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Josh Nye
Economist
416-974-3979
josh.nye@rbc.com

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Political ups and downs

Politics were once again in focus over the last month. This year's most anticipated vote, the French presidential election, saw the rising tide of populism stemmed by centrist candidate Emmanuel Macron in a decisive victory over Marine Le Pen on May 7. Markets reacted positively to news that the pro-EU and pro-euro Macron is set to take charge of the currency bloc's second -largest economy. Reduced political uncertainty should help sustain recent improvement in euro area sentiment, paving the way for further economic recovery. Next up is the UK heading to the polls on June 8. Prime Minister May called a snap election just weeks after invoking Article 50 which initiated the Brexit negotiation process. The Conservatives are seeking to strengthen their mandate as divorce proceedings begin, though recent indications are that the process will be contentious with EU officials establishing a tough bargaining position.

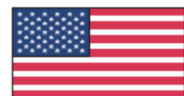
Relations have also been less than friendly between North American trading partners. The Trump Administration has stepped up its protectionist rhetoric, recently threatening to unilaterally withdraw from NAFTA and ordering a broad review of US trade agreements. Trump has singled out Canada specifically, slapping tariffs on softwood lumber imports and criticizing supply management in the dairy industry. Tough talk on trade was one of several factors that put downward pressure on the Canadian dollar in April, even as the domestic economy continues to improve.

All of this is unfolding against an improving global economic backdrop. The IMF's latest outlook saw global growth revised up this year for the first time in recent memory. The agency warned, however, that inward-looking policies threaten global integration and any associated reduction in trade and investment flows pose downside risk to the economic outlook.

Central bank near-term bias

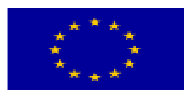
Three-months out, policy rate

The Bank of Canada shifted to a "decidedly neutral" stance in April even as they revised up growth forecasts and brought forward the expected closing of the output gap. However, given the rising risk of US trade protectionism, we still expect monetary policy will be on hold this year.



The Fed seems to be looking through a few recent, soft data points including disappointing Q1 GDP. We expect signs of a rebound in growth will push the Committee toward another rate hike in June.

Rising inflation but slowing growth is making for a tough tradeoff for the Bank of England, though we expect they will use their flexible mandate to hold policy steady this year as the economy struggles with sub-potential activity.



ECB President Draghi noted an improving economic outlook in the euro area but was keen to emphasize that conditions that would warrant a withdrawal of stimulus are far from being met. Even the central bank's easing bias isn't likely to disappear in June.

The RBA sounds more optimistic about the economic outlook thanks to strengthening global growth. We continue to see a soft out look domestically, but think the RBA is in no rush to ease policy near-term.

The RBNZ still holds a mild easing bias, but with growth remaining strong and signs that underlying inflation is gradually rising, we expect the central bank's easing cycle has come to an end.

Highlights

▲ US Q1 consumer spending growth was the weakest in years but we don't expect the slowdown will last.

▲ Other details in the Q1 GDP report were more encouraging, particularly a pickup in business investment.

▲ The Trump Administration's latest tax proposal called for cuts to personal and corporate income taxes but was light on details.

▲ The Fed indicated slower Q1 growth is likely to prove transitory, leaving the door open to another rate hike in June.

Slower US consumer spending in Q1 not expected to persist…

US GDP growth slowed to just 0.7% (annualized) in Q1, marking the weakest quarterly gain in three years. In addition to a pullback in inventories that trimmed nearly a percentage point from the headline rate, much of the slowdown was due to a paltry 0.3% increase in consumer spending. The latter is the slowest since 2009, and is hard to square with a number of factors supporting US households: rising wages and solid job growth, 25-year-high consumer confidence, wealth effects from rising equity and home prices, and low interest rates. Temporary factors were partly to blame—a substantial decline in utilities spending amid unseasonably warm weather early in the year shaved about ½ percentage point from consumer spending growth in the quarter. March's PCE already indicated a partial rebound in utilities spending that should continue as temperatures return to seasonal norms. Another soft spot in consumer spending was auto sales, though that too is showing some signs of reversal with unit sales picking up modestly in April from a two-year-low in March. In addition to reversal of those transitory factors, we expect broad-based strengthening (again reflecting households' positive financial backdrop) will contribute to consumer spending growth returning to the 3% range in the second quarter.

