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# The not-so-almighty dollar

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The US dollar's losing streak continued in July with the currency dipping nearly 3% on a trade weighted basis over the month. The US dollar has fallen 9% year-to-date, losing ground in six of the first seven months of 2017. Some of the decline reflects retracement of the currency's post-election bump when markets were eyeing pro-growth and potentially inflationary fiscal policies. But the Trump administration and Congress' inability to advance their legislative agenda has investors trimming back expectations for tax cuts and infrastructure investment. This was underscored by the IMF lowering their US GDP growth forecast to 2.1% this year and next, a cumulative markdown of about 1/2 percentage point. Odds of the Trump administration implementing a border tax, which would be a boon to the US dollar, have also slipped. And markets are skeptical that the Fed will continue to withdraw accommodation amid slowing inflation. Despite raising rates in each of the last three quarters and signaling further hikes are likely, just one more 25 basis point increase is priced in over the next twelve months.

While the US dollar's woes partly reflect domestic factors, an improving outlook in some of the country's major trading partners has also been at play. This has clearly been a factor for the Canadian dollar, which is up nearly 10% against the US dollar over the last two months. Canada's economy has outperformed its G7 peers in recent quarters and the Bank of Canada's hawkish shift, including a rate hike in July, boosted the loonie. With less policy divergence relative to the US, we now expect the Canadian dollar will average just under 80 US cents over our forecast horizon. Not to be outdone, the euro has also rallied strongly in recent months as the currency bloc's economic recovery continues to build momentum and markets look for the European Central Bank to begin scaling back its asset purchases.

### Central bank near-term bias

Three-months out, policy rate



The Bank of Canada followed through on its forward guidance, raising interest rates in July for the first time in nearly seven years. While another move in September can't be completely ruled out given upside risk to the bank's growth forecasts, we expect the next hike will come in October.



The Fed held rates steady in July and indicated tapering of reinvestment would likely begin soon. We expect an announcement in September alongside another unchanged rate decision as policymakers hold off until December in order to judge the impact of tapering reinvestment.



The Bank of England left rates unchanged in August but once again had a minority voting for a hike. Some hawkish dissent will likely continue amid above-target inflation, but we expect monetary policy will be held steady as growth slows over the second half of the year.



The European Central Bank is set to re-evaluate its bond-buying program in the autumn. We think September's meeting will see the central bank extend asset purchases beyond the end of this year, albeit with the pace of purchases tapering off by mid-2018.



With the global easing cycle coming to an end, we don't see the Reserve Bank of Australia swimming against the tide. So despite sub-trend domestic growth and inflation, we have removed the final cash rate cut from our forecast profile.



Another soft inflation print in Q2 is likely to keep the Reserve Bank of New Zealand from raising rates when they gather next on August 10. We expect the RBNZ will remain on the sidelines through next year.

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## Highlights

▲ The uptick in Q2 GDP growth reflected less drag from inventories as domestic spending remained strong.

▲ Inflation and wage growth have failed to pick up despite tighter economic and labour market conditions.

▲ Rising commodity prices and a weaker US dollar should put upward pressure on import prices.

▲ The Fed is set to announce tapering of reinvestment in September.

### Updated US GDP figures show domestic strength in H1...

US GDP growth met expectations in Q2, rebounding to 2.6% following the previous quarter's disappointing 1.2% annualized increase. That sharp acceleration belies fairly consistent demand growth over the first half of the year—domestic spending rose an annualized 2.4% in both quarters with a drawdown in inventories in Q1 accounting for much of the difference in production figures. The previously-reported slowing in consumer spending, which looked out of sync with solid employment growth and improving sentiment, was softened after revisions and Q2 still recorded a healthy pickup. The second quarter saw another solid gain in business investment, with both energy and non-energy capex increasing. Residential investment slowed, however, and we think some of Q1's double-digit gain was due to activity being pulled forward amid unseasonably warm winter weather. Housing is expected to return as a positive contributor over the second half of the year, helping sustain the first half's strength in domestic spending. Overall we look for the economy to continue growing at an above-trend 2.5% annualized pace into next year as both households and businesses contribute to the expansion.

