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New year, new risks

It was an inauspicious start to 2020 with US-Iran tensions flaring up following the assassination of a top Iranian general. Oil prices rose to multi-month highs while risk aversion saw Treasuries and safe haven currencies rally. But with a measured response from Iran, and the US following up with sanctions rather than military action, financial markets calmed in the first full week of the year. North American oil prices are back below \$60 per barrel, 10-year Treasury yields are within a few basis points of where they closed 2019, and the S&P 500 is once again at a record high. Geopolitical risk can't be dismissed, but at this stage it seems cooler heads are prevailing and markets are taking these developments in stride.

It helps that trade tensions have been dialed back—the US and China are set to ink a phase-one trade deal (providing only modest tariff relief, but at least not escalating their trade war), USMCA ratification looks likely, and the UK is heading toward an orderly Brexit at the end of January. Reduced trade uncertainty combined with last year's easing in financial conditions have helped business sentiment stabilize in many major economies. Global manufacturing activity generally remains soft but contagion to other sectors—a necessary condition for a broader slowdown—appears to be contained.

Assuming global growth stabilizes this year and trade concerns aren't as prominent, we think major central banks will be less active in 2020 and government bond yields will drift modestly higher. However, rates will likely be capped by lingering late-cycle growth worries and indications that monetary policy will remain stimulative—modestly so in North America, more significantly in Europe—for some time yet.

Central bank near-term bias



Governor Poloz sounded balanced in remarks in early-January. But we continue to think sub-trend growth in H2/19 and lingering effects of global headwinds leave the door open to a rate cut in Q2.



Having lowered rates three times in H2/19, the Fed sounds unlikely to ease further but is also in no rush to reverse those cuts. We think 2020 will be a much less interesting year for the Fed.



Less political uncertainty could support sentiment near-term, but Brexit concerns are likely to resurface later this year. We expect the BoE will maintain a supportive policy stance, but not add to it, in 2020.



There was a touch of optimism in ECB President Lagarde's first post-meeting press conference, but we continue to think the ECB is a long way from making any policy changes.



A recent, positive run of economic data puts at risk our call for a February rate cut, but we continue to think the RBA will ease monetary policy further in 2020.

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Highlights

▲ Last year's Fed rate cuts lifted equity markets and supported the housing sector.

▲ 2019 was a year to forget for the US industrial sector as tariffs weighed on manufacturing activity.

▲ Sentiment could improve with trade tensions being dialed back, but policy uncertainty isn't about to disappear.

▲ The Fed seems to have little appetite to move rates higher or lower this year.

Lower rates supporting US housing

One of the most notable effects of last year's Fed rate cuts was support for asset prices. The S&P 500 rose 29% in 2019—its second-best annual gain in two decades—despite lacklustre profits, slowing global growth and recession fears. (It's also worth noting that a late-2018 selloff provided a flattering comparison for 2019.) As for the real economy, it was the US housing sector that benefited most from lower borrowing costs. Housing starts rebounded to a cycle high in the second half of 2019 after having stalled out in mid-2018 when interest rates were nearing their peak. A surge in building permit issuance in Q4/19 and a 20-year high in homebuilders' confidence suggest starts will continue to grind higher in 2020. The resale market also picked up over the course of 2019 but remains short of recent highs. Limited supply is likely a restraining factor—in November, the number of homes on the market was the lowest on record (based on our own seasonal adjustment). Indeed, sales in the less supply-constrained new home market are running at a cycle high. The US housing sector isn't the behemoth it once was—it now represents less than 4% of the economy, down from more than 6% pre-recession. Nonetheless, its shift from a drag on growth in 2018 and H1/19 to positive contributor will provide a nice cushion, helping the economy achieve trend-like growth in 2020.

Relief coming for the factory sector?

Easier financial conditions did little to help US manufacturers in 2019. The factory sector entered its worst slump since 2015-16 and the ISM manufacturing index declined steadily throughout the year, hitting a cycle low in December. Temporary shutdowns in the auto sector and now aerospace have added to the sector's woes, but the bigger issue last year was escalating trade tensions. A recent Fed paper analyzing US import tariffs found that, in more tariff-exposed manufacturing industries, the negative effects of higher input costs and other countries' retaliatory measures more than offset any positives from import protection. And that didn't even take into account the negative impact of trade policy uncertainty on business investment, which had knock-on effects for manufacturers via slower orders for capital goods.

