

FINANCIAL MARKETS MONTHLY

September 12, 2018

# It pays to be patient

Ten years on from the collapse of Lehman Brothers—the unofficial kickoff of the last global recession—it is worth taking stock of just how far job markets have come since the downturn. The US unemployment rate, having jumped to 10% in 2009, is now below 4% for just the second time since the moon landing. Canada’s jobless rate, which rose to a lesser degree during the recession, has also been at multi-decade lows throughout 2018. We’ve seen the same across the Atlantic, with the UK unemployment rate hitting 4% for the first time since the 1970s, down from more than 8% six years ago. The euro area has lagged behind, having to recover from a double-dip downturn, and unemployment in a number of member countries is still too high. But for the currency bloc as a whole, the jobless rate has fallen consistently over the last five years and is now within reach of pre-crisis lows.

While some of these labour markets are pushing beyond estimates of full employment, wages haven’t followed suit. Relatively slow pay growth has puzzled policymakers, leading them to revise estimates of just how low unemployment can fall before wages and inflation accelerate. That has been a factor keeping monetary policy accommodative so late into the cycle, even as these economies appear to be operating at full capacity. But evidence of wage pressures is starting to emerge. Surveys show employers are increasingly offering higher pay to attract scarce labour, and most measures of wage growth are on the rise. With one fewer reason to keep interest rates low, we look for the Fed and BoC to continue with gradual hikes into next year. Brexit, not wage growth, is likely to keep the BoE cautious, while the ECB is on a path to end QE later this year—likely comforted by signs that pay settlements are increasing.

## Central bank near-term bias



The Bank of Canada was encouraged by recent economic developments and sounds more firm in their tightening bias. We are with the market in expecting a rate increase at their next meeting in October.



The Fed’s discussion of downside risks in the July meeting minutes drew some attention but the bottom line is most participants expect a near-term rate increase. A hike in September looks like a slam dunk.



Timing of the next Bank of England rate hike will likely be driven more by Brexit developments than economic data. We think the central bank will remain on hold for the rest of the year as UK and EU negotiators continue to work toward an exit deal.



Recent data likely won’t have altered the European Central Bank’s monetary policy outlook. Net asset purchases will be tapered in October and end later this year, but a rate hike remains off the table through next summer.



Australian growth was solid in H1/19 but we now expect the Reserve Bank of Australia will be on hold well into next year given global growth risks and slow absorption of domestic slack.

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## Highlights

▲ The US ISM manufacturing index hit a cycle high in August, and the nonmanufacturing index also rebounded nicely.

▲ Consumer confidence continues to post cycle highs, bolstered by a positive assessment of labour market conditions.

▲ Wage growth hit a cycle high in August and should continue to pick up amid decades-low unemployment.

▲ A rate hike at the Fed's September meeting looks like a sure thing, and likely won't be their last move this year.

## Surveys point to another quarter of solid US growth

This cycle might be getting long in the tooth but the US economy is showing few signs of slowing to its longer-run potential rate. Q2's 4.2% annualized GDP growth marked one of the strongest increase in the last decade. And recent survey data point to above-trend gains continuing over the second half of 2018. The ISM manufacturing index just posted its highest reading since 2004 thanks to strong new orders and robust hiring. Firms have some complaints—rising tariff-related costs are a concern and there are shortages of skilled labour and supply chain problems to contend with—but strong business conditions seem to be outweighing those issues. New orders for capital goods hit a cycle high in July and we expect business investment will remain a key contributor to growth in the coming quarters.

Consumer confidence also continues to be buoyant, hitting its highest level since 2000 in August. Much of that likely has to do with a strong labour market—very few Americans are saying jobs are tough to find and more than a quarter of respondents expect their incomes will rise over the next six months. Lower personal income taxes have bolstered household savings, giving additional room for consumer spending to continue to rise over the second half of the year.

