mark on the nasty winter, with the 1% drop prompting us to slash our annual forecast to a modest 2.2% (no better than Canada). And while we are looking for a rebound in Q2 GDP to 3.8%, that still leaves average growth for the first half at just 1.4%. A bigger pullback in housing than expected has accounted for much of the underlying downside surprise in activity, but weaker exports have also weighed. GDP growth in each of China (7.4% y/y), India (4.6%), Brazil (1.9%) and Mexico (1.8%) was on the soft side in Q1.

But if the root cause of the bond rally is weakness in the global economy, other financial markets haven't read the memo. This week saw record highs for the S&P 500, and emerging market equities are quietly staging a comeback. Credit spreads are probing multi-year lows. Commodities are generally stronger, not weaker, with the CRB up roughly 10% so far this year. Even copper prices have rebounded smartly from their multi-year lows early this year. The commodity currencies have also been firming, hardly a sign of widespread strain in the global economy. The Australian dollar has been one of the strongest in the world this year with a gain of more than 4%, while everyone's previously favourite short—the Canadian dollar—has quietly worked itself almost back to flat on the year. And, the Fed is also not validating the view that the economy is struggling, as it seems to be on autopilot to end QE. In fact, a number of (admittedly hawkish) Fed speakers have suggested in recent weeks that rate hikes should come sooner than expected, scarcely a positive for bonds.

Regardless of the source of the rally, the effect will be real. The steady drop in yields has helped cut 30-year mortgage rates to only a tad above 4%. And just as last year's mortgage rate spike may have done more damage to housing than initially expected, this year's retreat could help juice housing more than expected in coming quarters.

It's been a broadly similar story in Canada, somewhat surprisingly. Typically, the Canadian bond market tends to lag Treasuries during hefty rallies. Yet, GoCs have matched the drop in U.S. yields almost tick-for-tick this year, with 10-year Canadian rates plunging just over 50 bps to 2.25%, and 5s down more than 40 bps to just over 1.5%. This presents a major league conundrum for the Bank of Canada. The plunge in yields has prompted some banks to slice 5-year mortgage rates below 3%, which in turn could throw yet another log on the fire for housing prices, which are already raging away in many cities (hello Calgary and Toronto!). Yet, the BoC can hardly warn about higher rates with the C$ marching higher again and the economy disappointing in Q1 with GDP growth of just 1.2%. This is the same dilemma the Bank has been dealing with for much of the past four years; we suspect they will be more concerned about weak growth and live with the risks of a still-hot housing market.

Looking ahead, we continue to believe that it's a matter of time—and better U.S. economic data—before yields start heading higher again. Note that even with the sickly Q1 outcome, U.S. nominal GDP growth is still running at 3.4% y/y (just a snick below its 5-year trend of 3.5%), and yet the 30-year yield is just 3.3% and 10s are less than 2.5%. The gap is even more extreme in Canada, where nominal GDP is running at 4%, or nearly double the current 10-year yield. To those who are tempted to buy at these levels, knock yourself out, but don't expect any capital gains for the next few years. Perhaps the fact that 10-year Treasuries managed to not dip below the technically important 2.4% level this week, and even backed up to almost 2.5% by week's end is a signal—the yield also rises.

First-time Home Buyers: Hot in Canada, Not in U.S.

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While the U.S. housing market has merely awoken from a lengthy slumber that began well before the nasty winter weather hit, the Canadian market continues to cruise along. U.S. pending sales rose modestly in April and are still 9% below year-ago levels, while Canadian resale activity is on par with last year's level and close to past decade norms. One crucial ingredient for a vibrant housing market—strong participation by first-time buyers—is sorely lacking in the U.S. yet thriving in Canada. Although investors have pumped some life into the U.S. market (and prices ever higher), first-time buyers remain missing in action, accounting for just 29% of resales in April, well below the 40%-plus norm. By contrast, according to the latest survey from the Canadian Association of Accredited Mortgage Professionals, first-time buyers in Canada accounted for a majority (55%) of 2013 sales.

Why are first-time buyers so much more active north of the border? The answer boils down to three things: lower borrowing costs, greater confidence and lower student debt. For Canadian homeowners, the average mortgage rate was 3.24% in the spring of 2014, down from 3.50% in CAAMP's fall survey. By contrast, the average effective rate in the U.S. was somewhat higher at 3.85% in the first quarter, according to the BEA, though that's still a record low back to 1977.

Secondly, Canadians have more confidence in real estate than Americans. The CAAMP survey found that many Canadians believe housing is a good investment and that a price correction wouldn't hurt much. Ask 12.7 million Americans who received foreclosure notices since 2007 whether they believe the same thing and you will get a decidedly different response (and possibly a punch in the nose). With Canadian house prices falling only briefly in the recession and quickly rebounding to new highs, owners don't have the deep scars grafted onto American minds during the crash. While U.S. prices have made a spirited recovery, they are still well below 2006 levels, leaving millions of owners upside down on their mortgage. For Canadians, the 27% slide in Toronto house prices in the early 1990s is a faded memory; while Vancouverites, having weathered four serious price corrections of at least 15% since 1980, appear nonchalant about the next possible downturn. The confidence factor has also rubbed off on Canadian parents who are "gifting" down-payments to their heirs.

