Inside...

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

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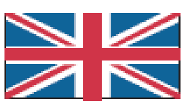
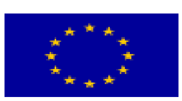
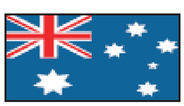
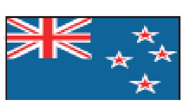
Pushing ahead

The gradual shift away from ultra-accommodative global monetary policy continued in earnest in September. The charge is being led by the Fed who announced they would begin tapering reinvestment of QE holdings in October. They are the first of the 'big four' central banks to start shrinking their sizeable balance sheet after years of buying assets to stimulate the economy. The Fed also indicated they expect to continue on a path of gradually normalizing interest rates later this year and throughout 2018. Confirmation that rate hikes are likely to continue despite low inflation contributed to a selloff in US Treasuries, with the 2-year yield in particular rising to a post-recession high of around 1.5%. And the US dollar rallied further from the year-to-date lows seen in early-September. The prospect of US lawmakers turning their attention to tax cuts also contributed to fixed income and currency moves.

Not to be left behind, the Bank of Canada raised rates again in September following indications that the Canadian economy continued to grow faster than expected over the first half of the year. A subsequent speech by BoC Governor Poloz toned down the hawkishness, emphasizing data dependency and uncertainty about slack in the economy. On balance, however, his comments were consistent with a further, gradual withdrawal of stimulus. Meanwhile, the Bank of England indicated in September that a rate hike might not be far off if high inflation and low unemployment persist. We still see downside risks to the UK's economic outlook, so while the Bank Rate is likely to be raised in November, we don't think the move will be followed by further tightening near-term. Finally, while the ECB continues to provide stimulus through QE and low interest rates, we expect they will announce the pace of asset purchases will be trimmed next year.

Central bank near-term bias

Three-months out, policy rate

	↗	A less hawkish tone from Bank of Canada Governor Poloz in September trimmed the odds of a third consecutive rate hike in October. But with limited economic slack and continued above-trend growth we expect one more move this year and further removal of accommodation in 2018.
	↗	With changes to the Fed's balance sheet policy having little adverse effect on financial markets we expect the central bank will return to gradually raising interest rates with a fed funds hike in December.
	↗	While we see downside risks to the UK's economic outlook, current high inflation and low unemployment warrant the Bank of England removing last year's rate cut. We now expect Bank Rate will be raised to 0.50% in November and held there through 2018.
	↔	We expect the European Central Bank's October meeting will see asset purchases extended into 2018, albeit with a lower gross purchase target. Continuing QE should keep rate hikes off the table through next year.
	↔	The Reserve Bank of Australia once again sounded a bit more upbeat thanks to improving business sentiment and a solid labour market. However, with no shift in their policy bias as yet, we continue to see monetary policy on hold.
	↔	With recent data in line with the Reserve Bank of New Zealand's expectations, they left monetary policy unchanged in September and kept a good deal of flexibility in their forward guidance. We don't see that stance shifting in the near term.

Highlights

▲ Hurricane-related disruptions and a subsequent rebound in activity will make it more difficult to gauge the economy's underlying pace of growth in H2/17.

▲ Tax cuts have the potential to boost the US economy but the net effect depends on how they are funded.

▲ The Fed's 'dot plot' continued to point to another rate hike before the end of the year, boosting market expectations of such a move.

▲ A changing of the guard at the Fed could add some uncertainty to the outlook for monetary policy.

US in for a period of volatile data after hurricanes

Recent US economic indicators have been negatively impacted by severe weather. Hurricane Harvey, which made landfall in Houston in late-August, was likely responsible for some of the weakness in retail sales, industrial production, home sales and housing starts in the month. The data will likely remain noisy in September with Hurricane Irma hitting Florida early in the month. The end result should be slower growth in Q3, though with trade and inventory reports pointing to less weakness on the production side, we have only trimmed our GDP forecast to 2.4% from 2.6% previously. As well, we expect any weather-related slowing will be made up in Q4 when activity has resumed and rebuilding begins. Looking through near-term volatility, we think the economy's underlying pace of growth remains strong, with further strength in consumer spending and business investment driving above-trend growth.

