FINANCIAL MARKETS MONTHLY

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Hiking, fast and slow

The days of rock-bottom interest rates are coming to an end in several economies but that doesn't mean central banks have returned to the relatively consistent, predictable tightening cycles of the past. Take the Federal Reserve—they first raised rates at the end of 2015 but waited a full year before following up with another move. Then after lifting rates at every other meeting earlier this year, the Fed hit pause to begin shrinking their balance sheet. We think they'll get back to raising rates, their main policy tool, in December and look for quarterly increases to resume in 2018. But the committee's 'dot plot' projections show a wide range of views on how much policy should tighten next year, and new leadership at the Fed adds an extra bit of uncertainty.

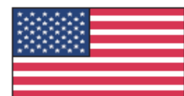
Meanwhile, the Bank of Canada surprised observers by raising rates in July and September, but just when markets caught up to the notion of a tightening cycle, the central bank tapped the brakes in October. While a tightening bias remains, concerns about Nafta renegotiation and low inflation have markets convinced that monetary policy is on hold into next year. Across the pond, the Bank of England raised their benchmark rate for the first time in a decade but indicated that any additional tightening will be gradual and limited. With lingering Brexit uncertainty weighing on the UK's economic outlook, it looks like it could be 'one and done' for now—we don't see any further moves from the BoE through next year.

Others remain committed to highly stimulative monetary policy. The European Central Bank just extended asset purchases into next year, albeit at a reduced pace, while the Bank of Japan remained firmly on the sidelines with their negative interest rate policy. We're still a ways away from those central banks undertaking their own tightening cycles. But if their global counterparts are anything to go by, the process will be gradual, data dependent, and likely uneven.

Central bank near-term bias

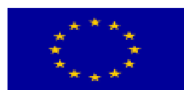
Three-months out, policy rate

While an at-capacity economy and above-trend growth forecast leave the Bank of Canada with a tightening bias, their concerns about Nafta renegotiation and the inflation outlook will likely keep the central bank from raising rates again this year.



The Fed made few changes in November's policy statement, and while there was no overt signal that rates are about to move higher, we continue to expect a move in December. Steady removal of accommodation is seen continuing next year.

The Bank of England raised their policy rate in November, undoing last year's cut that followed the Brexit referendum. It was a dovish hike though, with forward guidance that future rate increases would be gradual and limited. We don't see another rate hike through next year.



The European Central Bank met expectations by extending asset purchases into next year. Trimming the monthly pace in half, to €30 billion as of January, will allow the program to run for longer and, as per the ECB's guidance, keep interest rate hikes off the table through 2018.

A downside surprise on inflation reinforces the Reserve Bank of Australia's forecast for underlying inflation to remain at the lower end of their target range through next year, which should keep them from raising rates anytime soon.

The Reserve Bank of New Zealand's forward guidance indicates monetary policy will remain accommodative for a considerable period. We expect the cash rate will be held at a record low in November, their final meeting this year.

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Highlights

▲ The US economy recorded another quarter of 3% growth in Q3 despite hurricane-related disruptions.

▲ Severe weather likely weighed on housing in Q3, but the sector was already slowing earlier this year.

▲ With the little change in the Fed's November policy statement, we remain of the view that tightening will resume in December.

▲ Fed Governor Powell has been nominated to succeed Yellen as chair. His appointment is more status-quo than some of the other names outside the Fed that were floated.

US posts solid Q3 growth despite hurricane disruptions

US GDP growth surprised to the upside in Q3 with a 3.0% annualized increase. That was little changed from a 3.1% gain in Q2 despite activity having been weighed down by hurricane-related disruptions in late-August and early-September. Severe weather was likely a factor in declines in residential investment and business spending on structures. Other areas of the economy remained strong with consumer spending up 2.4% and business equipment investment rising by more than 8% for a second consecutive quarter. We expect GDP growth will remain above-trend in Q4, abetted by a modest post-hurricane boost as economic activity returns to normal levels and rebuilding begins in affected areas. There was already some evidence of a bounceback with personal spending jumping in September as a rush to replace flood-damaged cars spurred decade-high auto sales in the month.

