

FINANCIAL MARKETS MONTHLY

July 12, 2019

An ounce (or two) of prevention

The central bank tide continued to turn over the past month with policymakers lowering rates (RBA), signaling near-term cuts (Fed, ECB) or simply sounding more dovish (BoC, BoE). The common thread is rising trade tensions and slowing global growth, which is already having a notable impact on some economies (particularly in Asia and Europe) and generating a good deal of uncertainty in others. While June’s G-20 meetings turned down the temperature on the US-China trade dispute, recent tariff increases remain in place. And simmering US trade tensions with the EU and Japan have curbed enthusiasm about broader de-escalation.

Adding to the uncertain global backdrop, policymakers are growing frustrated with their inability to hit inflation targets. The ECB stands out most in this regard with core inflation stuck around 1% and inflation expectations worryingly low. The central bank has shifted back to an easing bias, and we now see its deposit rate being lowered over the second half of the year. US inflation is closer to the Fed’s objective but has been below 2% for much of the last decade. With inflation pressures remaining “muted,” the Fed has the flexibility to introduce a bit of accommodation. We now expect fed funds will be lowered in July and September to offset the negative impact of trade tensions and slowing global growth. The BoC and BoE have had more success on inflation over the last year, contributing to a more neutral policy stance for now. But we expect trade issues at home and abroad will have both central banks lowering rates modestly in the next six months.

Central bank actions and intentions have boosted both equity and bond markets—a sign that investors think monetary policy support will be sufficient to offset trade headwinds. They seem to share Fed Chair Powell’s view that an ounce of prevention is worth a pound of cure.

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Central bank near-term bias



The BoC maintained its neutral forward guidance in July but struck a dovish tone, sounding more concerned about global developments. We think the BoC will remain on hold near-term but have penciled in a rate cut early next year.



In his congressional testimony, Fed Chair Powell seemed to endorse market expectations for a July cut. We think that move, and a follow-up cut in September, will be seen as enough “insurance” against trade and global growth risks.



Uncertainty at home and abroad is weighing on the UK economy and has the BoE sounding more dovish. We now expect a rate cut in November, after a likely extension of the October 31 Brexit deadline.



Easier monetary policy is now the ECB’s base case. We think it will lower its deposit rate further into negative territory over the second half of this year.



The RBA cut rates at back-to-back meetings but its latest guidance suggests a near-term pause. We think the cash rate is ultimately heading lower, though not until next year.



Highlights

▲ Stronger consumer spending likely helped US GDP growth remain above-trend in Q2.

▲ Both manufacturing and non-manufacturing sentiment fell to near-term lows in June.

▲ The Fed seems to be growing impatient with inflation undershooting its 2% objective.

▲ We now expect the Fed will lower rates in July and September.

Mixed US indicators still point to 2% growth

Recent US economic data have been mixed but don't make an overwhelming case for lower rates at this stage. Q2 growth is looking solid—we continue to track a 2.2% annualized increase, down from 3.1% in Q1 but with a healthier composition. The US consumer's slow start to the year is proving to be a temporary blip with spending growth likely getting back to a 3.5% pace in the latest quarter. Housing activity, after softening for more than a year as the Fed raised rates, has shown signs of life thanks to an easing in financial conditions more recently. And business investment is poised to increase in Q2, albeit at a relatively slow rate. There is little to be concerned about in the labour market. Job growth rebounded nicely in June and the average pace of hiring this year, while down from 2018, has been enough to put downward pressure on the unemployment rate. Wages continue to rise at a healthy (but not inflationary) rate.

There are soft spots, though. The US industrial sector is losing momentum and manufacturing sentiment is slipping (two themes that are being observed globally). Even the latest ISM non-manufacturing report featured complaints about trade uncertainty or tariff-related cost increases (though overall sentiment remained close to its long-run average). And while business investment will add to growth in Q2, capex orders point to less momentum going forward. At the same time (and to no surprise) tariffs have done little to rein in the US trade deficit. A surge in imports in May suggests net trade was a drag on growth in Q2, and we see little prospect of the trade balance improving in a slower global growth environment. We don't think these data signal the beginning of the end for the current economic expansion, which is now the longest in US history. But it looks like they've been enough to convince the Fed that a bit of accommodation is needed.