Thirdly, soaring U.S. student debt has left many potential first-time buyers unprepared. In 2012, Americans owed $966 billion in student loans, or about $3,000 per person, proportionately nearly four-times larger than for Canadians who owed $28 billion, or about $800 per person. Today, American student debt tops a cool $1 trillion, a millstone around the neck of a generation of potential buyers.

Given the lousy start to U.S. GDP this year, Canada's economy could outperform again. And, until American first-time buyers step up to the plate, Canada's housing market could also place first. Who saw that coming? Sal

Waiting for the ECB

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Next week's ECB meeting (June 5th) is one of the most highly anticipated central bank meetings in recent memory. It was just a month ago that ECB President Draghi all but said that they would ease: "*the governing council is comfortable with acting next time but before we want to see the staff projections*" and there was a "*consensus about action*". That was all the market needed to hear. The ECB remains very concerned about too low inflation (the latest reading was just 0.7% y/y, well below the 2% target) and too-low credit growth (private sector lending was down 3.2% y/y in April, the 24th consecutive negative reading). And, as Draghi stated during the ECB's version of Jackson Hole, "*We are not resigned to allowing inflation to remain too low for too long*". Policymakers have been exploring their tool box for options to deal with these problems, with the 'simplest' solution being a refi rate cut (we are looking for a 15 bp cut to 0.10%). It could be accompanied by other, less conventional, moves such as introducing a negative deposit rate (i.e. charging banks to park their money), or a targeted long-term loan operation, or QE.

And, although the ECB insists that the exchange rate is not a target, the EUR does play a role. **Stephen Gallo, European Head of FX Strategy** at BMO, sees the strong EUR as a "*potential squeeze on corporate profit margins and a de facto tightening of monetary conditions. With a large current account surplus, a strong EUR also reflects deflationary adjustments in the periphery which have gone very far. However, in the immediate future we expect outright EUR declines to be temporary and look for an eventual move back up to the $1.370-1.380 range with the ECB refraining from full-scale QE for now. Additionally, easing in June and more supportive rhetoric should support EUR inflows*."

What instruments will be used, what form they will take, when they will be employed…all of these questions should be answered next week. Presumably, the ECB will take a big step toward ending what is appearing to be a *'negative spiral'* of low inflation, low credit growth and low inflation expectations. JLee

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	Good News	Bad News
Canada ▪ Weather weighed on Q1 growth ▪ Waiting for the BoC next week…	**Current Account Deficit** narrowed to $49.5 bln a.r. (Q1) **Real GDP at Basic Prices** +0.1% (Mar.)—but soft **Industrial Product Prices** -0.2% (Apr.) **Raw Material Prices** +0.1% (Apr.) **Ottawa's Budget Deficit** narrowed to $12.1 bln (FY13/14)—versus $18.7 bln a year ago	**Real GDP** +1.2% a.r. (Q1)
United States ▪ Economy contracts in Q1 ▪ Q2 bounceback expected, but consumers have a weak start ▪ 10-year Treasury yields tumble to 2.40%, a level not seen in a year	**Durable Goods Orders** +0.8% (Apr.) **S&P Case-Shiller House Price Index** +1.2% (Mar.) **FHFA House Price Index** +0.7% (Mar.) **Pending Home Sales** +0.4% (Apr.)—but disappointing **Conference Board's Consumer Confidence Index** +1.3 pts to 83.0 (May) **Initial Claims** -27k to 300k (May 24 wk) **Personal Income** +0.3% (Apr.) **Core PCE Deflator** +1.4% y/y (Apr.) **Chicago PMI** +2.5 pts to 65.5 (May)	**Real GDP** revised to -1.0% a.r. (Q1) **Real Personal Spending** -0.3% (Apr.)
Japan ▪ Sales tax hike pushes inflation to 23-year high ▪ BoJ Minutes indicate debate on timing of when 2% inflation target will be reached	**Consumer Price Index (core)** +3.2% y/y (Apr.)—fastest increase since 1991 **Jobless Rate** unch at 3.6% (Apr.) **Jobs-to-Applicant Ratio** rose to 1.08 (Apr.)	**Retail Sales** -13.7% (Apr.) **Household Spending** -4.6% y/y (Apr.) **Industrial Production** -2.5% (Apr. P)
Europe ▪ Waiting for the ECB next week… ▪ Slowing money supply and credit growth add pressure on ECB ▪ European Parliamentary elections see surge in anti-Europe parties	**Eurozone—Economic Confidence** +0.7 pts to 102.7 (May) **Germany—GfK Consumer Confidence** unch at 8.5 (June) **U.K.—GfK Consumer Confidence** +3 pts to 0 (May)	**Eurozone—Smoothed M3** slowed to 1.0% y/y (3 mths to Apr.) **Germany—Unemployment** +24,000 (May) **Germany—Retail Sales** -0.9% (Apr.) **France—Consumer Spending** -0.3% (Apr.) **Italy—Consumer Prices** -0.1% (May P)
Other ▪ China cuts reserve ratio for some banks ▪ Brazil on hold		**India—Real GDP** +4.6% y/y (Q1)—below expected **Brazil—Real GDP** slowed to +1.9% y/y (Q1)

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

Loonie Key to BoC Rate Cycle

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April's inflation report has all but shut the door on Bank of Canada rate cut speculation. While it's clear that policy rates are going nowhere for some time yet, expect the conversation to shift to the timing of eventual rate hikes as we move through the rest of 2014. We don't expect the next round of tightening to start until the second half of next year, but it's worth exploring the four major factors that will determine when Governor Poloz pulls the trigger.