Housing recovery hits pause, expected to resume next year

While some of the residential sector's Q3 weakness can be pinned on hurricane-related disruptions, the US economy's multi-year housing recovery appeared to stall prior to any weather effects. Both housing starts and existing home sales declined in each of the last two quarters, with the latter hitting a one-year low in Q3. A dip in pending home sales limits prospects for a near-term rebound, and factors like low inventories and rising interest rates that have crimped resales aren't going away anytime soon. The residential construction outlook is a bit more positive. Homebuilder confidence remains close to cycle highs, and solid permit issuance points to stronger activity in the multi-unit segment that has accounted for all of the recent slowing in housing starts. Construction could also get a near-term boost from rebuilding efforts following recent hurricanes. More generally, a number of factors continue to support the housing outlook—elevated consumer confidence, a strong labour market, and further easing lending standards. As such, we think the housing sector should get back to providing a consistent lift to GDP growth in 2018.

Fed appears on track to raise rates in December…

The Fed held rates steady in November, once again showing no inclination to change monetary policy at a non-press-conference meeting. The updated policy statement was plain vanilla with a nod to some transitory hurricane effects—higher inflation and lower employment—and a decent Q3 growth outturn despite weather-related disruptions. The usual themes of a strong labour market and soft inflation were unchanged, with the latter still expected to hit the Fed's 2% objective over the medium term. The policy statement made no overt signal that rates will rise in December but that didn't hurt the odds of such a move. The Fed's forecasts from September remain largely on track—if anything there is a bit of upside to their GDP forecast for the current year after GDP growth held up at 3% in Q3. Inflation continues to be disappointing but is not far from what the Fed has penciled in for the end of the year. All told, we see little reason for the 12 of 16 FOMC members who thought another rate hike would be warranted by end of year to change their minds. Markets are of the same view with a December rate increase almost fully priced in.

…as a new chair is set to take over in February

We continue to think steady but gradual rate hikes are in store next year. However, the Fed's 'dot plot' shows a wide range of views on how much tightening will likely be appropriate. A change of leadership at the Fed adds an extra dose of uncertainty, though the nomination of Jerome Powell as chair is certainly more status-quo than some of the other names outside the Fed that were floated. Powell has been a member of the Fed's Board of Governors since 2012, with most of that tenure under Chair Yellen's leadership. The two are seen as favouring a similar monetary policy prescription. That is, Powell is likely to continue with a gradual approach to normalizing interest rates and a slow, predictable shrinking of the Fed's balance sheet. The main difference between Chair Yellen and Governor Powell is in regards to financial system regulation, with the latter favouring a lighter regulatory touch. All told, we haven't changed our interest rate outlook based on Powell assuming the role of chair next February though we will watch his comments closely for any indications of a break from Yellen's thinking on monetary policy.

Canadian activity geared down in the third quarter

Canadian GDP surprised on the downside in August, slipping 0.1% following a flat reading in July. Growth has clearly come off the boil following an average annualized pace of more 4% over the first half of the year. Current data points to a near-trend increase of 1.7% in Q3. We think the slowdown reflects a more sustainable pace of consumer spending, which would be consistent with a moderation in job growth last quarter. Trade is expected to have been a drag on activity with exports retracing Q2's 10% gain. More encouragingly, business investment likely remained strong with sales and imports of machinery and equipment continuing to post solid gains. Exports and capex will be relied on to return growth to an above-potential pace as contributions from consumers and housing are hampered by higher interest rates and housing policy changes.

Strong economy allows for smaller deficits, more spending

The federal government issued its fall economic statement in late-October, providing an update on the state of finances between official budgets. Thanks to the country's G7-beating growth over the last year, higher government revenues provided a fiscal dividend that could be spent on programs and tax cuts, or saved through smaller deficits. In the end the government opted for a combination of the two, spending about a third of the $46.6 billion in additional fiscal room while still showing $33 billion less in cumulative borrowing over the next five years. There were no big ticket spending items—rather, a few billion dollars went to earlier indexation of Canada Child Benefit payments, support for lower-income workers and the earlier-announced small business tax cuts.