Will we see a turnaround in 2020? USMCA ratification and a preliminary US-China trade deal should resolve some of the most prominent trade concerns. Indeed, despite a disappointing headline reading, the latest ISM report noted, "signs that several industry sectors will improve as a result of the phase-one trade agreement between the U.S. and China." But substantial tariffs remain in place, and we continue to think the Trump administration's unpredictable approach to trade policy will give some firms pause as they lay out their investment plans. Uncertainty leading up to the November 2020 election could also delay some capital spending. We'll be keeping an eye on sentiment early this year but at this stage we don't see manufacturing and business investment making significant contributions to growth in 2020.

FOMC minutes indicate high bar for rate change

The Fed moved to the sidelines in December and looks set to remain there for some time. Minutes of that meeting seemed to show no appetite for further rate cuts amid easing in some downside risks (US-China, Brexit), indications that global growth is stabilizing, signs of resilience in the domestic economy, and reduced likelihood of recession. At the same time, only 4 of 17 policymakers think a rate hike is likely to be appropriate this year. Maintaining the current stance of monetary policy will give the Fed time to assess the full impact of last year's rate cuts, while also helping to soften the impact of global headwinds and return inflation to target. Some expressed financial stability concerns associated with keeping rates low for too long, but overall there was little to indicate the Fed will follow its 1999 playbook when it fully reversed the previous year's mid-cycle adjustment. Barring a significant deviation from our current forecasts, we think 2020 will be a much less interesting year for Fed-watchers than 2019.



Canadian economy's resilience faded in H2/19

Recent data suggest the Canadian economy's surprising resilience through much of 2019 began to fade late in the year. GDP fell 0.1% in October (the first decline since February), extending a streak of sub-trend gains with the economy having expanded a paltry 0.1% (non-annualized) since June. Goods production remained soft in October—posting its third decline in four months—while growth in the services sector stalled. Weakness in the latter was narrowly based and doesn't look like the start of a trend. The goods sector is another story. Labour disruptions south of the border impacted Canada's auto sector in October, and while we could see some rebound in the subsequent two months, the closure of GM's Oshawa plant at the end of 2019 represents a permanent hit to motor vehicle production. A strike by rail workers in November disrupted trade and will have weighed on economic output in the month. All told, it looks like Canadian GDP growth slipped below 1% in Q4/19. To the extent that some of that slowdown reflects transitory factors, we expect activity will pick up modestly early this year. But we still anticipate sub-trend growth in the first half of 2020.

Labour market losing its lustre

After an ugly November employment report, Canada's December jobs numbers caused a sigh of relief. The overall headcount retraced a good portion of the previous month's decline, and more importantly, the unemployment rate fell back to 5.6%—just 0.2 percentage points above May's 45-year low. If we're being picky, wage growth slowed somewhat in December but a 3.6% year-over-year increase is still strong given inflation and productivity trends. While closing 2019 on a positive note, it's still the case that Canada's previously impressive labour market lost some momentum late in the year. That suggests that the economy's shift to sub-trend growth in H2/19 can't be solely blamed on transitory factors.

Ottawa has a bit less fiscal room than we thought

With a federal election in October, we had to wait until December for the now-minority Liberal government's fall fiscal update. Its main policy change delivered on a key campaign pledge to reduce income taxes for nearly 20 million Canadians. Phased in over four years, the measure will lower a single individual's tax bill by nearly \$300 per year and a dual-income couple's by close to \$600 once fully implemented. That was just one of a number of campaign promises, but it appears the government has less fiscal room to deliver on its platform than previously thought. Lower interest rates, while easing debt service costs, inflated the government's future pension liabilities. As a result, planned program expenses had to be marked up by nearly \$6 billion per year. Rather than a \$20 billion deficit in the current fiscal year, the government is now looking at a shortfall of more than \$26 billion. The upshot is that, if it remains committed to reducing debt as a share of GDP (now projected to edge up to 31% this year) the Liberals will have to prioritize some of their election promises. So while we continue to expect federal fiscal policy will be stimulative in 2020-21 (beyond the very modest boost from tax cuts that took effect in January), it might be less supportive than previously thought.

