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FINANCIAL MARKETS MONTHLY

April 10, 2017

Range bound

Bond markets struggled to find direction in March, following the ebb and flow of economic data and central bank speak and ultimately ended the month little changed. Fiscal and monetary policy continued to share the spotlight in the US where Treasuries sold off early in the month as a more hawkish tone from Fed officials cemented expectations for another rate hike. That trend reversed, however, when the Committee's statement and projections failed to double down on the hawkish shift. Indication that the Trump Administration might have difficulty passing fiscal stimulus measures was also a factor pushing UST yields back to the lower end of their recent range. Canadian yields followed a similar pattern, driven in large part by US moves but with the domestic narrative also playing along. With Canada's economy continuing to outperform expectations (and the labour market going along for the ride), markets were pricing in rising odds that the Bank of Canada would follow the Fed in scaling back accommodation later this year. However, a less-than-optimistic tone from members of the Governing Council served to undercut those expectations ahead of the Bank's Monetary Policy Report on April 12.

The European Central Bank has also had to talk down expectations for tighter monetary policy after subtle changes to their March statement led to markets pricing in higher rates next year. While the euro area's recovery is clearly gaining momentum, the ECB has been keen to emphasize that stimulus will remain in place at least until a sustained pickup in underlying inflation is evident. The argument is more finely balanced in the UK, where a clash between rising inflation and expectations of softer growth have left the Bank of England ready to respond in either direction. Markets continue to lean in the direction of a rate hike this year, but with some evidence that Brexit effects are starting to weigh on the economy, we think those expectations will ultimately be disappointed.

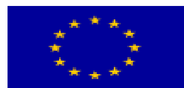
Central bank near-term bias

Three-months out, policy rate

BoC officials continue to push back against market pricing for higher rates this year. Expect the upcoming MPR to balance the positive trend in recent data with still-elevated uncertainty in the outlook and indications that slack in the economy remains.

The Fed's March 'dot plot' was less hawkish than expected but nonetheless indicated a growing consensus to continue scaling back accommodation this year. We look for the next rate hike in June.

The BoE's patience might be tested by rising inflation (indeed, one MPC member already voted for a hike) but we expect signs of a slowdown in the UK economy will keep policymakers on the sidelines this year as Brexit negotiations get underway.



Responding to expectations that stimulus might be scaled back next year, the ECB has been keen to emphasize that monetary policy will remain accommodative as long as underlying inflation remains subdued.

The RBA's tone was a bit more balanced in April, noting stronger growth but evidence of softer domestic conditions. We think there is scope for one more rate cut in the current cycle but not until Q4/17.

The RBNZ sounded a bit more positive on the economic outlook in March. We continue to see risk of further easing but have shifted our forecast for a final rate cut to Q4/17.

Highlights

▲ Slower consumer spending growth in Q1/17 led us to mark down our GDP forecast for the quarter…

▲ …but consumers are expected to bounce back with a number of supportive factors boosting confidence.

▲ Market reaction to the Fed's March meeting suggested disappointment with no change in the 'dot plot'…

▲ …though there was a growing consensus that further tightening will be appropriate this year.

US growth slowed in Q1 on less robust household spending…

US consumer spending got off to a slow start this year with real PCE falling in both January and February—the first back-to-back declines in five years. Some of this slowdown reflects temporary factors, particularly a decline in utilities spending amid mild winter weather, while payback for strong gains in earlier months may also have been at play. We now expect consumer spending rose by just 1% in Q1, well short of the above-3% pace seen through much of 2016. Other components of domestic spending are expected to pick up some of the slack in the first quarter—an improving trend in durable goods shipments and capex imports supports our forecast for stronger business investment, while solid home sales and housing starts point to another strong quarter for residential investment. Nonetheless, we now expect US GDP growth slowed to 1.6% from 2.1% in the previous quarter.

…but still plenty of reason for optimism on consumer outlook

The slowdown in consumer spending early this year isn't expected to continue. US consumer confidence began to pick up noticeably in November and continued to improve in 2017 with the Conference Board's measure hitting its highest level since 2000 in March. Consumers provided a better assessment of both the present situation and, even more significantly, expectations for the near-term. While timing of the upturn in sentiment—coinciding with Trump's election victory—suggests expectations of lower personal income taxes might be at play, a number of other supportive factors likely fuelled consumers' sunnier outlook. The low unemployment rate, faster wage growth, and wealth effects from rising home prices and equity markets are all bolstering household finances.