Even with stronger growth trimming the government's deficit projections, there is no return to balance in sight with a $12.5 billion shortfall penciled in for fiscal year 2022/23. A growing economy will help reduce the overall debt burden, with the federal debt-to-GDP ratio expected to trend lower in the coming years. But it is still a bit surprising for the government to refrain from targeting a return to balance, particularly at this stage in the business cycle when government revenues are high, the economy is close to full capacity and pro-cyclical fiscal policy isn't needed to shore up growth. So while there were some positives to take away from the fall update, we would prefer to see a bit more discipline in the form of even smaller deficits and a timetable for a return to balance.

Bank of Canada: the dove is in the details

After two consecutive rate hikes over the summer, a less hawkish tone from Governor Poloz and crew trimmed the odds of a follow-up move in October. Market expectations were vindicated with the Bank of Canada holding their benchmark interest rate at 1%. The bones of the policy statement and updated projections weren't all that dovish—the economy is operating close to capacity, above-trend growth is expected to continue and thus "less monetary policy stimulus will likely be required over time." But there was little evidence of the urgency that saw policymakers rush to raise rates in Q3. While maintaining a positive view on the economic outlook, Governor Poloz noted risks surrounding Nafta renegotiation, as well as uncertainty about how highly-indebted households would respond to the bank's recent tightening.

The theme of uncertainty was even more prevalent with regards to the inflation outlook. The bank investigated whether technology and globalization are weighing on inflation, and while finding little evidence that structural factors are at play, policymakers fell short of dismissing those issues entirely. Governor Poloz also noted that, even though businesses are running near full capacity, there is still some slack in labour markets to be absorbed that is preventing wages from growing faster. The bank thinks productivity-boosting business investment will provide a bit more room to grow without generating inflationary pressure. And thanks to a stronger currency, policymakers now see inflation remaining below their 2% target well into next year. Their audible concerns about the inflation outlook further reduced market expectations for near-term rate hikes and pushed the Canadian dollar 1% lower. We agree that it looks like the bank will be a bit more patient in removing accommodation but continue to think a near-capacity economy calls for higher interest rates. Our forecast now assumes the BoC will remain on the sidelines for the next couple of meetings before resuming a tightening cycle in the second quarter of 2018. A slightly slower pace of hikes prompted us to lower our Canadian dollar forecast, with the currency now expected to dip to 75 US cents early next year before recovering as the BoC resumes raising rates.

Highlights

▲ An unexpected decline in August GDP trimmed our Q3 forecast. We now expect a near-trend 1.7% increase in the latest quarter, down from a 4% pace in H1/17.

▲ Thanks to stronger growth earlier this year, the federal government was able to increase spending while still projecting smaller budget deficits.

▲ The BoC held interest rates steady as expected following consecutive rate hikes at the prior two meetings.

▲ Despite the economy running close to full capacity, the BoC remains concerned about downside risks to the inflation outlook.

Highlights

▲ The UK economy's upside surprise in Q3 further paved the way for the BoE to raise rates in November.

▲ The euro area economy was characterized by familiar themes in Q3: above-trend growth and below-target inflation.

▲ With their inflation objective nowhere in sight, the ECB announced asset purchases will continue next year.

▲ Australia's inflation data continued to show few signs of underlying price pressure, reinforcing the RBA's accommodative stance.

BoE raises rates, but don't expect a follow-up anytime soon

The Bank of England voted 7-2 to raise their policy rate in November, the first 25 basis point increase in a decade. The move undid last year's rate cut that followed the Brexit referendum. With the economy operating near capacity—the unemployment rate of 4.3% is below estimates of its longer run level—the central bank had been signaling it might soon be appropriate to withdraw some stimulus. That view was reinforced by an upside surprise in GDP, with growth picking up to 0.4% in Q3 from 0.3% in each of the prior two quarters. While Brexit uncertainty continued to weigh on the economy, a strengthening industrial sector, particularly manufacturing activity, helped lift growth in the latest quarter.

The Bank of England's November move was seen as a dovish hike with Sterling falling 1% after the announcement. The market reaction can be attributed to the BoE's forward guidance, which indicates any further moves will be gradual and "to a limited extent." They also dropped an earlier reference to markets under-pricing future tightening. And policymakers were a bit more explicit in their concerns about Brexit, which is weighing on domestic activity and constraining investment and labour supply. With little progress in negotiations thus far, we remain of the view that Brexit risks will keep the BoE cautious in removing accommodation, even as inflation remains above target and the economy near capacity. We don't see any follow up to November's rate hike next year.

