

Economic Outlook: Picking Up Steam in 2014?

Michael Gregory, CFA Deputy Chief Economist and Head of US Economics, BMO Capital Markets



Weakest Recovery-Expansion in History

United States (% chng)

Real GDP

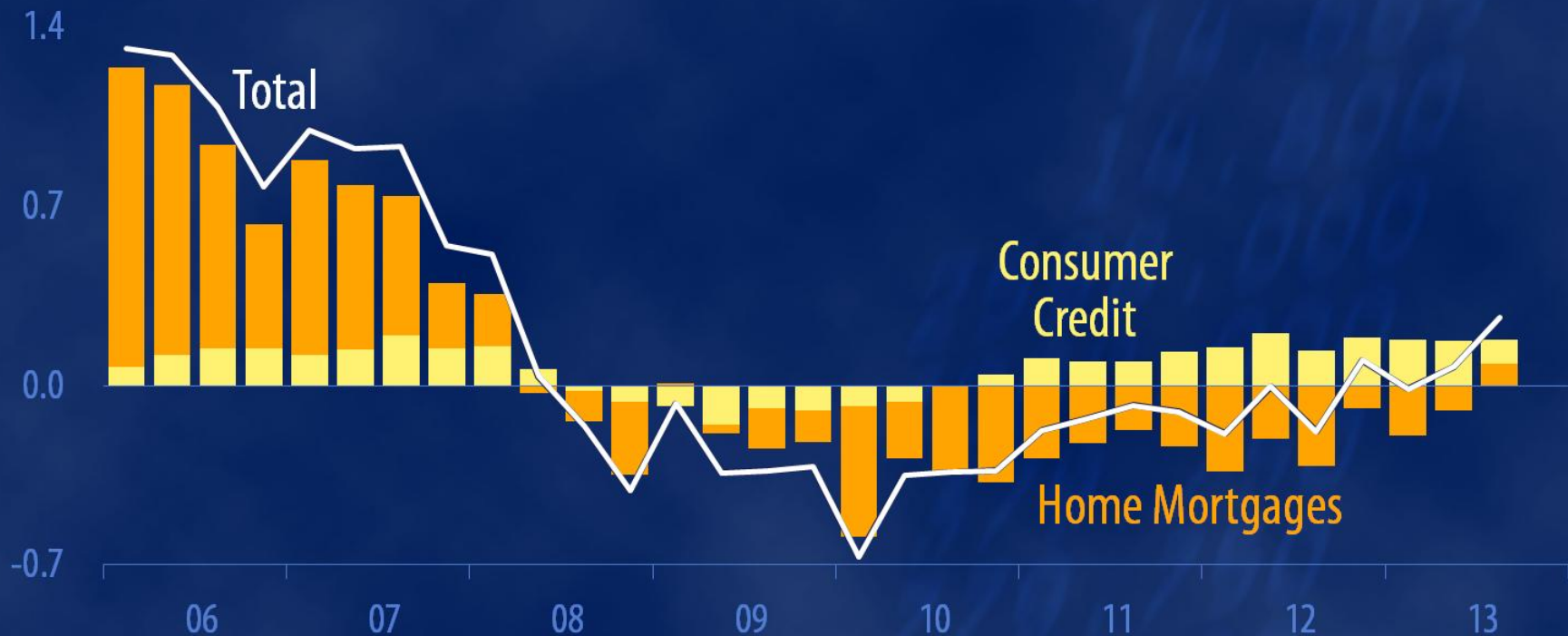


2013 Q4: Payback for Q3 inventories surge + government shutdown

Household Deleveraging Headwinds Ebbing

United States (\$ trlns : saar)

