Economic Developments and Outlook

Economic Developments in 2017 and Outlook for 2018

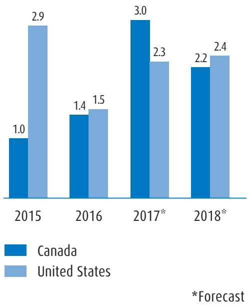
The Canadian economy rebounded sharply in 2017 after struggling for two years with the downturn in energy prices. The effects of this rebound were widespread across industries and regions. The fastest annual employment growth in nearly a decade and enhanced federal child benefit payments raised levels of disposable income, supporting consumer spending and driving record sales of new automobiles. While activity in the Greater Toronto Area housing market has weakened due to policy measures undertaken by the Ontario government, housing market activity strengthened in many regions this year, led by a recovery in Vancouver following earlier declines. Business investment in the energy-producing regions increased as a result of the recovery in oil prices. Canada's exports also strengthened in response to an upturn in the global economy, including the Eurozone and Japan. The Bank of Canada raised its policy rate twice in 2017, leading to a strong appreciation in the Canadian dollar. Overall, real GDP is expected to grow by 3.0% in 2017, more than double the previous year's rate and exceeding all other G7 countries. Looking ahead to 2018, the rate of GDP growth is expected to moderate to 2.2% due to higher interest rates and the stronger Canadian dollar. Growth in consumer spending will likely moderate in response to expected increases in interest rates, some moderation in employment growth and elevated household debt, reducing household loan growth to around 3.0% in 2018 from an estimated 3.6% in 2017. Although we expect that real estate markets in most regions will continue to benefit from good affordability and robust population growth, residential mortgage growth is projected to moderate to below 5.0% as a result of higher interest rates and stricter mortgage underwriting rules. An improvement in business sentiment should support business loan growth above 6.0% in 2018. The economic expansion is expected to reduce the unemployment rate to 5.7% by late 2018. The Bank of Canada is projected to lift its policy rate from the current 1.0% to 1.75% before the end of 2018. The Canadian dollar is expected to weaken modestly to around US$0.76 in 2018. Canada's economy faces the risk that more protectionist measures could be taken by the U.S. government if the North American Free Trade Agreement is not renegotiated. Additional risks include potential global market turbulence stemming from tensions between the United States and North Korea, and uncertain Brexit talks between the United Kingdom and the European Union.

The U.S. economy improved in 2017, led by an upturn in business investment in anticipation of deregulation and more expansionary fiscal policies. Despite this upturn in investment, business loan growth weakened, possibly due to uncertainty about trade and tax policies. Consumer spending remained strong, while housing market activity was steady. Exports were supported by increased global demand and some weakness in the U.S. dollar. Growing employment reduced the unemployment rate to a 16-year low of 4.1% in October. Household spending was supported by heightened consumer confidence, rising income and record wealth. Real GDP growth is expected to pick up from 1.5% in 2016 to 2.3% in 2017, and it is projected to strengthen modestly further to 2.4% in 2018 in response to proposed tax reductions. Firm household spending should sustain consumer loan growth above 5.0% in 2018. Housing market activity is expected to strengthen further in response to increased household formations and ongoing affordability, supporting an increase in residential mortgage growth to above 6.0% next year. Increased business spending on new equipment is projected to lift the rate of business loan growth above 5.0%. Interest rates will likely continue to rise moderately, with the Federal Reserve expected to raise its main policy rate from just above 1.0% currently to slightly above 2.0% before the end of 2018. The trade-weighted U.S. dollar is projected to remain firm due to rising interest rates. The unemployment rate is expected to fall below 4.0% in 2018. However, the U.S. economic outlook faces risks related to possible delays in proposed personal and corporate income tax reductions, protectionist trade policies and heightened geopolitical tensions.

The expansion in the U.S. Midwest region, which includes the six contiguous states within the BMO footprint, is expected to improve from 1.2% in 2016 to 1.5% in 2017 and to 1.8% in 2018, reflecting healthy business investment and stronger exports. However, the performance of the regional economy is expected to lag the national economy due to downshifting of production in the auto industry and restrained government spending in Illinois reflecting budgetary constraints.

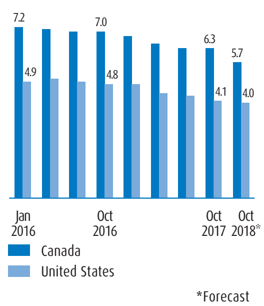
This Economic Developments and Outlook section contains forward-looking statements. Please see the Caution Regarding Forward-Looking Statements.

Real Growth in Gross Domestic Product (%)



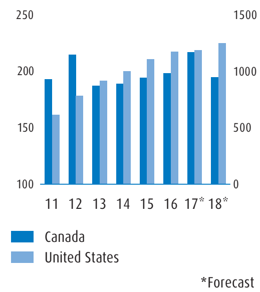
The Canadian and U.S. economies are expected to grow moderately in 2018.

Canadian and U.S. Unemployment Rates (%)



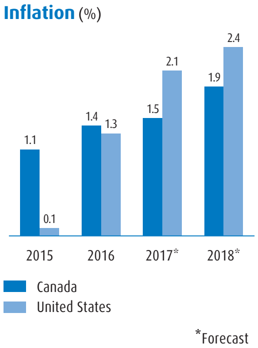
Unemployment rates in Canada and the United States are projected to decline modestly.

Housing Starts
(in thousands)



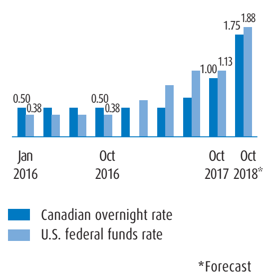
Housing market activity is expected to moderate in Canada but strengthen in the United States.

Consumer Price Index Inflation (%)



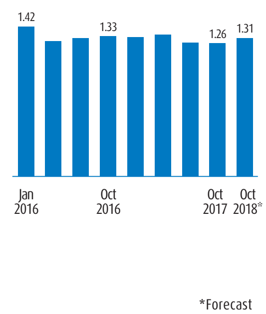
Inflation is expected to rise modestly but remain low.

Canadian and U.S. Interest Rates (%)



Central banks are expected to continue to raise policy rates in 2018.

Canadian/U.S. Dollar Exchange Rates



After rallying sharply in 2017, the Canadian dollar is expected to weaken modestly in 2018.

Data points are averages for the month, quarter or year, as appropriate. References to years are calendar years.