

June 5, 2020  
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**After unprecedented declines, an uneasy recovery begins**

Many countries were able to get their coronavirus outbreak under control in May, pushing global case growth down into the low single digits (about 2.5% per day in the first week of June, compared with more than 15% in late-March). That allowed for a gradual easing in lockdown restrictions and the re-opening of some shuttered factories and businesses. Recent soft data captures that turning point—whether it's mobility metrics, card spending, or business sentiment—and employment indicators are also starting to improve. That said, incoming hard data is laying bare the unprecedented scale of economic contraction through April. May's green shoots must be viewed against a very low starting point. Global PMIs, for instance, retraced about half the previous two months' declines but still point to depressed levels of economic activity. The road to recovery will be slow, and it could be quite bumpy. While advances in testing and contact tracing will help (some countries doing better than others), risk of a second wave of infections and the re-imposition of strict containment measures is likely to linger until a vaccine is developed. And geopolitical risk is heating up amid escalating tensions over Hong Kong, civil unrest in the US and the return of Brexit uncertainty.

Markets have nonetheless seized on positive data and re-opening plans, and risk appetite has continued to improve. The US S&P 500 rose another 4.5% in May and is now within 2% of its 2019 close. Investor demand for the safety of US dollars has eased, with the greenback falling by 6% on a trade-weighted basis over the past two months. Oil prices have essentially doubled since late-April but remain close to 2016's lows. Still, the increase (along with improving risk sentiment in general) has given a lift to currencies like the Canadian dollar, which rose above 74 US cents for the first time since early-March. Government bond yields have remained low thanks to aggressive central bank action. The BoC and Fed are continuing with open-ended asset purchase programs, the ECB just increased its QE target and we expect the BoE will do the same in mid-June.

**Central bank near-term bias**

We expect the BoC will continue to hold the overnight rate at its “effective lower bound” of 0.25%. Its open-ended asset purchases will provide ongoing support during the recovery.



The Fed has started to slow the pace of asset purchases after aggressive action early in the crisis but QE remains open-ended. Its balance sheet will also continue to grow alongside uptake of new programs. And a near-zero fed funds rate will provide ongoing stimulus.



The BoE is likely to increase its asset purchase target in mid-June. The negative policy rate debate is also likely to intensify, and we think the bank rate will be lowered to -0.15% later this year.



The ECB nearly doubled the size of its pandemic asset purchase program in June, and an upcoming term financing operation (at very attractive rates) will provide additional stimulus to the banking sector.



The RBA sounds pretty comfortable with its current monetary policy stance: a low 0.25% cash rate and QE targeting 3-year government bond yields at that same level.



## Highlights

- ▲ The US labour market started to rebound in May.
- ▲ Consumer spending fell sharply in April...
- ▲ ...despite a stimulus-driven jump in personal income.
- ▲ The Fed has expanded its balance sheet by 14% of GDP this year.

### Lockdown conditions easing...

May appears to have been a turning point for the US economy. Average daily case growth slowed to the low single digits in most states, allowing authorities to start gradually easing coronavirus containment measures. The result was a surprising improvement in the labour market with 2.5 million jobs added in May and aggregate hours worked rising by 4%. Purchasing managers' indices (both manufacturing and services) picked up from April's lows, and rising auto sales suggest consumers are out shopping again. It's hard to get excited when employment remains 13% below pre-pandemic levels, auto sales are still at decade lows, and PMIs only suggest a modest easing in the pace of economic contraction. But we're seeing steps in the right direction that are likely to continue through the summer as restrictions are eased further. That should set up for a pickup in GDP over the second half of the year.

### ...but it's a long road to recovery

But the economy has a deep hole to get out of. US GDP contracted at a 5% annualized rate (-1.3% non-annualized) in Q1 due in large part to a late-quarter plunge in household spending. That trend only accelerated in April with a record 13% drop in inflation-adjusted consumer spending nearly doubling the previous month's decline. While online sales flourished and spending on essentials temporarily increased, store closures and stay-at-home orders drove a sharp decline in discretionary spending. The US industrial sector was also under pressure with a collapse in auto production (reflecting widespread factory shutdowns) contributing to an 18% decline in manufacturing output between February and April. Even as employees get back to work, health regulations are likely to keep plants from operating at full capacity. And with revenue declines crimping companies' investment plans, new orders for capital goods have fallen sharply. We think the US economy is operating about 11% below its Q4/19 level in the second quarter. While that should be the low point, we expect GDP will only stage a partial recovery in the second half of the year and will remain 5% below year-ago levels at the end of 2020.

