RBC ECONOMICS | **RESEARCH**

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US tax cuts… to what effect?

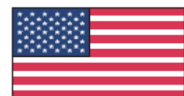
The US government pulled off their first big legislative win of the year, passing a $1.5 trillion tax bill in December that slashed the corporate rate and trimmed personal income taxes—at the expense of higher deficits. But while the prospect of fiscal stimulus helped boost interest rates and the US dollar following Trump's election, neither yields nor the currency were able to break out of recent ranges after the bill was passed. Treasuries sold off somewhat in mid-December but the move ultimately wasn't sustained and 10-year yields closed the year around 2.40%—just below where they started 2017. The US dollar, meanwhile, benefited little from the tax bill despite measures that encourage repatriation of foreign profits. The currency effectively treaded water in December and lost about 10% on a trade-weighted basis in 2017 as a whole.

The market reaction was relatively muted, but that is not to say the US tax cuts won't have any impact. We have upgraded our US GDP forecast by half a percentage point over the next two years as business investment and consumer spending are expected to get a boost from lower tax bills. With the economy already running at full capacity, fiscal stimulus provides even greater reason for the Fed to remain in tightening mode with once-a-quarter hikes in 2018—a faster pace than markets are currently pricing in. Combined with the prospect of greater Treasury supply to fund higher deficits, we think bond yields are set to break to the upside of the range that prevailed in 2017. This year should be a better one for the US dollar as well. We think the Fed will keep pace with the Bank of Canada in raising rates, and we don't expect much in the way of tightening from the Bank of England or European Central Bank. That will help avoid a repeat of 2017's US dollar selloff against the Canadian dollar, sterling and euro.

Central bank near-term bias

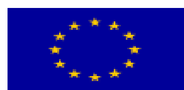
Three-months out, policy rate

A bit less caution from Governor Poloz raised the odds of a near-term hike, and we think December's banner jobs report sealed the deal for a move in January. We now expect the Bank of Canada will raise rates once a quarter in 2018, leaving the overnight rate at 2% by end of year.



The Fed raised rates in December and continued to signal three rate increases are likely in 2018. With the US economy getting a fiscal boost we think they might have to move even faster and expect once-a-quarter hikes this year starting with a move in March.

We think 2018 will be another year of middling growth for the UK economy as Brexit headwinds continue to blow. And with currency-induced inflation becoming less prominent, we don't think the Bank of England will need to follow up on last November's rate hike.



The euro area's solid growth has led to rumblings about the end of the European Central Bank's asset purchases. But with inflation still yet to respond to better economic conditions, we don't see the central bank rushing to remove accommodation.

Australia's economy is adding jobs at an impressive rate but wages are likely to pick up only gradually. Until inflationary pressures start to firm, we expect the Reserve Bank of Australia will remain on the sidelines with a steady cash rate in 2018.

With the Reserve Bank of New Zealand's new governor not taking the reins until late-March, we don't expect much in the way of policy changes when the central bank next meets in February.

Highlights

▲ Despite a pickup in domestic spending, US GDP growth was likely a bit more moderate in Q4 relative to 3% gains in Q2 and Q3.

▲ We think tax changes will boost US GDP growth by an additional 1/2 percentage point over the next two years relative to our previous forecast.

▲ Fiscal stimulus will show up in the form of stronger consumer spending, and to a lesser extent, greater business investment.

▲ With fiscal stimulus set to push the US economy beyond its longer run capacity limits, we think the Fed will pick up the pace of tightening in 2018.

US domestic spending picked up toward the end of 2017…

We think US GDP growth remained firm in Q4 following back-to-back gains of more than 3% in the prior two quarters. While earlier increases were helped by inventory investment and net trade, we expect Q4's gain was more domestic demand-driven with final sales rising at a 3% annualized rate for the first time since 2015. Our forecast assumes consumer spending led the charge, while business investment also continued to trend higher through the end of the year. Housing is also getting back in on the action after slowing in the middle of the year. Some of the increase in domestic demand was met by imports, so we expect overall GDP rose at a slightly more moderate 2.4% pace.

