

FINANCIAL MARKETS MONTHLY

July 12, 2018

Onward and upward

Trade talk tensions continued to grab headlines and influence markets over the last month. After their exemptions from US steel and aluminum tariffs were allowed to expire, Canada, Mexico and the EU all hit back with retaliatory tariffs on select US goods. Trump doubled down with threats to impose stiff levies on auto imports in what would amount to significant escalation of the trade spat. As with steel and aluminum, it's up to the Commerce Department to determine whether auto imports pose a national security risk—a process that could extend into next year. US trade measures against China are also at risk of escalating. The US slapped tariffs on \$34 billion of Chinese imports and is evaluating action on another \$16 billion. After China retaliated in kind, the Trump administration put forth another \$200 billion in goods that could be subject to tariffs come September. The president also threatened to shake up the international trade order by hinting the US could pull out of the World Trade Organization.

Trade risks are clearly on the rise. But with some economies already at capacity and growth appearing to pick up in Q2, central banks are pushing ahead with plans to remove monetary policy stimulus. The Fed raised rates again in June as strong economic data drowned out firms' complaints about tariffs and trade uncertainty. The Bank of Canada did the same in July after their survey of businesses showed growing capacity pressures and strong order books were exerting more influence than deteriorating trade rhetoric. The European Central Bank announced plans to end net asset purchases at the end of this year, with rate hikes likely in the second half of 2019. And we expect the Bank of England will raise their benchmark rate in August. Trade-related risk aversion is weighing on government bond yields, and that will likely remain a factor over the second half of the year. But with several central banks still in tightening mode, we think market interest rates will drift higher from here.

Central bank near-term bias



The Bank of Canada raised rates as expected in July and didn't sound all that dovish in the face of growing trade threats. While tightening will remain data dependent, the bank seems increasingly convinced the economy needs less stimulus. We expect another rate hike in Q4.



With their rate hike in June the Fed dropped guidance that rates will remain below neutral for some time. Changes to economic projections and the dot plot also leaned slightly hawkish. We continue to expect once-a-quarter rate increases through the end of next year.



The Bank of England left rates unchanged in June though three dissenters (previously two) voted in favour of a hike. With indications that growth picked up in Q2, we think a majority of MPC members will be convinced to raise rates in August.



The European Central Bank announced they'll stop growing their balance sheet at the end of this year. But they said rates are expected to remain on hold at least through next summer, in line with our view.



The Reserve Bank of Australia leaned a bit dovish in June but didn't move any further in that direction with July's policy statement. We still expect the cash rate will remain on hold this year.

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Highlights

▲ We think US GDP growth picked up above 4% in Q2, one of the best quarterly growth rates in the last decade.

▲ The unemployment rate rose in June as more Americans were drawn into the labour force, encouraged by the prospects of finding a job.

▲ With fed funds getting further from its crisis lows, the Fed dropped their well-worn guidance that rates will remain below neutral for some time.

▲ Changes to the Fed's economic and interest rate projections were minor, but all leaned hawkish.

US likely had a banner Q2 for GDP growth

Our expectation has been that the US economy would rebound in Q2 following a relatively slow start to the year. Recent data have supported that idea—and then some. We are now tracking a 4.1% annualized increase in Q2 GDP that would be one of the strongest quarterly gains in the last decade. We think the increase was broadly-based with consumer spending, housing and business investment all making solid contributions. The standout, however, is likely to be exports which have trended higher over the last four months. That sent May's trade deficit to its lowest level in a year and a half, suggesting net trade will add more than a percentage point to GDP growth in the second quarter.

We don't think Q2's export growth will be sustained, particularly in light of US import tariffs that have generally been reciprocated by trading partners. That trade skirmish (we still don't think this qualifies as an all-out trade war) stands to weigh on both export and import flows. But while less strength in exports means Q2's 4% GDP growth should be a one-off, we think strong domestic demand will keep the economy expanding at an above-trend pace over the second half of the year. Both households and businesses remain upbeat despite deteriorating trade relations. Consumer confidence is likely being buoyed by a strong labour market and rising wages, as well as an equity market that has held up well in the face of growing trade risks. Businesses are complaining of rising cost pressures related to tariffs and general uncertainty surrounding trade policy, but strong order books have left most with a positive outlook overall.

