FINANCIAL MARKETS MONTHLY

February 8, 2019

‘Doves’ of a feather

Risk appetite was back in January with equity markets recovering nicely from December’s swoon and corporate spreads coming off recent highs. But government bonds held their ground with 10-year US Treasury yields ending the month slightly lower, even as rising oil prices put upward pressure on inflation expectations. The same was true across the G7. The common thread was an expectation that central banks are becoming more dovish about raising interest rates when trade tensions and political uncertainty appear to be taking their toll on the global economy. That wasn’t just idle speculation on the part of investors—the Fed shifted to a neutral bias in January as a number of “cross-currents” have weakened the case for further tightening. Markets now indicate the Fed’s next move is more likely to be a rate cut than a hike. The Bank of Canada didn’t sound as dovish but their softened tightening bias suggests a pause in rate hikes that will extend through the first half of this year. The European Central Bank and Bank of England, both watching their economies lose momentum toward the end of last year, seemed to endorse a more gradual removal of accommodation. And in a shift from last year, the Reserve Bank of Australia is now saying their next move is just as likely to be a rate cut as it is a hike.

The next few months will be key in shaping the path of monetary policy. US-China trade talks face a soft deadline of March 1, while the UK is due to exit the EU on March 29—deal or no deal. There is a possibility that these deadlines are punted by a few months, particularly for Brexit. That could mean heightened uncertainty extending through the first half of 2019. Our forecast still looks for rate hikes from the Fed, BoC, BoE and ECB this year. But it appears central banks will want some clarity on these major issues before increasing rates any further.

Central bank near-term bias

↔ The BoC’s forward guidance in January was for rates to rise to neutral “over time,” and recent comments from Governing Council don’t suggest a change in thinking. We expect they’ll remain on pause through the first half of 2019 before raising rates twice by end of year.

↔ The Fed’s dovish shift continued with their statement no longer pointing to further tightening. But we think their base case for continued expansion will play out, and an easing in some of Chairman Powell’s ‘cross-currents’ could see them get back to raising rates in June.

↔ With Brexit uncertainty only increasing, the BoE is unlikely to change policy anytime soon. Their mantra for gradual but limited tightening remains in place, subject to a smooth Brexit, but they did seem to endorse markets’ slightly more shallow path for rates.

↔ The euro area economy has lost some momentum and that could prompt the ECB to extend their guidance on how long interest rates will remain at current levels. Even if they opt to leave forward guidance unchanged, risks around our forecast for hikes in H2/19 is skewed to a later start.

↔ The RBA shifted into neutral in February as slowing global growth, less domestic momentum, and dovishness from other central banks have reduced the impetus to raise rates.

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Highlights

▲ The Fed unexpectedly dropped their tightening bias in January.

▲ Chairman Powell pointed to a number of "cross-currents" that have weakened the case for further rate hikes.

▲ An easing in global trade tensions could go a long way in reducing downside risks to the outlook.

▲ Domestic data, particularly inflation, will have to make the case for further rate increases.

Fed's dovish shift continues with tightening bias nixed

What a change in tone we've seen from the Fed in just six weeks. Despite market volatility and global growth concerns, they were confident enough in the economic outlook to continue raising interest rates in December. That move was softened by a watered-down tightening bias and a commitment to keep an eye on global and financial risks, but that did little to placate jittery investors who continued to unload risk assets. Cue a more cautious, market-friendly tone early this year that emphasized a patient, data dependent approach to further tightening. We assumed that would be the message at their January meeting as well, and indeed the statement noted "global economic and financial developments and muted inflation pressures" call for patience in making future policy adjustments. But that last part was a surprise—"adjustments" implying the next interest rate move could be up or down. The Fed appears to have abandoned their tightening bias despite expecting continued economic expansion as their base case.

When asked what prompted this change in tack, Chairman Powell pointed to a number of "cross-currents" that suggest risk of a less favourable outlook. Those include signs of slowing global growth (particularly in Europe and China), persistent uncertainty over trade policy, tighter financial conditions, and a government shutdown that will impact Q1 growth (and hasn't been definitively resolved). He also noted inflation trends and financial stability risks don't point to a pressing need for tighter monetary policy. Summing things up, Powell said the case for raising rates has weakened. Markets liked the Fed's dovish tone, as well as their more flexible approach to balance sheet normalization. After saying in December that balance sheet runoff is effectively on "automatic pilot," the FOMC is now prepared to adjust the details for completing normalization in light of "economic and financial developments." Powell also confirmed the Fed will continue to operate with a large balance sheet going forward, meaning 'quantitative tightening' could be completed by the end of this year.

