RBC ECONOMIC RESEARCH

FINANCIAL MARKETS MONTHLY

November 9, 2018

The hurt from red October

Concerns about rising protectionism and slowing global growth saw equity markets drop in October. The S&P 500 plunged nearly 7%, its worst monthly performance in seven years. Other global benchmarks saw similar declines, with the MSCI World index down 7.4% in October. Volatility resurfaced with the VIX (volatility index) spiking, though not to the extent seen in the selloff earlier this year. Equities peaked in early October just as the IMF released their latest economic projections. They marked down their global growth forecasts for this year and next amid increasing trade barriers and tightening financial conditions that are seen weighing on emerging markets in particular. Concerns about global growth were also evident in the commodities space with oil prices falling to six-month lows. That's one reason the Canadian dollar hasn't seen much of a boost from the USMCA trade deal.

While the risk-off move saw some intermittent fixed income rallies, Treasury and GoC yields ultimately ended the month higher. That's even as lower oil prices weighed on breakeven inflation rates. A push higher in real yields comes as the Fed and Bank of Canada show no sign of slowing down their tightening cycles. The BoC is now indicating rates need to rise to a neutral level, while some Fed officials have indicated monetary policy will eventually need to become restrictive. That contrasts with Europe, where the ECB isn't likely to raise rates until later next year while the BoE remains handcuffed by Brexit uncertainty. Monetary policy divergence between the US and some of its trading partners saw the greenback gain 2% in October, hitting its highest level in more than a year. Stress on emerging markets from a higher US dollar and rising interest rates was one of the IMF's key concerns in their October outlook.

Central bank near-term bias

The Bank of Canada dropped "gradual" from their forward guidance, but we think the change was more about maintaining flexibility rather than speeding up the pace of tightening. We see low odds of a December rate hike, but think a move in January is likely.

The Fed is showing little inclination to deviate from the once-a-quarter rate hikes we've seen throughout their tightening cycle. We expect a move in December and four rate increases in 2019.

The Bank of England remains Brexit dependent. Until that issue is clarified, we don't see them acting on their guidance that gradual and limited rate hikes will be needed to keep inflation on target.

The European Central Bank doesn't sound too alarmed about a recent softening in euro area growth. They remain on track to end net asset purchases at the turn of the year, but rate hikes will be a story for H2/19.

The Reserve Bank of Australia upped their growth forecasts in November, but firmer activity alone won't move the central bank from the sidelines. We expect a steady cash rate until late next year.

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

Highlights

▲ The US economy has picked up this year while its G7 partners are seeing more moderate growth.

▲ A strong consumer backdrop and ongoing fiscal stimulus should keep the US economy growing at a solid pace next year.

▲ The midterm elections featured few surprises and didn't change our economic projections.

▲ The Fed's November meeting was a non-event but December's should see another rate hike.

US economy continues to lead the pack

The US economy has been the exception to slower growth across the G7 this year. Canadian GDP growth has moderated from last year's impressive 3% pace, activity in Japan has softened, and Europe has been hit by both transitory factors and political uncertainty. But fiscal stimulus has helped the US economy accelerate in 2018, even as higher interest rates and capacity constraints would typically see growth leveling off at this point in the cycle. US GDP was up an annualized 3.5% in Q3, building on a 4.2% gain in Q2 to deliver the best back-to-back growth in four years. Consumer spending led the way as a strong job market, rising wages, and near-record confidence have Americans opening up their pocketbooks. The public sector also provided support, with federal government spending running at its fastest year-over-year pace since 2010. It wasn't all positive—business investment was softer than expected after strong gains earlier this year. And net trade was a sizeable drag in Q3, more than retracing the previous quarter's add when purchasers likely tried to get ahead of rising import tariffs. But those factors only served to partially offset robust consumer and government spending.

