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The Balancing Act: Containment vs. Recovery

Election results and vaccine hopes buoyed market sentiment in early-November even as the pandemic continued to worsen in many countries. It took four days to declare Biden president-elect and even though Trump still hasn't conceded, markets are discounting an upending of the election result. And with Republicans likely holding onto the Senate, investors are betting on more market-friendly policies than a Democratic "blue wave" might have produced. Treasuries rallied post-election but sold off again as positive vaccine trial results boosted growth prospects. US and global equities jumped sharply on the news that an effective COVID-19 vaccine might be just months away.

But until a vaccine is widely available, governments face a tough balancing act between containing the virus's spread and keeping the economy open. Policymakers in the UK and Europe have re-imposed lockdown measures that aren't as restrictive as in the spring but will nonetheless shift the recovery into reverse in Q4. Authorities in Canada and the US haven't been willing to go as far, though record case growth and rising hospitalizations suggest further restrictions might be needed. In any case, both countries' economic recoveries are slowing in the fourth quarter.

Governments have extended some support programs to manage the economic fallout of renewed containment measures, and a number of central banks are doing their part by providing additional stimulus. The ECB signaled more support will be coming in December, which we think will include an expansion of its QE program. The BoE expanded its own asset purchases, and we think negative rates remain on the table for early next year. Not to be outdone, the RBA cut rates slightly and launched a new QE program that goes beyond its existing yield curve control policy. Both the Fed and BoC stand ready to add stimulus if necessary, but seem content with the accommodation they're providing at this stage. Central banks focused on keeping borrowing costs low will have a watchful an eye on rising yields, but might be reluctant to push back against modest increases that reflect improving economic prospects.

Central bank near-term bias

The BoC sharpened its forward guidance, saying the overnight rate will likely be held at its current level until 2023. While it reduced the pace of asset purchases, the central bank emphasized its QE program will continue to provide as much stimulus as it did previously.

The Fed made no policy changes in early-November, maintaining its forward guidance that suggests low rates for years to come. It discussed options around its QE program but decided enough stimulus is being provided at present.

The BoE increased the size of its asset purchase program by more than expected in November. There was no discussion of negative rates but growth concerns suggest that option remains on the table.

The ECB made no policy changes in late-October but signaled additional stimulus is coming in December. We don't see a deposit rate cut but think an extension of its QE program is likely.

The RBA lowered rates in November and launched a new QE program worth about 5% of GDP. That will help keep longer-term rates low, while ongoing yield curve control will anchor the short end.

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Highlights

▲ A divided Congress could keep Biden from implementing a more activist agenda.

▲ US Q3 GDP retraced two thirds of the decline seen during the first half of 2020.

▲ Payroll growth has slowed with employment still down 10 million from February's level.

▲ FOMC members have continued to call for additional fiscal stimulus.

Biden wins election but "blue wave" didn't make it to shore

Biden's election victory wasn't accompanied by the "blue wave" some pollsters thought would see Democrats sweep the presidency and both chambers of Congress. Democrats maintained control of the House of Representatives despite losing a few seats, but barring surprising results in two run-off elections it looks like Republicans will hold onto a slim majority in the Senate. A split Congress would check Biden's ambitions when it comes to large-scale fiscal stimulus, tax increases and addressing climate change. A more status-quo outcome has been positive for equity markets.

While large-scale stimulus looks less likely, investors are holding out hope for a more modest fiscal package. For months policymakers have failed to agree on a follow-up to the CARES Act. But if Senate Republicans and House Democrats are stuck with each other for another two years, a near-term compromise might be in the offing—potentially even during the lame duck session. Any new support measures would pose some upside risk to our GDP forecast—for now, we're simply assuming earlier stimulus that padded household savings will help sustain moderate consumer spending growth.