## Wages and inflation are trending higher

Echoing consumers' views of the labour market, the latest US employment figures continued to point to a strong jobs backdrop. More than 200k jobs were added in August the unemployment rate stayed below 4%. But the stand-out was an increase in average hourly earnings. Wage growth ticked up to 2.9%, the fastest pace since 2009. Pay growth has certainly been slow to pick up—wage growth accelerated by less than 1/2 percentage point over the last two years, despite the unemployment rate dipping by a full percent. But it does appear that tight labour market conditions and shortages in some skilled positions are pushing compensation higher.

Inflation readings have also been on the rise. Headline CPI is close to 3% for the first time since 2012, reflecting both rising energy prices and firmer core inflation. Prices excluding food and energy were up a cycle-high 2.4% year-over-year in July. Services inflation continues to lead the way, though goods price deflation has also eased over the last year. The Fed's preferred PCE inflation measures remain slightly lower but are at or above the central bank's 2% objective.

## September rate hike looks like a slam dunk

Wage growth around 3% hardly signals an imminent bout of inflation, but it's increasingly difficult to argue for monetary policy stimulus in the current environment. Indeed, most committee members thought another rate hike would soon be appropriate according to minutes of July's meeting. Their discussion of downside risks to the outlook—not just from trade policy, but also slower emerging market growth and potential fiscal tightening in the medium term—drew some attention. But investors still fully expect a rate hike in September, and the odds of another move by year end are good. With the Fed appearing to be in cruise control for 2018, attention might start turning to the outlook for monetary policy next year. In June the committee was split on how much further tightening would be appropriate in 2019, with most looking for either two or three rate hikes. That would leave fed funds close to most estimates of its neutral rate. Markets remain underpriced for such a scenario, and we think risks are to the upside. Fiscal stimulus is pushing the US economy beyond its longer run capacity limits, and any catch-up in inflation over the next year could test the Fed's patience. We think they'll raise rates four times next year, shifting monetary policy into a slightly restrictive position—something we've seen in past economic cycles.



## Canada's economy lived up to expectations in Q2

Canadian GDP growth accelerated to nearly 3% in Q2, double the previous quarter's pace. The increase was in line with both market expectation's and the Bank of Canada's forecast. Consumer spending rebounded from a soft start to the year, and residential investment managed to tick higher despite further slowing in home sales in the quarter. Business investment increased further, though not at the impressive pace seen since the start of last year. And trade provided the best add to growth since 2016. Looking at the first half of the year as a whole there was a lot for policymakers to like. A more trend-like pace of growth, with the economy already at full capacity, should keep inflationary pressure contained. Less reliance on consumers and housing has allowed for improvement in household balance sheets. And the long-awaited rotation toward exports and investment is proceeding.

We expect those trends will persist over the second half of the year. But the path will likely be uneven. Last quarter ended on a soft note with GDP flat in June. Combined with production shutdowns in the oil sands in July, that will make for a weak start to Q3. We expect a rebound from those temporary factors should see activity pick up again in Q4. All told, we look for modestly above-trend growth to be sustained in the second half of 2018, leaving GDP up 2.1% for the year as a whole.

### The two amigos?

While recent export and investment data have been positive, trade tensions with the US continue to represent a downside risk to the outlook. Canada was shut out of negotiations between the US and Mexico as the two countries worked through bilateral sticking points over the summer. That yielded an agreement on wages and content requirements in the auto sector that should be palatable to the Canadian negotiators. But talks went beyond autos, with Mexico apparently agreeing to a watered-down dispute resolution mechanism and 16-year sunset clause. It is unclear whether the deal represents a negotiating position to be brought back to the Nafta table, or a bilateral deal in case trilateral talks stall. President Trump has taken the latter position, submitting notice to Congress that he wants to sign a trade agreement with Mexico—and telling Canada they can join or face punitive auto tariffs. Canada has returned to the negotiating table, with all sides pushing for an agreement by the end of September when text of a deal has to be sent to Congress. We continue to expect a renegotiated Nafta agreement will emerge, though odds of a negative outcome remain uncomfortably high.