Inflation making the case for cuts?

The case for lower rates has also been built on "muted" inflation pressures. The PCE deflator, the Fed's preferred measure, held below 2% for a seventh consecutive month in May and core inflation remained stuck at 1.6%. Chair Powell was somewhat dismissive of low inflation readings after the Fed's May meeting—saying the recent slowdown should be transitory—but has been less emphatic on that point recently. It's hard to see what has changed. Core inflation actually appears to have a bit more momentum, running at a 2% annualized rate in the last three months. And the Dallas Fed's trimmed inflation measure, which Powell pointed to back in May, remains at 2%.

It could be that policymakers are growing impatient with their inability to get inflation back to target on a sustained basis. Core PCE has been 2% or higher for just six months in the last decade. This persistent undershoot might be weighing on inflation expectations. Market-based inflation compensation remains low (five-year breakevens around 1.5-1.6%) and survey-based measures of expected inflation (also over the next five years) are at record lows. That has some of the FOMC thinking a period of above-2% inflation might be needed to push inflation expectations higher.

Markets prepped for a Powell put

The Fed has done little to push back against growing expectations for cuts. The central bank's June meeting was more dovish than expected, with the dot plot showing roughly half of committee members think two rates cuts will be appropriate by the end of the year. Even those not calling for a move thought the case for easing had strengthened. The post-meeting statement—dropping reference to being "patient" and instead saying the committee would "act as appropriate" to sustain the expansion—was seen as an indication that rates could be lowered as soon as July. With a relatively positive G-20 outcome and strong payroll report doing little to change Powell's view, we now expect a 25 basis point cut in July and a follow-up move in September. We don't think this is the start of a full-on easing cycle; rather, these cuts are about providing a bit more accommodation to offset trade headwinds. 50 basis points of easing (in total) would fall short of what markets are currently pricing in over the next year, but should be enough to placate investors that are concerned monetary policy has become a bit too restrictive.



Canada's energy slowdown continues to ease

Despite rising global headwinds, recent Canadian data have been broadly positive and there is growing evidence of the economy emerging from its Q4/18-Q1/19 slowdown. April GDP was up 0.3%, handily beating expectations for a second consecutive month. Unlike in March, growth was concentrated in the energy sector, which was a major drag on activity over the winter. Some of the increase is likely to be temporary—oil companies ramped up production rather than undertaking usual maintenance, so we should see some give-back in the coming months—but rising drilling activity and further easing in production restrictions suggest the energy sector's recovery is becoming entrenched.

Canada's non-energy economy continues to chug along. Housing hasn't exactly turned from headwind to tailwind like the energy sector, but recent stabilization is encouraging. Consumer spending is also emerging from a winter slump with retail sales up an annualized 3% in the last three months. Other services sectors like wholesale trade, hospitality, and tech continue to expand at a solid rate. Manufacturing has shown some signs of weakness, though not to the extent seen in other economies. While exports jumped higher in May, the increase isn't likely to be sustained—manufacturing sentiment has fallen sharply amid rising trade tensions and slowing global industrial production. Overall, however, Q2 GDP growth is tracking a 2.2% annualized pace with healthy contributions from both energy and non-energy industries.

Business Outlook Survey better than expected (feared) in Q2

Business confidence fell sharply in Q1; rising trade tensions and a decline in manufacturing sentiment had us concerned about a further slip in Q2. But the BoC's latest Business Outlook Survey was stronger than expected with overall sentiment moving back above its longer-term average (though only slightly). The future sales indicator posted a solid increase, with foreign sales likely to see modest growth even as firms expect global trade headwinds and uncertainty will restrain exports. In fact, concerns about global trade tensions were less prevalent than expected—among factors restraining sales, capacity pressures and domestic regulation ranked higher than trade policy. With domestic demand remaining supportive, hiring and investment intentions remained slightly above longer-term levels. Overall, the Q2 BOS was about as good as the BoC could have hoped for given global developments during the May survey period.