So are they done raising interest rates?

It certainly appears the bar to further tightening has been raised. So what will we need to see to get the two interest rate hikes assumed in our forecast? An easing of Chairman Powell's 'cross-currents' will be key. It's difficult to say whether US-China trade tensions will be resolved—comments surrounding high-level talks have been fairly positive, but negotiators say the two sides are still far apart. China will likely stand their ground on some of the US's key trade irritants, but they at least seem willing to give President Trump a few 'wins,' like pledging to increase imports of US soybeans and other products. A similar strategy worked for Canada and Mexico in last year's Nafta negotiations. A truce between the world's two largest economies could help reverse some of the slowing in the global industrial sector seen over the second half of 2018. It would also boost market sentiment, which has become key to the Fed's reaction function. But the situation could also deteriorate. An escalation of tariffs (either through higher rates or greater product coverage) would reinforce the recent decline in manufacturing sentiment and put renewed pressure on equities. The US's self-imposed deadline for trade talks is March 1, so the Fed could be looking at a changed set of cross-currents—for better or worse—at their next meeting.

While global developments will be watched closely, it goes without saying that domestic indicators will be important for the data dependent Fed. Surveys have shown some deterioration in sentiment, but the bits of hard data that weren't delayed by the government shutdown have been generally positive. Most significantly, the US economy continued to add jobs at a solid clip in recent months, including a gain of more than 300,000 in January. That suggests that while business sentiment has softened, firms are still confident enough in their own prospects to bring on new workers. And it's hard to see the recent decline in consumer confidence extending when jobs are plentiful, unemployment is low and wages are trending higher. We're still waiting on a number of data points to see how the US economy was performing around the turn of the year, but what we have so far suggests the Fed's base case of ongoing expansion and low unemployment remains on track.

Inflation developments will also be central to the Fed's deliberations. Powell's comments suggest that with fed funds close to its neutral range, policymakers are wary of continuing to raise rates *in anticipation* that tighter policy is needed to keep price pressures in check. They want to see a *need* for further moves. While headline inflation is set to spend most of this year below 2% due to lower energy price, core readings should continue to drift higher amid capacity pressures and rising wages. That process has been slow to unfold, but we see underlying inflation moving up toward 2.5% over the course of 2019. We think the combination of above-trend growth and above-2% inflation will be enough to convince the Fed that a little more tightening is needed. Our forecast calls for rate hikes in June and December this year.

Teasing out the trend in Canada's economy

Canadian GDP fell 0.1% in November as rotating Canada Post strikes weighed on transport activity, adding to an already-soft month for the manufacturing, wholesale and retail sectors. The impact of labour disruptions should have reversed in December, but we think the energy sector stepped in as a new source of weakness. Drilling activity fell 30% toward the end of last year as oil producers responded to lower global prices, sharp discounts on Canadian crude, and production cuts ordered by the Alberta government. With storage levels beginning to normalize and price differentials narrowing, mandatory curtailments are already being eased. But that won't stop lower energy output from exerting a drag on Canada's economy early this year. We are with the Bank of Canada in expecting GDP growth will average just over 1% annualized in Q4/18 and Q1/19.

Much of this soft patch can be blamed on the energy sector or transitory issues, but rising interest rates and regulatory tightening are also having an effect. Last year was the slowest for home resales since 2012 and some markets (particularly Vancouver) have yet to fully stabilize. Meanwhile, retail sales have leveled off with housing-related and rate-sensitive purchases taking a hit. Households can no longer be relied upon to do the heavy lifting—like the Bank of Canada, we view business investment and exports as key contributors to growth this year. That means we're watching closely for any sign of energy sector spillover into the broader economy, or weakness related to slowing global growth and trade uncertainty. Manufacturing sentiment has declined and activity in the sector has been close to flat in recent months—potentially a sign that the rollover in global industrial production and trade growth is hitting Canadian producers. If that trend continues, it would jeopardize a return to at- or slightly-above-potential GDP growth later this year. But as the BoC has been keen to point out, there are two-way risks around trade policy. Any easing in US-China tensions would reduce a key source of uncertainty, and could put the global industrial sector back on an upward trend.

