RBC Economics
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New highs, new lows

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Policy uncertainty reached new heights in August (at least according to one US index) and bounced around equity markets in the process. Last month saw the S&P 500's three largest daily declines of the year as investors reacted to fresh volleys in the US-China trade war. There was a glimmer of hope in early-September, though, as the two sides agreed to a new round of talks. And for all the escalation in trade tensions throughout August, the S&P index is just 2% off its late-July record highs. While equities saw plenty of ups and downs, fixed income markets moved in one direction last month. 10-year US Treasury yields dropped by an eye-watering 50 basis points in August (to near-record lows), German and French yields plumbed deeper into negative territory, and even Italian 10-year borrowing costs fell below 1%. Despite less-dovish central bankers, those moves spilled over into Canada and the UK. Even with some retracement in September, yields across developed economies remain well below where they started the year (and the summer, for that matter).

A decline in longer-term interest rates flattened, and in some cases inverted, yield curves. That dreaded precursor of an economic downturn led to no shortage of recession talk. It's worth noting that yield curve inversion needs to be sustained for several months to really flag a slowdown, and even then the lag can be a year or longer. Investors are still trying to disentangle whether we should start the recession countdown or if this time is different. One thing that's clear is financial markets are signaling slower growth ahead, and the need for easier monetary policy. Some central banks have been more obliging than others. The Fed remains committed to a mid-cycle adjustment and looks likely to cut rates again in September. The ECB is about to unveil a new easing package that we think will include its first interest rate cut in more than three years. But the BoC was defiantly neutral in September, saying it will set monetary based on domestic conditions, not what other central banks are doing. The BoE also sounds reluctant to lower rates as it continues to grapple with Brexit uncertainty.

Central bank near-term bias

The Bank of Canada was more neutral than expected in September, which trimmed the odds of a near-term cut. We still see an implicit easing bias, though, and expect a move early next year.

The Fed's mid-cycle adjustment is set to continue with a rate cut on September 18, and we expect one more move by the end of the year, in keeping with the 1995 and 1998 mini-easing cycles.

Sorting through recent volatility, the UK economy's underlying trend looks subdued. With Brexit uncertainty potentially extending into 2020, we continue to assume the BoE will cut rates by the end of this year.

The ECB will step up its fight against subdued inflation in September with an even lower (more negative) deposit rate and forward guidance that emphasizes the central bank's commitment to hitting its inflation goal on a sustained basis.

Soft economic data suggest the RBA won't wait too long before acting on its easing bias and we expect a cut in November. But policymakers might want to take a bit more time to judge the impact of past cuts.

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

Highlights

▲ US manufacturing sentiment declined further in August as trade tensions continued to escalate.

▲ Non-manufacturing sentiment has also softened but to a much lesser extent, suggesting limited spillover into other industries.

▲ Job growth has slowed this year but remains strong enough to keep unemployment low—and consumers happy.

▲ Past mid-cycle policy adjustments (1995 and 1998) saw the Fed cut rates by 75 basis points.

US manufacturing woes grow…

The US manufacturing sector continues to bear the brunt of tariff increases and unprecedented uncertainty over trade policy. The latest evidence of that came in August's ISM manufacturing survey, which slipped below 50 (now signaling contraction in the sector) for the first time since the 2015-16 industrial downturn. New orders matched a cycle low, with export orders in particular taking a dive (imports were also down sharply). It's worth noting that manufacturing output declined over the first half of the year, so the ISM's dip below 50 might just be catching down to actual activity. Either way, it suggests the industry's woes are continuing in the second half of the year. As with the headline reading, the employment sub-index fell below 50. As we've noted recently, job growth in the sector has slowed sharply this year (more than any other industry) though a scarcity of available workers is also factor with vacancy rates remaining high.

…but spillover still contained

The worry generated by a further decline in the ISM manufacturing index was subsequently offset by a stronger-than-expected non-manufacturing print, which covers a far larger share of the US economy. That index rebounded to a three-month high, with the business activity and new orders components jumping back above 60, indicating a solid pace of output and demand growth. The widening gap between the manufacturing and non-manufacturing indices suggests limited spillover into the latter and is reminiscent of the 2015-16 oil price shock and the 2012 euro crisis when the industrial sector slowed but a broader US downturn was avoided.