The question is, how long will this strength be sustained? In the near-term the economy looks set to maintain an above-trend pace of growth. The household savings rate is healthy and wages are picking up, suggesting continued momentum on the consumer side. Rising protectionism and higher interest rates present headwinds to business investment, but sentiment remains strong and financial conditions are still broadly accommodative. We doubt Q3's soft business investment is the start of a trend. And while much of the boost from government stimulus will occur this year, the fiscal impulse will remain positive in 2019. The trade outlook is less rosy—protectionist measures have failed to rein in the trade deficit and relative strength in the domestic economy points to imports outpacing exports again next year. On balance, we look for GDP growth to moderate slightly to 2.5% in 2019 from 2.9% this year—still well above potential growth of around 2%.

Midterm elections limit prospects for further tax cuts

The US midterm elections were generally free of surprises. The Democrats took control of the House of Representatives, while the Republicans added a couple seats to their narrow majority in the Senate. A divided Congress could spell political deadlock over the next two years—Democrats will be reluctant to give the Trump administration any 'wins', while a GOP-controlled Senate will make it difficult for Democrats to advance their own legislative agenda. It looks unlikely that further income tax cuts floated by President Trump will be passed. However, there does appear to be bipartisan support for infrastructure spending that could deliver a further fiscal jolt. We're also keeping our eye on ratification of USMCA. It wasn't an election issue, and Democrats should be pleased with some of the labour-friendly changes in the auto sector. But if the new Congress wants to put their own stamp on the deal, it could delay passage.

No surprises in latest Fed announcement

November's FOMC meeting was very straightforward—no rate hike and only minor tweaks to the policy statement. Risks to the outlook remain "balanced," and further, gradual rate increases are expected. That guidance has become synonymous with hikes at every other meeting, a pattern we expect will continue with a move in December and four more rate increases next year. Markets are pricing in less tightening through the end of next year, even relative to the Fed's 'dot plot' median of three hikes in 2019. We see little reason for policymakers to slow the tightening cycle, even as fed funds gets closer to most estimates of the 'neutral' rate. With unemployment at its lowest in nearly 50 years and the economy still carrying decent momentum, we think inflation risks are tilted to the upside.

Canada's economy keeps up its growth streak

Canada's economy extended its growth streak to seven months with August GDP rising 0.1%. But the increase was narrowly based, led by a rebound in oil production following supply outages in July. Manufacturing, wholesale and retail trade were all lower in the month. Thanks to earlier momentum, GDP is still tracking close to a 2% annualized pace in Q3. Softening retail sales and homebuilding activity suggest the household sector once again provided less support than in recent years. But we think a further pickup in business investment and another add from net exports provided enough offset to keep the economy growing at a trend-like pace. On net we think GDP growth will average 2% over the second half of the year—a not-too-hot, not-too-cold pace that should please the Bank of Canada given an economy operating at capacity.

Canadian businesses report growing capacity pressures

The Bank of Canada's latest *Business Outlook Survey* showed another quarter of positive sentiment—and that was before announcement of the new USMCA deal. Even if the survey was a bit stale in that sense, there were still some notable takeaways. A common theme was growing capacity pressures. More than half of firms said they'd have difficulty meeting an unexpected increase in demand. The share of companies reporting labour shortages was at a decade high, and the intensity of labour shortages was near a record in Q3. More than a third of firms surveyed said they intend to respond to capacity pressures by investing and/or hiring over the next year.

The latest CFIB *Business Barometer* also pointed to capacity issues. The share of firms reporting skilled and un/semi-skilled labour shortages jumped higher in October. Businesses say those shortages are the most significant factor restricting their ability to increase sales or production—more than insufficient demand or competitive pressures. These surveys support the Bank of Canada's conclusion that the economy is operating close to full capacity—if not slightly beyond. That should help keep a floor under inflation, and argues for the BoC to continue removing monetary policy stimulus.

