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# Naughty and nice

Trade policy remained a key driver of financial markets in the first half of December. News of a "deal in principle" between the US and China buoyed equity markets to record highs and put upward pressure on bond yields. The agreement will reportedly suspend any further US tariff hikes (including levies on some $160 billion of Chinese imports that were scheduled for December 15) and roll back some existing tariffs. That would be on the more ambitious end of the terms of a "phase one" deal that have been floated in recent months.

In another positive trade development, leaders from the US, Canada and Mexico agreed to a modified version of last year's USMCA that is expected to be ratified in early-2020. While the latest deal still doesn't represent a dramatic change from its NAFTA predecessor, it should remove lingering uncertainty about Canada's trading relationship with the US. (Mexico might continue to harbour some concerns, having faced fresh tariff threats earlier this year.)

But at the same time those deals were being hammered out, President Trump was picking trade fights with other countries. His surprise announcement (via tweet, no less) that the US will reinstate tariffs on steel and aluminum imports from Brazil and Argentina caught markets off guard. France has also attracted the administration's ire for a digital services tax that it thinks unfairly targets American companies. And the US continues to undermine the WTO by blocking new appointments to its appellate body. So while recent trade developments were generally positive—more "nice" than "naughty"—there were also timely reminders of the unpredictability of US trade policy and the president's protectionist bent. Markets are cheering the US-China and USMCA deals, which should help reinforce the recent stabilization in business sentiment globally. But trade policy is unlikely to simply fade into the background in 2020.

## Central bank near-term bias

↔ The BoC left rates unchanged in December and sounded more comfortable on the sidelines than in October. But with GDP growth expected to remain below-trend, we continue to expect a rate cut in 2020.

↔ The Fed held rates steady in December, and we expect it will continue to do so throughout 2020. Powell set a fairly high bar to reverse this year's hikes, and none of the committee members expect to lower rates further.

↔ The BoE is caught between a sluggish economy and a tight labour market (with strong wage growth to boot). We expect it will hold rates steady throughout 2020 as the UK negotiates a new trading relationship with the EU.

↔ The ECB has moved to the sidelines after announcing a number of new easing measures in September. Even with new president Christine Lagarde sounding slightly more optimistic, it looks like that stimulus will remain in place for an extended period.

↘ Another quarter of slow growth—and particularly weak private demand—suggests the RBA will follow up this year's rate cuts with another move early next year.

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## Highlights

▲ Lower rates have boosted the US housing sector, but not business investment.

▲ A strong labour market has supported household incomes and consumer spending.

▲ Chair Powell set a fairly high bar (a persistent increase in inflation) to unwind 2019's rate cuts…

▲ …while at the same time, none of the FOMC expect to have to lower rates further in 2020.

## US economy keeps rolling into 2020…

The US economy is on track to close out 2019 with a fourth straight quarter of above-trend GDP growth—a noteworthy accomplishment in a year characterized by rising trade tensions, slowing global growth and recession fears. The Fed's about-face on monetary policy helped, particularly in the housing sector where lower interest rates have stimulated resale and homebuilding activity. Residential investment added to growth in Q3 for the first time since 2017 and looks set to do so again in Q4. Rate cuts have done less to stimulate business investment (not surprising given the challenges noted above) which declined in each of the last two quarters. That downdraft might be easing with capex shipments and new orders picking up in October and business sentiment showing signs of stabilization—a trend that should be helped by a US-China trade deal. However, it looks like the pullback in oil and gas investment that began in mid-2018 continued toward the end of the year. Reports of financial difficulties among some shale producers hint the sector's challenges could extend into 2020.

## …with a strong labour market supporting consumers

Meanwhile, the US consumer has remained a reliable source of growth. The combination of steady job gains, healthy wage growth, and low inflation has aggregate real incomes increasing at a solid 3% rate. The business sector's reluctance to invest hasn't been mirrored in hiring plans, with private sector job gains averaging 200,000 over the last three months. That will be difficult to sustain with the unemployment rate at 3.5% and firms complaining of labour shortages. But even if job creation slows as we expect in 2020, firmer wage growth could provide a buffer for household incomes. A survey of small businesses shows plans to increase compensation are at a cycle high, while an increase in the quit rate suggests job churn (a key driver of wage growth) has picked up. All told, we think there is good reason to expect the household sector will continue to support the US economy in 2020. Nonetheless, with smaller contributions from business investment and government stimulus, we think GDP growth will slow to 1.8% from 2.3% this year.

## Fed shifts to neutral after 75 bps of cuts this year

The Fed held monetary policy steady in December after lowering rates at each of its last three meetings (a cumulative 75 basis points of easing). The steady rate decision was entirely expected with policymakers having signaled a shift to the sidelines following October's cut. Chair Powell reiterated that the current stance of monetary policy is likely to remain appropriate if incoming data are broadly consistent with the Fed's outlook. The statement dropped an earlier reference to uncertainties about the economic outlook—a change that could be interpreted as slightly hawkish—but still noted that "global developments and muted inflation pressures" will influence the future path of monetary policy. That same language was used to justify rate cuts earlier this year.