From healthcare to tax policy

After failing to pass healthcare legislation, lawmakers in the US are now turning their attention to tax cuts. While still lacking key details, the Trump administration's proposal to lower the corporate tax rate to 20%, and taxes for pass-through businesses to 25%, would represent a sizeable cut for businesses. Personal taxes are also set for a revamp, with a proposed shift to just three income tax brackets (and potentially a fourth) while repealing the alternative minimum tax and estate tax. It appears that much of the proposed reduction in personal income taxes would accrue to higher tax brackets, which tend to have lower multipliers for GDP growth. The corporate tax proposal, however, could provide more of a boost to the economy. We caution, however, that how these tax cuts are funded is an important piece of the puzzle. Fully offsetting lower corporate and personal taxes by cutting discretionary spending could ultimately have little or even a negative impact on the economy. The proposed tax cuts will likely have a to be deficit-financed to provide a noticeable lift to GDP growth. Given uncertainty about exactly which tax measures might be passed and how they will be funded, we have included only a marginal boost to growth as a placeholder while awaiting further information.

Little change from the Fed still counts as hawkish

As expected, the Fed left interest rates unchanged in September and announced that they will begin tapering reinvestment of balance sheet assets in October. The move was well-flagged and easily digested by markets. So the focus was instead on the Fed's latest thoughts on inflation, which has slowed this year despite limited economic slack, and any implications for the pace of tightening outlined in the 'dot plot'. In the event, Chair Yellen's comments largely stuck to the script: inflation has been held down by some transitory factors and should return to the Fed's 2% objective as those factors dissipate and tighter economic and labour market conditions put upward pressure on prices. That view was backed up by a little-changed set of 'dot plot' projections showing another rate hike is likely by the end of this year with three more moves seen next year. The Fed noted that recent hurricanes are likely to result in volatility in near-term economic data but won't impact the economy's medium-term growth.

Despite little change in either tone or economic projections, markets saw the Fed's September meeting as hawkish. Confirmation that gradual tightening is likely to continue despite slowing spot inflation prompted a modest USD rally and slight selloff in Treasuries that has since continued. And with the Fed saying they'll look through weather-related volatility in the data, a bad economic report here and there over the next few months shouldn't keep policymakers on the sidelines. As such, we continue to expect the Fed will resume raising rates in December after last month's pause. We look for a quarterly pace of rate hikes to continue in 2018, slightly ahead of the three hikes in the Fed's 'dot plot'. But there is a greater-than-usual degree of uncertainty around monetary policy next year with the Fed's leadership up in the air. Stanley Fischer, Vice Chairman of the Fed's Board of Governors and a prominent voice in setting monetary policy, is retiring in October before his term expires. At the same time, whether Chair Yellen will be renewed for a second term as chair when her first expires in early-February remains up in the air. And there are additional vacancies on the board that have yet to be filled. All told, we could be looking at a much different group of decision-makers at the Fed next year, raising uncertainty about whether the recent path of policy will continue in 2018.

Canada's economy took a breather in July

Canadian GDP was flat in July following eight consecutive monthly increases with growth averaging an impressive 0.4% over that period. July's pause reflected a pullback in the goods sector led by further runoff of an earlier, unexpected increase in oil and gas production. That offset a trend-like increase in services output driven by another solid gain in wholesale trade. With the economy having carried good momentum into mid-year, the slow start to Q3 didn't dent our forecast for another above-trend GDP gain. We continue to forecast a 2.5% annualized increase—slightly ahead of the Bank of Canada's 2% projection—though we'll need to see a return to at least modest monthly gains in August and September to hit that mark. We think Q3 will mark the start of a more moderate but still above-trend period of growth after the economy posted its best-year-over-year increase in more than a decade in Q2. Consumer spending and business investment will remain the primary contributors to growth, though not at the heady pace recorded over the first half of the year.