BoC raises rates, drops "gradual" from forward guidance

The Bank of Canada raised rates in October for the fifth time in 15 months. The move was fully expected but Governing Council still managed to surprise markets by shifting their forward guidance. The policy statement no longer indicated rate increases will be "gradual"—a term that markets associated with the Fed's rate hikes at every other meeting. We think Governing Council conversely wants to emphasize that they will be flexible in raising rates, potentially speeding up or slowing down the pace of tightening based on incoming data—particularly how households are handling higher borrowing costs. While their guidance on the pace of tightening is now less specific, the ultimate destination is clearer: they indicated the overnight rate "will need to rise to a neutral stance" to keep inflation on target. The BoC estimates 'neutral' is in the range of 2.5-3.5%, well above today's 1.75% overnight rate. That change in language was seen as a hawkish development. Markets are now expecting the overnight will reach the lower end of that neutral range by the end of 2019.

But we aren't ready to change our forecast for next year. Sure, the BoC says monetary policy needs to become neutral, but they didn't give a timeframe for that adjustment. We still think they'll have to be gradual in removing accommodation given household sensitivity to rising rates. Our forecast assumes higher borrowing costs will weigh on the household sector a bit more than the BoC has penciled in next year. As such, we only look for two rate increases in 2019. In our view, it won't be until 2020 that the overnight rate shifts into the central bank's neutral range.

Highlights

▲ Canada's economy grew for a seventh consecutive month in August, one of the better streaks seen this cycle.

▲ Businesses surveys point to growing capacity pressures and labour shortages in particular.

▲ The BoC no longer indicated rate hikes will be "gradual," but that doesn't necessarily mean they'll speed up the pace of tightening.

▲ We don't see the overnight rate reaching a 'neutral' setting until 2020.

Highlights

▲ The UK economy picked up in Q3 but business investment continued to moderate…

▲ …and business surveys point to deteriorating sentiment as Brexit deadlines approach.

▲ Once again, temporary factors were behind some of the weakness in Q3 euro area growth.

▲ Australia's unemployment rate fell to a six-year low but underutilization remains elevated.

UK sentiment waning as Brexit deadlines draw closer

UK GDP growth picked up to a 0.6% non-annualized pace in Q3, the fastest in nearly two years. Solid consumer spending and a rebound in exports provided much of the lift, while business investment fell for a third consecutive quarter. We don't expect last quarter's acceleration will be sustained as stronger consumer spending over the summer has started to fade, while capital spending continues to be weighed down by Brexit uncertainty. On the latter, October's PMI surveys showed deteriorating sentiment in both the manufacturing and services industries—the composite reading is at its lowest since the month after the referendum—as key Brexit deadlines draw closer. There have been bouts of optimism that a deal might be reached between the UK and EU, though passage through UK parliament remains another hurdle. Until there is greater clarity, the Bank of England will remain on the sidelines as they did in November. Economic fundamentals argue for less accommodation—unemployment is low, wages are rising and core inflation is close to target. Indeed, BoE Governor Carney sounded somewhat hawkish in his latest comments, noting upside news on pay growth that should support firming price pressures. So if the central bank's assumption of a 'smooth' Brexit transition comes to fruition, we expect they will raise rates early next year. That scenario would also likely see some release of pent up investment that should help sustain the economy's expansion.

More temporary factors weighing on euro area growth

Euro area GDP growth fell short of expectations in Q3, slipping to a 0.2% non-annualized pace that was the weakest in four years. Italy's economy was flat, also a first since 2014, as political uncertainty appeared to weigh on domestic demand. Activity picked up in France as a number of temporary factors that limited growth over the first half of the year dissipated, while Spain's economy continued to expand at a steady rate. Germany's Q3 GDP is not yet available but growth looks to have slowed due to disruptions in the auto sector. The trade sector has also provided less support amid weaker exports to emerging markets. A confluence of transitory factors has weighed on euro area growth this year—activity should pick up somewhat as those issues fade but we're not likely to see a return to the last year's impressive pace. The ECB seems willing to look through transitory wobbles in the data. Draghi indicated in October that growth was weaker than expected but not enough for the central bank to change their policy path. Asset purchases should come to an end (on a net basis) after December while policy rates are expected to start moving higher later next year. But Draghi has also indicated that monetary policy is not on a pre-set course, noting the ECB has options if the economic situation worsens.

