



Economic & Financial Outlook

CFA Montréal

Stéfane Marion

Chief Economist and Strategist

Centre Mont-Royal

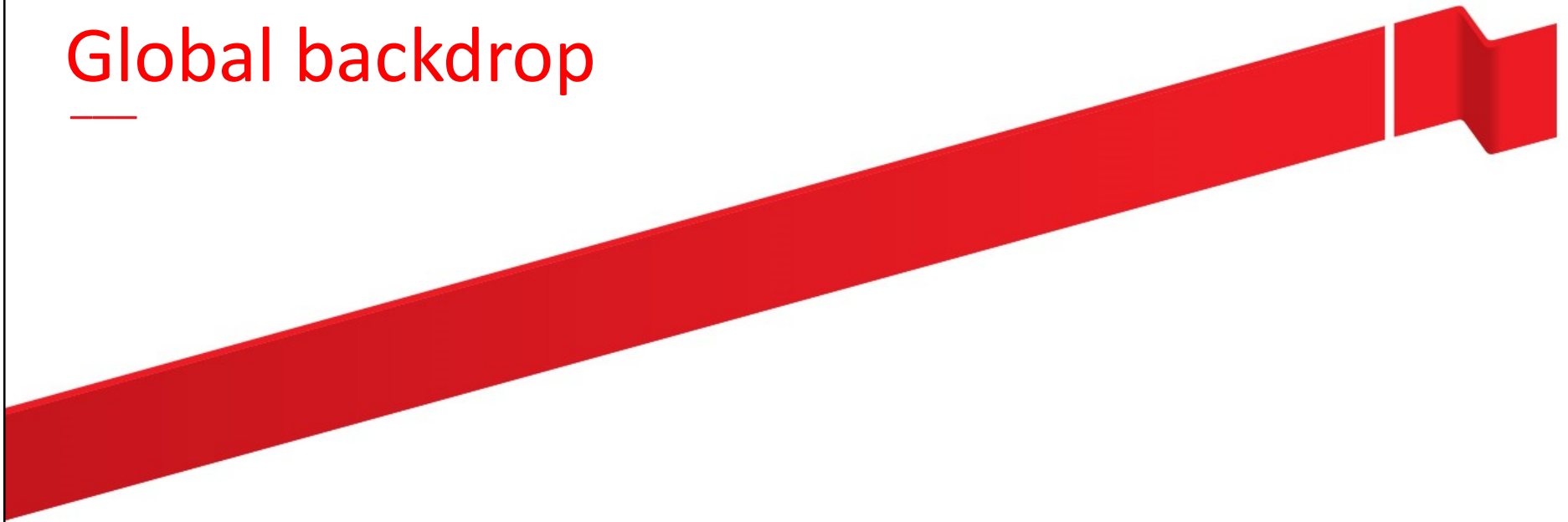
January 26, 2017



**NATIONAL
BANK**

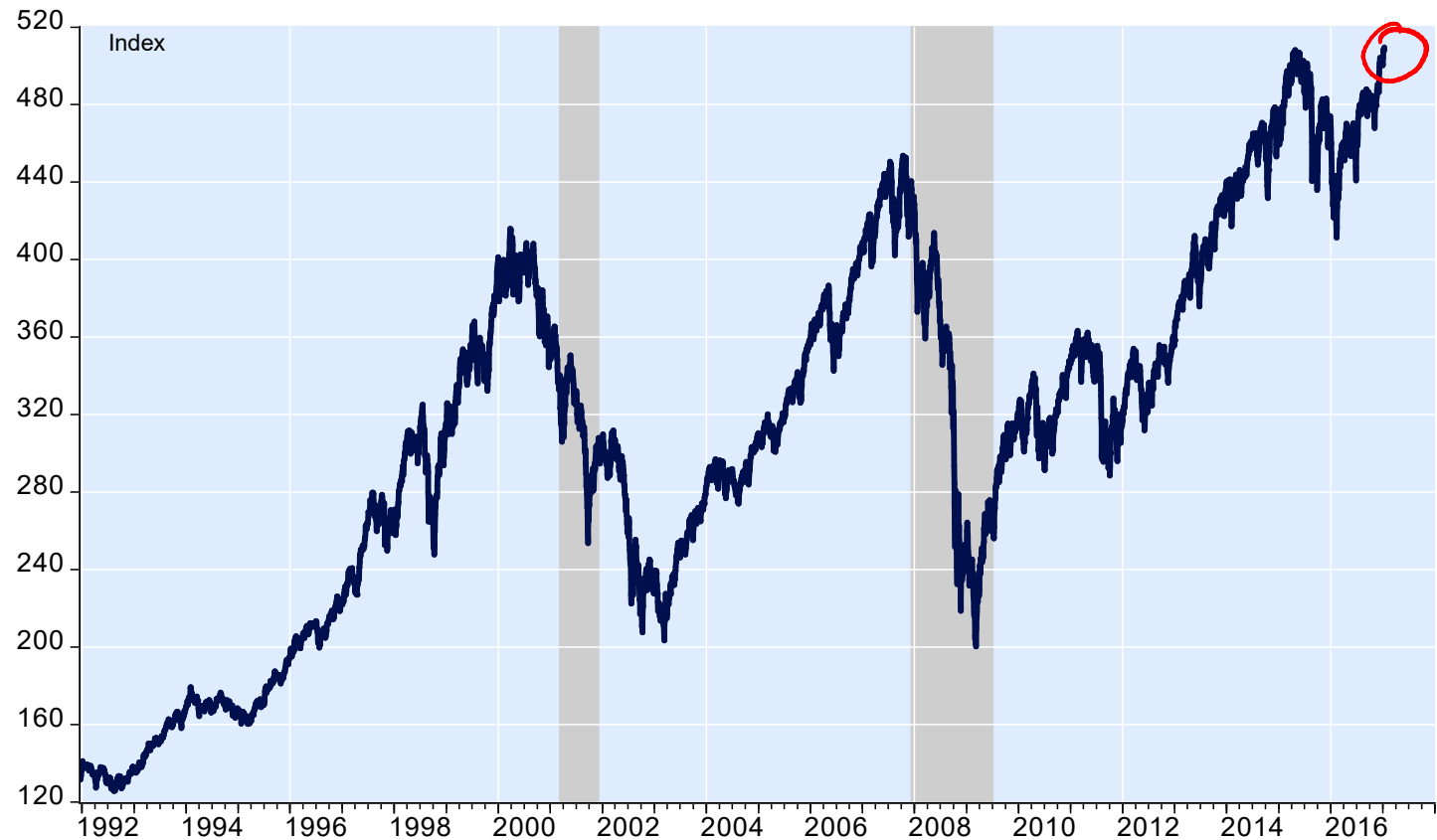
FINANCIAL MARKETS

Global backdrop



World: Global equities at a record high

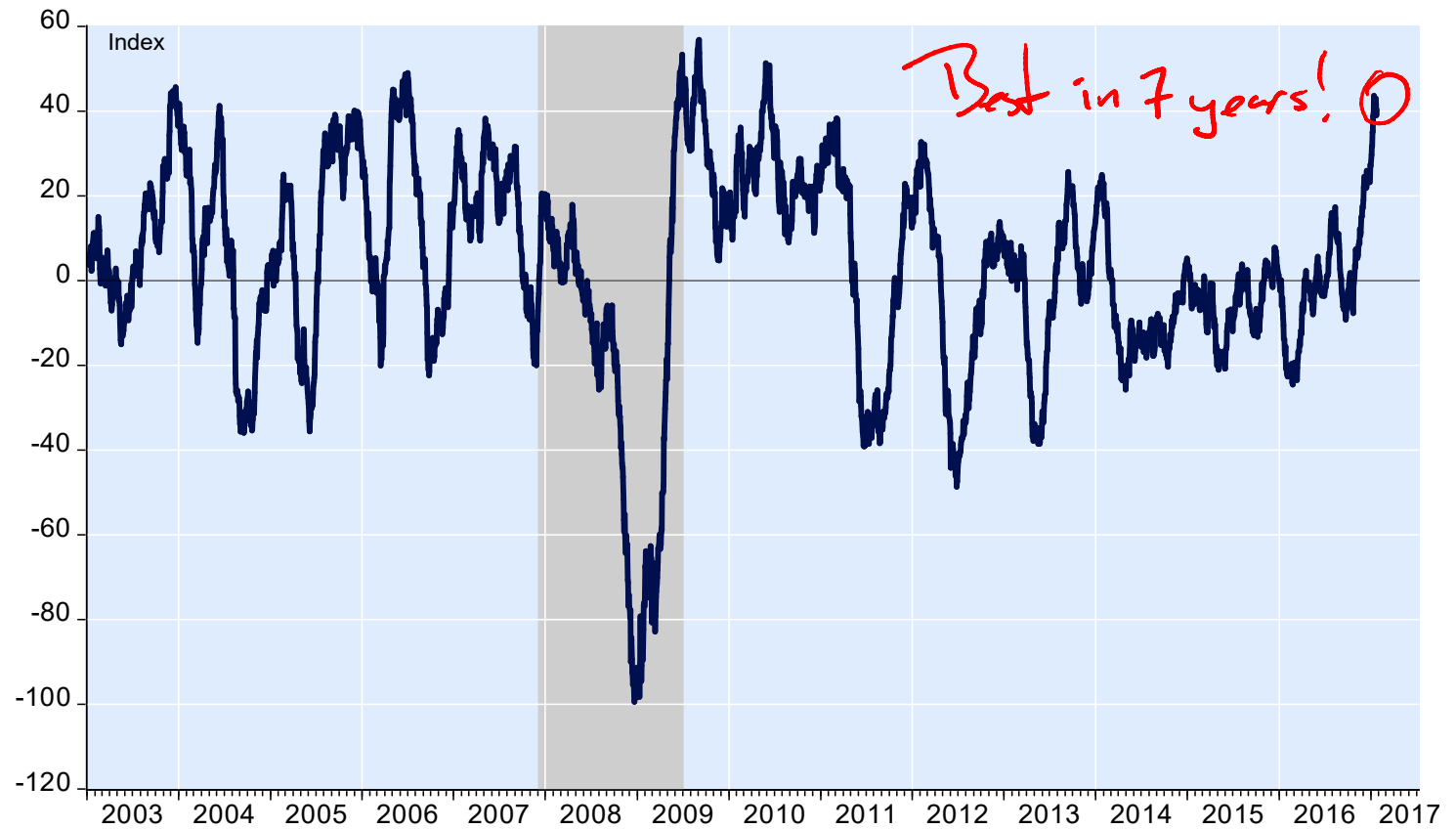
MSCI AC



NBF Economics and Strategy (data via Datastream)

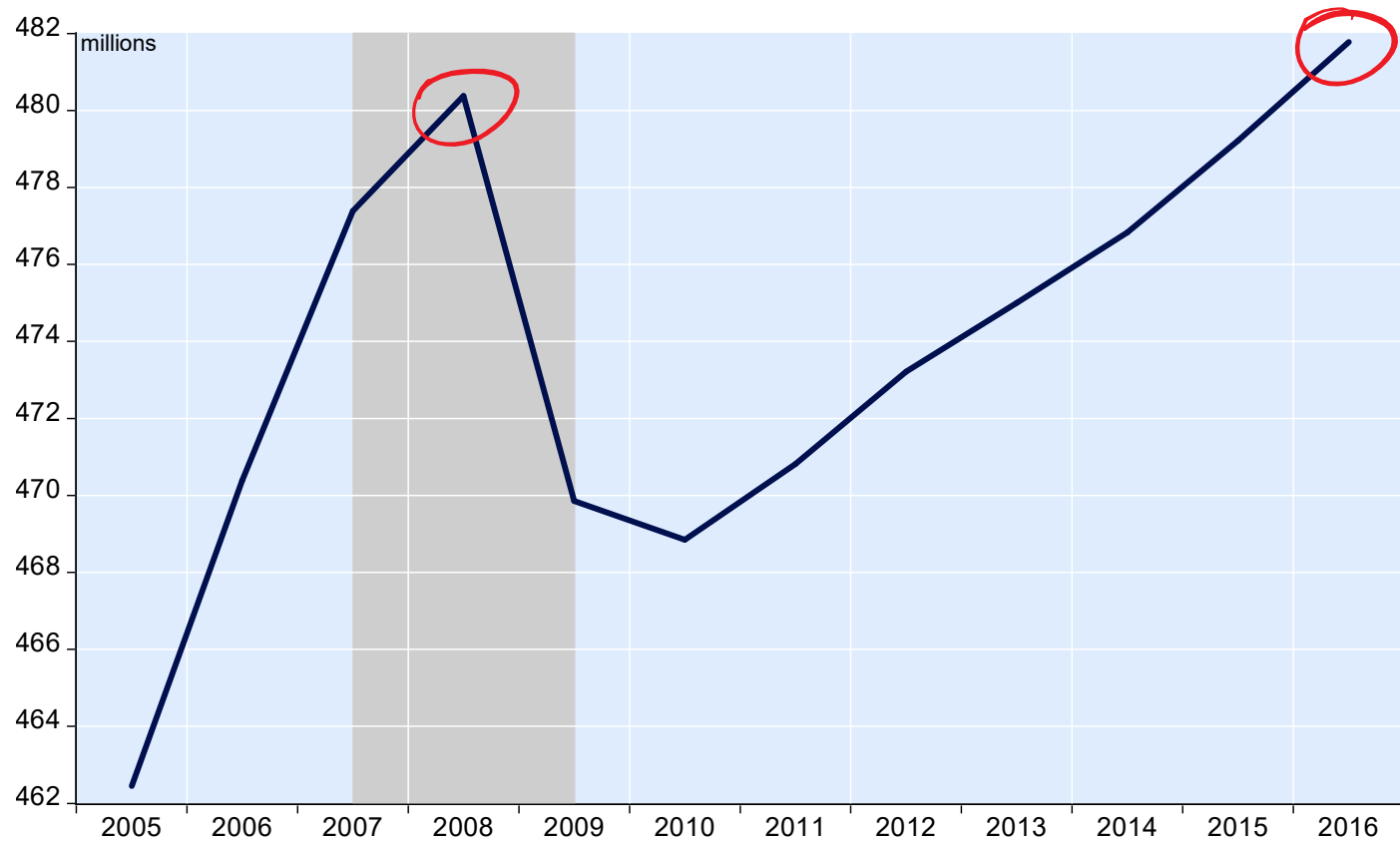
World: Economy is surpassing expectations

Citi Economic Surprise Index - World



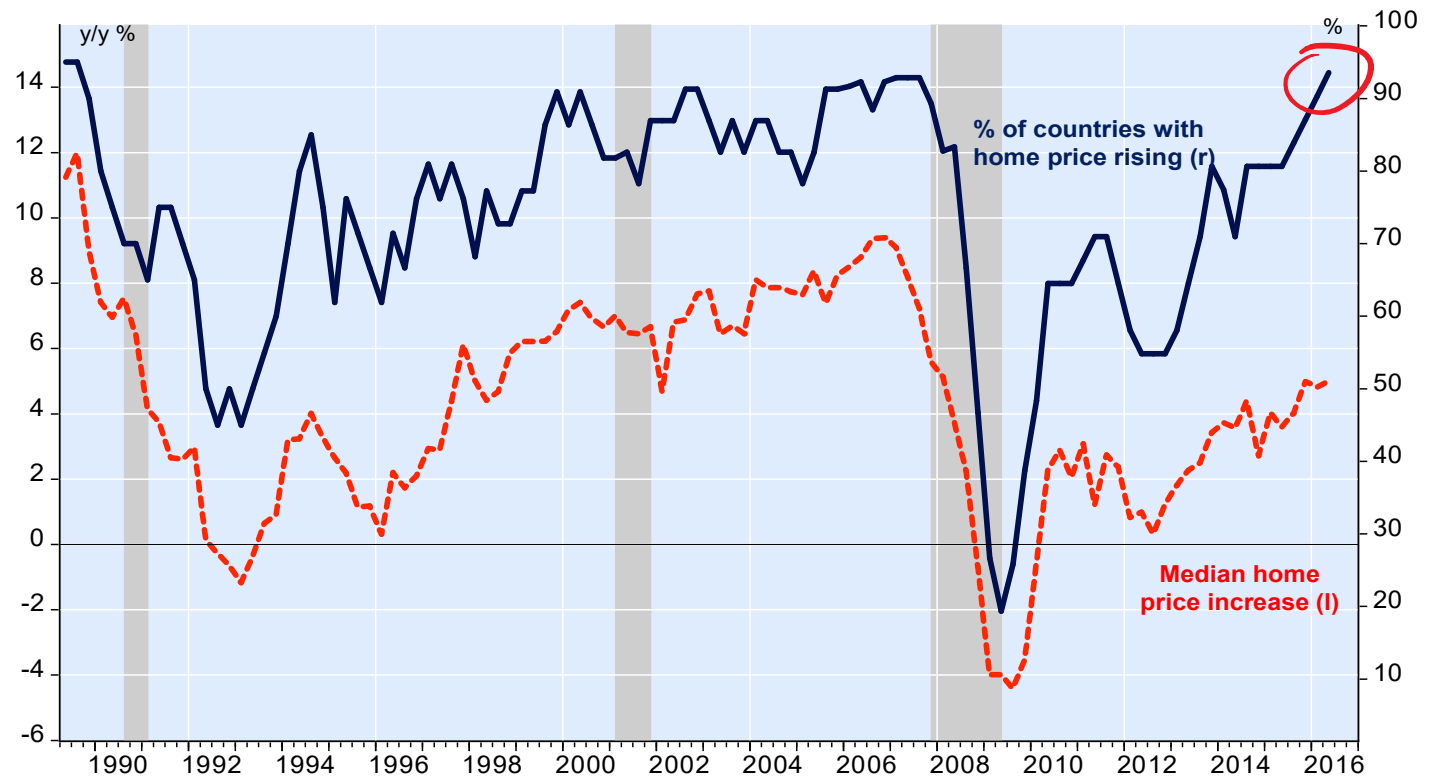
World: This is finally starting to look like an expansion in the OECD

Total employment in the advanced economies



World: Widespread wealth effect occurring in advanced economies

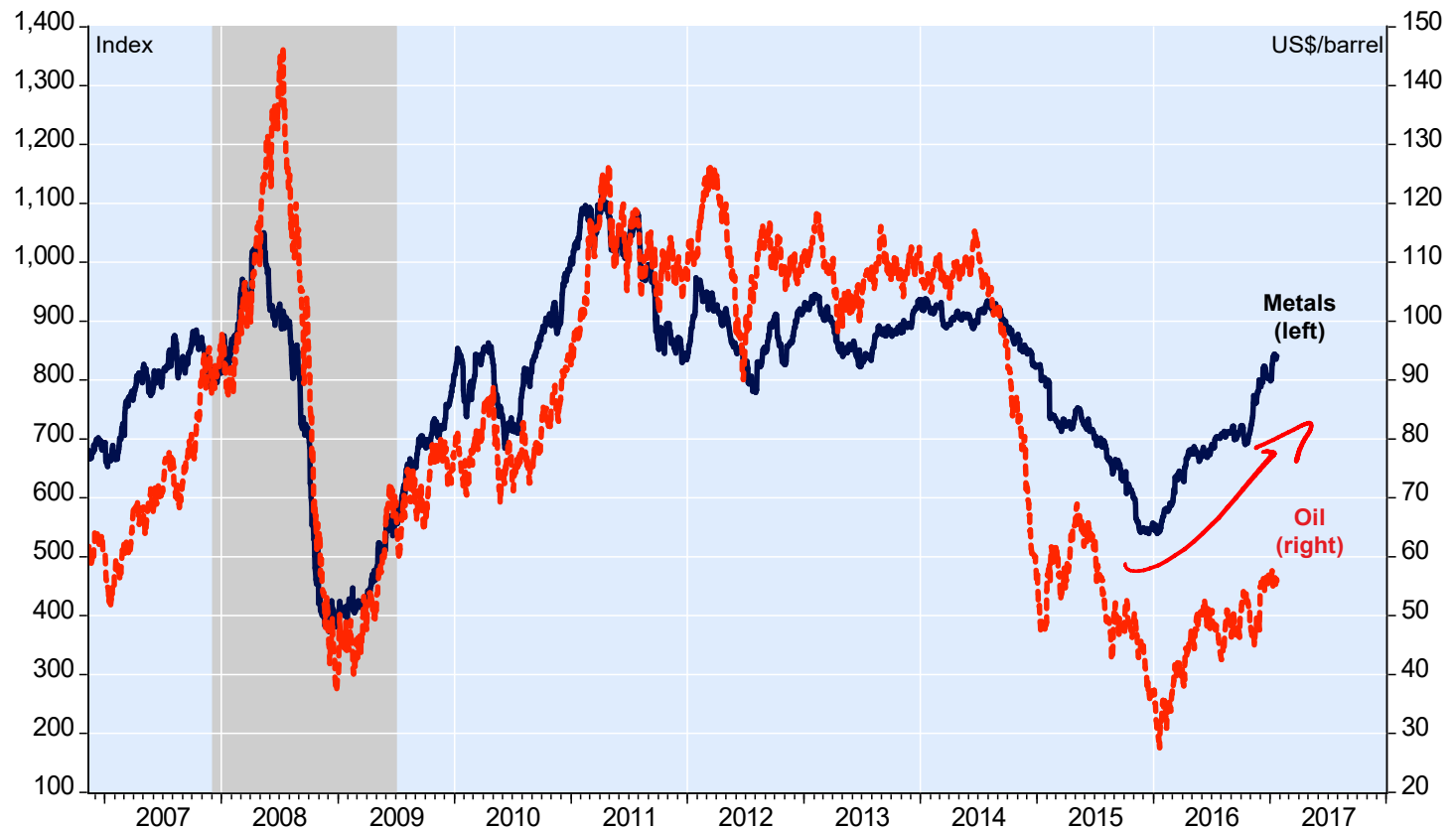
% of countries with year-over-year home price rising and median increase among advanced economies