1) Inflation

The Bank of Canada views everything from an inflation perspective. This should come as no surprise given that the 2% inflation target is the Bank's sole mandate. Headline inflation jumped to 2% in April and is likely to hold there for another month before hovering in the 1.5%-to-2% range through the rest of 2014. Governor Poloz said the Bank will look through the energy-induced rise in total inflation; however, core inflation has perked up as well. While far from scorching at 1.4% y/y, that's two ticks above the BoC's April MPR forecast and short-term trends are pointing upward—core is 2.2% annualized through the first four months of the year (*Chart 1*). And, the weaker loonie and anticipated firmer activity are expected to put upward pressure on inflation over the next couple of years.

2) Output Gap

Perhaps the most compelling reason for the BoC to raise rates in-line with the Fed, or perhaps even earlier, is Canada's relatively small output gap. The 2008/09 recession didn't hit Canada nearly as hard as the U.S., leaving much less ground to make up. Indeed, the BoC estimates the output gap is between 0.5% and 1.5% of GDP; while in the U.S., that figure is likely at least twice as large (*Chart 2*). If the economy expands at around a 2.5% quarterly annualized pace on average over the rest of 2014 and through 2015 (well-above about 2% potential growth), the output gap will be all but closed by the end of next year. Barring a change in the assessment of potential growth, such an outcome would be consistent with rising inflation, which brings us back to #1, the Bank's focus on inflation. Even if price pressures don't immediately materialize, it would likely be just a matter of time before inflation picks up.

3) Household Debt

One of the lasting legacies of the Mark Carney era at the Bank is that monetary policy has evolved into flexible inflation targeting, providing some wiggle room if necessary. This flexibility was invoked over the past couple of years as high household debt levels

Chart 1
Slowly on the Rise
Canada

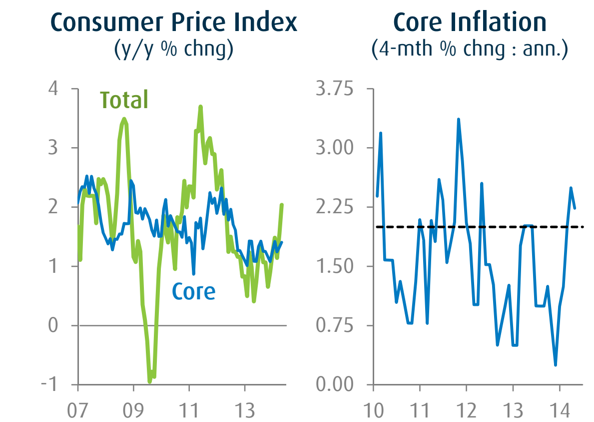
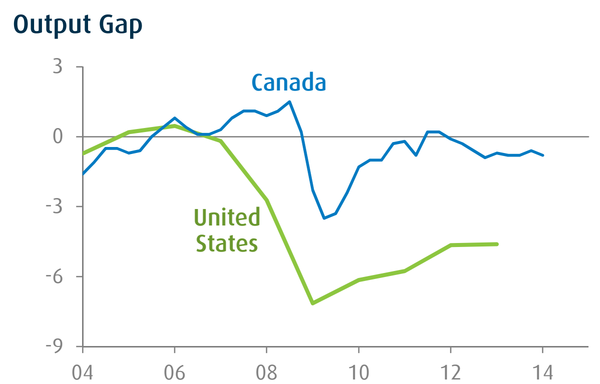
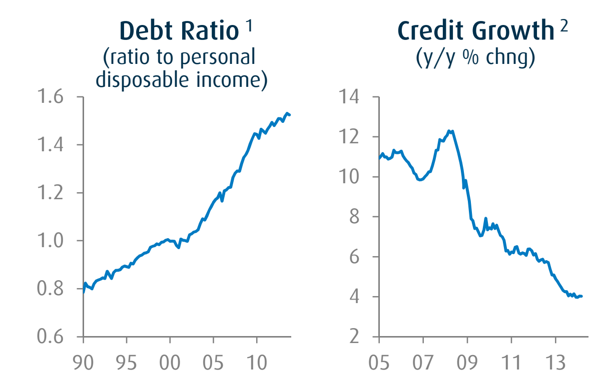


Chart 2
Mind the Gap
(percent)



Sources: Bank of Canada, Congressional Budget Office

Chart 3
Elevated Debt Levels Still a Concern
Canada



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

were used as an excuse not to cut rates even as the economy remained soft. Recall that Governor Carney highlighted household debt as a pretext for a tightening bias, while more recently it's reasonable to believe that Governor Poloz would have cut rates late last year due to well-below-target inflation if not for elevated household debt levels. Notably, the deceleration in household credit growth has ended, holding at around a 4% annual rate since last summer (*Chart 3*). And, with home-buying season picking up and prices strong, credit growth could accelerate. While not an immediate concern, household debt levels and potentially firmer credit growth argue for earlier tightening from the BoC.