Aggregate income growth and strong consumer sentiment underpin our forecast for household spending to return to a 2½% pace after the disappointing first quarter. While there is a risk that support from lower taxes falls short of consumers' expectations (the size of personal income tax cuts and the extent to which they will accrue to a majority of households remains uncertain) we think improving labour market conditions and household balance sheets will keep consumers upbeat on the economic outlook even if the fiscal boost isn't as advertised or comes a bit later than anticipated.

Not exactly a dovish hike

The Fed raised rates again in March, just three months after December's hike—the shortest interval between moves this cycle. The increase was fully expected after a positive run of economic data and strong indications from Fed officials that a near-term hike was likely. Changes to the policy statement were minor and the tone on the economy remained upbeat, noting moderate growth, solid job gains, rising consumer spending and somewhat firmer business investment. There was a subtle shift on inflation with the statement emphasizing a "symmetric" goal; however, Chair Yellen downplayed the change at her press conference. The Committee's guidance was untouched, with a gradual pace of tightening still expected and no new details on reinvestment of QE assets (Yellen said the latter was discussed but no decision was made). Similarly, the Committee's economic projections were little changed and the 'dot plot' showed another two rate hikes are expected this year and three next year, as was the case in December.

Given modest changes in the statement and projections, and a balanced tone from Chair Yellen in her press conference, it is somewhat surprising that the market reaction was decidedly dovish—10-year UST yields fell by close to 10 basis points on the day and the dollar slipped nearly 1%. The response likely reflected expectations that the Fed might indicate an even faster pace of tightening going forward. Looking at the 'dot plot' itself, however, you would be hard-pressed to see a dovish undertone; all but three members now see two additional hikes as appropriate this year, indicating a growing consensus that policy normalization should be underway given progress toward the Committee's inflation and employment objectives. We are with the Fed in looking for two more rate hikes this year (June and December) with a pause in September when tapering of QE reinvestment is expected to be announced. The latter is seen as a passive policy tool although we think the Fed will hold off on a rate hike at the same time to gauge the market impact.

Canada's economy jumped out of the starting gate in 2017…

Canada's run of solid economic growth showed no sign of letting up with January GDP rising 0.6%—twice the pace expected heading into the report—to build on solid gains in late-2016. January's increase was widespread across industries; goods production recorded another solid gain on strength in manufacturing and mining while growth in the more stable services sector was the strongest in a year. On a year-over-year basis, non-commodities output continues to increase at a 2% pace while a shift to positive growth in the energy sector—in contrast with the sharp declines seen for much of the last two years—has helped overall GDP growth accelerate to an above-trend rate. This pickup in economic activity gives less reason to discount strong labour market data, although the pace of job gains since mid-2016 still looks unsustainable.

Given the solid start to the year, we have revised up our Q1/17 GDP growth forecast to 3.8% from 1.9% previously. That would mark a third consecutive quarter of Canada's economy outperforming the US. It would also represent another sizeable upside surprise relative to the Bank's January growth projections—implying slack in the economy is being absorbed more quickly than policymakers anticipated. That said, it isn't a foregone conclusion that the Bank will bring forward their estimate of when the economy is likely to reach full capacity. The Governing Council seems keen to avoid any hawkish shift that might lead markets to price in higher Canadian policy rates as the Fed continues to tighten in the US. If the Bank continues to project slack persisting until mid-2018, attention will be paid to the factors offsetting stronger growth.

…and business sentiment is improving…

The Bank of Canada's quarterly Business Outlook Survey (BOS) joined the growing list of indicators showing improvement in the economic backdrop. The most positive development was a further increase in firms' investment intentions, with the balance of opinion on machinery and equipment spending now the second-best since the recession. That improvement is at odds with Statistics Canada's CAPEX survey from a month ago—one of the few disappointing data releases so far this year—that pointed to declining private sector investment intentions in 2017. The Bank's survey does imply that nonresidential investment won't act as a drag on growth again this year. Also in the BOS, hiring intentions and expectations for future sales growth remained positive with both domestically-oriented firms (including those in energy-producing regions) and exporters seeing improving prospects. The latter group, however, is facing heightened uncertainty amid potential US policy changes including corporate tax cuts and protectionist trade measures—two issues that the Bank highlighted recently.

…so time for a change of tune?

The Bank of Canada's March policy statement fell on the cautious side of neutral and recent comments from the Governing Council have maintained that tone despite accumulating upside surprises in the data. Governor Poloz, while careful not to prejudge the upcoming forecast, sounded somewhat skeptical of recent indicators, noting we've seen improving trends in years past that haven't been sustained. So while the Bank will have to acknowledge evidence of a strengthening economic backdrop in the April MPR, we expect some of that optimism will be tempered by continued emphasis on risks to the outlook and persistent slack in the economy.