…with tax changes set to push the economy into overdrive

With the economy now operating close to its longer run capacity limits, we thought it would be tough to sustain 2-1/2% to 3% GDP growth in 2018. However, consumers and businesses are getting a shot in the arm from tax breaks that we think will help keep the economy growing at an above-trend pace this year. We assume the tax changes passed in December, including a heavily-reduced corporate rate and lower personal rates, among a host of other changes, will boost GDP by 3/4 of a percentage point over the next two years. That is half a percent more than the modest stimulus we previously assumed as a placeholder. As a result, we have raised our 2018 annual growth forecast to 2.6% from 2.5% and brought our 2019 projection up to 2.2% from 1.9%. The tax cuts for businesses and households are comparable on a dollar basis over that two year period, but we think the lions share of stimulus will show up in consumer spending as lower corporate tax cuts are likely to boost dividend payments and create wealth effects for households. Business investment is also likely to increase as some of the tax savings go to capital spending, reinforcing an improving trend seen over the last year.

We remain somewhat conservative in our estimates of the stimulative effect of these tax changes for two main reasons. For one, much of the tax savings—both from lower personal and corporate rates—will fall to higher-income households that tend to spend a smaller share of tax cuts than lower-income households. Secondly, with limited spare capacity in the economy, fiscal stimulus is likely to be offset by more restrictive monetary policy. Our forecast assumes the Fed will be less gradual in withdrawing accommodation than the 125 basis points of hikes they have penciled in over the next two years.

Fed can't tarry with fiscal boost in the pipeline

The Fed met expectations by raising the fed funds rate by 25 basis points in December, their third rate increase of the year. There were few changes to the policy statement but updated economic projections pointed to greater confidence in the economic outlook. The committee raised their GDP growth projections over the next three years, with 2018 in particular being lifted to 2.5% from 2.1% previously. Chair Yellen indicated that expected changes in tax policy (the meeting occurred prior to final passage of the tax bill) were responsible for some of the upward revision to growth forecasts. Despite stronger growth projections, inflation is forecast to remain close to the Fed's 2% objective and the 'dot plot' continued to show a median of three rate hikes are seen as appropriate in 2018.

Minutes from the meeting revealed diverging views among committee members. Some thought the three rate hikes implied in the 2018 dot plot were overly aggressive, citing limited inflationary pressure and concerns that the fed funds rate might already be close to its current neutral level. Others, however thought the Fed might have to move even faster this year. They pointed to little tightening in financial conditions since the Fed started raising rates and expressed concern that persistently interest rates would raise financial stability risks. We are with the latter camp in thinking the Fed will raise rates slightly faster than their latest dot plot indicated. We expect once-a-quarter increases in 2018 as policymakers try to get ahead of the inflationary impact of fiscal stimulus. Our forecast also assumes wages and inflation respond more to tight economic conditions than they did in 2017, providing the Fed with greater reason to tighten further.

Canadian GDP settled in at a more trend-like pace in H2/17…

Canadian GDP was unexpectedly flat in October following a 0.2% increase in September. As was the case over the summer when the economy appeared to hit a soft patch, temporary shutdowns in one industry (energy this time around) were responsible for some of October's weakness. Nonetheless, GDP growth clearly shifted to a more modest trend after 4% gains in the fist half of 2017. A soft start to Q4 points to GDP growth coming in closer to Q3's 1.7% increase than the Bank of Canada's 2.5% forecast.

On an expenditure basis it looks like consumer spending and business investment were once again the main drivers of domestic growth. We think the former slowed relative to the 4% pace seen earlier this year, though persistently strong job growth in Q4 argues against too much moderation. Business spending on machinery and equipment is expected to have posted another solid increase. But with much of that demand coming from imported capital goods, it looks like net trade won't provide much of a lift in the quarter—though that will represent an improvement from the sizeable drag in Q3. The add from trade has been disappointing all year, though recent export data does show a pickup in non-energy products that raises our hopes for the export sector in 2018—as long as trade isn't disrupted by a particularly bad outcome in Nafta negotiations.

…but job growth showed no signs of slowing

Canadian employment continued to defy gravity, adding nearly 80 thousand jobs for a second consecutive month in December—the best back-to-back gains in five years. That was pretty much the story of Canada's labour market throughout 2017 with jobs added each and every month to push employment up 422k on the year—the largest annual increase since 2002. With labour force participation holding steady, and near all-time highs for the 25-54 population, the unemployment rate dropped more than a percentage point over the course of the year. At 5.7% in December, unemployment is at its lowest rate since the 1970s. Even a broader measure of unemployment that includes discouraged and marginally attached workers and those in part-time jobs for economic reasons, is just above last cycle's lows—providing little evidence of 'hidden' labour market slack. Average hours worked, often watched by the Bank of Canada, also improved.