Consistent with that, our forecast assumes relatively modest US GDP growth in the coming quarters, but not a recession. Much of that hinges on the health of US consumers, where indicators remain generally (but not universally) positive. Job growth has undoubtedly slowed this year—average monthly gains of 158,000 through August, if sustained, would be the slowest since 2010. And last year's disposable income bump from tax cuts has faded. But steady real wage growth, lower interest rates, and a nice savings buffer should keep consumer spending from slowing too much relative to its recent pace. It's also worth noting that job growth remains strong enough to keep the unemployment rate near historical lows, which should support consumer confidence. Of course, we'll need to keep an eye on sentiment if recent equity market volatility and recession fears are sustained. For now, though, there are no red flags on the consumer side that suggest the sector won't continue to offset weaker growth in exports and business investment.

Fed sticking with mid-cycle adjustment

In his speech at Jackson Hole, Chair Powell noted the three weeks since the Fed's July rate cut had been "eventful", including a new round of tariffs on China, further evidence of slowing global growth (particularly in China and Germany), and a number of other adverse geopolitical events. But he also pointed out the US economy's overall positive performance and indications that inflation is heading back to 2%. On balance, Chair Powell didn't alter his tone, leaving investors convinced that further cuts are on the way.

We are with the market in expecting the Fed's mid-cycle policy adjustment will continue with another 25 basis point cut in September. The real question is how much further the central bank will go. At Jackson Hole, Powell pointed out the two times during the 1990s when the Fed eased policy in response to threats to growth. The fed funds rate was lowered by 75 basis points in each of those mid-cycle adjustments. Using history as a guide, as well as recent comments from other Fed officials, we now expect the current easing will be of similar magnitude. So in addition to a rate cut on September 18, our forecast now assumes another move by year-end. That is roughly in line with current market pricing, though we continue to think investors will be disappointed in their easing expectations next year (nearly 50 bps of additional cuts priced in). So while government bond yields look set to remain close to current, low levels in the near-term, we expect a moderate selloff will push yields higher as we head through 2020.

Making sense of the latest Canadian GDP figures…

Canadian GDP rose an annualized 3.7% in Q2, coming in well ahead of expectations. That's the strongest increase in two years but the good news ended there. Consumer spending grew at its slowest pace in seven years, which as the BoC pointed out, is hard to square with a 7% annualized increase in aggregate household payrolls in the quarter. Business investment returned to a downward trend, posting the fourth (and largest) decline in the last five quarters. The combination of slower consumer spending and less investment saw overall domestic demand decline in the quarter. So where did all that GDP growth come from? Net exports added a whopping 5.5 ppts to growth—the second-largest contribution in the last two decades.

What to make of these messy (and sometimes contradictory) details? We think it's best to look through quarterly volatility and focus on the first half of the year as a whole, which tells a more coherent story. Consumer spending growth has picked up slightly this year, reflecting a strong labour market, rising wages, and less pressure on debt service costs thanks to lower rates. Housing activity has shifted from a drag last year to a very modest add so far this year with the resale market adapting to policy changes and getting help from declining borrowing costs. Business investment continues to slow, partially due to a further decline in oil and gas capex, but with global uncertainty likely hampering spending by companies outside the energy industry. International trade added to growth over the first half of 2019, but less so than last year, and mostly due to a combination of rising energy exports and weaker imports. Non-energy exports haven't done much of the heavy lifting over the last year.

…and what it means for H2/19

That context should help explain our growth forecasts for the second half of the year. Consumer spending and residential investment will remain less of a headwind than in 2018, as long as the labour market continues to support household incomes. But business investment will likely once again be held back by concerns about US trade policy and the health of the global economy. Net trade is likely to be a more neutral force—energy exports won't provide endless support, and a global manufacturing and trade slowdown doesn't inspire confidence in non-energy exports. All told, we agree with the BoC's assessment that GDP growth is likely to be slower over H2/19 than the 2.1% average pace seen in the first half of this year. Our forecast is for average gains of 1.6%, which would be slightly below the economy's longer-run trend. Further escalation in the US-China trade dispute (or a greater-than-expected impact on the US economy from the latest round of tariff hikes) remains a key downside risk to the outlook. But that is balanced somewhat by the Canadian economy's recent, unexpected strength and the potential for consumer spending and housing to get a bit more of a boost from lower rates than we have penciled in.