The Fed's updated dot plot was consistent with a neutral bias, showing most committee members expect rates will be held steady throughout 2020. While a small minority think a rate hike might be appropriate next year, Chair Powell threw cold water on the idea that the Fed would follow its 1998 playbook when a mid-cycle adjustment was reversed less than a year later. He said he'd need to see a persistent increase in inflation to move rates higher—an unlikely prospect in the near-term with core PCE running below 2%. At the same time, none of the committee expect to lower rates further in 2020. (It's worth noting that was also the case last December, and the Fed cut rates three times in 2019.) So what might it take to see additional easing? Our GDP growth forecast for next year (1.7% on a Q4/Q4 basis) is below the Fed's 2% projection, but we don't think a modest shortfall—when the economy is already beyond full employment and monetary policy is accommodative—would be enough to trigger further easing. It will likely take a more pronounced slowing in industrial production and business investment or further weakening in global growth for the Fed to move from the sidelines. Those risks can't be dismissed entirely but seem less acute if a US-China trade deal holds. Our base case remains for the Fed to hold rates steady through 2020.

## Canadian business investment perking up?

Canadian GDP growth slowed as expected in Q3, with a 1.3% annualized increase marking the third sub-trend gain in the last four quarters. But underlying details were firmer than expected with domestic spending rising by more than 3%. Much of the surprise was in business investment which jumped by nearly 10%. That was just the second increase in the last six quarters, and while encouraging, we think it's too early call this the start of an upward trend in capital spending. Forward looking indicators of business investment remain mixed. The BoC's Q3 Business Outlook Survey showed a solid increase in investment intentions, but the broader confidence reading (which the BoC says provides a better read on capex) remains subdued. Another survey that focuses more on small and medium-sized businesses shows investment plans have softened, on balance, in recent months.

That said, there is reason to think the drag from oil and gas investment will ease in 2020. Producers' latest capex plans are mixed but on balance suggest flat to slightly positive spending growth next year. And while the industry continues to await additional pipeline capacity from major projects like Enbridge's Line 3 Replacement and the Trans Mountain Expansion, a number of measures to increase throughput on existing pipelines and ongoing use of crude-by-rail should provide a bit more egress capacity next year. So even with the Alberta government keeping production caps in place, we think there is scope for investment to edge up from the lows seen in 2019.

## Housing rebound comes with more debt

Housing also made a strong contribution to growth in Q3 with residential investment rising at its fastest quarterly pace since 2012. Housing starts were close to a cycle high over the summer and the resale market is now the strongest since late-2017 when buyers rushed to get ahead of new stress tests. Lower mortgage rates (down nearly 1 percent this year despite the BoC holding its policy rate steady) have stimulated demand by making borrowing cheaper and lowering the bar for stress tests. The result, though, has been a renewed pickup in mortgage credit growth, which had slowed to a 17-year low in early 2019, and an increase in the share of highly indebted borrowers. So while a resurgent housing market has helped support GDP growth in the last two quarters, it has also reignited financial stability concerns.

## BoC patience to be tested by sub-trend growth

The Bank of Canada left its policy rate unchanged in early-December, cementing its status as a holdout in 2019 while some 40 other central banks, including the Fed, lowered rates. The BoC sounded more comfortable on the sidelines than in October when it openly discussed a rate cut. In an economic update following the decision, Deputy Governor Lane noted that recent developments gave Governing Council "more confidence" in its October forecasts. The bank also noted "nascent evidence" that global growth is stabilizing but said ongoing trade conflicts and uncertainty are still weighing on activity. Ultimately its upcoming rate decisions will come down to the extent to which external headwinds challenge the household sector's resilience.

The BoC's more neutral tone suggests a January rate cut (our previous forecast) is unlikely. But we continue to think persistently sub-trend growth—including lacklustre investment and exports—will test the BoC's patience and result in a rate cut in Q2. Such a move would provide a bit of relief to highly indebted Canadians, particularly those renewing mortgages in 2020. That said, if recent strength in the resale market persists, the BoC might be reluctant to spur on activity (and increase household vulnerabilities) by lowering rates. Fiscal policy could also give the BoC cause for patience. The government just announced that a promised increase in the basic personal amount (benefiting most Canadian taxpayers, at a cost of about $3 billion next fiscal year) will take effect at the start of 2020, slightly earlier than we expected. If that modest fiscal boost is followed by further near-term stimulus, it might convince the BoC that additional monetary policy support is unnecessary.

## Highlights

▲ Canada logged another quarter of sub-trend growth in Q3…

▲ …but domestic demand rose at a solid pace, helped by a surprising increase in business investment.

▲ A rebound in the housing sector has also meant a bounceback in mortgage credit.

▲ We've pushed back our forecast for a BoC rate cut to Q2 2020.