ECB extends QE as stronger growth yet to lift inflation

Euro area GDP surprised to the upside with a 0.6% non-annualized increase in Q3. A similar, above-trend pace over the prior three quarters left output 2.5% above its year-ago level, the strongest increase since 2011 when activity rebounded following the global recession. Above-trend growth appears to have continued into Q4—early survey data for October showed some signs of moderation but are consistent with activity remaining only slightly below Q3's pace. Some of the softening in sentiment likely reflects less optimism in Spain amid political upheaval in Catalonia. Those developments bear watching as Spain has been one of the euro area's fastest-growing economies in recent quarters. Solid growth continues to be accompanied by a strengthening labour market. The euro area unemployment rate fell to 8.9% in September, the first sub-9% reading since the start of 2009. Wage growth remains muted, however, and in a familiar theme, there is little evidence of above-trend activity translating into higher inflation. In fact, inflation surprised to the downside in October, with the year-over-year rate of core inflation falling below 1% for the first time since May.

With few signs that inflation is heading toward their target, the European Central Bank remains committed to stimulative monetary policy. As expected, the central bank announced in October that their asset purchase program would be extended into next year. Quantitative easing is now scheduled to continue at least through September 2018, albeit with the monthly pace of purchases being trimmed to €30 billion starting in January from €60 billion currently. Given the ECB's forward guidance that interest rates will remain at present levels well beyond the horizon of net asset purchases, higher policy rates remain off the table at least through 2018.

Another weak inflation report will keep the RBA sidelined

Australia's headline inflation rate edged down to 1.8% year-over-year in Q3, falling short of both market and central bank expectations. The decline was despite upward pressure from a regulated increase in utility prices. In fact, regulated services prices continue to provide much of the impetus for inflation, with nontradables up more than 3% from a year ago. That was offset by renewed downward pressure on tradables inflation in Q3 due to a stronger Australian dollar. Core price measures remained weak, averaging slightly below the Reserve Bank of Australia's 2-3% target range—as has been the case for two years now. We see little prospect of inflation picking up in the near-term given slow wage growth and relatively flat unit labour costs. While the trough in wage growth is likely behind us, we'll need to see a continuation of strong job gains and a decline in the unemployment rate below its recent range for labour market conditions to begin feeding through to consumer prices. Until then, the RBA is likely to see underlying inflation remaining on the low side of target and thus little need to raise the cash rate from its current, record-low.

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	1.00	1.00	1.00	1.25	1.50	1.75
Three-month	0.45	0.48	0.53	0.46	0.52	0.71	1.00	0.90	1.05	1.30	1.55	1.80
Two-year	0.54	0.52	0.52	0.75	0.75	1.10	1.52	1.45	1.70	1.95	2.15	2.35
Five-year	0.67	0.57	0.62	1.12	1.12	1.40	1.75	1.80	2.10	2.35	2.55	2.70
10-year	1.23	1.06	1.00	1.71	1.62	1.76	2.10	2.10	2.40	2.65	2.85	3.00
30-year	2.00	1.72	1.66	2.31	2.30	2.14	2.47	2.45	2.75	3.00	3.15	3.30
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	1.03	1.06	1.30	1.55	1.80	2.05	2.30
Two-year	0.73	0.58	0.77	1.20	1.27	1.38	1.47	1.85	2.05	2.35	2.55	2.70
Five-year	1.21	1.01	1.14	1.93	1.93	1.89	1.92	2.25	2.45	2.65	2.85	3.00
10-year	1.78	1.49	1.60	2.45	2.40	2.31	2.33	2.65	2.85	3.00	3.20	3.40
30-year	2.61	2.30	2.32	3.06	3.02	2.84	2.86	3.15	3.30	3.45	3.60	3.75
United Kingdom												
Bank rate	0.50	0.50	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50
Two-year	0.45	0.13	0.13	0.08	0.12	0.36	0.46	0.50	0.50	0.50	0.50	0.50
10-year	1.43	0.89	0.76	1.24	1.14	1.26	1.38	1.50	1.60	1.65	1.75	1.80
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	-0.57	-0.69	-0.70	-0.70	-0.70	-0.70	-0.70
10-year	0.15	-0.11	-0.12	0.21	0.33	0.47	0.47	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	1.50	1.50	1.50	1.50	1.50
Two-year	1.89	1.59	1.55	1.86	1.76	1.78	1.94	2.00	2.00	2.10	2.20	2.25
10-year	2.49	1.98	1.91	2.76	2.70	2.60	2.84	3.05	3.25	3.40	3.70	3.90
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	2.32	2.19	2.20	2.30	2.40	2.50	2.60
10-year swap	2.97	2.65	2.41	3.58	3.41	3.35	3.24	3.40	3.60	3.75	4.00	4.25
Yield curve*												
Canada	69	54	48	96	87	66	58	65	70	70	70	65
United States	105	91	83	125	113	93	86	80	80	65	65	70
United Kingdom	98	76	63	116	102	90	92	100	110	115	125	130
Eurozone	63	50	57	99	107	104	116	130	135	135	140	145
Australia	60	39	36	90	94	82	90	105	125	130	150	165
New Zealand	78	43	45	108	110	103	105	120	130	135	150	165