Household Credit Growth



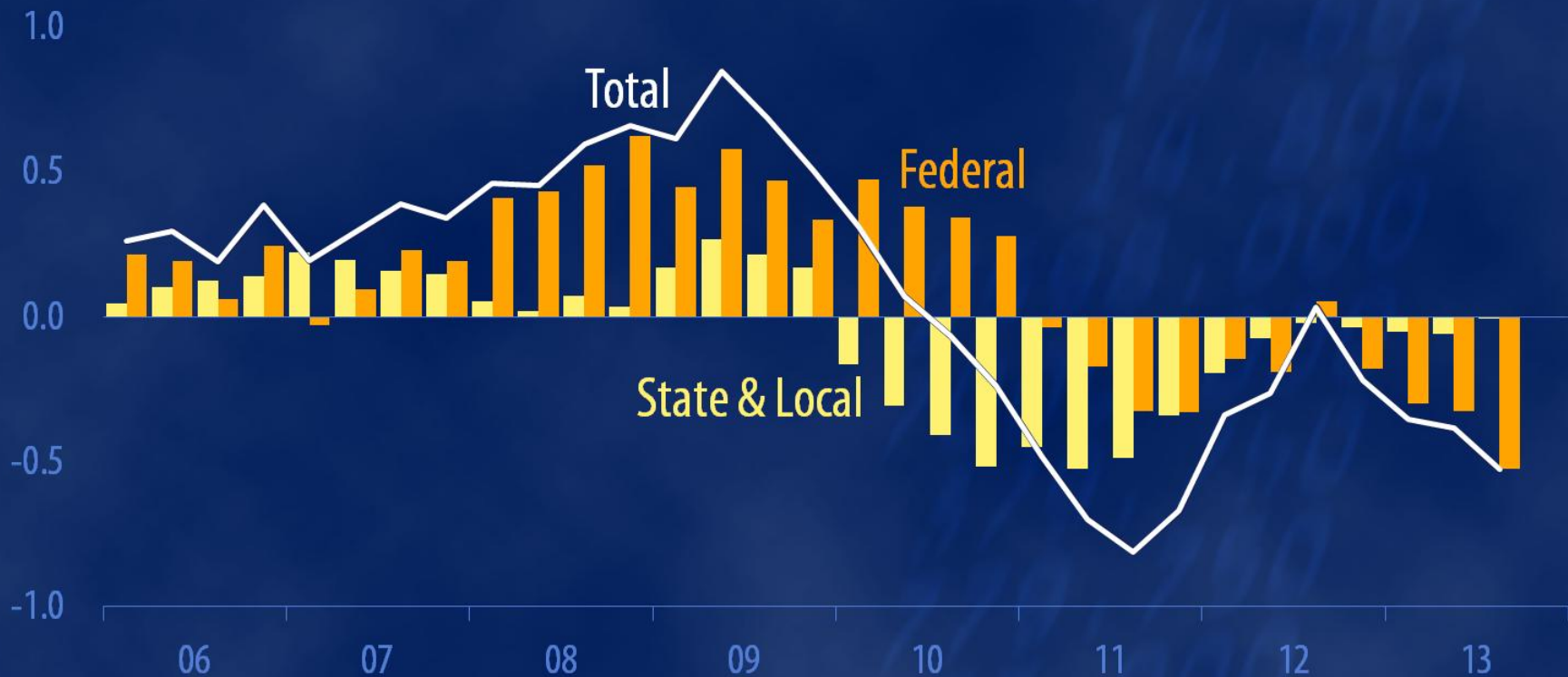
Net mortgages growing again

Households include nonprofit organizations

Government's a Drag

United States (ppts : saar : 4-qtr ma)