BoC defiant in its neutral bias

We were expecting a dovish tone from the Bank of Canada in September given escalating trade tensions (identified as a key risk to the global and domestic outlook) since its July meeting. But the central bank sounded surprisingly neutral, giving no direction regarding future policy moves and simply reiterating that the current degree of accommodation remains appropriate. It did note that the US-China trade conflict is "weighing more heavily on global economic momentum" than assumed in July, and that global developments and their impact on Canada's economy will receive "particular attention" when its forecasts are updated in October. But the BoC sounded rather reluctant to follow its dozen or so global peers that eased policy over the summer. In fact, in its economic progress report, the bank emphasized that it will set monetary policy based on domestic conditions, and that the Canadian economy is close to full capacity and inflation is right on its 2% target. That good starting point, along with monetary policy that's already slightly accommodative, gives the central bank a buffer against negative external developments. The BoC's defiant attitude trimmed the odds of a rate cut later this year, and a move next January (our assumption) is seen as a 50/50 prospect.

Highlights

- ▲ Canadian GDP growth surged to 3.7% but domestic spending declined in the quarter.
- ▲ Lower market interest rates took some pressure off consumers and helped support the recovery in housing.
- ▲ Business investment is likely to remain subdued in the coming quarters amid persistent trade policy uncertainty.
- ▲ The BoC said the economy's solid starting point gives it a "welcome degree of resilience" against negative external developments.

Highlights

▲ UK MPs passed a bill that will force the government to ask the EU for a Brexit deadline extension.

▲ UK GDP growth has slowed but low unemployment continues to boost wages.

▲ Slower euro area growth complicates the ECB's battle against persistently below-target inflation.

▲ Australia's economy is growing at its weakest pace in a decade.

UK general election, Brexit delay look increasingly likely

Boris Johnson's short tenure as prime minister has been chaotic. His move to prorogue parliament, limiting the time MPs have to debate Brexit ahead of the October 31 deadline, received swift backlash. Lawmakers responded by passing a bill that will force the government to seek a three-month deadline extension if a deal with the EU can't be reached by October 19. A general election is likely to be the next step, though whether it will come before (Johnson's preference) or after (the opposition's stance) the potential deadline extension is unclear. So the only certainty remains uncertainty—for UK businesses, households and policymakers. As BoE Governor Carney said recently, forecasting the economy's near-term path is "challenging."

UK GDP surprised to the upside in July, rising 0.3% month-over-month. A rebound in the services sector (after four months of flat activity) accounted for much of the increase, though the manufacturing and construction sectors also eked out gains. It looks like the UK will avoid a technical recession (two consecutive quarters of negative growth) in Q3 but choppiness around another Brexit deadline (similar to what we saw in H1/19) will make it hard to identify the economy's underlying trend. PMI data, for their part, suggest that trend is close to flat, with a further decline in the manufacturing index and another subdued services reading leaving the composite index just above 50. It's hard to see business sentiment improving absent some clarity regarding Brexit, and we expect the UK economy will continue to muddle along over the second half of the year. Our forecast still assumes a rate cut in November, but with inflation and wage trends remaining relatively firm, the BoE sounds reluctant to make a policy change in this uncertain environment.

ECB "package" its latest bid to boost inflation

The ECB is set to unveil a "package" of easing measures in September as it continues to battle persistently low inflation. The central bank is likely to lower its deposit rate for the first time since 2016 and we expect a tiering system will be introduced to soften the impact of (even deeper) negative rates on the banking system. We'll be watching to see whether the ECB's forward guidance makes explicit reference to the symmetry of its inflation objective in an attempt to boost flagging inflation expectations and underline policymakers' commitment to keep rates low until inflation is returned to target on a sustained basis. The ECB's efforts to boost inflation have been complicated by the economy's disappointing growth of late. Germany, the euro area's largest and most manufacturing/export-oriented economy, remains mired in an industrial sector slowdown that saw GDP decline in two of the last four quarters (year-over-year growth of 0.4% is the weakest since the euro crisis). With services activity holding up fairly well across the currency bloc, other more domestically-oriented economies like France and Spain have expanded more steadily. But PMI data suggest the manufacturing sector's slump is becoming entrenched, which will make it difficult to achieve the above-trend growth needed to boost inflation.