Governor Poloz doesn't tip the BoC's hand

In remarks early this year, BoC Governor Poloz was a bit more dovish than in December but still didn't stray far from a balanced tone. While noting some improvement in global trade tensions “on the surface,” he said it remains to be seen whether investment and trade will improve with US trade policy remaining unpredictable. On the domestic economy, he mentioned a number of transitory factors that have weighed on growth recently but still described recent data as “mixed.” The BoC doesn't appear to be in any rush to ease monetary policy (having held rates steady last year while others cut) and markets are pricing less than 50/50 odds of a move this year. But with growth numbers having disappointed recently—and as noted above, not entirely due to transitory factors—we continue to think the door is open to a rate cut by the middle of the year.

Highlights

▲ Canadian GDP growth likely slowed to around 1% in H2/19, though some transitory factors were at play.

▲ Canada's labour market rebounded in December but was still less robust in H2/19.

▲ Higher pension costs could limit the government's ability to deliver on its campaign promises while still lowering debt-to-GDP.

▲ We think markets are a bit complacent—odds of a BoC rate cut are too low.



Highlights

▲ The UK is set to leave the EU in an orderly fashion at the end of January...

▲ But the two parties don't have much time to negotiate a longer-term trade deal.

▲ ECB President Lagarde noted signs that global growth is stabilizing and downside risks are easing.

▲ A jump in Australian retail sales in November doesn't necessarily signal the end of sluggish consumer spending.

How will the UK respond to less near-term Brexit uncertainty?

All signs point to the UK economy having lost momentum toward the end of last year. Retail sales were sluggish in the lead-up to the holiday shopping season, the manufacturing sector softened, and PMI data suggest the all-important services sector isn't picking up the slack. We expect GDP increased by just 0.1% (non-annualized) in Q4/19, capping off a second consecutive year of sub-trend growth. There is scope for improvement in 2020, though, with fiscal policy becoming more stimulative and political uncertainty fading into the background. The Conservatives' decisive election victory ensures the UK will leave the EU at the end of January but maintain Single Market access during a transition period that is set to last at least until the end of the year. With a damaging no-deal Brexit being taken off the table for the time being we might see business and consumer confidence pick up in the first half of 2020.

But we caution that an abbreviated timeframe to negotiate a longer-term trade agreement could see concerns about the UK's trading relationship with the EU return to the fore later this year. As such, we expect any improvement in business investment will be modest, while consumer spending growth is likely to be held in check. The question of how much and how persistently the UK economy picks up in 2020 will remain central to the BoE's policy deliberations as Andrew Bailey takes over as governor in March. In December, the central bank left rates unchanged but once again two MPC members voted for a rate cut. And the committee hedged its forward guidance that rates might need to rise modestly over time, noting that downside risks to the outlook could call for more stimulus. Our expectation is that modest growth, coupled with some upside risk to inflation from rising wages, will keep the central bank on the sidelines again in 2020.

Euro area growth stabilizing, but nothing more

The euro area looks to have closed out 2019 with another quarter of sub-trend growth. The currency bloc's composite PMI averaged a cycle low in Q4/19 and overall economic sentiment was the softest in nearly five years. The good news is that those indicators stabilized toward the end of the quarter, suggesting the worst may be over. To be sure, the industrial sector remains under pressure—manufacturing PMIs point to ongoing contraction in most major euro area economies. But services data continues to suggest spillover to other industries has been contained. Even in Germany where manufacturing activity has been particularly weak, the services PMI hit a four-month high in December. We think resilience in the consumer and services sectors, along with slightly more stimulative fiscal policy in some euro area economies, will help GDP growth return to a more trend-like (but still modest) pace as 2020 progresses. New ECB President Christine Lagarde espoused a similar view at her first post-meeting press conference, noting signs that growth is stabilizing and downside risks are becoming less pronounced. Markets saw that as slightly hawkish, pushing short-term yields higher. Still, we think the scope for a near-term policy change is remote, which should keep the front end of the curve anchored. Meanwhile, a modest pickup in growth but persistently low inflation means 10-year Bund yields will rise only gradually.