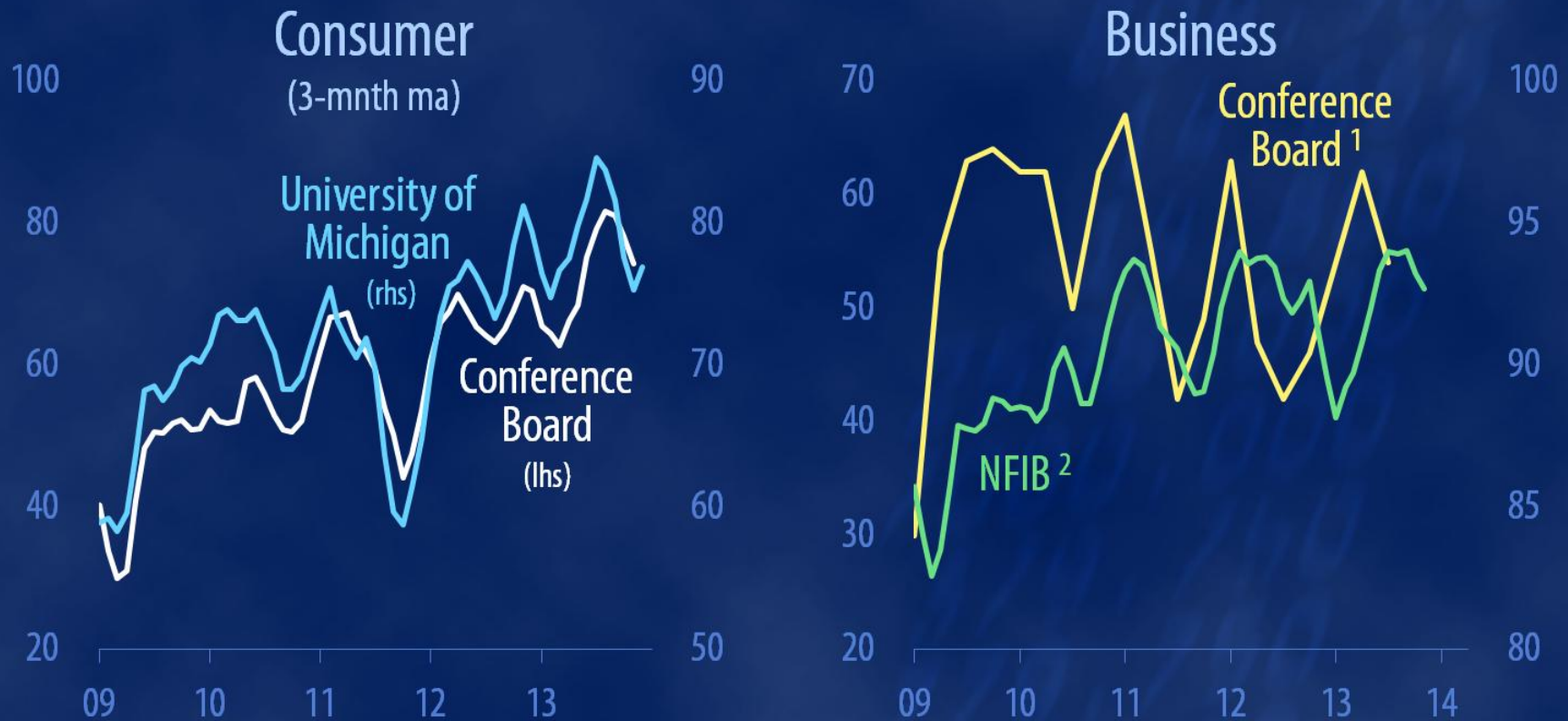
Contribution to Real GDP Growth from Government Spending



Budget deal could soften sequestered cuts

Fickle Confidence

Confidence Indices – United States



Reflecting both domestic and global concerns

¹ CEO Confidence Survey (lhs) ² NFIB Small Business Optimism Index (3-mnth ma : rhs)

Global Uncertainty: Are the Clouds Parting?



Euro Area:

Stagnant growth, ECB easing
Lack of job and credit growth

China:

7%-range the new normal for growth

Japan:

Growth resuming, inflation accelerating
VAT hike next year

Emerging markets:

Volatile capital flows

Geopolitics:

Syria, Egypt, North Korea

Domestic Uncertainty: Mostly Fiscal



Tax hikes... Sequestered spending cuts

16-day shutdown... Default scare

Obamacare rollout

New fiscal deadlines:

December 13 - Budget deal

January 15 - Funding runs out
(another shutdown?)

February 7 - Debt ceiling reactivated
(another default scare?)

The Case for 3% Growth



Ebbing Headwinds:

- Household deleveraging
- Fiscal consolidation
- Easily bruised confidence

Continued Tailwinds:

- Well-entrenched housing recovery
- Other pent-up demand unleashing
- Wealth effects
- Rising energy production
- Strong corporate balance sheets
- Extremely accommodative monetary policy

Housing Hangover Cured

Homes – United States

Sales and Inventories (mlns)



Months' Supply (ratio)



Housing Units (mlns)



Tightest housing segments since crest of bubble

Inventories = (nsa) include new and existing homes available for sale, and homes in foreclosure

Buying a Home Has Become a Wealth-building Proposition Again

Home Price Indices – United States (y/y % chng)



Knee Jerk Reaction to Mortgage Rate Rise, Fiscal Uncertainty

United States



Still historically very affordable

¹ Mortgage Applications for Purchase (4-wk ma : lhs) ² 30-year Fixed-rate Mortgages (% : rhs)