Job growth shows no sign of slowing

With another solid increase in June, US employment rose at an above-200k pace for a third consecutive quarter. Job gains have shown little sign of slowing despite some of the lowest unemployment rates we've seen in decades. And as June's household survey showed—the unemployment rose on a jump in labour force participation—there are still people sitting on the sidelines who can be attracted into the workforce by good prospects of finding a job. To that end, the share of consumers saying jobs are hard to get hit a 17-year low in June. Hiring has remained strong even as employers are increasingly complaining of labour shortages. The Fed's latest *Beige Book* indicated firms are responding to talent shortages by increasing compensation, but thus far the upward trend in wage growth has been protracted. Average hourly earnings were up 2.7% in June, compared with a 2.6% pace two years ago.

Chair Powell puts his stamp on Fed policy statement

The Fed raised their benchmark rate by 25 basis points in June—a unanimous decision that was fully expected by markets. The move was announced in a pared down policy statement that leaned hawkish. Most significantly the Fed drop their forward guidance that rates will remain below neutral “for some time.” Chair Powell downplayed that change in language at his press conference, noting it simply reflects that rates are now closer to neutral. His comment that the Fed's policy outlook hasn't changed was backed up by the dot plot, which showed only a minor shift among some committee members' expectations for monetary policy—even if that was enough to move the median from three to four total hikes in 2018. Other forecast changes were relatively minor but mirrored the more hawkish policy statement. Growth and inflation projections were revised slightly higher this year while the unemployment rate is expected to be even lower.

Longer-term US Treasury yields have pulled back since the Fed's June 13 policy statement, with the 10-year benchmark down more than 10 basis points. We think that move reflects safe haven flows amid rising trade risks rather than shifting expectations for monetary policy. Over the second half of the year we expect further Fed tightening and ongoing fiscal stimulus (necessitating more borrowing) will be the dominant factors influencing Treasuries. We see the 10-year yield moving back above 3% on a sustained basis.



Canadian GDP set to remain volatile—but trending higher

Canada's economy had a slow start to Q2, though it wasn't as bad as feared with GDP eking out an above-consensus 0.1% gain in April. Some of the slowdown relative to the previous two months reflected adverse weather conditions that weighed on retail sales and construction activity (but boosted the utilities sector). Unplanned shutdowns—a familiar theme this year—at some refineries dinged manufacturing output. Nonetheless, solid momentum heading into the quarter and an expectation that transitory weakness was subsequently reversed leaves us monitoring above-trend GDP growth in Q2.

Volatility in Canadian GDP data will continue in the second half of the year. A shutdown at a major oil producer through all of July, with production expected to gradually return in August and September, will weigh on energy output in the third quarter. Our early estimate of a 1/2 percentage point drag on annualized growth has us tracking a 1.6% increase in Q3 GDP. With that decline expected to be fully unwound in the fourth quarter, we see growth rebounding to an above-trend pace. On net we have lowered our growth forecast for 2018 as a whole to 1.9% from 2.0% previously, which would still be slightly ahead of our estimate of the economy's longer-run potential.

Canadian businesses remain optimistic

The Bank of Canada's quarterly *Business Outlook Survey* painted an upbeat picture of economic conditions despite growing trade uncertainty. Firms reported strong sales over the past year and, even with more modest gains expected going forward, solid foreign and domestic demand was seen supporting order books. Companies boosted their hiring plans, and while investment intentions slipped somewhat, they were still described as "buoyant." Hiring and investment decisions are being driven by growing capacity pressures and labour shortages. Meanwhile, strong demand conditions were allowing businesses to pass on rising input costs to their customers. That likely contributed to further firming in inflation expectations—about 2/3 of respondents now expect inflation to be on the higher side of 2%, up from less than 1/3 at this time last year.