BoC sounding more concerned about global risks

With a run of positive economic data and a less worrying Business Outlook Survey in hand, we thought the Bank of Canada would come out with a neutral tone again in July. They did maintain a neutral bias—saying current accommodation remains appropriate—but sounded more concerned about global developments than in May. Whereas the last policy statement put an improving domestic economy front and centre, July's led with rising trade tensions and a deteriorating global outlook. The BoC lowered its global growth forecast this year and next, and said escalating trade conflicts are the biggest downside risk to the outlook globally and in Canada. And while marking up its Q2 growth forecast, Governing Council pointed out that some of the increase will be from temporary factors, and growth is expected to moderate somewhat in Q3. GDP growth was revised lower for 2020, largely due to less contribution from business investment and exports, but is still expected to average around 2%.

Overall, the BoC thinks trade conflicts and uncertainty will reduce the level of GDP by up to 2% by the end of 2021. Given that sizeable headwind, it's no surprise policymakers were sounding more cautious in July. For now, though, the BoC looks set to diverge from the Fed, holding rates steady while the US central bank cuts. Firmer core inflation in Canada (close to 2% for the last year) and an already more-accommodative stance give the BoC some leeway in that regard. But its latest comments suggest further deterioration in the global outlook, or an increase in trade tensions, would see the BoC joining its global peers in lowering rates. We have penciled in a 25 basis point rate cut in early-2020 that should help take some pressure off the Canadian dollar, which has increased 2.5 cents in the last six weeks thanks to the Fed's dovish shift.

Highlights

- ▲ Canadian GDP growth likely rebounded to a 2.2% pace in Q2 after limited gains in the prior two quarters.
- ▲ A pickup in the energy sector contributed to stronger growth and exports in Q2.
- ▲ Business sentiment improved in the second quarter despite growing trade tensions.
- ▲ The BoC remains in neutral (officially) but sounded more concerned about the global outlook.



Highlights

▲ It looks like UK GDP was flat in Q2 after Brexit-related stockpiling boosted Q1 growth.

▲ We think extension of the October 31 Brexit deadline is the most likely scenario, but a no-deal exit can't be ruled out.

▲ The euro area's manufacturing sector remains under pressure.

▲ We think the RBA will pause to evaluate the impact of new fiscal and monetary stimulus.

BoE shifting from tightening bias to easing

Recent data show the UK economy struggling amid Brexit uncertainty and a softening European and global growth backdrop. Manufacturing output has been volatile due to Brexit-related stockpiling and unusual seasonal shutdowns in the auto sector. Overall production was flat year-over-year in May—likely a good indication of the underlying trend—and the latest PMI readings show little momentum heading into Q3. Growth in services industries (80% of the UK economy) has also geared down, posting just a single monthly gain in the last three. That's consistent with services PMIs that have bounced around the 50 'no change' mark since late last year. On balance, it looks like GDP was flat in Q2 after a 1/2% gain in Q1. The economy should return to growth over the second half of this year, but we expect a sub-trend pace of around 1/4%, on average. Growing external headwinds and an increase in Brexit tensions (heading toward October 31) are expected to weigh on activity. Odds of a no-deal Brexit have increased, though we think the likeliest scenario is that parliament pushes back against that strategy, potentially triggering a general election. That would require a further extension of the Article 50 deadline, effectively prolonging this period of uncertainty for UK businesses. Given Governor Carney's growing concerns about the impact of trade and Brexit tensions, we think such a scenario (now our base case) will see the Bank of England joining the Fed and ECB in lowering rates. Our forecast assumes a 25 basis point cut to the bank rate in November.