4) The Canadian Dollar

Despite the three points above, there's one key reason the BoC could choose to lag the Fed when rate hikes eventually come: the Canadian dollar. Since Governor Poloz took the reins, the Canadian dollar had been in steady retreat, until recently (*Chart 4*). Through the first year of his tenure, Poloz has been consistently dovish, first dropping the tightening bias, and later leaving the door to rate cuts wide open. The latest MPR was a clear sign of the Bank's dovish leanings, with the statement and MPR all but ignoring the upward revisions to core CPI projections. Indeed, the low starting point for core CPI was a key concern for the Bank at the turn of the year, and the upward revision in April should have eased those worries (even if only slightly). The apparent dovish slant to the BoC had kept the Canadian dollar on the defensive. The loonie's resilience of late likely isn't a welcome development for policymakers, as they are counting on exports to boost growth. A recent BoC paper noted that about half of exports are underperforming historical trends—a weaker currency would certainly help turn that around (*Chart 5*).

Given our forecast for improving Canadian growth and a weakening C$ over the next year, we're sticking with our call for the Bank and Fed to hike rates for the next/first time in July 2015 (*Chart 6*). An earlier rate hike should not be ruled out, but only if inflation forces the Bank's hand and the loonie isn't meaningfully stronger than current levels. However, if the currency stays around current levels or better, there's a solid chance Governor Poloz will choose to lag the Fed by a few months in an effort to weaken the loonie and provide a boost to exports. Such a scenario has little downside for the BoC, aside from financial stability concerns.

Bottom Line: It's steady as she goes for Governor Poloz, with the risks tilted toward a later rate hike—particularly if the Canadian dollar keeps creeping higher.

Chart 4

One Way Bet?

(US$/C$: as of May 30, 2014)

Canadian Dollar

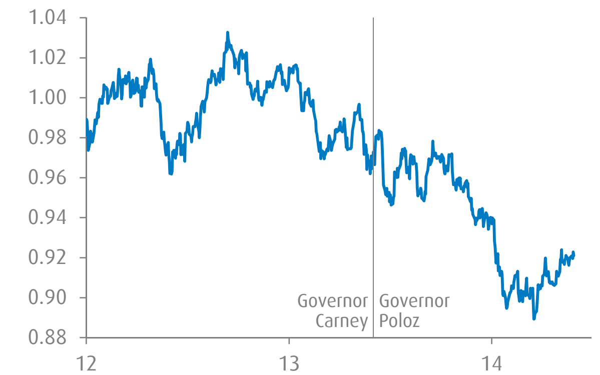


Chart 5

Canadian Exporters' Lost Decade

(2000:Q1 = 100)

Trade — Real Goods and Services

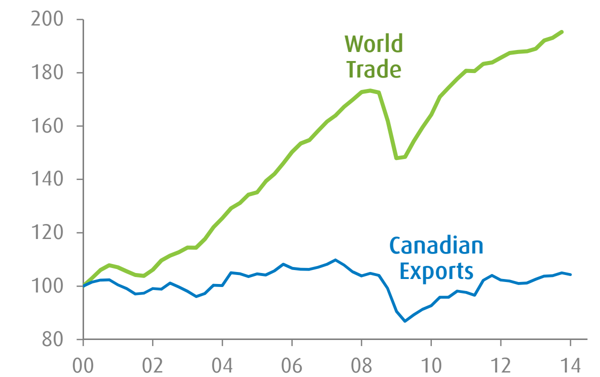
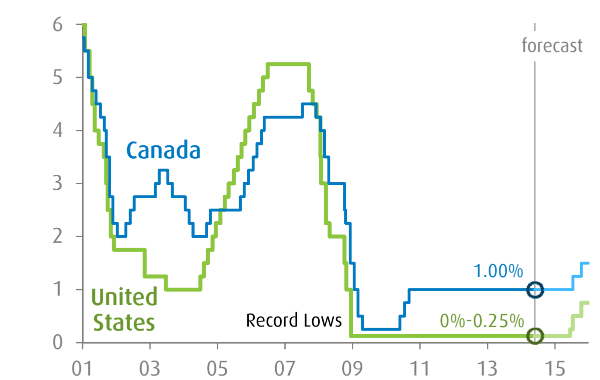


Chart 6

Rate Hikes on the Horizon

(% : as of May 30, 2014)