### BoC but holds rates steady but strikes positive tone

The Bank of Canada held interest rates steady in September, as expected following an on-consensus GDP report and Governor Poloz's dismissal of the latest jump in inflation. The tone of the policy statement was fairly positive. The bank lauded the economy's rotation toward exports and investment, as well as developments in housing and consumer balance sheets. A change in language on trade tensions—Governing Council now “monitoring closely the course of NAFTA negotiations”—drew some attention given Poloz's earlier comments that monetary policy would be data dependent, not headline dependent. But subsequent remarks from Senior Deputy Governor Wilkins confirmed no change in the bank's stance. In fact, she noted that there were *upside* as well as downside risks to the outlook from trade, and that other policy tools might be better suited to managing the fallout from protectionism. Otherwise her comments echoed the policy statement, if anything sounding even more upbeat. All told, we remain confident that the BoC will raise rates at their next meeting in October. Markets are equally convinced, with a move almost fully priced.

## Highlights

▲ Canada's 2.9% GDP growth in Q2 was the best in a year, led by stronger growth in consumer spending and exports.

▲ June's flat GDP and oil sector outages in July set up for a slower Q3, but we think activity will rebound in Q4.

▲ The threat of a bilateral US-Mexico trade deal hangs over Canadian negotiators as Nafta talks resume.

▲ The BoC sounded more firmly in tightening mode than they have over the last year. We expect the next rate hike in October.



## Highlights

▲ The UK economy had a solid start to Q3 with July GDP up 0.3%.

▲ But BoE policy is currently more Brexit-dependent than data-dependent.

▲ France's economy looks set to pick up over the second half of 2018, while Italy's is poised to soften.

▲ We have pushed back our call for the RBA's first rate hike to the end of next year.

### UK economy had a solid start to Q3 but Brexit key for BoE

UK GDP growth rebounded in Q2 after a weather-related slowdown earlier this year and the economy appears to have carried some of that momentum into the second half of 2018. Monthly output rose by an above-trend 0.3% in July, led by a solid increase in services. The construction industry continued to recover from a particularly weak Q1, though the latest PMI data indicate the sector might be losing some steam. The struggling manufacturing sector shows no sign of perking up—the industry PMI hit a two year low in August. But survey readings for the much larger services sector continue to point to trend-like growth. And a strong start to Q3 even lends some upside risk to our forecast for 0.3% growth in the current quarter.

We don't expect the near-term growth outlook will have much bearing on Bank of England policy at this stage. After raising rates in August, we doubt they'll consider further tightening before we get more clarity on the outcome of Brexit talks. There have been some positive signals from EU negotiators recently, though disagreement among the UK government on what Brexit should look like remains a hurdle. The BoE's expectation for very gradual rate hikes in the coming years is contingent on a smooth Brexit outcome, which looks far from assured. But if that does come to fruition, we think the central bank has a case to continue scaling back accommodation. Unemployment was 4% in July, the lowest since 1975. And wage growth ticked higher, supporting survey evidence that tight labour market conditions are leading employers to offer better pay.

### Ups and downs across the euro area

The latest euro area survey data were a mixed bag. On a positive note, readings have remained solid in the currency bloc's two largest economies—Germany and France. The latter had a slow first half of 2018 due in part to bad weather and labour disputes. Recent PMI readings indicate the French economy should pick up as those transitory factors fade, which will bolster euro area GDP over the second half of the year. But at the same time it looks like political headwinds in Italy are increasingly affecting the country's economy. Italy grew at a decent pace through much of last year but lost some momentum in 2018. August's survey data, with the composite PMI falling to a two-year low, points to that trend continuing over the second half of the year. But on balance we think stronger activity in France will provide enough offset for euro area GDP growth to tick higher to 0.5% per quarter over the second half of the year. That would be strong enough to put renewed downward pressure on the unemployment rate, which has flattened out in recent months but is still down nearly 1/2 percentage point year to date. A return to above trend-growth could see the jobless rate test 8% later this year for the first time since 2008. An improving labour market and rising wages have increased the ECB's confidence that inflation will eventually return to target. That was key in their laying out a course to gradually exit from ultra-accommodative monetary policy.