ECB set to add more stimulus

Recent data suggests the euro area's pickup in growth early this year was short-lived. A slowdown in the manufacturing sector is becoming entrenched, particularly in Germany. Industrial production likely returned to drag on growth in Q2, and recent PMI data show little momentum heading into Q3. Retail sales have also softened in recent months, though data for the broader services sector has been more positive. Services PMIs ticked higher in all major euro area economies in June, with the overall index hitting a year-to-date high. Easing in political uncertainty and less unrest in France and Italy has likely helped in that regard. But despite signs of domestic resilience, growing external headwinds are likely to keep the euro area from growing at an above-trend rate. We have lowered our 2019 GDP forecast for the currency bloc to 1.1%, which would be the slowest in six years. A subdued growth outlook, along with persistently low inflation and declining inflation expectations, has the ECB contemplating further easing. In particular, President Draghi noted that more stimulus should be expected unless economic conditions improve (he previously said conditions would need to deteriorate to warrant further action). We now expect the ECB will lower its deposit rate from -0.4% to -0.6% over the second half of this year via 10 basis point rate cuts in September and December. It is also likely to signal that further QE is on the table, though we don't think asset purchases will restart in the near-term.

RBA pausing its easing cycle, for now

The Reserve Bank of Australia was first out of the gate (second to the RBNZ, actually) in the nascent, global shift toward lower rates. It followed up its May cut with another move at the beginning of July. A tweak to its policy statement—monetary policy will be adjusted "if needed" to support growth—seems to signal a pause for now. We think the RBA will want to evaluate the impact of its latest moves, as well as fiscal measures (including income tax cuts) before contemplating further easing. That said, the RBA has left the door open to more cuts if the labour market softens further or inflation continues to disappoint. The unemployment rate has ticked up to 5.2% in Q2, about 3/4 percent above what the RBA views as consistent with full employment, and the underemployment rate is less than 1/2 percent from its record high. Without a return to above-trend growth, which we don't anticipate, it's hard to see inflation moving back into the middle of the RBA's 2-3% target. Combined with a softening in the global economic backdrop and (expected) easing from other central banks, we don't think the RBA will be on the sidelines for long. Our forecast now assumes the cash rate will be lowered by 50 basis points over the first half of next year, bringing it to a new low of 0.50%.



