

Economic Developments and Outlook

Economic Developments in 2018 and Outlook for 2019

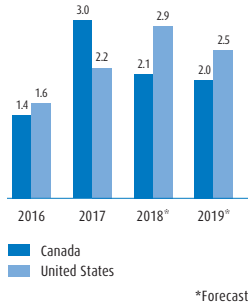
Growth in the Canadian economy moderated in 2018 after a robust expansion in 2017. Consumer spending slowed in response to higher interest rates, elevated household debt and slower employment growth. The level of housing market activity fell in the first half of the year as stricter mortgage rules took effect, although markets in most regions stabilized in the second half of the year as a result of population growth that was the highest in 27 years, reflecting record net immigration. Business investment strengthened early in the year, but weakened subsequently in response to rising concerns about trade protectionism. After a disappointing performance in 2017, export growth accelerated in response to stronger U.S. demand, a robust global economy and the relatively low value of the Canadian dollar compared with the U.S. dollar. The Bank of Canada raised its policy rate by 125 basis points over a 16-month period that ended in October 2018, and it is expected to increase rates by an additional 75 basis points before the end of 2019. After leading all other G7 countries with GDP growth of 3.0% in 2017, the rate of economic expansion in Canada is projected to moderate to 2.1% in 2018 and 2.0% in 2019, while remaining slightly above the country's longer-term potential growth rate. The unemployment rate is expected to decline modestly to a 45-year low of 5.6% before the end of 2019 from 5.8% in October 2018. Industry-wide consumer credit growth is projected to slow from an estimated 4.7% in 2018 to 3.2% in 2019. Residential mortgage growth is anticipated to moderate to below 4% in both years, the slowest pace since 2001, in response to higher borrowing costs and stricter mortgage rules. Non-financial business loan growth is projected to decelerate from an estimated 6.2% in 2018 to a still-healthy rate of 5.6% in 2019. By removing a downside risk that had been facing Canada's economy, the new United States-Mexico-Canada Agreement, assuming it is ratified by the legislatures in each country, should support an improvement in business spending and a modest increase in the value of the Canadian dollar to around US\$0.78 by year-end 2019.

Growth in the U.S. economy strengthened in 2018 due to expansionary fiscal policies. Deregulation and tax reform, including a sizeable decrease in corporate tax rates, led to sustained increases in business investment. Consumer spending remained strong in response to reductions in personal income taxes, healthy employment growth and record levels of household wealth. However, housing market activity moderated as higher borrowing costs and rising home prices eroded affordability. Despite an appreciation of the U.S. dollar, exports strengthened in response to robust global demand. After accelerating from a rate of 2.2% in 2017 to an estimated 2.9% in 2018, real GDP growth is projected to moderate to 2.5% in 2019 as a result of higher interest rates and reduced fiscal stimulus. The continued economic expansion is expected to reduce the unemployment rate to a 49-year low of 3.5% by the end of 2019 from 3.7% in October 2018. The Federal Reserve is expected to increase policy rates by a further 75 basis points before the end of 2019. The higher cost of borrowing will likely cause industry-wide consumer credit growth to moderate from an estimated 3.9% in 2018 to 3.7% in 2019, with residential mortgage growth easing from 3.9% to 3.8%. Slower growth in business spending is projected to reduce the rate of non-financial business loan growth to a still-healthy 5.8% rate in 2019. The main risks to the U.S. economic outlook relate to trade protectionism, geopolitical tensions and the possibility of rising inflation. While the tariffs imposed to date are unlikely to markedly slow the economy, additional protectionist measures could lead to more pronounced weakness and a rising unemployment rate.

The U.S. Midwest region, which includes the six contiguous states within the BMO footprint, has benefited from the pickup in national and global economic activity and manufacturing. Growth in the region's GDP is expected to improve from 1.0% in 2017 to 2.1% in 2018 and 1.9% in 2019. However, the regional rate of growth will likely continue to lag the national rate due to slower population growth, downshifting of automobile production in Indiana and continued budgetary constraints in Illinois.

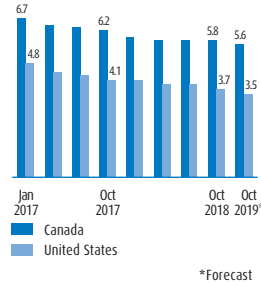
This Economic Developments and Outlook section contains forward-looking statements. Please see the Caution Regarding Forward-Looking Statements on page 29.

Real Growth in Gross Domestic Product (%)



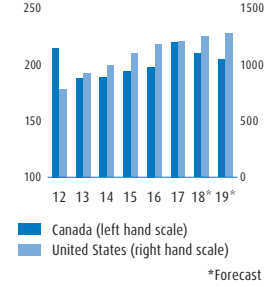
The U.S. economy is expected to grow modestly faster than the Canadian economy in 2019.

Canadian and U.S. Unemployment Rates (%)



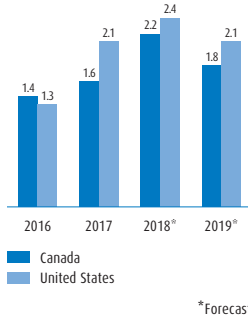
Unemployment rates in Canada and the United States are projected to further modestly decline.

Housing Starts (in thousands)



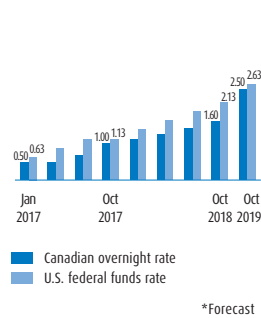
Housing market activity is expected to decline modestly in Canada, but strengthen somewhat in the United States.

Consumer Price Index Inflation (%)



Inflation is expected to remain low.

Canadian and U.S. Interest Rates (%)



Central banks are expected to continue to raise policy rates slowly.

Canadian/U.S. Dollar Exchange Rates



The Canadian dollar is expected to strengthen slightly in 2019.

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