### Pushing back our RBA call despite stronger Australian growth

Australian GDP rose a non-annualized 0.9% in Q2, building on an upwardly-revised 1.1% gain in Q1 to leave year-over-year growth at its best pace since 2012. Household spending and residential investment were key drivers in the latest quarter though both face headwinds going forward. Recent gains on the consumer side have come from a decline in household savings that will be hard to sustain, while the housing sector is set for a cyclical slowdown over the coming year. But given strength over the first half of the year, we have revised up our 2018 GDP growth forecast to 3.3% from 3.0% previously. That above-trend pace is consistent with the RBA's forecast for some reduction in spare capacity, though we continue to expect the process of reducing labour market slack and stimulating wage growth will be gradual. We see little reason for the RBA to deviate from their current, steady policy stance. And given rising risks to the global outlook and some domestic issues—rising funding costs and political uncertainty—we now see the RBA on hold well into next year. We have shifted our forecast for the first cash rate hike from early next year to late-2019.





## Interest rate outlook

%, end of period

	Actuals						Forecast					
	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
<b>Canada</b>												
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
<b>United States</b>												
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
<b>United Kingdom</b>												
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
<b>Euro area</b>												
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
<b>Australia</b>												
Cash target rate	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75
Two-year	1.76	1.78	1.94	2.00	2.00	2.00	2.00	2.10	2.20	2.25	2.35	2.50
10-year	2.70	2.60	2.84	2.63	2.60	2.63	2.80	2.80	2.85	3.00	3.20	3.35
<b>New Zealand</b>												
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	2.15	2.25	2.30	2.35	2.40	2.55
10-year swap	3.41	3.35	3.24	3.13	3.06	3.02	3.10	3.10	3.15	3.30	3.50	3.65
<b>Yield curve*</b>												
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	80	70	65	75	85	85
New Zealand	110	103	105	93	85	88	95	85	85	95	110	110

\* Two-year/10-year spread in basis points, \*\*Top of 25 basis point range

Source: Reuters, RBC Economics Research

## Central bank policy rate

%, end of period

		Current	Last				Current	Last	
United States	Fed funds	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	0.75	0.50	August 1, 2018	New Zealand	Cash rate	1.75	2.00	November 10, 2016

Source: Bloomberg, Reuters, RBC Economics Research



## Economic outlook

### Growth outlook

% change, quarter-over-quarter in real GDP

	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	1.4	2.9	1.6	2.6	1.9	1.7	1.7	1.7	1.4	3.0	2.1	2.0
United States*	1.8	3.0	2.8	2.3	2.2	4.2	2.8	2.8	1.8	2.4	2.2	1.8	1.6	2.2	2.8	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	0.6	0.7	0.7	0.7	0.4	0.4	0.5	0.5	0.4	0.4	0.4	0.4	1.8	2.5	2.1	1.8
Australia	0.4	0.7	0.7	0.7	1.1	0.9	0.6	0.8	0.7	0.6	0.8	0.8	2.6	2.2	3.3	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	2.8	2.7	2.3	2.7	2.4	2.3	1.4	1.6	2.5	2.4
United States	2.5	1.9	2.0	2.1	2.2	2.7	2.7	2.7	2.5	2.6	2.6	2.4	1.3	2.1	2.6	2.5
United Kingdom	2.2	2.8	2.8	3.0	2.7	2.4	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	2.0	1.8	1.9	1.7	1.6	1.5	0.2	1.5	1.7	1.7
Australia	2.1	1.9	1.8	1.9	1.9	2.1	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	1.5	1.9	1.6	1.6	1.6	1.6	1.7	0.7	1.9	1.6	1.6

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

## Inflation tracking

### Inflation Watch

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	CPI ex food & energy <sup>1</sup>	Jul	0.4	2.3	1.1	2.0
United States	Core PCE <sup>1,2</sup>	Jul	0.2	2.0	2.0	2.1
United Kingdom	All-items CPI	Jul	0.0	2.5	2.7	2.2
Euro area	All-items CPI <sup>1</sup>	Aug	0.1	2.0	2.6	2.1
Australia	Trimmed mean CPI <sup>1</sup>	Q2	0.5	1.9	N/A	N/A
New Zealand	All-items CPI	Q2	0.4	1.5	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	1.29	1.28	1.27	1.28	1.28
Euro	1.07	1.14	1.18	1.20	1.23	1.17	1.16	1.12	1.14	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	0.67	0.67	0.69	0.70	0.70	0.70
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	0.71	0.70	0.71	0.71	0.70	0.70