* 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	1.00-1.25	0.75-1.00	June 15, 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

RBC

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*	2.8	-1.4	4.2	2.7	3.7	4.5	1.7	2.0	2.0	1.8	1.7	1.7	0.9	1.5	3.0	2.1
United States*	0.6	2.2	2.8	1.8	1.2	3.1	3.0	2.6	2.5	2.3	2.0	2.0	2.9	1.5	2.2	2.5
United Kingdom	0.2	0.5	0.4	0.6	0.3	0.3	0.4	0.2	0.4	0.5	0.5	0.5	2.3	1.8	1.5	1.6
Euro area	0.5	0.3	0.4	0.6	0.6	0.7	0.6	0.5	0.5	0.4	0.4	0.4	2.0	1.8	2.3	1.9
Australia	1.0	0.8	-0.4	1.1	0.3	0.8	0.5	0.8	0.7	0.6	0.7	0.6	2.4	2.5	2.2	2.7
New Zealand	0.7	0.8	0.7	0.4	0.6	0.8	0.8	0.6	0.6	0.6	0.6	0.6	2.5	3.0	2.6	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	1.3	1.4	1.5	1.3	1.8	1.9	1.9	1.1	1.4	1.5	1.7
United States	1.1	1.0	1.1	1.8	2.5	1.9	2.0	2.0	1.6	2.0	1.9	1.5	0.1	1.3	2.1	1.7
United Kingdom	0.3	0.3	0.7	1.2	2.2	2.8	2.8	3.0	2.7	2.6	2.6	2.5	0.1	0.6	2.7	2.6
Euro area	0.0	-0.1	0.3	0.7	1.8	1.5	1.5	1.4	1.1	1.2	1.3	1.3	0.0	0.2	1.5	1.2
Australia	1.3	1.0	1.3	1.5	2.1	1.9	1.8	2.0	2.1	2.5	2.4	2.3	1.5	1.3	2.3	2.5
New Zealand	0.4	0.4	0.4	1.3	2.2	1.7	1.9	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	CPI ex food & energy[1]	Sep	0.0	1.2	1.4	1.2
United States	Core PCE[1,2]	Sep	0.1	1.3	1.3	1.2
United Kingdom	All-items CPI	Sep	0.3	3.0	2.1	3.3
Euro area	All-items CPI[1]	Oct	0.0	1.4	1.4	1.0
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				
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
Canadian dollar	1.30	1.29	1.31	1.34	1.33	1.30	1.25	1.27	1.33	1.30	1.27	1.24
Euro	1.14	1.11	1.12	1.05	1.07	1.14	1.18	1.14	1.12	1.10	1.08	1.12
U.K. pound sterling	1.44	1.33	1.30	1.24	1.26	1.30	1.34	1.23	1.19	1.22	1.24	1.32
New Zealand dollar	0.69	0.71	0.73	0.69	0.70	0.73	0.72	0.75	0.72	0.70	0.69	0.69
Japanese yen	112.6	103.2	101.3	117.0	111.4	112.4	112.5	110.0	107.0	105.0	107.0	109.0
Australian dollar	0.77	0.75	0.77	0.72	0.76	0.77	0.78	0.80	0.77	0.74	0.73	0.73