Another disappointing GDP report supports further RBA easing

Australia's economy expanded by 0.5% for a second consecutive quarter in Q2, bringing the year-over-year growth rate down to 1.4%—the weakest pace since the global financial crisis. Activity was once again boosted by net exports, one of the more consistent sources of growth recently, while government spending also accounted for a good chunk of the increase. Other details were soft, with another modest increase in consumer spending and a further decline in residential and business investment resulting in a fourth consecutive quarterly decline in private domestic demand. These data justify the RBA's rate cuts around the middle of the year—and our expectation that there is more easing to come. While there is some mixed evidence of monetary policy traction in the housing data, consumer indicators continue to look soft. Even with fiscal stimulus set to lend a hand, we continue to think the RBA's assumption of a return to trend-like growth by this time next year looks overly optimistic. A soft domestic economy combined with rising global risks suggest further rate cuts in the near-term, with our forecast assuming the next move will be in November. However, there is a risk the RBA takes a bit more time to evaluate the impact of its earlier moves.

Interest rate outlook

%, end of period

	Actuals						Forecast					
	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4
Canada												
Overnight	1.25	1.25	1.50	1.75	1.75	1.75	1.75	1.75	1.50	1.50	1.50	1.50
Three-month	1.10	1.26	1.59	1.64	1.67	1.66	1.65	1.60	1.40	1.40	1.40	1.40
Two-year	1.78	1.91	2.21	1.86	1.55	1.47	1.45	1.35	1.30	1.45	1.45	1.50
Five-year	1.97	2.07	2.34	1.89	1.52	1.39	1.40	1.35	1.40	1.50	1.55	1.60
10-year	2.09	2.17	2.43	1.97	1.62	1.47	1.45	1.35	1.45	1.55	1.60	1.70
30-year	2.23	2.20	2.42	2.18	1.89	1.69	1.70	1.60	1.70	1.80	1.90	1.95
United States												
Fed funds**	1.75	2.00	2.25	2.50	2.50	2.50	2.00	1.75	1.75	1.75	1.75	1.75
Three-month	1.73	1.93	2.19	2.45	2.40	2.12	1.90	1.65	1.65	1.65	1.65	1.65
Two-year	2.27	2.52	2.81	2.48	2.27	1.75	1.50	1.50	1.60	1.65	1.70	1.70
Five-year	2.56	2.73	2.94	2.51	2.23	1.76	1.50	1.50	1.60	1.65	1.85	1.95
10-year	2.74	2.85	3.05	2.69	2.41	2.00	1.50	1.50	1.70	1.85	2.00	2.10
30-year	2.97	2.98	3.19	3.02	2.81	2.52	2.05	1.95	2.10	2.25	2.40	2.45
United Kingdom												
Bank rate	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.50	0.50	0.50	0.50	0.50
Two-year	0.82	0.72	0.82	0.75	0.63	0.62	0.60	0.55	0.60	0.60	0.60	0.60
10-year	1.34	1.28	1.57	1.27	0.99	0.84	0.75	0.85	0.90	1.00	1.10	1.10
Euro area												
Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.60	-0.80	-0.80	-0.80	-0.80	-0.80
Two-year	-0.59	-0.69	-0.55	-0.59	-0.60	-0.73	-0.80	-0.80	-0.80	-0.80	-0.75	-0.75
10-year	0.50	0.31	0.47	0.25	-0.07	-0.33	-0.40	-0.20	-0.10	-0.05	0.00	0.00
Australia												
Cash target rate	1.50	1.50	1.50	1.50	1.50	1.25	1.00	0.75	0.50	0.50	0.50	0.50
Two-year	2.00	2.00	2.02	1.89	1.47	0.98	0.90	0.75	0.70	0.70	0.70	0.80
10-year	2.60	2.63	2.67	2.32	1.78	1.32	0.90	0.80	0.95	1.10	1.30	1.40
New Zealand												
Cash target rate	1.75	1.75	1.75	1.75	1.75	1.50	1.00	0.75	0.50	0.50	0.50	0.50
Two-year swap	2.21	2.14	2.02	1.96	1.62	1.35	1.00	0.85	0.80	0.80	0.80	0.80
10-year swap	3.06	3.02	2.89	2.64	2.15	1.78	1.20	0.95	1.05	1.20	1.35	1.45
Yield curve*												
Canada	31	26	22	11	7	0	0	0	15	10	15	20
United States	47	33	24	21	14	25	0	0	10	20	30	40
United Kingdom	52	56	75	52	36	22	15	30	30	40	50	50
Eurozone	109	100	102	84	53	40	40	60	70	75	75	75
Australia	60	63	65	43	31	34	0	5	25	40	60	60
New Zealand	85	88	87	68	53	43	20	10	25	40	55	65