### ...but still few signs of inflation

The return to above-trend growth in Q2 should allay concerns that the Fed is tightening monetary policy just as the economy is beginning to lose momentum. But another criticism of the Fed's rate hikes remains—absence of inflationary pressure. After picking up above 2% on rising energy prices, headline inflation has consistently disappointed in recent months while core CPI slipped to a two-year low in May and June. The story has been much the same for the Fed's preferred PCE price deflators. Wage pressures are also failing to materialize despite tight labour market conditions. Average hourly earnings growth is a healthy 2.5% but that is little change from a year and a half ago despite a 1/2 percentage point decline in the unemployment rate and an even greater improvement in broader measures of slack.

The Fed continues to hold the view that inflation will pick up toward 2% over the medium term, even with further gradual rate hikes. We agree that a temporary shift into excess demand next year should ultimately be inflationary, even if, as the Fed has noted, the relationship between economic slack and inflation has weakened somewhat. Policymakers have pointed to temporary factors weighing on inflation—particularly a sharp drop in wireless phone service prices that shaved 0.2 percentage points from headline inflation—so the recent slowing is likely overstated. Meanwhile, some of the sources of disinflation encountered in recent years might be turning around. Imported goods prices are beginning to pick up, and the US dollar's recent depreciation as well as some increase in key commodity prices could further lift import costs. All told, while our forecast assumes inflation will remain low in the near-term, we are with the Fed in seeing inflation settle around their 2% objective toward the end of next year when transitory factors have dissipated and tight economic conditions begin to feed into higher prices.

### Fed teeing up for change in balance sheet policy

The Fed left interest rates unchanged in July and made few changes to their policy statement. The sole development was a shift in language on balance sheet normalization. The Fed is now indicating that the planned change in their reinvestment policy, which was outlined in June, will begin “relatively soon.” We think their updated guidance is consistent with our long-held assumption that tapering will be announced in September and implemented in October. The pace of tapering laid out by policymakers is gradual but we still think they will want to see how the market reacts. As such, we look for interest rates to be held steady once again in September, breaking the recent trend of one hike per quarter. Holding off on further rate increases until December will also give the Fed some time to evaluate inflation developments. We don't think the Fed has to see 2% inflation to continue tightening, but at least some evidence that core inflation is trending higher would bolster their confidence in a return to target over the next year. Firmer inflation readings would also help convince markets that the Fed will actually follow through on projected tightening—three more hikes next year as implied in their June forecast. But until investors are convinced that is the case, the US dollar likely won't get much help from expectations about monetary policy.

## BoC raises rates, following through on guidance

The Bank of Canada followed through on their forward guidance, raising interest rates for the first time in nearly seven years on July 12. The 25 basis point hike, which brought the overnight rate to 0.75%, was clearly telegraphed by members of the Governing Council over the month prior to the meeting. In justifying the move, the central bank noted broadening growth across industries and regions as well as evidence that the energy sector's adjustment to lower oil prices is largely complete. With above-trend growth looking more sustainable and excess capacity being absorbed, policymakers saw less need for ultra-low interest rates. The statement provided little guidance on when we might expect another hike, though it is worth noting that July's increase was not necessarily framed as simply walking back some of the stimulus provided in 2015. Rather, we think their forecast for the output gap to close later this year tees up for a gradual tightening cycle to begin in earnest. But at what pace will the bank proceed?

## Strong GDP growth supports the case for further rate hikes...

Canada's strong growth figures argue for the Bank of Canada to continue raising rates. GDP increased by a much stronger than expected 0.6% in May, the third monthly gain of 1/2% or more so far this year. Much of the unanticipated increase was in oil and gas output, though a broad range of industries also contributed to growth. The gain was also despite a temporary drag on construction activity related to a strike in Quebec, a factor that should be reversed in June. Given an unexpectedly strong trend in the monthly figures, we have revised our Q2 GDP growth forecast up to 3.7% from 2.7% previously. That would be stronger than the central bank's revised Q2 forecast of 3.0%, raising the prospect that the economy might reach potential output before the end of the year. An earlier-than-expected shift into excess demand might necessitate a slightly faster pace of rate hikes than the bank envisioned as recently as July.

