RBC Economics
Financial Markets Monthly

August 9, 2019

From simmer to boil

Just when we thought US-China trade tensions were at a simmer—with negotiations restarting after a G20 détente—President Trump once again turned up the heat. Unsatisfied with the pace of trade talks, he pledged an additional 10% tariff on all remaining Chinese imports starting in September (i.e. those goods spared from previous tariff hikes, about $265 billion by our count). Financial markets, already disappointed by the Fed's 'hawkish' rate cut the day before, didn't take the news well, selling stocks and piling into fixed income. The Chinese government's subsequent move to let the yuan depreciate (USD/CNY rising above the 7.00 mark for the first time since 2008) and the US Treasury's response (labeling China a currency manipulator) deepened equity market losses with the S&P 500 recording its largest single day decline this year. The risk-off move was also evident in commodities, with oil prices slipping to near-term lows and gold prices hitting a multi-year high.

Demand for safe assets saw US 10-year Treasury yields fall to levels not seen since Trump's 2016 election win, while German Bund yields dropped to record lows of less than -0.50%. The move was abetted by the prospect of additional easing as central banks try to offset the impact of rising trade tensions. The ECB has signaled that more help is coming—we expect a rate cut in September, and preparations for a new round of QE could be underway. Meanwhile, markets don't seem to be taking Fed Chair Powell at his word that near-term cuts are just a mid-cycle adjustment—nearly 100 basis points of further easing is priced in for the Fed over the next year. The RBNZ surprised with a 50 basis point rate cut in August (25 bps had been expected) and it looks like the RBA will move again before the end of the year. Solid domestic data have kept the BoC from leaning too far in that direction, but it looks like it's just a matter of time now before Poloz and Co. join in and lower rates.

Central bank near-term bias

↔ A further increase in global trade tensions—a key risk flagged by the Governing Council—should result in a more dovish tone from the BoC in September. Our forecast assumes a rate cut early next year, but there is risk of an earlier move.

↘ Powell's comments on mid-cycle easing suggest another cut or two from the Fed. Our forecast is for just one more move in September but risk of more easing is growing as US-China tensions escalate.

↘ The BoE's policy path is entirely Brexit dependent. Our base case assumption of a general election and deadline extension—meaning persistent uncertainty—could result in a rate cut in November.

↘ The ECB laid the groundwork for additional easing and we expect rate cuts in September and December. Odds are tilted in favour of even more accommodation, with deeper cuts and a new round of QE among potential measures.

↘ Rising global trade tensions have brought forward our expectations for RBA cuts. We think a pause in the central bank's easing cycle (after lowering rates in June and July) will only last until November.

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

Highlights

▲ US manufacturing activity and job growth slowed over the first half of the year.

▲ Business investment fell in Q2 for the first time since 2016.

▲ Strong consumer spending kept the US economy growing at an above-2% rate in Q2.

▲ Powell had limited success guiding markets toward 'mid-cycle' easing rather than deeper rate cuts.

Tallying up trade tensions' toll

As US-China trade tensions continue to escalate, we remain on watch for signs that tariffs and uncertainty are weighing on the US economy. Thus far, the impact has generally been confined to the industrial sector, which has borne the brunt of tariff-related cost increases. Manufacturing activity fell for a second consecutive quarter in Q2 with most subsectors seeing declines, on net, over the first half of the year. Factory output increased in the last two months, but further softening in the ISM manufacturing index in July (including a nearly three-year low in the production index) suggests limited momentum. Manufacturing has also been a laggard in terms of hiring. Job growth in the sector has averaged 8,000 per month in 2019, down from last year's 22,000 pace—that's the most significant slowing in any industry this year. Transportation and warehousing has also seen a moderation in hiring as tariffs crimp overall trade flows. Those employment trends can't be solely attributed to trade policy, though. Job openings in manufacturing are back at cycle highs, suggesting tight labour markets are also a factor in slower hiring.