As noted above, the Bank might tweak growth forecasts (or key assumptions) rather than bring forward their estimate of when the economy will reach full capacity. Indeed, despite recent strength in GDP, employment, and headline inflation, the Bank can point to little change in their preferred measures of underlying inflation (all below 2%) and weak wage growth as evidence of slack. Results of the latest BOS were also consistent with limited capacity pressures or labour shortages and little change in inflation expectations. As for risks to the outlook, the threat of protectionism will likely remain a significant concern as the new US administration seeks to renegotiate NAFTA and global support for trade liberalization appears to be faltering (the latest G20 meeting saw finance ministers drop a pledge to oppose protectionism). Overall, while it is becoming increasingly difficult to justify a dovish stance—and a rate cut now seems like a remote possibility compared with six months ago—there are enough risks and caveats in recent data for the Bank to continue to push back against market odds (~36%) of a rate hike this year.

Highlights

▲ Canada's January GDP gain sets up for growth of nearly 4% in Q1/17.

▲ Recent data suggest slack is being absorbed more quickly than the BoC previously projected.

▲ The Bank's Business Outlook Survey showed further improvement in business sentiment early this year.

▲ The BoC's reaction to improving data has been fairly muted—the upcoming MPR should give a better idea of how they see the outlook evolving.

Highlights

▲ Survey data suggest UK GDP growth slowed from the unexpectedly strong pace seen over the second half of 2016.

▲ The euro area recovery continues to gain momentum but underlying inflation isn't going anywhere.

▲ Australia's rising unemployment rate suggests slack in the economy has increased in recent months.

▲ New Zealand's strong growth relative to advanced economy peers partly reflects stronger labour market growth.

Cracks beginning to show after solid stretch for UK economy

The UK economy's surprising run of above trend growth since last year's Brexit referendum appears to be coming to an end just as negotiations on the UK's exit are set to begin. While far from suggesting a sharp slowdown, moderation in PMI readings to start 2017 are consistent with our forecast for GDP growth to slip to 0.4% in the first quarter from an average of 0.6% in H2/16. A slowdown in retail sales and services spending early in the year supports our expectation that consumer spending will be less robust than in 2016 as higher import prices put a squeeze on real incomes. Indeed, despite tight labour market conditions, wages are rising at just 2¼% year-over-year (a pace that is expected to continue based on a BoE survey of businesses) while inflation continued to trend higher in February and is expected to average more than 2½% this year. The Bank of England has thus far tolerated rising inflation (although one of nine MPC members did vote for a rate hike in March) and we expect they will remain patient amid mixed activity indicators, even as headline inflation picks up further. We think this balance between above-target inflation and slower growth will tilt in favour of the latter over the second half of this year, prompting the BoE to return to an easing bias and eventually opting for another round of QE in early-2018.

Euro area recovery in full swing

Survey data point to the euro area economy gaining further momentum early this year. The currency bloc's composite PMI rose to a post-recession high in March on improving conditions in Germany and France—the latter is particularly encouraging after the French economy appeared to stall in the middle of last year. The PMI data point to upside risk to our GDP growth projection although with the surveys having somewhat overestimated the pace of activity recently we continue to forecast another 0.4% gain in Q1/17. Improving economic activity, higher inflation (the euro area headline inflation rate hit 2% in February for the first time in four years before slipping back in March), and a slight change in ECB language fuelled expectations that policymakers might begin withdrawing stimulus as early as next year. The ECB pushed back against those expectations, however, clearly expressing discomfort with market expectations for higher rates. We do think there might be scope for a shift away from negative policy rates even as asset purchases continue, though with little progress on core inflation (which has been at or below 1% for nearly three years) we think discussion of policy normalization is premature.

RBA set to sit on the sidelines a bit longer

In their decision to hold the cash rate steady in April, the RBA noted a number of developments that we see shaping the monetary policy outlook this year. On the positive side, global growth is picking up and higher commodity prices have boosted Australia's terms of trade and national income. However, domestic growth remains moderate and sub-trend activity over the second half of last year has led to an increase in labour market slack. The latter is contributing to slow wage growth, underpinning both our cautious view on consumer spending and our forecast for core inflation to remain below the RBA's target range this year. The upswing in housing has been more durable than expected, though new macroprudential regulations should contribute to a slowdown later this year. Those measures will also help address financial stability concerns that have been an important factor in recent monetary policy deliberations. With the domestic economy set to remain patchy and housing expected to peak later this year, we continue to expect a lower cash rate though that move is unlikely to come before Q4.