## ...but inflation remains absent from the picture

While the economy is approaching full capacity, as in the US there are few signs that limited slack is translating into upward pressure on consumer prices. Headline inflation has spent much of the last five years in the lower half of the Bank of Canada's 1-3% target range and slipped to just 1% in June as energy prices returned to deflationary territory. The bank's three new core measures have trended lower over the last year and averaged 1.4% in June, close to a 20-year low. The central bank has attributed much of the recent slowing to transitory factors, particularly food price competition, electricity price rebates in Ontario and slower growth in motor vehicle prices. As those factors fade and slack in the economy is absorbed, the bank expects inflation will return to their 2% target on a sustained basis. However, as the Fed has observed in the US, it appears the link between resource utilization and inflation has weakened. With that in mind, we think policymakers might want to see some progress toward 2% inflation before raising interest rates more substantially—even if they think the output gap is closed.

## Tightening policy or scaling back accommodation?

We think July's rate increase should be viewed as scaling back accommodation rather than tightening monetary policy. The current overnight rate of 0.75% is just 50 basis points above the emergency level it hit during the recession. With the policy rate remaining at or below 1% over the eight years since the financial crisis, it is easy to forget that these are not normal interest rates. Granted the neutral interest rate—the rate that is neither expansionary nor contractionary and keeps the economy growing close to potential—has declined in recent years. But the Bank of Canada estimates neutral is now 3%, well above the current policy setting. Even if, as Governor Poloz noted, households will be more sensitive to higher interest rates given elevated debt levels, it will take a number of increases before monetary policy shifts from tailwind to headwind. Given the contrast between highly stimulative monetary policy and limited economic slack, we think the bank will raise rates again in October and continue removing accommodation next year. We still see the bank pausing its tightening cycle in the first half of 2018 to evaluate the trend in inflation and see how households respond to rising rates before hikes continue in the second half of 2018. Policymakers will also be keeping an eye on the currency, which has strengthened significantly in recent months and contributed to tightening in broader financial conditions.

▲ Canada's unexpectedly strong May GDP report led us to revise Q2 growth up to 3.7%.

▲ Stronger growth implies the economy could reach capacity even earlier than the end of the year as the Bank of Canada projected in July.

▲ Lack of inflationary pressure could keep the central bank from removing accommodation too quickly.

▲ Further rate hikes will still leave monetary policy in a stimulative position, even if households are more sensitive to higher rates than in the past.

## Highlights

▲ The Bank of England marked down their near-term growth forecasts as slower consumer spending won't be fully offset by investment and trade.

▲ The euro area's 2.1% year-over-year growth in Q2 is the best pace since 2011.

▲ We no longer expect the RBA will lower its cash rate further.

### Another divided vote at the Bank of England

UK GDP growth edged up to 0.3% in Q2 from the previous quarter's 0.2% non-annualized pace. However, that is still down from an average quarterly increase of 0.6% in the second half of last year. The services sector accounted for all of the economy's growth in Q2 as industrial production and construction activity declined. Another subdued GDP gain is consistent with purchasing managers' index readings moderating toward the middle of the year. July's survey data provide early evidence that sub-trend growth is continuing in Q3. Indeed, we expect GDP growth will remain subdued over the second half of the year as declining real incomes and an already-low household savings rate limit the pace of consumer spending. The Bank of England has been counting on business investment and exports to offset slower consumption, but their recently marked-down growth forecasts acknowledged that those factors won't be enough to lift activity above potential in the near-term.

Given the softening economic backdrop, the central bank is using its discretion and not responding to above-target inflation. The Bank of England's latest policy decision once again saw some dissent, however, with two of eight members voting for a rate increase in August. Those more hawkish members will likely continue to favour higher rates as headline inflation picks up toward 3% by the end of the year. But we expect the majority will continue to vote for maintaining current policy given concerns about consumer spending, soft wage growth and Brexit uncertainty. We previously projected a rate cut early next year, but with the BoE's centre of gravity shifting more in the direction of tightening, we no longer expect additional stimulus but rather see the Bank Rate on hold through next year.