Businesses grappling with policy uncertainty

Canadian businesses are facing policy uncertainty on several fronts. Internationally, concerns about US protectionism continue to loom large. Trump's threats to tear up NAFTA may have lost their shock value, but the US's tough stance on trade was evident when the Commerce Department slapped a sizeable countervailing duty on some of Canada's aircraft exports—in the middle of the third round of NAFTA renegotiation no less. Also south of the border, potential changes to US tax policy could impact Canadian businesses. The Trump administration's proposal to lower the corporate tax rate to 20% would erode Canada's competitive advantage in that area, potentially offsetting any strengthening in US GDP growth—and thus increased demand for Canadian exports—that comes along with the cut.

Policy changes at home are also generating uncertainty. The federal government's proposed tweaks to the taxation of small businesses have been a source of controversy, while a planned increase in Ontario's minimum wage has businesses across a range of sectors concerned about rising labour costs. Those issues may have been behind a drop in small business confidence in September, with Ontario's reading in particular falling to a post-recession low. We'll be keeping a close eye on the Bank of Canada's Q3 Business Outlook Survey, due October 16th, to see if the decline in small business sentiment shows up in the form of reduced investment or hiring intentions. The latter survey remains an important input in the BoC's decision-making process, with strong readings in Q2 playing a role in their decision to start raising rates in July.

Bank of Canada breaks the silence

We hadn't heard a peep from the Bank of Canada since their July hike but that didn't stop policymakers from raising rates again in September, arguing that their emphasis on data dependence combined with steady upside surprises provided all the information necessary. Either way, the Governing Council broke their silence with two speeches in September. The first, by Deputy Governor Lane, centred more on trade than current monetary policy although his concern about recent Canadian dollar strength was notable. But it was the second speech by Governor Poloz that really drew attention. He emphasized that monetary policy remains particularly data dependent, with uncertainty around potential GDP growth, the impact of technology on inflation, puzzlingly slow wage growth and highly indebted households' reaction to higher rates all making it difficult to pin down the appropriate path for interest rates.

The speech was less hawkish than prior comments, and Governor Poloz's views on economic slack were of particular significance. He acknowledged that a mechanical reading of their earlier estimate of slack alongside recent growth numbers would indicate the output gap is now closed. However, he also noted that stronger productivity growth and resulting supply-side expansion meant the economy may still have some room to run. So don't be surprised if the BoC's October forecast shows stronger potential growth and some remaining slack. Nonetheless, we think the economy's proximity to full capacity and decent growth momentum will leave the bank confident that we're not far from 'home' and a gradual withdrawal of monetary policy stimulus should continue. We still expect another rate hike this year but acknowledge the odds of a third consecutive move at the upcoming meeting have slipped in the wake of Poloz's speech.

Highlights

▲ Canada's economy paused in July after a string of impressive gains, but we still expect above-trend growth in Q3.

▲ Canadian businesses are facing uncertainty from domestic and international policy changes.

▲ A less hawkish tone from Governor Poloz had markets trimming back the odds of another near-term rate hike.

▲ Even if the BoC's estimate of potential growth is revised higher, we think the economy's proximity to full capacity continues to argue for gradually removing accommodation.

Highlights

▲ With the BoE indicating a near-term hike is likely, we now expect a move in November to undo last year's rate cut.

▲ We expect the ECB will extend its asset purchase program into next year at a reduced monthly pace.

▲ Australia's economy has added 268k jobs so far this year but the unemployment rate is just 0.1 ppt lower than a year ago.

▲ New Zealand's GDP growth picked up to 0.8% in Q2 from 0.6% and 0.4% in the prior two quarters.