Overnight Rate



Economic Forecast Summary for May 30, 2014

BMO Capital Markets Economic Research

	2014				2015				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2013	2014	2015
CANADA											
Real GDP (q/q % chng : a.r.)	1.2	2.5	2.5	2.3	2.4	2.5	2.8	2.7	2.0	2.2 ↓	2.5
Consumer Price Index (y/y % chng)	1.4	1.9	1.8	2.0	1.8	1.7	1.9	2.0	0.9	1.8	1.8
Unemployment Rate (percent)	7.0	6.9	6.9	6.8	6.7	6.7	6.6	6.5	7.1	6.9	6.6
Housing Starts (000s : a.r.)	175	188	175	180	181	176	179	184	188	180	180
Current Account Balance ($blns : a.r.)	-49.5	-50.5 ↓	-50.0 ↑	-46.0 ↑	-43.6 ↑	-41.0 ↑	-38.4 ↑	-34.8 ↑	-60.3	-49.0	-39.5 ↑
Interest Rates	(average for the quarter : %)										
Overnight Rate	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.50	1.00	1.00	1.19
3-month Treasury Bill	0.87	0.93	0.93	0.93	0.93	0.93	1.19	1.45	0.97	0.92	1.12
10-year Bond	2.47	2.34 ↓	2.51 ↓	2.90 ↓	3.14 ↑	3.29 ↑	3.43 ↑	3.55 ↑	2.26	2.55 ↓	3.35 ↑
Canada-U.S. Interest Rate Spreads	(average for the quarter : bps)										
90-day	82	90	90	90	90	87	82	84	91	88	86
10-year	-30	-25	-24 ↑	-23 ↑	-20 ↑	-17 ↑	-16 ↑	-16 ↑	-9	-25 ↑	-17 ↑
UNITED STATES											
Real GDP (q/q % chng : a.r.)	-1.0	3.8	2.9	3.0	3.1	3.3	2.9	2.9	1.9	2.2 ↓	3.1
Consumer Price Index (y/y % chng)	1.4	1.9	1.9	2.0	2.0	2.0	2.0	2.0	1.5	1.8	2.0
Unemployment Rate (percent)	6.7	6.3	6.2	6.0	5.8	5.6	5.4	5.2	7.4	6.3	5.5
Housing Starts (mlns : a.r.)	0.92	1.02	1.14	1.22	1.28	1.30	1.31	1.33	0.93	1.08	1.30
Current Account Balance ($blns : a.r.)	-370 ↓	-364 ↓	-363 ↓	-363 ↓	-361 ↓	-365 ↓	-366 ↓	-367 ↓	-379	-365 ↓	-365 ↓
Interest Rates	(average for the quarter : %)										
Fed Funds Target Rate	0.13	0.13	0.13	0.13	0.13	0.17	0.50	0.75	0.13	0.13	0.39
3-month Treasury Bill	0.05	0.03	0.03	0.03	0.03	0.07	0.37	0.60	0.06	0.03	0.27
10-year Note	2.76	2.59 ↓	2.75 ↓	3.13 ↓	3.33	3.46	3.58	3.71	2.35	2.81 ↓	3.52
EXCHANGE RATES	(average for the quarter)										
US¢/C$	90.6	90.7	89.8	88.9	88.1	87.2	87.0	87.0	97.1	90.0	87.3
C$/US$	1.103	1.103	1.114	1.125	1.135	1.146	1.150	1.150	1.030	1.111	1.145
¥/US$	103	102 ↓	104 ↓	107	109	111	113	114	98	104	112
US$/Euro	1.37	1.37	1.36	1.35	1.37	1.36	1.34	1.32	1.33	1.36	1.35
US$/£	1.66	1.68	1.68	1.68	1.70	1.70	1.69	1.68	1.56	1.68	1.69

Blocked areas represent BMO Capital Markets forecasts
Up and down arrows indicate changes to the forecast ↑↓

Canada

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Merchandise Trade Balance

Wednesday, 8:30 am

Apr. (e)	**+$250 mln**
Consensus	*-$230 mln*
Mar.	+$79 mln

Canada's merchandise trade account is expected to record its third straight surplus to the tune of around $250 mln in April. And, with the Q1 current account data showing a larger-than-expected goods surplus, there should be sizeable upward revisions to prior months. Energy exports are expected to remain firm, though natural gas prices softened in the month. Oil prices gained ground, despite a modestly stronger C$, leaving volumes as the wildcard. Non-energy exports look to rise for the fifth time in the past six months, quietly making decent progress—though there's still a lot of room for improvement. Imports have been racking up similar gains, keeping the non-energy deficit near record levels. If trade is going to add to growth over the next couple of years as we anticipate, non-energy exports will need to gain a bit of steam. A weaker C$ will help, but stronger global demand (especially in the U.S.) is essential.

Bank of Canada Policy Announcement

Wednesday, 10:00 am

The Bank of Canada is widely expected to hold policy rates steady at 1% for the 30th consecutive meeting—nearing four years—on June 4. Inflation has been the Bank's key concern since late last year, but the latest CPI report should have provided some relief. With headline inflation at 2% and right in line with U.S. trends, it's tough to claim that "*inflation in Canada remains low*". Look for that phrase to be fine-tuned, or dropped altogether, and the opening paragraph on inflation possibly moved to a less prominent position later in the statement. While the Bank should realistically also soften the phrase "*downside risks to inflation remain important*", there's a decent chance it will remain in the statement as core inflation is still subdued at 1.4% y/y. Perhaps Poloz will downgrade the concern on that front. With respect to the economy, conditions appear to be evolving largely in-line with the BoC's April MPR forecast, leaving little need for a change in tone. Overall, while the Bank should take a slightly less dovish tone on inflation, look for Poloz to ensure that the language remains dovish enough—possibly by highlighting the ongoing disappointing export performance—to keep the Canadian dollar from building on its recent gains. For more on the Bank of Canada, see this week's Focus feature (page 6).