Wealth Effects

United States

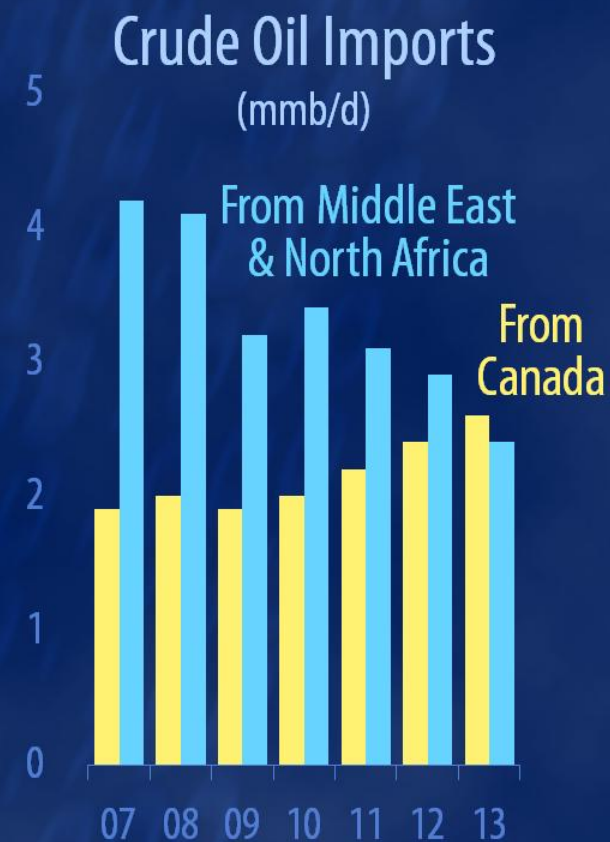
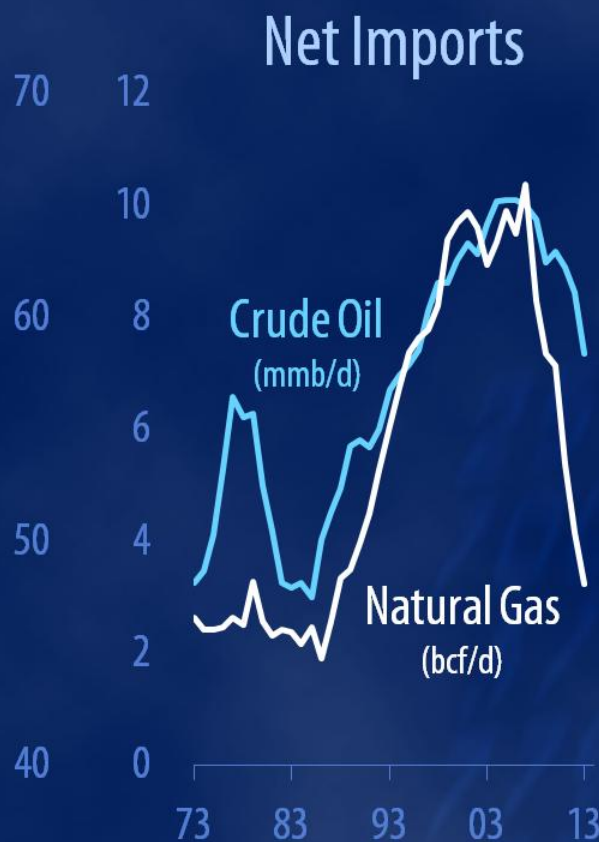
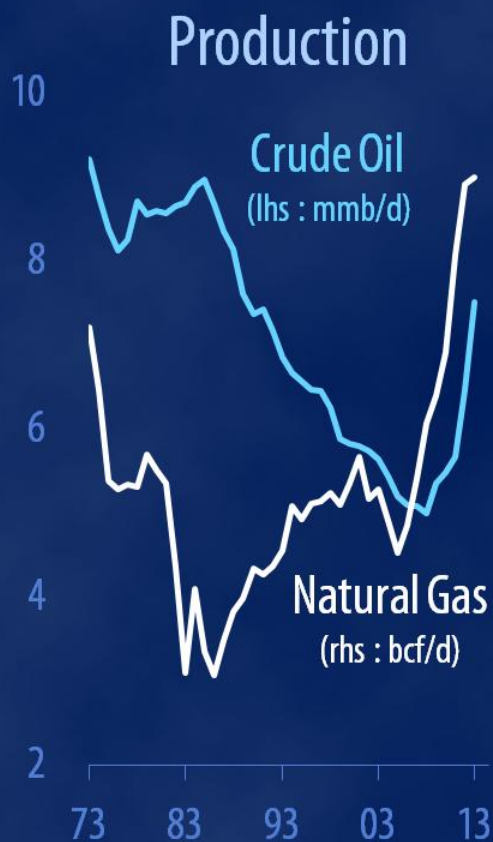


Average home prices recovered 18%, 17% to go

¹ Includes households & nonprofit organizations

US Energy Independence?