BoE set to raise rates but economic outlook still a concern

UK survey data continued to signal a bit less momentum in the economy in Q3. The services index in particular slipped further, while manufacturing activity held up with a more competitive exchange rate providing some help. With July's index of services confirming a slow start to the quarter for the UK economy's largest sector, we continue to project a sub-trend 0.2% increase in Q3 GDP. That would be down slightly from 0.3% gains in each of the first two quarters this year, and a downwardly-revised 0.5% average pace in the second half of last year. Despite slowing GDP growth, the UK labour market has continued to tighten with the unemployment rate hitting a multi-decade low of 4.3%. That is south of the Bank of England's recently-lowered 4.5% estimate of the longer-run neutral unemployment rate. Meanwhile, inflation is close to the upper-limit of the BoE's target range and core inflation has trended higher in recent months. The combination of tight conditions and above-target inflation led a majority of BoE policymakers to conclude in September that "some withdrawal of monetary stimulus was likely to be appropriate over the coming months." So while we continue to expect UK economic growth will remain subdued in the near-term, we acknowledge that the BoE is likely to raise the Bank Rate by 25 basis points to 0.50% in November. That would undo the cut announced in the wake of last year's Brexit referendum. We don't see this as the beginning of a tightening cycle but rather expect the policy rate will be held steady through 2018 amid a mixed economic outlook.

ECB set to announce QE extension

The euro area economy grew at its fastest year-over-year pace since 2011 in Q2 and appears to have maintained solid momentum in Q3. Purchasing managers' index readings slipped slightly from the previous quarter's average but remained elevated. And activity picked up toward the end of the quarter—a good sign for Q4—though we caution that the improvement in Spain's survey readings might not be sustained given recent political uncertainty. Overall, we expect GDP growth will continue at an above-trend 0.5% quarterly pace over the second half of the year. Despite the currency bloc's sustained recovery, inflation continues to go nowhere with September's core reading slipping back to 1.1% year-over-year. Given the lack of progress toward the European Central Bank's inflation target, we expect policymakers will keep conditions accommodative by announcing an extension of asset purchases into 2018. However, continuing to buy government debt without running into self-imposed limits will require a reduced pace of purchases—we expect monthly buying will be trimmed to €40 billion gross from €60 billion net. An extension of the QE program, combined with the ECB's forward guidance on rates, would leave a hike off the table through 2018.

RBA maintains upbeat tone while holding policy steady

The Reserve Bank of Australia left the cash rate unchanged as expected in early-October but once gain struck a fairly upbeat tone with nods to strengthening global growth, improving business conditions and solid job gains. Business investment in particular was characterized more positively thanks to indications of improving non-mining capex intentions and likely positive feedback from the RBA's own business liaison survey. The central bank sounded pleased with recent job growth, which has averaged an impressive 33k per month so far this year. Improving labour market conditions are reinforcing policymakers' expectation that wage growth and inflation should pick up over time, and we think job reports over the remainder of the year will help shape the central bank's policy bias. A growing labour force has so far constrained the drop in the unemployment rate, but if the recent pace of hiring is sustained, we could see unemployment dipping below the 5.5-6.3% range seen over the last four years. For now though, we think the RBA will maintain its ambiguous forward guidance and the cash rate unchanged into next year.

Little change from the RBNZ in September

As expected, New Zealand's GDP growth perked up in Q2 after slowing around the turn of the year. The increase was in line with the central bank's expectation, leaving their characterization of the economy little changed at September's meeting. Their inflation outlook, comments on the currency and forward guidance that monetary policy will remain accommodative were also copied from August. With wage growth and underlying inflation set to remain sub-trend, we don't see the Reserve Bank of New Zealand coming off the sidelines anytime soon. The cash rate has been held steady at a record-low of 1.75% for nearly a year now, and we see that streak continuing through 2018.