Interest rate outlook

%, end of period

	Actuals						Forecast					
	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4
Canada												
Overnight	1.25	1.25	1.50	1.75	1.75	1.75	1.75	1.75	1.50	1.50	1.50	1.50
Three-month	1.10	1.26	1.59	1.64	1.67	1.66	1.65	1.60	1.40	1.40	1.40	1.40
Two-year	1.78	1.91	2.21	1.86	1.55	1.47	1.60	1.45	1.35	1.40	1.45	1.50
Five-year	1.97	2.07	2.34	1.89	1.52	1.39	1.60	1.55	1.45	1.50	1.55	1.65
10-year	2.09	2.17	2.43	1.97	1.62	1.47	1.70	1.70	1.60	1.60	1.70	1.80
30-year	2.23	2.20	2.42	2.18	1.89	1.69	1.85	1.85	1.90	1.95	2.00	2.00
United States												
Fed funds**	1.75	2.00	2.25	2.50	2.50	2.50	2.00	2.00	2.00	2.00	2.00	2.00
Three-month	1.73	1.93	2.19	2.45	2.40	2.12	1.90	1.90	1.90	1.90	1.90	1.90
Two-year	2.27	2.52	2.81	2.48	2.27	1.75	1.85	1.90	1.95	2.00	2.10	2.15
Five-year	2.56	2.73	2.94	2.51	2.23	1.76	1.85	1.95	2.00	2.10	2.20	2.30
10-year	2.74	2.85	3.05	2.69	2.41	2.00	2.05	2.15	2.25	2.30	2.35	2.45
30-year	2.97	2.98	3.19	3.02	2.81	2.52	2.55	2.60	2.65	2.70	2.75	2.80
United Kingdom												
Bank rate	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.50	0.50	0.50	0.50	0.50
Two-year	0.82	0.72	0.82	0.75	0.63	0.62	0.60	0.55	0.60	0.60	0.60	0.60
10-year	1.34	1.28	1.57	1.27	0.99	0.84	0.75	0.85	0.90	1.00	1.10	1.10
Euro area												
Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60
Two-year	-0.59	-0.69	-0.55	-0.59	-0.60	-0.73	-0.80	-0.80	-0.80	-0.80	-0.75	-0.75
10-year	0.50	0.31	0.47	0.25	-0.07	-0.33	-0.40	-0.20	-0.10	-0.05	0.00	0.00
Australia												
Cash target rate	1.50	1.50	1.50	1.50	1.50	1.25	1.00	1.00	0.75	0.50	0.50	0.50
Two-year	2.00	2.00	2.02	1.89	1.47	0.98	0.90	0.75	0.70	0.70	0.70	0.80
10-year	2.60	2.63	2.67	2.32	1.78	1.32	1.45	1.45	1.50	1.55	1.65	1.75
New Zealand												
Cash target rate	1.75	1.75	1.75	1.75	1.75	1.50	1.25	1.25	1.25	1.25	1.25	1.25
Two-year swap	2.21	2.14	2.02	1.96	1.62	1.35	1.25	1.25	1.30	1.45	1.55	1.75
10-year swap	3.06	3.02	2.89	2.64	2.15	1.78	1.75	1.85	1.95	2.10	2.20	2.35
Yield curve*												
Canada	31	26	22	11	7	0	10	25	25	20	25	30
United States	47	33	24	21	14	25	20	25	30	30	25	30
United Kingdom	52	56	75	52	36	22	15	30	30	40	50	50
Eurozone	109	100	102	84	53	40	40	60	70	75	75	75
Australia	60	63	65	43	31	34	55	70	80	85	95	95
New Zealand	85	88	87	68	53	43	50	60	65	65	65	60

* 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	2.25-2.50	2.00-2.25	December 20, 2018	Eurozone	Deposit rate	-0.40	-0.30	March 16, 2016
Canada	Overnight rate	1.75	1.50	October 24, 2018	Australia	Cash rate	1.00	1.25	July 3, 2019
United Kingdom	Bank rate	0.75	0.50	August 1, 2018	New Zealand	Cash rate	1.50	1.75	May 8, 2019

Source: Bloomberg, Reuters, RBC Economics Research



Economic outlook

Growth outlook

% change, quarter-over-quarter in real GDP

	<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>	<u>2017</u>	<u>2018</u>	<u>2019F</u>	<u>2020F</u>
Canada*	1.5	2.5	2.1	0.3	0.4	2.2	2.2	1.8	1.8	1.7	1.7	1.6	3.0	1.9	1.4	1.8
United States*	2.2	4.2	3.4	2.2	3.1	2.2	1.5	1.7	1.8	1.9	1.8	1.7	2.2	2.9	2.6	1.8
United Kingdom	0.1	0.4	0.7	0.2	0.5	0.0	0.2	0.3	0.3	0.3	0.4	0.4	1.8	1.4	1.3	1.2
Euro area	0.4	0.4	0.1	0.2	0.4	0.2	0.3	0.3	0.3	0.4	0.4	0.3	2.5	1.9	1.1	1.3
Australia	1.0	0.9	0.3	0.2	0.4	0.5	0.6	0.7	0.5	0.7	0.7	0.7	2.4	2.8	1.8	2.5