RBA continues to sound upbeat but rates likely to remain steady

The Reserve Bank of Australia continued to strike a positive tone in November, taking note of stronger GDP growth over the first half of 2018 and the lowest unemployment rate in six years. They expect the economy will continue to expand at an above-trend rate going forward, lifted by business investment, exports and government spending. But they described the household sector as a source of "continuing uncertainty," a view we share and one that was reinforced by soft retail sales in Q3. Consumer spending looks to have provided less support to growth over the second half of the year, and we see that trend persisting in 2019 amid a weaker housing market and limited room for households to dip into savings. Recent employment trends have been positive but wage growth will likely be slow to pick up as underutilization rates point to more slack than unemployment itself suggests. We continue to think that the process of tightening capacity translating into greater wage and inflationary pressure will be a slow one—as international experience suggests. As such, the RBA is likely to keep the cash rates steady well into next year, even if they remain optimistic on the growth outlook.

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	2.00	2.25	2.25	2.25	2.50	2.75	2.75	2.75
Three-month	1.10	1.26	1.59	1.65	1.90	2.15	2.15	2.20	2.45	2.70	2.70	2.75
Two-year	1.78	1.91	2.21	2.30	2.45	2.45	2.40	2.45	2.70	2.85	2.90	3.00
Five-year	1.97	2.07	2.34	2.45	2.55	2.65	2.70	2.75	2.95	3.10	3.10	3.15
10-year	2.09	2.17	2.43	2.60	2.70	2.80	2.90	2.90	3.05	3.20	3.30	3.30
30-year	2.23	2.20	2.42	2.70	2.80	2.90	2.95	2.95	3.10	3.25	3.30	3.30
United States												
Fed funds**	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.50	3.75	4.00	4.00	4.00
Three-month	1.73	1.93	2.19	2.35	2.65	2.90	3.15	3.35	3.60	3.85	3.85	3.85
Two-year	2.27	2.52	2.81	2.90	3.10	3.25	3.40	3.60	3.80	4.00	3.95	3.90
Five-year	2.56	2.73	2.94	3.10	3.25	3.40	3.55	3.65	3.85	4.05	4.00	3.95
10-year	2.74	2.85	3.05	3.30	3.45	3.60	3.70	3.75	3.90	4.05	4.05	4.00
30-year	2.97	2.98	3.19	3.50	3.65	3.75	3.80	3.85	3.95	4.05	4.05	4.00
United Kingdom												
Bank rate	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.25	1.25	1.50	1.50	1.75
Two-year	0.82	0.72	0.82	0.95	1.10	1.15	1.20	1.30	1.40	1.45	1.55	1.70
10-year	1.34	1.28	1.57	1.75	2.00	2.10	2.20	2.30	2.40	2.50	2.60	2.70
Euro area												
Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	-0.10	0.00	0.00	0.00
Two-year	-0.59	-0.69	-0.55	-0.50	-0.50	-0.50	-0.40	-0.30	-0.10	0.10	0.25	0.25
10-year	0.50	0.31	0.47	0.65	0.80	0.85	1.05	1.10	1.20	1.25	1.25	1.25
Australia												
Cash target rate	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75	-	-	-	-
Two-year	2.00	2.00	2.02	2.10	2.20	2.25	2.35	2.50	-	-	-	-
10-year	2.60	2.63	2.67	2.80	2.85	3.00	3.20	3.35	-	-	-	-
New Zealand												
Cash target rate	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	-	-	-	-
Two-year swap	2.21	2.14	2.02	2.25	2.30	2.35	2.40	2.55	-	-	-	-
10-year swap	3.06	3.02	2.89	3.10	3.15	3.30	3.50	3.65	-	-	-	-
Yield curve*												
Canada	31	26	22	30	25	35	50	45	35	35	40	30
United States	47	33	24	40	35	35	30	15	10	5	10	10
United Kingdom	52	56	75	80	90	95	100	100	100	105	105	100
Eurozone	109	100	102	115	130	135	145	140	130	115	100	100
Australia	60	63	65	70	65	75	85	85	-	-	-	-
New Zealand	85	88	87	85	85	95	110	110	-	-	-	-