Perhaps more significantly, tight labour market conditions are finally starting to feed through to higher wages. Average hourly pay for permanent employees was up 2.9% from a year ago, having accelerated in each of the last six months. Wages will likely take another step higher in January with Ontario having raised the province's minimum wage by 20% at the start of the year. The Bank of Canada will likely look through the inflationary impact of that increase, but it is hard to deny that broader wage pressures are beginning to emerge. Along with the recent increase in several measures of core inflation, we think that argues for the central bank to not wait on the sidelines too long.

A hot labour market means the BoC won't be too cautious

The Bank of Canada left monetary policy unchanged at their final meeting of 2017 and continued to emphasize caution. But in a subsequent speech, Governor Poloz sounded a bit less dovish, indicating the central bank is "increasingly confident" that less stimulus will be required over time. That raised the odds of a hike in early-2018, and we think December's employment report sealed the deal for a move in January. The bank was concerned about lingering labour market slack even after November's solid jobs numbers, but with the unemployment rate falling again to a 40-year low in December, that is becoming increasingly hard to argue. We previously thought concerns about Nafta, and a desire to see the impact of earlier rate hikes and new mortgage regulations, would leave the BoC holding rates steady until April—and those issues remain. But with wages and inflation picking up, we think the central bank will be increasingly concerned about falling behind the curve in tightening monetary policy. We now look for a move in January and once-a-quarter hikes through the rest of the year, leaving the overnight rate at 2.00% by the end of 2018 rather than the 1.75% rate we previously expected.

Highlights

- ▲ Canada's 1.7% GDP growth over the second half of 2017 is less than half the pace of H1 but still marginally above the economy's longer run speed limit.
- ▲ It was hard to find fault with December's strong employment report.
- ▲ Inflation and wages are finally starting to respond to tight economic and labour market conditions.
- ▲ With unemployment hitting multi-decade lows we don't think the BoC will delay further rate hikes, even as Nafta concerns persist.

Highlights

▲ We expect the UK economy will grow 1.4% this year following a 1.8% increase in 2017.

▲ Broadly-based growth in the euro area continued in late-2017 but inflation is showing no signs of life.

▲ Australia's labour market is also on an impressive streak that, if continued, could see wage growth starting to pick up.

UK economy expected to muddle through 2018

The UK economy expanded at a not-too-hot, not-too-cold pace of 0.3-0.4% through the first three quarters of 2017 and we expect that continued through the end of the year. The latest survey data would put Q4 GDP growth in the upper end of that narrow range—manufacturing sentiment picked up in Q4 and the services PMI retraced the previous quarter's decline. But while improving factory readings jibe with a currency-related boost for exporters, higher import prices remain a sore point for households. So while the services sector appeared to improve in Q4, we aren't so sure that Q3's increase in consumer spending can be repeated. We continue to expect a 0.3% GDP gain in the final quarter of 2017, which would leave growth for the year as a whole at 1.5%—the slowest pace since 2012. We don't expect 2018 will be much better with the economy expanding 1.4% as consumer headwinds are slow to ease and Brexit-related uncertainty weighs on businesses. Near-trend growth should keep the economy from bumping up against capacity limits and will limit underlying inflationary pressures. Meanwhile, we think headline inflation readings are set to slip back from the 3% mark this year as earlier currency weakness is worked through. That will take some of the pressure off the Bank of England to follow up on November's rate hike. We continue to expect the bank rate will be held at 0.50% this year amid a middling macroeconomic environment and no shortage of uncertainty regarding the outlook.

Euro area economy remains on the up and up

The euro area economy appears to have maintained solid momentum in Q4 after stringing together the strongest four quarters of growth since 2011. December's purchasing managers' index readings built on November's increase to push the composite measure to a fresh multi-year high. Survey readings in Germany and France, in particular, posted solid gains in the final quarter of 2017 while Italy's readings have stabilized at a solid level after picking up earlier this year. Spain saw confidence dip somewhat in Q4, likely in response to political uncertainty in Catalonia. But overall the euro area remains on a solid growth track and we expect another above-trend 0.6% increase in Q4 GDP. We think 2018 will look much the same with the economy expanding 2.2%, nearly matching 2017's 2.3% gain. Inflation remains slow to respond to the improved macroeconomic backdrop, and while market-based measures of inflation expectations are beginning to creep higher, we think the European Central Bank will remain concerned with spot core inflation remaining around 1%. Thanks to improving growth there are already rumblings about an end to the central bank's QE program. But we think any talk of tapering won't begin in earnest until the summer. For now, the ECB is committed to asset purchases of €30 billion per month at least through September 2018. We think that keeps interest rate hikes off the table through this year.