…while stronger business investment should persist

Putting aside the slowdown in consumer spending, there were some encouraging details in the Q1 GDP report. Business investment jumped by nearly 10% (annualized) to start the year after having been more or less flat since the end of 2014. Some of the increase in structures investment was due to a nascent rebound in energy investment after the sector weighed on growth for much of the last two years. With oil prices forecast to return to levels above $50/barrel we expect the improving trend in oil and gas investment will continue—indeed, rig counts continued to rise in the second quarter to-date. And the improvement in Q1 business investment was not confined to the energy sector; equipment investment also saw a broadly-based increase. Adding to that another strong gain in the housing sector, private fixed investment rose at its fastest pace in five years in Q1. We don't expect above-10% investment growth can be sustained, but given improving business and consumer sentiment and accommodative financial conditions, we think the trend will remain positive going forward.

Some of the recent improvement in business sentiment likely reflects expectations of lower corporate taxes and a lighter regulatory touch under the Trump Administration. However, there remains considerable uncertainty regarding the timing and scale of any changes in tax policy. The Administration's latest proposal continued to call for a reduction in the corporate tax rate to 15%. But with the plan lacking in detail, including how tax cuts will be financed, it is difficult to say whether it would get through Congress.

Fed not too concerned about soft start to the year

The Fed left rates unchanged in May and maintained a balanced tone despite a few recent data hiccups. The statement explicitly indicated that slower growth early this year is "likely to be transitory"—in fact, their take on Q1 growth was similar to ours: the slowdown in consumer spending appears anomalous given solid fundamentals, while other details were a bit more encouraging, including a pickup in business fixed investment. The statement made little mention of March's disappointing payroll figure, recognizing that recent job gains have been solid on average and that the unemployment rate declined. The Committee did, however, make note of softer core inflation in March, though we would add that the dip in core PCE and CPI inflation was narrowly-based with about half the slowing reflecting lower prices for mobile phone services (something policymakers would be expected to look through). Aside from a mark-to-market of the economic outlook, there were no notable changes in the policy statement. The Committee reiterated their expectation that economic conditions will warrant a gradual removal of accommodation but gave no overt signal on the timing of the next hike. Our forecast assumes the next move will be in June though we think the Committee will want to see evidence of a pickup in economic activity before continuing their tightening cycle. Data releases over the next six weeks supporting our call for GDP growth to rebound to 2.9% in Q2 would help firm up expectations for a hike at the June 13-14 meeting. April's payroll report, showing a rebound in job growth and further decline in the unemployment rate, provided a good start.

RBC

February stall does little to dent Canada's Q1 growth

Canada's economy took a breather in February with GDP flattening out following one of the more impressive growth streaks in recent years (gains averaged 0.5% per month between November and January). A slowdown in the goods sector, led by declines in mining and manufacturing, offset a return to more trend-like growth in services industries—including an unsurprisingly robust gain in real estate activity. Despite the pause in February, industry GDP is tracking close to our forecast (and the Bank of Canada's) for growth to have picked up to 3.8% in Q1. On an expenditure basis we expect the gain was broadly-based, with particularly strong growth in domestic demand. Consumer spending looks to have posted another 2½% gain and our forecast assumes government outlays continued to trend higher with federal fiscal stimulus rolling out.

As with the US, investment is expected to be a bright spot in Q1. Our forecast assumes a 7% increase in business investment that would represent just the second quarterly gain since late-2014. A further rebound in drilling activity points to growing energy sector capex, while more broadly, rising capital goods imports in Q1 indicate a reversal of the disappointing declines in M&E investment seen over the second half of last year. Adding to stronger business investment, we expect further strengthening in residential investment given stronger housing starts and resales so far this year. While our forecast assumes nonresidential investment will continue to be a positive contributor to growth throughout 2017, recent strength in the residential sector is less likely to persist.

Ontario takes measures to cool the housing market

The federal government's tightening of mortgage insurance rules late last year only had a brief impact at the national level and there was virtually no sign of policy-induced cooling in Southern Ontario's hottest markets. Tight demand-supply conditions kept sellers in the driver's seat, pushing Toronto home prices up roughly 30% from a year earlier. Upward pressure has spilled over with several markets outside the GTA now seeing 20% price growth. Faced with deteriorating housing affordability in the province and increasing evidence that real estate activity is being fueled by speculation, the Ontario government stepped in with new regulations that could help cool things down. The hallmark of their Fair Housing Plan is a 15% tax on foreign speculators in the GTA and surrounding markets. A similar policy in Vancouver helped curb price growth, although the share of foreign buyers in that city was likely larger than in Toronto. Nonetheless, the government's efforts to cool the market could have a psychological impact. Indeed, the latest data show new listings in Toronto surged in April, potentially pushing demand-supply conditions closer to balanced territory. That provides some early support to our forecast that policy tightening will be a factor in slowing the resale market in 2017, resulting in less support to growth from housing than in recent years.