### ECB likely to announce extension and tapering of bond buying

The euro area continued to build momentum in Q2 with GDP growth matching our 0.6% non-annualized forecast following a downwardly revised 0.5% increase in Q1. Year-over-year growth picked up above 2% for the first time in the currency bloc's ongoing recovery. Purchasing managers' index readings moderated somewhat to start Q3 after hitting six-year highs in April and May but continued to signal an above-trend pace of expansion. The euro area's improving growth picture reflects broadening activity across countries as well as sectors, with business investment in particular rising at a faster pace than in recent years. Policymakers at the European Central Bank have continued to express confidence in the economic outlook and are optimistic that stronger growth will eventually help inflation return to target. However, there are few signs of upward price pressure at present; core inflation has picked up slightly in recent months but remains well short of 2%. As such, we think the ECB will keep stimulus flowing into 2018. The central bank is set to re-evaluate their bond-buying program in the autumn, and we think September's meeting will see purchases extended beyond December but at a pace that tapers off by the middle of next year. Given forward guidance that rates will remain at current levels well past the end of QE, that would likely leave rate hikes off the table until 2019.

### Dropping our last rate cut as RBA looks set to sit on the sidelines

Australia's recent employment and inflation trends have generally mirrored global developments. Job gains have been fairly strong in recent months, pushing the unemployment rate lower but failing to put upward pressure on wages. Inflation, in turn, remains well-contained with most core measures stuck below the RBA's 2-3% target range. Meanwhile, domestic activity data continue to be mixed. We think sub-trend GDP growth and below-target inflation still support the argument for easier monetary policy. However, with the global easing cycle coming to an end, we don't see the RBA swimming against the tide and have thus removed the last rate cut from our forecast. Nonetheless, we don't expect Australia's central bank will be joining any of its global counterparts in tightening monetary policy in the near-term—we look for the cash rate to be on hold at 1.50% through the end of next year. That is consistent with policymakers' recent push-back against market expectations that interest rates might be heading higher. We see the RBA maintaining that stance in order to keep a lid on the stubbornly rising Australian dollar. As the central bank pointed out in August, further appreciation would result in slower growth and an even more gradual pickup in inflation than currently expected.

## Interest rate outlook

%, end of period

	Actuals						Forecast					
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
<b>Canada</b>												
Overnight	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.00	1.00	1.25	1.50
Three-month	0.45	0.48	0.53	0.46	0.52	0.71	0.85	1.10	1.10	1.15	1.35	1.60
Two-year	0.54	0.52	0.52	0.80	0.75	1.10	1.20	1.40	1.50	1.60	1.85	2.10
Five-year	0.67	0.57	0.62	1.15	1.12	1.40	1.50	1.75	1.90	2.05	2.25	2.45
10-year	1.23	1.06	1.00	1.80	1.62	1.76	1.85	2.05	2.25	2.45	2.65	2.85
30-year	2.00	1.72	1.66	2.35	2.30	2.14	2.25	2.45	2.70	3.00	3.15	3.25
<b>United States</b>												
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	1.03	1.05	1.30	1.55	1.80	2.05	2.30
Two-year	0.73	0.58	0.77	1.25	1.27	1.38	1.60	1.85	2.05	2.35	2.55	2.70
Five-year	1.21	1.01	1.14	2.00	1.93	1.89	2.05	2.25	2.45	2.65	2.85	3.00
10-year	1.78	1.49	1.60	2.55	2.40	2.31	2.45	2.65	2.85	3.00	3.20	3.40
30-year	2.61	2.30	2.32	3.15	3.02	2.84	2.95	3.15	3.30	3.45	3.60	3.75
<b>United Kingdom</b>												
Bank rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Two-year	0.45	0.13	0.13	0.08	0.12	0.36	0.20	0.15	0.15	0.15	0.15	0.15
10-year	1.43	0.89	0.76	1.24	1.14	1.26	1.50	1.60	1.70	1.85	1.95	2.00
<b>Euro area</b>												
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	-0.57	-0.55	-0.50	-0.50	-0.50	-0.50	-0.50
10-year	0.15	-0.11	-0.12	0.21	0.33	0.47	0.50	0.60	0.65	0.65	0.70	0.75
<b>Australia</b>												
Cash target rate	2.00	1.75	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Two-year	1.89	1.59	1.55	1.86	1.76	1.78	1.75	1.75	1.70	1.70	1.80	2.00
10-year	2.49	1.98	1.91	2.76	2.70	2.60	2.65	2.75	2.95	3.20	3.40	3.70
<b>New Zealand</b>												
Cash target rate	2.25	2.25	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Two-year swap	2.19	2.22	1.96	2.50	2.31	2.32	2.20	2.20	2.30	2.30	2.30	2.40
10-year swap	2.97	2.65	2.41	3.58	3.41	3.35	3.55	3.75	3.95	4.20	4.30	4.50
<b>Yield curve*</b>												
Canada	69	54	48	100	87	66	65	65	75	85	80	75
United States	105	91	83	130	113	93	85	80	80	65	65	70
United Kingdom	98	76	63	116	102	90	130	145	155	170	180	185
Eurozone	63	50	57	99	107	104	105	110	115	115	120	125
Australia	60	39	36	90	94	82	90	100	125	150	160	170
New Zealand	78	43	45	108	110	103	135	155	165	190	200	210