Australia's job boom continues but won't push the RBA into action

Australia's labour market once again bested expectations with an impressive 62 thousand jobs added in November—the largest monthly increase in two years. The economy has now posted employment gains in each of the last fourteen months. And much of the 3.7% job growth over that period was in full-time positions. The increase is more a reflection of rising labour force participation than falling unemployment, though November's 5.4% jobless rate is still among the lowest in the last five years. We have previously argued that unemployment will need to fall below the 5-1/2% to 6-1/2% range seen in recent years to get any upward pressure on wages. So if the recent trend in job growth is sustained, we could see that dynamic starting to play out in 2018. We think the process will be gradual, however, as has been the case in other advanced economies. And with additional headwinds facing the household sector, we remain cautious on the outlook for consumer spending. Rising business investment and exports underpin our forecast for trend-like GDP growth in 2018 but we don't think that will be enough to bring the Reserve Bank of Australia off the sidelines this year. We continue to see a steady cash rate into early 2019.

Interest rate outlook

%, end of period

	Actuals				Forecast							
	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
Canada												
Overnight	0.50	0.50	1.00	1.00	1.25	1.50	1.75	2.00	2.25	2.25	2.25	2.25
Three-month	0.52	0.71	1.00	1.06	1.20	1.45	1.70	2.05	2.25	2.15	2.15	2.15
Two-year	0.75	1.10	1.52	1.69	1.75	2.05	2.25	2.45	2.60	2.50	2.40	2.30
Five-year	1.12	1.40	1.75	1.87	2.00	2.30	2.55	2.75	2.90	2.85	2.85	2.80
10-year	1.62	1.76	2.10	2.04	2.20	2.50	2.75	2.95	3.10	3.10	3.05	3.05
30-year	2.30	2.14	2.47	2.27	2.45	2.75	3.05	3.15	3.25	3.25	3.30	3.30
United States												
Fed funds**	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.50
Three-month	0.76	1.03	1.06	1.39	1.55	1.80	2.05	2.30	2.55	2.80	3.05	3.30
Two-year	1.27	1.38	1.47	1.89	2.10	2.35	2.55	2.75	3.00	3.25	3.40	3.55
Five-year	1.93	1.89	1.92	2.20	2.50	2.70	2.90	3.05	3.25	3.45	3.55	3.65
10-year	2.40	2.31	2.33	2.40	2.80	3.00	3.15	3.30	3.45	3.60	3.70	3.75
30-year	3.02	2.84	2.86	2.74	3.20	3.35	3.50	3.60	3.70	3.75	3.80	3.85
United Kingdom												
Bank rate	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Two-year	0.12	0.36	0.46	0.45	0.65	0.70	0.70	0.70	0.70	0.75	0.80	0.85
10-year	1.14	1.26	1.38	1.19	1.60	1.65	1.75	1.80	1.90	2.05	2.25	2.30
Euro area												
Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20
Two-year	-0.74	-0.57	-0.69	-0.63	-0.65	-0.65	-0.60	-0.50	-0.50	-0.50	-0.40	-0.30
10-year	0.33	0.47	0.47	0.43	0.65	0.65	0.70	0.80	1.00	1.05	1.25	1.25
Australia												
Cash target rate	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75	2.00	2.00	2.00
Two-year	1.76	1.78	1.94	2.00	2.00	2.10	2.25	2.40	2.50	2.60	2.60	2.60
10-year	2.70	2.60	2.84	2.63	2.90	3.10	3.40	3.55	3.85	4.10	4.10	4.05
New Zealand												
Cash target rate	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00
Two-year swap	2.31	2.32	2.19	2.20	2.20	2.30	2.40	2.50	2.60	2.75	2.80	2.80
10-year swap	3.41	3.35	3.24	3.13	3.40	3.60	3.80	3.95	4.10	4.30	4.40	4.35
Yield curve*												
Canada	87	66	58	35	45	45	50	50	50	60	65	75
United States	113	93	86	51	70	65	60	55	45	35	30	20
United Kingdom	102	90	92	74	95	95	105	110	120	130	145	145
Eurozone	107	104	116	106	130	130	130	130	150	155	165	155
Australia	94	82	90	63	90	100	115	115	135	150	150	145
New Zealand	110	103	105	93	120	130	140	145	150	155	160	155