### Canadian dollar cross-rates

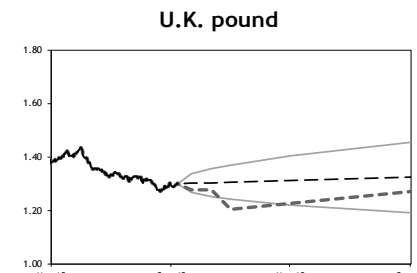
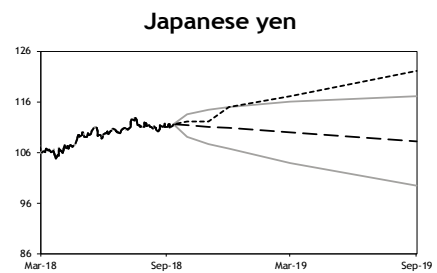
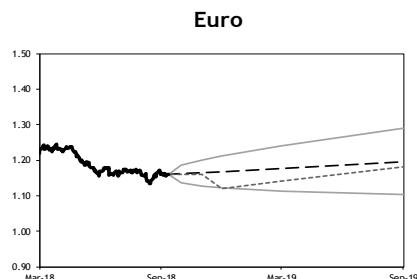
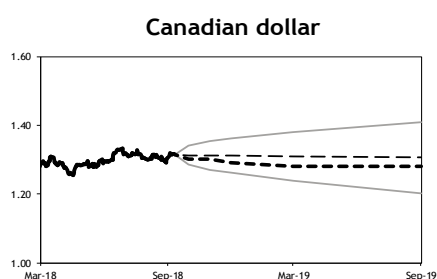
	17Q1	17Q2	17Q3	17Q4	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4
EUR/CAD	1.42	1.48	1.47	1.51	1.59	1.53	1.51	1.44	1.46	1.47	1.51	1.54
GBP/CAD	1.67	1.69	1.67	1.70	1.81	1.74	1.66	1.55	1.57	1.58	1.62	1.65
NZD/CAD	0.93	0.95	0.90	0.89	0.93	0.89	0.87	0.86	0.88	0.89	0.90	0.90
CAD/JPY	83.7	86.7	90.2	89.6	82.4	84.3	86.2	89.1	91.4	93.7	95.3	97.7
AUD/CAD	1.02	1.00	0.98	0.98	0.99	0.97	0.92	0.90	0.91	0.90	0.90	0.90

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.





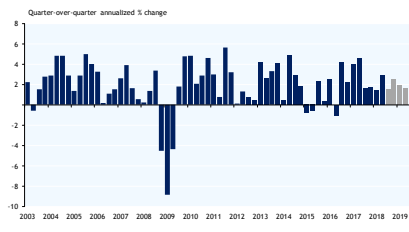
## Central bank watch

### Bank of Canada

Canada's economy picked up in Q2 but a soft June GDP report and oil sector shutdowns in July point to a softer Q3. The BoC indicated slower current quarter growth doesn't necessarily indicate weaker underlying momentum.

The BoC sounds increasingly convinced that less monetary policy stimulus is needed. We expect they'll raise rates again in October.

Canadian real GDP growth



Source: Statistics Canada, RBC Economics Research

Canadian overnight rate



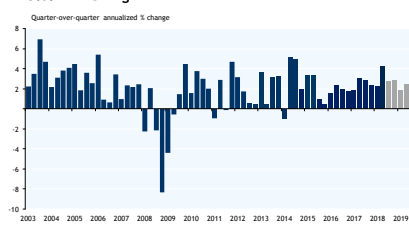
Source: Bank of Canada, Federal Reserve Board, RBC Economics Research

### Federal Reserve

The US economy is expected to continue growing at an above-trend pace over the second half of the year thanks to further gains in consumer spending and business investment and an ongoing fiscal lift.