* 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	2.25-2.50	July 31, 2019	Eurozone	Deposit rate	-0.40	-0.30	March 16, 2016
Canada	Overnight rate	1.75	1.50	October 24, 2018	Australia	Cash rate	1.00	1.25	July 3, 2019
United Kingdom	Bank rate	0.75	0.50	August 1, 2018	New Zealand	Cash rate	1.00	1.50	August 6, 2019

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	2018	2019F	2020F
Canada*	1.5	2.5	2.1	0.3	0.5	3.7	1.8	1.4	1.4	1.6	1.7	1.6	3.0	1.9	1.6	1.7
United States*	2.6	3.5	2.9	1.1	3.1	2.0	2.0	1.5	1.5	1.6	1.8	1.8	2.4	2.9	2.3	1.7
United Kingdom	0.1	0.4	0.7	0.2	0.5	-0.2	0.2	0.3	0.3	0.3	0.4	0.4	1.8	1.4	1.1	1.1
Euro area	0.3	0.4	0.2	0.3	0.4	0.2	0.2	0.3	0.3	0.4	0.4	0.3	2.7	1.9	1.1	1.3
Australia	1.0	0.7	0.3	0.1	0.5	0.5	0.7	0.7	0.6	0.5	0.8	0.7	2.4	2.7	1.8	2.5

*annualized

Inflation outlook

% change, year-over-year

	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	2017	2018	2019F	2020F
Canada*	2.1	2.3	2.7	2.0	1.6	2.1	2.0	2.1	1.9	1.5	1.5	1.7	1.6	2.3	2.0	1.7
United States*	2.2	2.7	2.6	2.2	1.6	1.8	1.7	1.7	1.9	1.7	1.9	2.2	2.1	2.4	1.7	1.9
United Kingdom	2.7	2.4	2.5	2.3	1.8	2.0	1.7	1.7	1.9	1.7	1.8	1.8	2.7	2.5	1.8	1.8
Euro area	1.3	1.7	2.1	1.9	1.4	1.4	1.0	1.2	1.9	1.4	1.4	1.4	1.5	1.8	1.3	1.5
Australia	1.9	2.1	1.9	1.8	1.3	1.6	1.5	1.4	1.9	1.9	2.0	2.1	1.9	1.9	1.4	2.0

Source: Statistics Canada, Bureau of Economic Analysis, Bureau of Labor Statistics, Office for National Statistics, Statistical Office of the European Communities, Australian Bureau of Statistics, Statistics New Zealand, RBC Economics Research

Inflation tracking

Inflation Watch

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	CPI ex food & energy[1]	Jul	0.2	2.2	2.8	2.3
United States	Core PCE[1,2]	Jul	0.2	1.6	2.0	1.4
United Kingdom	All-items CPI	Jul	0.0	2.1	2.9	1.5
Euro area	All-items CPI[1]	Aug	0.1	1.0	1.1	1.2
Australia	Trimmed mean CPI[1]	Q2	0.4	1.6	N/A	N/A
New Zealand	All-items CPI	Q2	0.6	1.7	N/A	N/A

1 Seasonally adjusted measurement.
2 Personal consumption expenditures less food and energy price indices.

Source: Statistics Canada, Bureau of Labor Statistics, Office for National Statistics, Statistical Office of the European Communities, Australian Bureau of Statistics, Statistics New Zealand, RBC Economics Research

Currency outlook

Level, end of period

	Actuals						Forecast					
	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4
Canadian dollar	1.29	1.31	1.29	1.36	1.33	1.31	1.30	1.30	1.30	1.31	1.32	1.33
Euro	1.23	1.17	1.16	1.15	1.12	1.14	1.10	1.08	1.08	1.10	1.10	1.12
U.K. pound sterling	1.40	1.32	1.30	1.28	1.30	1.27	1.22	1.19	1.19	1.18	1.18	1.20
Japanese yen	106.3	110.8	113.7	109.7	110.9	107.9	108.0	110.0	112.0	111.0	110.0	109.0
Australian dollar	0.77	0.74	0.72	0.70	0.71	0.70	0.68	0.68	0.67	0.67	0.66	0.66