\* 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				Current	Last	
United States	Fed funds	1.00-1.25	0.75-1.00	June 15, 2017	Eurozone	Deposit rate	-0.40	-0.30	March 10, 2016
Canada	Overnight rate	0.75	0.50	July 12, 2017	Australia	Cash rate	1.50	1.75	August 3, 2016
United Kingdom	Bank rate	0.25	0.50	August 4, 2016	New Zealand	Cash rate	1.75	2.00	November 10, 2016

Source: Bloomberg, Reuters, RBC Economics Research

## 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*	2.8	-1.4	4.2	2.7	3.7	3.7	1.9	2.0	2.1	1.9	1.7	1.7	0.9	1.5	2.9	2.0
United States*	0.6	2.2	2.8	1.8	1.2	2.6	2.5	2.4	2.4	2.3	2.0	2.0	2.9	1.5	2.1	2.3
United Kingdom	0.2	0.6	0.5	0.7	0.2	0.3	0.2	0.2	0.4	0.5	0.5	0.5	2.2	1.8	1.5	1.6
Euro area	0.5	0.3	0.4	0.6	0.5	0.6	0.4	0.4	0.4	0.4	0.4	0.4	1.9	1.7	2.0	1.7
Australia	0.9	0.7	-0.4	1.1	0.3	0.1	1.1	0.8	0.8	0.6	0.6	0.6	2.4	2.5	1.9	2.9
New Zealand	0.7	0.8	0.8	0.4	0.5	0.8	0.8	0.6	0.6	0.6	0.6	0.6	2.5	3.1	2.6	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	1.9	1.3	1.3	1.3	1.1	1.8	2.2	2.3	1.1	1.4	1.5	1.9
United States	1.1	1.0	1.1	1.8	2.5	1.9	1.7	1.5	1.3	1.8	2.1	2.0	0.1	1.3	1.9	1.8
United Kingdom	0.3	0.4	0.7	1.2	2.1	2.7	2.9	3.0	2.8	2.7	2.6	2.5	0.0	0.7	2.7	2.6
Euro area	0.0	-0.1	0.3	0.7	1.8	1.5	1.4	1.3	1.2	1.3	1.5	1.4	0.0	0.2	1.5	1.4
Australia	1.3	1.0	1.3	1.5	2.1	1.9	2.1	2.3	2.4	2.7	2.4	2.3	1.5	1.3	2.1	2.5
New Zealand	0.4	0.4	0.4	1.3	2.2	1.7	2.3	2.3	1.7	1.7	1.8	1.8	0.3	0.6	2.3	1.8

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	CPI ex food & energy <sup>1</sup>	Jun	0.2	1.4	0.5	1.6
United States	Core PCE <sup>1,2</sup>	Jun	0.1	1.5	0.9	1.5
United Kingdom	All-items CPI	Jun	0.0	2.6	4.7	2.8
Euro area	All-items CPI <sup>1</sup>	Jul	0.1	1.3	0.2	1.6
Australia	Trimmed mean CPI <sup>1</sup>	Q2	0.5	1.8	N/A	N/A
New Zealand	All-items CPI	Q2	0.0	1.7	N/A	N/A

<sup>1</sup> Seasonally adjusted measurement.