Fiscal support has been key to preventing an even more severe economic downturn, and is laying the foundation for a return to growth in the second half of the year. While 20 million Americans lost their jobs in April, economy-wide personal income actually increased by 10% thanks to Economic Impact Payments and more generous unemployment benefits. Forgivable loans through the Paycheck Protection Program likely prevented even more significant layoffs. These generous programs are helping to tide over households and businesses until the economy begins to re-open, but there are concerns that support will run out before the economy has substantially recovered. PPP loans are only intended to cover eight weeks of payroll, cash payments to households were a one-time thing, and the federal government's top-up for state unemployment insurance is set to expire at the end of July. Congress is reportedly working on another sizeable stimulus package.

### Fed to give more guidance on QE?

The Fed has added to substantial fiscal support with programs meant to ensure credit continues to flow to municipal, corporate and small business borrowers. The Fed's balance sheet will continue to grow to unprecedented levels as uptake of its programs increases. Aggressive asset purchases (US\$1.8 trillion in Treasuries and US\$400 billion in mortgage-backed securities year-to-date) and other liquidity operations have already lifted central bank reserve assets to 1/3 of GDP. The Fed's asset purchase program remains open-ended, though we might get some clarity on the planned size and duration of purchases in the coming months. Minutes of the Fed's April meeting showed policymakers debating forward guidance on the future path of policy rates and QE, and even yield curve control. Whatever framework the Fed decides on, we think it will be one that keeps borrowing costs low for an extended period to allow the economy to get back on its feet as health restrictions are lifted.

### Canada also seeing some green shoots...

As with the US, a flattening coronavirus curve allowed Canadian provinces to begin re-opening their economies to varying degrees in May. Employment rose by a surprising 290,000 in the month and fewer workers were on a reduced schedule. RBC's consumer



spending tracker (using anonymized card data) suggests household spending started to recover as the month progressed. A decent rebound in auto sales and modest pickup in home resales in May suggests consumers were more comfortable making big-ticket purchases, even as measured consumer confidence remained low. Small business sentiment improved, while Canada's manufacturing PMI also ticked higher but remained historically low. Again, we have to add the caveat that the level of most of these indicators suggests economic activity remained well below normal levels in May, even if conditions improved relative to April.

### ...but only after devastating declines

And April was quite the low point. Statistics Canada's "nowcast" suggests the economy shrank by 11% in the month, on top of an already-record 7.2% decline in March GDP. That two month slowdown is 3.5 times as large as the peak-to-trough decline during the 2008-09 recession. Output fell across 19 of 20 industries in March (utilities the lone exception) making it the most broadly-based slowdown on record. Industries most directly impacted by physical distancing measures—accommodation and food services, arts entertainment and recreation—unsurprisingly saw the sharpest pullback with activity falling by around 40% despite restrictions only taking effect in the middle of the month. While services were hit hardest, goods production also fell sharply in March and will have only worsened in April—plant closures in the auto sector, for instance, saw Canada produce zero finished vehicles in the month.

Even with some tentative green shoots in May, a sharp slowdown early in the quarter means the decline in Q2 GDP will be significantly worse than Q1's 8.2% annualized drop (-2.1% non-annualized). We expect economic activity in the second quarter as a whole will be 11% below its Q4/19 level. A partial rebound over the second half of the year is likely to leave GDP down 5% year-over-year by the end of 2020. That will reflect ongoing health restrictions—some industries will likely be operating below full capacity until a vaccine is widely available—as well as challenging finances for households and businesses. More than 8 million Canadians have now applied for CERB income support, with the program paying out C\$43 billion in benefits through the end of May. But for those that started collecting in mid-March, 16 weeks of support will run out around mid-year. Some that remain jobless will be able to fall back on regular EI (which is less generous for lower-income workers) but others are likely to fall through the cracks if federal support isn't extended. The government did extend its wage subsidy program (CEWS) by another 12 weeks (to the end of August). It has been hoped that individuals will migrate from CERB to CEWS as businesses re-hire employees, but CEWS uptake thus far has fallen short of expectations. Slightly fewer than 200,000 businesses have made wage subsidy claims with less than \$10 billion paid out.