Canadian dollar cross-rates

	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4
EUR/CAD	1.59	1.53	1.50	1.56	1.50	1.49	1.43	1.40	1.40	1.44	1.45	1.49
GBP/CAD	1.81	1.73	1.68	1.74	1.74	1.66	1.59	1.55	1.54	1.55	1.56	1.60
CAD/JPY	82.4	84.3	88.1	80.4	83.0	82.4	83.1	84.6	86.2	84.7	83.3	82.0
AUD/CAD	0.99	0.97	0.93	0.96	0.95	0.92	0.88	0.88	0.87	0.88	0.87	0.88

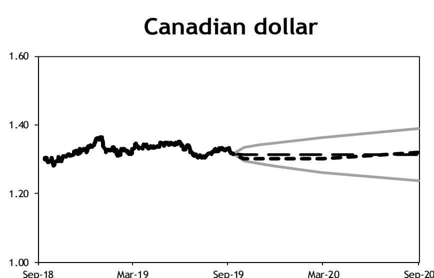
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

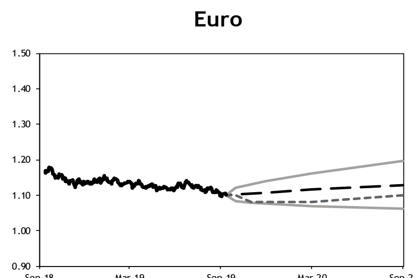
RBC Economics outlook compared to the market

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

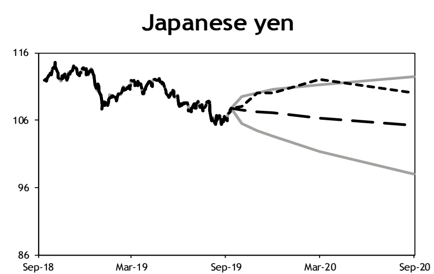
Canadian dollar



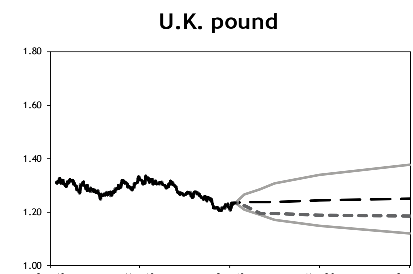
Euro



Japanese yen



U.K. pound

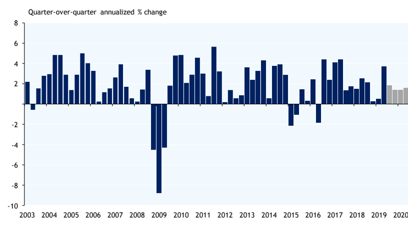


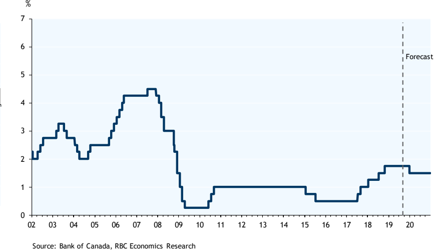
Central bank watch

Bank of Canada

Canadian GDP surprised to the upside in Q2 (+3.7% vs. the BoC's 2.3% forecast), bringing the economy closer to full capacity than previously thought.

The BoC will incorporate an escalating US-China trade war into its forecasts in October, which will likely mean downward revisions in 2020. But the economy's good starting point has kept the BoC from sounding too dovish as of yet.

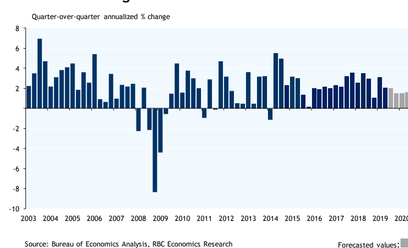


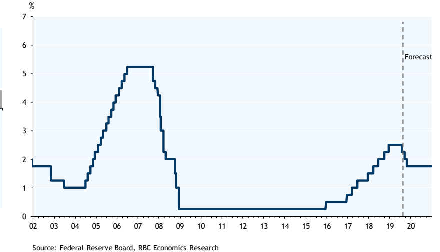


Federal Reserve

Consumer spending should keep the US economy growing at a modestly above-trend pace in Q3 but overall activity is likely to soften heading into 2020 as trade headwinds increase.