Employment

Friday, 8:30 am

May (e)	**+25,000 (+0.1%)**
Consensus	*+21,300 (+0.1%)*
Apr.	-28,900 (-0.2%)
	Unemployment Rate
May (e)	**6.9%**
Consensus	*6.9%*
Apr.	6.9%
	Average Hourly Wages
May (e)	**+2.1% y/y**
Apr.	+1.8% y/y

Canadian employment is expected to rise 25,000 in May, retracing much of the prior month's surprising drop. Good Friday falling on the survey week in April may have impacted the headline—the holiday shouldn't have significantly impacted whether one has a job or not—but definitely weighed heavily on hours worked. Look for the latter to rebound sharply, as has been the case in past years with similar calendar quirks. Employment growth has been quite weak in recent months, averaging less than 3,000 over the past 3 and 6 months, and only 12,400 over the past year. Part of the softness in employment is weak labour force growth, as the jobless rate is actually down from a year ago despite lacklustre hiring. However, there's still some slack in the labour market and we'll need to see stronger economic growth if employment is going to strengthen. While projecting employment gains for any given sector is exceptionally difficult, big losses in accommodation and food services and finance last month suggest that those sectors could be among the better performers in May. The jobless rate was just barely sitting at 6.9% in April and could move up a tick if labour force growth rebounds.

United States

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Manufacturing ISM

Monday, 10:00 am

	PMI	Prices Paid
May (e)	**54.9**	**56.9**
Consensus	*55.5*	*56.9*
Apr.	54.9	56.5

Following successive gains, the manufacturing index likely stalled in May according to the regional surveys. Still, the backdrop for factories has improved. Nearly all industries expanded in April, and the respondents' comments were generally upbeat. Manufacturing output has fully recovered after a horrid winter and looks set for continued growth this year.

Goods & Services Trade Deficit

Wednesday, 8:30 am

Apr. (e)	**$40.0 bln**
Consensus	*$40.6 bln*
Mar.	$40.4 bln

Trade undercut growth in the first quarter, as harsh weather hampered exports more than imports. An export rebound should support growth in Q2 and trim the trade gap to $40 billion in April. Stronger domestic demand will lift imports, though declining energy purchases should limit the increase. While the U.S. current account deficit could rise to 2.2% of GDP in Q1, that's still down from 2.5% a year ago thanks largely to the shale energy boom.

Nonmanufacturing ISM

Wednesday, 10:00 am

May (e)	**55.0**
Consensus	*55.5*
Apr.	55.2

The nonmanufacturing index likely pulled back in May from eight-month highs. While mining, construction and retail trade should increase, the return of more seasonable temperatures will curb utilities output. The April survey reported that 14 of 18 industries expanded in the month, the most since last summer, suggesting the expansion is broadening. With new orders perched at eight-month highs, activity should improve further this year.

Beige Book

Wednesday, 2:00 pm

The last Beige Book struck a more upbeat chord, citing firmer activity *"in most regions"*, but still described growth as *"modest to moderate"*. With business leaders more optimistic, consumers on an upswing, and the polar vortex in hibernation, the new report should upgrade this assessment to "moderate". It should also confirm that labor markets are making steady headway and that some regions are having difficulty finding skilled help, keeping the Fed's nose to the tapering grindstone.

Nonfarm Payrolls

Friday, 8:30 am

8:30 am	**Nonfarm Payrolls**
May (e)	**+200,000**
Consensus	*+219,000*
Apr.	+288,000
8:30 am	**Unemployment Rate**
May (e)	**6.4%**
Consensus	*6.4%*
Apr.	6.3%

Although jobless claims hover at seven-year lows, they jumped in the payroll survey week, so expect a slowing in nonfarm payrolls growth to 200,000 in May from two-year highs of 288,000 in April. The expected increase is in line with the past-year mean (197,000). It would normally lead to lower unemployment, but the jobless rate plunged 0.4 ppts in April (only the fourth time that's happened in three decades) due to a sharp drop in the participation rate to 36-year lows. So, the jobless rate should edge up to 6.4%, as discouraged workers troop back to the labor force. The Fed will have an eye on other measures of slack in the report, including the duration of joblessness and the number of part-time workers for economic reasons. Note that, barring a soft May figure or a downward revision to prior months' data, nonfarm payrolls will have finally recovered the 8.7 million jobs lost during the Great Recession—five years after it ended.

Financial Markets Update

BMO Capital Markets

		May 30 [1]	May 23	Week Ago	4 Weeks Ago	Dec. 31, 2013
					(basis point change)	
Canadian Money Market	Call Money	1.00	1.00	0	0	0
	Prime Rate	3.00	3.00	0	0	0
U.S. Money Market	Fed Funds (effective)	0.25	0.25	0	0	0
	Prime Rate	3.25	3.25	0	0	0
3-Month Rates	Canada	0.92	0.92	0	-2	1
	United States	0.03	0.03	0	2	-4
	Japan	0.05	0.04	1	-1	-1
	Eurozone	0.31	0.32	-1	-3	2
	United Kingdom	0.53	0.53	0	1	1
	Australia	2.72	2.69	3	4	12
2-Year Bonds	Canada	1.05	1.05	0	-2	-8
	United States	0.38	0.34	3	-5	-1
10-Year Bonds	Canada	2.25	2.30	-5	-10	-50
	United States	2.48	2.53	-6	-11	-55
	Japan	0.57	0.59	-1	-3	-16
	Germany	1.36	1.41	-5	-9	-57
	United Kingdom	2.57	2.63	-7	-7	-45
	Australia	3.66	3.78	-13	-25	-58
Risk Indicators	VIX	11.6	11.4	0.2 pts	-1.4 pts	-2.2 pts
	TED Spread	20	20	0	-1	2
	Inv. Grade CDS Spread [2]	63	63	-1	-1	0
	High Yield CDS Spread [2]	317	322	-5	-27	11
					(percent change)	
Currencies	US¢/C$	92.17	92.07	0.1	1.1	-2.1
	C$/US$	1.085	1.086	—	—	—
	¥/US$	101.77	101.97	-0.2	-0.4	-3.4
	US$/€	1.3623	1.3629	0.0	-1.8	-0.9
	US$/£	1.675	1.683	-0.5	-0.7	1.2
	US¢/A$	92.96	92.31	0.7	0.2	4.3
Commodities	CRB Futures Index	305.98	308.26	-0.7	-0.4	9.2
	Oil (generic contract)	102.95	104.35	-1.3	3.2	4.6
	Natural Gas (generic contract)	4.52	4.41	2.6	-3.3	6.8
	Gold (spot price)	1,251.76	1,292.56	-3.2	-3.7	3.8
Equities	S&P/TSX Composite	14,560	14,708	-1.0	-1.4	6.9
	S&P 500	1,919	1,901	1.0	2.0	3.8
	Nasdaq	4,248	4,186	1.5	3.0	1.7
	Dow Jones Industrial	16,677	16,606	0.4	1.0	0.6
	Nikkei	14,632	14,462	1.2	1.2	-10.2
	Frankfurt DAX	9,940	9,768	1.8	4.0	4.1
	London FT100	6,850	6,816	0.5	0.4	1.5
	France CAC40	4,509	4,493	0.4	1.1	5.0
	S&P ASX 200	5,493	5,493	0.0	0.6	2.6