Bank of Canada raises rates despite growing trade impact

With economic data evolving largely as expected and businesses appearing to look past growing trade uncertainty, market odds of a July rate hike rose significantly. The Bank of Canada delivered on those expectations, raising the overnight rate by 25 basis points for the first time since January. There was some speculation we'd see a dovish hike given rising trade tensions, but the BoC took recent developments in stride. They didn't waffle on their bias to raise rates gradually and as in May they refrained from using the word "cautious". They did mark down their growth forecasts somewhat more, with tariffs and trade uncertainty now expected to lower Canadian GDP by 2/3 of a percent by the end of 2020 (the impact was expected to be a bit less than 1/2 ppt in April's forecast). But the economy is still expected to grow at a 2% pace over the next few years, slightly ahead of its potential rate thanks to some supportive factors like higher oil prices. So even with trade issues weighing on business investment and exports, those sectors are expected to make decent contributions to growth this year and next. That will be an important factor offsetting the impact of higher rates and tighter mortgage regulation on consumers and housing. All told, with the economy operating close to full capacity and growth expected to remain above potential, higher rates are needed to keep inflation in check.

Looking ahead, the trade backdrop will remain key to the rates outlook and we think the BoC's assumed impact from tariffs and trade uncertainty will remain fluid. But their forecast for slightly above-potential growth perhaps gives them a bit of leeway on that front. And Governor Poloz was keen to point out that the monetary policy implications of trade actions aren't necessarily clear cut. Overall we remain comfortable with our call for official rates to rise another 25 basis points in the fourth quarter, with two further hikes expected in the first half of 2019.

Highlights

▲ Despite a slow start to the quarter, we think GDP growth rose to an above-trend pace in Q2.

▲ Upcoming GDP data will be choppy with Q3 set to be hit by an unplanned shutdown in the oil sands.

▲ Business sentiment improved in Q2 as strong demand and growing capacity pressures helped offset trade worries.

▲ The BoC stuck to their tightening bias in July despite assuming an even larger economic impact of trade tensions.



Highlights

▲ Recent data provide further evidence the UK economy rebounded in Q2.

▲ There has been plenty of drama surrounding the UK government's plan for a 'soft' Brexit.

▲ The ECB's forward guidance on rates gave their announcement a dovish spin, despite the announcement that QE would likely end this year.

▲ Australian employment isn't growing fast enough to put sustained downward pressure on the unemployment rate.

Bank of England watching for Q2 rebound

Evidence continues to mount that the UK economy's Q1 slowdown was transitory. A new monthly GDP series from the Office for National Statistics showed output was up 0.2% and 0.3% in April and May, respectively. Those gains were led by the services sector, particularly retail and wholesale trade which appear to have recovered from a weather-related dip in March. Survey readings are providing a similar signal, with the composite PMI rising throughout Q2 to hit a year-to-date high in June. We think these data support our forecast for GDP growth to rebound to 0.4% in the second quarter. The BoE took a similar view at their latest meeting, noting that recent data provided reassurance that Q1's slowdown was largely temporary (their Q2 forecast is also at 0.4%). Interest rates were left unchanged in June but the vote was split 6-3 (compared with 7-2 in May) with the dissenters favouring an immediate rate hike. While no additional forward guidance was provided, we think that hawkish shift foreshadows a rate increase in August.

Our forecast assumes further moves will be gradual, with a follow-up rate hike not expected until 2019. The BoE is likely to keep monetary policy somewhat accommodative amid ongoing headwinds from Brexit uncertainty. Recent political drama—two high-level cabinet ministers just resigned over Prime Minister May's 'soft' approach to Brexit—indicates there is still a ways to go before businesses get more certainty about the UK's future trading relationship with the EU. It also remains to be seen how European leaders will react to May's plan, which appears to take some liberties with a traditional customs union.