BoC shifts to "decidedly neutral" but still has concerns

The Bank of Canada held the overnight rate steady at 0.50% in April and shifted to a "decidedly neutral" policy stance. The Bank acknowledged recent strengthening in economic indicators (which prompted an upward revision to their growth projections for the current year) but noted it is too early to conclude that stronger growth will be sustained. Uncertainty and downside risks, particularly surrounding US trade policy, were once again highlighted. The Bank continues to see signs of material excess capacity, but given an upgraded growth forecast, now projects the economy will reach full capacity in the first half of 2018—slightly earlier than previously expected. Our forecast also assumes slack will gradually be absorbed over the coming year, with the Bank likely to begin tightening monetary policy in the second quarter of 2018.

A degree of caution from the Bank seems warranted, particularly in light of increasingly protectionist rhetoric from the Trump Administration. Canada in particular has been a target recently with Trump singling out the country's lumber, dairy and energy industries. And it isn't all talk—the Congress Department slapped tariffs on Canadian softwood lumber exports, reigniting the decades-old debate and possibly signaling a tough stance on other trade issues. That concern, in addition to housing worries and a dip in oil prices, led investors to shy away from the Canadian dollar, which fell to a one-year low of 73 US cents in early-May. While we expect a return to gradually rising oil prices will provide some support to the currency, further US-Canada monetary policy divergence and trade threats are likely to keep CAD on the defensive. As such we have lowered our end of year forecast by a cent to 71.5.

Highlights

▲ Despite zero growth in February, Canada is on track for a 3.8% gain in Q1 GDP given earlier strength.

▲ We expect business investment picked up to start 2017 following disappointing declines over much of the last two years.

▲ The Ontario government tightened housing regulation amid 30% price growth in Toronto.

▲ The Bank of Canada now expects the economy will reach full capacity in the first half of 2018.

Highlights

▲ UK inflation is set to overtake wage growth, putting pressure on household income and weighing on spending.

▲ Euro area survey data have improved strongly but the pickup in GDP growth has been a bit more modest.

▲ Australia's headline inflation rate rose to 2.1% in Q1 but core measures remain below the RBA's target range.

▲ With inflation now rising gradually we have removed the final rate cut from our RBNZ cash rate forecast.

UK growth slowed in Q1 as household incomes flattened out

The advance estimate of Q1 UK GDP confirmed some loss of momentum to start 2017 with growth slowing to 0.3%, just half the pace recorded over the second half of last year. The slowdown is generally consistent with survey indicators that softened early in the year (particularly in the services sector) before rebounding somewhat in March and picking up further to start Q2. On an expenditure basis, some of the slowing likely reflected weaker consumer spending growth as moderate wage gains are now being fully offset by rising inflation, leaving real incomes flat. We expect consumers will continue to struggle this year, while business investment is also likely to soften as ongoing Brexit negotiations fuel uncertainty. Prime Minister May invoked Article 50 in late-March and early indications are that the divorce process will be contentious. May called an election, set for June 8, in an effort to strengthen the ruling Conservatives' mandate for Brexit negotiations. Polls indicating the Conservatives could secure a larger majority than in the last election have helped boost Sterling to multi-month highs, though we don't see that result having much impact on either the Brexit process or implications for the economic outlook.

Euro area Q1 GDP confirms a solid start to 2017

The preliminary 'flash' estimate of euro area GDP showed activity remained firm in Q1 with 0.5% growth matching the previous quarter's pace. Details are sparse in the initial release though available country-level data indicate France's rate of expansion slowed a bit (despite sharp improvement in PMI readings year-to-date) while Spain's economy maintained good momentum. Recent euro area survey data provide early evidence of modestly above-trend growth continuing in the second quarter—April's composite PMI picked up to a post-recession high while overall economic sentiment reached its best level in a decade. The improvement in sentiment so far this year should be sustained as political uncertainty wanes. The French presidential election—the most significant in a fairly busy political year for Europe—handed an important victory to pro-euro and pro-EU candidate Emmanuel Macron, greatly reducing the tail risk of EU disintegration. At the ECB's latest meeting, President Draghi took note of improving economic momentum but emphasized that conditions under which the ECB could begin to consider tightening policy, namely a sustained pickup in inflation across the currency bloc, have yet to be realized. There has been some chatter regarding policymakers' continued easing bias, though we think expectations of a change in language as early as June will go unrealized with the ECB unlikely to soften their stance amid little traction in core inflation.