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

Source: Reuters, RBC Economics Research

Central bank policy rate

%, end of period

		Current	Last	
United States	Fed funds	1.25-1.50	1.00-1.25	December 13, 2017
Canada	Overnight rate	1.00	0.75	September 6, 2017
United Kingdom	Bank rate	0.50	0.25	November 2, 2017

		Current	Last	
Eurozone	Deposit rate	-0.40	-0.30	March 10, 2016
Australia	Cash rate	1.50	1.75	August 3, 2016
New Zealand	Cash rate	1.75	2.00	November 10, 2016

Source: Bloomberg, Reuters, RBC Economics Research

Economic outlook

Growth outlook

% change, quarter-over-quarter in real GDP

	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	2016	2017F	2018F	2019F
Canada*	3.7	4.3	1.7	1.7	1.9	1.7	1.7	1.6	1.6	1.6	1.5	1.5	1.4	2.9	1.9	1.6
United States*	1.2	3.1	3.2	2.4	2.5	2.5	2.7	2.7	2.2	2.0	1.7	1.7	1.5	2.2	2.6	2.2
United Kingdom	0.3	0.3	0.4	0.3	0.3	0.4	0.3	0.4	0.3	0.4	0.3	0.4	1.9	1.8	1.4	1.4
Euro area	0.6	0.7	0.6	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	1.8	2.3	2.2	1.9
Australia	0.4	0.9	0.6	0.9	0.8	0.6	0.5	0.5	0.7	0.7	0.9	0.9	2.6	2.2	2.8	3.0
New Zealand	0.8	1.0	0.6	0.8	1.0	0.8	0.8	0.7	0.7	0.7	0.7	0.7	4.0	2.7	3.4	2.9

*annualized

Inflation outlook

% change, year-over-year

	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	2016	2017F	2018F	2019F
Canada	1.9	1.3	1.4	1.8	1.7	2.2	2.3	2.0	1.9	2.0	2.0	2.0	1.4	1.6	2.1	2.0
United States	2.5	1.9	2.0	2.1	1.7	2.1	2.0	1.5	1.7	1.9	2.0	2.1	1.3	2.1	1.8	1.9
United Kingdom	2.2	2.8	2.8	2.9	2.8	2.6	2.6	2.5	2.3	2.2	2.2	2.0	0.6	2.7	2.6	2.2
Euro area	1.8	1.5	1.4	1.4	1.2	1.3	1.4	1.4	1.4	1.4	1.5	1.5	0.2	1.5	1.3	1.5
Australia	2.1	1.9	1.8	2.0	2.1	2.5	2.4	2.3	2.3	2.5	2.6	2.7	1.3	2.0	2.3	2.5
New Zealand	2.2	1.7	1.9	1.8	1.4	2.0	2.1	2.0	2.0	2.0	2.0	2.0	0.6	1.8	2.0	2.0

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[1]	Nov	0.2	1.8	1.4	1.3
United States	Core PCE[1,2]	Nov	0.1	1.5	1.7	1.3
United Kingdom	All-items CPI	Nov	0.4	3.1	3.4	3.0
Euro area	All-items CPI[1]	Nov	0.2	1.5	1.5	0.9
Australia	Trimmed mean CPI[1]	Q3	0.4	1.8	N/A	N/A
New Zealand	All-items CPI	Q3	0.5	1.9	N/A	N/A

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

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

Currency outlook

Level, end of period

	Actuals				Forecast							
	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
Canadian dollar	1.33	1.30	1.25	1.26	1.33	1.30	1.27	1.24	1.25	1.26	1.27	1.27
Euro	1.07	1.14	1.18	1.20	1.12	1.10	1.08	1.12	1.12	1.13	1.13	1.14
U.K. pound sterling	1.26	1.30	1.34	1.35	1.24	1.21	1.17	1.20	1.20	1.22	1.22	1.23
New Zealand dollar	0.70	0.73	0.72	0.71	0.72	0.70	0.69	0.69	0.69	0.69	0.69	0.69
Japanese yen	111.4	112.4	112.5	112.7	107.0	105.0	107.0	109.0	112.0	115.0	118.0	120.0
Australian dollar	0.76	0.77	0.78	0.78	0.77	0.74	0.73	0.73	0.73	0.73	0.73	0.73