NBF Economics and Strategy (data via OECD)

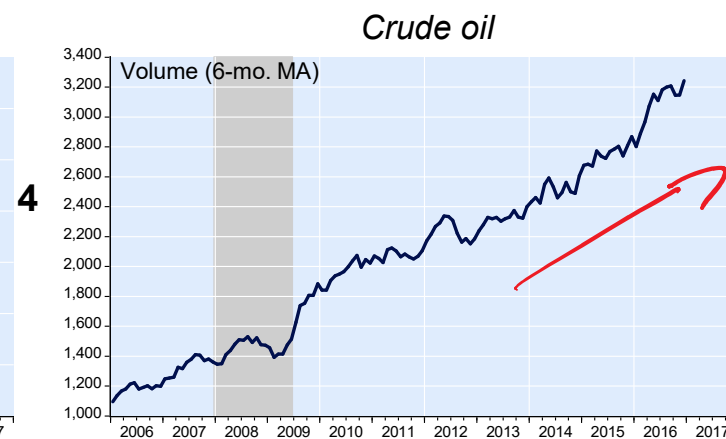
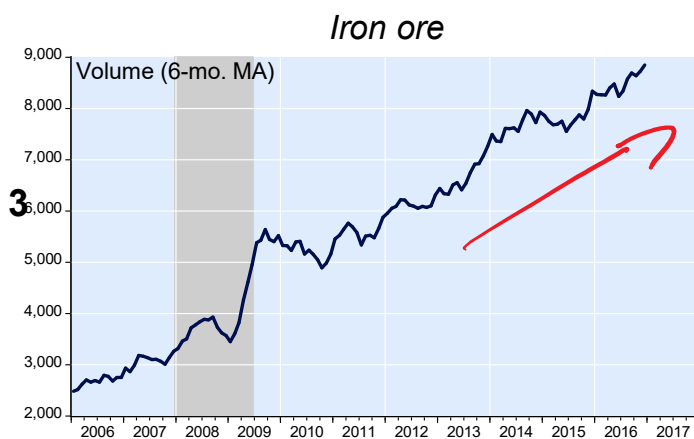
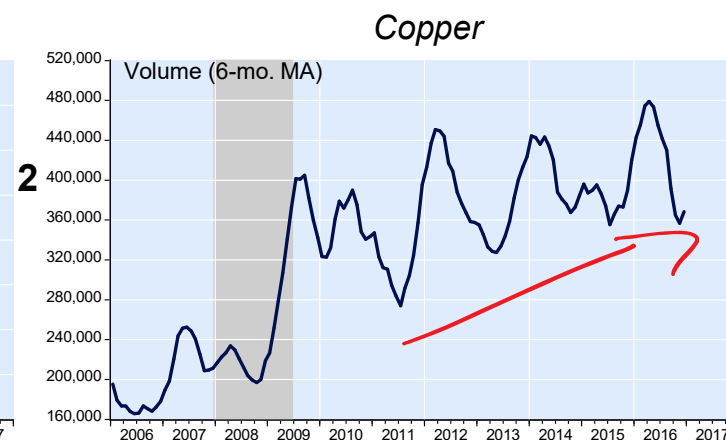
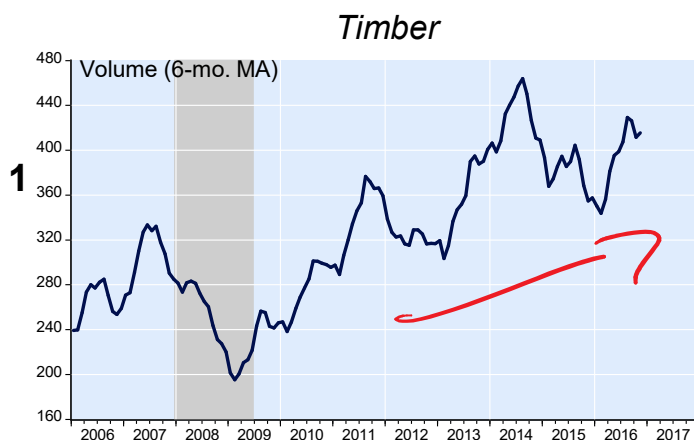
World: Commodity prices

CRB metals and Brent oil



NBF Economics and Strategy (data via Datastream)

China: Volume imports of key commodities



NBF Economics and Strategy (data via Datatream)

BUSINESS INSIDER

33 giant Chinese infrastructure projects that are reshaping the world



CHRIS WELLER
SEP. 21, 2016, 2:25 PM

A huge change is underway in China.

Over the next 10 years, the country plans to move 250 million people — the equivalent of Indonesia's entire population — into the country's rapidly growing megacities.

To accommodate that enormous migration, the country has invested billions of dollars in massive infrastructure projects. Some are already complete, while others are still in the works.

From highways that span the continent and the largest wind-power base in the world to enormous airports and new cities in the desert, China is showing what it really means to do big things.



Robert Johnson and Vivian Giang contributed to an earlier version of this story.

China To Build 66 New Airports Over The Next Five Years

Investing 77 billion yuan this year alone



Charles Liu, May 27, 2016 10:52am (updated)

China plans to build 66 new airports over the next five years says Dong Zhiyi, a Deputy Director of the Civil Aviation Administration of China (CAAC). The expansion will raise the number of airports in mainland China from 206 to 272.

The China Post

www.ChinaPost.com.tw

Top regulator approves \$10b major infrastructure projects in September

Friday, September 30, 2016
By Wu Xiaobo (chinadaily.com.cn)

The National Development and Reform Commission (NDRC), China's top economic regulator, has given green light to 10 major infrastructure projects with aggregate investment of 66 billion yuan (\$9.89 billion) in September, according to a report by the Securities Daily on Thursday.

The third phase of Longdongbao International Airport construction in Guiyang, Southwest China's Guizhou province, totals 19.585 billion yuan, and the highway from Baoshan to Hushui in Southwest China's Yunnan province involves a total investment of 14.7 billion yuan.

Approved projects also include a 9.88 billion yuan railway project from Xingguo, East China's Jiangxi province, to Ninghua, Southeast China's Fujian province; a 9.61 billion yuan national highway project in Chun'an, East China's Zhejiang province; and a 4.13 billion yuan cross sea highway project in Shachengwan, Southeast China's Fujian province.

The NDRC has approved more than 1 trillion yuan of infrastructure projects in the first eight months this year, according to Li Kun, analyst with Ping'an Securities.

Amid week global economic recovery, investment plays a significant role in driving economic growth, he said, adding that the country's investment in railway is expected to gather speed in the second half.

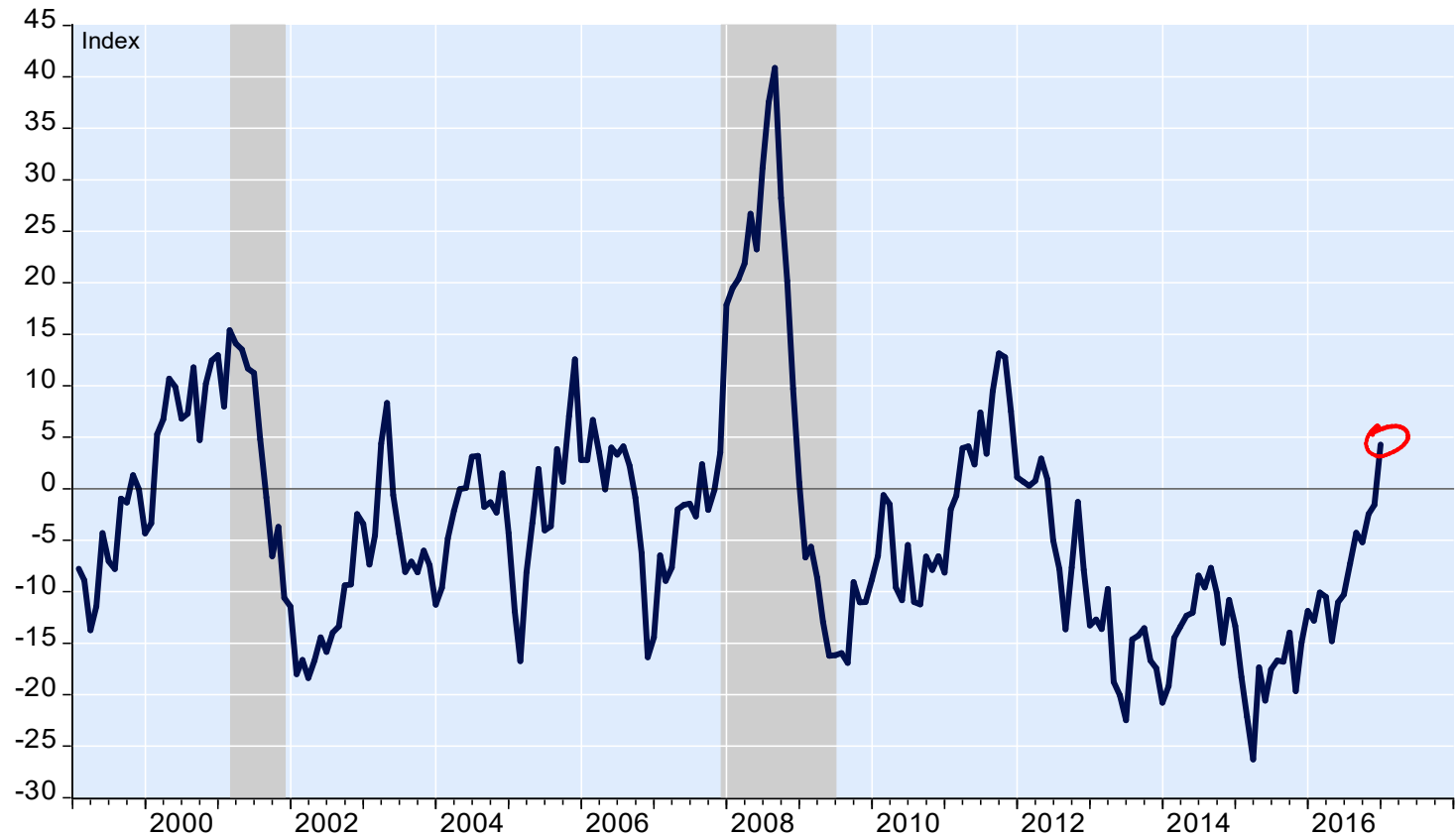
In the first half of 2016, China has invested 264.6 billion yuan in railway infrastructure, meeting 43 percent of the annual target, which means it has to complete 345.4 billion yuan of investment in the second half, he added.

"Pro-growth fiscal policies and public-private partnership will help accelerate the development of the rail transportation industry," he said.

\$166 billion in 2016

World: Inflation is surprising on the upside

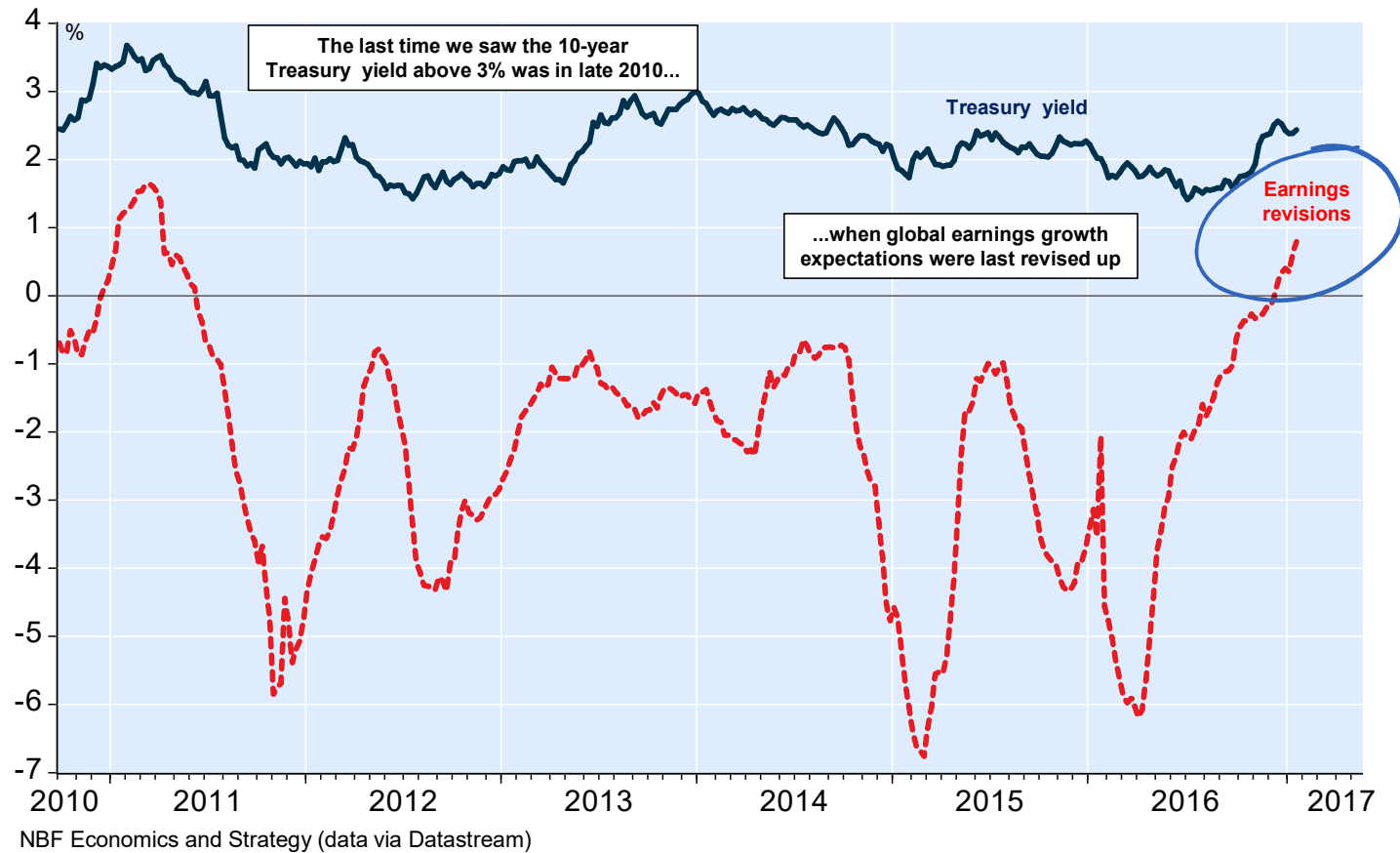
Citi inflation surprise Index - World



NBF Economics and Strategy (data via Bloomberg)

World: Upward earnings revisions for the first time in 6 years!

Three-month change in 12-month forward earnings growth for the MSCI AC vs. yield on 10-year U.S. Treasury



MSCI composite index: EPS Performance

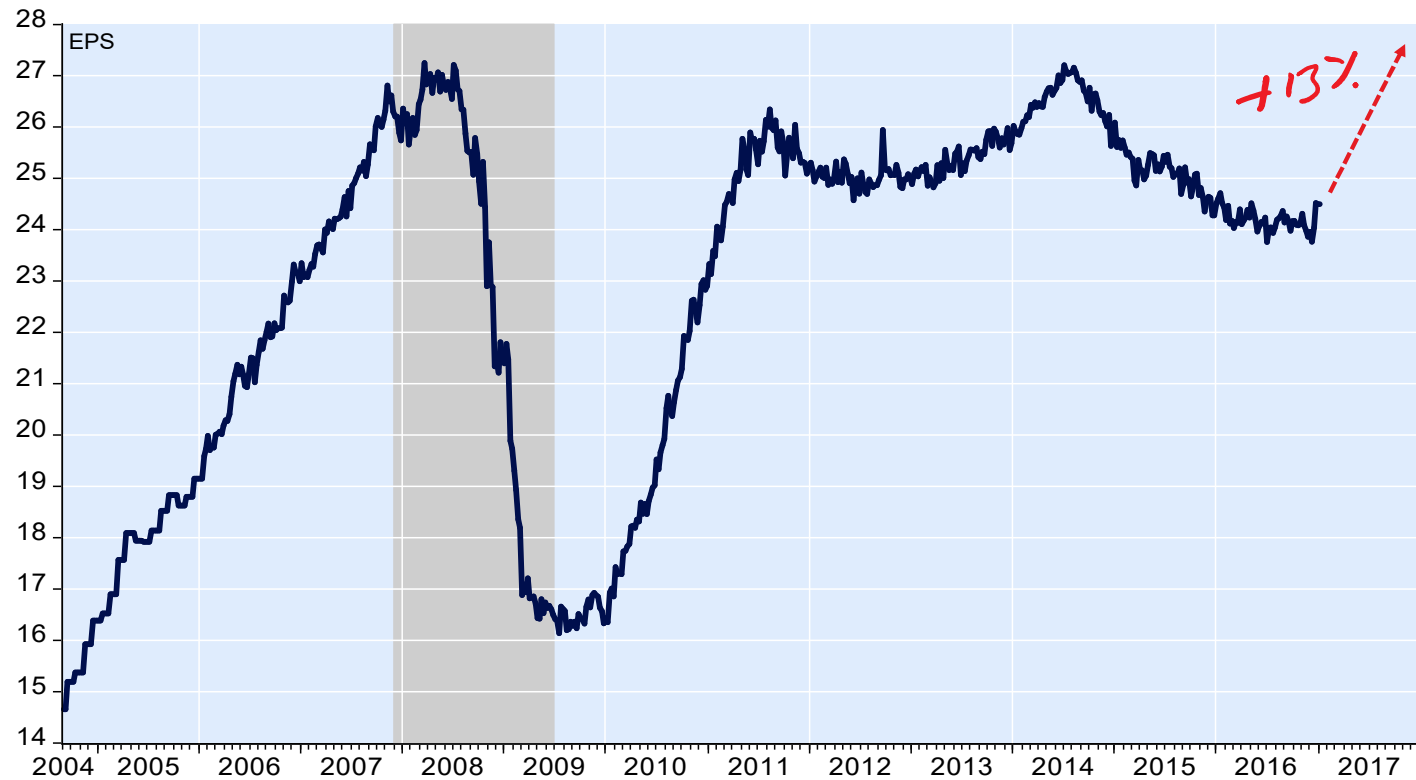
	2015	2016	2017	2018
MSCI AC World	-3.5	1.9	13.1	11.2
MSCI World	-3.0	0.9	12.9	11.1
MSCI USA	0.2	1.4	12.1	12.4
MSCI Canada	-13.5	-5.4	24.1	11.6
MSCI Europe	-6.1	-1.6	14.1	10.3
MSCI Pacific ex Jp	-10.3	-8.5	13.0	5.7
MSCI Japan	NA	-3.5	13.0	10.2
MSCI EM	-7.0	8.3	14.7	11.7
MSCI EM EMEA	-22.2	9.2	12.9	14.8
MSCI EM Latin America	-36.1	59.5	16.7	10.1
MSCI EM Asia	2.6	2.7	14.9	11.2

1/20/2017

NBF Economics and Strategy (data via Datastream)