Will the BoC echo the Fed's dovish message?

Recall that the Bank of Canada also softened their tightening bias in early-January, saying they expect interest rates will have to rise to a neutral level "over time" to keep inflation on target. Might they follow the Fed and abandon that forward guidance altogether? We don't think so. Fed funds is now close to most neutral estimates but the BoC's overnight rate remains 75 basis points below its assumed neutral range. And while the Fed wants to see a *need* to raise rates further, the BoC continues to note that monetary policy must be forward-looking. We expect they'll hold off on raising rates over the first half of the year, watching global developments and the economy's reaction to lower oil prices. But assuming this current soft patch is just a "detour" and the non-energy economy remains near full capacity, we think the BoC will want to tighten policy somewhat further to defend their 2% inflation target. We look for them to raise rates twice over the second half of 2019, leaving the overnight rate at 2.25%—close to where fed funds is today.

Highlights

▲ Transitory issues and energy sector weakness weighed on growth around the turn of the year…

▲ …but slower growth in housing and rate-sensitive consumer spending have also been factors.

▲ Exports and business investment are expected to support the Canadian economy this year, so we're watching closely for any impact from trade tensions and global growth concerns.

▲ We think the BoC will maintain their tightening bias despite the Fed sounding less confident in further rate hikes.

Highlights

▲ The UK's January PMIs point to an economy with limited momentum to start 2019.

▲ Euro area GDP growth averaged 0.2% in H2/18, half the pace seen in H1. Some of that slowing reflects transitory factors.

▲ The currency bloc's loss of momentum appears to have extended into early 2019 with French and Italian PMIs remaining below 50.

▲ Our forecast now assumes the RBA will keep the cash rate steady through next year.

UK economy stumbling toward March 29

The closer we get to the March 29 Brexit deadline without a Parliament-approved deal, the more UK business sentiment falters. We think GDP growth slowed to a 0.2% pace in Q4/18 from an average pace of 0.5% in the prior two quarters, and early indications are Q1/19 won't be much better. Outside of the immediate post-referendum decline, January's composite PMI was the lowest in six years. Labour market data have been a bright spot—job growth picked up nicely in the three months to November—but that momentum appears to have faded more recently. Employment sub-indices in both the manufacturing and services PMIs dipped below 50 in January, suggesting firms have halted hiring until Brexit uncertainty is resolved. When might they get some clarity? Prime Minister May has gone back to the EU in an attempt to renegotiate the controversial Irish border backstop. However, EU negotiators have ruled out reopening the agreement, making it unlikely May will be able to return to Parliament with the desired changes. The whole process will have put the UK two weeks closer to Brexit without any substantive progress toward a palatable deal. That delay raises the risk of a no-deal Brexit, though our central assumption remains for a short extension of the Article 50 deadline that will ultimately allow for an agreement to be reached. Unsurprisingly, the Bank of England continues to wait on the sidelines to see how all of this unfolds. In February they maintained a bias for 'limited and gradual' rate hikes though that comes with the caveat of an assumed smooth Brexit transition.

Euro area slowdown extending into early 2019

The euro area's loss of momentum extended through the end of last year with the another subtrend 0.2% increase in GDP in the fourth quarter. France recorded a 0.3% gain though domestic demand was flat and a sharp decline in business sentiment in recent months (driven in good part by civil unrest) suggests a slow start to 2019. Italy saw a 0.2% decline in Q4/18 GDP, entering a technical recession for the third time in a decade (the prior two were certainly more than 'technical'). We think Germany avoided that fate despite another quarterly decline in industrial production. Survey readings suggest the country's manufacturing woes continued early this year, though improvement on the services side raises hopes that spillover into the broader-economy will be limited. Of the currency bloc's largest economies, Spain remains the lone bright spot.