RBA sounding a bit more optimistic

The RBA has shifted to a more positive tone in recent communications, clearly pleased with a strengthening global outlook and further recovery in Australia's terms of trade. The central bank is also encouraged by a solid streak of job gains over the last six months. However, with labour force participation picking up, the unemployment rate remains stuck at a one-year high. That is keeping wage growth muted, something the RBA sees as "likely to remain the case for a while yet" as GDP growth struggles to exceed potential. Core inflation is also showing little sign of capacity pressure; the RBA's preferred measures ticked up to 1.8% on average in Q1, though largely due to base effects. We are with the RBA in expecting underlying inflation will remain below the 2-3% target range well into next year. We think the persistence of sub-trend growth and below-target inflation will eventually lead to another rate cut, though the RBA will likely wait for housing to cool some (recent macro-prudential tightening should help) before adding further monetary policy stimulus.

RBNZ easing likely done with inflation finally picking up

New Zealand's inflation rate jumped to 2.2% in Q1 from 1.3% in the prior quarter, marking the first time in seven years (excluding a policy-induced spike in 2010-11) that headline inflation has exceed the 2% midpoint of the RBNZ's target range. A good deal of the increase was in some of the more volatile components—higher food and energy prices pushed tradables inflation into positive territory after years of deflation—though underlying price pressure also appears to have picked up somewhat. The latter suggests above-trend growth last year helped remove some of the economy's excess capacity. That said, we don't expect a significant acceleration in core inflation anytime soon—employment growth has been strong but with the labour force keeping up the unemployment rate has struggled to break through cycle lows and wage growth remains muted. Nonetheless, strong activity growth and a gradual firming in underlying inflation will make it difficult for the RBNZ to maintain their mild easing bias. We now expect the current cash rate of 1.75% will prove to be the cycle low, having removed the Q4 rate cut from our forecast profile.

Interest rate outlook

%, end of period

	Actuals					Forecast						
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
Canada												
Overnight	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25
Three-month	0.45	0.48	0.53	0.46	0.52	0.50	0.55	0.60	0.65	0.85	1.15	1.40
Two-year	0.54	0.52	0.52	0.80	0.75	0.80	0.95	1.05	1.20	1.40	1.60	1.80
Five-year	0.67	0.57	0.62	1.15	1.12	1.20	1.45	1.75	2.05	2.30	2.45	2.60
10-year	1.23	1.06	1.00	1.80	1.62	1.80	2.05	2.30	2.55	2.80	2.95	3.10
30-year	2.00	1.72	1.66	2.35	2.30	2.35	2.60	2.85	3.00	3.20	3.30	3.45
United States												
Fed funds**	0.50	0.50	0.50	0.75	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.50
Three-month	0.21	0.26	0.29	0.51	0.76	1.00	1.05	1.30	1.55	1.80	2.05	2.30
Two-year	0.73	0.58	0.77	1.25	1.27	1.45	1.60	1.90	2.15	2.40	2.60	2.80
Five-year	1.21	1.01	1.14	2.00	1.93	2.10	2.25	2.50	2.65	2.90	3.05	3.20
10-year	1.78	1.49	1.60	2.55	2.40	2.65	2.80	3.00	3.15	3.40	3.50	3.60
30-year	2.61	2.30	2.32	3.15	3.02	3.20	3.35	3.50	3.60	3.75	3.80	3.90
United Kingdom												
Bank rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25	0.25	0.10	0.10	0.10	0.10
Two-year	0.45	0.13	0.13	0.08	0.12	0.15	0.20	0.15	0.05	0.10	0.15	0.15
10-year	1.43	0.89	0.76	1.24	1.14	1.35	1.50	1.60	1.70	1.85	1.95	2.00
Euro area												
Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40
Two-year	-0.48	-0.61	-0.69	-0.78	-0.74	-0.65	-0.55	-0.50	-0.50	-0.50	-0.50	-0.50
10-year	0.15	-0.11	-0.12	0.21	0.33	0.35	0.50	0.60	0.65	0.65	0.70	0.75
Australia												
Cash target rate	2.00	1.75	1.50	1.50	1.50	1.50	1.50	1.25	1.25	1.25	1.50	1.50
Two-year	1.89	1.59	1.55	1.86	1.76	1.70	1.60	1.50	1.50	1.75	1.75	2.00
10-year	2.49	1.98	1.91	2.76	2.70	3.05	3.20	3.30	3.45	3.80	3.90	4.10
New Zealand												
Cash target rate	2.25	2.25	2.00	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Two-year swap	2.19	2.22	1.96	2.50	2.31	2.20	2.20	2.20	2.30	2.30	2.30	2.40
10-year swap	2.97	2.65	2.41	3.58	3.41	3.70	3.90	4.10	4.30	4.70	4.90	5.00
Yield curve*												
Canada	69	54	48	100	87	100	110	125	135	140	135	130
United States	105	91	83	130	113	120	120	110	100	100	90	80
United Kingdom	98	76	63	116	102	120	130	145	165	175	180	185
Eurozone	63	50	57	99	107	100	105	110	115	115	120	125
Australia	60	39	36	90	94	135	160	180	195	205	215	210
New Zealand	78	43	45	108	110	150	170	190	200	240	260	260