Households lift US Q3 GDP, but gains slowing

Despite a second wave of COVID-19 cases over the summer, the US economy saw a sizeable rebound in Q3. GDP was up 7.4% (33% annualized) in the quarter, retracing about two thirds of the decline seen during the first half of the year. Households led the recovery with consumer spending and residential investment both seeing strong growth. But gains in consumer spending slowed during Q3 (monthly increases averaging about 1%) as the previous quarter's stimulus-driven surge in personal income continued to unwind and the household savings rate remained at twice pre-pandemic levels. Consumer confidence is up from its August low but still suggests caution, and higher frequency spending data show retail and food services activity started to pull back last month.

Employment growth continued in October but only slightly more than half of the 22 million jobs lost in March and April have been recovered. And payroll gains have slowed in each of the past four months—if job gains continue at the pace seen in September and October, employment won't return to pre-pandemic levels until early-2022. A third wave of COVID-19 infections (record case growth, hospitalizations now exceeding previous peaks) will keep pressure on industries that have been hardest hit by physical distancing. On balance we expect US GDP growth will slow to 0.7% (3% annualized) in Q4, leaving activity nearly 3% below its year-ago level.

Federal Reserve stays the course post-election

November's FOMC meeting immediately after the election was mostly a non-event with the policy statement seeing only minor tweaks to reflect the current economic backdrop. The committee reiterated its forward guidance from September, saying fed funds will be held at 0-0.25% until the economy is back to maximum employment and inflation has risen to 2% and is on track to "moderately exceed 2%" for some time (the latter reflects the Fed's new flexible average inflation targeting framework). Based on the committee's latest forecasts that won't be until after 2023, so low short-term rates are locked in for the foreseeable future.

More relevant in the near term is the Fed's QE program which it says will continue at the current pace "over coming months." Chair Powell said the committee discussed options around QE—we think that might include more specific forward guidance, an increase in purchases, or shifting purchases to longer maturities—but that the "very large, effective program" is delivering enough stimulus at this stage. A number of FOMC members have continued to call for additional fiscal stimulus, and Powell acknowledged back in September that lack of additional fiscal support was a downside risk to the committee's economic projections (he was less vocal on that point in November). In that sense, ongoing failure to reach a compromise in Congress would increase the odds of the Fed tweaking its QE program. But we think a more meaningful increase in QE stimulus would only materialize if economic conditions deteriorate unexpectedly.

Targeted restrictions will still slow Canada's recovery

Canada's economic recovery continued over the summer with steady but slowing GDP gains in August (+1.2%) and September (+0.7% preliminary estimate). The latter leaves economic activity 4% below pre-pandemic levels, a marked improvement from the 18% shortfall seen in April. But making up remaining ground is expected to be a slower process. Targeted restrictions to address a second wave of COVID-19 infections weighed on some industries in October—accommodation and food services, for instance, suffered job losses for the first time in six months and restaurant bookings were down. Other sectors are proving more resilient during the second wave. RBC's consumer spending tracker indicates card spending growth was relatively steady over the past month, though with a renewed shift toward online purchases. Most industries saw continued job gains in October, and some that are less sensitive to physical distancing have now fully retraced earlier job losses. We are penciling in relatively flat Q4 GDP following Q3's 10% gain (+45% annualized). Much will depend on containment measures—some of October's restrictions have already been eased as policymakers try to balance health and the economy. But with few signs that case curves are flattening, authorities may have to reverse course and put tougher measures in place.

Stimulus check

With containment measures continuing to impact many businesses and households, the federal government has modified and extended some key support measures. The wage subsidy program that at one point supported nearly 4 million jobs will now remain in place until mid-2021 (pending Parliamentary approval). Ditto for a modified commercial rent assistance program that will help hard-hit businesses, particularly those forced to close, cover their rent. The $82 billion CERB income support program has run its course but roughly 1.5 million Canadians transitioned to expanded Employment Insurance in early-October, while another 1 million (mostly self-employed, gig, or contract workers) applied for the new Canada Recovery Benefit. All told, the Canadian government is providing more sustained fiscal support than many of its peers. The full cost of those measures and any additional efforts to stimulate growth will be clearer when the government releases its fall economic statement sometime in the next month.