<sup>2</sup> 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	1.30	1.25	1.28	1.31	1.29	1.28	1.27
Euro	1.14	1.11	1.12	1.05	1.07	1.14	1.16	1.12	1.09	1.06	1.08	1.12
U.K. pound sterling	1.44	1.33	1.30	1.24	1.26	1.30	1.30	1.20	1.16	1.18	1.24	1.32
New Zealand dollar	0.69	0.71	0.73	0.69	0.70	0.73	0.75	0.75	0.72	0.70	0.69	0.69
Japanese yen	112.6	103.2	101.3	117.0	111.4	112.4	107.0	103.0	100.0	102.0	104.0	106.0
Australian dollar	0.77	0.75	0.77	0.72	0.76	0.77	0.80	0.80	0.77	0.74	0.73	0.73

## Canadian dollar cross-rates

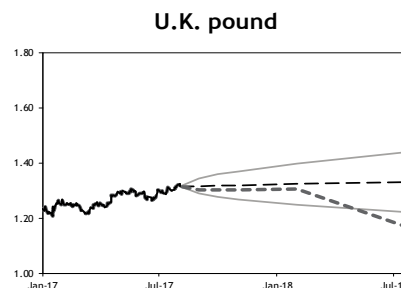
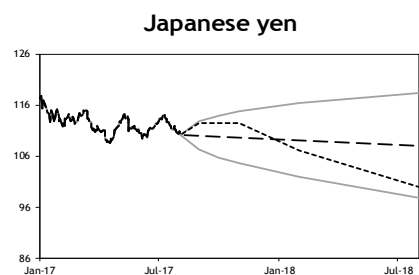
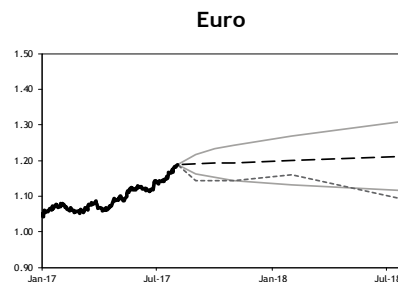
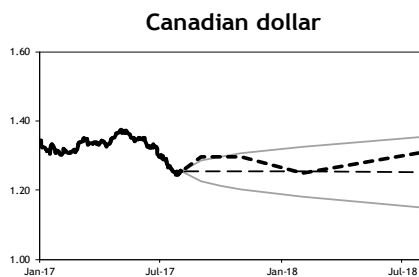
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
EUR/CAD	1.48	1.43	1.48	1.41	1.42	1.48	1.45	1.43	1.42	1.37	1.38	1.42
GBP/CAD	1.87	1.72	1.70	1.66	1.67	1.69	1.63	1.54	1.52	1.52	1.59	1.67
NZD/CAD	0.90	0.92	0.96	0.93	0.93	0.95	0.94	0.96	0.94	0.90	0.88	0.88
CAD/JPY	86.6	79.9	77.2	87.0	83.7	86.7	85.6	80.5	76.3	79.1	81.3	83.5
AUD/CAD	1.00	0.96	1.01	0.97	1.02	1.00	1.00	1.02	1.01	0.95	0.93	0.93

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

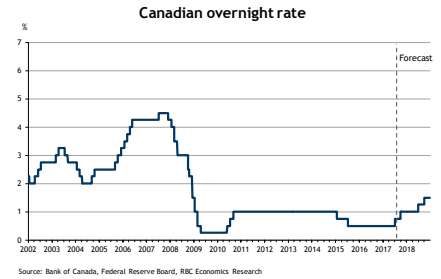
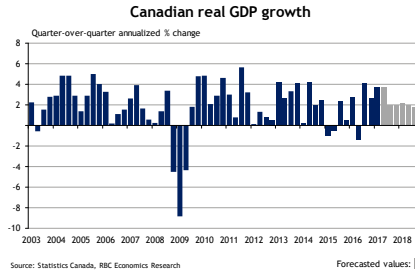
The following charts track historical exchange rates plus the forward rate (dashed line) compared to the RBC Economics forecast (dotted line) out one year. The cone for the forecast period frames the forward rate with confidence bounds using implied option volatilities as of the date of publication.



## Bank of Canada

May's unexpectedly-strong 0.6% GDP increase raised our Q2 forecast to 3.7% from 2.7% previously. An upside surprise relative to the Bank of Canada's 3.0% projection implies the output gap could close even sooner than the end of this year.