Will this slowdown continue in 2019? Certainly there have been some idiosyncratic issues (Germany's auto sector, France's protests, Italy's political drama) weighing on growth that have either been resolved or are unlikely to persist. But it also looks like the loss of momentum globally is weighing on euro area exporters, who are more exposed to emerging markets than some of their advanced economy counterparts. Our forecast now assumes growth will remain soft over the first half of the year—GDP gains in a 0.2-0.3% range, down from 0.4% previously—before recovering somewhat over the second half when transitory factors have faded and there is a bit more clarity (hopefully) on trade. We think the ECB will also revise down their growth projections at their next meeting in March. There is also potential for the central bank to push back their forward guidance on how long interest rates will be held at current levels, though reports suggest they might hold off for now. Either way, the risk around our forecast for gradual rate hikes to begin in the second half of this year is skewed toward a later start to tightening.

RBA shifts to neutral and we drop our call for hikes

RBA Governor Lowe presented a much more neutral stance in his first speech of the year, noting that the likelihood of scenarios that would call for a higher cash rate was now balanced by scenarios that might require a cut. Last year's refrain that the next move was more likely to be up than down is no longer appropriate given uncertainty surrounding global growth and less-than-robust domestic conditions (including a weakening housing market and lingering labour market slack). We have said for some time that the RBA was likely to remain on hold well into 2019, with limited tightening expected to follow. But with G7 central banks now sounding more cautious, and given Australia's greater exposure to global developments (particularly China) our base case now assumes the cash rate will be held at 1.50% through 2020. A reduction in trade tensions, greater global growth momentum, and hawkishness from other central bankers would reignite prospects of rate hikes, while softening in the domestic labour market would be a catalyst to move rates lower.

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	2.00	2.25	2.25	2.25	2.25	2.25
Three-month	1.10	1.26	1.59	1.64	1.65	1.65	1.95	2.20	2.20	2.20	2.20	2.20
Two-year	1.78	1.91	2.21	1.86	2.00	2.15	2.30	2.40	2.35	2.30	2.25	2.25
Five-year	1.97	2.07	2.34	1.89	2.10	2.30	2.45	2.50	2.45	2.40	2.35	2.30
10-year	2.09	2.17	2.43	1.97	2.20	2.40	2.55	2.60	2.60	2.55	2.50	2.45
30-year	2.23	2.20	2.42	2.18	2.40	2.55	2.65	2.70	2.70	2.65	2.60	2.55
United States												
Fed funds**	1.75	2.00	2.25	2.50	2.50	2.75	2.75	3.00	3.00	3.00	3.00	3.00
Three-month	1.73	1.93	2.19	2.45	2.40	2.65	2.65	2.90	2.90	2.90	2.90	2.90
Two-year	2.27	2.52	2.81	2.48	2.75	2.95	3.05	3.10	3.10	3.10	3.05	3.05
Five-year	2.56	2.73	2.94	2.51	2.80	3.00	3.10	3.15	3.15	3.15	3.10	3.10
10-year	2.74	2.85	3.05	2.69	2.95	3.15	3.25	3.30	3.25	3.25	3.20	3.15
30-year	2.97	2.98	3.19	3.02	3.20	3.30	3.40	3.45	3.40	3.40	3.35	3.30
United Kingdom												
Bank rate	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50
Two-year	0.82	0.72	0.82	0.75	0.80	0.85	1.10	1.15	1.30	1.40	1.45	1.55
10-year	1.34	1.28	1.57	1.27	1.50	1.70	1.85	2.00	2.10	2.15	2.20	2.20
Euro area												
Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	-0.10	0.00	0.00	0.00
Two-year	-0.59	-0.69	-0.55	-0.59	-0.50	-0.50	-0.40	-0.30	-0.10	0.10	0.25	0.25
10-year	0.50	0.31	0.47	0.25	0.40	0.45	0.65	0.80	0.90	0.95	1.00	1.00
Australia												
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	1.50
Two-year	2.00	2.00	2.02	1.89	1.75	1.80	1.70	1.65	1.50	1.50	1.60	1.75
10-year	2.60	2.63	2.67	2.32	2.10	2.20	2.20	2.15	2.05	2.05	2.15	2.25
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	1.75
Two-year swap	2.21	2.14	2.02	1.96	1.85	1.75	1.70	1.60	2.15	2.15	2.15	2.15
10-year swap	3.06	3.02	2.89	2.64	2.60	2.70	2.70	2.70	3.10	3.10	3.05	3.00
Yield curve*												
Canada	31	26	22	11	20	25	25	20	25	25	25	20
United States	47	33	24	21	20	20	20	20	15	15	15	10
United Kingdom	52	56	75	52	70	85	75	85	80	75	75	65
Eurozone	109	100	102	84	90	95	105	110	100	85	75	75
Australia	60	63	65	43	35	40	50	50	55	55	55	50
New Zealand	85	88	87	68	75	95	100	110	95	95	90	85