BoC "calibrates" QE but keeps accommodation in place

Given the strength of the fiscal response at home, the Bank of Canada faces less pressure than other central banks to increase monetary policy stimulus. So it wasn't surprising to see the BoC largely stay the course in October, keeping the overnight rate steady at 0.25% and reiterating its forward guidance that rate hikes are off the table until the economy is back at full capacity. Updated economic projections allowed Governing Council to firm up that timeline, indicating the policy rate is likely to remain at the effective lower bound until 2023. The BoC said it would calibrate its QE program as needed and did just that in October, trimming weekly purchases to at least $4 billion per week from $5 billion previously. Despite a slower pace of bond-buying, the BoC says it will provide "at least as much monetary stimulus as before" by moving further out the yield curve, focusing on the 3- to 15-year range that it says has more of an impact on household and business borrowing costs.

Even with a slower pace of purchases the BoC's footprint in the GoC market will continue to expand—it currently holds slightly more than 1/3 of federal government bonds. And with new issuance likely to slow after this year's record deficit, we think the central bank will need to further reduce bond buying in the first half of 2021. How long QE continues will depend on the path of the recovery, which itself will be greatly influenced by the course of the pandemic. The BoC's updated GDP forecast is similar to our own, with a more gradual recovery in 2021 meaning the economy won't return to pre-pandemic levels until around the turn of next year. In such a scenario, we think the BoC might stop new asset purchases sometime next fiscal year. Even then its significant GoC holdings (we don't see the central bank selling bonds it has purchased) will keep a lid on government borrowing costs.

Highlights

▲ GDP is expected to be increase slightly in Q4…

▲ …but rising case counts could prompt further restrictions that would weigh on growth.

▲ The Canadian government has extended a number of support schemes, resulting in a more sustained fiscal response than its peers.

▲ The BoC reduced the pace of asset purchases but says QE will provide at least as much stimulus as it did previously.

Highlights

▲ A Q4 decline will leave UK GDP well below its year-ago level.

▲ Euro area surveys already suggested a Q4 slowdown…

▲ …and a return to lockdowns in a number of countries will shift the recovery into reverse.

▲ The RBA went beyond yield curve control (i.e. buying bonds as needed to achieve its target) by launching a full QE program.

UK lockdowns to keep GDP well below pre-pandemic levels

The UK economy posted a sizeable 15.5% increase in Q3 GDP but looks set to give some of that back in the fourth quarter. A second wave of COVID-19 infections and rising hospitalizations prompted a second national lockdown in England that is set to last a month (until early-December) and could be extended if necessary. PMI data show the UK's recovery was already losing momentum in October, and new restrictions effectively lock in a decline in November GDP. We are now expecting a 3.6% decline in Q4 GDP, which would leave activity a staggering 13% below its end of 2019 level. The Bank of England trimmed its growth forecasts to a lesser extent in November (Q4 GDP -2% q/q; -11% y/y) and increased its Gilt purchase target by a larger-than-expected £150 billion to £875 billion. There was no discussion of negative rates but concerns about longer-term scarring and Brexit headwinds suggest the BoE is open to further stimulus. On the fiscal front, the government extended its furlough scheme for the duration of the lockdown—that program was set to be replaced by a less generous wage subsidy at the end of October.

ECB flags more stimulus as fresh lockdowns begin

The euro area saw a stronger-than-expected economic rebound in Q3 with GDP rising 12.7% (consensus was for a gain of less than 10%). The increase retraced more than two thirds of the decline seen over the first half of the year. Economic activity for the currency bloc as a whole was 4.3% below pre-pandemic levels in Q3 with Germany, France and Italy all close to that mark despite the latter two seeing much more significant H1 declines. Among major euro area economies, Spain underperformed with GDP still 9% below its end of 2019 level, thanks in part to a second wave of COVID-19 infections that began in the summer and necessitated tighter restrictions than some of its neighbours. More recently, a surge in cases in France has prompted a return to national lockdown, while Germany has also reverted to a month-long "lockdown light." These containment measures aren't as all-encompassing as in the spring—schools remain open and industrial activity is facing fewer disruptions—but will nonetheless be enough to push Euro area GDP lower in Q4. Indeed, the currency bloc's PMIs already showed loss of momentum early in the current quarter, with October's composite reading falling below 50 for the first time since June. We think a return to growth early next year will depend on the duration of these new containment measures, but on balance we've penciled in a modest increase in Q1/21 GDP. So despite an upside surprise on Q3 growth, we're still expecting a protracted recovery that will leave economic activity below pre-pandemic levels even by the end of next year.