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

Global Calendar: June 2 – June 6

BMO Capital Markets®

	Monday June 2	Tuesday June 3	Wednesday June 4	Thursday June 5	Friday June 6
Japan	**Capital Spending** **Q1 (e) +5.8% y/y** Q4 +4.0% y/y **Manufacturing PMI** **May F (e) 49.9** Apr. 49.4		**Services PMI** **May** Apr. 46.4 **Composite PMI** **May** Apr. 46.3		**Leading Index** **Apr. P (e) 106.2** Mar. 107.1
Euro Area	EURO AREA **Manufacturing PMI** **May F (e) 52.5** Apr. 53.4 GERMANY **Consumer Price Index** **May P (e) +0.1% +1.0% y/y** Apr. -0.3% +1.1% y/y T-Bill Auction: Netherlands, France	EURO AREA **Consumer Price Index** **May P (e) +0.6% y/y** Apr. +0.7% y/y **Core CPI** **May P (e) +0.9% y/y** Apr. +1.0% y/y ITALY **Jobless Rate** **Apr. P (e) 12.8%** Mar. 12.7% T-Bill Auction: Belgium, ESM Bond Auction: Austria	EURO AREA **Services PMI** **May F (e) 53.5** Apr. 53.1 **Composite PMI** **May F (e) 53.9** Apr. 54.0 **Real GDP** **Q1 P (e) +0.2% +0.9% y/y** Q1 A +0.2% +0.9% y/y Q4 +0.2% +0.5% y/y **Producer Price Index** **Apr. (e) -0.1% -1.2% y/y** Mar. -0.2% -1.6% y/y G7 Leaders Meet in Brussels (June 4-5) Bond Auction: Germany	EURO AREA **Retail Sales** **Apr. (e) unch +1.2% y/y** Mar. +0.3% +0.9% y/y **Retail PMI** **May** Apr. 51.2 GERMANY **Factory Orders** **Apr. (e) +1.4% +4.6% y/y** Mar. -2.8% +1.5% y/y ECB Monetary Policy Meeting Bond Auction: France, Spain	GERMANY **Industrial Production** **Apr. (e) +0.4% +2.7% y/y** Mar. -0.5% +3.0% y/y **Trade Surplus** **Apr. (e) €15.1 bln** Mar. €16.4 bln FRANCE **Trade Deficit** **Apr. (e) €5.0 bln** Mar. €4.9 bln
U.K.	**Manufacturing PMI** **May (e) 57.0** Apr. 57.3	**Construction PMI** **May (e) 61.0** Apr. 60.8 **Nationwide House Prices** **May (e) +0.6% +10.9% y/y** Apr. +1.2% +10.9% y/y	**Services PMI** **May (e) 58.2** Apr. 58.7 **Composite PMI** **May (e) 58.7** Apr. 59.2 Bank of England Monetary Policy Meeting (June 4-5)		**Trade Deficit Non-EU** **Apr. (e) £8.6 bln £3.2 bln** Mar. £8.5 bln £3.2 bln
Other	CHINA **Manufacturing PMI** D **May (e) 50.7** Apr. 50.4 China markets closed (Holiday) AUSTRALIA **Building Approvals** **Apr. (e) +2.0% +12.3% y/y** Mar. -3.5% +20.0% y/y	CHINA **Non-manufacturing PMI** D **May** Apr. 50.4 **HSBC Manufacturing PMI** **May F (e) 49.7** Apr. 48.1 **HSBC PMI Services Composite** **May** Apr. 51.4 49.5 AUSTRALIA **Retail Sales** **Apr. (e) +0.3%** Mar. +0.1% Reserve Bank of Australia Monetary Policy Meeting INDIA Reserve Bank of India Monetary Policy Meeting	AUSTRALIA **Real GDP** **Q1 (e) +0.9% +3.2% y/y** Q4 +0.8% +2.8% y/y	CHINA **HSBC PMI Services Composite** **May** Apr. 51.4 49.5 AUSTRALIA **Trade Surplus** **Apr. (e) A$510 mln** Mar. A$731 mln	CHINA **Trade Surplus** D **May (e) $22.8 bln** Apr. $18.5 bln