ECB announces taper, but with a dovish spin

Euro area PMI readings settled into a lower gear in Q2, providing further evidence that growth has moderated in 2018 relative to last year's impressive pace. That said, we think recent readings are still consistent with above-trend growth (we expect 0.6% in Q2) that will continue to take up spare capacity in the economy. Inflation remains quiescent—while headline inflation just hit 2% for only the second time in five years, the core measure remains stuck at 1%. But tightening labour market conditions and gradually rising wages suggest inflation will pick up over the medium term. Along with a solid economy, that was enough for the European Central Bank to announce in June that they'd likely cease net asset purchases at the end of this year. Despite the short QE taper, which was unveiled earlier than some expected, markets saw the meeting as dovish and the euro sold off. That was due to the central bank's guidance that interest rates are expected to remain at present levels at least through next summer—a bit later than markets were pricing in. Our expectation that gradual rate hikes will begin in the third quarter of 2019 remains unchanged.

Mixed indicators keep the RBA from sounding too dovish

Australian retail sales came in above consensus for a second consecutive month in May, suggesting a pickup in consumer spending after a slow Q1. However, we remain cautious on the outlook for households amid modest wage growth, rising costs for non-discretionary spending and a slowdown in household borrowing. On wages, we think it will take a sustained period of above-trend hiring for pay growth to rise more meaningfully. There was limited evidence of that in the latest jobs data. While trend employment growth ticked higher in May, it remained short of the pace needed to put sustained downward pressure on the unemployment rate (even if joblessness did fall in the latest month on lower labour force participation). The overall GDP picture is somewhat more supportive—we think decent gains in public spending, business investment and exports will keep growth around 3% this year and next. A similar outlook kept the Reserve Bank of Australia from skewing dovish again in July, even in the face of rising risks to the global outlook. But with slow wage growth keeping a lid on inflation, we doubt the RBA will join some of their global counterparts in tightening monetary policy this year.

Interest rate outlook

%, end of period

		Actuals						Forecast					
		17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
Canada													
	Overnight	0.50	0.50	1.00	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.25	2.25
	Three-month	0.52	0.71	1.00	1.06	1.10	1.26	1.40	1.65	1.90	2.15	2.15	2.15
	Two-year	0.75	1.10	1.52	1.69	1.78	1.91	2.10	2.30	2.45	2.45	2.40	2.35
	Five-year	1.12	1.40	1.75	1.87	1.97	2.07	2.25	2.45	2.55	2.65	2.70	2.70
	10-year	1.62	1.76	2.10	2.04	2.09	2.17	2.35	2.60	2.70	2.80	2.90	2.95
	30-year	2.30	2.14	2.47	2.27	2.23	2.20	2.45	2.70	2.80	2.90	3.00	3.00
United States													
	Fed funds**	1.00	1.25	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.50
	Three-month	0.76	1.03	1.06	1.39	1.73	1.93	2.15	2.35	2.65	2.90	3.15	3.35
	Two-year	1.27	1.38	1.47	1.89	2.27	2.52	2.65	2.80	3.00	3.25	3.40	3.55
	Five-year	1.93	1.89	1.92	2.20	2.56	2.73	2.95	3.10	3.25	3.45	3.55	3.65
	10-year	2.40	2.31	2.33	2.40	2.74	2.85	3.15	3.30	3.45	3.60	3.70	3.75
	30-year	3.02	2.84	2.86	2.74	2.97	2.98	3.35	3.50	3.65	3.75	3.80	3.85
United Kingdom													
	Bank rate	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.25
	Two-year	0.12	0.36	0.46	0.45	0.82	0.72	0.80	0.95	1.00	1.05	1.10	1.15
	10-year	1.14	1.26	1.38	1.19	1.34	1.28	1.60	1.75	2.00	2.10	2.20	2.30
Euro area													
	Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20
	Two-year	-0.74	-0.57	-0.69	-0.63	-0.59	-0.69	-0.60	-0.50	-0.50	-0.50	-0.40	-0.30
	10-year	0.33	0.47	0.47	0.43	0.50	0.31	0.70	0.80	1.00	1.05	1.25	1.25
Australia													
	Cash target rate	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75	2.00	2.00	2.00
	Two-year	1.76	1.78	1.94	2.00	2.00	2.00	2.20	2.25	2.30	2.50	2.60	2.60
	10-year	2.70	2.60	2.84	2.63	2.60	2.63	2.90	3.15	3.30	3.60	3.85	4.00
New Zealand													
	Cash target rate	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	2.00
	Two-year swap	2.31	2.32	2.19	2.20	2.21	2.14	2.40	2.50	2.60	2.75	2.80	2.80
	10-year swap	3.41	3.35	3.24	3.13	3.06	3.02	3.50	3.60	3.75	3.85	4.10	4.25
Yield curve*													
	Canada	87	66	58	35	31	26	25	30	25	35	50	60
	United States	113	93	86	51	47	33	50	50	45	35	30	20
	United Kingdom	102	90	92	74	52	56	80	80	100	105	110	115
	Eurozone	107	104	116	106	109	100	130	130	150	155	165	155
	Australia	94	82	90	63	60	63	70	90	100	110	125	140
	New Zealand	110	103	105	93	85	88	110	110	115	110	130	145