## Highlights

▲ A Conservative majority suggests the UK will exit the EU at the end of January and begin negotiating a future trading relationship.

▲ Christine Lagarde took over as ECB president at the end of a tough year for the currency bloc.

▲ We expect the ECB's extraordinary stimulus will remain in place for an extended period.

▲ Nearly flat consumer spending held Australian GDP growth to a sub-trend pace again in Q3.

## 'Getting Brexit done' just the beginning

The UK economy has effectively flat-lined in recent months, not seeing the same flurry of activity ahead of the October 31 Brexit deadline that it did around the previous March deadline. The manufacturing sector remains weak, construction has slowed, and the all-important services sector is just inching along. The latest PMI readings also point to sluggish growth, and we are penciling in a modest 0.1% increase in Q4 GDP. We think growth will pick up slightly in 2020 (on a quarterly, not annual average basis) thanks to more stimulative fiscal policy and a steady consumer backdrop. But a more significant upturn is hard to see with Brexit uncertainty (albeit of a different form) likely to persist throughout 2020. While a strong Conservative majority coming out of the general election means the UK will exit the EU at the end of January 2020, it will only have until the end of next year to negotiate a new trading relationship with the EU. (The UK is reportedly seeking a 'Canada-style' deal—CETA took seven years to negotiate.) We ultimately expect the UK's transition period will be extended by up to two years, allowing for longer trade negotiations. But uncertainty about whether that extension will be agreed to (the alternative would be something like a no-deal Brexit in 2021) and what the future trading relationship will look like will persist even after the UK is officially out of the EU in January.

## Germany's industrial slowdown deepens

The latest PMI data point to another quarter of muted GDP growth in the euro area, continuing what has been a challenging year for the currency bloc. Both manufacturing and services readings have stabilized but at low levels—the former indicating ongoing contraction and the latter suggesting only modest growth. Business sentiment remains weak in Germany, where an industrial sector recession continued in early-Q4, and Italy where PMIs have bounced around 50 (suggesting flat economic activity) for more than a year. The currency bloc's other large economies—France and Spain—are hardly looking impressive. Despite sub-trend GDP growth, the euro area unemployment rate has fallen to an 11-year low. But a tighter labour market is doing little to simulate wage growth, and we expect inflation will remain well below the ECB's target through 2021.

Against this uninspiring backdrop, Christine Lagarde took over as president of the ECB in November. As expected, there was no change in monetary policy following her first meeting at the helm (the central bank having announced a number of new stimulus measures back in September). There was, however, a slight change in tone, with Lagarde sounding a bit more optimistic than her predecessor. She noted signs that growth is stabilizing and that downside risks have become less pronounced. That said, there was little to suggest a near-term change in the direction of monetary policy, with an extended period of accommodation remaining our central assumption. Where Lagarde did echo former president Draghi was in calling for fiscal policy to lighten the load on monetary policy. But the countries that have fiscal room remain reluctant to deploy it, and we expect European fiscal policy won't be nearly as stimulative as in the UK next year.

## Another soft GDP report sets up for RBA cut in 2020

Australian GDP increased by just 0.4% (non-annualized) in Q3, leaving year-over-year growth at a sub-trend 1.7%. As expected, details of the report were weak with household spending up a meagre 0.1%—the slowest quarterly increase since 2009—and both business and residential investment continuing to soften. Government spending supported growth but otherwise fiscal stimulus was less evident with an increase in the household savings rate suggesting consumers tucked away their tax windfall (and any savings from lower mortgage rates). We expect GDP growth will be slightly firmer in 2020, picking up to 2.4% from 1.8% this year—hence the RBA's "gentle turning point." But in contrast with the central bank, we think activity will remain below trend amid subdued consumer spending and a continued pullback in residential investment. The result should be further softening in a labour market that is already carrying some slack. To spur things along, we think the RBA will act on its easing bias and lower its policy rate again in February (it cut rates by 75 basis points this year). With the cash rate nearing zero, we expect discussion around potential quantitative easing will intensify next year.