* 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	2.00-2.25	1.75-2.00	September 26, 2018	Eurozone	Deposit rate	-0.40	-0.30	March 10, 2016
Canada	Overnight rate	1.75	1.50	October 24, 2018	Australia	Cash rate	1.50	1.75	August 3, 2016
United Kingdom	Bank rate	0.75	0.50	August 1, 2018	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

	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	2017	2018F	2019F	2020F
Canada*	1.4	2.9	2.0	2.1	1.9	1.7	1.7	1.7	1.7	1.7	1.6	1.5	3.0	2.1	1.9	1.7
United States*	2.2	4.2	3.5	2.8	1.8	2.4	2.2	1.8	1.8	1.8	1.7	1.5	2.2	2.9	2.5	1.9
United Kingdom	0.1	0.4	0.6	0.4	0.3	0.4	0.3	0.4	0.4	0.4	0.4	0.4	1.7	1.3	1.5	1.6
Euro area	0.4	0.4	0.2	0.4	0.4	0.4	0.3	0.4	0.4	0.4	0.4	0.4	2.5	1.9	1.7	1.5
Australia	1.1	0.9	0.6	0.8	0.7	0.6	0.8	0.8	-	-	-	-	2.2	3.3	3.0	-
New Zealand	0.5	1.0	0.9	0.8	0.8	0.8	0.8	0.8	-	-	-	-	2.8	2.8	3.3	-

*annualized

Inflation outlook

% change, year-over-year

	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	2017	2018F	2019F	2020F
Canada	2.1	2.3	2.7	2.3	2.1	2.5	2.3	2.5	2.4	2.3	2.3	2.2	1.6	2.3	2.4	2.3
United States	2.2	2.7	2.6	2.5	2.3	2.4	2.5	2.5	2.4	2.4	2.4	2.3	2.1	2.5	2.4	2.4
United Kingdom	2.7	2.4	2.5	2.5	2.3	2.2	2.2	2.0	2.4	2.3	2.2	2.1	2.7	2.6	2.2	2.3
Euro area	1.3	1.7	2.1	1.8	1.9	1.7	1.6	1.5	1.6	1.7	1.7	1.8	1.5	1.8	1.7	1.7
Australia	1.9	2.1	1.9	2.2	2.3	2.5	2.6	2.7	-	-	-	-	1.9	2.1	2.5	-
New Zealand	1.1	1.5	2.0	1.6	1.6	1.6	1.6	1.7	-	-	-	-	1.9	1.6	1.6	-

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

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	CPI ex food & energy[1]	Sep	-0.1	1.8	2.5	1.7
United States	Core PCE[1,2]	Sep	0.2	2.0	1.6	2.0
United Kingdom	All-items CPI	Sep	0.1	2.4	2.4	2.5
Euro area	All-items CPI[1]	Oct	0.2	2.2	2.0	2.3
Australia	Trimmed mean CPI[1]	Q3	0.4	1.8	N/A	N/A
New Zealand	All-items CPI	Q3	0.9	1.9	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				
	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
Canadian dollar	1.33	1.30	1.25	1.26	1.29	1.31	1.29	1.29	1.28	1.27	1.28	1.28
Euro	1.07	1.14	1.18	1.20	1.23	1.17	1.16	1.12	1.10	1.10	1.13	1.16
U.K. pound sterling	1.26	1.30	1.34	1.35	1.40	1.32	1.30	1.26	1.24	1.22	1.24	1.25
New Zealand dollar	0.70	0.73	0.72	0.71	0.72	0.68	0.66	0.66	0.64	0.63	0.63	0.63
Japanese yen	111.4	112.4	112.5	112.7	106.3	110.8	113.7	115.0	117.0	119.0	122.0	125.0
Australian dollar	0.76	0.77	0.78	0.78	0.77	0.74	0.72	0.70	0.68	0.67	0.67	0.67