* 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	1.75-2.00	1.50-1.75	June 13, 2018	Eurozone	Deposit rate	-0.40	-0.30	March 10, 2016
Canada	Overnight rate	1.50	1.25	July 11, 2018	Australia	Cash rate	1.50	1.75	August 3, 2016
United Kingdom	Bank rate	0.50	0.25	November 2, 2017	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

	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	2016	2017	2018F	2019F
Canada*	4.0	4.6	1.7	1.7	1.3	2.2	1.6	2.3	1.8	1.7	1.7	1.7	1.4	3.0	1.9	1.9
United States*	1.2	3.1	3.2	2.9	2.0	4.1	2.8	2.8	1.8	2.4	2.2	1.8	1.5	2.3	2.9	2.4
United Kingdom	0.4	0.2	0.4	0.4	0.2	0.4	0.3	0.4	0.3	0.4	0.3	0.4	1.8	1.7	1.3	1.4
Euro area	0.7	0.7	0.7	0.7	0.4	0.6	0.5	0.5	0.4	0.4	0.4	0.4	1.8	2.6	2.2	1.8
Australia	0.3	1.0	0.5	0.5	1.0	0.5	0.8	0.7	0.8	0.7	0.9	0.9	2.6	2.2	2.9	3.0
New Zealand	0.8	0.9	0.6	0.6	0.5	0.8	0.9	0.8	0.8	0.8	0.8	0.8	4.0	2.8	2.8	3.3