RBNZ also likely to delay easing

New Zealand's 0.4% increase in Q4/16 GDP fell short of both market and RBNZ expectations, with the latter attributing some of the slowdown to temporary factors. Year-over-year growth is now running at 2.7%—in line with the RBNZ's estimate of potential growth which reflects stronger labour force trends relative to other advanced economies. A slowdown to more trend-like growth is consistent with recent levelling off in the unemployment rate and steady underlying inflation. The RBNZ took note of some constructive developments, including recent NZD depreciation and signs of pickup in global activity. Even with those positives, however, we continue to expect growth will struggle to exceed potential this year, leaving the central bank disappointed with progress in underlying inflation (even as headline readings pick up). We think there remains scope to ease monetary policy but only after more evidence of weak price pressure becomes available. As such, we have shifted our forecast for a final rate cut to Q4/17.

Interest rate outlook

%, end of period

	Actuals					Forecast						
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
Canada												
Overnight	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25
Three-month	0.45	0.48	0.53	0.46	0.52	0.50	0.55	0.60	0.65	0.85	1.15	1.40
Two-year	0.54	0.52	0.52	0.80	0.75	0.85	0.95	1.05	1.20	1.40	1.60	1.80
Five-year	0.67	0.57	0.62	1.15	1.12	1.30	1.55	1.85	2.05	2.30	2.45	2.60
10-year	1.23	1.06	1.00	1.80	1.62	1.90	2.15	2.45	2.60	2.80	2.95	3.10
30-year	2.00	1.72	1.66	2.35	2.30	2.45	2.70	2.95	3.05	3.20	3.30	3.45
United States												
Fed funds**	0.50	0.50	0.50	0.75	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.50
Three-month	0.21	0.26	0.29	0.51	0.76	1.00	1.05	1.30	1.55	1.80	2.05	2.30
Two-year	0.73	0.58	0.77	1.25	1.27	1.45	1.60	1.90	2.15	2.40	2.60	2.80
Five-year	1.21	1.01	1.14	2.00	1.93	2.10	2.25	2.50	2.65	2.90	3.05	3.20
10-year	1.78	1.49	1.60	2.55	2.40	2.65	2.80	3.00	3.15	3.40	3.50	3.60
30-year	2.61	2.30	2.32	3.15	3.02	3.20	3.35	3.50	3.60	3.75	3.80	3.90
United Kingdom												
Bank rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25	0.25	0.10	0.10	0.10	0.10
Two-year	0.45	0.13	0.13	0.08	0.12	0.15	0.20	0.15	0.05	0.10	0.15	0.15
10-year	1.43	0.89	0.76	1.24	1.14	1.35	1.50	1.60	1.70	1.85	1.95	2.00
Euro area												
Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40
Two-year	-0.48	-0.61	-0.69	-0.78	-0.74	-0.65	-0.55	-0.50	-0.50	-0.50	-0.50	-0.50
10-year	0.15	-0.11	-0.12	0.21	0.33	0.35	0.50	0.60	0.65	0.65	0.70	0.75
Australia												
Cash target rate	2.00	1.75	1.50	1.50	1.50	1.50	1.50	1.25	1.25	1.25	1.50	1.50
Two-year	1.89	1.59	1.55	1.86	1.76	1.70	1.60	1.50	1.50	1.75	1.75	2.00
10-year	2.49	1.98	1.91	2.76	2.70	3.05	3.20	3.30	3.45	3.80	3.90	4.10
New Zealand												
Cash target rate	2.25	2.25	2.00	1.75	1.75	1.75	1.75	1.50	1.50	1.50	1.50	1.50
Two-year swap	2.19	2.22	1.96	2.50	2.31	2.10	2.00	2.00	2.10	2.20	2.30	2.40
10-year swap	2.97	2.65	2.41	3.58	3.41	3.70	3.90	4.10	4.30	4.70	4.90	5.00
Yield curve*												
Canada	69	54	48	100	87	105	120	140	140	140	135	130
United States	105	91	83	130	113	120	120	110	100	100	90	80
United Kingdom	98	76	63	116	102	120	130	145	165	175	180	185
Eurozone	63	50	57	99	107	100	105	110	115	115	120	125
Australia	60	39	36	90	94	135	160	180	195	205	215	210
New Zealand	78	43	45	108	110	160	190	210	220	250	260	260