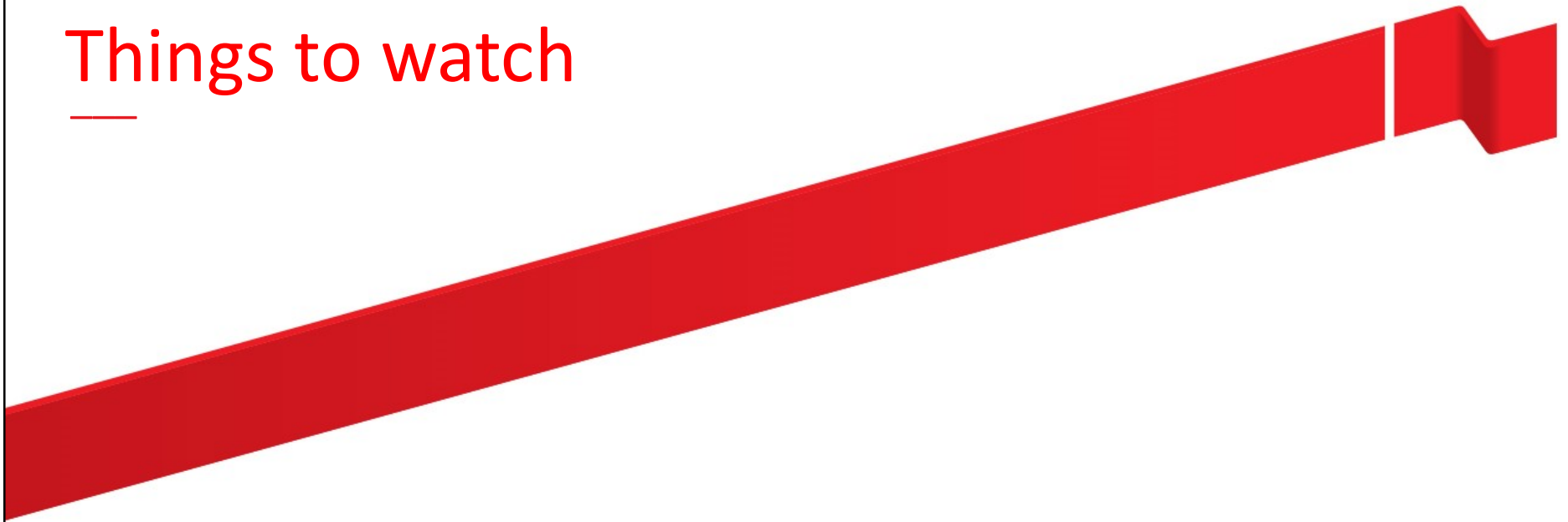
World: Perspective on profits

Trailing earnings for MSCI AC



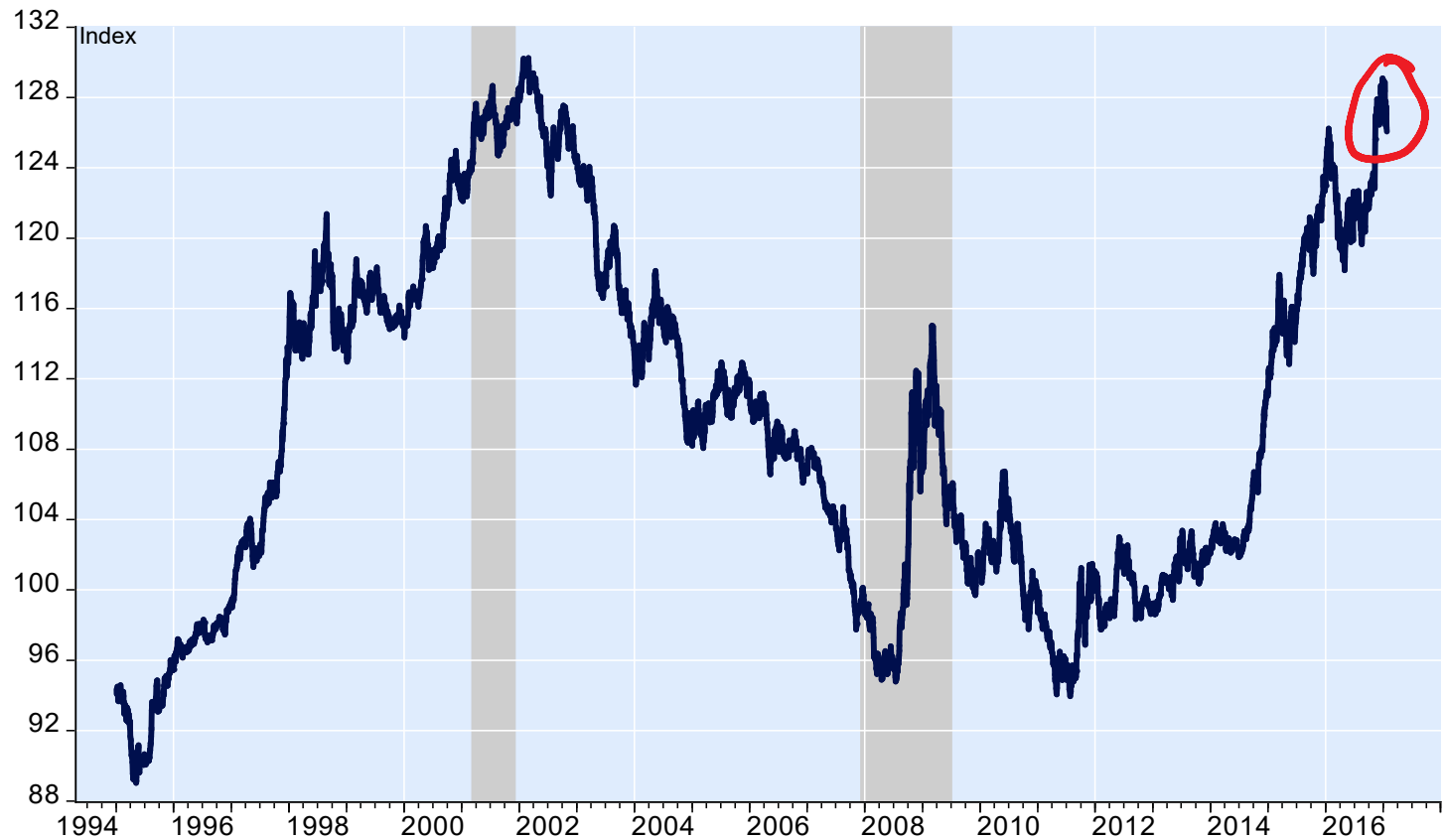
NBF Economics and Strategy (data via Datastream)

Things to watch



World: The dollar menace?

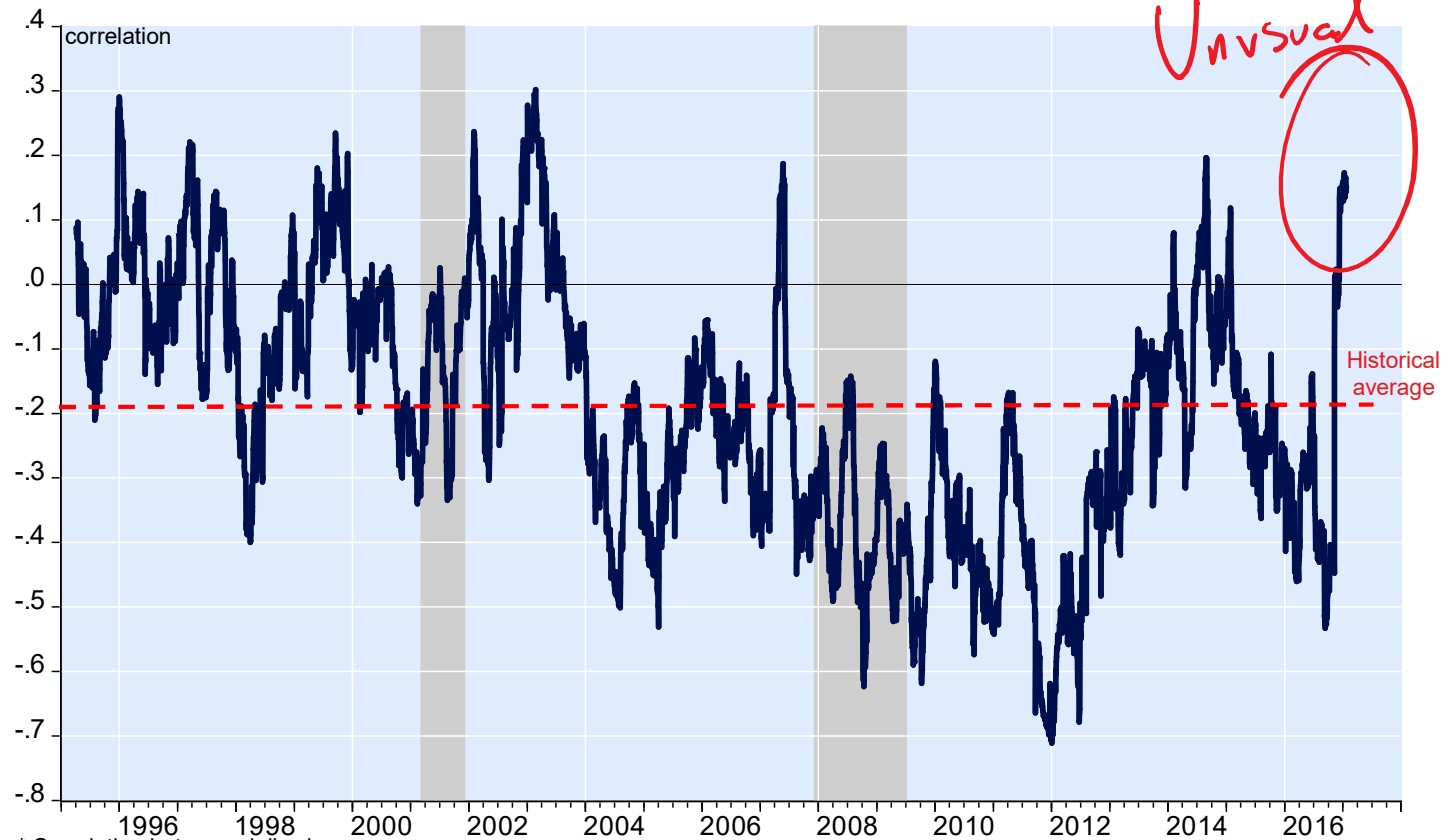
USD broad dollar index (26 currencies)



NBF Economics and Strategy (data via Bloomberg)

Markets: Positive correlation between USD and commodities!

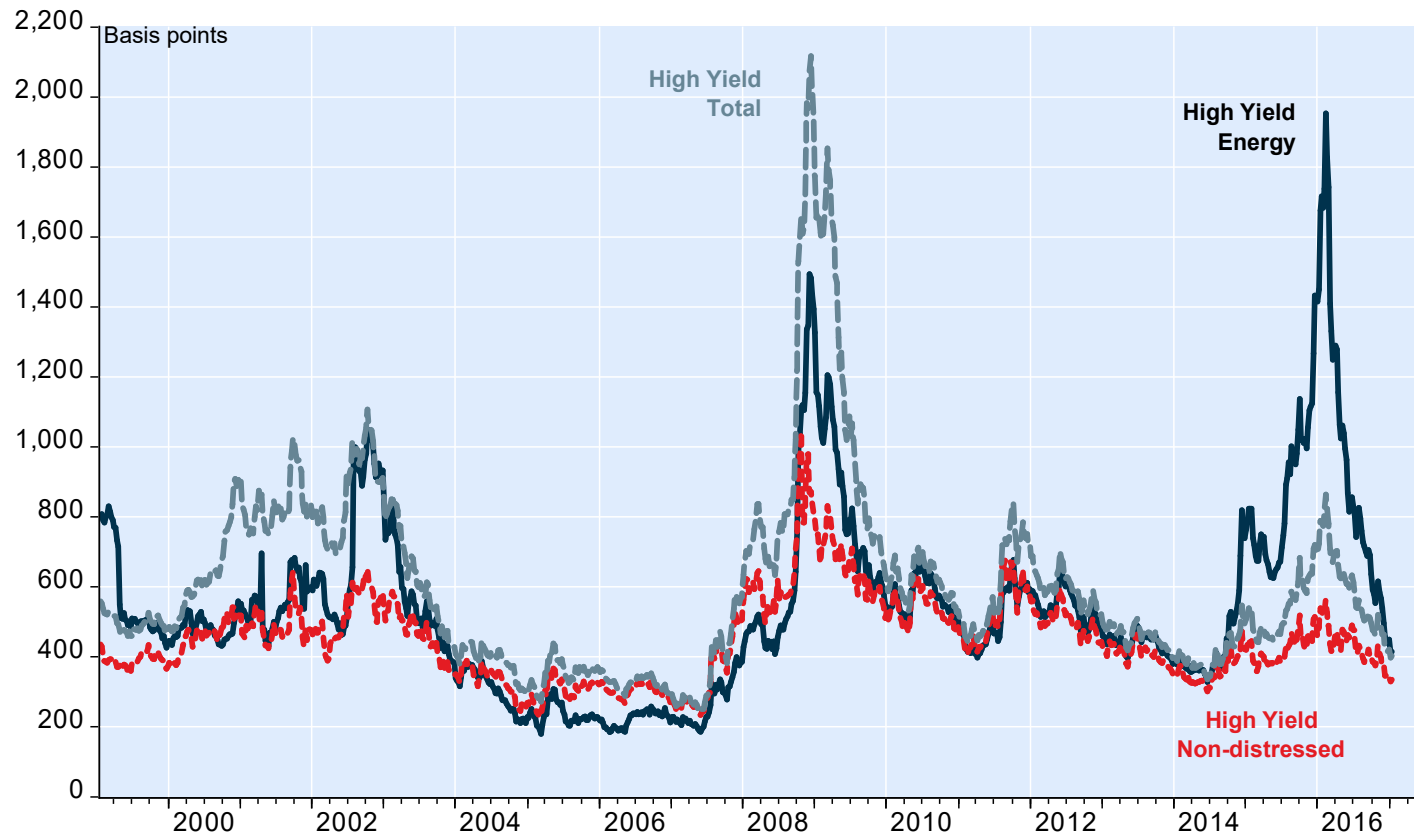
Moving correlation* (65 days) between broad USD index and CRB metals



* Correlation between daily changes
NBF Economics and Strategy (data via Datastream)

U.S.: High-yield corporate spreads

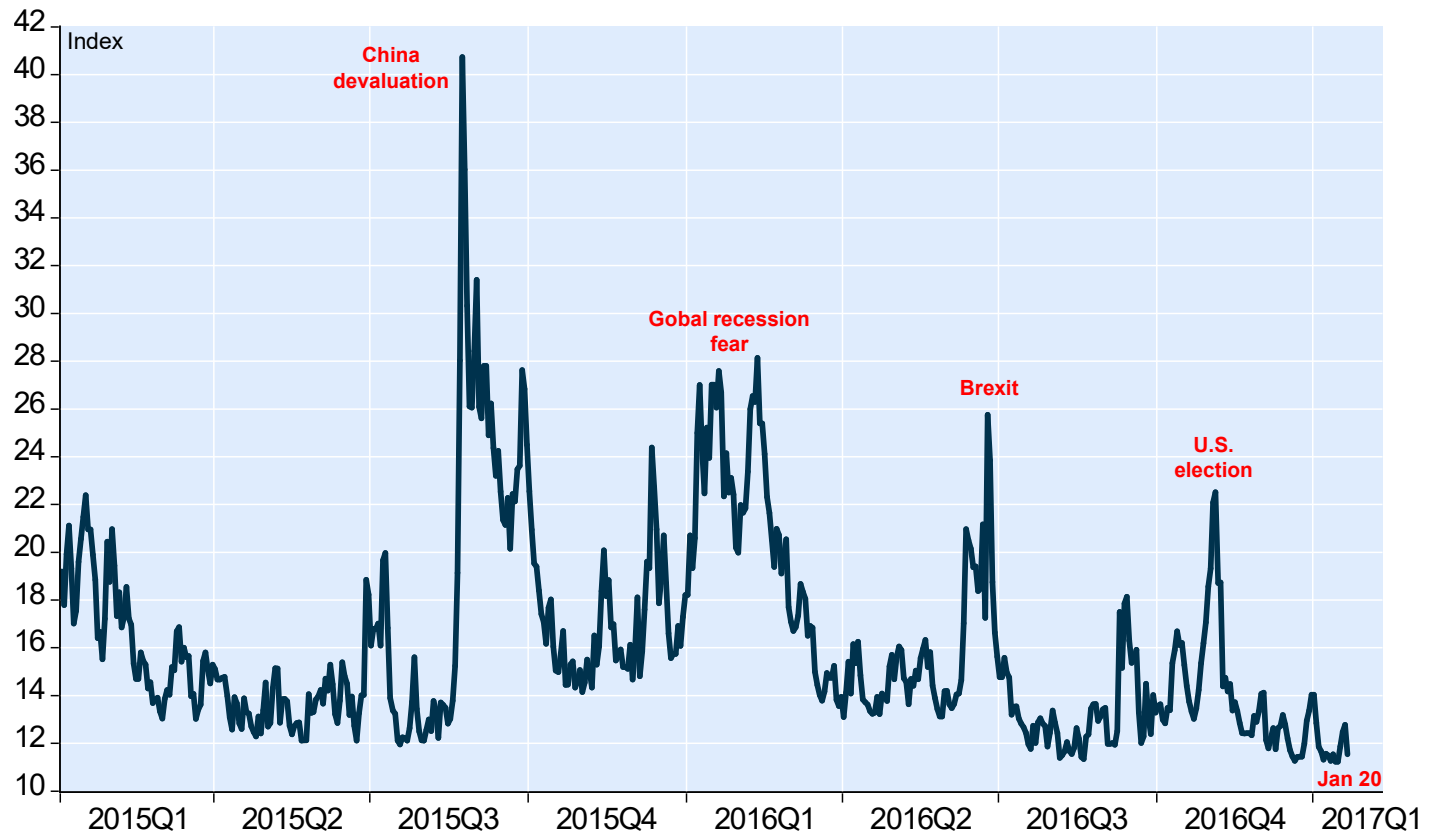
Option adjusted spreads



NBF Economics and Strategy (Source BofAML Bond Indices) 2017-01-11

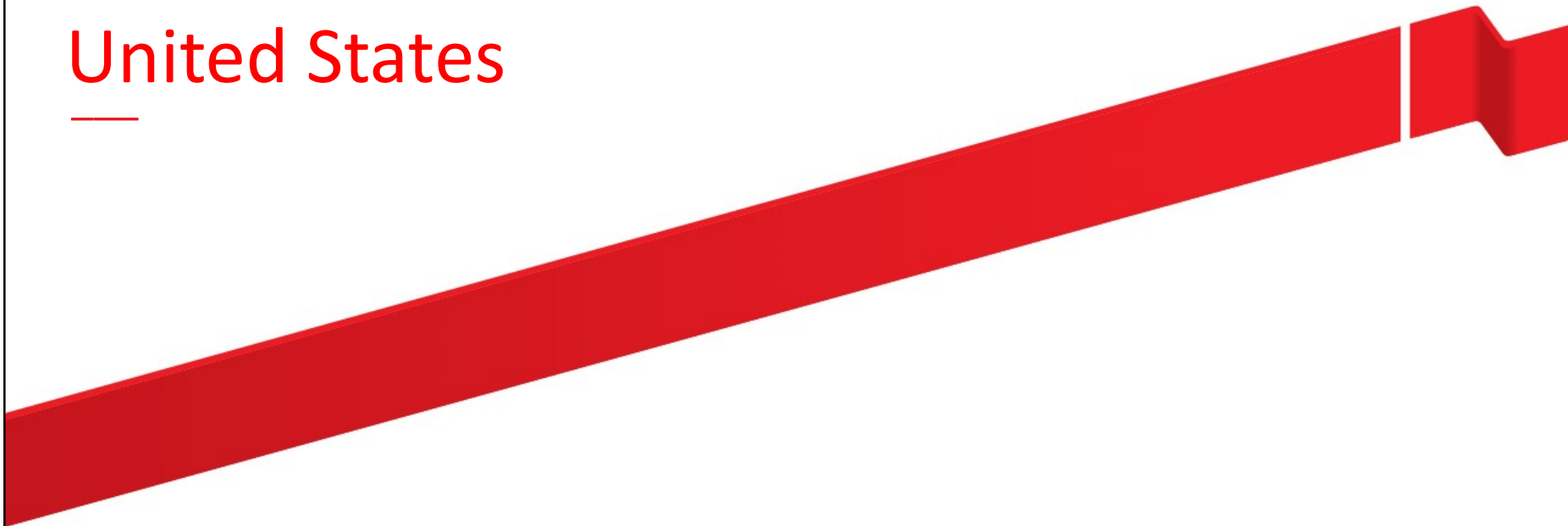
U.S.: Are markets complacent?

Stock market volatility (VIX)



NBF Economics and Strategy (data via Datastream)

United States



**NATIONAL
BANK**

FINANCIAL MARKETS

What is creative destruction?