### BoC's Macklem era begins... sort of

Acknowledging that monetary policy can't do much to stimulate the economy during a lockdown, the Bank of Canada has focused its efforts on supporting market functioning and ensuring access to credit. Liquidity-providing programs—most significantly term repos and large scale asset purchases—have swelled the BoC's balance sheet from 5% of GDP at the end of 2019 to slightly more than 20% by the end of May. By that measure, the BoC has been one of the more aggressive central banks in expanding its asset holdings. The results thus far have been positive with the BoC noting previously-stressed markets are now functioning well. And demand for some of its crisis response programs has eased enough that the central bank is halving the frequency of its term repo and bankers' acceptance purchase operations.

Aside from those tweaks, the BoC made no policy changes in June. Its scheduled rate announcement coincided with Governor Tiff Macklem's first day on the job, though he was only an "observer" in Governing Council's deliberations (and endorsed the decision). The overnight rate was held steady at the "effective lower bound" of 0.25% and large scale asset purchases (QE) will continue at their current frequency and scope. Provincial and corporate bond purchase programs are scheduled to last a year, but the bank's GoC bond purchases are more open-ended and will continue "until the economic recovery is well underway."

## Highlights

- ▲ Canadian consumer spending picked up in May but confidence remained low.
- ▲ GDP declines in March and April easily eclipsed the entire 2008-09 recession.
- ▲ CERB income support has seen significant uptake; CEWS wage subsidies have been less popular.
- ▲ The BoC's recent balance sheet growth has been driven more by asset purchases than liquidity support.



## Highlights

▲ QE will be key in the BoC's battle against disinflation.

▲ UK and euro area PMIs partially rebounded in May, but remain at worrying lows.

▲ The BoE is giving negative rates more thought than the BoC and Fed.

▲ EU fiscal transfers would be an important step forward, and provide an assist to the ECB in its stimulus efforts.

We might get some more well-defined guidance on asset purchases once Macklem settles into his new role and the BoC has more clarity on the economic recovery. While June's policy statement noted Canada's economy seems to have avoided the worst outcomes laid out in the bank's April MPR, a 10-20% (non-annualized) decline in Q2 GDP is still expected and the outlook for H2/20 remains "heavily clouded." Our economic forecast envisions the economy continuing to operate well below full capacity into 2021, only slightly better than the midpoint of the range of scenarios the BoC presented in April. Associated disinflationary pressure will force the central bank to keep its foot on the gas, and we think QE will be a key part of its stimulus efforts when it shifts focus from crisis management to supporting the recovery. GoC purchases have helped pin term yields close to record lows despite growing debt issuance (which would normally put upward pressure on borrowing costs) to fund the government's fiscal response. We think ongoing bond-buying will keep longer-term yields from straying far from current levels over the next year.

### BoE to tread negative rate path

The UK economy shrank by nearly 6% month-over-month in March with services output, construction and industrial production all slowing sharply. PMI data unsurprisingly point to further contraction in April when lockdown measures were in place throughout the entire month. With restrictions beginning to ease in mid-May business sentiment staged a partial rebound from April's lows. However, PMI readings continued to signal a substantial contraction. In the hard-hit services sector (80% of the UK economy) only 12% of firms reported an increase in activity relative to April. Manufacturing firms fared slightly better but were generally working at reduced capacity and expressed concerns about a slow recovery in demand. We expect Q2 GDP will be about 20% below its Q4/19 level. Further easing of health restrictions and currently-ample fiscal support—the government is now paying 80% of the wages of 8.7 million furloughed workers, and providing income support to another 2.5 million self-employed—should set the stage for a partial recovery in economic activity over the second half of the year. However, we think some labour market slack will remain, and as extraordinary fiscal measures are scaled back or run out, additional monetary policy stimulus will be required.