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	1.25	1.25	1.50	1.75	2.00
Three-month	0.45	0.48	0.53	0.46	0.52	0.71	1.00	1.30	1.25	1.55	1.80	2.05
Two-year	0.54	0.52	0.52	0.80	0.75	1.10	1.52	1.70	1.80	1.90	2.15	2.35
Five-year	0.67	0.57	0.62	1.15	1.12	1.40	1.75	2.00	2.15	2.40	2.55	2.70
10-year	1.23	1.06	1.00	1.80	1.62	1.76	2.10	2.40	2.50	2.65	2.85	3.00
30-year	2.00	1.72	1.66	2.35	2.30	2.14	2.47	2.75	2.85	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	1.25	1.27	1.38	1.47	1.85	2.05	2.35	2.55	2.70
Five-year	1.21	1.01	1.14	2.00	1.93	1.89	1.92	2.25	2.45	2.65	2.85	3.00
10-year	1.78	1.49	1.60	2.55	2.40	2.31	2.33	2.65	2.85	3.00	3.20	3.40
30-year	2.61	2.30	2.32	3.15	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	100	87	66	58	70	70	75	70	65
United States	105	91	83	130	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	0.25	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*	2.8	-1.4	4.2	2.7	3.7	4.5	2.5	2.0	2.0	1.8	1.7	1.7	0.9	1.5	3.1	2.2
United States*	0.6	2.2	2.8	1.8	1.2	3.1	2.4	2.8	2.5	2.3	2.0	2.0	2.9	1.5	2.2	2.4
United Kingdom	0.2	0.5	0.4	0.6	0.3	0.3	0.2	0.2	0.4	0.5	0.5	0.5	2.3	1.8	1.4	1.6
Euro area	0.5	0.3	0.5	0.6	0.5	0.6	0.5	0.5	0.5	0.4	0.4	0.4	1.9	1.8	2.2	1.8
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	1.3	1.3	1.0	1.7	1.9	2.0	1.1	1.4	1.5	1.7
United States	1.1	1.0	1.1	1.8	2.5	1.9	2.0	1.9	1.5	2.0	1.9	1.6	0.1	1.3	2.1	1.8
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	2.1	2.3	2.4	2.7	2.4	2.3	1.5	1.3	2.1	2.5
New Zealand	0.4	0.4	0.4	1.3	2.2	1.7	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	CPI ex food & energy[1]	Aug	0.1	1.5	1.5	1.3
United States	Core PCE[1,2]	Aug	0.1	1.3	1.4	1.2
United Kingdom	All-items CPI	Aug	0.6	2.9	2.1	3.3
Euro area	All-items CPI[1]	Sep	0.2	1.5	1.0	1.2
Australia	Trimmed mean CPI[1]	Q2	0.5	1.8	N/A	N/A
New Zealand	All-items CPI	Q2	0.0	1.7	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	1.24	1.27	1.26	1.26	1.26
Euro	1.14	1.11	1.12	1.05	1.07	1.14	1.18	1.12	1.09	1.06	1.08	1.12
U.K. pound sterling	1.44	1.33	1.30	1.24	1.26	1.30	1.34	1.20	1.16	1.18	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	103.0	100.0	102.0	104.0	106.0
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	1.39	1.42	1.34	1.36	1.41
GBP/CAD	1.87	1.72	1.70	1.66	1.67	1.69	1.67	1.49	1.47	1.48	1.56	1.66
NZD/CAD	0.90	0.92	0.96	0.93	0.93	0.95	0.90	0.93	0.91	0.88	0.87	0.87
CAD/JPY	86.6	79.9	77.2	87.0	83.7	86.7	90.2	83.1	78.7	81.0	82.5	84.1
AUD/CAD	1.00	0.96	1.01	0.97	1.02	1.00	0.98	0.99	0.98	0.93	0.92	0.92

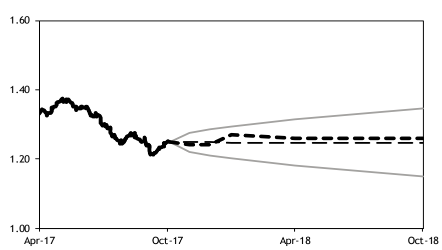
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

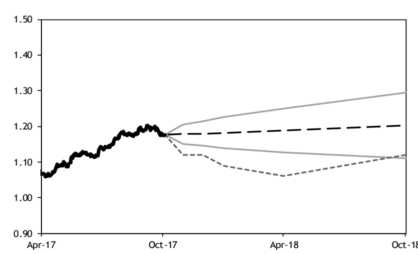
RBC Economics outlook compared to the market

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.