*annualized

Inflation outlook

% change, year-over-year

	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	2016	2017	2018F	2019F
Canada	1.9	1.3	1.4	1.8	2.1	2.3	2.7	2.6	2.3	2.6	2.4	2.2	1.4	1.6	2.4	2.4
United States	2.5	1.9	2.0	2.1	2.2	2.7	2.7	2.6	2.4	2.6	2.6	2.5	1.3	2.1	2.6	2.5
United Kingdom	2.2	2.8	2.8	3.0	2.7	2.5	2.6	2.5	2.3	2.2	2.2	2.0	0.6	2.7	2.6	2.2
Euro area	1.8	1.5	1.4	1.4	1.3	1.7	1.9	1.7	1.7	1.4	1.5	1.5	0.2	1.5	1.6	1.5
Australia	2.1	1.9	1.8	1.9	1.9	2.2	2.2	2.2	2.3	2.5	2.6	2.7	1.3	1.9	2.1	2.5
New Zealand	2.1	1.7	1.9	1.6	1.1	1.6	1.9	1.6	1.6	1.6	1.6	1.7	0.6	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	May	-0.1	1.7	1.5	2.1
United States	Core PCE ^{1,2}	May	0.2	2.0	2.2	2.0
United Kingdom	All-items CPI	May	0.4	2.4	2.6	2.3
Euro area	All-items CPI ¹	Jun	0.2	2.0	2.3	2.0
Australia	Trimmed mean CPI ¹	Q1	0.5	1.9	N/A	N/A
New Zealand	All-items CPI	Q1	0.5	1.1	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	1.30	1.28	1.26	1.26	1.27	1.28
Euro	1.07	1.14	1.18	1.20	1.23	1.17	1.16	1.12	1.14	1.16	1.18	1.20
U.K. pound sterling	1.26	1.30	1.34	1.35	1.40	1.32	1.27	1.20	1.23	1.25	1.27	1.29
New Zealand dollar	0.70	0.73	0.72	0.71	0.72	0.68	0.69	0.70	0.70	0.71	0.72	0.72
Japanese yen	111.4	112.4	112.5	112.7	106.3	110.8	112.0	115.0	117.0	119.0	122.0	125.0
Australian dollar	0.76	0.77	0.78	0.78	0.77	0.74	0.73	0.70	0.71	0.72	0.73	0.73

Canadian dollar cross-rates

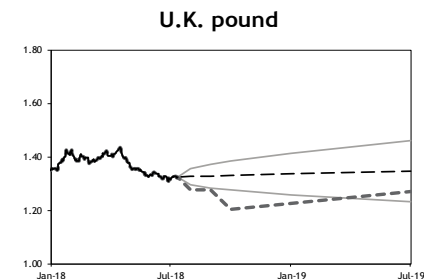
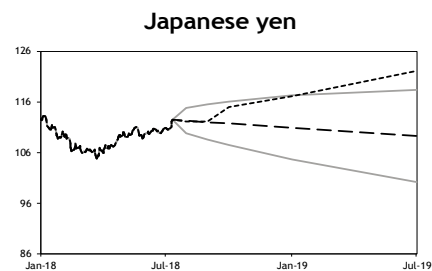
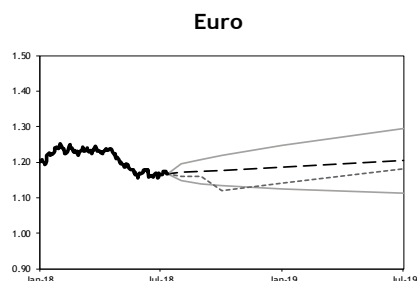
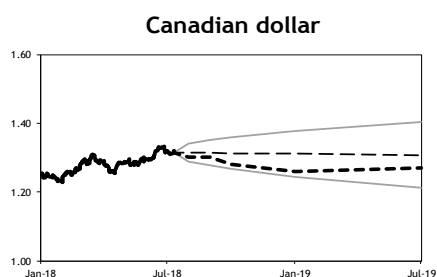
	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
EUR/CAD	1.42	1.48	1.47	1.51	1.59	1.53	1.51	1.43	1.44	1.46	1.50	1.54
GBP/CAD	1.67	1.69	1.67	1.70	1.81	1.74	1.66	1.54	1.54	1.57	1.61	1.65
NZD/CAD	0.93	0.95	0.90	0.89	0.93	0.89	0.90	0.90	0.88	0.89	0.91	0.92
CAD/JPY	83.7	86.7	90.2	89.6	82.4	84.3	86.2	89.8	92.9	94.4	96.1	97.7
AUD/CAD	1.02	1.00	0.98	0.98	0.99	0.97	0.95	0.90	0.89	0.91	0.93	0.93

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.