Canadian dollar cross-rates

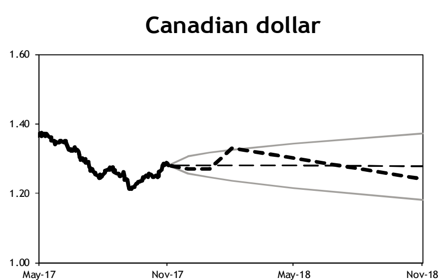
	16Q1	16Q2	16Q3	16Q4	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4
EUR/CAD	1.48	1.43	1.48	1.41	1.42	1.48	1.47	1.45	1.42	1.43	1.37	1.39
GBP/CAD	1.87	1.72	1.70	1.66	1.67	1.69	1.67	1.56	1.58	1.59	1.58	1.63
NZD/CAD	0.90	0.92	0.96	0.93	0.93	0.95	0.90	0.95	0.96	0.91	0.88	0.86
CAD/JPY	86.6	79.9	77.2	87.0	83.7	86.7	90.2	86.6	80.5	80.8	84.3	87.9
AUD/CAD	1.00	0.96	1.01	0.97	1.02	1.00	0.98	1.02	1.02	0.96	0.93	0.91

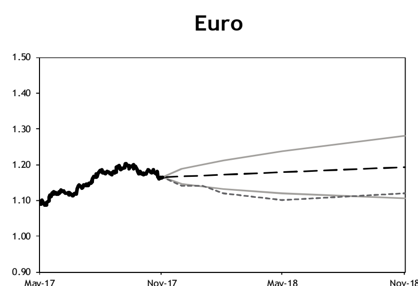
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

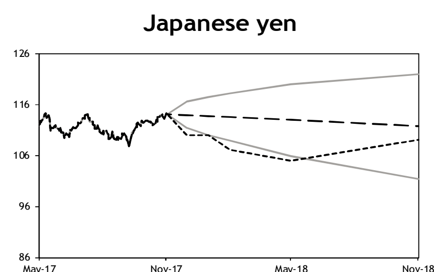
Source: Bloomberg, RBC Economics Research

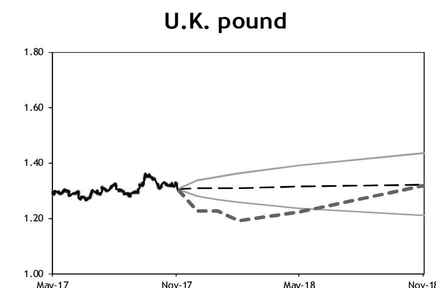
RBC Economics outlook compared to the market

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.









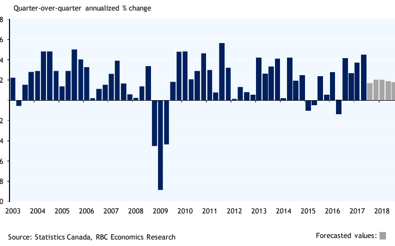
RBC

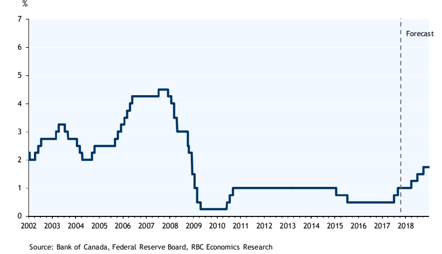
Central bank watch

Bank of Canada

Canada's 0.1% decline in August GDP followed a flat reading in July. Thanks to a strong handoff from the previous quarter, Q3 GDP should still manage a trend-like 1.7% increase—close to the Bank of Canada's latest forecast.

A more cautious tone from the BoC prompted us to trim our interest rate forecast. However, we continue to expect rates will rise next year as capacity pressures push inflation closer to 2%.