Creative destruction is a process through which something new brings about the demise of whatever existed before it, leading to a more efficient and dynamic economy. It was coined by Joseph Schumpeter (1942), who considered it “the essential fact about capitalism”.

What is creative destruction?

Creative destruction is a process through which something new brings about the demise of whatever existed before it, leading to a more efficient and dynamic economy. It was coined by Joseph Schumpeter (1942), who considered it “the essential fact about capitalism”.

A Trump White House

The 45th president

What is Donald Trump likely to achieve in power?

Jan 21st 2017



Like

5.1K

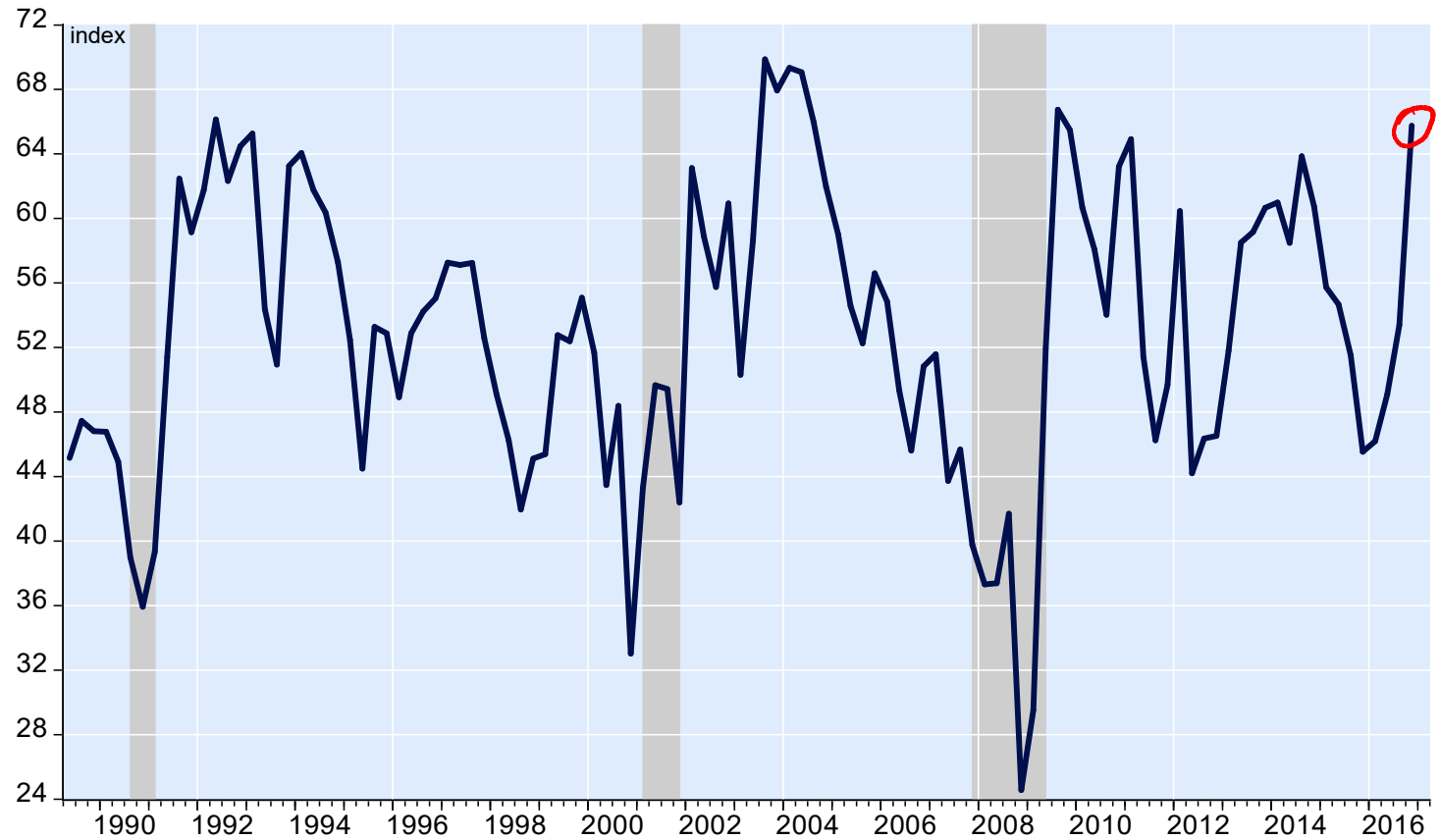
Tweet

Is this the face
of creative
destruction?



U.S.: CEO confidence surges to six-year high

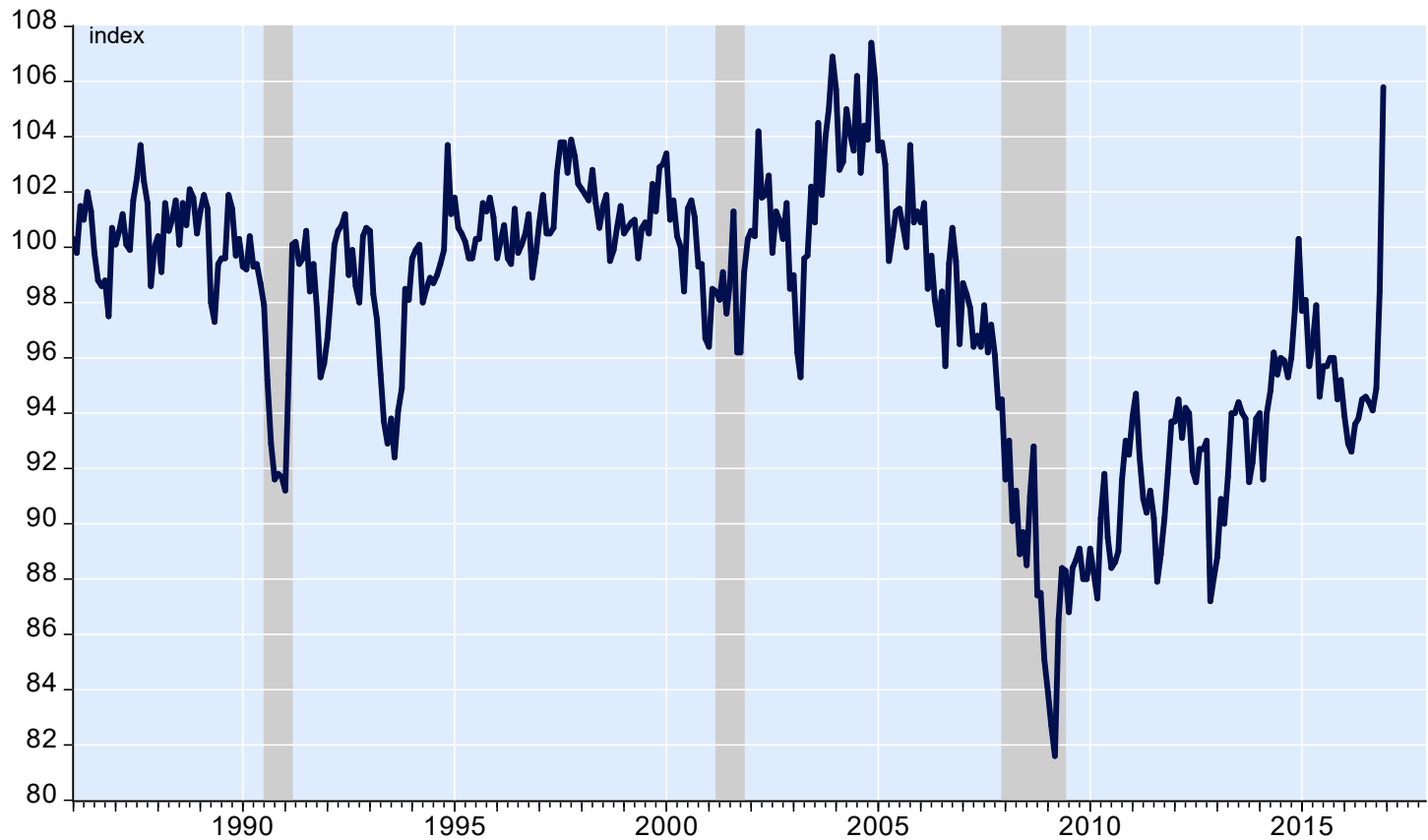
CEO confidence index – quarterly data seasonally adjusted by NBF



NBF Economy and Strategy (Conference Board data via Datastream)

U.S.: Surge in small business confidence

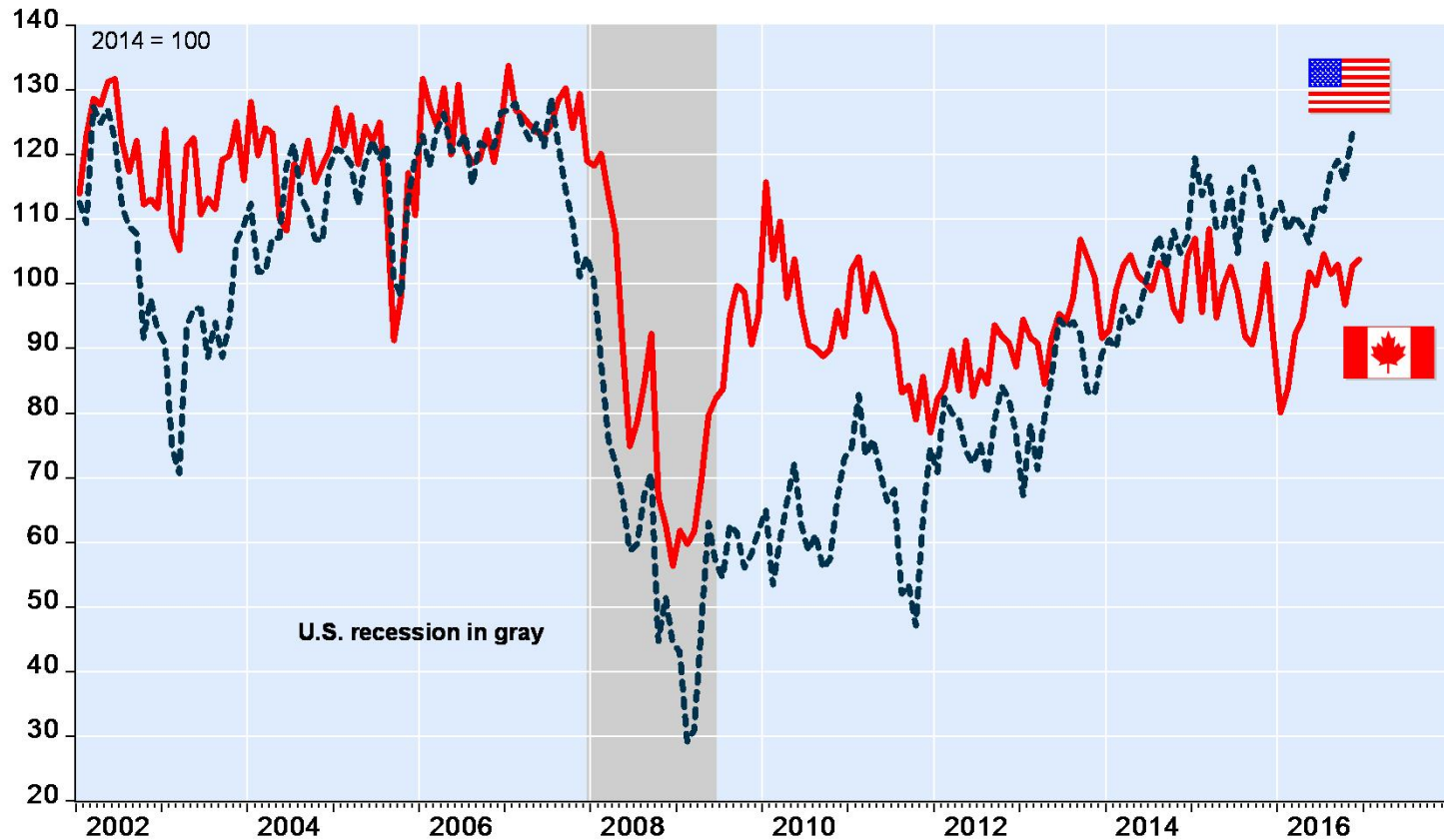
Small Business Confidence



NBF Economy and Strategy (NFIB data via Datastream)

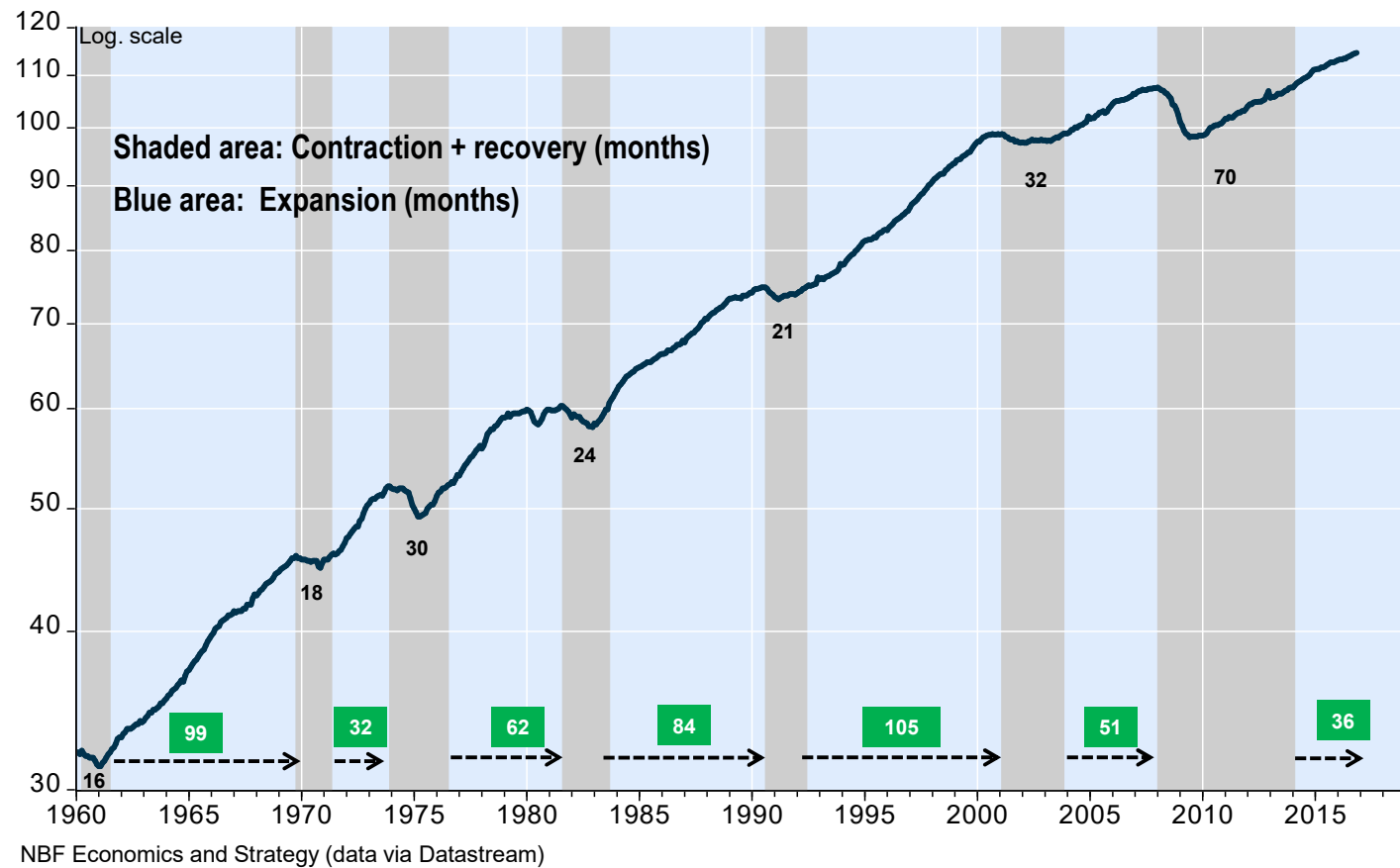
U.S.: Outlook for domestic demand is good

Consumer confidence



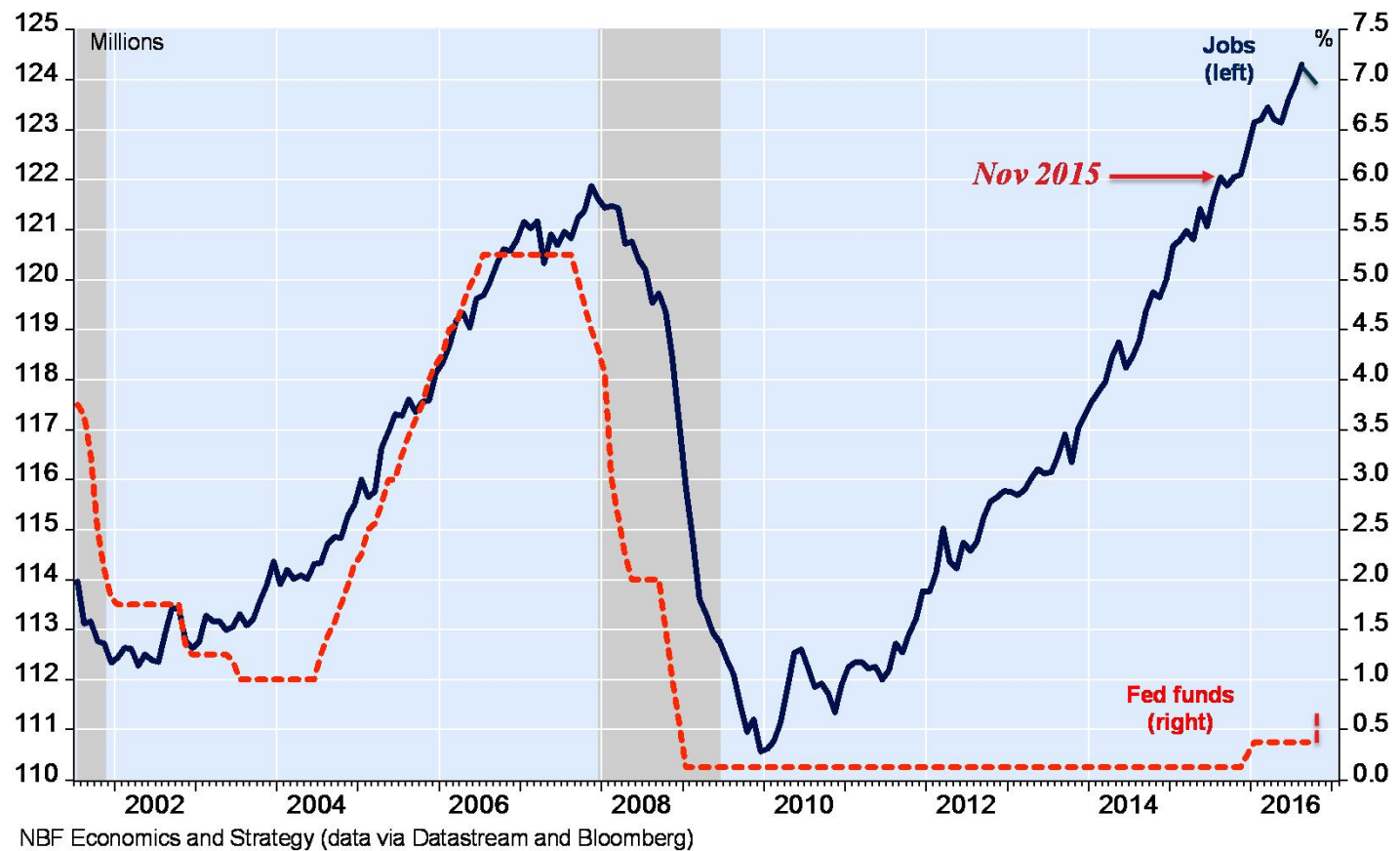
U.S.: Where are we in this economic cycle?