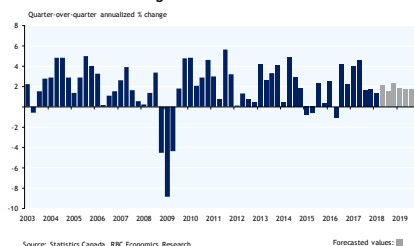
Central bank watch

Bank of Canada

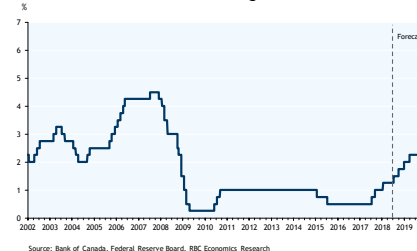
A slow start to the second quarter means there's a ways to go to get to the BoC's updated 2.8% Q2 forecast. But the transitory nature of April's slowdown suggests we'll see a rebound in May GDP.

The BoC didn't waffle on their tightening bias in July. We think further evidence that households are adjusting to higher rates and businesses are remaining upbeat will be key to another move in Q4.

Canadian real GDP growth



Canadian overnight rate

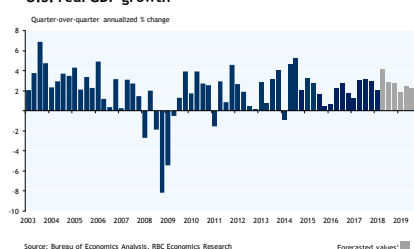


Federal Reserve

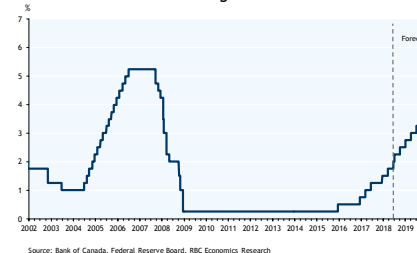
The US economy was firing on all cylinders in Q2 with GDP growth expected to jump above 4%—one of the fastest quarterly rates in the last decade.

Changes to the Fed's last policy statement suggest their tightening cycle is in cruise control. While inflation and wages remain well-behaved for now, the recent pace of growth indicates they can't delay in continuing to raise rates.

U.S. real GDP growth



U.S. target rate

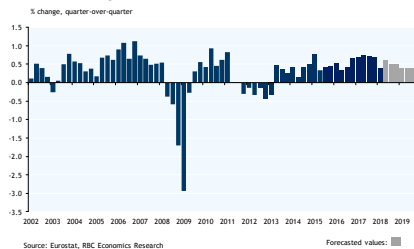


European Central Bank

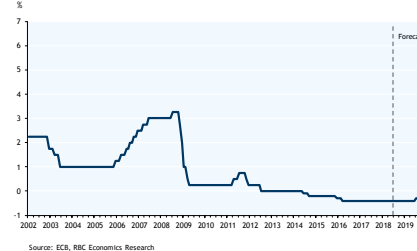
Survey data show the euro area economy lost some momentum in the first half of the year, though we think GDP growth remained above potential in Q2.

The ECB announced net asset purchases are likely to end later this year, but in an unexpectedly dovish development, indicated rates aren't likely to move higher until after next summer. We continue to expect the first rate increase in Q3/19.

Euro area GDP



ECB Deposit rate



Bank of England

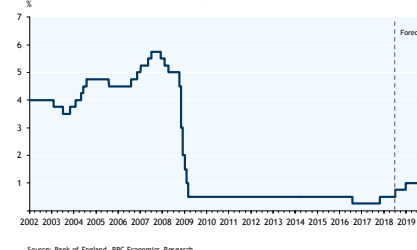
New monthly GDP figures provided further evidence that the UK economy's Q1 slowdown was transitory. We expect growth returned to a near-trend pace in Q2.

The economy's Q2 rebound is expected to trump rising Brexit uncertainty at the BoE's August meeting. We expect they'll raise rates then, but don't see a follow-up until next year.