Canadian dollar cross-rates

	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
EUR/CAD	1.42	1.48	1.47	1.51	1.42	1.43	1.37	1.39	1.40	1.42	1.44	1.45
GBP/CAD	1.67	1.69	1.67	1.70	1.66	1.57	1.49	1.49	1.51	1.53	1.54	1.56
NZD/CAD	0.93	0.95	0.90	0.89	0.96	0.91	0.88	0.86	0.86	0.87	0.88	0.88
CAD/JPY	83.7	86.7	90.2	89.6	80.5	80.8	84.3	87.9	89.6	91.3	92.9	94.5
AUD/CAD	1.02	1.00	0.98	0.98	1.02	0.96	0.93	0.91	0.91	0.92	0.93	0.93

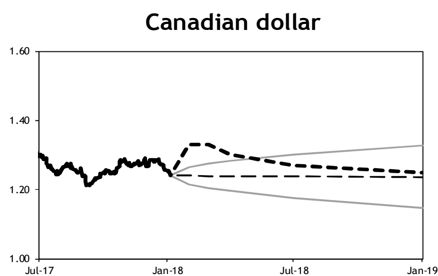
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

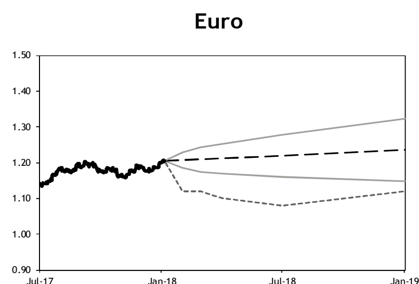
RBC Economics outlook compared to the market

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.

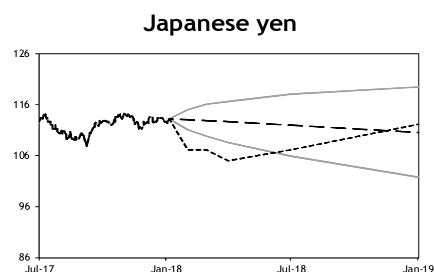
Canadian dollar



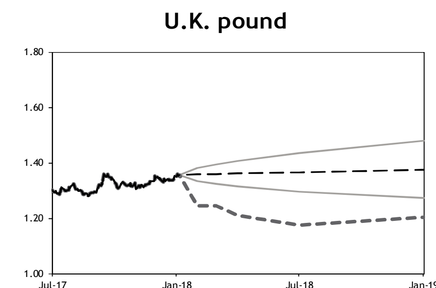
Euro



Japanese yen



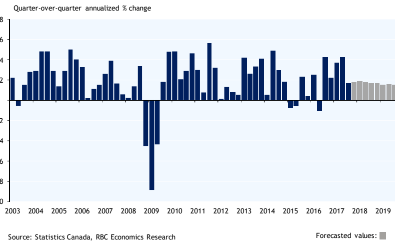
U.K. pound

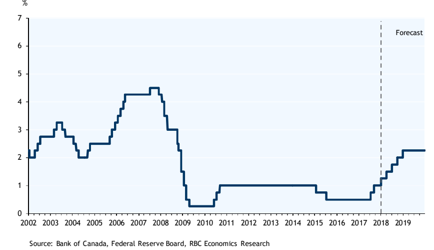


Bank of Canada

We think Canada's economy grew at a 1.7% annualized pace again in Q4, a bit short of the BoC's latest forecast. But strong job numbers should offset modest disappointment on the GDP front.

With the labour market looking very tight and wages and inflation starting to respond we now think the next rate hike will come in January rather than April.

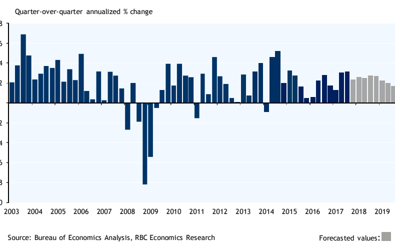


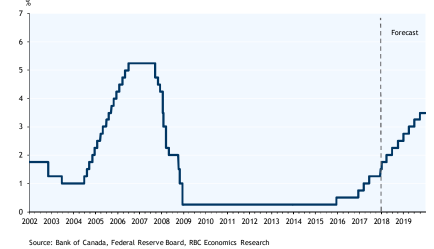


Federal Reserve

The US economy closed out 2017 with solid momentum, including a broadly-based increase in Q4 domestic spending. Tax cuts passed in December are set to boost growth over the next two years.