Positive data might be cause for RBA patience in February

Since a soft Q3/19 GDP report, Australian economic data have generally surprised to the upside. The labour market rebounded in November with employment more than retracing the previous month's decline and both the unemployment and underemployment rates ticking lower. Retail sales, having disappointed through much of 2019, jumped higher in November, though the ABS noted its seasonal adjustment didn't fully adjust for the positive impact of Black Friday, meaning we could see some retracement in December. Dwelling approvals also picked up in November, suggesting lower rates are supporting the housing sector. So while minutes of the RBA's December meeting indicated policymakers are likely to consider a rate cut when they meet next in February (and our forecast assumes such a move), decent data flow since then could give the central bank pause. Even if that's the case, we continue to think the RBA will lower rates further this year to assist an economy that is running short of full employment and seeing little progress toward its inflation target.



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	1.66	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.65
Two-year	1.55	1.47	1.58	1.70	1.50	1.40	1.50	1.55	1.60	1.65	1.70	1.80
Five-year	1.52	1.39	1.40	1.69	1.55	1.50	1.60	1.70	1.70	1.75	1.80	1.90
10-year	1.62	1.47	1.36	1.70	1.70	1.70	1.75	1.80	1.85	1.90	1.95	2.00
30-year	1.89	1.69	1.53	1.76	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	1.55	1.65	1.65	1.65	1.65	1.65	1.65	1.90	1.90
Two-year	2.27	1.75	1.63	1.58	1.70	1.75	1.75	1.75	1.80	1.85	1.90	1.95
Five-year	2.23	1.76	1.55	1.69	1.80	1.90	1.90	1.90	1.90	1.95	1.95	2.00
10-year	2.41	2.00	1.68	1.92	2.00	2.10	2.10	2.10	2.15	2.15	2.20	2.25
30-year	2.81	2.52	2.12	2.39	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	0.54	0.60	0.60	0.60	0.60	0.70	1.00	1.00	1.00
10-year	0.99	0.84	0.49	0.83	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	-0.59	-0.80	-0.80	-0.75	-0.75	-0.75	-0.75	-0.70	-0.70
10-year	-0.07	-0.33	-0.58	-0.19	-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	0.92	0.50	0.40	0.35	0.30	0.30	0.30	0.30	0.30
10-year	1.78	1.32	1.01	1.37	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	1.00	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	1.25	0.75	0.75	0.75	0.70	0.65	0.60	0.60	0.60
10-year swap	2.15	1.78	1.20	1.78	1.35	1.45	1.45	1.40	1.45	1.40	1.35	1.30
Yield curve*												
Canada	7	0	-22	0	20	30	25	25	25	25	25	20
United States	14	25	5	34	30	35	35	35	35	30	30	30
United Kingdom	36	22	12	29	30	40	50	50	55	50	50	50
Eurozone	53	40	16	40	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	53	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

	<u>19Q1</u>	<u>19Q2</u>	<u>19Q3</u>	<u>19Q4</u>	<u>20Q1</u>	<u>20Q2</u>	<u>20Q3</u>	<u>20Q4</u>	<u>21Q1</u>	<u>21Q2</u>	<u>21Q3</u>	<u>21Q4</u>	<u>2018</u>	<u>2019F</u>	<u>2020F</u>	<u>2021F</u>
Canada*	0.8	3.5	1.3	0.7	1.4	1.6	1.7	1.7	1.7	1.7	1.7	1.6	2.0	1.7	1.5	1.7
United States*	3.1	2.0	2.1	2.2	1.7	1.8	1.8	1.8	1.7	1.6	1.5	1.5	2.9	2.3	1.9	1.7
United Kingdom	0.6	-0.2	0.4	0.1	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	1.3	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

	<u>19Q1</u>	<u>19Q2</u>	<u>19Q3</u>	<u>19Q4</u>	<u>20Q1</u>	<u>20Q2</u>	<u>20Q3</u>	<u>20Q4</u>	<u>21Q1</u>	<u>21Q2</u>	<u>21Q3</u>	<u>21Q4</u>	<u>2018</u>	<u>2019F</u>	<u>2020F</u>	<u>2021F</u>
Canada*	1.6	2.1	1.9	2.1	2.1	1.6	1.5	1.6	1.6	1.7	1.9	2.0	2.3	2.0	1.7	1.8
United States*	1.6	1.8	1.8	2.1	2.4	2.2	2.1	1.9	1.9	2.0	2.1	2.2	2.4	1.8	2.1	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	1.0	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