## Interest rate outlook

%, end of period

| | Actuals | | | Forecast | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 19Q1 | 19Q2 | 19Q3 | 19Q4 | 20Q1 | 20Q2 | 20Q3 | 20Q4 | 21Q1 | 21Q2 | 21Q3 | 21Q4 |
| **Canada** | | | | | | | | | | | | |
| Overnight | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.75 |
| Three-month | 1.67 | 1.66 | 1.65 | 1.60 | 1.40 | 1.40 | 1.40 | 1.40 | 1.40 | 1.40 | 1.40 | 1.65 |
| Two-year | 1.55 | 1.47 | 1.58 | 1.60 | 1.50 | 1.40 | 1.50 | 1.55 | 1.60 | 1.65 | 1.70 | 1.80 |
| Five-year | 1.52 | 1.39 | 1.40 | 1.60 | 1.55 | 1.50 | 1.60 | 1.70 | 1.70 | 1.75 | 1.80 | 1.90 |
| 10-year | 1.62 | 1.47 | 1.36 | 1.65 | 1.70 | 1.70 | 1.75 | 1.80 | 1.85 | 1.90 | 1.95 | 2.00 |
| 30-year | 1.89 | 1.69 | 1.53 | 1.80 | 1.85 | 1.90 | 1.90 | 1.95 | 2.00 | 2.05 | 2.05 | 2.10 |
| **United States** | | | | | | | | | | | | |
| Fed funds** | 2.50 | 2.50 | 2.00 | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 | 2.00 | 2.00 |
| Three-month | 2.40 | 2.12 | 1.88 | 1.65 | 1.65 | 1.65 | 1.65 | 1.65 | 1.65 | 1.65 | 1.90 | 1.90 |
| Two-year | 2.27 | 1.75 | 1.63 | 1.65 | 1.70 | 1.75 | 1.75 | 1.75 | 1.80 | 1.85 | 1.90 | 1.95 |
| Five-year | 2.23 | 1.76 | 1.55 | 1.70 | 1.80 | 1.90 | 1.90 | 1.90 | 1.90 | 1.95 | 1.95 | 2.00 |
| 10-year | 2.41 | 2.00 | 1.68 | 1.90 | 2.00 | 2.10 | 2.10 | 2.10 | 2.15 | 2.15 | 2.20 | 2.25 |
| 30-year | 2.81 | 2.52 | 2.12 | 2.40 | 2.45 | 2.50 | 2.50 | 2.50 | 2.55 | 2.55 | 2.60 | 2.65 |
| **United Kingdom** | | | | | | | | | | | | |
| Bank rate | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 |
| Two-year | 0.63 | 0.62 | 0.37 | 0.55 | 0.60 | 0.60 | 0.60 | 0.60 | 0.70 | 1.00 | 1.00 | 1.00 |
| 10-year | 0.99 | 0.84 | 0.49 | 0.85 | 0.90 | 1.00 | 1.10 | 1.10 | 1.25 | 1.50 | 1.50 | 1.50 |
| **Euro area** | | | | | | | | | | | | |
| Deposit Rate | -0.40 | -0.40 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 |
| Two-year | -0.60 | -0.73 | -0.74 | -0.80 | -0.80 | -0.80 | -0.75 | -0.75 | -0.75 | -0.75 | -0.70 | -0.70 |
| 10-year | -0.07 | -0.33 | -0.58 | -0.25 | -0.10 | -0.05 | 0.00 | 0.00 | 0.05 | 0.10 | 0.15 | 0.15 |
| **Australia** | | | | | | | | | | | | |
| Cash target rate | 1.50 | 1.25 | 1.00 | 0.75 | 0.50 | 0.50 | 0.50 | 0.50 | 0.25 | 0.25 | 0.25 | 0.25 |
| Two-year | 1.47 | 0.98 | 0.76 | 0.75 | 0.50 | 0.40 | 0.35 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| 10-year | 1.78 | 1.32 | 1.01 | 1.20 | 1.25 | 1.30 | 1.20 | 1.15 | 1.15 | 1.05 | 0.95 | 1.00 |
| **New Zealand** | | | | | | | | | | | | |
| Cash target rate | 1.75 | 1.50 | 1.00 | 0.75 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Two-year swap | 1.62 | 1.35 | 0.92 | 0.85 | 0.75 | 0.75 | 0.75 | 0.75 | 0.65 | 0.60 | 0.60 | 0.60 |
| 10-year swap | 2.15 | 1.78 | 1.20 | 1.35 | 1.35 | 1.45 | 1.45 | 1.45 | 1.45 | 1.40 | 1.35 | 1.30 |
| **Yield curve*** | | | | | | | | | | | | |
| Canada | 7 | 0 | -22 | 5 | 20 | 30 | 25 | 25 | 25 | 25 | 25 | 20 |
| United States | 14 | 25 | 5 | 25 | 30 | 35 | 35 | 35 | 35 | 30 | 30 | 30 |
| United Kingdom | 36 | 22 | 12 | 30 | 30 | 40 | 50 | 50 | 55 | 50 | 50 | 50 |
| Eurozone | 53 | 40 | 16 | 55 | 70 | 75 | 75 | 75 | 80 | 85 | 85 | 85 |
| Australia | 31 | 34 | 25 | 45 | 75 | 90 | 85 | 85 | 85 | 75 | 65 | 70 |
| New Zealand | 53 | 43 | 28 | 50 | 60 | 70 | 70 | 70 | 80 | 80 | 75 | 70 |

* 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 | 1.50-1.75 | 1.75-2.00 | October 31, 2019 | Eurozone | Deposit rate | -0.50 | -0.40 | September 18, 2019 |
| Canada | Overnight rate | 1.75 | 1.50 | October 24, 2018 | Australia | Cash rate | 0.75 | 1.00 | October 1, 2019 |
| United Kingdom | Bank rate | 0.75 | 0.50 | August 1, 2018 | New Zealand | Cash rate | 0.75 | 1.00 | October 1, 2019 |