Contractions, recoveries and expansions based on the coincident economic indicator



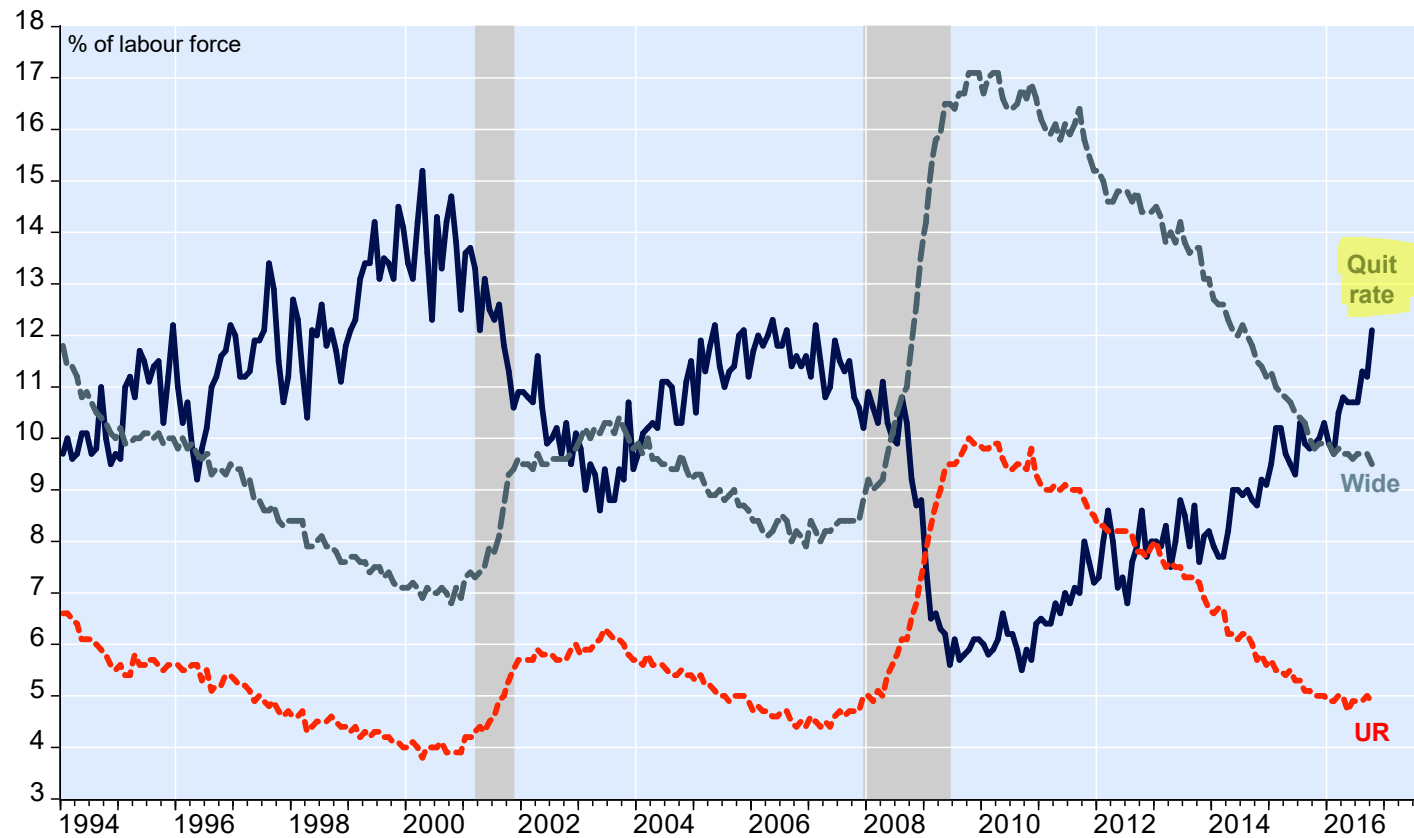
U.S.: Perspective on full time jobs

Fed funds rate vs. full-time employment



U.S.: Perspective on labour markets

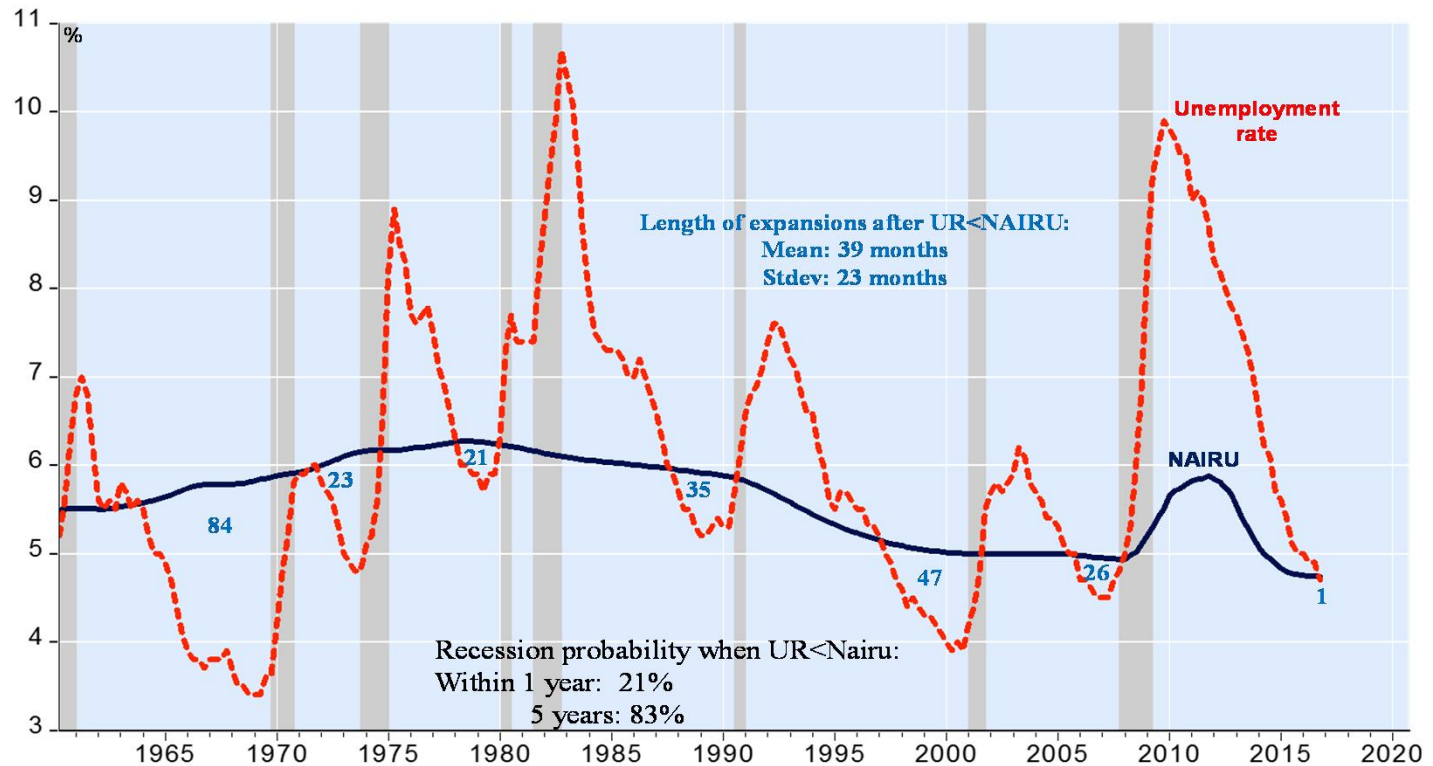
Quit-rate, official unemployment rate and wide-measure of unemployment



NBF Economics and Strategy (BLS data via Datastream)

U.S.: Another perspective on the economic cycle

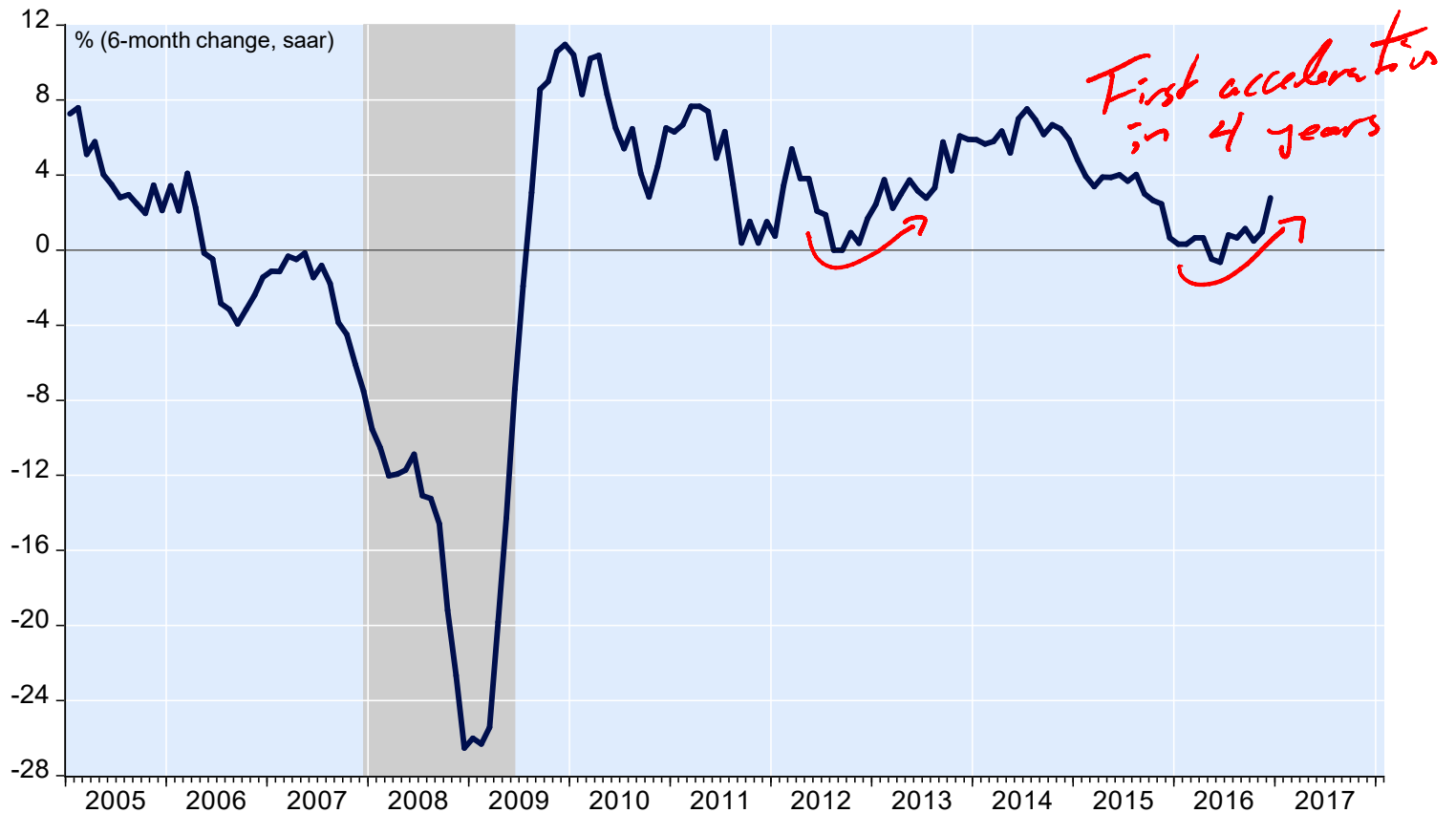
Observed unemployment rate vs. non-accelerating inflation rate of unemployment



NBF Economics and Strategy (data via Datastream and Macroadvisers)

U.S.: Outlook still OK

Leading economic indicator



Yellen defends pace of Federal Reserve tightening policy

Chair argues for measured drawdown in monetary support as economy strengthens



© Reuters



2 HOURS AGO by: **Sam Fleming** in Washington

Janet Yellen said the Federal Reserve has not been too slow in tightening policy to date but that the US central bank needs to act to gradually withdraw monetary support as the economy strengthens.

She may need to surrender the outcome to greater powers!

In God We Trust ?

“I will be the
greatest job
producer God ever
created”

Donald Trump
January 11, 2017



World Bank: Trump's fiscal proposal

**Cutting the statutory corporate tax rate from 35% to 15%
could boost U.S. GDP by 0.6% after four quarters
and
between 0.9% and 1.3% after eight quarters**

+

**Cutting personal income taxes and changing the structure of tax
deduction could increase U.S. GDP by
0.3% after four quarters and by 0.4% to 0.6% after eight quarters**

**However the FOMC should normalize its policy stance faster than
currently assumed:**

**Rule of thumb: + 100 bps => lower GDP by 0.6%
Assuming the effective fed funds rate is 66 bps higher than
currently assumed => - 0.4% on GDP**

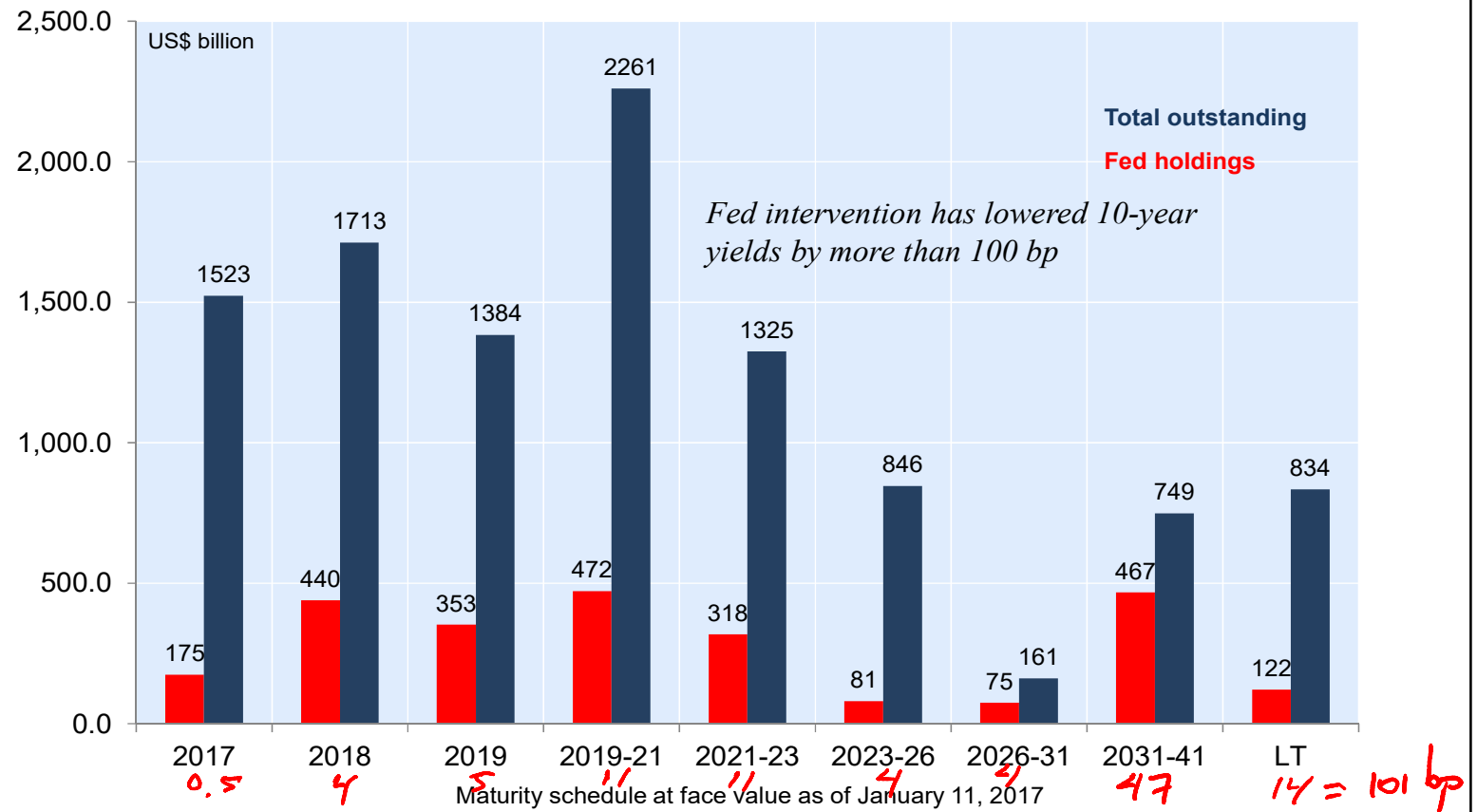
Net impact => + 0.5 % to GDP underlying trend

Trump
vs.
Yellen

NBF Economics and Strategy (World Bank's January 2017 Global Economic Prospects)

Federal Reserve: To unwind or not to unwind ?

SOMA Treasury holdings and total outstanding



NBF Economics and Strategy (data via Bloomberg)

Fair value model: Projections

- *Original fair-value model*
- *GDP growth, output gap*
- *Inflation expectations*
- *Monetary policy*
- *Bond market volatility*
- *Fiscal policy*
- *Foreign demand*
- *Changing investment guidelines: long mandates*

Adjustment

Operation Twist => Fed portfolio duration longer than that of the Treasuries index

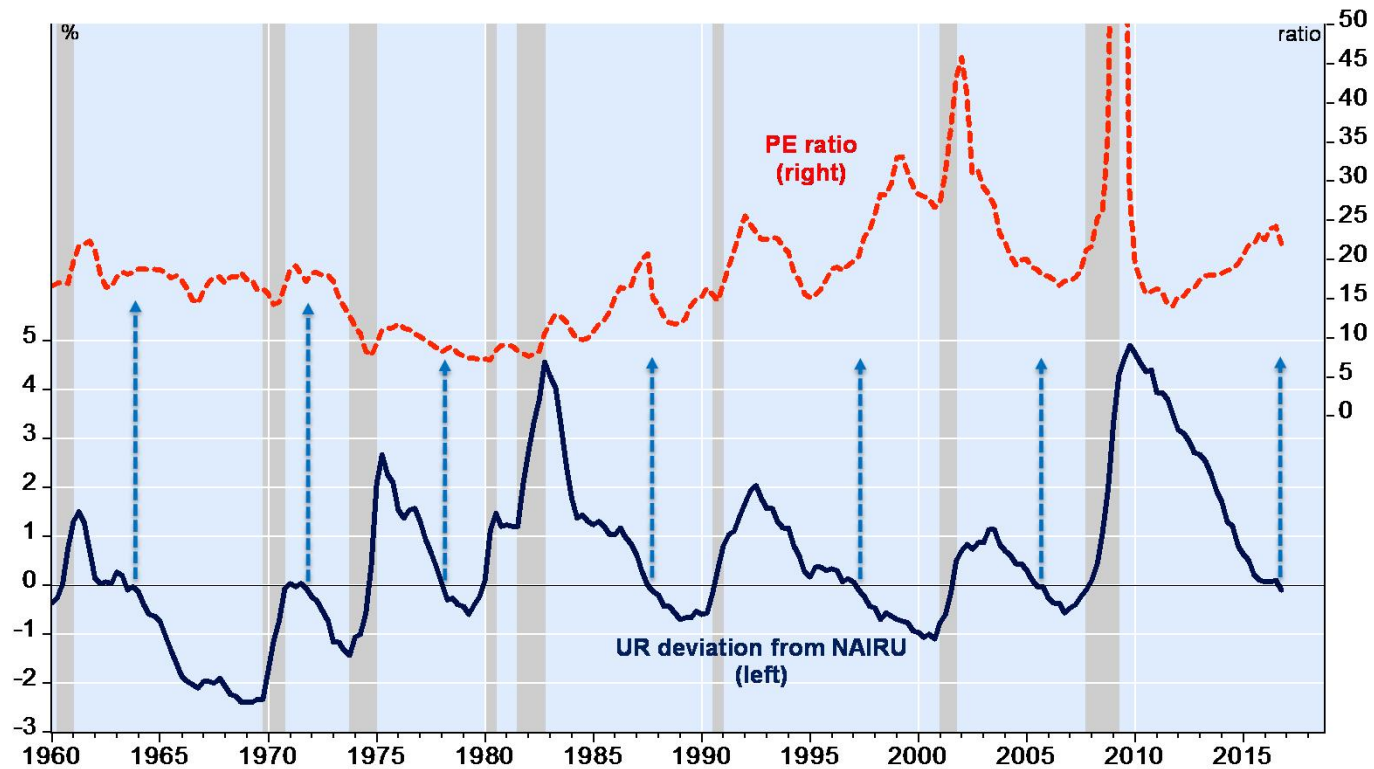
This should shave 58 bps to the model forecast

Fair Value	December 2017	
10-year Treasuries		
Variables	Variables	Impact
Inflation 10 year	2.3	1.38
Inflation (1 year)	2.2	-0.05
GDP growth	2.4	0.504
Mkt vol (36 mth std)	0.2	0.9
Fed funds	1.6	0.64
Deficit/GDP	4.3	1.075
Foreign purchases % of GDP	3.6	-0.8349
Adjustment factor	-0.58	-0.58
Original	3.6141	
Adjusted	3.0341	

Comments: The Fed's dot plot suggests 3 rate hikes in 2017. If that was to become the market view , it would had 10 bps to the forecast.