At the Bank of England's last meeting in May, two MPC members already voted to increase the size of the bank's asset purchase program. We think the rest of the MPC will be on board with an expansion in June—otherwise, the BoE is likely to hit its current purchase target around the beginning of July, and leaving the Gilt market to absorb significant new issuance on its own could result in undue tightening in financial conditions. The BoE has also sounded more open to negative rates as a potential policy option, and as Brexit uncertainty returns to the fore later this year (the UK is approaching the deadline to ask for an extension of the current transition period) we think the central bank might go down that road. We are now penciling in a bank rate cut from 0.1% to -0.15% at the BoE's November meeting.

### EU fiscal authorities to lighten the ECB's load?

As with the UK, an easing of lockdown restrictions in some form or another in May helped business sentiment partially recover from April's remarkable lows. However, PMI readings in each of the currency bloc's four largest economies remain depressed, particularly for the services sector. And employment indicators point to little improvement in labour demand, even if generous support schemes have kept many European economies from seeing layoffs on a North American scale. We expect euro area GDP will be nearly 30% below its Q4/19 level in the second quarter. A substantial rebound in activity in the second half of the year is expected to leave the economy operating well below full capacity by the end of 2020. Responding to the prospect of persistent slack and a "pandemic-related downward revision to inflation," the ECB almost doubled the size of its Pandemic Emergency Purchase Program and extended the program until at least mid-2021. PEPP purchases are in addition to €360 billion in bond-buying this year through the ECB's regular Asset Purchase Program, as well as another TLTRO operation at very attractive rates (as low as -1%) that could see take-up in the €1 trillion range.

While monetary policy is helping some of Europe's struggling economies, additional fiscal support is also required. To that end, France and Germany have proposed a rescue fund worth up to €750 billion that would see funds borrowed on behalf of all EU states and distributed among members countries based on need—the end result would be fiscal transfers to economically-challenged Southern European countries. That proposal will be debated at a European leaders' summit in mid-June.





## Interest rate outlook

%, end of period

	Actuals					Forecast						
	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	21Q1	21Q2	21Q3	21Q4
<b>Canada</b>												
Overnight	1.75	1.75	1.75	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Three-month	1.67	1.66	1.65	1.66	0.21	0.25	0.25	0.20	0.20	0.25	0.25	0.30
Two-year	1.55	1.47	1.58	1.70	0.42	0.40	0.45	0.50	0.50	0.50	0.60	0.70
Five-year	1.52	1.39	1.40	1.69	0.59	0.50	0.55	0.60	0.60	0.65	0.80	0.90
10-year	1.62	1.47	1.36	1.70	0.70	0.70	0.65	0.70	0.70	0.85	1.00	1.10
30-year	1.89	1.69	1.53	1.76	1.31	1.20	1.15	1.10	1.10	1.20	1.30	1.35
<b>United States</b>												
Fed funds**	2.50	2.50	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Three-month	2.40	2.12	1.88	1.55	0.11	0.15	0.15	0.15	0.15	0.15	0.15	0.15
Two-year	2.27	1.75	1.63	1.58	0.23	0.25	0.30	0.35	0.40	0.45	0.55	0.65
Five-year	2.23	1.76	1.55	1.69	0.37	0.45	0.50	0.60	0.70	0.75	0.90	1.00
10-year	2.41	2.00	1.68	1.92	0.70	0.70	0.75	0.90	1.00	1.10	1.25	1.35
30-year	2.81	2.52	2.12	2.39	1.35	1.35	1.40	1.50	1.55	1.60	1.65	1.70
<b>United Kingdom</b>												
Bank rate	0.75	0.75	0.75	0.75	0.10	0.10	0.10	-0.15	-0.15	-0.15	-0.15	-0.15
Two-year	0.63	0.62	0.37	0.54	0.13	0.00	-0.10	-0.25	-0.25	-0.15	-0.10	-0.10
10-year	0.99	0.84	0.49	0.83	0.34	0.30	0.25	0.10	0.15	0.20	0.25	0.30
<b>Euro area</b>												
Deposit Rate	-0.40	-0.40	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Two-year	-0.60	-0.73	-0.74	-0.59	-0.69	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60
10-year	-0.07	-0.33	-0.58	-0.19	-0.48	-0.50	-0.50	-0.40	-0.35	-0.30	-0.25	-0.20
<b>Australia</b>												
Cash target rate	1.50	1.25	1.00	0.75	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Two-year	1.47	0.98	0.76	0.92	0.24	0.20	0.20	0.20	0.20	0.20	0.20	0.20
10-year	1.78	1.32	1.01	1.37	0.77	0.90	0.85	0.90	0.95	1.00	1.10	1.10
<b>New Zealand</b>												
Cash target rate	1.75	1.50	1.00	1.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Two-year swap	1.62	1.35	0.92	1.25	0.52	0.45	0.40	0.40	0.40	0.40	0.40	0.40
10-year swap	2.15	1.78	1.20	1.78	0.92	0.95	0.90	0.90	0.90	0.90	1.00	1.10
<b>Yield curve*</b>												
Canada	7	0	-22	0	28	30	20	20	20	35	40	40
United States	14	25	5	34	47	45	45	55	60	65	70	70
United Kingdom	36	22	12	29	21	30	35	35	40	35	35	40
Eurozone	53	40	16	40	21	10	10	20	25	30	35	40
Australia	31	34	25	45	53	70	65	70	75	80	90	90
New Zealand	53	43	28	53	40	50	50	50	50	50	60	70