Source: Bloomberg, Reuters, RBC Economics Research

# Economic outlook

## Growth outlook

% change, quarter-over-quarter in real GDP

| | 19Q1 | 19Q2 | 19Q3 | 19Q4 | 20Q1 | 20Q2 | 20Q3 | 20Q4 | 21Q1 | 21Q2 | 21Q3 | 21Q4 | 2018 | 2019F | 2020F | 2021F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Canada* | 0.8 | 3.5 | 1.3 | 1.4 | 1.4 | 1.6 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.6 | 2.0 | 1.7 | 1.6 | 1.7 |
| United States* | 3.1 | 2.0 | 2.1 | 2.2 | 1.5 | 1.6 | 1.8 | 1.8 | 1.7 | 1.6 | 1.5 | 1.5 | 2.9 | 2.3 | 1.8 | 1.7 |
| United Kingdom | 0.6 | -0.2 | 0.3 | 0.1 | 0.2 | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 | 1.4 | 1.3 | 1.0 | 1.5 |
| Euro area | 0.4 | 0.2 | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 1.9 | 1.2 | 1.0 | 1.2 |
| Australia | 0.5 | 0.6 | 0.4 | 0.6 | 0.6 | 0.6 | 0.6 | 0.8 | 0.8 | 0.8 | 0.9 | 0.9 | 2.7 | 1.8 | 2.4 | 3.1 |

*annualized

## Inflation outlook

% change, year-over-year

| | 19Q1 | 19Q2 | 19Q3 | 19Q4 | 20Q1 | 20Q2 | 20Q3 | 20Q4 | 21Q1 | 21Q2 | 21Q3 | 21Q4 | 2018 | 2019F | 2020F | 2021F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Canada* | 1.6 | 2.1 | 1.9 | 2.2 | 2.0 | 1.5 | 1.5 | 1.5 | 1.6 | 1.7 | 1.9 | 2.0 | 2.3 | 2.0 | 1.6 | 1.8 |
| United States* | 1.6 | 1.8 | 1.8 | 2.0 | 2.3 | 2.0 | 2.0 | 1.9 | 2.2 | 2.1 | 2.1 | 2.1 | 2.4 | 1.8 | 2.0 | 2.1 |
| United Kingdom | 1.8 | 2.0 | 1.9 | 1.5 | 1.7 | 1.3 | 1.3 | 1.6 | 1.7 | 1.8 | 1.9 | 1.9 | 2.5 | 1.8 | 1.5 | 1.9 |
| Euro area | 1.4 | 1.4 | 1.0 | 0.9 | 1.4 | 1.1 | 0.9 | 1.0 | 1.1 | 1.3 | 1.4 | 1.4 | 1.8 | 1.2 | 1.1 | 1.3 |
| Australia | 1.3 | 1.6 | 1.7 | 1.6 | 2.2 | 2.0 | 1.9 | 1.9 | 1.9 | 2.0 | 2.1 | 2.2 | 1.9 | 1.6 | 2.1 | 2.1 |

Source: Statistics Canada, Bureau of Economic Analysis, Bureau of Labor Statistics, Office for National Statistics, Statistical Office of the European Communities, Australian Bureau of Statistics, Statistics 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[1] | Oct | 0.2 | 2.0 | 1.7 | 2.4 |
| United States | Core PCE[1,2] | Oct | 0.1 | 1.6 | 1.7 | 1.7 |
| United Kingdom | All-items CPI | Oct | -0.2 | 1.5 | 1.9 | 2.2 |
| Euro area | All-items CPI[1] | Nov | 0.2 | 1.0 | 0.9 | 1.3 |
| Australia | Trimmed mean CPI[1] | Q3 | 0.4 | 1.6 | N/A | N/A |
| New Zealand | All-items CPI | Q3 | 0.7 | 1.5 | N/A | N/A |

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

Source: Statistics Canada, Bureau of Labor Statistics, Office for National Statistics, Statistical Office of the European Communities, Australian Bureau of Statistics, Statistics New Zealand, RBC Economics Research

# Currency outlook

Level, end of period

| | Actuals | | | | | | | Forecast | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 18Q1 | 18Q2 | 18Q3 | 18Q4 | 19Q1 | 19Q2 | 19Q3 | 19Q4 | 20Q1 | 20Q2 | 20Q3 | 20Q4 |
| Canadian dollar | 1.29 | 1.31 | 1.29 | 1.36 | 1.33 | 1.31 | 1.32 | 1.31 | 1.30 | 1.31 | 1.32 | 1.33 |
| Euro | 1.23 | 1.17 | 1.16 | 1.15 | 1.12 | 1.14 | 1.09 | 1.11 | 1.10 | 1.08 | 1.10 | 1.12 |
| U.K. pound sterling | 1.40 | 1.32 | 1.30 | 1.28 | 1.30 | 1.27 | 1.23 | 1.35 | 1.39 | 1.37 | 1.36 | 1.35 |
| Japanese yen | 106.3 | 110.8 | 113.7 | 109.7 | 110.9 | 107.9 | 108.1 | 110 | 112 | 111 | 110 | 109 |
| Australian dollar | 0.77 | 0.74 | 0.72 | 0.70 | 0.71 | 0.70 | 0.68 | 0.68 | 0.67 | 0.67 | 0.66 | 0.66 |