*annualized

Inflation outlook

% change, year-over-year

	<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>	<u>2017</u>	<u>2018</u>	<u>2019F</u>	<u>2020F</u>
Canada*	2.1	2.3	2.7	2.0	1.6	2.2	2.0	2.4	2.5	2.1	2.2	2.0	1.6	2.3	2.1	2.2
United States*	2.2	2.7	2.6	2.2	1.6	1.8	1.8	1.9	2.2	2.1	2.2	2.1	2.1	2.4	1.8	2.1
United Kingdom	2.7	2.4	2.5	2.3	1.8	2.2	1.9	1.8	2.2	2.1	2.1	2.1	2.7	2.5	1.9	2.1
Euro area	1.3	1.7	2.1	1.9	1.4	1.4	0.8	1.1	1.2	1.4	1.4	1.4	1.5	1.8	1.2	1.3
Australia	1.9	2.1	1.9	1.8	1.3	1.5	1.5	1.4	1.9	1.9	2.0	2.1	1.9	1.9	1.4	2.0

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	May	0.3	2.4	2.5	2.2
United States	Core PCE ^{1,2}	May	0.2	1.6	1.4	1.6
United Kingdom	All-items CPI	May	0.3	2.0	2.9	1.4
Euro area	All-items CPI ¹	Jun	0.0	1.2	2.2	0.9
Australia	Trimmed mean CPI ¹	Q1	0.3	1.6	N/A	N/A
New Zealand	All-items CPI	Q1	0.1	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	1.28	1.29	1.30	1.31	1.32	1.33
Euro	1.23	1.17	1.16	1.15	1.12	1.14	1.10	1.12	1.14	1.15	1.15	1.18
U.K. pound sterling	1.40	1.32	1.30	1.28	1.30	1.27	1.25	1.27	1.30	1.31	1.31	1.34
Japanese yen	106.3	110.8	113.7	109.7	110.9	107.9	111.0	113.0	115.0	114.0	113.0	112.0
Australian dollar	0.77	0.74	0.72	0.71	0.71	0.70	0.69	0.68	0.67	0.67	0.66	0.66

Canadian dollar cross-rates

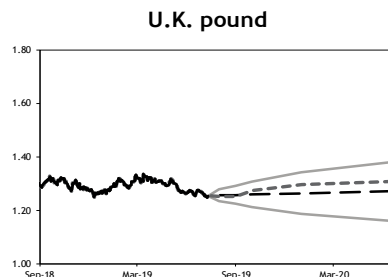
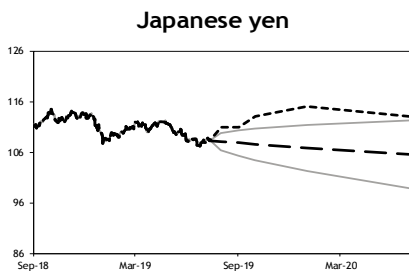
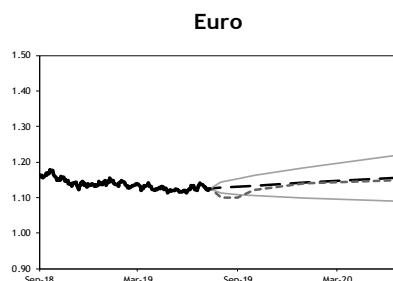
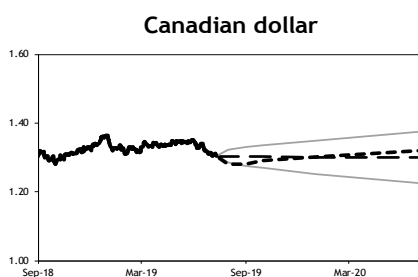
	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4
EUR/CAD	1.59	1.53	1.50	1.56	1.50	1.49	1.41	1.44	1.48	1.51	1.52	1.57
GBP/CAD	1.81	1.74	1.68	1.74	1.74	1.66	1.60	1.64	1.68	1.71	1.73	1.78
CAD/JPY	82.4	84.3	88.1	80.4	83.0	82.4	86.7	87.6	88.5	87.0	85.6	84.2
AUD/CAD	0.99	0.97	0.93	0.96	0.95	0.92	0.88	0.88	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.