* Two-year/10-year spread in basis points, **Top of 25 basis point range,

Source: Reuters, RBC Economics Research

Central bank policy rate

%, end of period

		Current	Last	
United States	Fed funds	0.75-1.00	0.50-0.75	March 15, 2017
Canada	Overnight rate	0.50	0.75	July 15, 2015
United Kingdom	Bank rate	0.25	0.50	August 4, 2016
Eurozone	Deposit rate	-0.40	-0.30	March 10, 2016
Australia	Cash rate	1.50	1.75	August 3, 2016
New Zealand	Cash rate	1.75	2.00	November 10, 2016

Source: Bloomberg, Reuters, RBC Economics Research

RBC

Economic outlook

Growth outlook

% change, quarter-over-quarter in real GDP

	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	2015	2016	2017F	2018F
Canada*	2.7	-1.2	3.8	2.6	3.8	1.5	1.6	2.0	2.1	2.2	1.9	1.7	0.9	1.4	2.4	2.0
United States*	0.8	1.4	3.5	2.1	1.6	2.2	2.5	2.4	2.4	2.3	2.0	2.0	2.6	1.6	2.2	2.3
United Kingdom	0.2	0.6	0.5	0.7	0.4	0.4	0.2	0.2	0.4	0.5	0.5	0.5	2.2	1.8	1.6	1.6
Euro area	0.5	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.4	0.4	0.4	0.4	1.9	1.7	1.5	1.5
Australia	1.1	0.8	-0.5	1.1	0.7	0.8	0.8	0.7	0.7	0.7	0.6	0.6	2.4	2.5	2.7	2.8
New Zealand	0.7	0.8	0.8	0.4	0.7	0.8	0.8	0.6	0.6	0.6	0.6	0.6	2.5	3.1	2.8	2.6

*annualized

Inflation outlook

% change, year-over-year

	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	2015	2016	2017F	2018F
Canada	1.5	1.6	1.2	1.4	2.1	2.4	2.6	2.6	2.2	2.0	2.2	2.3	1.1	1.4	2.4	2.2
United States	1.1	1.0	1.1	1.8	2.6	2.4	2.5	2.3	2.0	2.2	2.2	2.2	0.1	1.3	2.4	2.2
United Kingdom	0.3	0.4	0.7	1.2	2.1	2.7	2.8	2.7	2.8	2.5	2.4	2.4	0.0	0.7	2.6	2.5
Euro area	0.0	-0.1	0.3	0.7	1.8	1.6	1.6	1.5	1.4	1.3	1.2	1.2	0.0	0.2	1.6	1.3
Australia	1.3	1.0	1.3	1.5	2.2	2.3	2.3	2.4	2.5	2.5	2.4	2.3	1.5	1.3	2.3	2.4
New Zealand	0.4	0.4	0.4	1.3	1.3	1.2	1.3	1.5	1.6	1.7	1.8	1.8	0.3	0.6	1.3	1.7

Source: Statistics Canada, Bureau of Labor Statistics, Bank of England, European Central Bank, Reserve Bank of Australia, Reserve Bank of New Zealand, RBC Economics Research

Inflation tracking

Inflation Watch

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	Core CPI (CPIX)[1]	Feb	0.0	1.7	1.7	1.1
United States	Core PCE[1,2]	Feb	0.2	1.8	1.9	1.7
United Kingdom	All-items CPI	Feb	0.7	2.3	2.3	2.1
Euro area	All-items CPI[1]	Mar	-0.2	1.5	2.6	1.7
Australia	Trimmed mean CPI[1]	Q4	0.4	1.6	N/A	N/A
New Zealand	All-items CPI	Q4	0.4	1.3	N/A	N/A

1 Seasonally adjusted measurement.
2 Personal consumption expenditures less food and energy price indices.

Source: Statistics Canada, US Bureau of Labor Statistics, Bank of England, European Central Bank, Reserve Bank of Australia, Reserve Bank of New Zealand, RBC Economics Research

Currency outlook

Level, end of period

	Actuals					Forecast						
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
Canadian dollar	1.30	1.29	1.31	1.34	1.33	1.38	1.38	1.38	1.37	1.36	1.35	1.33
Euro	1.14	1.11	1.12	1.05	1.07	1.04	1.00	0.96	0.98	1.00	1.02	1.04
U.K. pound sterling	1.44	1.33	1.30	1.24	1.26	1.20	1.15	1.15	1.18	1.20	1.23	1.25
New Zealand dollar	0.69	0.71	0.73	0.69	0.70	0.72	0.73	0.74	0.74	0.74	0.75	0.75
Japanese yen	112.6	103.2	101.3	117.0	111.4	110.0	107.0	103.0	100.0	102.0	104.0	106.0
Australian dollar	0.77	0.75	0.77	0.72	0.76	0.75	0.73	0.72	0.72	0.72	0.73	0.73