### Canadian dollar cross-rates

| | 18Q1 | 18Q2 | 18Q3 | 18Q4 | 19Q1 | 19Q2 | 19Q3 | 19Q4 | 20Q1 | 20Q2 | 20Q3 | 20Q4 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| EUR/CAD | 1.59 | 1.53 | 1.50 | 1.56 | 1.50 | 1.49 | 1.44 | 1.45 | 1.43 | 1.41 | 1.45 | 1.49 |
| GBP/CAD | 1.81 | 1.73 | 1.68 | 1.74 | 1.74 | 1.66 | 1.63 | 1.76 | 1.81 | 1.79 | 1.79 | 1.79 |
| CAD/JPY | 82.4 | 84.3 | 88.1 | 80.4 | 83.0 | 82.4 | 81.6 | 84.0 | 86.2 | 84.7 | 83.3 | 82.0 |
| AUD/CAD | 0.99 | 0.97 | 0.93 | 0.96 | 0.95 | 0.92 | 0.89 | 0.89 | 0.87 | 0.88 | 0.87 | 0.88 |

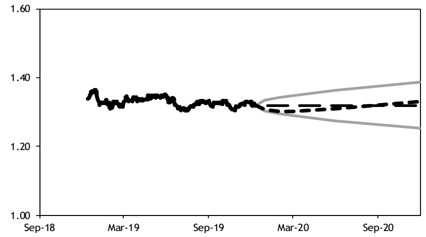
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

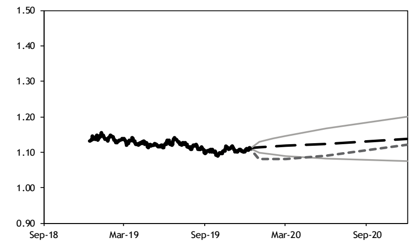
# RBC Economics outlook compared to the market

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.

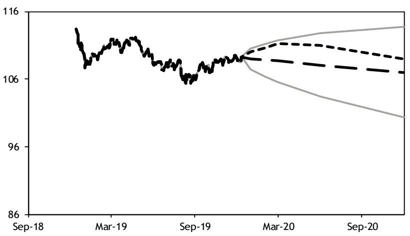
**Canadian dollar**



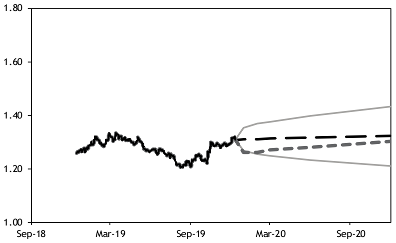

**Euro**




**Japanese yen**




**U.K. pound**

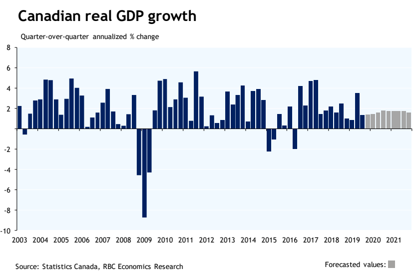


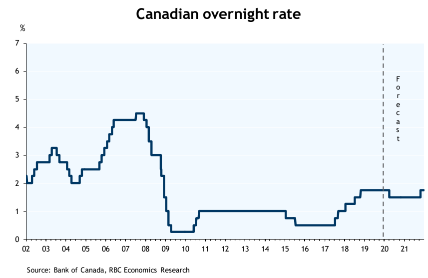
# Central bank watch

## Bank of Canada

A 1.3% increase in Q3 GDP was bang-on the BoC's forecast, but the details were firmer than expected with a surprising increase in business investment.

We expect sub-trend growth will continue through the early stages of 2020, testing the BoC's patience. We look for a rate cut in Q2, but acknowledge that persistent strength in housing and earlier fiscal stimulus could keep the bank on the sidelines.