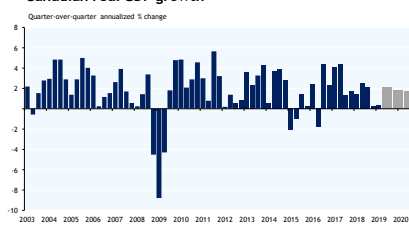
Central bank watch

Bank of Canada

The Bank of Canada revised up its Q2 growth forecast by 1 percentage point on the back of stronger-than-expected March and April GDP reports.

But the central bank expressed greater concern about global growth and trade tensions, and marked down its 2020 growth forecast. While the BoC's official guidance remains neutral, we think odds favour a cut early next year.

Canadian real GDP growth



Canadian overnight rate

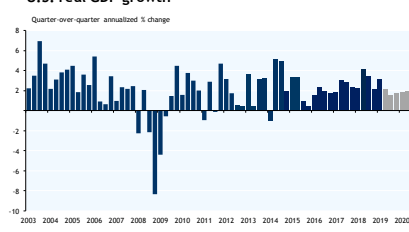


Federal Reserve

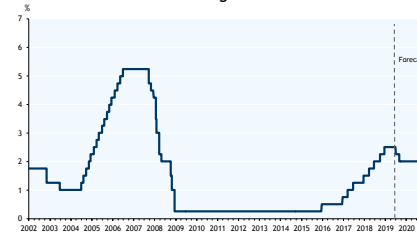
A strong pickup in consumer spending should keep the US economy growing at an above-trend rate (2.2%) in Q2.

Despite solid growth and a healthy labour market, the Fed sounds increasingly concerned about trade policy and global developments. We now expect it will lower rates in July and September, providing a bit of accommodation to offset those headwinds.

U.S. real GDP growth



U.S. target rate

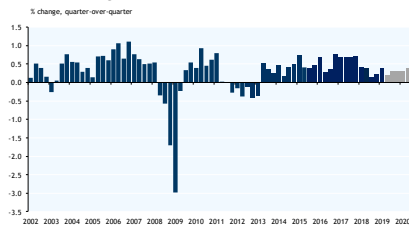


European Central Bank

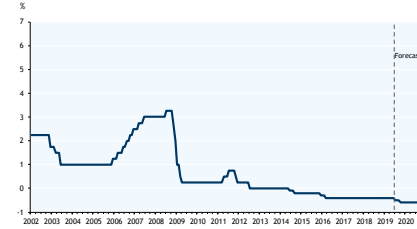
While the services sector has shown signs of improvement lately, manufacturing remains a drag on activity and should keep the euro area economy from growing at an above-trend rate.

With the economy not generating much inflationary pressure (and inflation expectations coming down) it looks like the ECB will add more stimulus over the second half of the year.

Euro area GDP



ECB Deposit rate

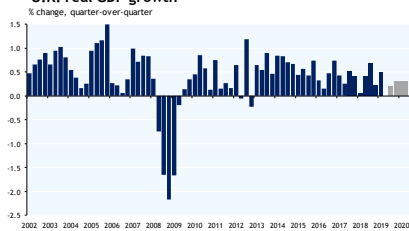


Bank of England

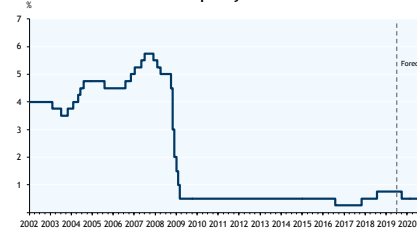
UK GDP was likely flat in Q2 with the services sector posting only modest growth while manufacturing saw an unwind of Brexit-related stockpiling.

The latest comments from BoE Governor Carney showed more concern about trade developments and their impact on the UK economy—a far cry from the earlier guidance for gradual and limited rate hikes. We now expect a rate cut in November.