\* 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	0-0.25	1.00-1.25	March 15, 2020	Eurozone	Deposit rate	-0.50	-0.40	September 18, 2019
Canada	Overnight rate	0.25	0.75	March 27, 2020	Australia	Cash rate	0.25	0.50	March 19, 2020
United Kingdom	Bank rate	0.10	0.25	March 19, 2020	New Zealand	Cash rate	0.25	1.00	March 16, 2020

Source: Bloomberg, Reuters, RBC Economics Research



## Economic outlook

### Growth outlook

% change, quarter-over-quarter in real GDP

	<u>19Q1</u>	<u>19Q2</u>	<u>19Q3</u>	<u>19Q4</u>	<u>20Q1</u>	<u>20Q2</u>	<u>20Q3</u>	<u>20Q4</u>	<u>21Q1</u>	<u>21Q2</u>	<u>21Q3</u>	<u>21Q4</u>	<u>2018</u>	<u>2019</u>	<u>2020F</u>	<u>2021F</u>
Canada*	1.2	3.2	1.1	0.6	-8.2	-32.0	20.0	8.0	5.0	4.0	5.0	5.0	2.0	1.7	-5.9	4.2
United States*	3.1	2.0	2.1	2.1	-5.0	-35.0	20.0	10.0	7.0	5.0	4.0	4.0	2.9	2.3	-5.5	4.8
United Kingdom	0.7	-0.2	0.5	0.0	-2.0	-18.7	20.4	1.2	1.6	1.2	0.3	0.4	1.3	1.4	-7.1	7.6
Euro area	0.5	0.1	0.3	0.1	-3.8	-25.7	24.0	5.2	6.5	3.6	0.2	0.0	1.9	1.2	-12.3	16.7
Australia	0.5	0.6	0.6	0.5	-0.3	-8.5	3.9	0.8	0.7	0.7	0.8	0.7	2.8	1.8	-4.5	2.1

\*annualized

### Inflation outlook

% change, year-over-year

	<u>19Q1</u>	<u>19Q2</u>	<u>19Q3</u>	<u>19Q4</u>	<u>20Q1</u>	<u>20Q2</u>	<u>20Q3</u>	<u>20Q4</u>	<u>21Q1</u>	<u>21Q2</u>	<u>21Q3</u>	<u>21Q4</u>	<u>2018</u>	<u>2019</u>	<u>2020F</u>	<u>2021F</u>
Canada*	1.6	2.1	1.9	2.1	1.8	-0.1	-0.1	-0.1	0.0	1.3	1.4	1.6	2.3	1.9	0.4	1.1
United States*	1.6	1.8	1.8	2.0	2.1	0.3	0.0	-0.2	0.1	1.7	2.1	2.3	2.4	1.8	0.6	1.6
United Kingdom	1.8	2.0	1.9	1.4	1.7	0.9	0.7	1.0	0.9	1.4	1.4	1.5	2.5	1.8	1.1	1.3
Euro area	1.4	1.4	1.0	1.0	1.1	0.1	0.2	0.3	0.3	1.3	1.3	1.4	1.8	1.2	0.4	1.0
Australia	1.3	1.6	1.7	1.8	2.2	0.9	1.0	0.9	1.1	2.3	2.2	2.2	1.9	1.6	1.3	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