The ECB will take these developments into account when updating its forecasts in December. The central bank said it will use that updated assessment to "recalibrate its instruments, as appropriate," with Lagarde indicating there was unanimous support for more stimulus at the upcoming meeting. While the ECB will be looking at all of its policy tools, we don't expect a further deposit rate cut (as priced by markets) will be announced. Rather, we think lower rates on longer-term funding are more likely. The centrepiece of the ECB's new package should be an extension of its Pandemic Emergency Purchase Programme (PEPP) through the end of next year, with the envelope likely increased by €500 billion from €1.35 trillion currently.

RBA cuts rates, launches new QE program

The Reserve Bank of Australia announced a raft of new stimulus measures in early November. As expected, the central bank cut its cash rate, 3-year yield target, and term funding rate from 0.25% to 0.1%. A lower deposit rate will also help pin down short-term borrowing costs. The RBA also launched a new QE program that will purchase A$100 billion (about 5% of GDP) of government bonds over the next six months. The announced pace was at the higher end of expectations, and will be in addition to any purchases in support of the 3-year yield target (QE will lower yields further out the yield curve, particularly in the 5- to 10-year space). The RBA left the door open to extending and expanding the QE program if needed. The central bank revised up its near-term GDP forecasts but still expects inflation to increase only gradually, remaining below its target range by the end of 2022. We think more QE (rather than negative rates) will be the tool of choice if those forecasts prove too optimistic.

Interest rate outlook

%, end of period

	Actuals							Forecast				
	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	21Q1	21Q2	21Q3	21Q4
Canada												
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	0.20	0.12	0.15	0.15	0.15	0.25	0.25
Two-year	1.55	1.47	1.58	1.70	0.42	0.29	0.25	0.30	0.30	0.30	0.35	0.35
Five-year	1.52	1.39	1.40	1.69	0.59	0.37	0.36	0.40	0.45	0.50	0.60	0.65
10-year	1.62	1.47	1.36	1.70	0.70	0.53	0.57	0.60	0.65	0.70	0.80	0.90
30-year	1.89	1.69	1.53	1.76	1.31	0.99	1.11	1.15	1.25	1.30	1.35	1.40
United States												
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	0.16	0.10	0.15	0.15	0.15	0.15	0.15
Two-year	2.27	1.75	1.63	1.58	0.23	0.16	0.13	0.20	0.20	0.20	0.25	0.25
Five-year	2.23	1.76	1.55	1.69	0.37	0.29	0.28	0.30	0.35	0.40	0.45	0.50
10-year	2.41	2.00	1.68	1.92	0.70	0.66	0.69	0.75	0.80	0.85	0.95	1.00
30-year	2.81	2.52	2.12	2.39	1.35	1.41	1.46	1.50	1.55	1.60	1.65	1.70
United Kingdom												
Bank rate	0.75	0.75	0.75	0.75	0.10	0.10	0.10	0.10	-0.15	-0.15	-0.15	-0.15
Two-year	0.63	0.62	0.37	0.54	0.13	-0.08	-0.02	-0.10	-0.25	-0.20	-0.20	-0.20
10-year	0.99	0.84	0.49	0.83	0.34	0.17	0.23	0.10	0.00	0.10	0.15	0.20
Euro area												
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	-0.69	-0.70	-0.75	-0.65	-0.60	-0.60	-0.60
10-year	-0.07	-0.33	-0.58	-0.19	-0.48	-0.45	-0.53	-0.55	-0.60	-0.50	-0.40	-0.35
Australia												
Cash target rate	1.50	1.25	1.00	0.75	0.25	0.25	0.25	0.10	0.10	0.10	0.10	0.10
Two-year	1.47	0.98	0.76	0.92	0.24	0.25	0.16	0.10	0.10	0.10	0.10	0.12
10-year	1.78	1.32	1.01	1.37	0.77	0.87	0.84	0.65	0.60	0.65	0.75	0.80
New Zealand												
Cash target rate	1.75	1.50	1.00	1.00	0.25	0.25	0.25	0.25	0.00	-0.25	-0.25	-0.25
Two-year swap	1.62	1.35	0.92	1.25	0.52	0.19	0.05	-0.05	-0.10	-0.10	-0.10	-0.10
10-year swap	2.15	1.78	1.20	1.78	0.92	0.72	0.50	0.50	0.50	0.50	0.60	0.65
Yield curve*												
Canada	7	0	-22	0	28	24	32	30	35	40	45	55
United States	14	25	5	34	47	50	56	55	60	65	70	75
United Kingdom	36	22	12	29	21	25	25	20	25	30	35	40
Eurozone	53	40	16	40	21	24	17	20	5	10	20	25
Australia	31	34	25	45	53	62	68	55	50	55	65	68
New Zealand	53	43	28	53	40	53	45	55	60	60	70	75