U.K. real GDP growth



U.K. policy rate

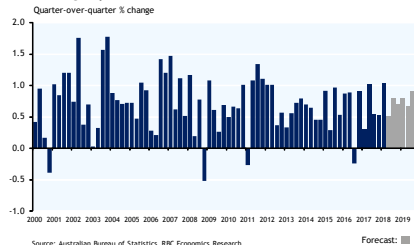


Australia

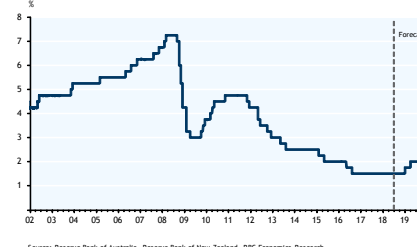
We have revised up our Australian GDP growth forecasts but still don't see the economy generating significant wage and inflationary pressure.

A mixed set of data kept the RBA from sounding dovish again in July. But we still don't think they're in any rush to join other central banks in raising rates. We expect they'll remain on the sidelines into next year.

Real GDP: Australia



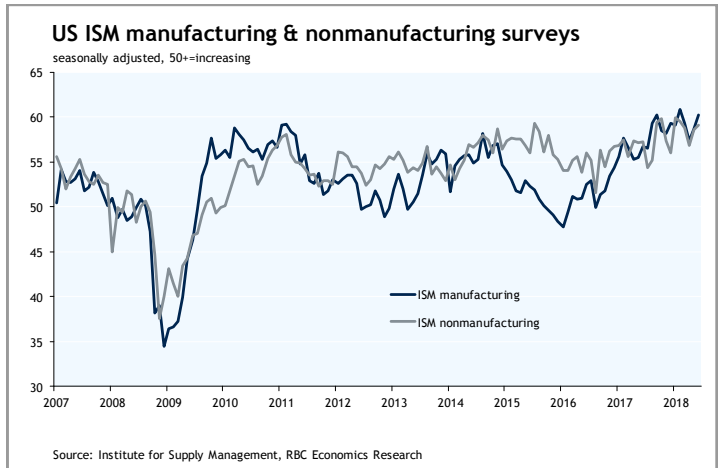
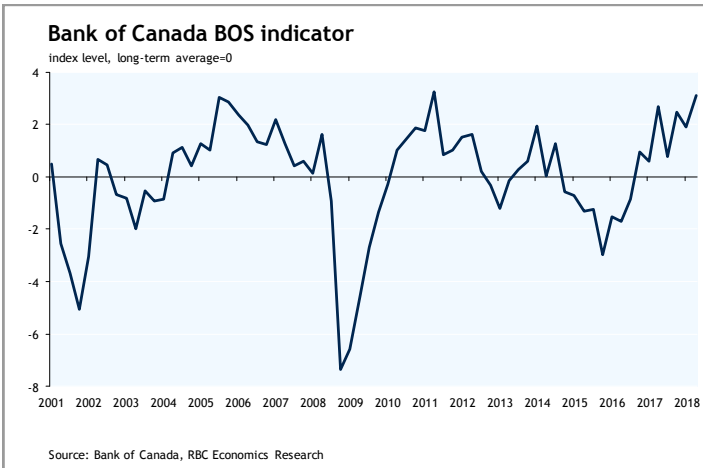
Australia policy rates



Survey says...

An upbeat *Business Outlook Survey* was likely a major factor in the Bank of Canada raising interest rates in July. Businesses reported strong order books and growing capacity constraints, while hiring and investment intentions didn't show much impact from rising trade uncertainty.

The US ISM manufacturing and nonmanufacturing indices both rose in June and were close to cycle highs. While businesses in both camps complained of tariffs and trade uncertainty, strong demand provided more than enough offset.



The UK's services sector has rebounded from a weather-related slowdown in March. Brexit uncertainty continues to weigh on sentiment but PMI data are consistent with trend-like growth of 0.3-0.4%. We'll have to wait to see if the latest Brexit drama impacts firms' confidence.

Euro area PMI readings have flagged a more moderate pace of growth this year, but sentiment remains generally positive in the context of the current cycle. Italy has yet to show much impact from their political wrangling. For now these indicators still point to above-trend GDP growth in the currency bloc.