Uncertainty about trade policy is clearly weighing on business sentiment, and that appears to be influencing capex decisions. US business investment declined in Q2 for the first time since 2016. Investment in structures fell across a number of industries, while equipment investment was close to flat over the first half of 2019. On the trade side, exports have slowed over the last year while imports continued to increase. Tariffs have done little to reduce the US trade deficit with China and the country's overall deficit continues to widen, particularly with Mexico, the EU, and some of China's neighbours. As a result, net exports have subtracted more than 1/2 percentage point, on average, from US GDP growth over the last year.

Consumers continue to power the US economy, for now

While we can point to a number of impacts from rising trade tensions, context is important. Even with slower business investment, industrial production and exports, US GDP growth remained above trend in Q2. A more-than-4% jump in consumer spending, making up for softer gains in the prior two quarters, was the driving force. Households continue to be supported by decent employment and wage growth, healthy savings and lower borrowing costs. July's confidence data showed consumers are feeling better than they have all year. The worry, though, is that a fresh round of tariffs will start to weigh on sentiment. Earlier tariff hikes generally spared consumer goods, but the proposed 10% levy on all remaining Chinese imports (about $265 billion) would change that, potentially raising prices for smartphones and other consumer electronics. At this stage, the impact on the $14.5 trillion US consumer sector should be manageable. But the fact that Trump is no longer trying to spare consumers in his trade fight means households could be exposed to further escalation in trade tensions.

Markets pricing in deeper cuts from the Fed

The Fed cut rates as expected in July with a 25 basis point reduction disappointing a few observers hoping for 50 bps of easing. The central bank also opted to end its balance sheet reduction two months earlier than scheduled (rather than easing with one lever and tightening, however modestly, with another). While acknowledging strong labour markets and moderate economic growth, the Committee thought uncertainty over trade policy and slowing global growth warranted slightly more accommodative monetary policy. In his press conference, Chair Powell characterized the move as mid-cycle easing rather than the start of a longer, more traditional rate-cutting cycle. Past mid-cycle cuts in 1995 and 1998 each saw the Fed lower rates by 75 basis points, so it's reasonable to expect another cut or two this time around (our forecast is for one more move in September). But Powell doesn't seem to have convinced markets of that—following Trump's latest trade threats, investors are betting on nearly 100 basis points of additional easing by the middle of next year. There is clearly a risk that the Fed cuts rates slightly further than our forecast assumes, but we still don't think the current outlook warrants more than the mid-cycle adjustment that Powell is trying to guide markets toward.

Canada's economic rebound continues to surprise

Canadian GDP growth surprised to the upside for a third consecutive month in May. Average growth of 0.4% since March is the economy's best three-month run rate in two years. Service industries have posted decent gains over that stretch (retail being a key exception) but it's the goods sector that has really impressed. Oil and gas output has rebounded as Alberta's production caps continue to ease, and higher oil prices earlier this year (both globally and in Western Canada) helped support drilling activity. It looks like the energy sector provided a sizeable add to growth in Q2 after acting as a drag in the prior three quarters. The construction sector has also perked up in recent months with the residential side supported by more stable housing markets and robust homebuilding. But it's decent growth in the manufacturing sector that is most surprising—Canada appears to be bucking the global trend in that regard. No single sector is driving the increase, and growth has been fairly consistent with manufacturing sales excluding transport yet to record a monthly decline so far this year. That trend seems too good to last, though. The all-important US industrial sector has clearly lost momentum and recent PMI readings suggest Canadian manufacturing is also in for slower growth.

Don't get used to Canada's trade surplus

Given the strong trend in monthly GDP, we have revised our Q2 growth forecast to 3% from 2.2% previously. It looks like a big chunk of that growth came from net exports—we're tracking one of the largest quarterly adds from trade this cycle. That reflects Canada's shift to a trade surplus in May and June, a rarity in the last decade. Agriculture (notwithstanding China's ban on some imports), energy, and transport equipment all contributed to rising exports, though it was a sharp drop in imports that preserved a surplus in June. In fact, overall trade (exports plus imports) was down year-over-year in June, mirroring the slowdown in global trade flows. Less dynamic global trade could hurt Canada's export sector, and with the domestic economy holding up fairly well amid slowing global growth, imports are likely to outpace exports. We expect that will be the case over the second half of the year, with the trade balance slipping back into deficit and net exports acting as a modest drag on growth.