United States



From risky regions, yes; from Canada, no

Tapering Coming

(US\$ blns)

Base Case

FOMC Meeting	Treasuries		MBS		Total	
	Taper	Pace ¹	Taper	Pace ¹	Taper	Pace ¹
18-Dec-13	0	45	0	40	0	85
29-Jan-13	-5	40	-5	35	-10	75
19-Mar-14	-10	30	-5	30	-15	60
30-Apr-14	-5	25	-10	20	-15	45
18-Jun-14	-10	15	-5	15	-15	30
30-Jul-14	-5	10	-10	5	-15	15
18-Sep-14	-10	0	-5	0	-15	0

Skipping "Septaper" was a "relatively close call"

October FOMC: "...the Committee could decide to slow the pace of purchases at one of its next few meetings"

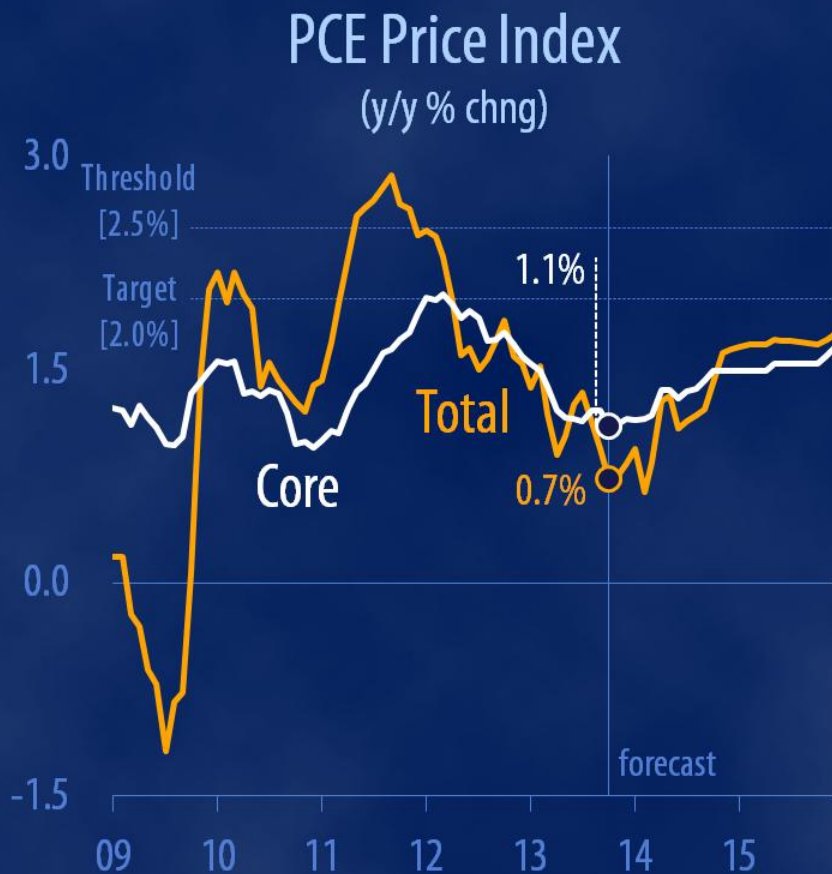
Probability of December < probability of January

Pushes policy rate liftoff to 2016:Q1

Source: BMO Capital Markets ¹ Beginning of the next month

Thresholds, Not Triggers

United States



Yellen-led Fed



Best person to sell “tapering is not tightening”

Forward guidance efforts:

Specifically cite employment rate or participation rate among *“additional measures of labor market conditions”*

Lower 6.5% unemployment threshold

Introduce lower threshold for inflation (1.5%)

Provide more detailed fed funds profile

Pressers after each FOMC meeting

Breaking Out of the Low-2% Rut

United States (% chng)

Real GDP



Canadian Economy in Transition

Canada (% chng)



Past growth drivers cooling down

- Housing
- Consumer spending
- Government spending

Future drivers have to heat up

- Exports
- Business investment

Canadian Economy to Underperform US

(q/q % chng : ar)



Reasons:

Canadian housing cooling,
US warming

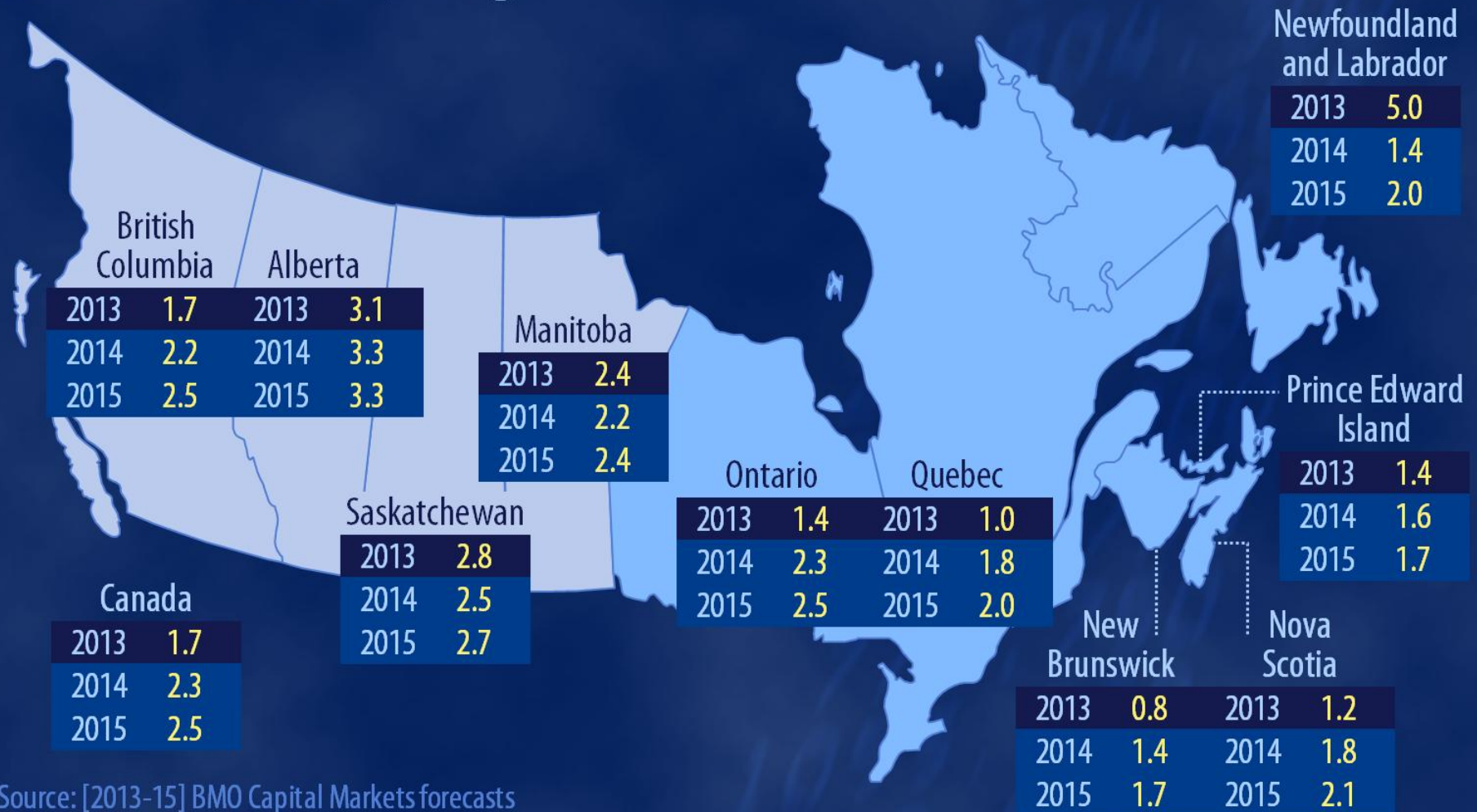
Canadian pent-up demand exhausted,
lots left in US

Bank of Canada on hold,
Fed easing aggressively

Strong C\$

West Still Best

Real GDP – Canada (% chng)