U.S.: PE expansion harder to come by when $UR < NAIRU$

S&P 500 trailing PEs and UR deviation from NAIRU



NBF Economics and Strategy (data via Shiller and Federal Reserve)

S&P 500 composite index: EPS Performance

	2015	2016	2017	2018
S&P 500	0.2	1.2	11.7	12.2
ENERGY	-61.5	-77.8	371.4	45.6
MATERIALS	-5.5	-2.7	14.9	5.9
INDUSTRIALS	3.0	1.4	3.6	12.4
CONS. DISC.	14.2	11.6	8.9	13.2
CONS. STAP.	0.1	4.4	6.4	8.4
HEALTH CARE	11.6	8.4	8.4	9.8
FINANCIALS	12.5	1.2	11.7	12.4
IT	7.7	4.5	11.7	11.4
TELECOM	11.8	0.6	3.3	4.2
UTILITIES	-0.1	5.6	0.2	6.1
REAL ESTATE	20.7	13.4	-22.8	11.7

1/20/2017

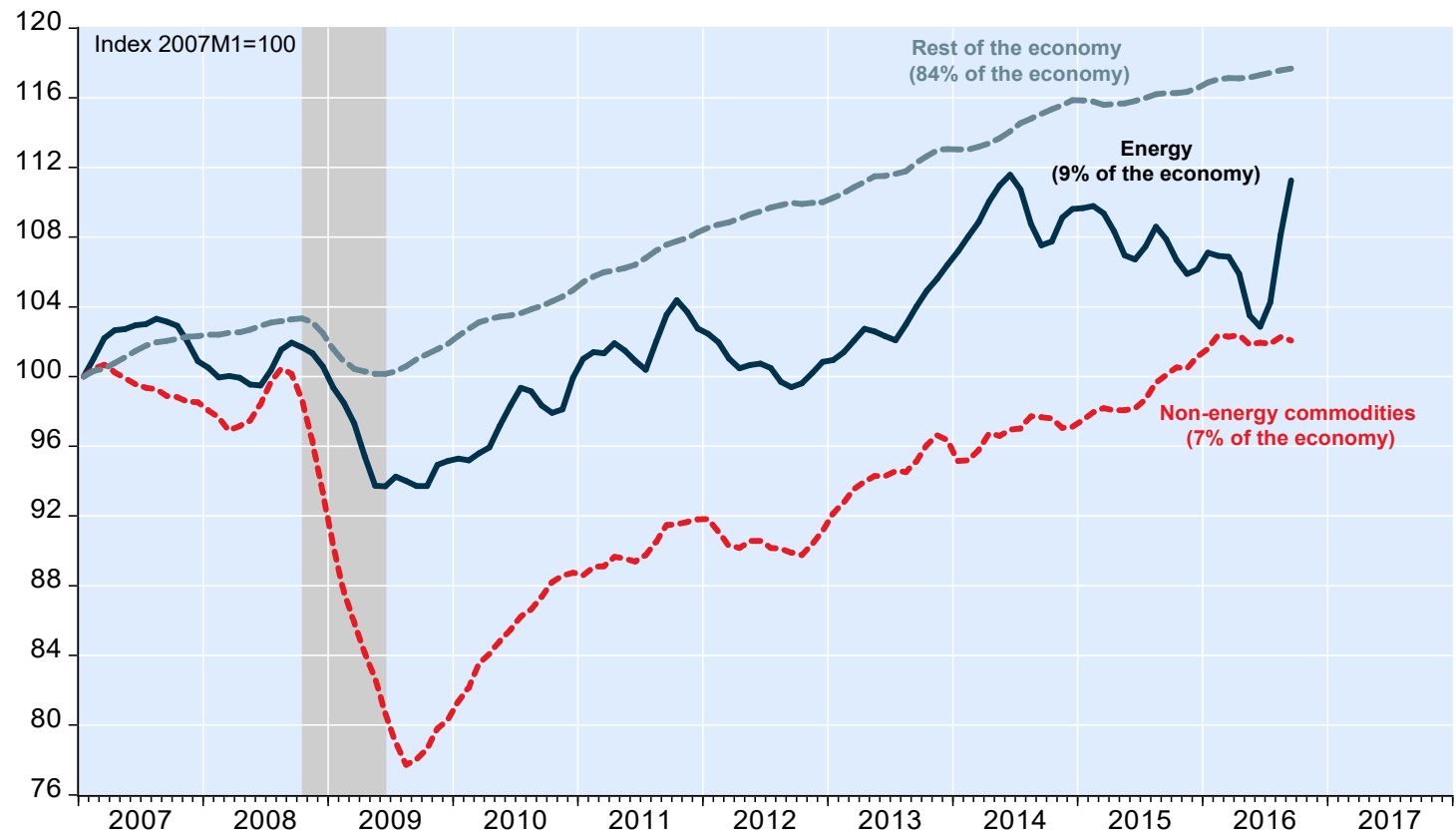
NBF Economics and Strategy (data via Datastream)

Canada



Canada: Perspective on economic growth

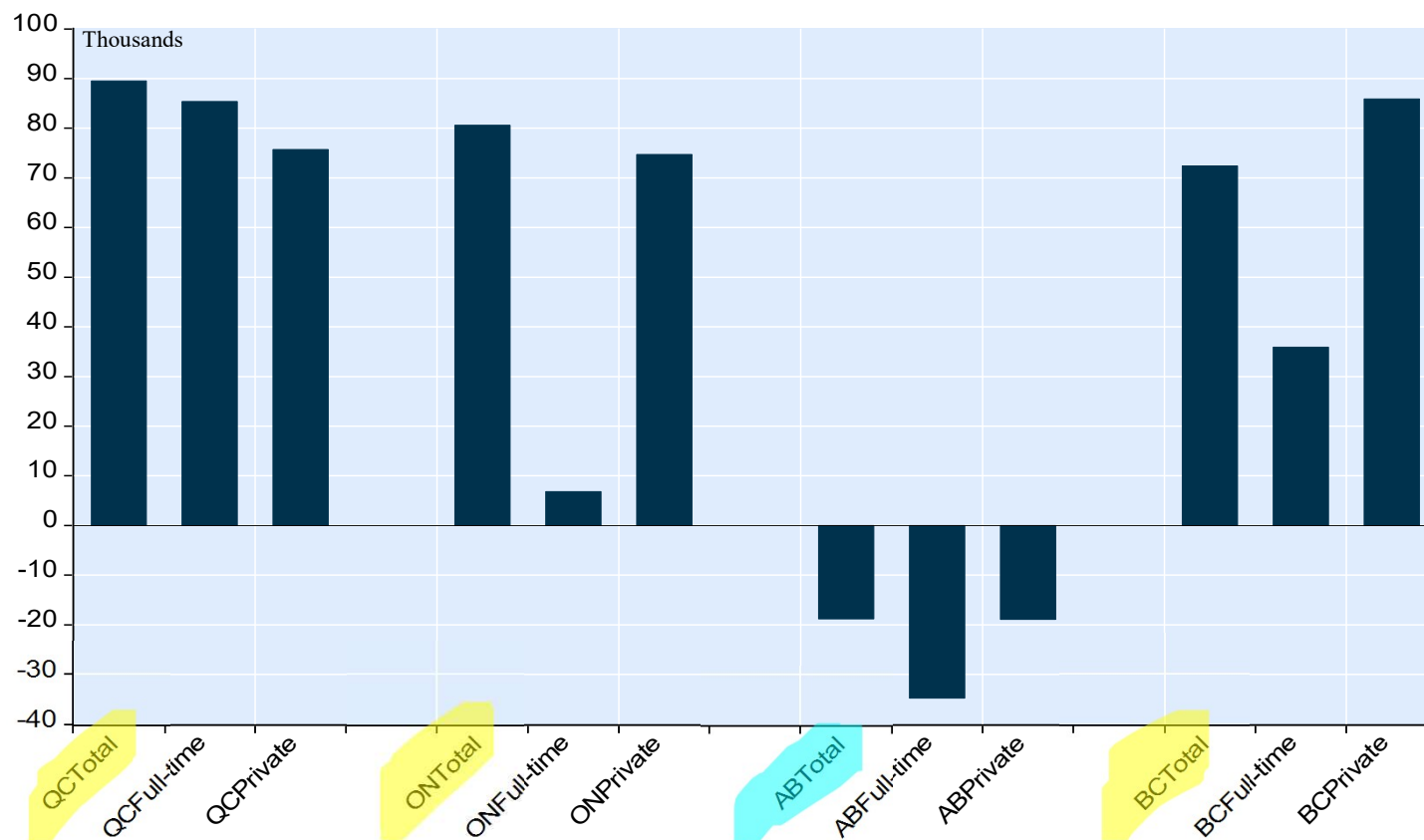
Real gross domestic product, constant 2007 dollars



NBF Economics and Strategy (data via Statistics Canada)

Canada: Job creation in the larger provinces in 2016

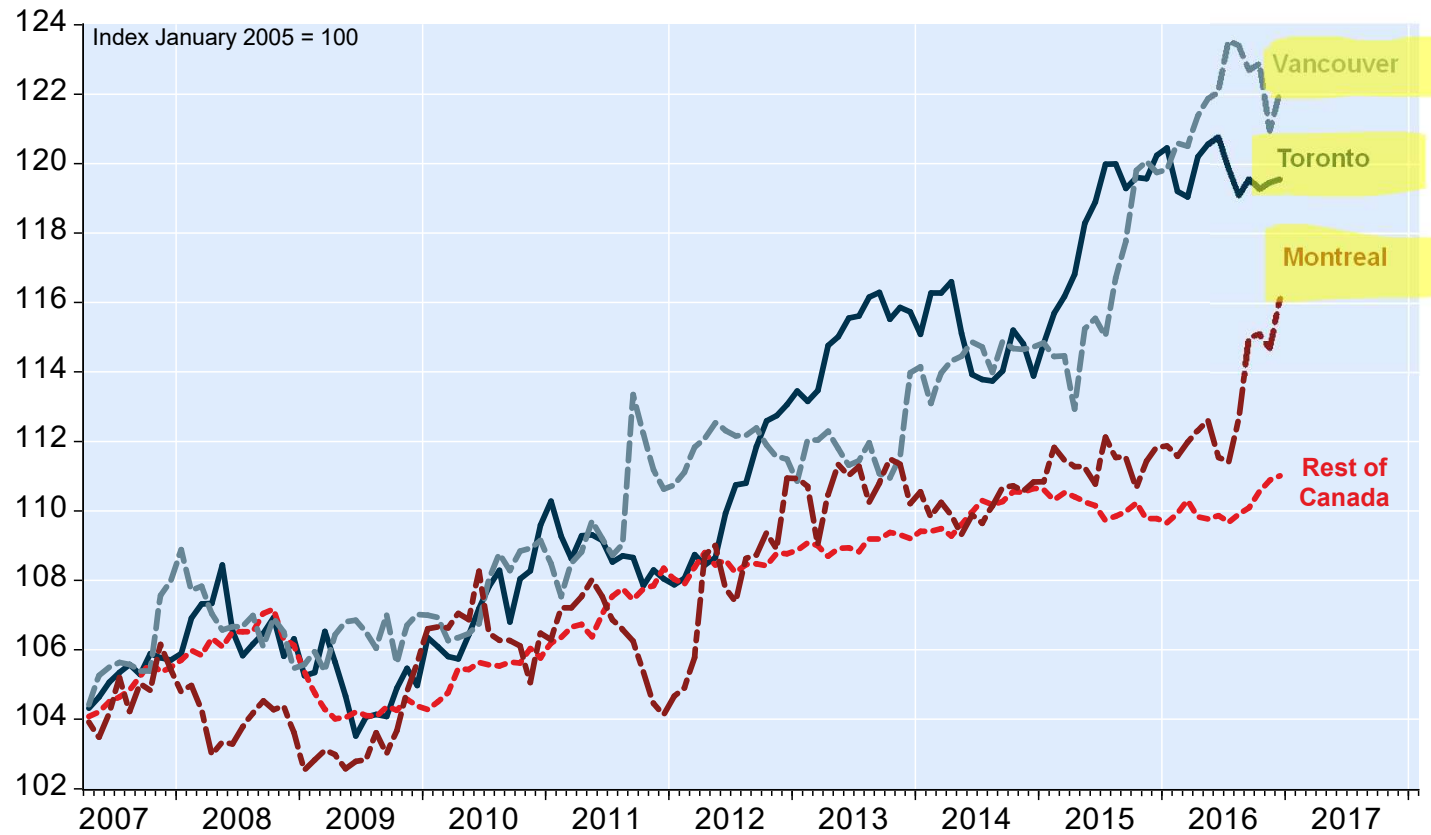
QC, ON, AB & BC Full-time and Private Employment (YTD through Dec 2016)



NBF Economics and Strategy (data via Statistics Canada)

Canada: Perspective on job creation in major metropolitan areas

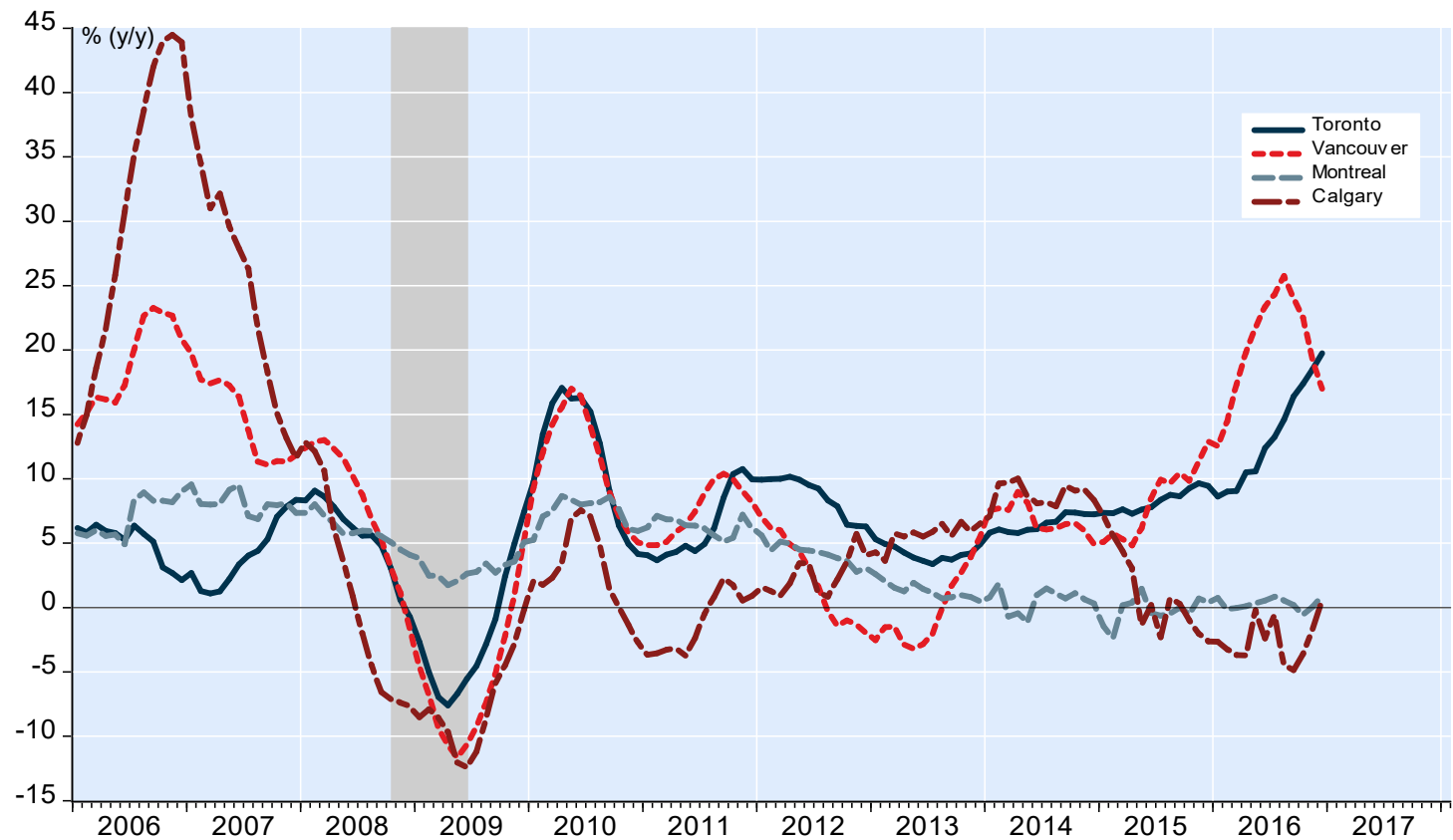
Total employment



NBF Economics and Strategy (data via Statistics Canada)

Canada: Housing markets are not homogenous

Teranet-National Bank regional sub-indexes



NBF Economics and Strategy (Teranet-National Bank House Price Index)



TV RADIO NEWS SPORTS MUSIC LIFE ARTS LOCAL ▼ MORE ▼

WATCH

LISTEN

LOG IN



Business

Tax Season

CBC SecureDrop

Trump administration will press Canada, Mexico to reopen NAFTA

Incoming U.S. administration reportedly wants to rewrite country of origin rules

By Pete Evans, [CBC News](#) Posted: Jan 18, 2017 10:38 AM ET | Last Updated: Jan 18, 2017 10:05 PM ET



'I think we should grant access to our markets to anyone who plays fair, plays by the rules and gives everybody a fair chance to compete,' would-be Commerce Secretary Wilbur Ross said. (Mike Segar/Reuters)

ADVERTISEMENT



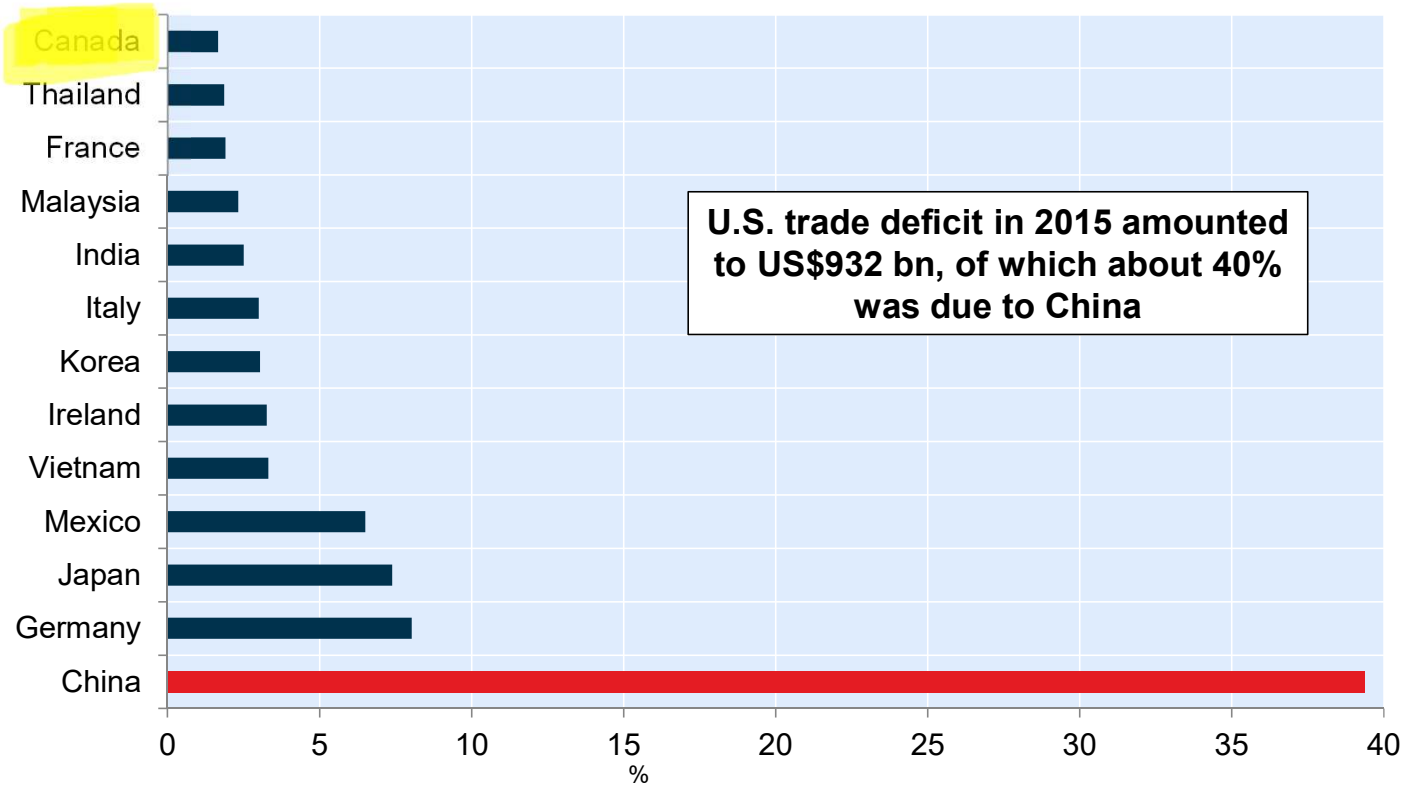
Latest Business Headlines



■ **Genworth follows CMHC's lead and hikes premiums for mortgage insurance**
January 19, 12:10 PM ET