* 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	2.25-2.50	2.00-2.25	December 19, 2018	Eurozone	Deposit rate	-0.40	-0.30	March 10, 2016
Canada	Overnight rate	1.75	1.50	October 24, 2018	Australia	Cash rate	1.50	1.75	August 3, 2016
United Kingdom	Bank rate	0.75	0.50	August 1, 2018	New Zealand	Cash rate	1.75	2.00	November 10, 2016

Source: Bloomberg, Reuters, RBC Economics Research

Economic outlook

Growth outlook

% change, quarter-over-quarter in real GDP

	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	2017	2018F	2019F	2020F
Canada*	1.7	2.9	2.0	1.1	1.3	2.1	1.9	1.7	2.0	1.7	1.7	1.6	3.0	2.0	1.7	1.8
United States*	2.2	4.2	3.4	2.5	1.5	2.7	2.2	1.8	1.8	1.8	1.7	1.5	2.2	2.9	2.4	1.9
United Kingdom	0.1	0.4	0.6	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.3	1.8	1.4	1.5	1.6
Euro area	0.4	0.4	0.2	0.2	0.2	0.3	0.4	0.4	0.3	0.4	0.3	0.3	2.5	1.8	1.1	1.4
Australia	1.0	0.9	0.3	0.8	0.8	0.6	0.7	0.6	0.6	0.7	0.7	0.7	2.4	3.0	2.8	2.6

*annualized

Inflation outlook

% change, year-over-year

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

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]	Dec	0.4	2.3	2.2	2.0
United States	Core PCE[1,2]	Nov	0.1	1.9	1.5	1.8
United Kingdom	All-items CPI	Dec	0.1	2.1	2.4	2.7
Euro area	All-items CPI[1]	Dec	-0.3	1.6	1.3	2.0
Australia	Trimmed mean CPI[1]	Q4	0.4	1.8	N/A	N/A
New Zealand	All-items CPI	Q4	0.1	1.9	N/A	N/A

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

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

Currency outlook

Level, end of period

	Actuals				Forecast							
	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4
Canadian dollar	1.29	1.31	1.29	1.36	1.33	1.34	1.33	1.33	1.34	1.33	1.31	1.30
Euro	1.23	1.17	1.16	1.15	1.13	1.10	1.13	1.16	1.17	1.18	1.20	1.21
U.K. pound sterling	1.40	1.32	1.30	1.28	1.27	1.22	1.24	1.25	1.26	1.28	1.32	1.34
Chinese Renminbi	6.3	6.6	6.9	6.9	7.0	7.3	7.4	7.5	7.5	7.6	7.7	7.8
Japanese yen	106.3	110.8	113.7	109.7	111.0	113.0	117.0	120.0	119.0	118.0	117.0	116.0
Australian dollar	0.77	0.74	0.72	0.70	0.71	0.69	0.68	0.67	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	1.47	1.50	1.54	1.57	1.57	1.57	1.57
GBP/CAD	1.81	1.73	1.68	1.74	1.69	1.64	1.65	1.66	1.69	1.71	1.73	1.75
CAD/CNY	4.86	5.04	5.32	5.04	5.26	5.41	5.56	5.64	5.60	5.71	5.88	6.00
CAD/JPY	82.4	84.3	88.1	80.4	83.5	84.3	88.0	90.2	88.8	88.7	89.3	89.2
AUD/CAD	0.99	0.97	0.93	0.96	0.94	0.92	0.90	0.89	0.90	0.89	0.86	0.86