* 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	0.75-1.00	0.50-0.75	March 15, 2017
Canada	Overnight rate	0.50	0.75	July 15, 2015
United Kingdom	Bank rate	0.25	0.50	August 4, 2016

		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

	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	2015	2016	2017F	2018F
Canada*	2.7	-1.2	3.8	2.6	3.8	1.5	1.6	2.0	2.1	2.2	1.9	1.7	0.9	1.4	2.4	2.0
United States*	0.8	1.4	3.5	2.1	0.7	2.9	2.5	2.4	2.4	2.3	2.0	2.0	2.6	1.6	2.1	2.3
United Kingdom	0.2	0.6	0.5	0.7	0.3	0.4	0.2	0.2	0.4	0.5	0.5	0.5	2.2	1.8	1.6	1.6
Euro area	0.6	0.3	0.4	0.5	0.5	0.3	0.3	0.3	0.4	0.4	0.4	0.4	1.9	1.7	1.6	1.5
Australia	1.1	0.8	-0.5	1.1	0.7	0.8	0.8	0.7	0.7	0.7	0.6	0.6	2.4	2.5	2.7	2.8
New Zealand	0.7	0.8	0.8	0.4	0.7	0.8	0.8	0.6	0.6	0.6	0.6	0.6	2.5	3.1	2.8	2.6

*annualized

Inflation outlook

% change, year-over-year

	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	2015	2016	2017F	2018F
Canada	1.5	1.6	1.2	1.4	1.9	2.2	2.5	2.5	2.3	2.3	2.1	2.2	1.1	1.4	2.3	2.2
United States	1.1	1.0	1.1	1.8	2.5	2.4	2.5	2.3	2.0	2.3	2.2	2.2	0.1	1.3	2.4	2.2
United Kingdom	0.3	0.4	0.7	1.2	2.1	2.7	2.9	2.9	2.8	2.5	2.4	2.4	0.0	0.7	2.6	2.5
Euro area	0.0	-0.1	0.3	0.7	1.8	1.7	1.6	1.5	1.4	1.3	1.2	1.2	0.0	0.2	1.6	1.3
Australia	1.3	1.0	1.3	1.5	2.1	2.3	2.2	2.4	2.5	2.5	2.4	2.3	1.5	1.3	2.2	2.4
New Zealand	0.4	0.4	0.4	1.3	2.2	2.3	2.3	2.3	1.7	1.7	1.8	1.8	0.3	0.6	2.3	1.8