Canadian exporters have had little help from the currency, which has been caught in a tug-of-war in recent months. The Canadian dollar rallied from a near-term low of 74 US cents in late-May to more than 76.5 cents in mid-July. That reflected widening in Canada-US interest rate spreads as the BoC remained in neutral while the Fed signaled lower rates. More recently, though, global growth concerns have weighed on both oil prices and the loonie and Trump's latest tariff threats only exacerbated that move. The Canadian dollar is now back to just above 75 cents, close to its year-to-date average. Unless we see a calming in trade tensions—which would boost commodity currencies and could keep the BoC in neutral for longer—it will be tough for the Canadian dollar to best its highs from earlier this year.

Another quiet (too quiet?) summer from the BoC

With the Bank of Canada maintaining a neutral bias on July 10 (saying current accommodation remains appropriate) and staying silent since then, a policy change in September seems unlikely. But a further increase in trade tensions since July's meeting—something Governor Poloz flagged as the biggest downside risk to the global and Canadian outlooks—has shifted the conversation to when, not if, the BoC will lower rates. There is precedent for the central bank taking both pre-emptive action (January 2015's cut) and making a surprise move after a quiet summer (September 2017's hike). However, with domestic data flow remaining positive, including indications that Q2 growth will come in above the BoC's forecast, we don't see Governing Council cutting as soon as September. Our forecast still assumes the BoC will hold off on lowering its overnight rate until January 2020, though risk of an earlier move has increased. Markets are now pricing in roughly 50/50 odds of a cut by October when the central bank will issue fresh economic projections that incorporate the latest trade developments.

Highlights

- ▲ Upside surprises in monthly GDP have us tracking 3% growth in Q2—above the BoC's 2.3% call.
- ▲ Growth has picked up in both energy and non-energy industries.
- ▲ Canada's recent trade surpluses aren't expected to persist.
- ▲ Markets are now pricing in significant odds of a BoC rate cut by the end of this year.

Highlights

▲ The UK economy contracted for the first time since 2012.

▲ Odds of a no-deal Brexit have increased, but we continue think a deadline extension is more likely.

▲ Germany's economy likely contracted in Q2 as an industrial slump deepened.

▲ It looks like the RBA won't be on the sidelines for long—we expect another cut in November.

UK GDP declined in Q2 after previous quarter's Brexit boost

UK GDP unexpectedly fell 0.2% in Q2 (expectations were for no change), marking the first quarterly decline since 2012. The slowdown was broadly based with agriculture, industrial production, and construction output all falling in Q2 while services activity (80% of the UK economy) edged up just 0.1%. Some of the decline reflects payback for stronger growth in Q1 when Brexit preparations boosted activity in some sectors. We expect a return to growth in the current quarter albeit to an uninspiring 0.2% pace. Services activity appears to have perked up a bit in Q3 (July's services PMI was the highest in nine months) but manufacturing remains soft. Uncertainty about the timing and shape of Brexit continues to weigh on the UK economy—business investment was a drag on growth in Q2, as it was throughout last year. We doubt relief is on the way. New PM Boris Johnson's hard-line approach to negotiations with the EU has raised the odds of a no-deal Brexit on October 31, but we continue to think the most likely course of action is a deadline extension and general election. In that scenario, we think the economy's subdued growth trend and continued uncertainty over Brexit would see the Bank of England lower its bank rate in November. The central bank didn't tip its hand in August though its projections and guidance—based on the admittedly incongruous assumptions of a smooth Brexit and a market path for interest rates that puts sizeable odds on a no-deal Brexit—are of little help at this stage.