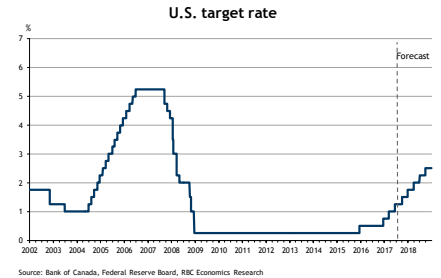
The BoC has provided little guidance on the pace of further rate hikes. But with the output gap nearly closed, we think policymakers will raise rates again before the end of the year.



## Federal Reserve

US GDP growth rebounded as expected in Q2 with stronger consumer spending contributing to another solid gain in domestic demand. The report supported the Fed's upbeat comments on household spending and business investment.

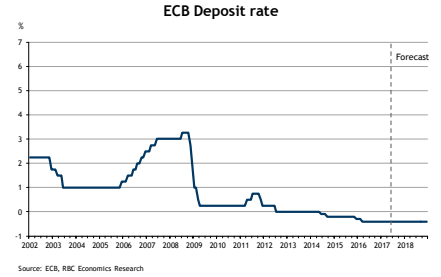
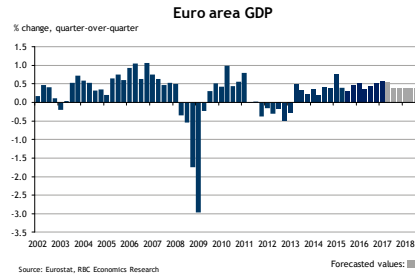
We expect the Fed will hold off on raising rates in September when they change their reinvestment policy. A short pause will also allow the central bank to get more information on inflation trends.



## European Central Bank

Euro area GDP growth picked up to 0.6% in Q2 and recent survey data point to above-trend growth continuing. Stronger activity data has boosted the European Central Bank's confidence that stimulative monetary policy is working.

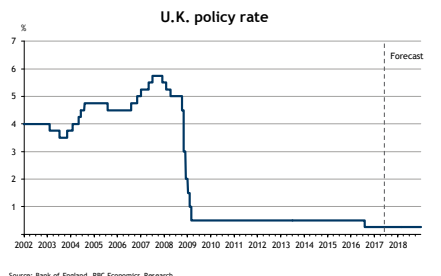
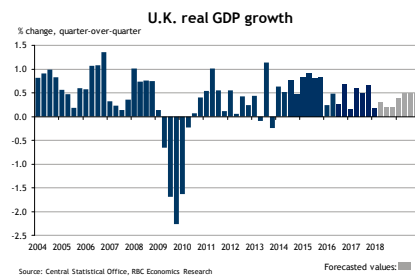
But with inflation remaining stubbornly low, the ECB is expected to maintain an accommodative stance, announcing an extension of asset purchases into next year, albeit with the pace likely to taper.



## Bank of England

The UK economy grew at a sub-trend pace over the first half of the year and early survey data for Q3 point to subdued growth continuing. Meanwhile, inflation continues to pick up thanks to earlier Brexit-related exchange rate depreciation.

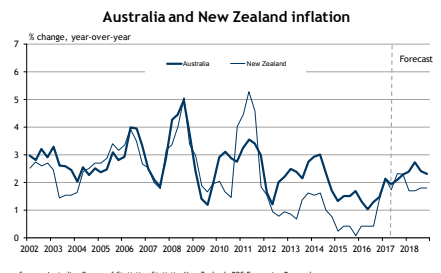
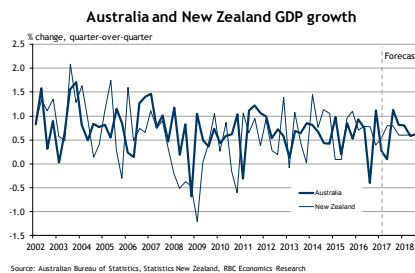
The Bank of England is putting more weight on slowing activity than rising inflation, though two members voted for a hike in August. We think the majority will continue to favour steady policy.



## Australia and New Zealand

Australia's sub-trend GDP growth and below-target inflation argue for monetary policy to remain highly stimulative. We no longer expect the Reserve Bank of Australia to ease further, but see the cash rate on hold at 1.50% through the end of next year.

New Zealand is seeing few signs of inflationary pressure despite limited economic slack. The Reserve Bank of New Zealand is likely to keep monetary policy stimulative to allow inflation to return sustainably to target over the medium term.