With fiscal stimulus likely to push the US economy into excess demand, we think the Fed will continue raising rates once a quarter in 2018—slightly faster than the three hikes envisioned in their December economic projections.

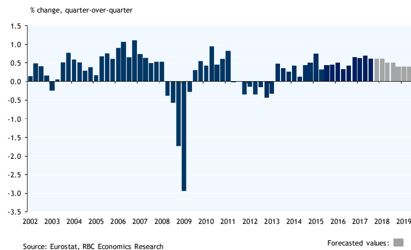


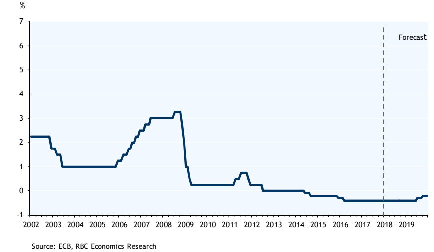


European Central Bank

Euro area GDP grew at its fastest annual pace in five years through Q3 and momentum appears to have been sustained through the end of the year. Solid growth is reflected in labour markets but isn't showing up in inflation.

The ECB is committed to asset purchases at least through September so we don't expect serious talk of tapering until the summer.

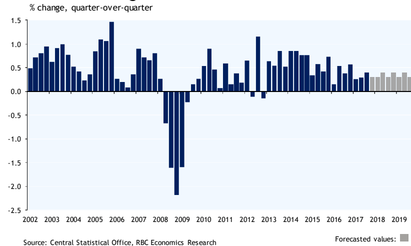


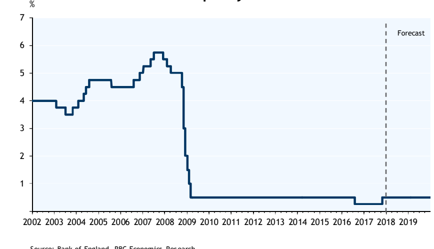


Bank of England

We think UK GDP growth is stuck in a 0.3-0.4% pattern that won't put much upward pressure on underlying inflation. Headline inflation is also set to slow from 3% as the earlier currency-driven increase in import prices begins to fade.

With unimpressive GDP growth and plenty of concern about Brexit developments we think the BoE will remain on the sidelines this year, making last November's rate increase a one-and-done move.

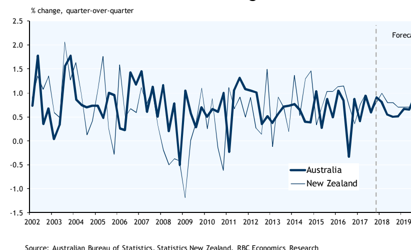


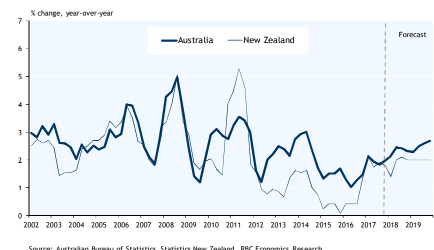


Australia and New Zealand

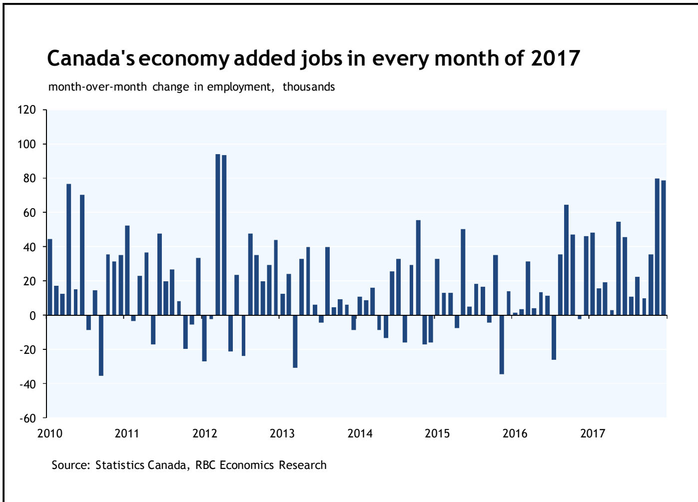
Australia is seeing a pickup in exports and business investment but consumer spending isn't expected to impress. We don't see the central bank raising their cash rate in 2018.