* 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	0.10	0.25	November 2, 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

	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	21Q1	21Q2	21Q3	21Q4	2018	2019	2020F	2021F
Canada*	1.2	3.2	1.1	0.6	-8.2	-38.7	48.0	1.0	3.0	5.0	4.5	4.5	2.0	1.7	-5.6	4.5
United States*	2.9	1.5	2.6	2.4	-5.0	-31.4	33.1	3.0	2.5	3.0	3.5	3.0	3.0	2.2	-3.6	3.6
United Kingdom	0.6	0.0	0.3	0.1	-2.5	-19.8	15.5	-3.6	2.3	1.7	1.4	0.5	1.3	1.3	-11.5	3.0
Euro area	0.5	0.1	0.3	0.0	-3.7	-11.8	12.7	-2.4	0.7	3.4	0.5	0.4	1.9	1.3	-7.2	4.5
Australia	0.4	0.8	0.5	0.6	-0.3	-7.0	0.3	1.5	1.3	1.1	1.1	1.0	2.8	1.8	-4.2	2.4

*annualized

Inflation outlook

% change, year-over-year

	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	21Q1	21Q2	21Q3	21Q4	2018	2019	2020F	2021F
Canada*	1.6	2.1	1.9	2.1	1.8	0.0	0.3	0.6	0.4	1.4	1.0	1.4	2.3	1.9	0.7	1.1
United States*	1.6	1.8	1.8	2.0	2.1	0.4	1.2	1.3	1.4	2.5	1.7	1.7	2.4	1.8	1.2	1.8
United Kingdom	1.8	2.0	1.9	1.4	1.7	0.7	0.6	0.8	0.7	1.3	1.4	1.5	2.5	1.8	0.9	1.2
Euro area	1.4	1.4	1.0	1.0	1.1	0.2	0.0	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	-0.3	0.7	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

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	CPI ex food & energy[1]	Sep	0.2	0.8	0.5	0.3
United States	Core PCE[1,2]	Sep	0.2	1.5	3.5	0.9
United Kingdom	All-items CPI	Sep	0.5	0.5	1.5	0.5
Euro area	All-items CPI[1]	Oct	0.1	-0.3	-1.0	-0.6
Australia	Trimmed mean CPI[1]	Q3	0.4	1.2	N/A	N/A
New Zealand	All-items CPI	Q3	0.7	1.4	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				
	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	21Q1	21Q2	21Q3	21Q4
Canadian dollar	1.33	1.31	1.32	1.30	1.41	1.36	1.33	1.34	1.35	1.35	1.34	1.33
Euro	1.12	1.14	1.09	1.12	1.10	1.12	1.17	1.20	1.20	1.20	1.18	1.16
U.K. pound sterling	1.30	1.27	1.23	1.33	1.24	1.24	1.29	1.28	1.26	1.25	1.23	1.21
Japanese yen	110.9	107.9	108.1	108.6	108	108	105	100	97	99	101	103
Australian dollar	0.71	0.70	0.68	0.70	0.61	0.69	0.72	0.70	0.69	0.69	0.69	0.69