Canadian dollar cross-rates

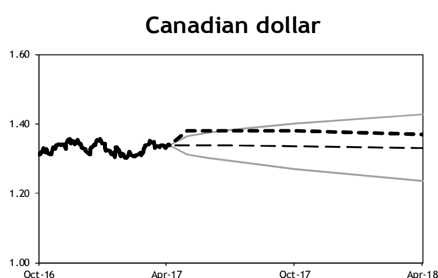
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
EUR/CAD	1.48	1.43	1.48	1.41	1.42	1.44	1.38	1.32	1.42	1.36	1.38	1.38
GBP/CAD	1.87	1.72	1.70	1.66	1.67	1.65	1.59	1.59	1.62	1.64	1.66	1.67
NZD/CAD	0.90	0.92	0.96	0.93	0.93	0.99	1.01	1.02	1.01	1.01	1.01	1.00
CAD/JPY	86.6	79.9	77.2	87.0	83.7	79.7	77.5	74.6	73.0	75.0	77.0	79.7
AUD/CAD	1.00	0.96	1.01	0.97	1.02	1.04	1.01	0.99	0.99	0.98	0.99	0.97

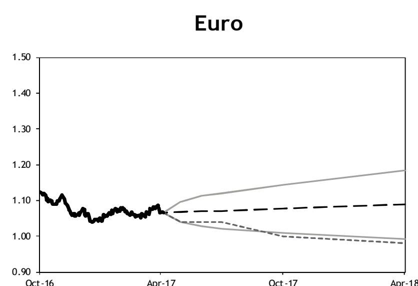
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

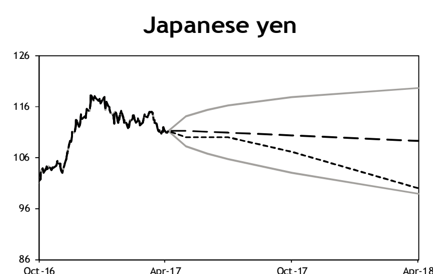
Source: Bloomberg, RBC Economics Research

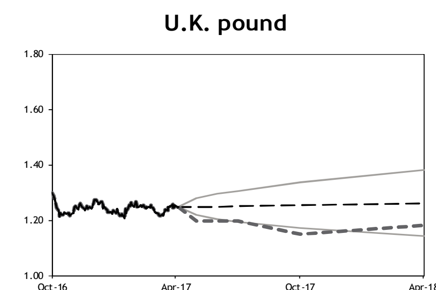
RBC Economics outlook compared to the market

The following charts track historical exchange rates plus the forward rate (dashed line) compared to the RBC Economics forecast (dotted line) out one year. The cone for the forecast period frames the forward rate with confidence bounds using implied option volatilities as of the date of publication.







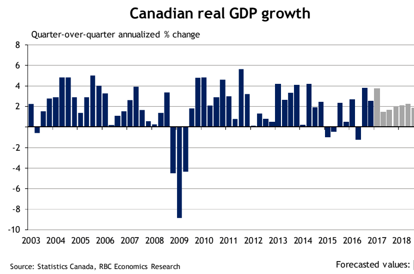


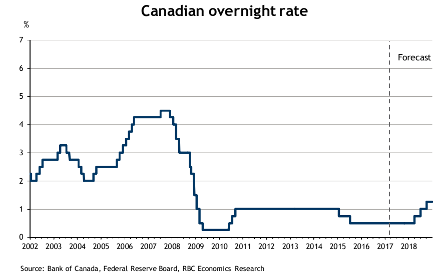
Central bank watch

Bank of Canada

A stronger-than-expected 0.6% increase in January GDP, built on solid gains in prior months, leading us to boost our Q1/17 forecast to 3.8%. That would make for a third consecutive quarter in which Canada's economy has outperformed the US.

The upcoming MPR should acknowledge strength in recent data and eroding economic slack, but we don't expect any hint of a tightening bias as the Bank remains focused on external risks.

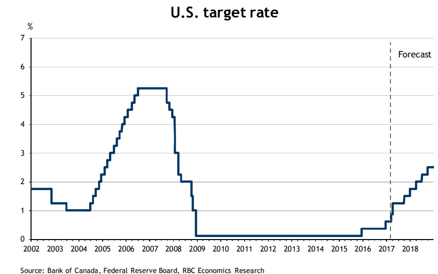




Federal Reserve

US GDP growth likely slowed to 1.6% in Q1/17 as consumer spending slowed. However, in the face of solid employment gains, we think that dip will prove temporary helping overall growth return to an above-trend pace this year.