Canadian dollar cross-rates

	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
EUR/CAD	1.42	1.48	1.47	1.51	1.59	1.53	1.50	1.44	1.41	1.40	1.45	1.48
GBP/CAD	1.67	1.69	1.67	1.70	1.81	1.74	1.68	1.62	1.58	1.55	1.59	1.60
NZD/CAD	0.93	0.95	0.90	0.89	0.93	0.89	0.85	0.85	0.82	0.80	0.81	0.81
CAD/JPY	83.7	86.7	90.2	89.6	82.4	84.3	88.1	89.1	91.4	93.7	95.3	97.7
AUD/CAD	1.02	1.00	0.98	0.98	0.99	0.97	0.93	0.90	0.87	0.85	0.86	0.86

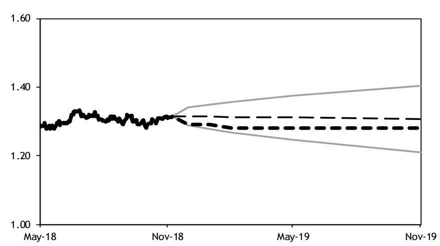
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

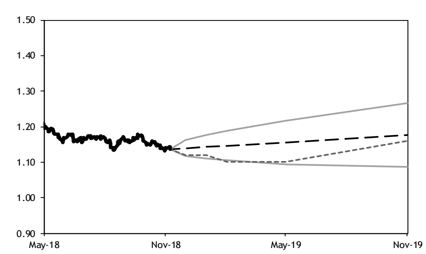
RBC Economics outlook compared to the market

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

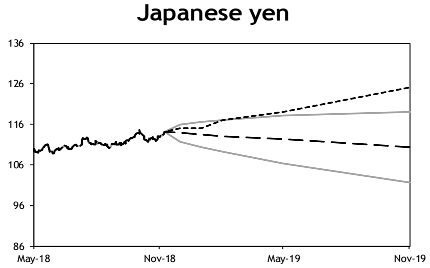
Canadian dollar



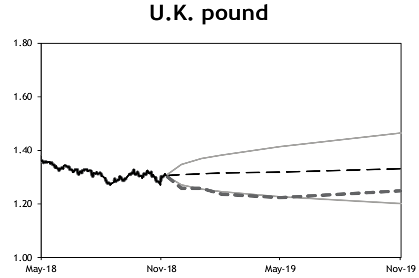
Euro



Japanese yen



U.K. pound

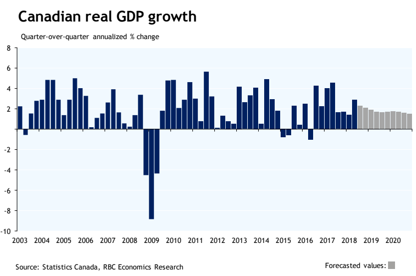


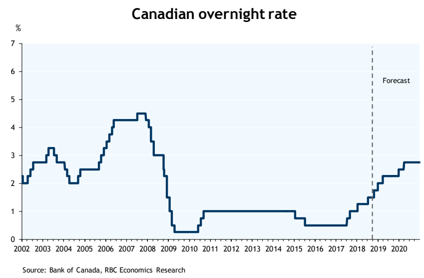
Central bank watch

Bank of Canada

Canada's economy has posted gains for seven consecutive months and we expect GDP growth continued at a 2% pace over the second half of the year.

The BoC sounds pleased with more broadly-based growth, including less reliance on the household sector. We expect they'll continue to raise rates over the first half of next year but don't see the overnight rate reaching 'neutral' until 2020.

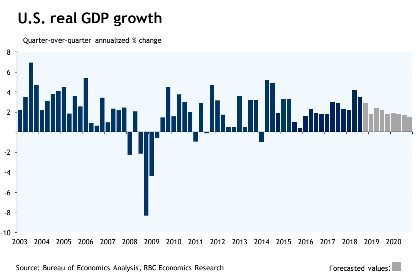




Federal Reserve

The US economy has a full head of steam, posting its best back-to-back growth since 2014. We expect above-trend gains will continue into next year.