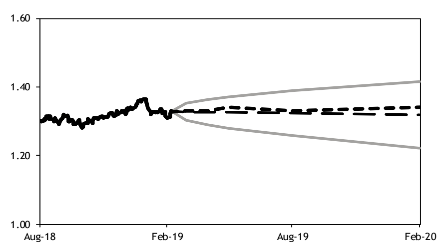
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

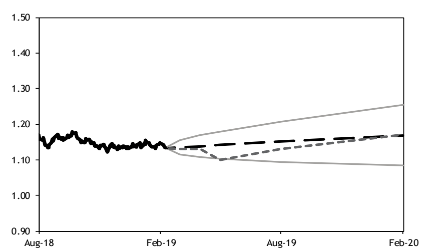
RBC Economics outlook compared to the market

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

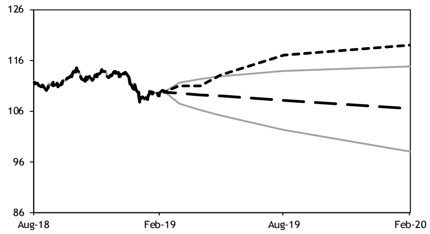
Canadian dollar



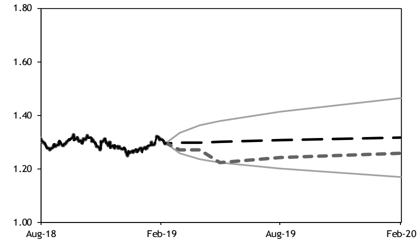
Euro



Japanese yen



U.K. pound

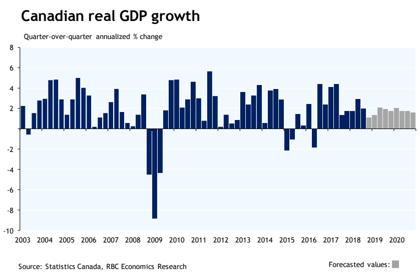


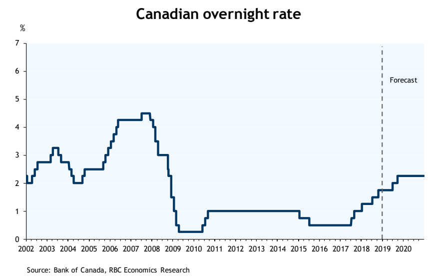
Central bank watch

Bank of Canada

A 0.1% decline in November GDP points to a soft Q4/18, and a pullback in the energy sector means Q1/19 won't look much better. We expect growth to average just over 1% in those two quarters.

The current slowdown will keep the Bank of Canada on pause until they have greater clarity on global developments and the oil sector. We now expect their next rate increase will be held off until Q3/19.

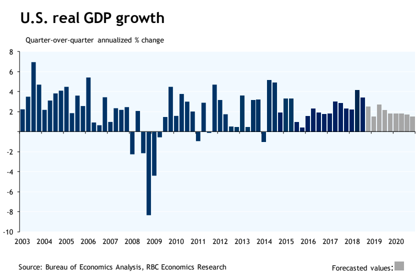


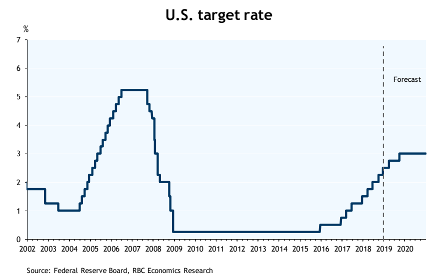


Federal Reserve

Data delays have complicated GDP monitoring but we still look for a solid 2.5% increase in Q4/18 GDP. Q1/19 is likely to be a bit slower with the government shutdown shaving 1/4 ppt off growth.

We think the Fed will want to see confirmation of above-trend growth continuing, and some improvement in 'cross-currents' before raising rates any further. Our forecast assumes a hike in June.