U.S.: Bulk of trade deficit due to China

Distribution of trade deficit by country



Investing under Trump

+ Add to myFT

Prospect of Trump tariffs unnerves Asian investors

Trade barriers against any one country would be felt across interconnected region



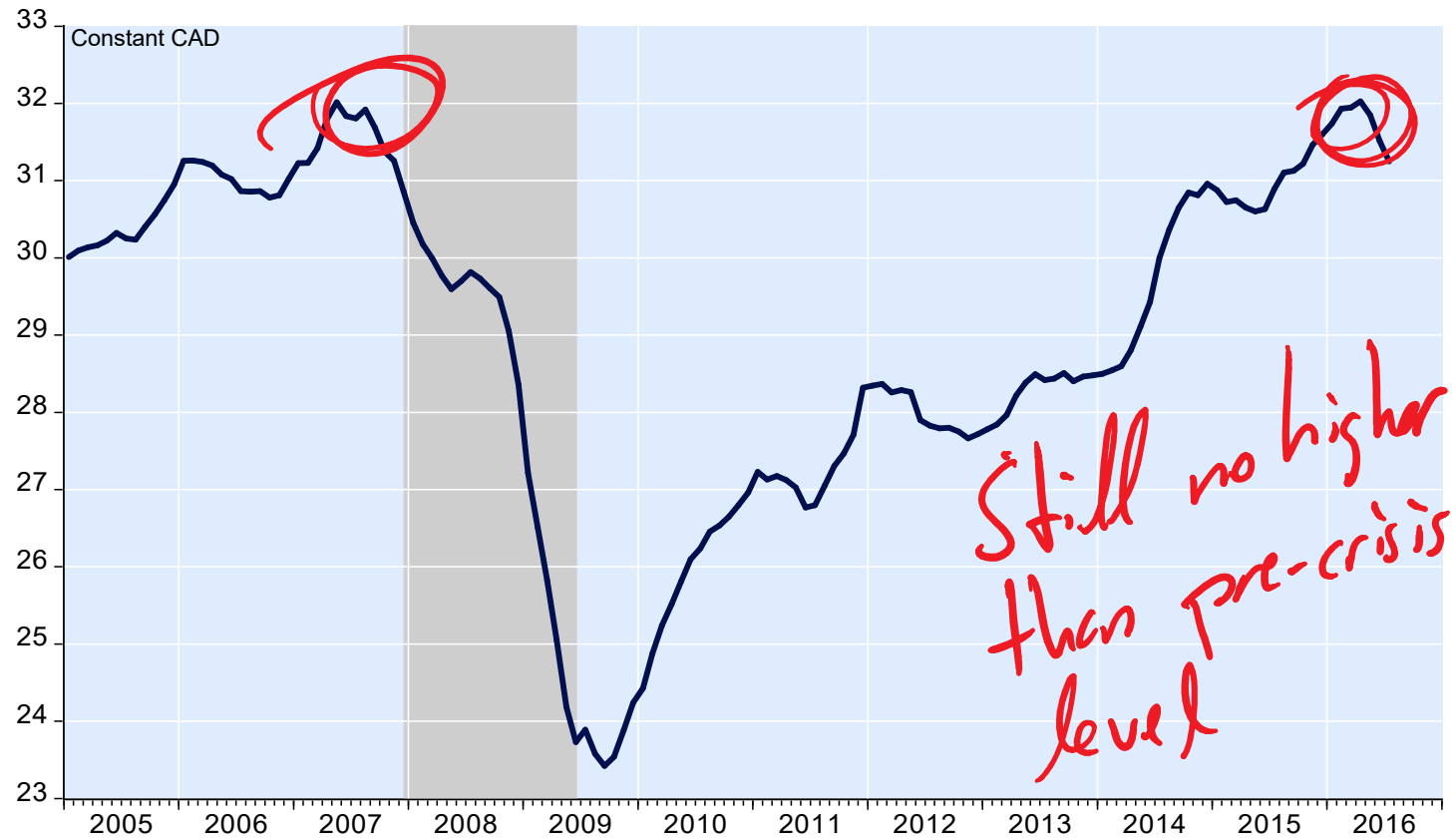
With the inauguration of Donald Trump as US president looming on Friday, markets have begun to analyse the potential impact of his eye-popping tariff proposals © FT montage; EPA



YESTERDAY by: **Jennifer Hughes** in Hong Kong

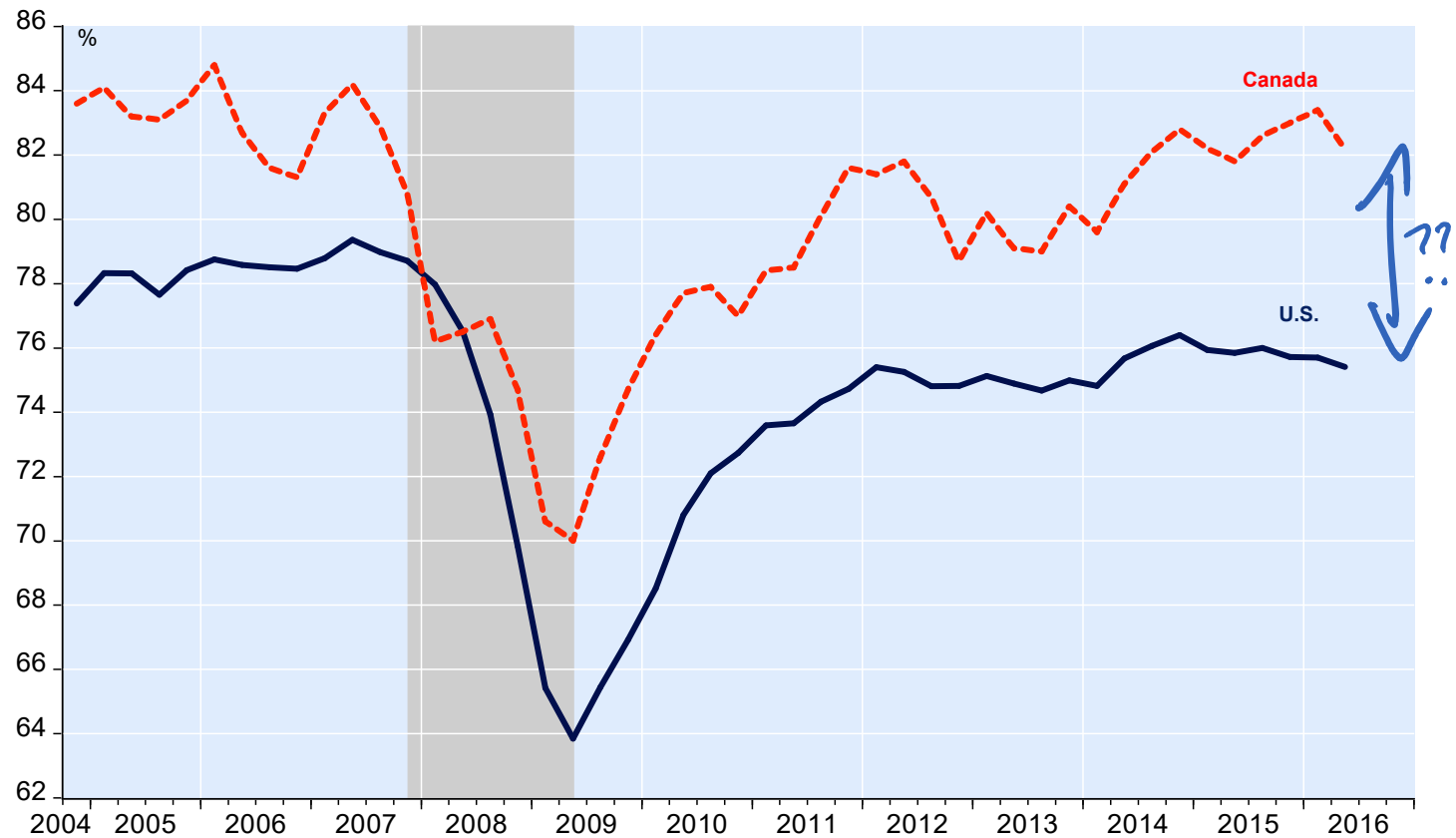
Canada: Why are non-energy exports struggling to break free ?

Volume exports of non-energy products



Canada: Capacity utilization higher than in the U.S. !

Capacity utilization in manufacturing



NBF Economics and Strategy (data from datastream)

Canada: Perspective on capacity utilization

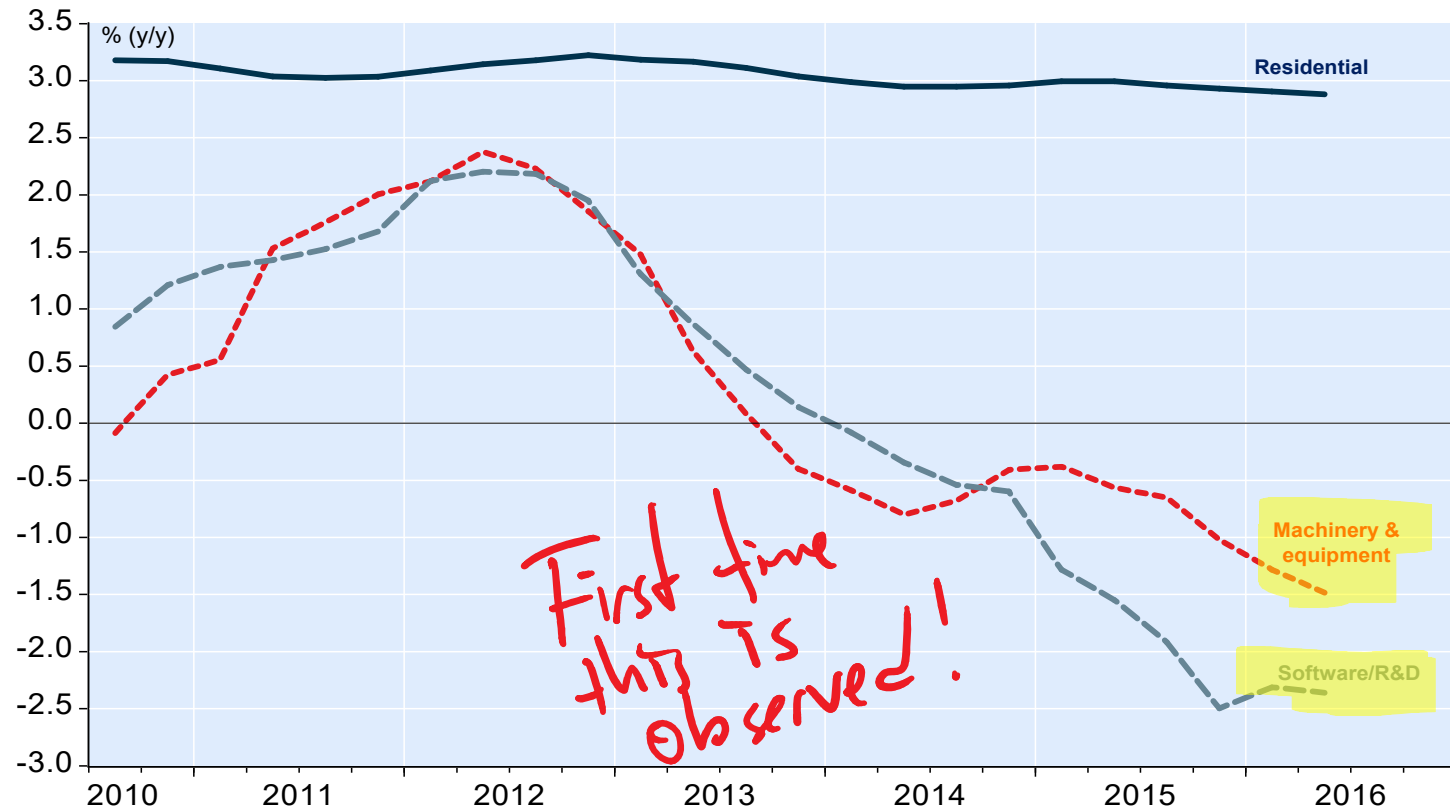
All sectors Q2 2016

	Latest	One year ago	5 year avg	10 year avg
Total	80.0	80.2	81.2	80.9
Forestry	87.0	93.3	89.1	84.5
Oil & Gas	73.9	75.1	76.8	77.3
Mining	71.3	68.5	75.4	77.2
Power	84.7	82.8	83.6	85.1
Construction	83.5	85.2	86.3	86.6
Manufacturing	82.2	81.8	81.1	79.5
Food	81.4	80.3	78.8	79.3
Beverages/Tobacco	80.8	78.7	75.1	72.9
Textiles	72.3	75.1	72.3	71.6
Clothing	68.5	73.7	71.2	71.8
Leather	80.2	78.4	74.3	71.6
Wood	95.1	89.2	85.6	79.4
Paper	95.0	91.4	89.6	88.3
Printing	67.4	69.9	69.6	71.2
Petrocoal	85.2	83.1	81.1	80.7
Chemical	82.3	81.3	78.6	77.5
Plastic/rubber	87.0	86.7	80.9	77.2
Non-metal minerals	72.0	75.4	75.3	76.1
Primary metal	78.2	70.4	80.6	82.7
Fabricated metal	73.4	81.2	79.7	77.9
Machinery	71.6	81.3	81.3	79.2
Computer	82.9	92.0	85.1	85.7
Electrical	74.3	75.9	75.4	76.9
Transpo. Equip.	93.5	87.2	88.5	83.0
Furniture	85.7	85.0	80.7	78.7
Misc	81.4	81.6	80.5	80.0

NBF Economics and Strategy (data via Statistics Canada)

Canada: That is not good news!

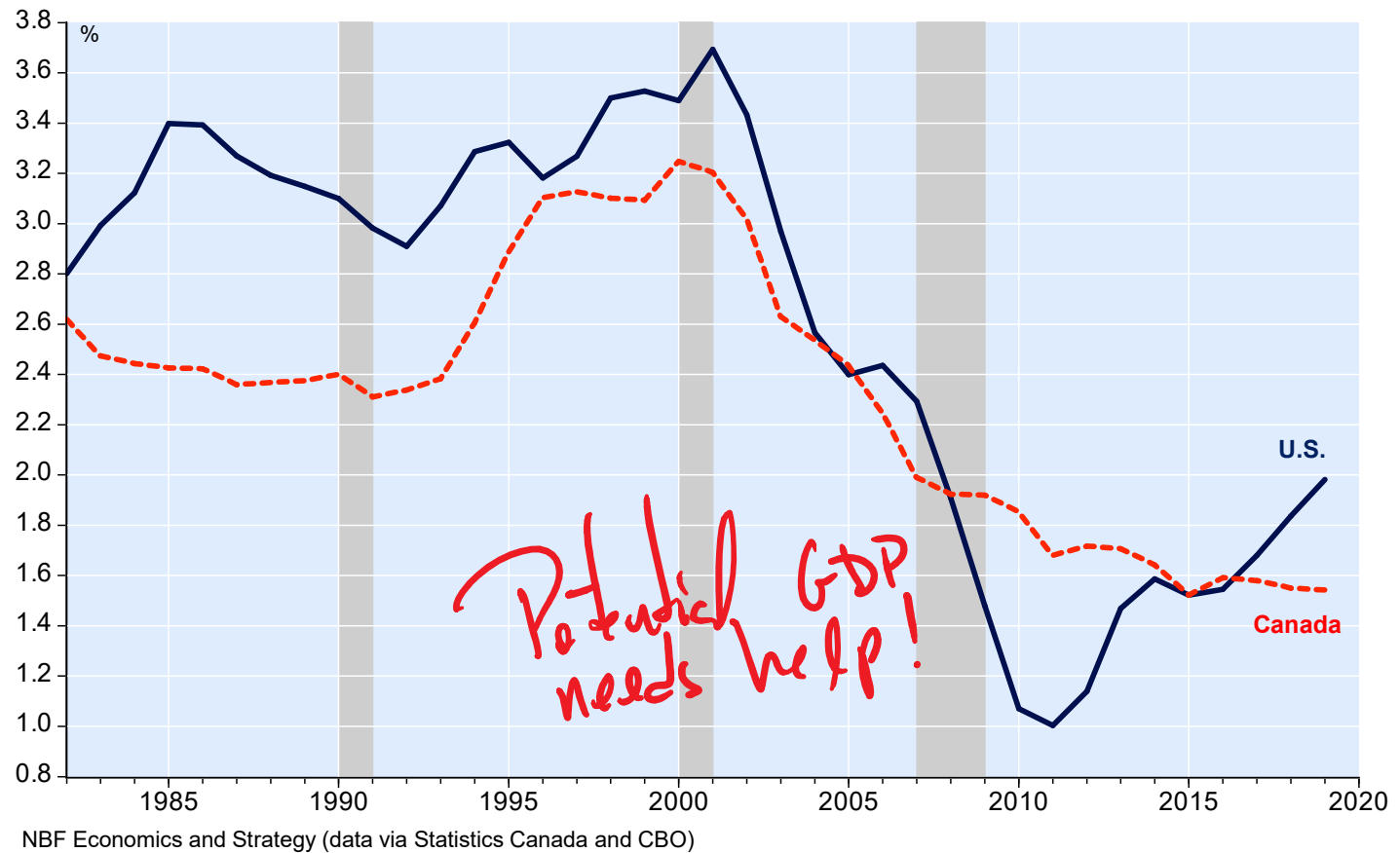
Net stock of capital in the business sector



NBF Economics and Strategy (data from Statistics Canada Table 031-0009)

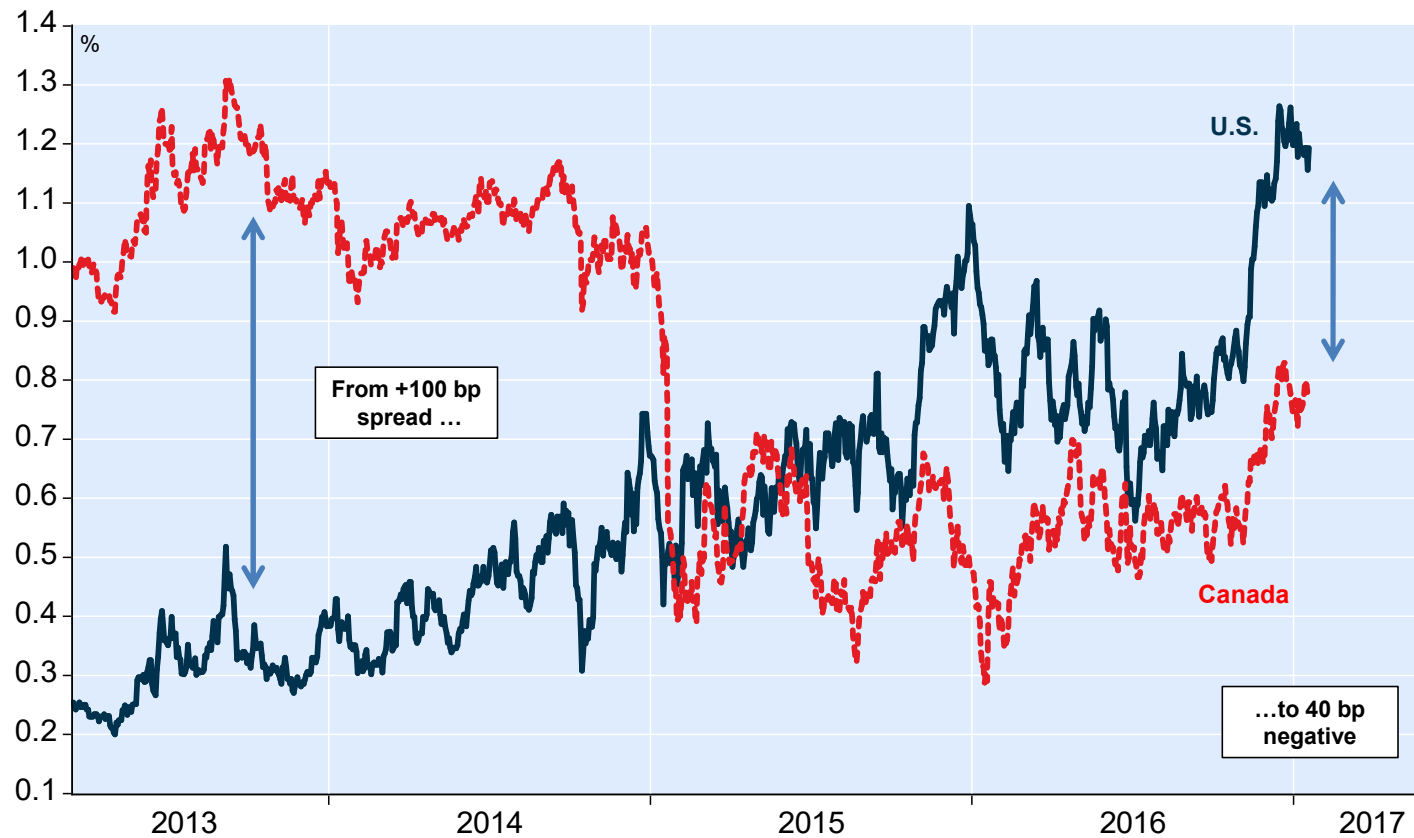
Perspective on potential GDP growth in North America