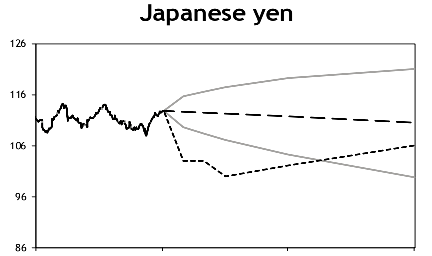
Canadian dollar



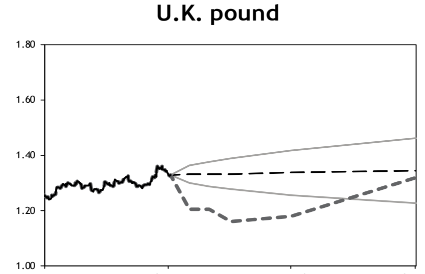
Euro



Japanese yen



U.K. pound

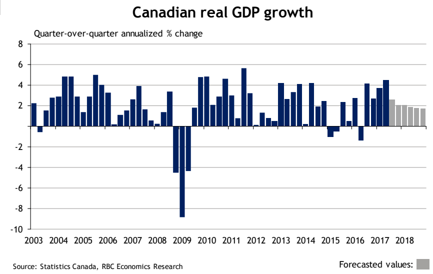


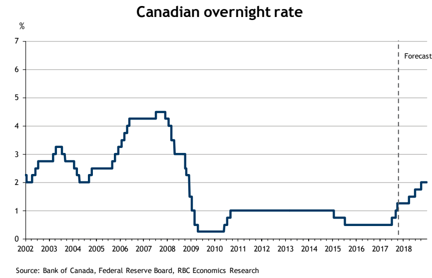
Central bank watch

Bank of Canada

Canada got off to a slow start in Q3 with GDP growth flat in July. However, solid momentum heading into the quarter and an expected return to growth in subsequent months left our 2.5% quarterly forecast unchanged.

Even with expected tweaks to the BoC's views on potential growth, we think a nearly-closed output gap and continued above-trend growth will have them raising rates again before the end of the year.

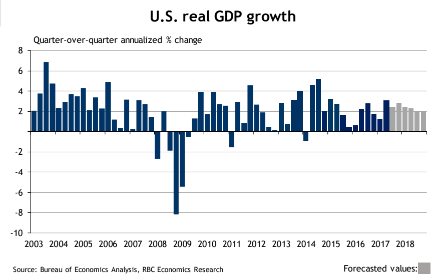


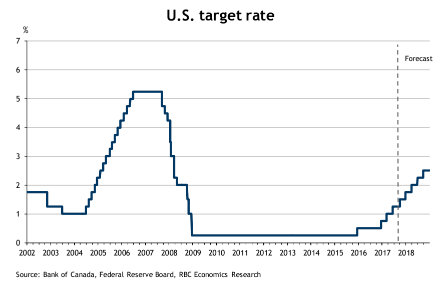


Federal Reserve

Severe weather is causing data volatility but we expect the US economy will expand at a solid 2.6% average annualized pace over the second half of the year.

Despite inflation holding below their 2% objective, the Fed maintained their view that further, gradual rate hikes are appropriate amid tight economic and labour market conditions. We expect a rate hike in December and further moves next year.