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

Inflation tracking

Inflation Watch

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	Core CPI (CPIX)[1]	Mar	0.0	1.3	2.0	1.1
United States	Core PCE[1,2]	Mar	-0.1	1.6	2.0	1.6
United Kingdom	All-items CPI	Mar	0.4	2.3	2.0	2.2
Euro area	All-items CPI[1]	Apr	0.2	1.9	2.0	1.8
Australia	Trimmed mean CPI[1]	Q1	0.5	1.9	N/A	N/A
New Zealand	All-items CPI	Q1	1.0	2.2	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						
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
Canadian dollar	1.30	1.29	1.31	1.34	1.33	1.38	1.39	1.40	1.38	1.36	1.35	1.33
Euro	1.14	1.11	1.12	1.05	1.07	1.08	1.06	1.04	1.02	1.06	1.08	1.12
U.K. pound sterling	1.44	1.33	1.30	1.24	1.26	1.24	1.19	1.15	1.16	1.22	1.26	1.32
New Zealand dollar	0.69	0.71	0.73	0.69	0.70	0.72	0.73	0.74	0.74	0.74	0.75	0.75
Japanese yen	112.6	103.2	101.3	117.0	111.4	110.0	107.0	103.0	100.0	102.0	104.0	106.0
Australian dollar	0.77	0.75	0.77	0.72	0.76	0.75	0.73	0.72	0.72	0.72	0.73	0.73

Canadian dollar cross-rates

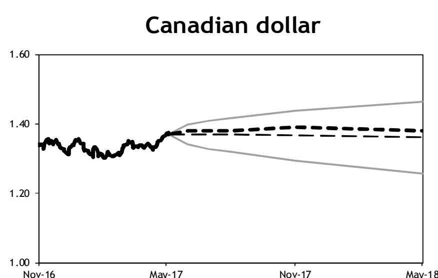
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
EUR/CAD	1.48	1.43	1.48	1.41	1.42	1.49	1.47	1.46	1.42	1.44	1.46	1.49
GBP/CAD	1.87	1.72	1.70	1.66	1.67	1.71	1.66	1.61	1.60	1.66	1.70	1.75
NZD/CAD	0.90	0.92	0.96	0.93	0.93	0.99	1.01	1.04	1.02	1.01	1.01	1.00
CAD/JPY	86.6	79.9	77.2	87.0	83.7	79.7	77.0	73.6	72.5	75.0	77.0	79.7
AUD/CAD	1.00	0.96	1.01	0.97	1.02	1.04	1.01	1.01	0.99	0.98	0.99	0.97

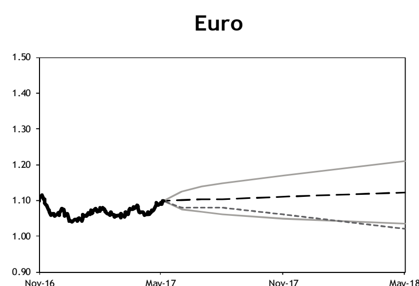
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

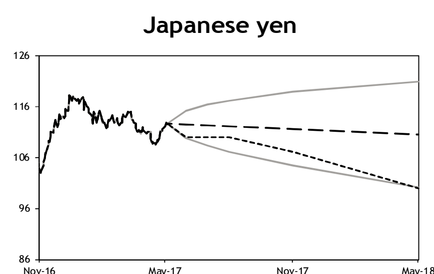
Source: Bloomberg, RBC Economics Research

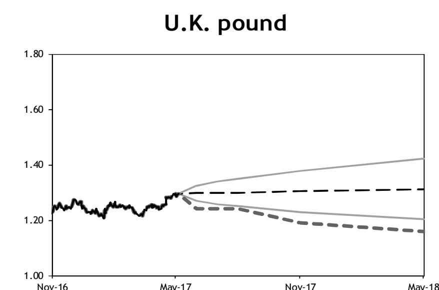
RBC Economics outlook compared to the market

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





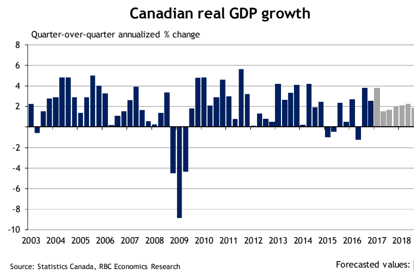


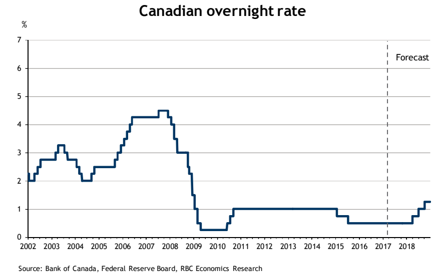


Bank of Canada

We are with the Bank of Canada in expecting GDP growth accelerated to 3.8% in Q1. Our forecast assumes the gain was driven by broadly-based strength in domestic spending, including an encouraging gain in business investment.