	<u>Measure</u>	<u>Current period</u>	<u>Period ago</u>	<u>Year ago</u>	<u>three-month trend</u>	<u>Six-month trend</u>
Canada	CPI ex food & energy <sup>1</sup>	Apr	-0.1	1.3	1.4	1.2
United States	Core PCE <sup>1,2</sup>	Apr	-0.4	1.0	0.6	1.3
United Kingdom	All-items CPI	Apr	-0.1	0.8	0.6	0.6
Euro area	All-items CPI <sup>1</sup>	May	-0.2	0.1	-1.7	0.4
Australia	Trimmed mean CPI <sup>1</sup>	Q1	0.5	1.8	N/A	N/A
New Zealand	All-items CPI	Q1	0.8	2.5	N/A	N/A

<sup>1</sup> Seasonally adjusted measurement.

<sup>2</sup> 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

	<u>Actuals</u>					<u>Forecast</u>						
	<u>19Q1</u>	<u>19Q2</u>	<u>19Q3</u>	<u>19Q4</u>	<u>20Q1</u>	<u>20Q2</u>	<u>20Q3</u>	<u>20Q4</u>	<u>21Q1</u>	<u>21Q2</u>	<u>21Q3</u>	<u>21Q4</u>
Canadian dollar	1.33	1.31	1.32	1.30	1.41	1.36	1.38	1.40	1.38	1.37	1.36	1.35
Euro	1.12	1.14	1.09	1.12	1.10	1.12	1.14	1.15	1.14	1.13	1.12	1.11
U.K. pound sterling	1.30	1.27	1.23	1.33	1.24	1.24	1.24	1.22	1.20	1.18	1.17	1.16
Japanese yen	110.9	107.9	108.1	108.6	108	105	100	95	97	99	101	103
Australian dollar	0.71	0.70	0.68	0.70	0.61	0.67	0.65	0.64	0.63	0.63	0.63	0.63

### Canadian dollar cross-rates

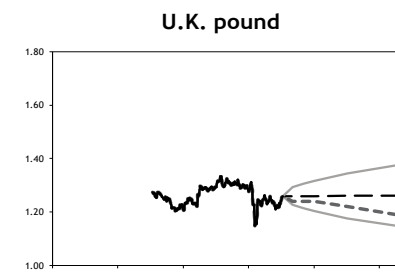
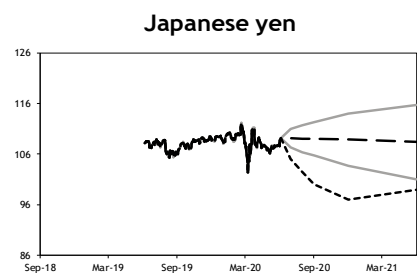
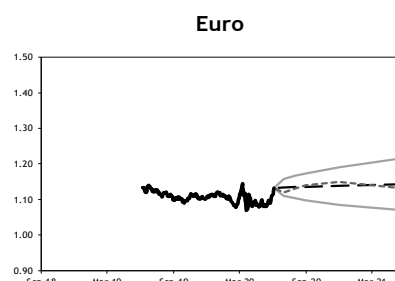
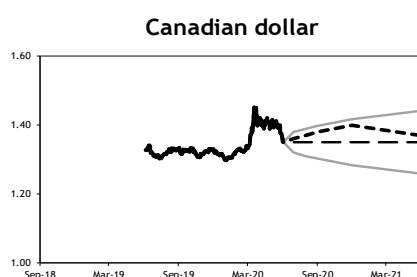
	<u>19Q1</u>	<u>19Q2</u>	<u>19Q3</u>	<u>19Q4</u>	<u>20Q1</u>	<u>20Q2</u>	<u>20Q3</u>	<u>20Q4</u>	<u>21Q1</u>	<u>21Q2</u>	<u>21Q3</u>	<u>21Q4</u>
EUR/CAD	1.50	1.49	1.44	1.46	1.55	1.52	1.57	1.61	1.57	1.55	1.52	1.50
GBP/CAD	1.74	1.66	1.63	1.72	1.75	1.69	1.71	1.71	1.66	1.61	1.59	1.56
CAD/JPY	83.0	82.4	81.6	83.6	76.5	77.2	72.5	67.9	70.3	72.3	74.3	76.3
AUD/CAD	0.95	0.92	0.89	0.91	0.86	0.91	0.90	0.90	0.87	0.86	0.86	0.85