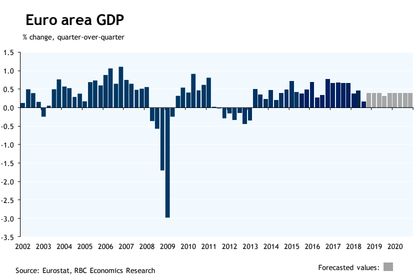
The Fed's once-a-quarter rate increases appear to be entrenched and we look for a hike in December. Monetary policy likely needs to become somewhat restrictive to counter fiscal stimulus—we expect four more hikes in 2019 and two in 2020.

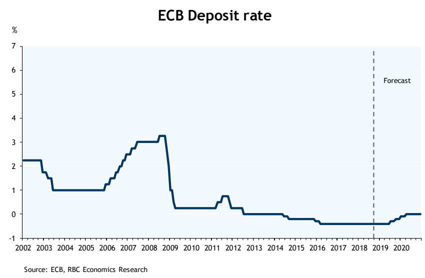


European Central Bank

An expected slowdown in Italy and pickup in France materialized, but temporary weakness in German activity resulted in the slowest euro area growth in four years.

The ECB remains on track to end asset purchases after December and raise rates later next year. But Draghi indicated monetary policy isn't on a pre-set course and can respond if the outlook deteriorates.

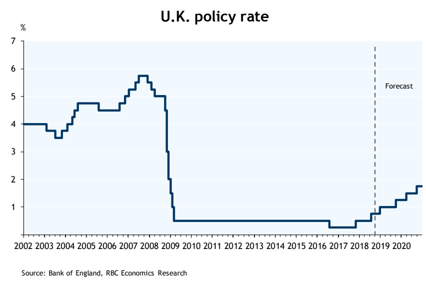




Bank of England

The UK economy posted its best growth in almost two years in Q3 but we don't think the pickup extended into the current quarter.

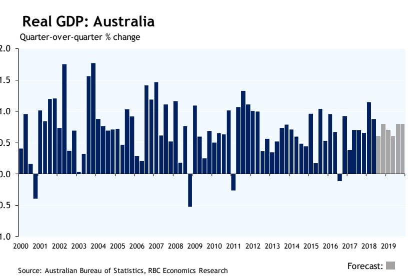
Low unemployment and rising wages point to less need for monetary policy accommodation. But the BoE won't make a move until there is more clarity on Brexit. That should come before the end of the year, so a February hike remains on the table.

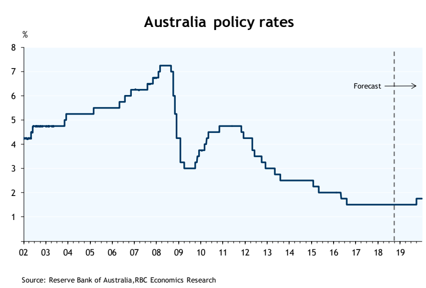


Reserve Bank of Australia

Australia will get less support from consumers, but rising business investment, exports and government spending should keep the economy expanding at a solid pace.

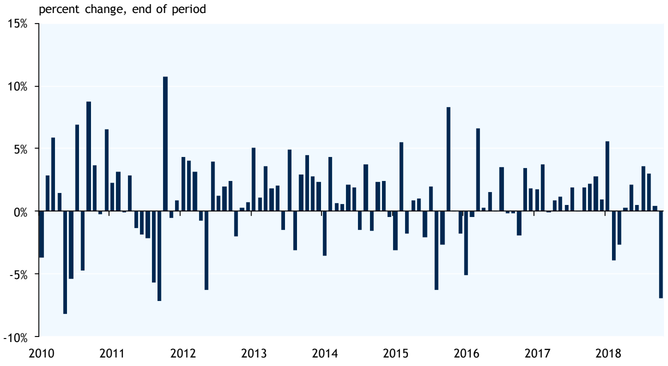
The RBA continues to sound positive on the economic backdrop, but with wages and inflation set to rise only gradually we doubt their tone will translate into a rate hike anytime soon.