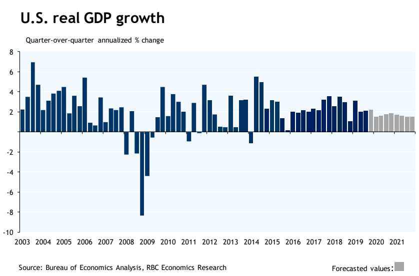


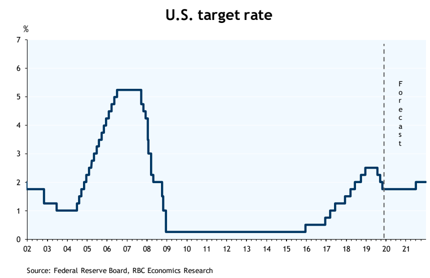




## Federal Reserve

We think the US economy continued to grow at an above-trend pace in Q4. Our 2020 growth forecast is slightly slower than the Fed's 2% projection, but not enough so (in our view) to justify the central bank lowering rates further.

With inflation remaining well behaved (core PCE still sub-2%) we don't see the Fed reversing this year's rate cuts anytime soon.

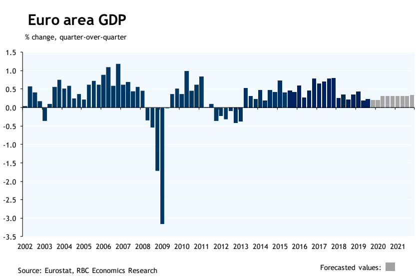


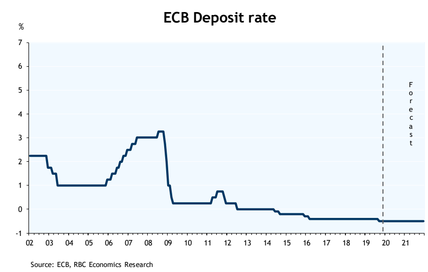




## European Central Bank

Euro area business sentiment is starting to stabilize, but we expect GDP growth will remain stuck at a modest 0.2% pace in Q4/19 and Q1/20.

With sub-trend activity unlikely to generate much inflationary pressure, the ECB is likely to keep monetary policy stimulus in place for the foreseeable future. The central bank is hoping for more fiscal support but that will be slow to come.

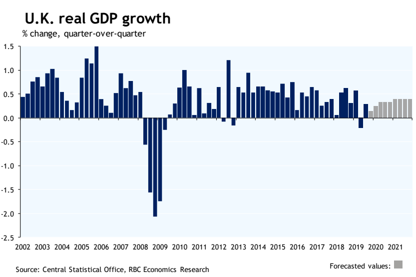


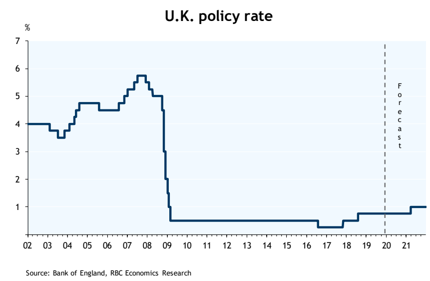




## Bank of England

We think the UK economy grew at a sub-trend 0.1% pace in Q4. The unemployment rate's downward trend has stalled out, but wage growth remains close to a post-recession high.

The next BoE governor will have to weigh slow growth and ongoing Brexit-related uncertainty against a tight labour market and solid wage growth. We expect no change in the bank rate in 2020.

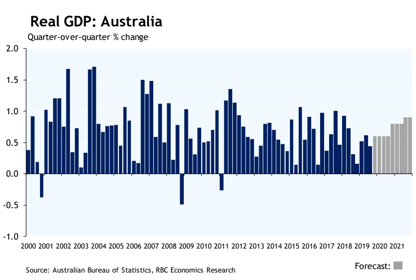


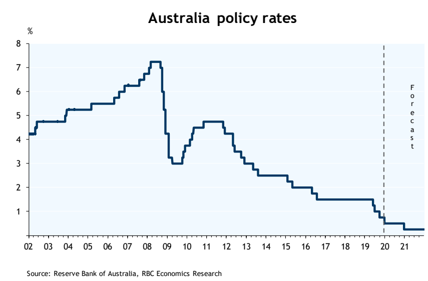




## Reserve Bank of Australia

Australian GDP growth slowed in Q3 and we think activity will continue at a sub-trend pace in 2020. With unemployment and underemployment already elevated, we think that will keep the RBA with an easing bias.

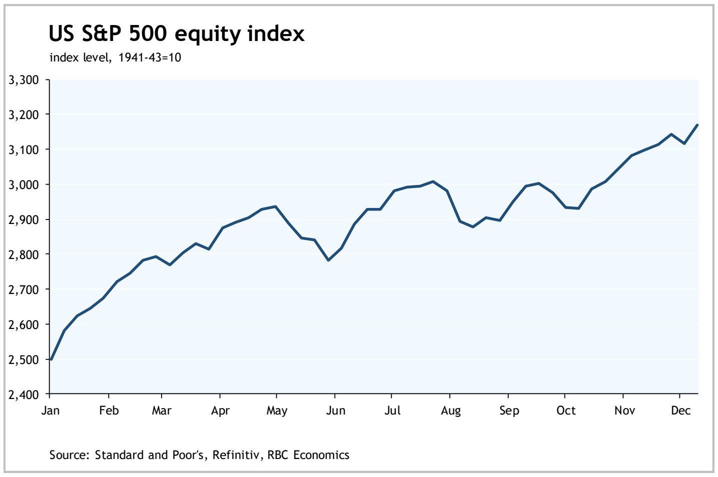
We look for another rate cut early next year, adding to 2019's 75 basis points of easing, and think discussion around QE will intensify in 2020.