Canadian dollar cross-rates

	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	21Q1	21Q2	21Q3	21Q4
EUR/CAD	1.50	1.49	1.44	1.46	1.55	1.53	1.56	1.61	1.62	1.62	1.58	1.54
GBP/CAD	1.74	1.66	1.63	1.72	1.75	1.68	1.72	1.71	1.71	1.69	1.65	1.61
CAD/JPY	83.0	82.4	81.6	83.6	76.5	79.5	79.2	74.6	71.9	73.3	75.4	77.4
AUD/CAD	0.95	0.92	0.89	0.91	0.86	0.94	0.95	0.94	0.93	0.93	0.92	0.92

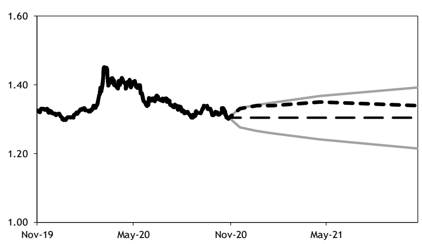
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

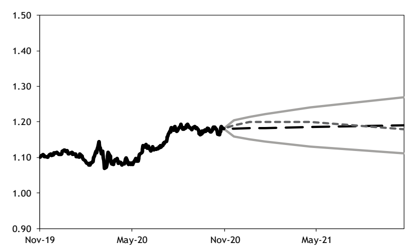
RBC Economics outlook compared to the market

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.

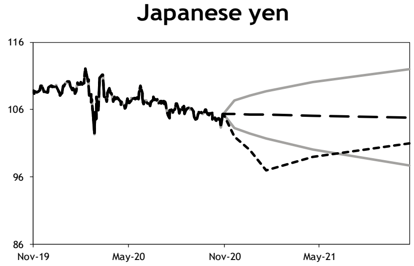
Canadian dollar



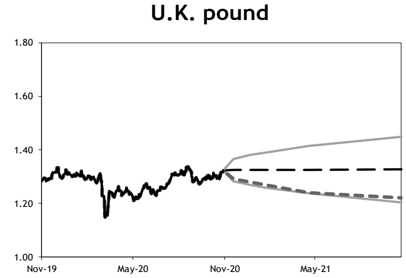
Euro



Japanese yen



U.K. pound

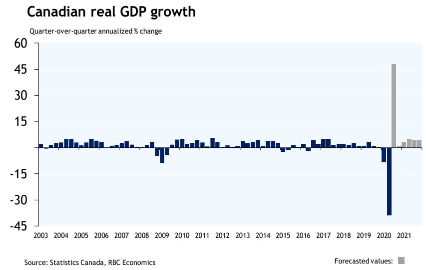


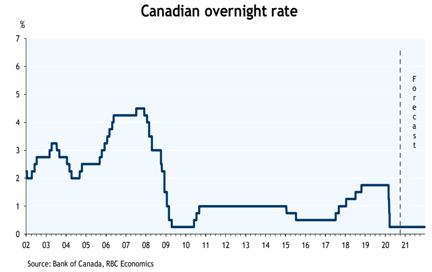
Central bank watch

Bank of Canada

The BoC's updated growth forecasts are similar to ours with a modest increase in Q4/20 GDP and activity not getting back to end of 2019 levels until around the turn of next year.

An earlier vaccine could mean the virus running its course sooner than mid-2022 as the BoC has assumed. But for now its guidance suggests rates are on hold until 2023.