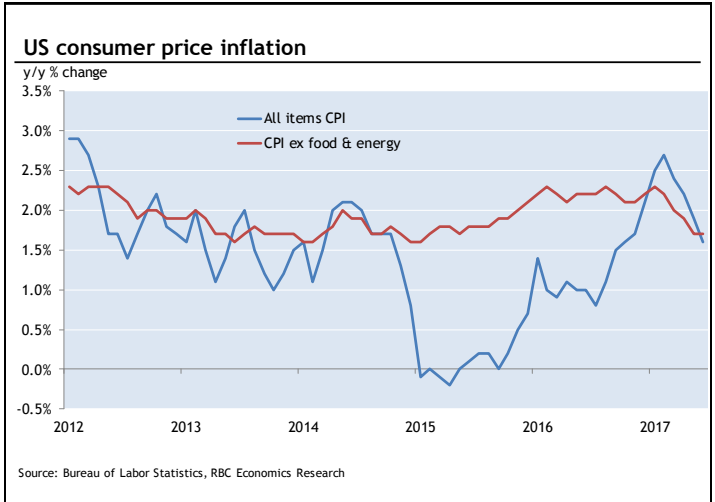




## A number of factors contributing to US dollar weakness

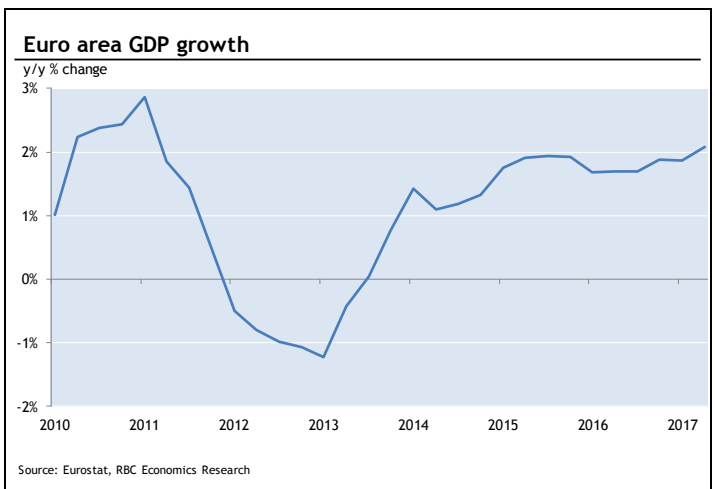
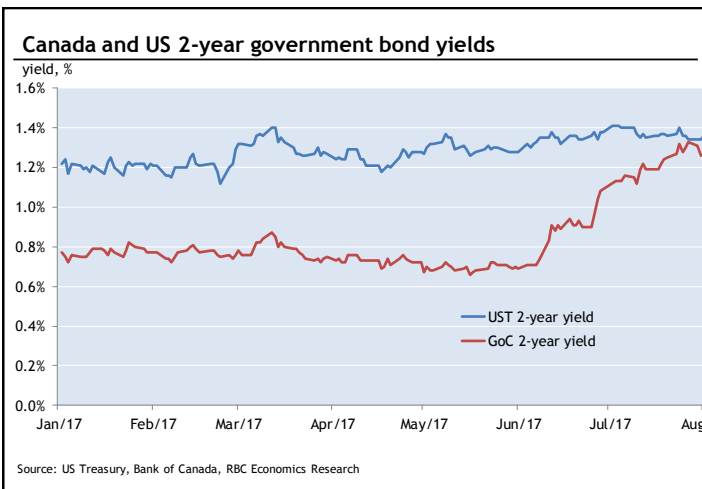
The US dollar jumped higher post-election as markets priced in stimulative fiscal policy and a potential border tax. Lack of policy traction by the Trump administration and Congress has seen that move retrace this year.

With inflation slowing, markets are skeptical that the Fed will continue to raise interest rates at the pace it has in recent quarters. Less monetary policy divergence relative to other advanced economies has contributed to a lower US dollar.



The seeming end of Canada-US monetary policy divergence is particularly stark. A hawkish shift from the Bank of Canada, culminating in July's rate hike, has closed the gap on 2-year yields and has been a factor sending the loonie higher.

A strengthening economic recovery in the euro area has the European Central Bank contemplating an end to their quantitative easing program. That has abetted the euro's climb against the US dollar in recent months.



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