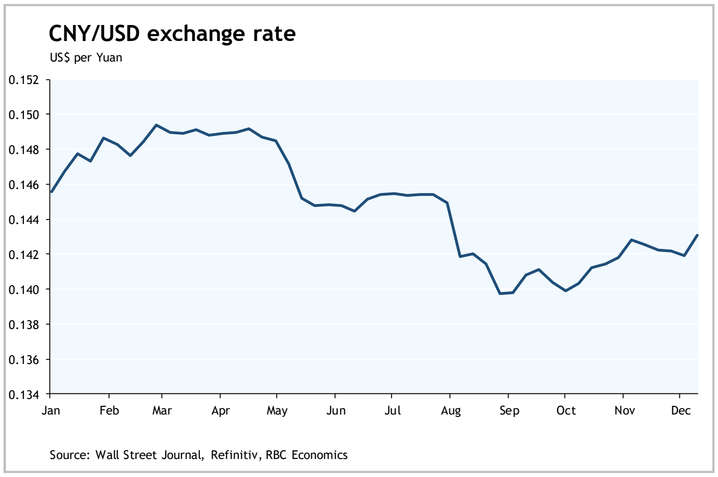



# Trade developments continued to influence markets in December

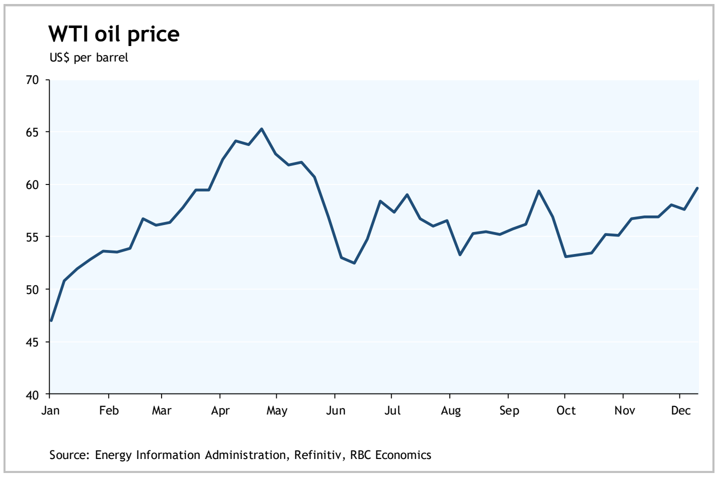
Reports that the US and China have agreed to a “phase one” trade deal—suspending further tariff hikes and potentially rolling back some existing tariffs—pushed equity markets to record highs. The US S&P 500 declined in May and August as trade tensions intensified, but is up more than 25% year-to-date.



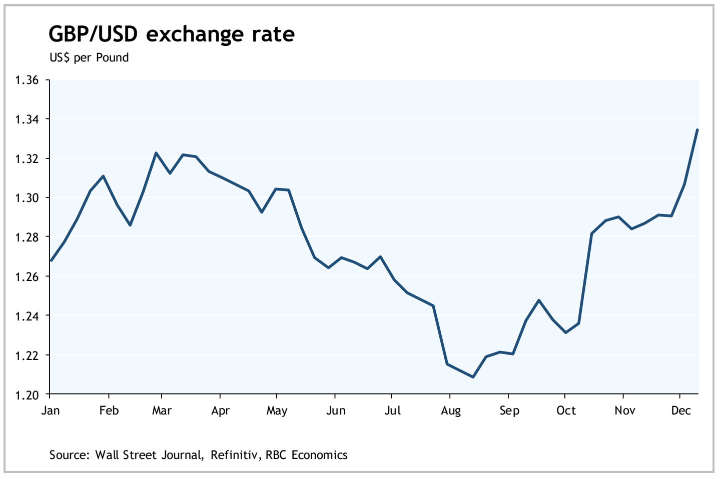

US tariffs have tended to put downward pressure on the Yuan, so news of a potential trade deal pushed China’s currency higher. The Yuan is up nearly 3% since the start of September when the last US tariff hike kicked in.




US-China trade tensions have been a key headwind to global growth, and by extension commodity prices. News of a trade deal helped lift WTI oil prices toward the US$60 per barrel mark for the first time since Saudi Arabia’s oil outage sparked supply fears.




In the UK, a strong Conservative majority is seen paving the way for the country to exit the EU at the end of January 2020. The two parties still need to negotiate a trade deal, but with a bit more clarity about the near-term Brexit path, Sterling has surged to a multi-month high.

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