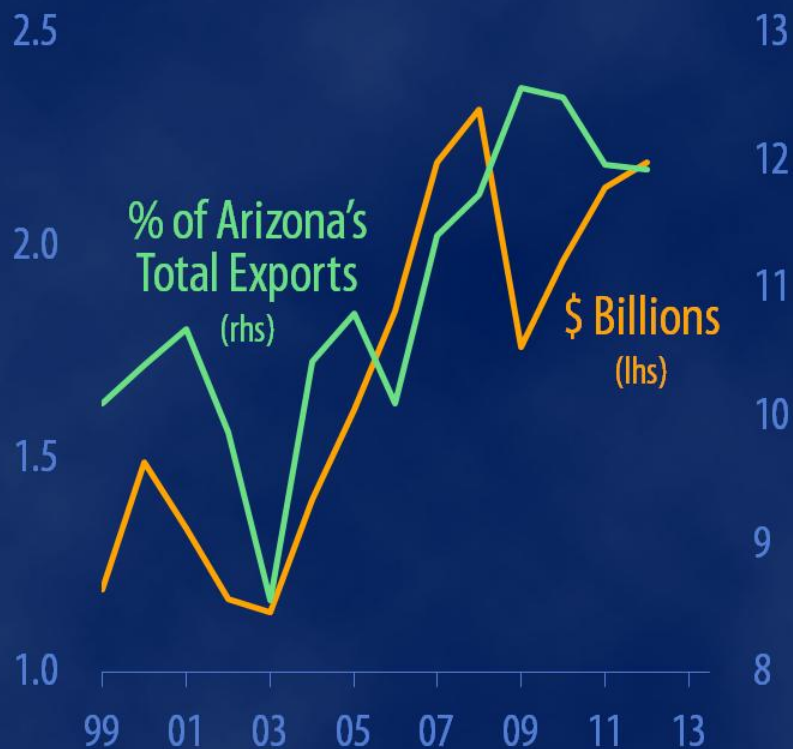


Source: [2013-15] BMO Capital Markets forecasts

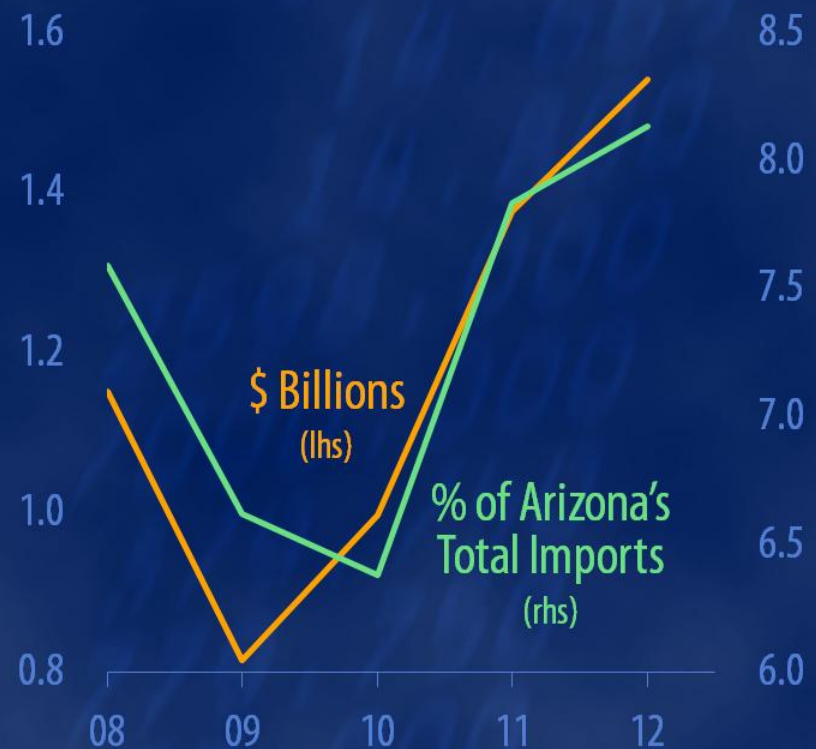
Arizona-Canada Trade

Arizona-Canada Trade

Arizona's Exports to Canada



Arizona's Imports from Canada



Canada: #2 export market behind Mexico

Arizona Exports to Canada

	September 2012 (\$ mlns : y-t-d)	September 2013	2013 (% of total)
Computer and Electronic Products	437.7	401.4	23.3
Transportation Equipment	379.9	368.5	21.4
Agricultural Products	225.8	262.3	15.2
Fabricated Metal Products	84.4	124.2	7.2
Chemicals	102.9	115.4	6.7

Arizona Imports from Canada

	September 2012 (\$ mlns : y-t-d)	September 2013	2013 (% of total)
Transportation Equipment	257.3	277.4	24.5
Computer and Electronic Products	122.8	127.1	11.2
Machinery (except electrical)	127.6	103.4	9.1
Chemicals	81.5	101.7	9.0
Wood Products	60.9	88.0	7.8

The Canada-Arizona Connection



Much more than just merchandise trade...