	<u>Measure</u>	<u>Current period</u>	<u>Period ago</u>	<u>Year ago</u>	<u>Three-month trend</u>	<u>Six-month trend</u>
Canada	CPI ex food & energy ¹	Nov	0.0	2.0	1.5	2.2
United States	Core PCE ^{1,2}	Nov	0.1	1.6	1.4	1.9
United Kingdom	All-items CPI	Nov	0.2	1.5	1.4	2.1
Euro area	All-items CPI ¹	Dec	0.1	1.3	1.1	1.2
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

	<u>Actuals</u>								<u>Forecast</u>			
	<u>18Q1</u>	<u>18Q2</u>	<u>18Q3</u>	<u>18Q4</u>	<u>19Q1</u>	<u>19Q2</u>	<u>19Q3</u>	<u>19Q4</u>	<u>20Q1</u>	<u>20Q2</u>	<u>20Q3</u>	<u>20Q4</u>
Canadian dollar	1.29	1.31	1.29	1.36	1.33	1.31	1.32	1.30	1.30	1.31	1.32	1.33
Euro	1.23	1.17	1.16	1.15	1.12	1.14	1.09	1.12	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	1.33	1.39	1.37	1.36	1.35
Japanese yen	106.3	110.8	113.7	109.7	110.9	107.9	108.1	108.6	112	111	110	109
Australian dollar	0.77	0.74	0.72	0.70	0.71	0.70	0.68	0.70	0.67	0.67	0.66	0.66

Canadian dollar cross-rates

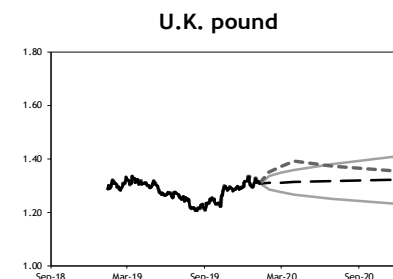
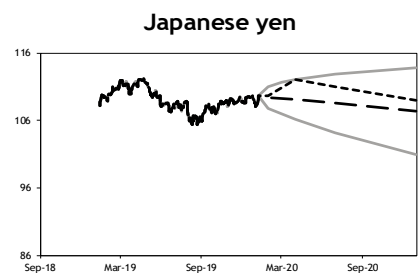
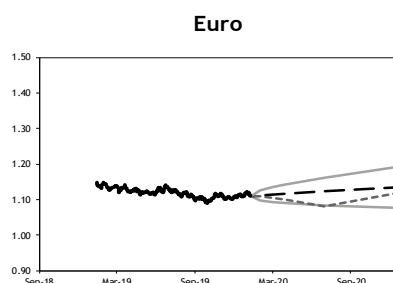
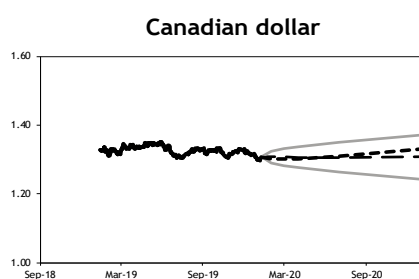
	<u>18Q1</u>	<u>18Q2</u>	<u>18Q3</u>	<u>18Q4</u>	<u>19Q1</u>	<u>19Q2</u>	<u>19Q3</u>	<u>19Q4</u>	<u>20Q1</u>	<u>20Q2</u>	<u>20Q3</u>	<u>20Q4</u>
EUR/CAD	1.59	1.53	1.50	1.56	1.50	1.49	1.44	1.46	1.43	1.41	1.45	1.49
GBP/CAD	1.81	1.73	1.68	1.74	1.74	1.66	1.63	1.72	1.81	1.79	1.79	1.79
CAD/JPY	82.4	84.3	88.1	80.4	83.0	82.4	81.6	83.6	86.2	84.7	83.3	82.0
AUD/CAD	0.99	0.97	0.93	0.96	0.95	0.92	0.89	0.91	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.