ECB lays the groundwork for more easing

Euro area GDP growth slipped lower to 0.2% in Q2 (the same pace seen over the second half of last year) from 0.4% in Q1. Among the currency bloc's largest economies, Italian GDP was flat (not much different from the trend seen over the last year) while France and Spain both expanded, albeit at a slightly slower pace than in the prior two quarters. We expect Germany's economy contracted slightly in Q2 after a return to growth in Q1. That country's industrial sector remains a sizeable drag on growth—industrial production fell for a fourth consecutive quarter and Q2's decline was the largest in that stretch. Manufacturing PMI data for July suggest little improvement in Q3. As is the case across the euro area, services activity is holding up fairly well for now and labour market conditions are generally improving. The concern, though, is that a manufacturing slowdown will spill over into other areas of the economy. And even if the slowdown is contained, drag from the industrial sector that keeps overall growth at a below-trend pace is worrying for a central bank that is already falling well short of its inflation target. With that in mind, the ECB laid the groundwork for additional easing in July by introducing an easing bias and saying it is examining additional policy measures, such as restarting QE and moving to a tiered system for deposit rates. Our forecast continues to assume 10 basis point rate cuts in both September and December, though there is growing risk that the ECB delivers more than that (markets currently pricing in a cumulative 30 basis points of cuts over the next year). And while we had assumed that lower rates would be the ECB's first policy level, odds of another round of quantitative easing have increased.

RBA clarifies easing bias, likely to cut again this year

The Reserve Bank of Australia held its cash rate steady in August after making back-to-back 25 basis point rate cuts in June and July. The policy statement acknowledge increased uncertainty around the global outlook and made clear the RBA's easing bias (it will *ease* rather than *adjust* monetary policy further if needed). It also hinted at upward revisions to unemployment projections and downward revisions to inflation forecasts. While modest, those changes are significant in the context of considerable labour market slack and persistently below-target inflation (core CPI readings slipped further below the RBA's 2-3% range in Q2). We previously assumed the RBA would hold rates steady through the remainder of this year—allowing it to evaluate the impact of 50 basis points of easing, as well as fiscal stimulus—before cutting rates further in 2020. However, given the central bank's sensitivity to global developments, we think the latest escalation in US-China trade tensions and further signs of slowing global growth will bring the RBA off the sidelines sooner rather than later. We still look for the cash rate to bottom out at 0.50% this cycle, but have brought forward our forecasted rate cuts to November and February.

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	1.40	1.35	1.40	1.45	1.50
Five-year	1.97	2.07	2.34	1.89	1.52	1.39	1.40	1.40	1.40	1.50	1.55	1.65
10-year	2.09	2.17	2.43	1.97	1.62	1.47	1.45	1.60	1.60	1.60	1.70	1.80
30-year	2.23	2.20	2.42	2.18	1.89	1.69	1.70	1.80	1.85	1.90	2.00	2.00
United States												
Fed funds**	1.75	2.00	2.25	2.50	2.50	2.50	2.00	2.00	2.00	2.00	2.00	2.00
Three-month	1.73	1.93	2.19	2.45	2.40	2.12	1.90	1.90	1.90	1.90	1.90	1.90
Two-year	2.27	2.52	2.81	2.48	2.27	1.75	1.85	1.90	1.95	2.00	2.10	2.15
Five-year	2.56	2.73	2.94	2.51	2.23	1.76	1.85	1.95	2.00	2.10	2.20	2.30
10-year	2.74	2.85	3.05	2.69	2.41	2.00	2.05	2.15	2.25	2.30	2.35	2.45
30-year	2.97	2.98	3.19	3.02	2.81	2.52	2.55	2.60	2.65	2.70	2.75	2.80
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	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60
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	1.45	1.45	1.50	1.55	1.65	1.75
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	1.75	1.60	1.60	1.65	1.70	1.80
Yield curve*												
Canada	31	26	22	11	7	0	0	20	25	20	25	30
United States	47	33	24	21	14	25	20	25	30	30	25	30
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	55	70	80	85	95	95
New Zealand	85	88	87	68	53	43	75	75	80	85	90	100