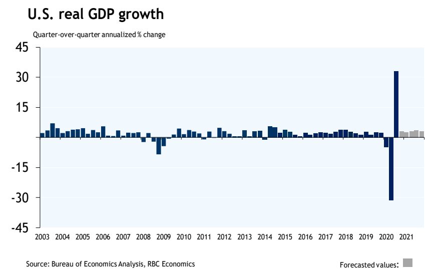


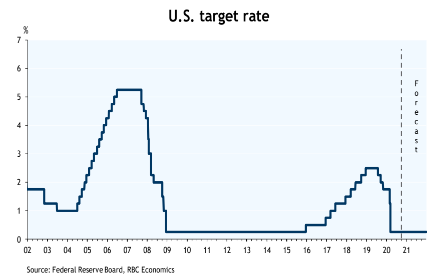


Federal Reserve

Despite not seeing the fiscal stimulus FOMC members have called for, unemployment has fallen faster than the Fed assumed and its 2020 GDP forecast still looks low.

The Fed sounds content with the stimulus QE is currently providing, and any fiscal agreement post-election would reduce pressure on the central bank to do more.

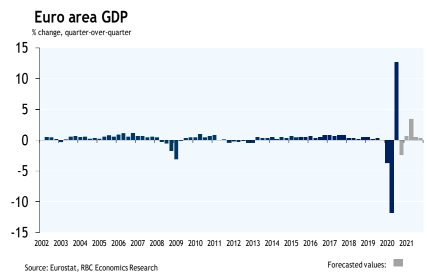


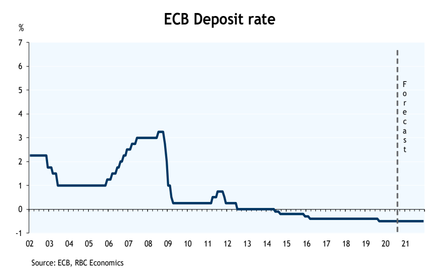


European Central Bank

With a number of major euro area economies going back into lockdown, the ECB will be lowering its growth forecasts in December. We're now expecting a 2.4% decline in Q4 GDP.

Downgraded forecasts will underpin a new stimulus package in December. We don't see the ECB cutting its deposit rate further into negative territory, but more QE should be on the way.

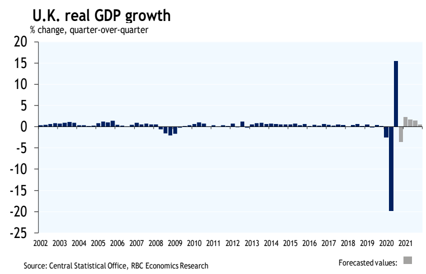


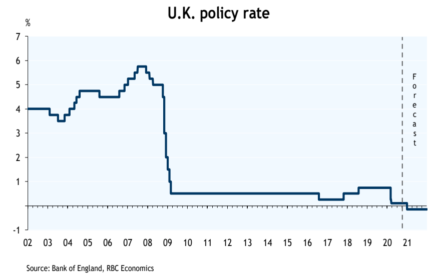


Bank of England

A November lockdown should sink Q4 GDP, with the BoE now looking for a 2% quarterly decline. That would leave activity significantly below year-ago levels—a big hole to climb out of in 2021.

The BoE expanded its QE program by more than expected in November. We think additional stimulus could come early next year with a negative bank rate, but there was little talk of that in November.

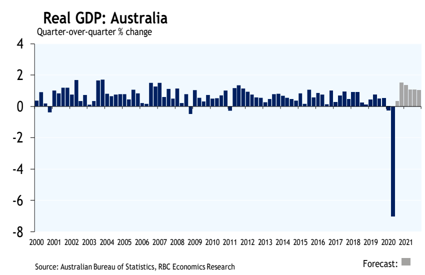


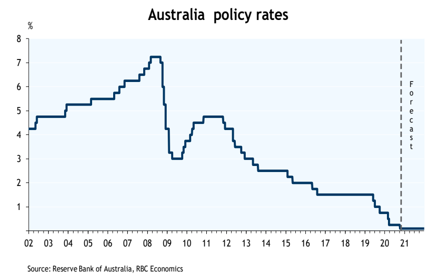


Reserve Bank of Australia

The RBA upgraded its GDP forecasts in November and revised unemployment projections lower. We see downside risks, and think inflation will remain well below the central bank's 2-3% target into 2022.

The RBA unveiled a number of new stimulus measures in November, including a proper QE program. Those purchases are set to last six months, and may very well need to be extended.