We think the RBNZ will remain on the sidelines under a new governor this year, keeping the cash rate at a record low of 1.75% well into 2019.

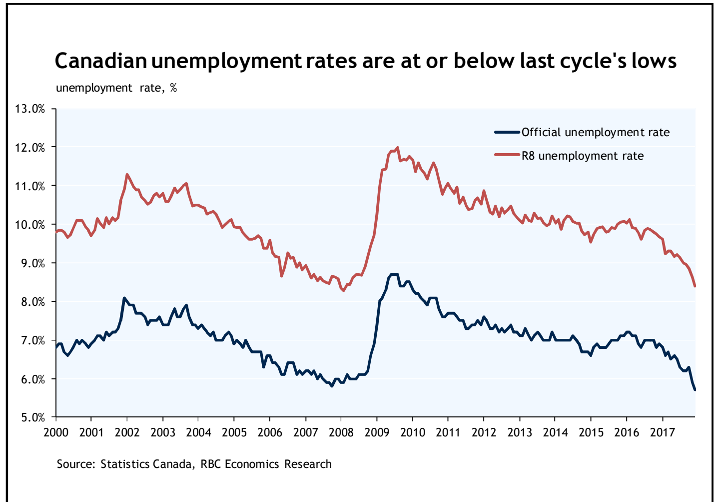




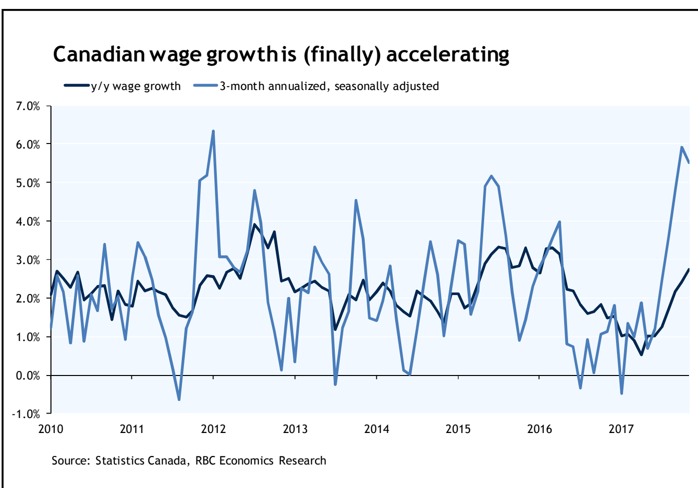
Canada's economy added jobs in all twelve months of 2017. The pace of hiring even managed to pick up at the end of the year with job gains of nearly 80 thousand in both November and December.



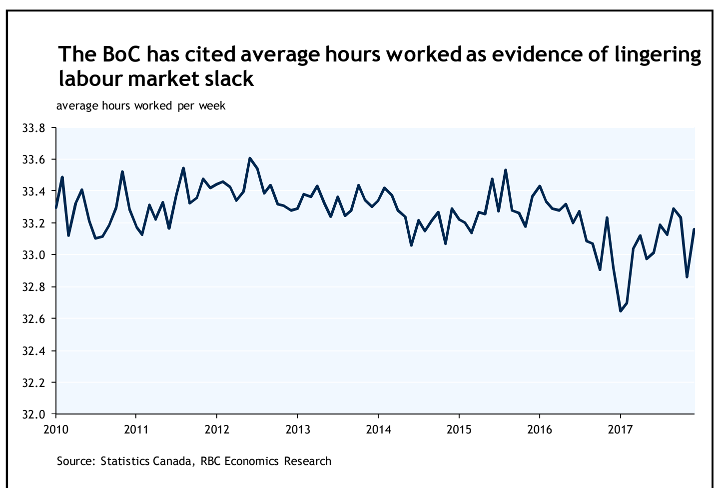
Strong hiring pushed Canada's unemployment rate to its lowest level since the 1970s. Even the broadest measure of unemployment, R8, was only slightly above last cycle's low in December—providing little evidence of 'hidden' labour market slack.



With labour market conditions continuing to tighten, wage growth has finally started to respond. The year-over-year increase in average hourly pay has accelerated since mid-2017 and annualized gains in the last three months are even stronger.



The Bank of Canada has cited a decline in average hours worked as evidence of lingering labour market slack. This measures remains a bit below trend but saw an encouraging bump higher in December.



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