The Bank now expects the economy will reach full capacity in the first half of 2018. However, policymakers are giving no indication that rates will rise in the near-term

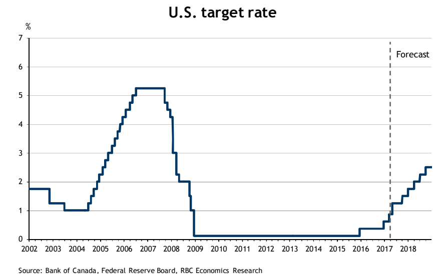




Federal Reserve

The Fed expects slower Q1 growth to be transitory. Weaker consumer spending in particular seems out of sync with strong employment and wage growth.

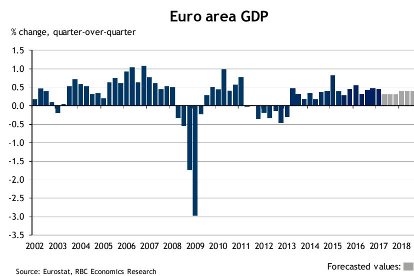
The Fed's relatively positive tone in May left the door open to a hike at the next meeting. Pending some evidence that growth is rebounding in Q2, we think they will go ahead with a rate hike in June.

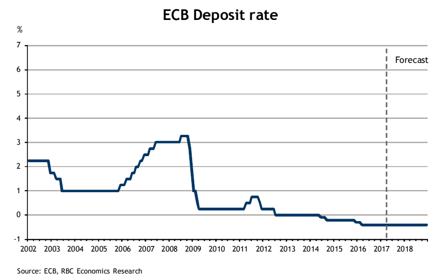


European Central Bank

Stronger GDP growth and declining unemployment rates have failed to boost inflationary pressure in the euro area.

ECB President Draghi pushed back against the idea that policymakers might pare back stimulus amid accelerating economic activity. Until there is evidence of a sustained pickup in inflation toward the ECB's target, monetary policy will remain in easing mode.

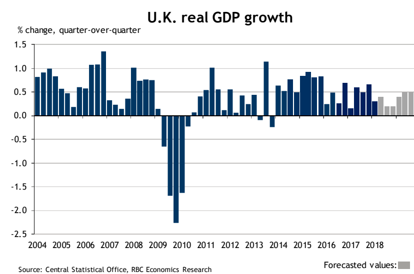


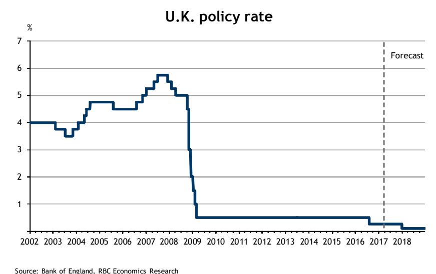


Bank of England

Rising inflation and modest wage gains are likely to push real income growth into negative territory. Notwithstanding a recovery in survey indicators, we expect consumer difficulties will keep GDP growth below trend this year.

The BoE is facing an increasingly difficult balance between slowing GDP growth and rising inflation. The former is expected to eventually dominate, resulting in further easing early next year.