* 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	0.4	3.0	1.8	1.6	1.6	1.7	1.7	1.6	3.0	1.9	1.5	1.7
United States*	2.6	3.5	2.9	1.1	3.1	2.1	1.5	1.5	1.6	1.8	2.0	1.8	2.4	2.9	2.2	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	1.3	1.2
Euro area	0.4	0.4	0.2	0.2	0.4	0.2	0.3	0.3	0.3	0.4	0.4	0.3	2.6	1.9	1.2	1.3
Australia	1.0	0.9	0.3	0.2	0.4	0.5	0.6	0.7	0.5	0.7	0.7	0.7	2.4	2.8	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	1.9	2.2	2.2	1.8	2.0	1.9	1.6	2.3	2.0	2.0
United States*	2.2	2.7	2.6	2.2	1.6	1.8	1.8	1.9	2.0	1.9	2.0	2.0	2.1	2.4	1.8	2.0
United Kingdom	2.7	2.4	2.5	2.3	1.8	2.0	1.9	1.8	2.2	2.1	2.1	2.1	2.7	2.5	1.9	2.1
Euro area	1.3	1.7	2.1	1.9	1.4	1.4	0.8	1.1	1.2	1.4	1.4	1.4	1.5	1.8	1.2	1.3
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]	Jun	0.1	2.3	2.8	2.1
United States	Core PCE[1,2]	Jun	0.2	1.6	1.8	1.4
United Kingdom	All-items CPI	Jun	0.0	2.0	4.2	1.2
Euro area	All-items CPI[1]	Jul	0.1	1.1	1.6	1.1
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	1.29	1.30	1.31	1.32	1.33
Euro	1.23	1.17	1.16	1.15	1.12	1.14	1.10	1.12	1.12	1.13	1.14	1.15
U.K. pound sterling	1.40	1.32	1.30	1.28	1.30	1.27	1.19	1.20	1.20	1.22	1.23	1.24
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	0.71	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	1.44	1.46	1.48	1.50	1.53
GBP/CAD	1.81	1.74	1.68	1.74	1.74	1.66	1.55	1.55	1.57	1.59	1.62	1.64
CAD/JPY	82.4	84.3	88.1	80.4	83.0	82.4	83.1	85.3	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

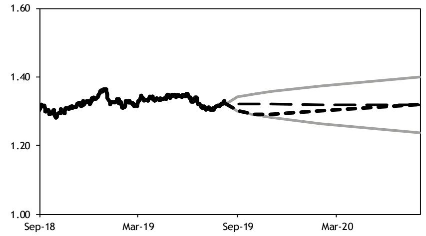
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

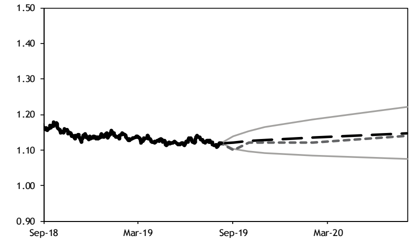
RBC Economics outlook compared to the market

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.

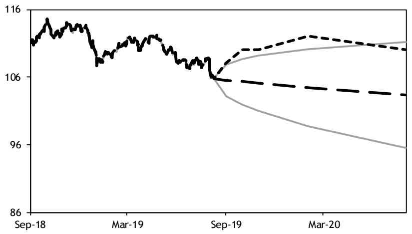
Canadian dollar



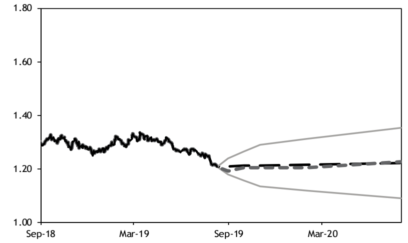
Euro



Japanese yen



U.K. pound

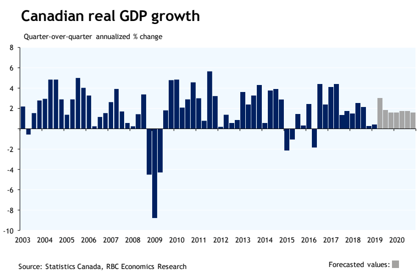


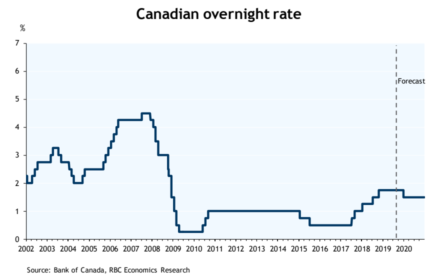
Central bank watch

Bank of Canada

A string of solid monthly GDP reports has us tracking Q2 growth of 3%—a nice upside surprise relative to the BoC's last forecast (2.3%).