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

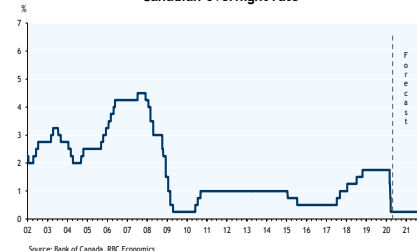
The BoC expects a further 10-20% decline in Q2 GDP (our forecast is -9% non-annualized) but said the outlook for the second half of 2020 and beyond remains “heavily clouded”.

The BoC’s asset purchase program remains open-ended. We think it will last at least a year, but are waiting on more detailed forward guidance when the bank has some clarity on the economic outlook.

Canadian real GDP growth



Canadian overnight rate

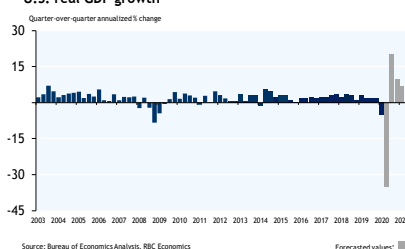


### Federal Reserve

The Fed hasn’t updated its economic projections since 2019, but Chair Powell has said it will take some time for the recovery to gather momentum, and additional policy support might be needed to prevent lasting economic damage.

Powell also said the Fed will rely on its existing tools if further stimulus is required, and that negative rates are not being considered by the FOMC.

U.S. real GDP growth



U.S. target rate

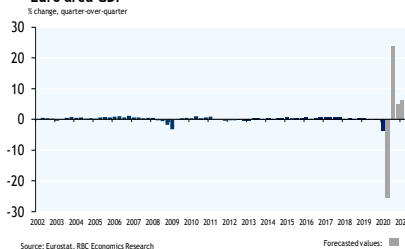


### European Central Bank

Disinflationary pressure from a sharp economic contraction in H1/20 will only make the ECB’s long running battle to achieve its inflation target more difficult.

The ECB is on track for record asset purchases this year and aggressive bond-buying is scheduled to continue at least through mid-2021. A negative deposit rate isn’t going away anytime soon.

Euro area GDP



ECB Deposit rate

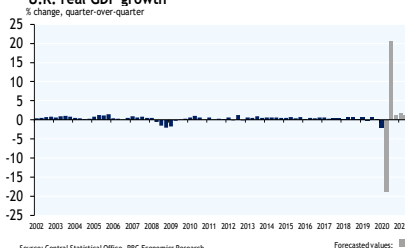


### Bank of England

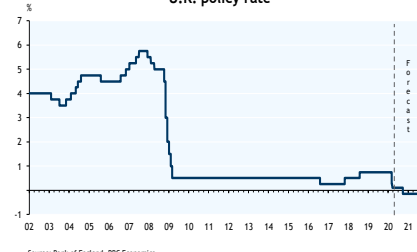
The UK economy has contracted sharply and more than 10 million people are relying on pandemic income support programs. A slow recovery in the labour market will demand more BoE stimulus.

We think the BoE will increase the size of its asset purchase program again in June. We also see the bank following the ECB’s example in moving its policy rate below zero later this year.

U.K. real GDP growth



U.K. policy rate

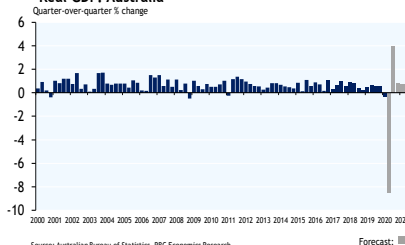


### Reserve Bank of Australia

The RBA sounded more positive in its early-June policy statement, saying the current downturn might be less severe than previously expected and noting signs the economy began to stabilize in May.