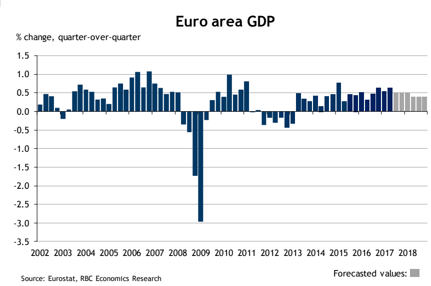


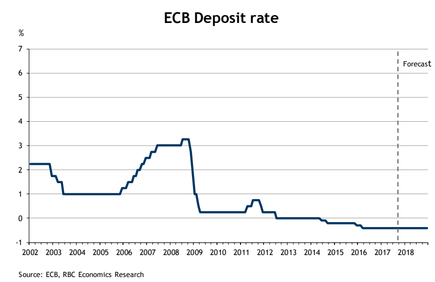


European Central Bank

We expect the euro area extended its consistent streak of above-trend gains with GDP rising 0.5% in Q3. Despite chipping away at the output gap, inflation remains subdued.

The ECB is set to extend its asset purchase program in October. With rates set to remain at current levels "well past the horizon of net asset purchases" we think a rate hike will remain off the table through 2018.

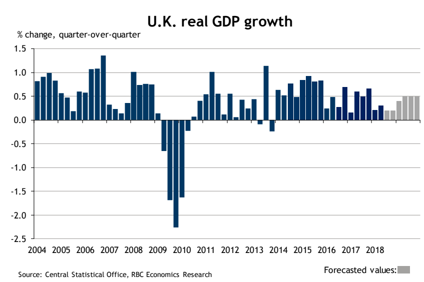


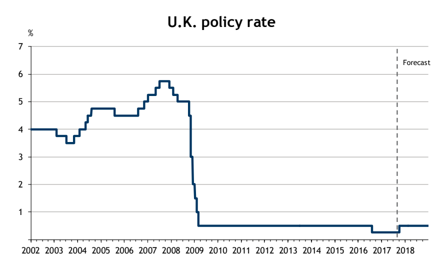


Bank of England

We think the UK economy continued to expand at a sub-trend pace in Q3 with GDP growth edging down to 0.2% from 0.3% gains in the first half of the year.

Despite limited momentum in the economy, the BoE looks likely to respond to elevated inflation and limited economic slack. We don't see November's rate hike being followed up by further tightening as economic conditions remain mixed.

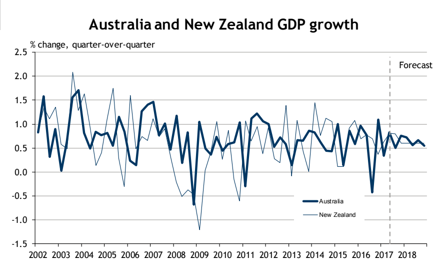


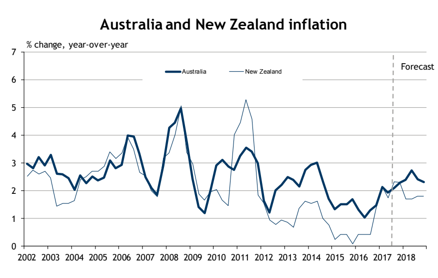


Australia and New Zealand

The RBA continues to sound a bit more upbeat but offered no change in their neutral bias. We think it would take further job gains and a lower unemployment rate to have the central bank thinking about raising interest rates.