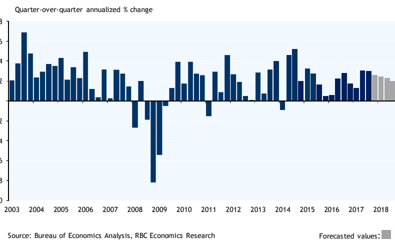


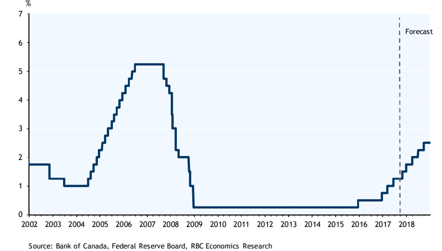


Federal Reserve

Another quarter of 3% GDP growth, even in the face of weather-related disruptions, reinforces the US economy's strong backdrop and will likely prompt the Fed to resume raising rates in December.

If inflation begins to pick up as we expect amid tight economic conditions, we see the Fed hiking rates once a quarter in 2018—slightly ahead of the median three increases in their latest 'dot plot' projection.

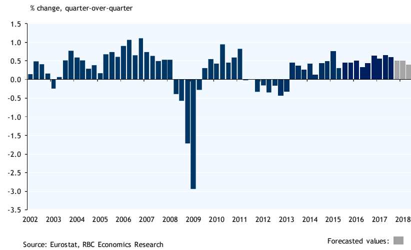


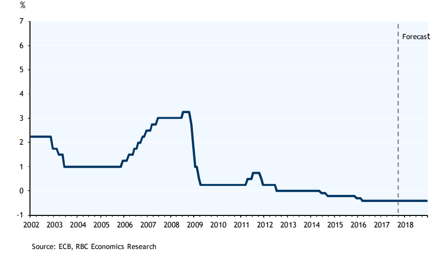


European Central Bank

Euro area GDP surprised to the upside in Q3 and the year-over-year growth rate of 2.5% is the strongest in six years. Labour markets are improving with the unemployment rate below 9% for the first time since 2009.

Despite an improving economic backdrop, inflation remains anemic and the ECB is committed to providing extraordinary stimulus through asset purchases and a negative policy rate.

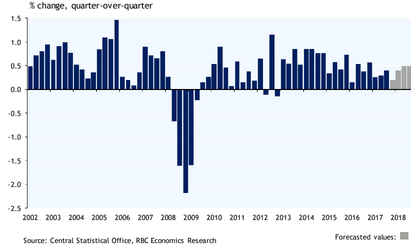


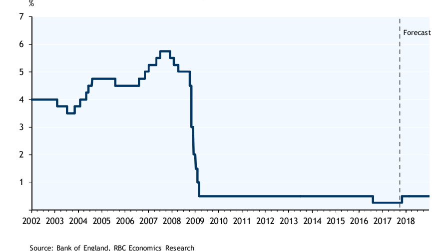


Bank of England

The UK economy surprised to the upside in Q3 with a 0.4% increase in GDP. The year-over-year pace of 1.5% is down only modestly from average growth closer to 2% just prior to the Brexit vote.

The BoE raised interest rates in November but we think tightening could be 'one and done' for now with Brexit weighing on the economic outlook. We don't see the bank rate moving higher in 2018.

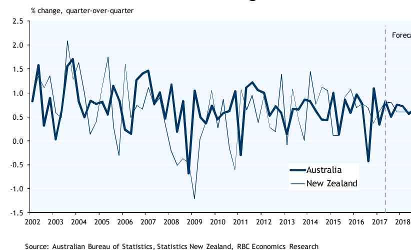


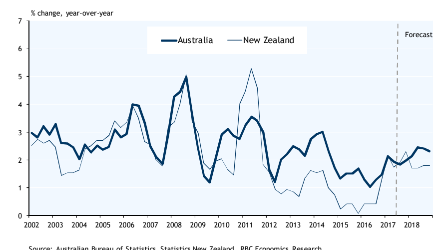


Australia and New Zealand

The RBA sounded a bit more upbeat in recent months but a downside surprise on inflation in Q3 reinforces our view that monetary policy isn't likely to tighten anytime soon. We see the cash rate on hold at 1.50% through next year.