Yield curve control has worked well for the RBA—it has had to expand its balance sheet by less than other central banks—and negative rates don’t seem to be part of the policy conversation.

Real GDP: Australia



Australia policy rates





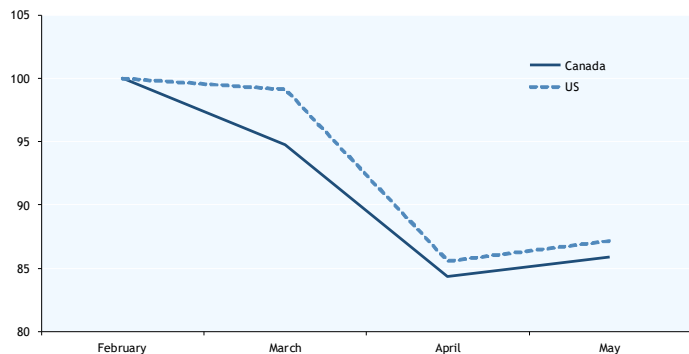
## Moving in the right direction... but a long way to go

Both Canadian and US employment reports showed significant upside surprises in May as re-opening businesses, factories and construction sites brought back some of their workers. It was a step in the right direction, but there's still a long way to go to reverse the unprecedented job losses seen in March and April.

Canadian small business sentiment has improved sharply in recent weeks, though 44% of respondents still described their general business situation as "bad" (only 14% said "good"). Hiring intentions have also improved but still suggest small businesses will be slow to bring back workers.

**Canadian and US employment**

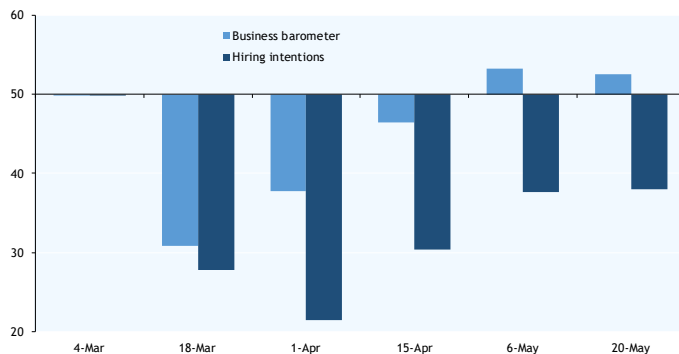
index, Feb/2020=100



Source: BLS, Statistics Canada, RBC Economics

**Canada CFIB business barometer**

50+=Expansion



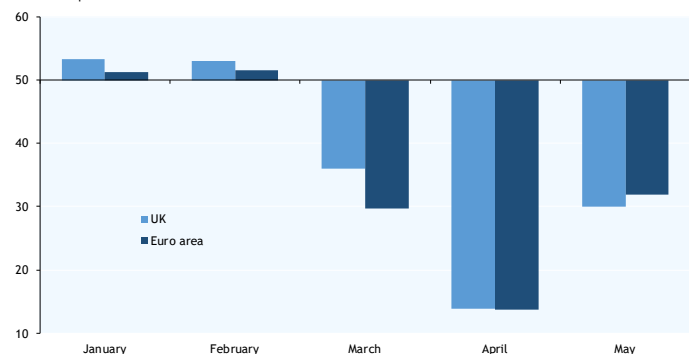
Source: Canadian Federation of Independent Business, RBC Economics

UK and euro area purchasing managers' indices bounced back from April's lows, but still suggest the economy is contracting. Sentiment in the services sector remains particularly soft—not surprising given the outsized impact of containment measures—but manufacturers aren't having an easy time either.

Oil prices have essentially doubled from April's sub-\$20 level but remain around oil crash lows. Re-opening will mean more demand for oil, but substantial inventories have to be worked through before prices return to levels seen in the past few years.

**UK and euro area composite PMIs**

50+=Expansion



Source: IHS Markit, RBC Economics

**WTI oil price**

US\$/barrel



Source: Energy Information Administration, RBC Economics