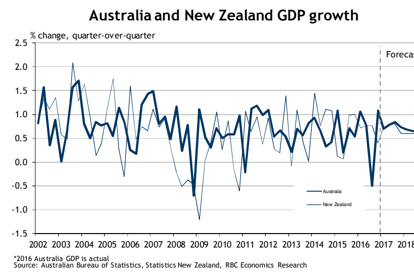


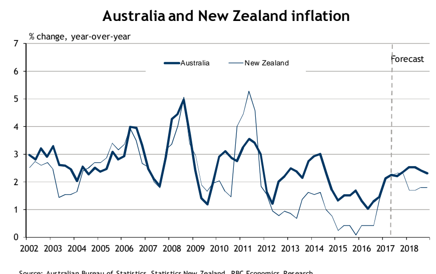


Australia and New Zealand

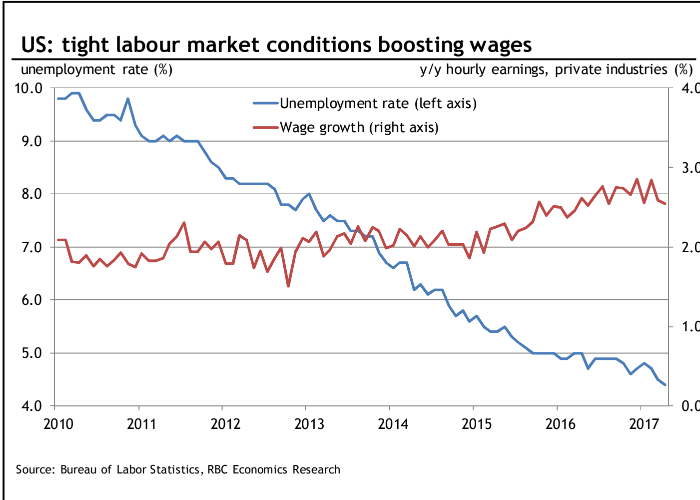
The RBA is sounding more optimistic, though their forecasts for near-trend growth and below-target inflation point to little tolerance for downside surprises. We continue to expect one more rate cut later this year, but we'll need to see housing pressure ease and activity to disappoint for that to be realized.

Decent growth and gradually rising inflation should see the RBNZ shift away from their easing bias. We no longer look for another rate cut, expecting 1.75% will be the low cash rate for this cycle.

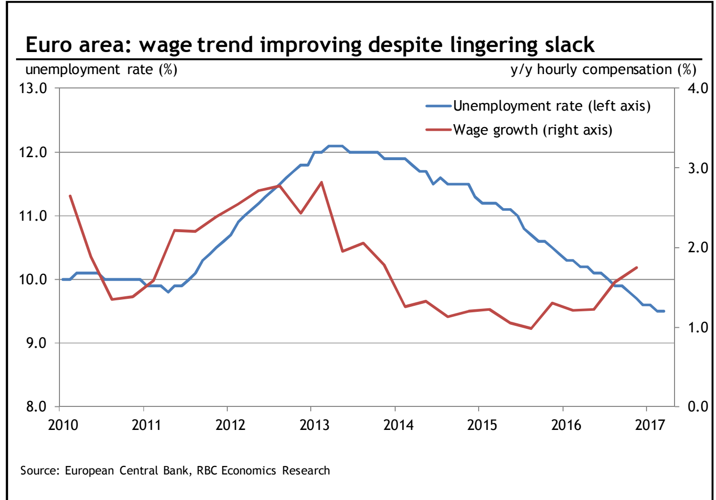




The good: A steadily declining unemployment rate in the US has pushed wage growth into a 2½-3% range. Rising wages should help offset slowing job growth as the economy reaches full employment.

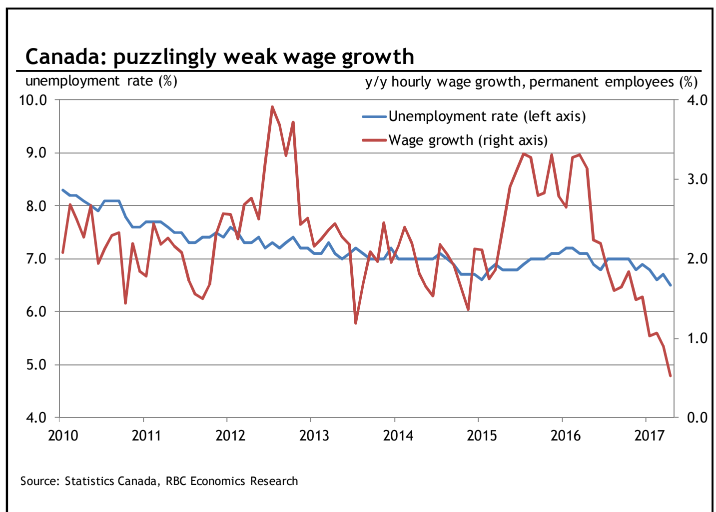


The not-so-bad: Euro area wage growth picked up a bit toward the end of last year; gains of 1½% are not all that bad considering still-elevated unemployment and 1% core inflation.



The bad: Even with very tight labour market conditions, UK wage growth is only slightly above 2%. As inflation continues to pick up toward 3%, negative real wage growth is likely to hold back consumer spending.

The ugly?: Canadian wages are growing at their slowest pace in decades, even as the unemployment rate appears to indicate little slack. That said, another survey measure puts wage growth in a more reasonable (though not overly impressive) 2% range.



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