Central bank watch

Bank of Canada

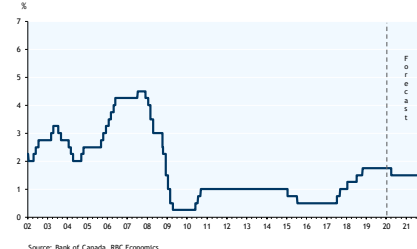
It looks like GDP growth slowed to around 1% in H2/19, with transitory factors only partly to blame. Less momentum in the labour market also suggests underlying growth has moderated.

Governor Poloz was neither overly excited about trade developments, nor overly downbeat about recent domestic data. But the BoC's neutrality will be tested if growth numbers continue to disappoint.

Canadian real GDP growth



Canadian overnight rate

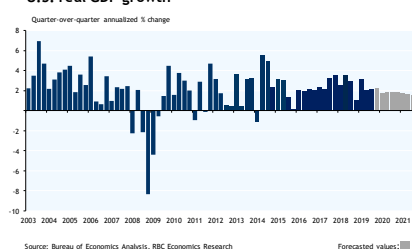


Federal Reserve

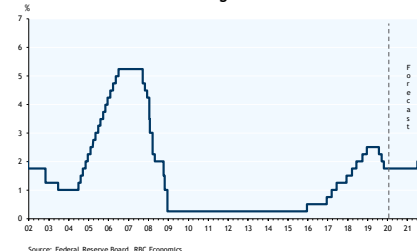
Lower interest rates are helping to soften the impact of trade tensions and global headwinds, while the US consumer remains a consistent source of demand. We expect near-trend GDP growth in 2020.

Well-behaved inflation and more moderate growth is likely to keep the Fed from raising interest rates anytime soon, while easing in downside risks should preclude further rate cuts.

U.S. real GDP growth



U.S. target rate

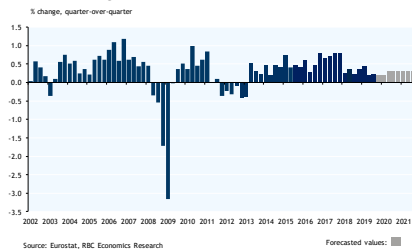


European Central Bank

Euro area growth appears to have stabilized at an unimpressive pace with the manufacturing sector remaining weak but services continuing to show some resilience.

Less acute concerns about the growth outlook give the ECB time to evaluate the impact of its latest round of easing. We don't anticipate any change in monetary policy this year.

Euro area GDP



ECB Deposit rate

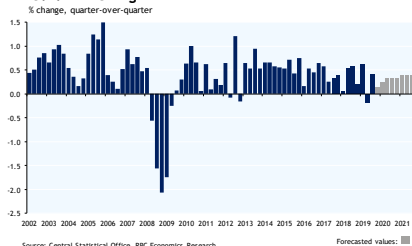


Bank of England

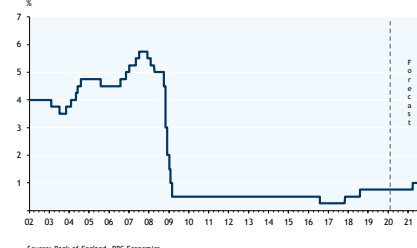
The UK economy carried little momentum into 2020 but sentiment could improve early this year with near-term Brexit risks fading. Trade concerns are likely to resurface later this year, though.

With inflation remaining contained (despite solid wage growth) and any improvement in growth likely to be limited, we think the BoE will remain on the sidelines in 2020.

U.K. real GDP growth



U.K. policy rate

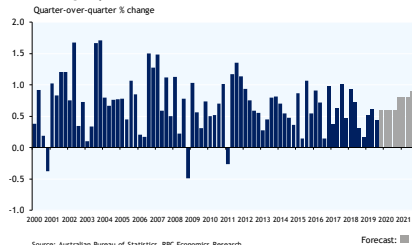


Reserve Bank of Australia

Australian GDP growth slowed in Q3/19 but more recent data—employment, retail sales, building approvals—have looked better.