Virus fears, vaccine hopes, and election impacts

US Treasuries sold off heading into the election as growing odds of a Democratic sweep had markets betting on more government borrowing. Yields fell when the "blue wave" didn't materialize, only to rise to fresh pandemic highs as vaccine hopes boosted growth and inflation prospects, steepening the yield curve.

Equities sold off in the week prior to the November 3 vote amid concerns about a contested election and less market-friendly policies. But a Biden win and likely split Congress proved to be a winning combination for markets, and vaccine hopes only further boosted risk appetite.

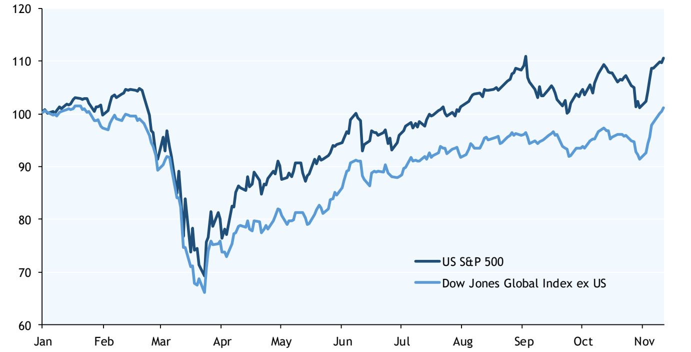
US yields rising, curve steepening

10-year yield (percent) and yield curve (basis points)

Source: US Treasury, RBC Economics

US and global equities rallying

re-indexed, Dec 31 2019=100



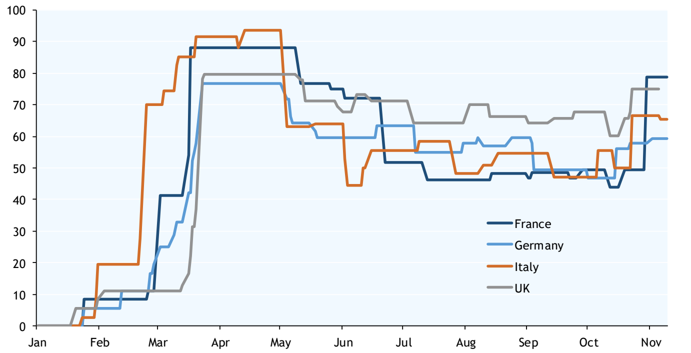
Source: Standard & Poor's, Dow Jones, RBC Economics

The largest economies in the UK and Europe have had to impose tighter restrictions amid record COVID-19 infection rates and hospitalizations that are trending toward spring highs. Containment measures will likely see these economies give back some of their Q3 GDP gains in the fourth quarter.

Canadian and US authorities have been more reluctant to impose tighter restrictions, generally relying on more targeted measures to limit economic damage. But with hospitalizations on the rise, health concerns might win out. Tighter restrictions would mean downside risk to our forecasts for modest Q4 growth.

European countries returning to lockdown as cases rise

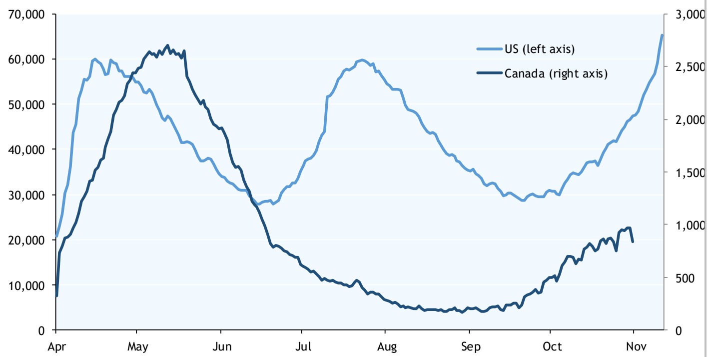
lockdown stringency index, 100=most strict



Source: University of Oxford, RBC Economics

COVID-19 hospitalizations are on the rise again in Canada & US

number of patients currently hospitalized



Source: Government of Canada, The COVID Tracking Project, RBC Economics