A still-solid economic backdrop should keep the Fed from doing more than a mid-cycle policy adjustment. We think fed funds will end the year at 1.75%, undoing most of 2018's tightening.

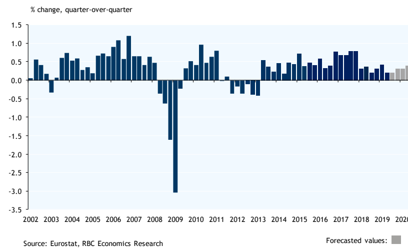


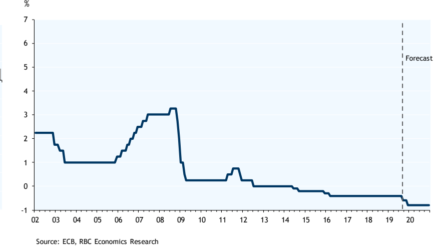


European Central Bank

Euro area GDP growth is expected to remain subdued at 0.2% in Q3. The currency bloc's unemployment rate has continued to decline despite slower growth, but cracks are beginning to appear.

With the economy lacking momentum and the ECB seeing little progress toward its inflation target, the central bank is set to embark on a new round of stimulus.

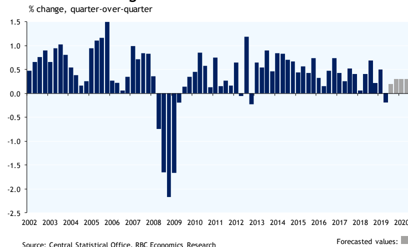


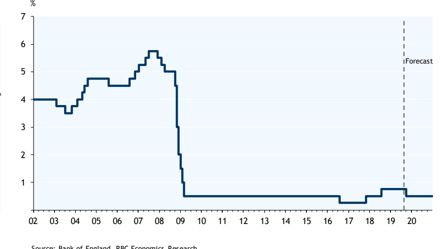


Bank of England

Brexit preparations resulted in volatile UK growth over the first half of the year, but the underlying trend is subdued and PMIs suggest that remained the case in Q3.

Our forecast has been for persistent Brexit uncertainty to prompt a rate cut from the BoE. But 2% core inflation and 4% wage growth might keep the central bank on the sidelines.

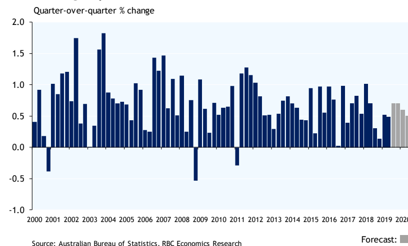


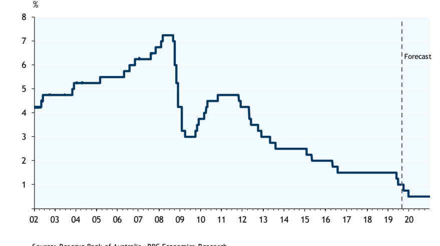


Reserve Bank of Australia

Australian GDP growth remained below trend in Q2 and private domestic spending contracted once again. A soft domestic economy and rising global risks should keep the RBA in easing mode.

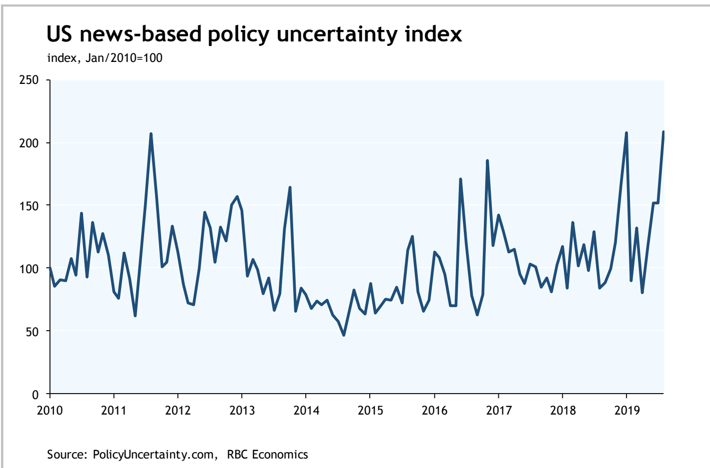
Our forecast assumes the RBA will lower rates again in November. But with fiscal stimulus and earlier monetary policy easing still working through the economy, its pause could last a bit longer.