Services:

Tourism... More than 1 million Canadian visitors projected this year, spending as much as \$1 billion

Financial services... BMO Harris Bank

Investment:

Residential real estate...

Canadians are the largest share of foreign buyers

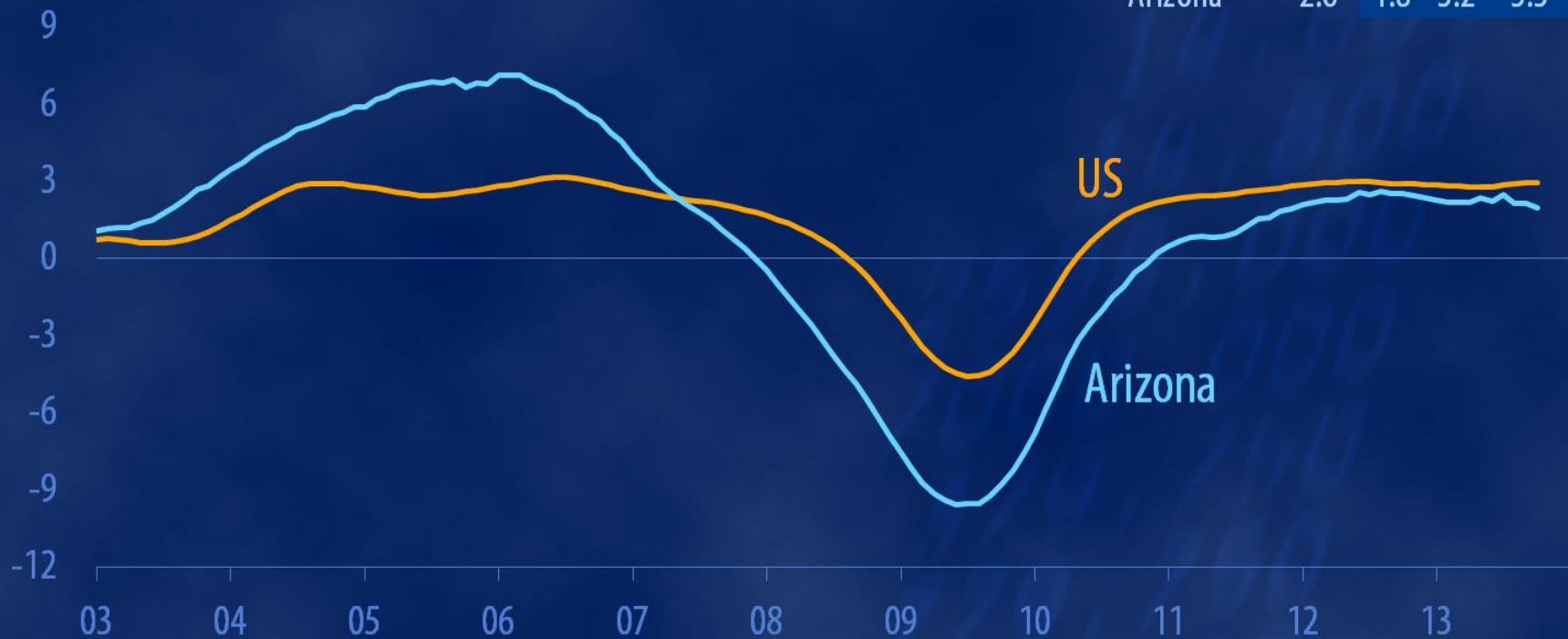
More than 200 Canadian-owned companies operate in the state, employing more than 13,000 Arizonans

Arizona Shifts from Lagging to Leading

United States (y/y % chng)

Coincident Economic Activity Index

Real GDP	12	13	14	15
US	2.8	1.7	2.7	2.9
Arizona	2.6	1.8	3.2	3.5



Led by housing (with a little help from a friend)

Source: Federal Reserve Bank of Philadelphia

Longer-term Yields: Moderately Rising Trend Ahead

United States (% : as of December 10, 2013)



Reasons for rise:

- Fed to taper, then end QE
- Stronger economic growth (applies upward pressure on real yields, whets risk appetites)

Reasons for moderate rise:

- Near-zero policy rates
- Inflation in check

Good news for US\$, bad news for equities (but with growth offset)

Actuals = daily closes Forecasts = monthly averages

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Questions and Answers



AND