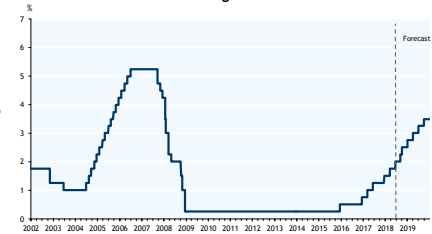
Given the economy's momentum we see little reason for the Fed to let up on their tightening cycle. We continue to expect steady rate increases through next year, including a hike at the coming meeting.

U.S. real GDP growth



Source: Bureau of Economic Analysis, RBC Economics Research

U.S. target rate



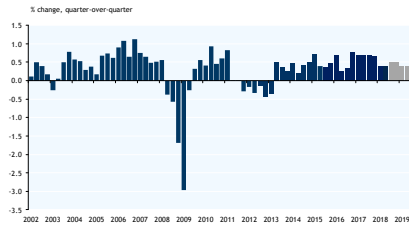
Source: Bank of Canada, Federal Reserve Board, RBC Economics Research

### European Central Bank

Euro area survey data continue to point to 0.5% growth in Q3. We think that will reflect stronger activity in France, while Italy's economy appears to be slowing further amid political uncertainty.

The ECB will cut net asset purchases in half in Q4 and cease new QE buying at the end of the year. We expect very gradual rate hikes will begin in the second half of next year.

Euro area GDP



Source: Eurostat, RBC Economics Research

ECB Deposit rate



Source: ECB, RBC Economics Research

### Bank of England

We expect the UK economy will grow at a trend-like pace over the second half of the year, though solid July GDP lends some upside risk to our call for a 0.3% gain in Q3.

Low unemployment and rising wages point to less need for monetary policy accommodation but the BoE's tightening cycle will be dictated by Brexit developments in the near term.

U.K. real GDP growth



Source: Central Statistical Office, RBC Economics Research

U.K. policy rate



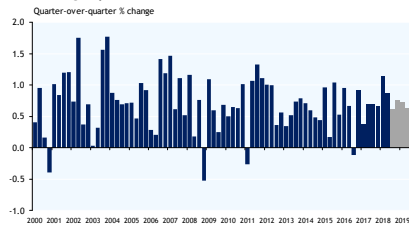
Source: Bank of England, RBC Economics Research

### Australia

Australia's economy picked up over the first half of the year but recent strength in consumer spending and housing isn't likely to be sustained.

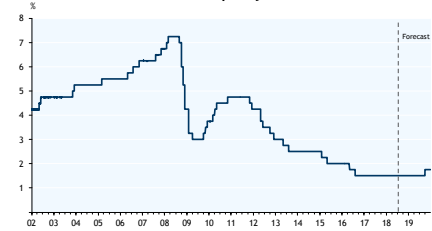
Above-trend growth points to some absorption of economic slack, but the international experience suggest higher wages and inflation will be slow to follow. We think the RBA will remain on hold for the foreseeable future.

Real GDP: Australia



Source: Australian Bureau of Statistics, RBC Economics Research

Australia policy rates



Source: Reserve Bank of Australia, Reserve Bank of New Zealand, RBC Economics Research





## Wage growth on the up-and-up in several G7 economies

US wage growth continued its gradual march to 3%, with the official payroll number hitting 2.9% in August. The Atlanta Fed's wage tracker, which controls for changes in labour market composition, has been running at a faster pace. That suggests individuals' pay growth has bested 3% for a few years now.

Canada's labour force survey has been a volatile indicator of wage growth, accelerating from less than 1% last year to nearly 4% this year. The measure turned down in recent months, and is now more in line with the BoC's 'wage-common' which we estimate at 2.4% in Q2.



UK wage growth has been just shy of 3% for much of this year and a number of surveys point to compensation picking up. With inflation already above-target, evidence of rising wages contributed to the central bank raising rates in August.

Euro area core inflation has been stubbornly low, but an uptick in wages this year has bolstered the ECB's confidence they'll hit their inflation target over time. A recent rise in negotiated wage settlements points to hourly compensation continuing to increase.