U.K. real GDP growth



U.K. policy rate

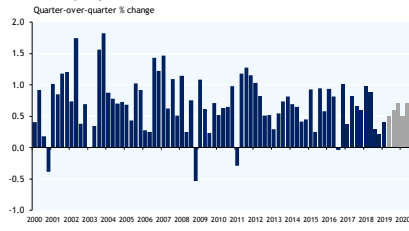


Reserve Bank of Australia

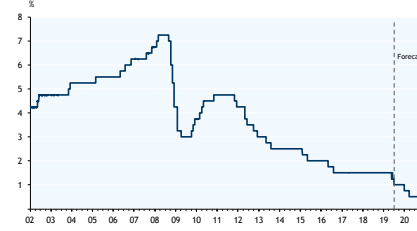
The Reserve Bank of Australia's latest estimate of NAIRU suggests the economy is even further from full employment than previously thought—and thus further from generating any inflationary pressure.

The RBA is expected to pause its easing cycle over the second half of this year, though cuts from other central banks and persistently sub-trend growth should see it lower the cash rate further in 2020.

Real GDP: Australia



Australia policy rates

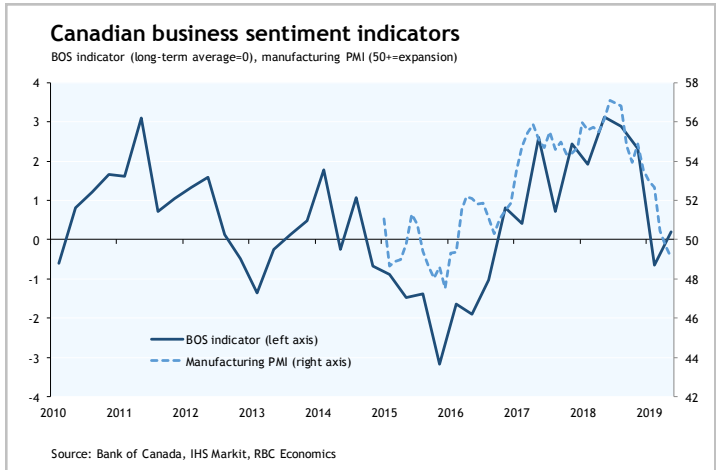
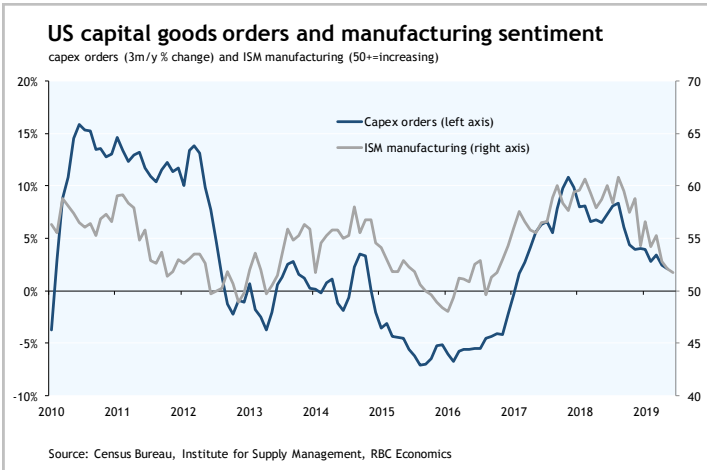




Central bank pain points

Fed Chair Powell has expressed growing concern about the impact that rising trade tensions and slowing global growth are having (or will have) on the US economy. Both manufacturing sentiment and capex orders have softened this year, a sign of greater uncertainty in the industrial sector.

Canadian manufacturing sentiment has fallen sharply in recent months. The BoC's Business Outlook Survey, which covers a broader range of industries, has also shown a decline in confidence this year, though Q2's reading was slightly above its long-run average.



In the UK, manufacturing sentiment has fallen sharply in the last two months (now below post-referendum lows) and the services PMI is pointing to limited growth. Rising uncertainty at home (Brexit) and abroad (trade tensions, slowing global growth) had BoE Governor Carney sounding more dovish in July.

Euro area core inflation has been stuck around 1% in the last several years and inflation expectations have declined over the last six months. With modest growth making it difficult to generate higher inflation, the ECB looks set to lower interest rates over the second half of this year.