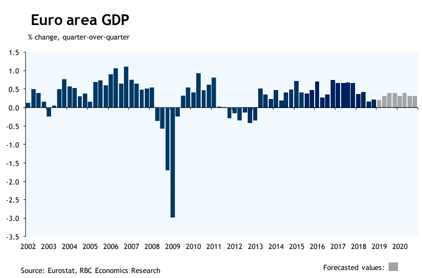


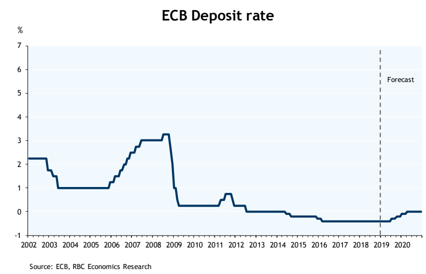


European Central Bank

The euro area has lost momentum with Italy in technical recession, Germany's industrial sector slowing, and France dealing with political unrest. It looks like growth will remain slightly below trend early this year.

We expect the ECB will begin moving the deposit rate back to zero later this year, but that is contingent on the economy returning to above-trend growth.

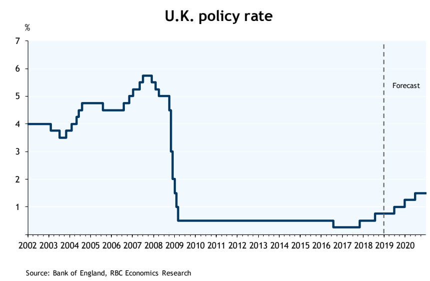




Bank of England

We expect UK GDP growth slipped to 0.2% in Q4/18. January's PMI readings point to much of the same early this year as Brexit uncertainty is increasingly weighing on business sentiment.

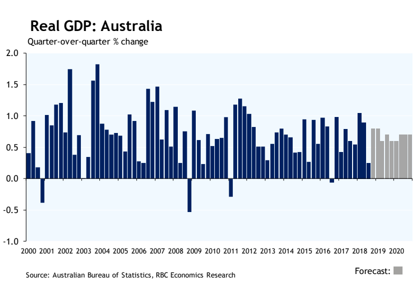
The BoE remains hamstrung by Brexit. We think the Article 50 deadline might be extended a few months, but that would still leave the central bank on the sidelines through mid-year.

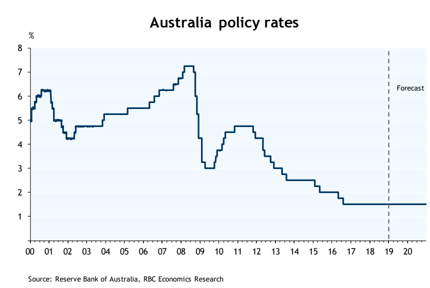


Reserve Bank of Australia

We expect the Australian economy will be held back by a slowdown in housing and weaker consumer spending. Trade tensions and less momentum globally add a dose of downside risk to the outlook.

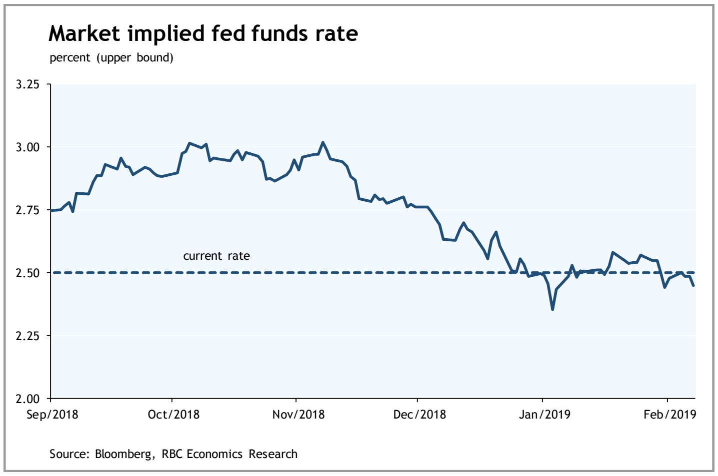
The RBA trimmed their growth and inflation forecasts in January, underpinning their shift to a more neutral stance. We now see the cash rate on hold through 2020.