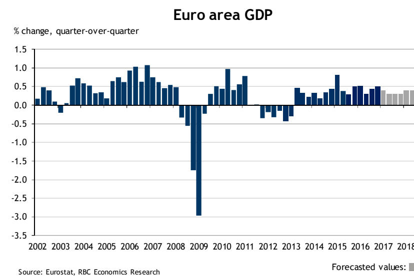
Notwithstanding a softer Q1, we expect an improving economic outlook will keep the Fed in tightening mode with two more rate hikes in 2017 and tapering of reinvestment announced later this year.

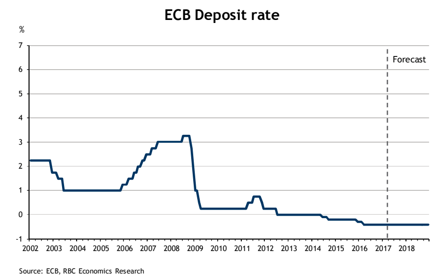


European Central Bank

Improving PMI readings point to growing momentum in the euro area's recovery; risks around our forecast for another 0.4% gain in Q1/17 GDP are tilted to the upside.

Growth is picking up and headline inflation readings are higher but there continue to be few signs of underlying inflationary pressure. We see the ECB remaining in easing mode with QE continuing through the end of this year.

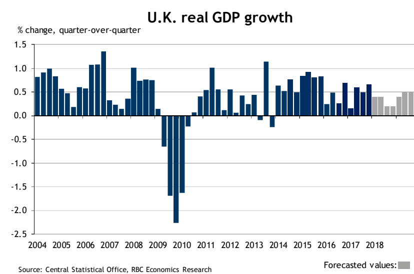


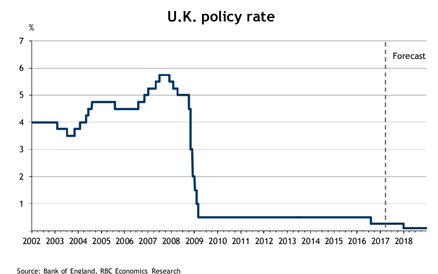


Bank of England

After stronger-than-expected growth in H2/16, growth appears to be moderating in early-2017. Softer PMI reading support our forecast for a 0.4% increase in Q1/17 GDP.

The BoE is balancing rising headline inflation with expectations of softer growth as Brexit begins to bite. We think the MPC will keep their options open—ready to respond in either direction—before shifting back to an easing bias later this year.

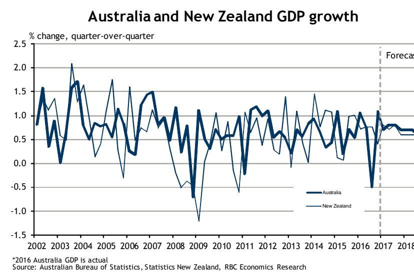


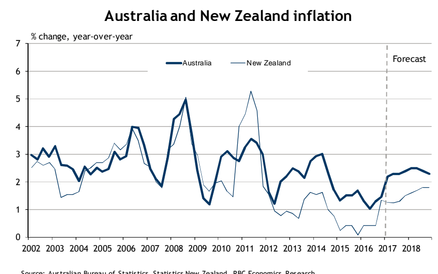


Australia and New Zealand

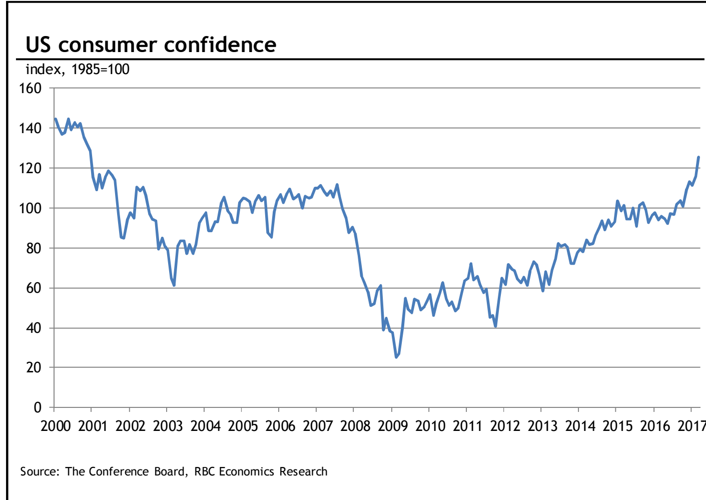
Higher commodity prices have helped boost income measures, but overall growth in Australia's economy remains subdued. With housing expected to slow later this year—easing a key financial stability concern—we see scope for a final rate cut in Q4/17.