Decent growth numbers are putting little pressure on the BoC to ease near-term. But a further increase in trade tensions will certainly have the BoC sounding more cautious in September. We expect a cut early next year, but there is risk of an earlier move.

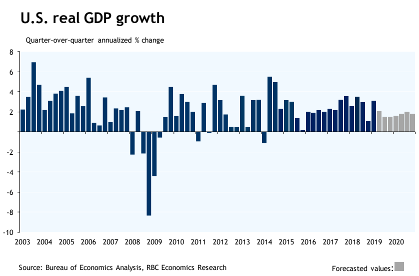


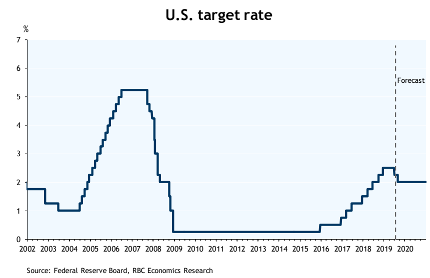


Federal Reserve

US GDP growth remained above trend in Q2 (+2.1%) thanks to a solid increase in consumer spending. But "moderate" growth wasn't enough to keep the Fed from lowering rates in July.

The Fed's "mid-cycle" policy adjustment is expected to continue with a cut in September. We think that will be it, but rising trade tensions raise the risk of additional easing.

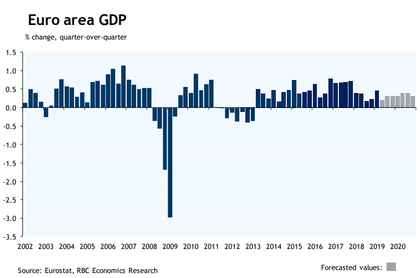


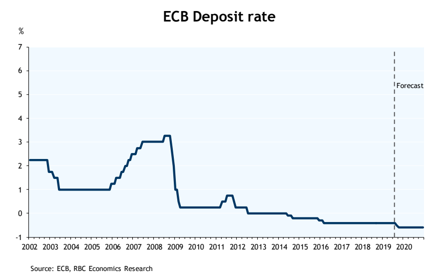


European Central Bank

Euro area growth slowed to 0.2% in Q2 with Germany's economy likely contracting in the quarter. That country's industrial sector has seen a significant slowdown, but services activity seems to be holding up fairly well.

Disappointing growth, global risks, and low inflation have the ECB pledging to add more stimulus. We look for a rate cut in September.

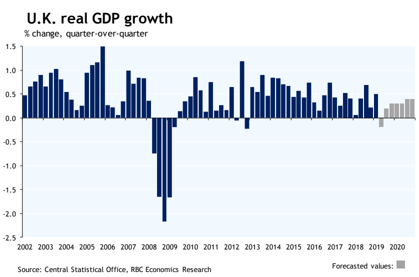


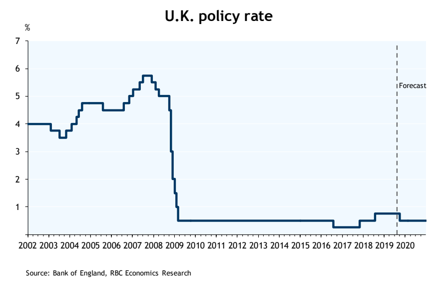


Bank of England

UK GDP unexpectedly declined in Q2 with growth in services softening and other sectors contracting in the quarter.

Some of the Q2 slowdown reflects payback for a strong Q1. But the economy's underlying trend remains soft, thanks in part to uncertainty over Brexit. We think the BoE will lower rates in November, even if the Brexit deadline is extended.