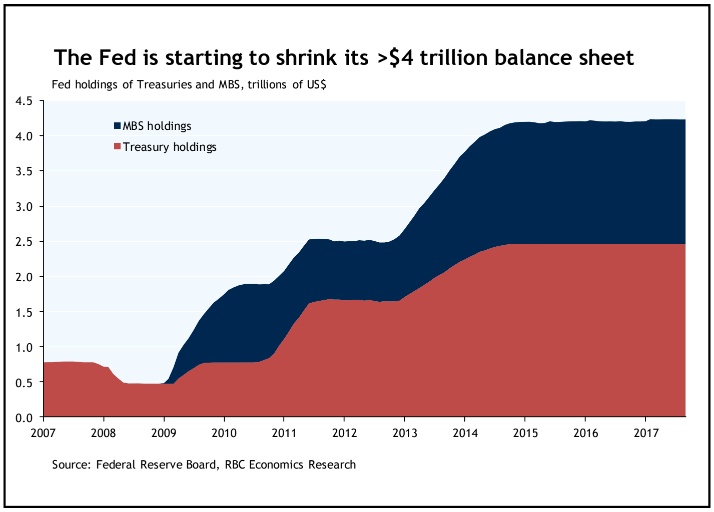
The RBNZ's latest meeting was a non-event with recent data coming in line with their expectations. Political uncertainty and an interim governor also likely kept the central bank from rocking the boat.



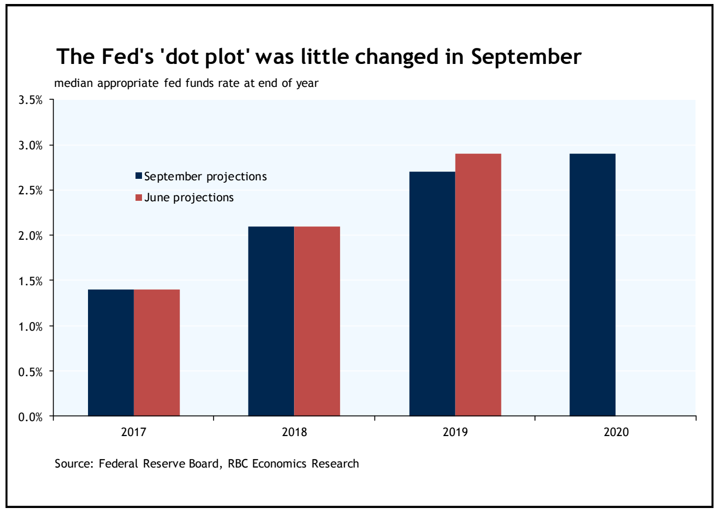


Several major central banks are removing accommodation

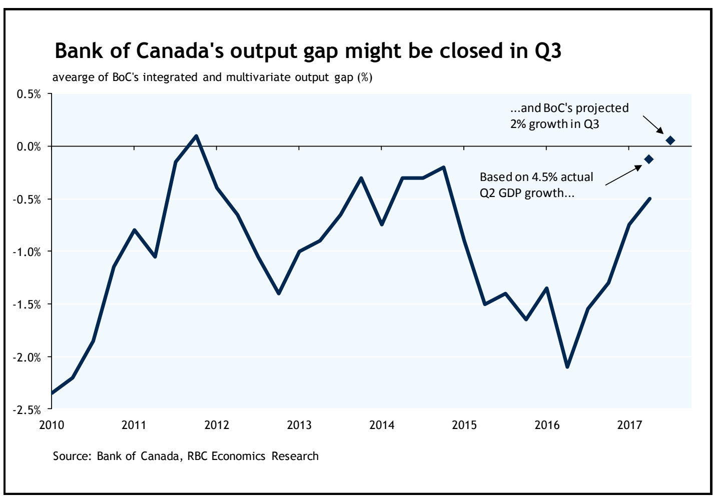
As expected, the Fed announced they would start shrinking their balance sheet in October by tapering reinvestment of principal payments and maturing assets. They will be the first of the 'big four' central banks to start unwinding QE purchases.



A little-changed set of 'dot plot' projections showed the Fed continues think one more hike this year and three more next year will be appropriate.



Stronger than expected growth points to Canada's output gap being roughly closed. Even if the economy's speed limit has ticked higher, we think the BoC will continue to remove accommodation with the economy so close to 'home'.



UK inflation has picked up well above the BoE's 2% target and the unemployment rate at 4.3% is below their longer-run estimate. Given these conditions, policymakers have indicated a near-term rate hike is likely.