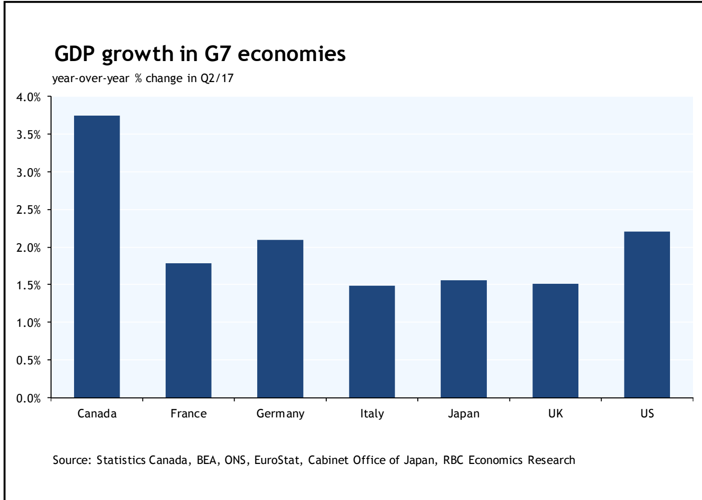
The RBNZ's November meeting will be their last one before summer break. We don't expect any change in monetary policy, with the cash rate held steady at a record low of 1.75%.



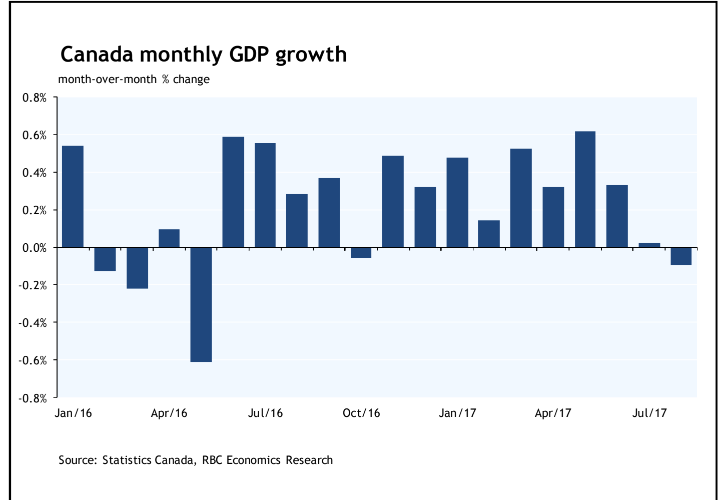


Advanced economies jockeying for growth leader

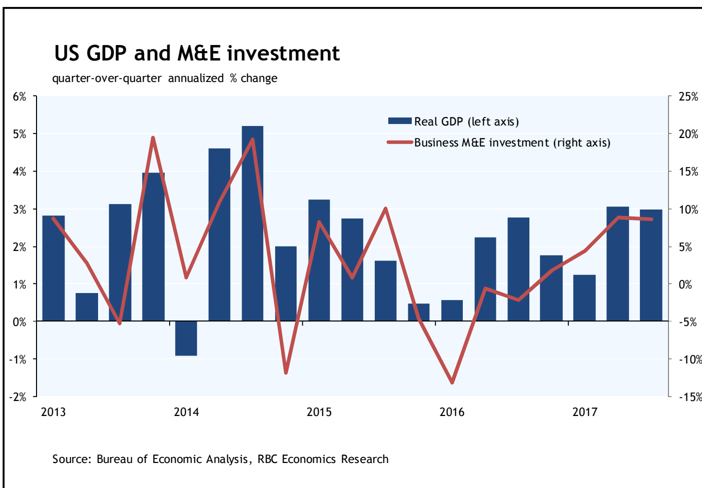
Thanks to a torrid pace of activity over the first half of this year, Canada vaulted to the top of the G7 growth table with GDP up 3.7% from a year earlier as of Q2/17.



But with monthly GDP figures showing a loss of momentum over the summer, Canada's economy appears to have returned to a more trend-like pace of activity in Q3.



The US economy grew at a 3% annualized rate in each of the last two quarters. Activity has been boosted by stronger business investment, with M&E spending up more than 8% in both Q2 and Q3.



Not to be outdone, euro area GDP is up 2.5% from a year ago, the best pace since growth rebounded following the 2008/09 recession. Keep in mind, the euro area's potential growth rate is likely lower than some other advanced economies.

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