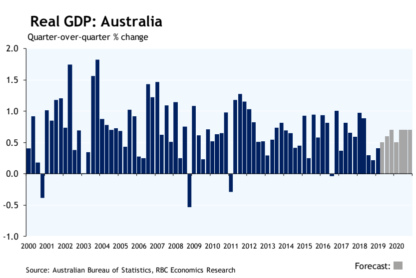


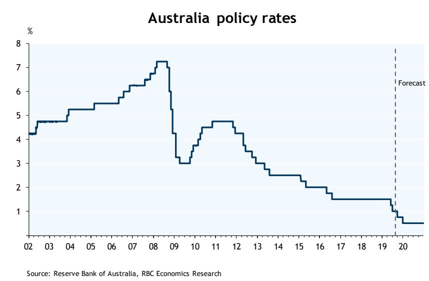


Reserve Bank of Australia

GDP growth likely remained sub-trend in Q2 and core inflation drifted further from target. The RBA's latest forecasts saw unemployment marked higher and inflation revised lower.

The RBA will likely take some time to evaluate the impact of its back-to-back cuts, but rising global risks suggest the central bank won't sit on the sidelines for long. We expect another cut in November.

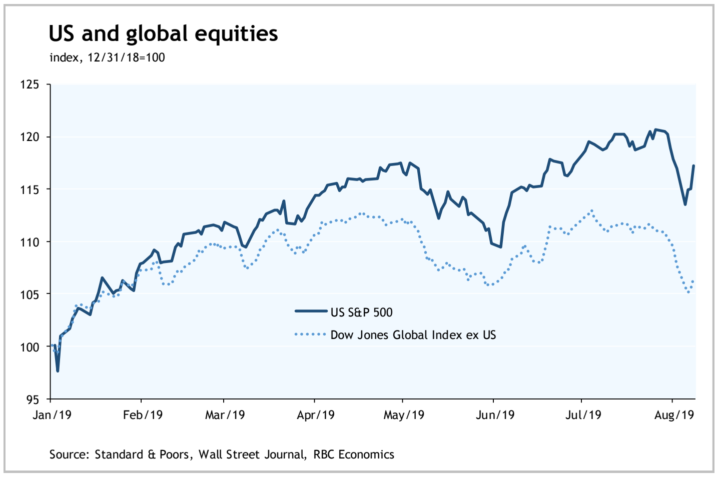




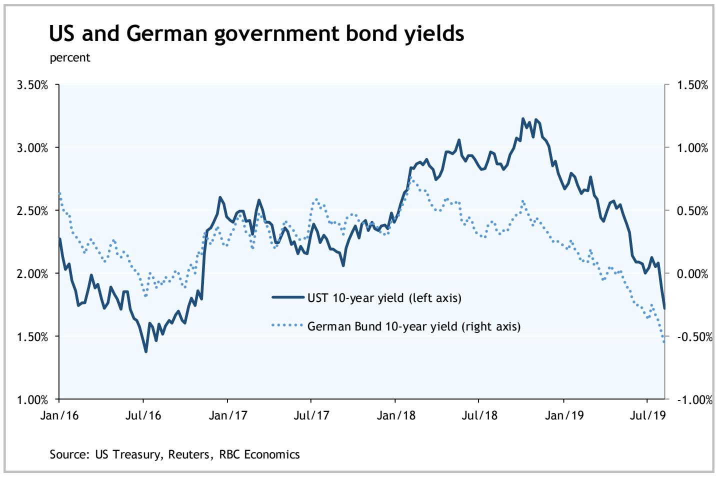
Trump's trade threats roiled financial markets in early-August

Trump's pledge to impose 10% tariffs on all remaining Chinese imports escalated the trade dispute between the world's two largest economies. But it was the Chinese government's subsequent decision to let the yuan depreciate—sparking fears of a currency war—that really scared markets.

The last week of July saw a string of equity market losses as the Fed disappointed with a hawkish cut and Trump issued new trade threats. The S&P 500 started the following week with a 3% loss—its worst this year—after the yuan was allowed to depreciate. Global equities also suffered.



A flight to safety and expectations that central banks would meet trade threats with more stimulus pushed government bond yields lower. 10-year US Treasury yields dropped to around 1.70% (and as low as 1.60% intra-day) and equivalent German yields hit fresh lows of less than –0.50%.



Commodity markets were also impacted. Concerns about global demand pushed oil prices to year-to-date lows, while demand for safe assets pushed gold prices above US$1,500/oz. for the first time since 2013. Lower crude prices put downward pressure on the Canadian dollar.