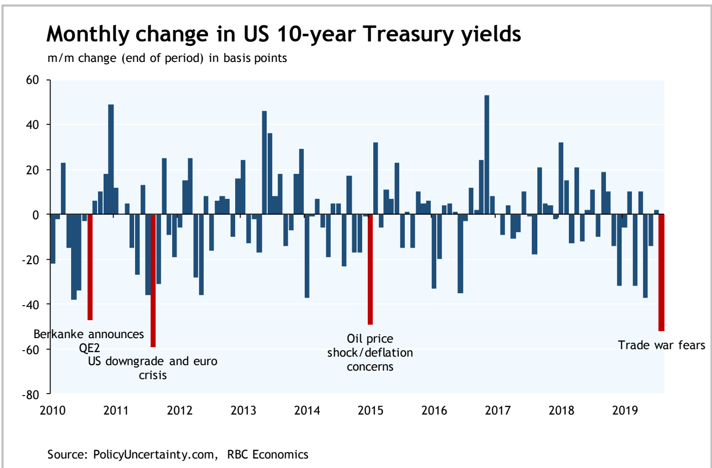


Trade wars and Treasuries

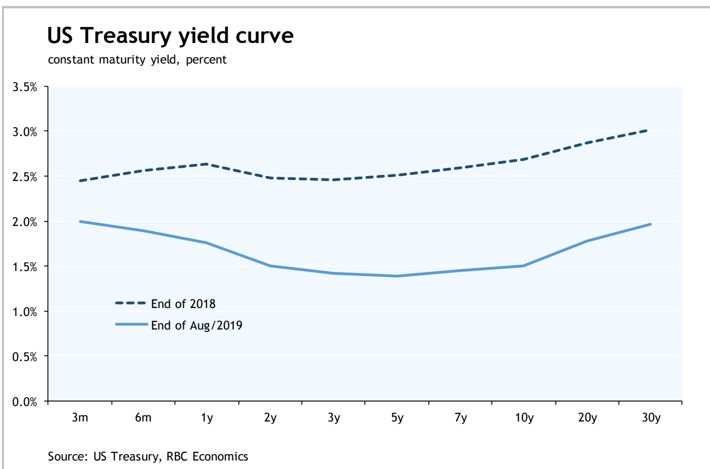
Trump's trade threats (and China's retaliation) took uncertainty to a new level—at least according to this news-based US policy uncertainty index. The two sides have agreed to a new round of talks but as of now further tariff increases are still scheduled to take effect in the coming months.



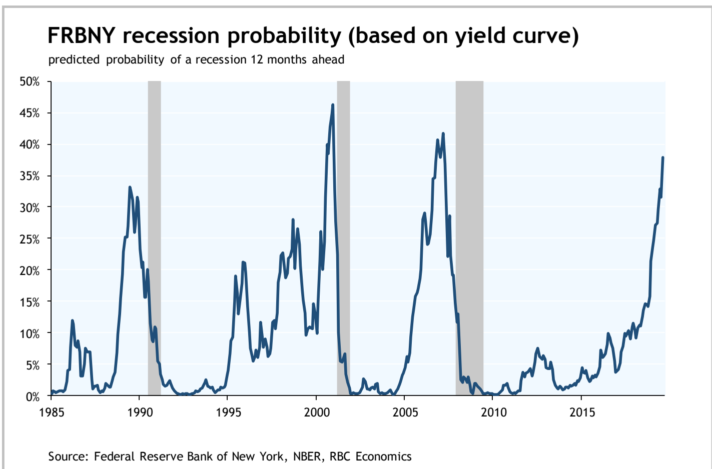
Growing concerns about a trade war and its impact on global growth once again had investors looking for safety. 10-year US Treasury yields fell by a whopping 52 basis points in August—the second largest monthly decline in the last decade (the largest, ironically, came when the US's credit rating was downgraded).



Yields have come down across the Treasury curve since the start of the year, most significantly at the longer end. The result is an "inverted" yield curve, something we haven't seen in more than a decade.



An inverted yield curve is commonly seen as a predictor of recession. This New York Fed model, based on the yield curve, shows the odds of a recession in the next twelve months have increased to more than 1/3.



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