A more positive tone from the RBNZ points to monetary policy being held steady for now but we expect an under-realization of the central bank's growth and inflation outlook will ultimately prompt another cash rate cut later this year.

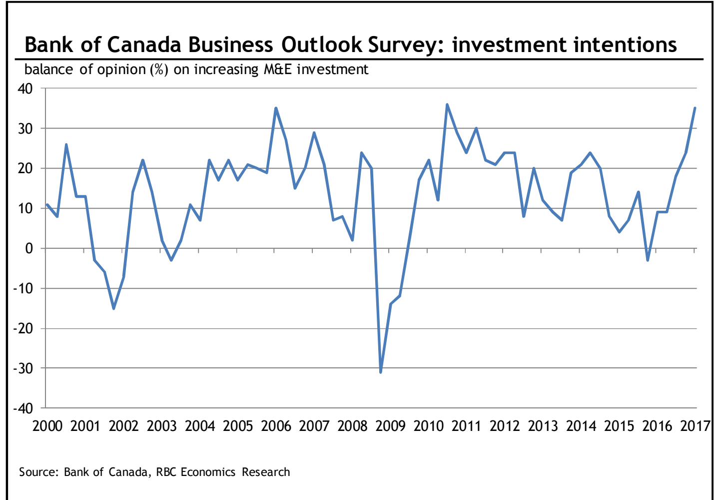




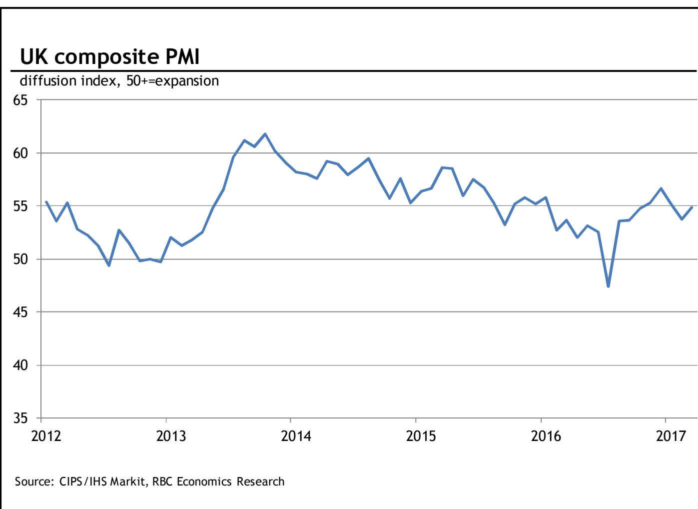
US consumer confidence jumped higher in recent months amid strong labour market conditions, improving household finances and the potential for income tax cuts. These conditions suggest slower Q1 GDP growth will prove temporary.



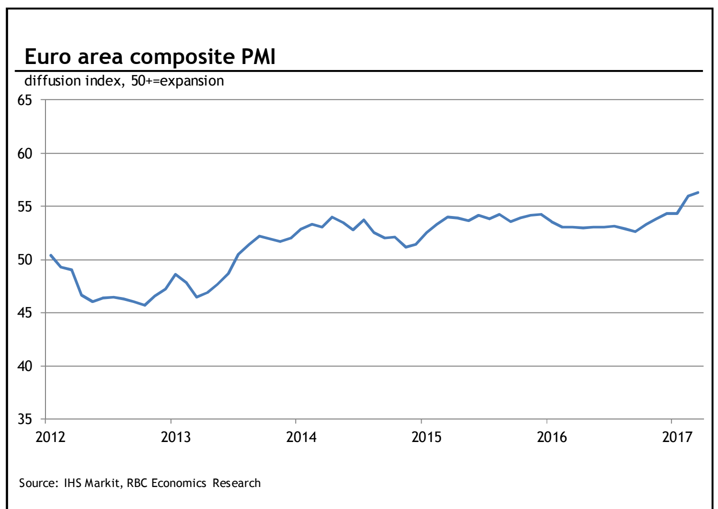
The best news in the Bank of Canada's overall-positive Business Outlook Survey was improving investment intentions. The strong reading goes against Statistics Canada's earlier survey that showed private sector investment intentions declining.



UK PMI readings have softened somewhat after the economy outperformed expectation over the second half of last year. We expect growth will slow this year as Brexit begins to weigh on both consumer and business activity.



Steady improvement in euro area PMIs continued in the first quarter of 2017 with March's composite hitting a recovery-high. Readings in all four of the currency bloc's largest economies are solidly in expansionary territory.



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