Minutes of the latest RBA meeting indicated policy-makers will evaluate the need for a rate cut in February. Our forecast calls for a move next month, but positive data flow might make the central bank a bit more patient.

Real GDP: Australia



Australia policy rates



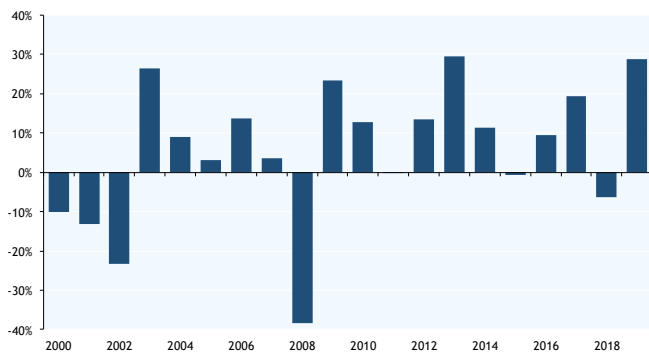
Fed's rate cuts having an impact, but not a panacea

The Fed's shift from raising rates in 2018 to easing in 2019 had a notable impact on equity markets. The S&P 500 rose by 29% last year despite, a slowdown in profits, softer global growth and recession fears. An easy year-ago comparison (the index fell by 14% in Q4/18) also helped.

As far as the real economy goes, it was the US housing market that benefited most from lower rates. Both home sales and housing starts slowed in 2018 as interest rates rose, but picked up through 2019 as the Fed eased monetary policy and mortgage rates fell.

Annual change in S&P 500 index

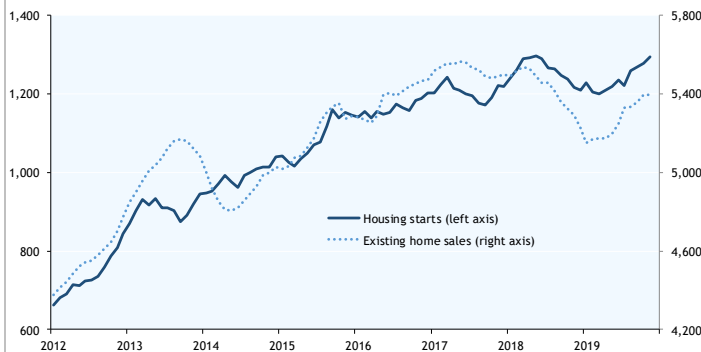
y/y % change, end of period



Source: Standard & Poor's, RBC Economics

US housing starts and existing home sales

SAAR, thousands



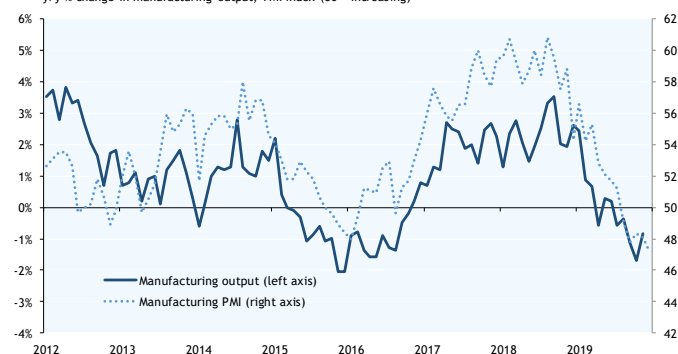
Source: Census Bureau, National Association of Realtors, RBC Economics

Lower rates did little to ease the industrial sector's woes. Manufacturing activity declined in 2019 for the first time since 2015-16 and the latest PMI data suggest the sector wasn't regaining momentum late in the year. Transitory factors like shutdowns in the auto and aerospace sectors are only partly to blame.

Rising trade barriers were a key factor in the manufacturing sector's underperformance last year. Recent easing in US-China trade tensions should lead to some improvement in sentiment, but uncertainty about US trade policy will likely continue to hold back investment.

US manufacturing output and sentiment

y/y % change in manufacturing output, PMI index (50+=increasing)



Source: Federal Reserve Board, Institute for Supply Management, RBC Economics

US trade policy uncertainty

news-based policy uncertainty index, 1985-10=100



Source: PolicyUncertainty.com, RBC Economics