Potential output growth estimation for Canada (NBF) and United States (CBO)



Perspective on Canada-U.S. interest rates

Yield on 2-year Treasuries



NBF Economics and Strategy (data via Datastream and Fred)

Home News Opinion Business Investing Sports Life Arts Tec

Streetwise

Economy

International

Industry News

Small Business

Commer

Currencies

Housing

Home » Report on Business » Economy



Bank of Canada says rate cut an option amid concern over Trump policies

BARRIE MCKENNA

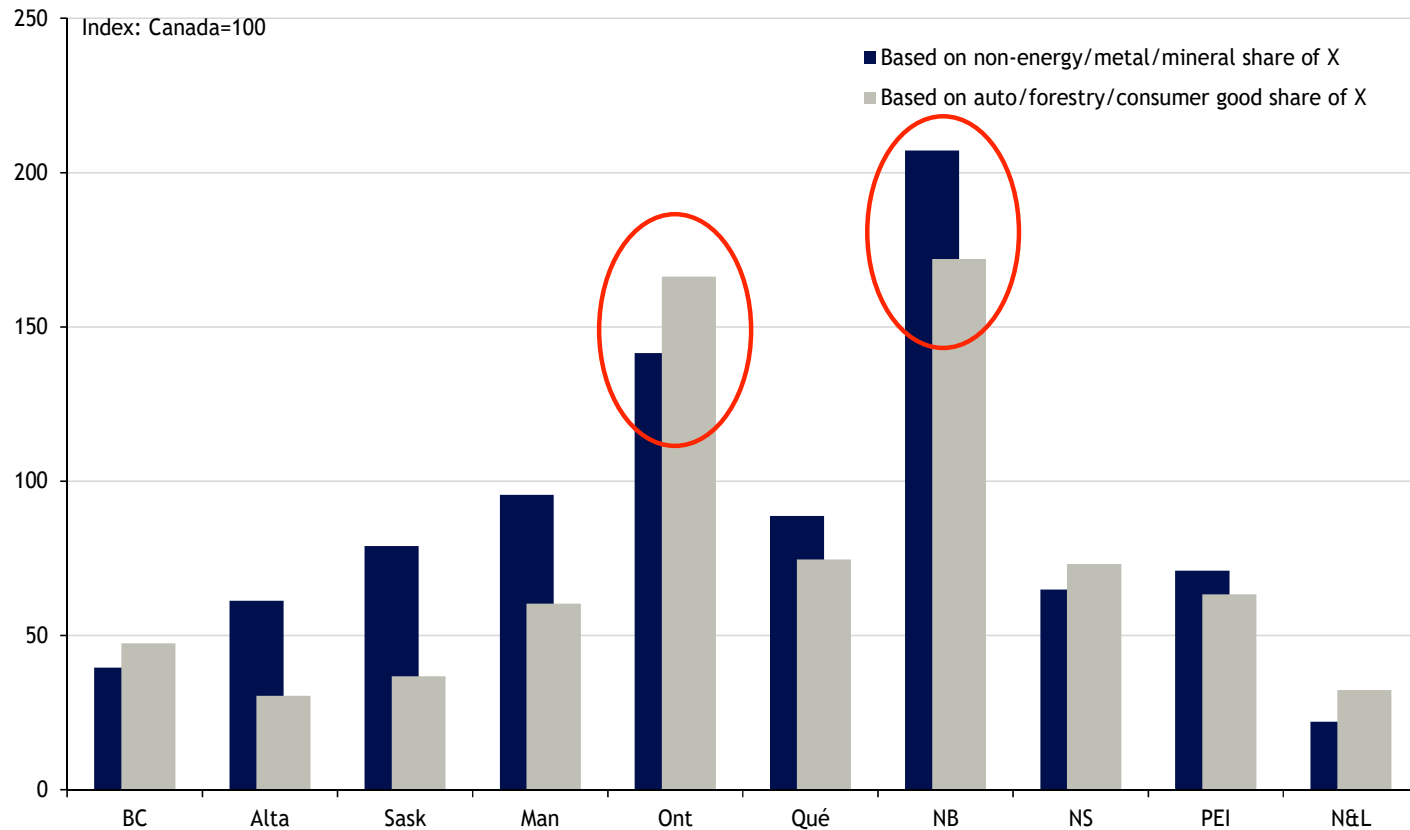
OTTAWA — The Globe and Mail

Published Wednesday, Jan. 18, 2017 10:04AM EST

Last updated Wednesday, Jan. 18, 2017 9:53PM EST

Canada: Ontario and New Brunswick more at risk of U.S. protectionism

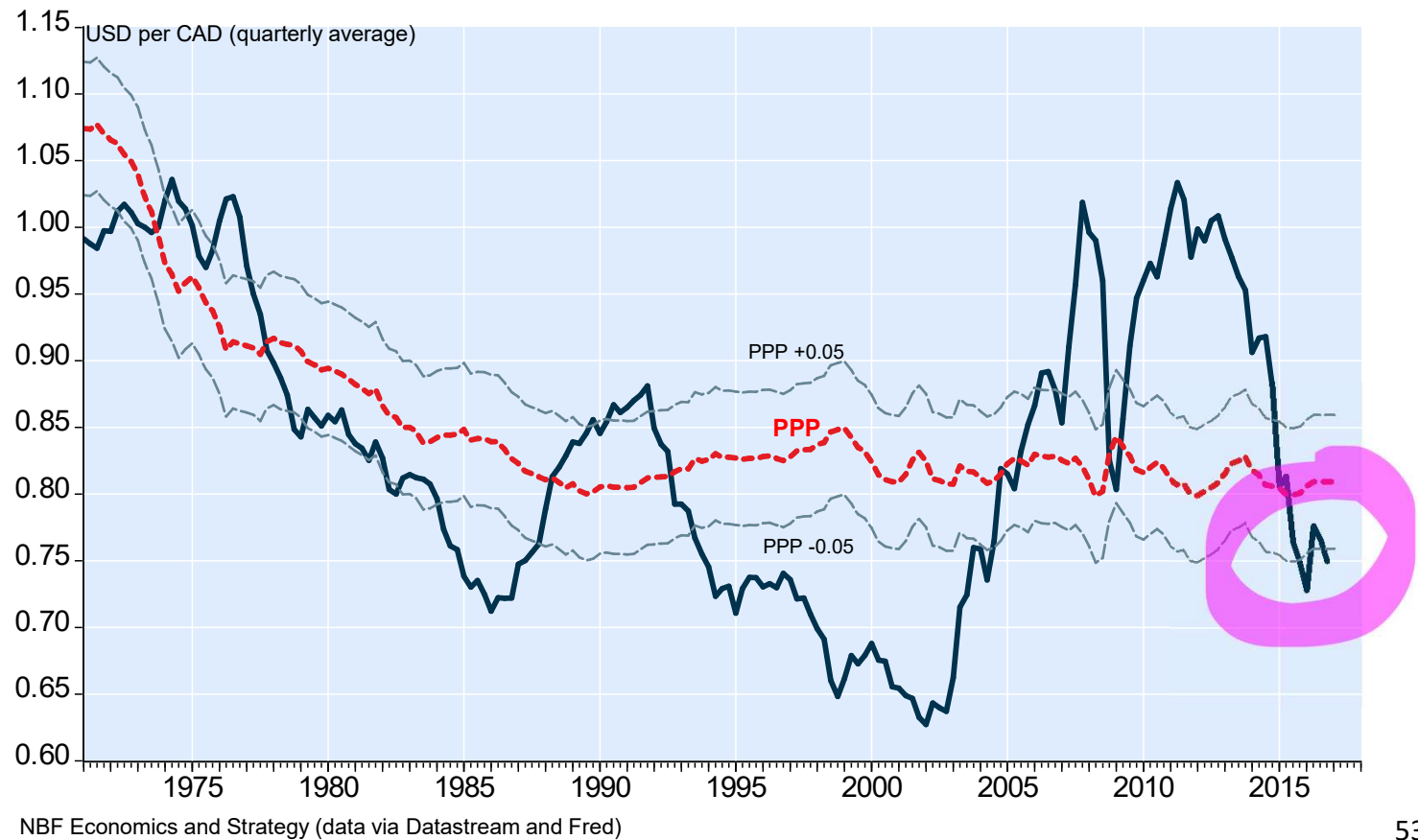
Export vulnerability index



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

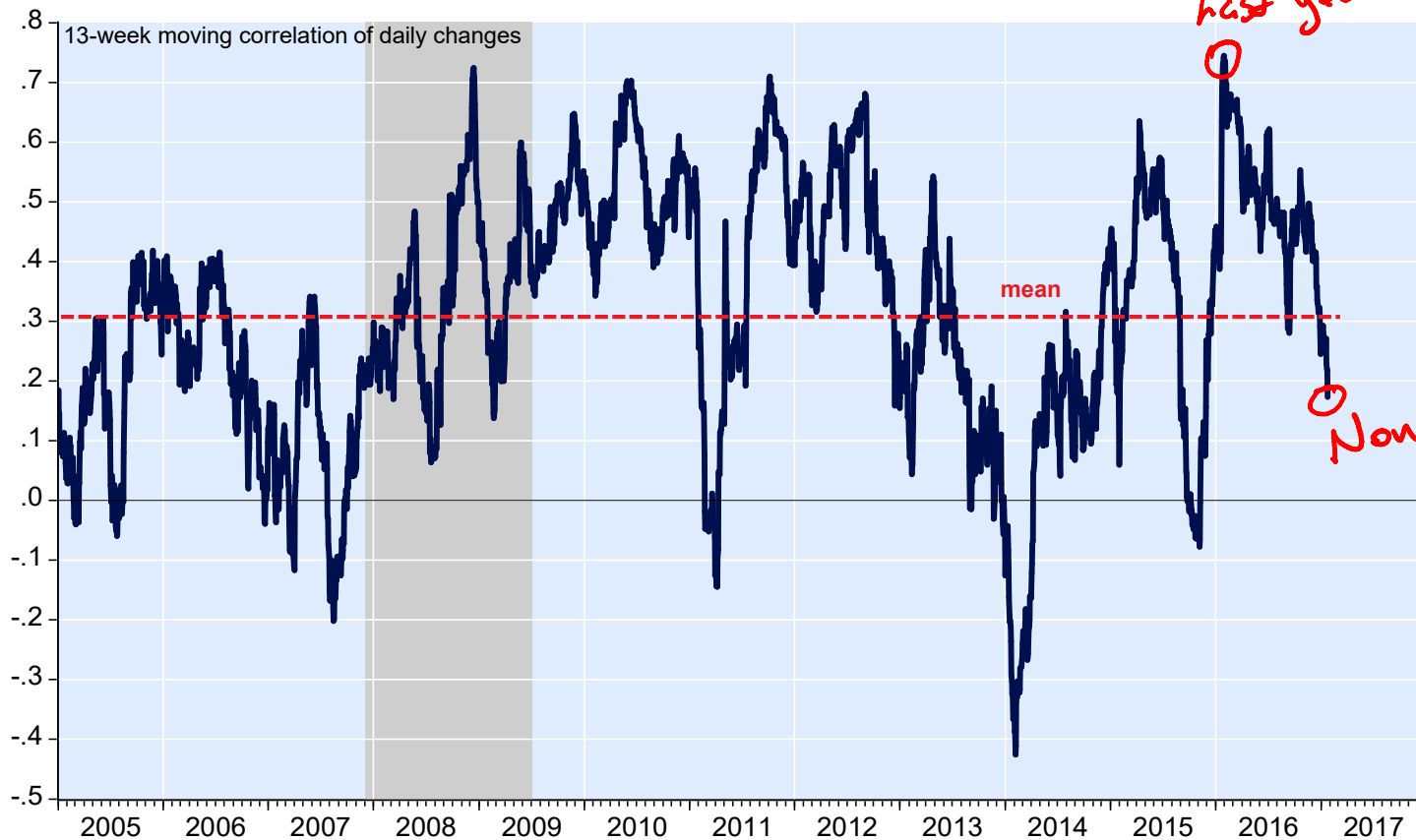
Canada: Historical perspective on valuation

CAD vs. its purchasing power parity



Canada: CAD not trading on oil in recent weeks

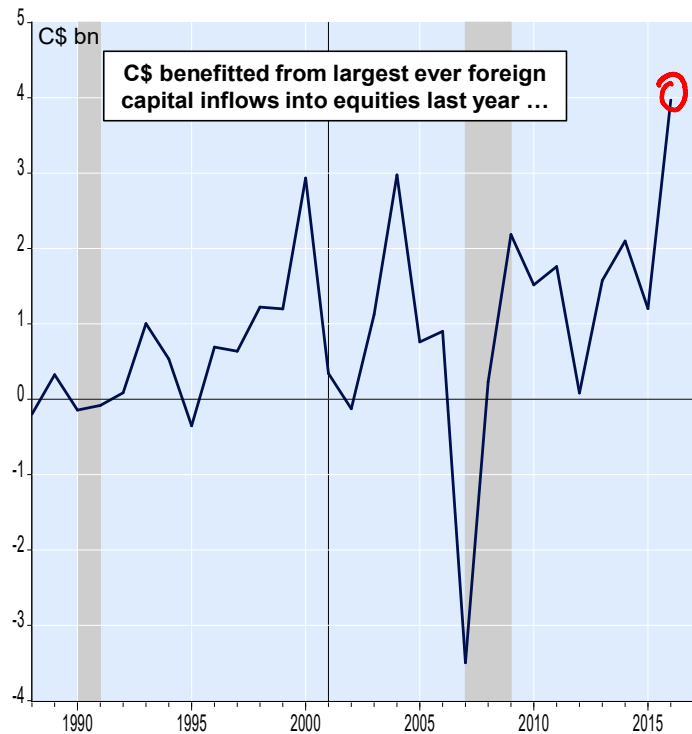
Correlation between CAD/USD and oil prices (WTI)*



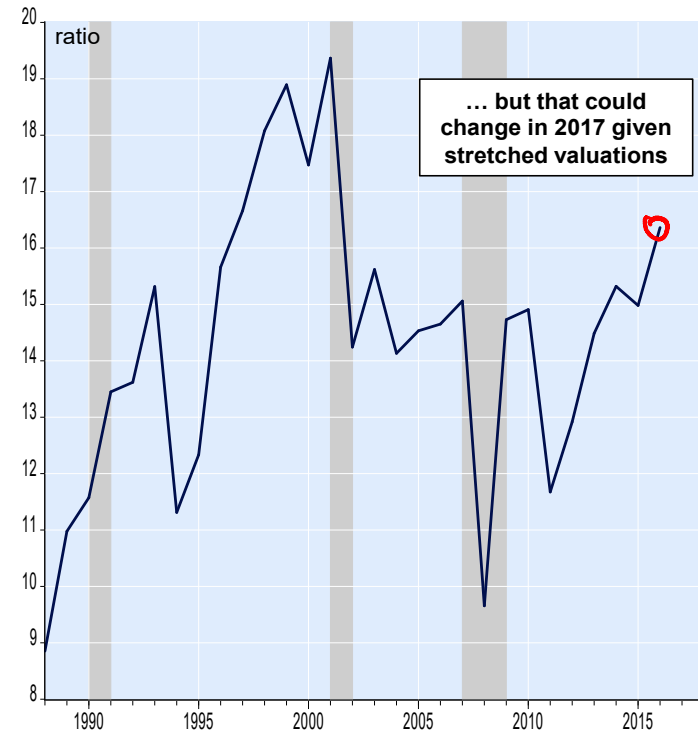
NBF Economy and Strategy (data via Datastream)

Canada: Foreign capital inflows into equities could soften in 2017

Monthly average net foreign
inflows into equities



Forward PE ratio:
Valuation of S&P/TSX at year-end



* Average for first eleven months of 2016
NBF Economics and Strategy (data via Statistics Canada, Datastream)

S&P/TSX composite index: EPS Performance

	2015	2016	2017	2018
S&P TSX	-17.4	-2.1	25.8	13.3
ENERGY	-87.3	-37.5	626.4	43.2
MATERIALS	-46.6	46.6	52.2	10.6
INDUSTRIALS	15.8	-11.1	12.7	14.2
CONS. DISC.	29.4	2.3	12.8	14.1
CONS. STAP.	10.6	12.5	14.6	9.8
HEALTH CARE	27.8	-54.2	-0.2	15.5
FINANCIALS	1.6	-0.2	8.3	7.4
BANKS	5.9	4.0	4.7	6.7
IT	5.6	12.6	11.2	10.0
TELECOM	-0.6	7.9	5.8	5.0
UTILITIES	38.8	27.6	1.4	11.5
REAL ESTATE	-1.0	-43.8	43.1	11.2

1/20/2017

NBF Economics and Strategy (data via Datastream)

Conclusion:

- **World, U.S.**

- Global growth above 3.0% in 2017 (accelerating)
- China continues to grow at around 6% (good enough)
- Eurozone, ok but elections coming and we need fiscal stimulus to keep protectionist forces at bay
- Geopolitical risks to remain a major source of concern: U.S. Trade Policy?

Interest rates, currency:

- The Fed probably hikes twice in H2 2016 ; 10-year U.S. Treasury heading towards 3%.
- Renewed USD strength due to Fed hikes but we assume 5% depreciation as the year unfolds;
- CAD in the 1.30-1.40 range (keep an eye on home prices in Canada): NAFTA?? FTA??
- Commodity prices: We assume \$50 WTI, metals to take their cue from fiscal policy.

Asset mix: Valuations are not cheap, but we still prefer stocks over bonds at this juncture.

TSX : +5% / S&P 500 : +10%

Thank you!

General – National Bank Financial (NBF) is an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on Canadian stock exchanges. The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete. The opinions expressed are based upon our analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein. Research Analysts – The Research Analyst(s) who prepare these reports certify that their respective report accurately reflects his or her personal opinion and that no part of his/her compensation was, is, or will be directly or indirectly related to the specific recommendations or views as to the securities or companies. NBF compensates its Research Analysts from a variety of sources. The Research Department is a cost centre and is funded by the business activities of NBF including, Institutional Equity Sales and Trading, Retail Sales, the correspondent clearing business, and Corporate and Investment Banking. Since the revenues from these businesses vary, the funds for research compensation vary. No one business line has a greater influence than any other for Research Analyst compensation. Canadian Residents – In respect of the distribution of this report in Canada, NBF accepts responsibility for its contents. To make further inquiry related to this report, Canadian residents should contact their NBF professional representative. To effect any transaction, Canadian residents should contact their NBF Investment advisor. U.S. Residents – With respect to the distribution of this report in the United States, National Bank of Canada Financial Inc. (NBCFI) is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC). This report has been prepared in whole or in part by, research analysts employed by non-US affiliates of NBCFI that are not registered as broker/dealers in the US. These non-US research analysts 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 a research analyst account. All of the views expressed in this research report accurately reflect the research analysts' personal views regarding any and all of the subject securities or issuers. No part of the analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report. The analyst responsible for the production of this report certifies that the views expressed herein reflect his or her accurate personal and technical judgment at the moment of publication. Because the views of analysts 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. UK Residents – In respect of the distribution of this report to UK residents, National Bank Financial Inc. has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). National Bank Financial Inc. 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 thereto. The value of investments can go down as well as up. Past performance will not necessarily be repeated in the future. The investments contained in this report are not available to retail customers. 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. National Bank Financial Inc. is authorised and regulated by the Financial Conduct Authority and has its registered office at 71 Fenchurch Street, London, EC3M 4HD. National Bank Financial Inc. is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom. Copyright – This report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of National Bank Financial.

NBC at 1155 Metcalfe Street, Montreal, Canada