D = date approximate

North American Calendar: June 2 – June 6

BMO Capital Markets®

Canada

Monday June 2

9:30 am **RBC Manufacturing PMI**
May
Apr. 52.9

Auto Sales[D]
May
Apr. +4.0% y/y

Tuesday June 3

10:35 am 3-, 6- & 12-month T-bill auction $13.0 bln (new cash -$3.2 bln)

Wednesday June 4

8:30 am **Merchandise Trade Balance**
Apr. (e) **+$250 mln**
Consensus *-$230 mln*
Mar. +$79 mln

10:00 am BoC Policy Announcement

Quebec Budget

Thursday June 5

8:30 am **Building Permits**
Apr. (e) **+4.0%**
Mar. -3.0%

10:00 am **Ivey Purchasing Managers' Index (s.a.)**
May
Apr. 54.1

30-year real return bond auction announcement

Friday June 6

8:30 am **Employment**
May (e) **+25,000 (+0.1%)**
Consensus *+21,300 (+0.1%)*
Apr. -28,900 (-0.2%)

8:30 am **Unemployment Rate**
May (e) **6.9%**
Consensus *6.9%*
Apr. 6.9%

8:30 am **Average Hourly Wages**
May (e) **+2.1% y/y**
Apr. +1.8% y/y

8:30 am **Labour Productivity**
Q1 (e) **unch**
Q4 +1.0%

United States

Monday June 2

9:45 am **Markit Manufacturing PMI (May F)**

10:00 am **Manufacturing ISM**

	PMI	Prices Paid
May (e)	**54.9**	**56.9**
Consensus	*55.5*	*56.9*
Apr.	54.9	56.5

10:00 am **Construction Spending**
Apr. (e) **+0.6%**
Consensus *+0.7%*
Mar. +0.2%

Total Vehicle Sales[D]
May (e) **16.2 mln a.r.**
Consensus *16.1 mln a.r.*
Apr. 16.0 mln a.r.

Fed Speaker: Chicago's Evans (3:00 am)

11:00 am 4-week bill auction announcement

11:30 am 13- & 26-week bill auction $48.0 bln

Note: At press time, Fed purchases for June have not yet been announced

Tuesday June 3

7:45 am **ICSC Same-Store Sales**
May 31
May 24 (mtd) -2.1% +2.7% y/y

8:55 am **Redbook Same-Store Sales**
May 31
May 24 (mtd) +0.7% +3.8% y/y

9:45 am **New York ISM**
May
Apr. 50.6

10:00 am **Factory Orders**
Apr. (e) **+0.3%**
Consensus *+0.5%*
Mar. +0.9%

10:00 am **IBD/TIPP Economic Optimism Index**
June (e) **46.5**[C]
May 45.8

Fed Speaker: Kansas City's George (1:50 pm)

11:30 am 4-week bill auction

Wednesday June 4

7:00 am **MBA Mortgage Apps**
May 30
May 23 -1.2%

8:15 am **ADP National Employment Report**
May (e) **+200,000**
Consensus *+215,000*
Apr. +220,000

8:30 am

	Productivity	Unit Labor Costs
Q1 F (e)	**-2.7% a.r.**	**+5.0% a.r.**
Consensus	*-2.6% a.r.*	*+4.8% a.r.*
Q1 P	-1.7% a.r.	+4.2% a.r.
Q4	+2.3% a.r.	-0.4% a.r.

8:30 am **Goods & Services Trade Deficit**
Apr. (e) **$40.0 bln**
Consensus *$40.6 bln*
Mar. $40.4 bln

8:30 am **International Trade revisions**

10:00 am **Nonmanufacturing ISM**
May (e) **55.0**
Consensus *55.5*
Apr. 55.2

2:00 pm Beige Book

Thursday June 5

7:30 am **Challenger Layoff Report**
May
Apr. +5.7% y/y

8:30 am **Initial Claims**
May 31 (e) **313k (+13k)**[C]
May 24 300k (-27k)

8:30 am **Continuing Claims**
May 24
May 17 2,631k (-17k)

12:00 pm **Flow of Funds (Q1)**

ICSC Chain-Store Sales
May
Apr. +6.2% y/y

Fed Speaker: Minnesota's Kocherlakota (1:30 pm)

11:00 am 13- & 26-week bill, 3-& 10R-year note, 30R-year bond auction announcements (R = reopening)

Friday June 6

8:30 am **Nonfarm Payrolls**
May (e) **+200,000**
Consensus *+219,000*
Apr. +288,000

8:30 am **Unemployment Rate**
May (e) **6.4%**
Consensus *6.4%*
Apr. 6.3%

8:30 am **Average Hourly Earnings**
May (e) **+0.2%**[C]
Apr. unch

3:00 pm **Consumer Credit**
Apr. (e) **+$16.0 bln**
Consensus *+$16.0 bln*
Mar. +$17.5 bln

[C] = consensus [D] = date approximate

Upcoming Policy Meetings | **Bank of Canada:** July 16, Sep. 3, Oct. 22 | **FOMC:** June 17-18, July 29-30, Sep. 16-17