A look at October's equity market selloff

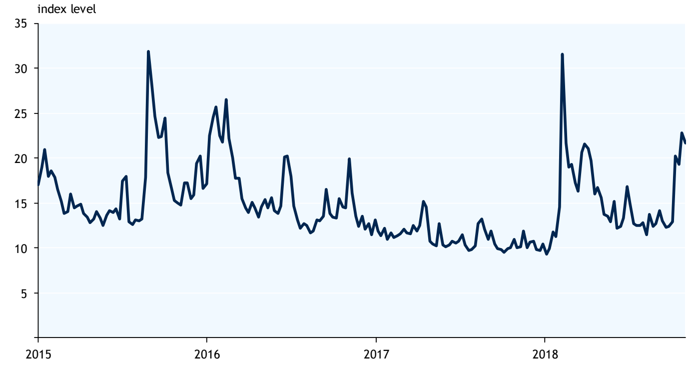
The S&P 500 index posted its worst monthly decline in seven years in October. Global market indices also fell in the month. Concerns that protectionism and rising interest rates will weigh on global growth were a major factor in the selloff.



S&P 500 monthly change

Source: Standard & Poor's, RBC Economics Research

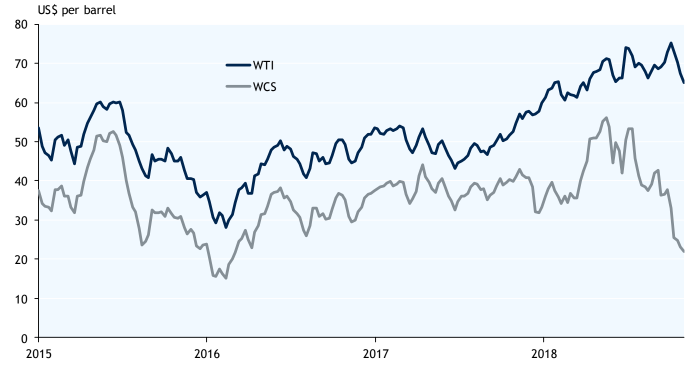
Equity market volatility also returned in October. After record-low volatility throughout 2017, this year has seen two sizeable spikes in the VIX volatility index. We're likely to see more turbulence as interest rates continue to rise.



S&P VIX volatility index

Source: Wall Street Journal, RBC Economics Research

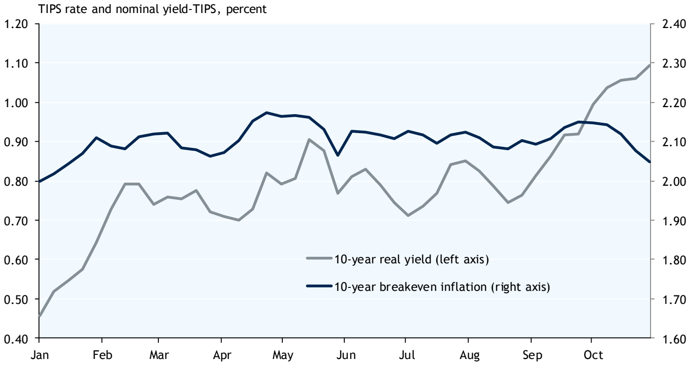
Commodities were caught up in the equity market selloff, with oil prices falling to multi-month lows. Some US concessions on Iranian sanctions were also factor. Meanwhile, discounts on Canadian heavy oil hit record highs in October amid refinery shutdowns in the US.



North American oil prices

Source: Bloomberg, EIA, RBC Economics Research

Lower oil prices weighed on breakeven inflation, but US Treasury yields still ended the month higher as real yields continued to rise. With the Fed showing no sign of slowing their tightening cycle, we expect yields will continue to grind higher next year.



UST 10-year yield breakdown

Source: US Treasury, Federal Reserve Board, RBC Economics Research