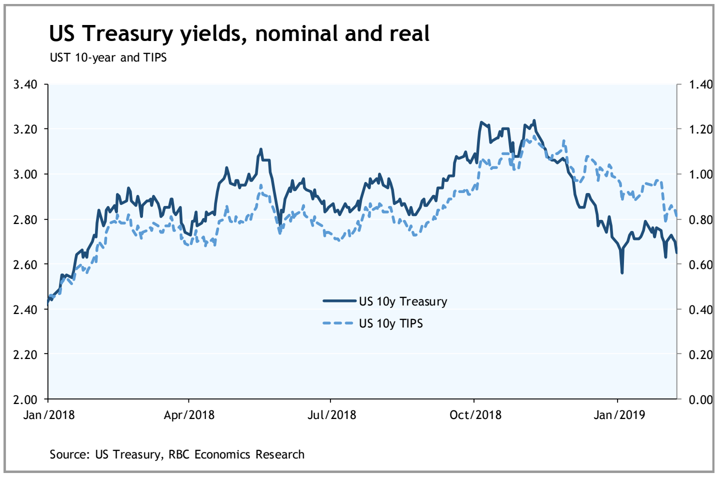


The Fed's dovish shift helped increase risk appetite

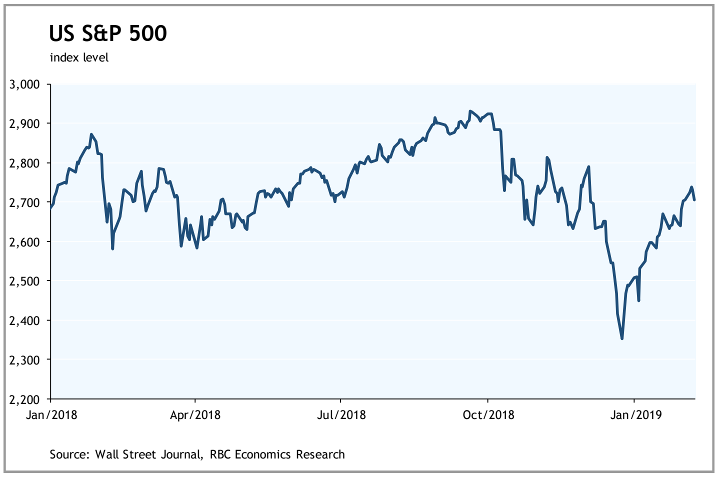
Over the course of three months, markets have gone from pricing in two more fed funds hikes to slight odds of a rate cut. The Fed has done little to push back against that shift, sounding more dovish in comments in January and dropping their tightening bias altogether at their last meeting.



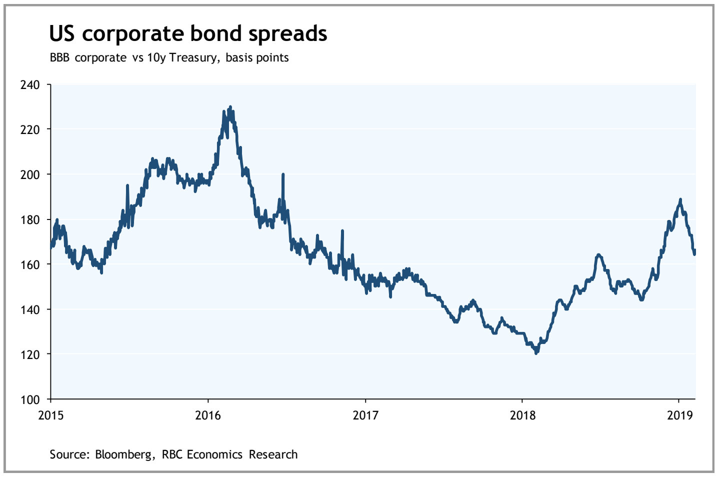
Despite an improvement in risk appetite in January, US Treasury yields remain close to recent lows. A dovish Fed helped push real yields lower, while an increasing inflation premium (due to rising oil prices and expectations of easier monetary policy) meant less downward pressure on nominal yields.



After nearly entering bear market territory (-20%) on Christmas Eve, the S&P 500 has bounced back some 15%. Some decent jobs data and hopes on the trade front have likely helped, but a much more market-friendly tone from the Fed was also a major factor supporting equities.



The improvement in risk appetite also helped corporate borrowers. Corporate spreads have come down from recent highs but are still up from the lows seen a year ago. This is one of the key indicators Chairman Powell pointed to when he referred to tightening financial conditions.



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