FINANCIAL MARKETS MONTHLY

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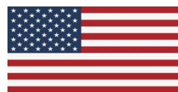
Getting sentimental

It was a December to remember, but for all the wrong reasons. The S&P 500 suffered its worst monthly drop since the recession, while global equities (as measured by the MSCI World index) posted their largest decline since the euro crisis in 2012. Investor confidence was battered by global growth worries—spurred on by flagging business sentiment in many economies—and concerns that the Fed is sleepwalking into a policy mistake. A US government shutdown, kicking off what looks set to be two years of Washington gridlock, didn't help. Investors ran for cover, piling into government bonds and pushing yields sharply lower and corporate spreads wider. Oil prices fell to their lowest level in more than a year despite OPEC's efforts to trim supply. Meanwhile, recession watch was in full swing with inversion in some segments of the yield curve prompting plenty of hand-wringing.

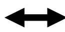
Volatility continued early this year with markets moving in both directions and we've seen brief glimpses of what could turn sentiment around. The tone surrounding US-China talks has been more positive and there is growing optimism that a trade war truce will be reached by March 1. The Fed appears to be more conscious of investors' concerns—we now think they'll slow the pace of tightening in 2019 rather than lift interest rates above neutral as they have in past tightening cycles. And more economic data like the latest US jobs report would help put the focus back on solid fundamentals. That's not to say there isn't cause for concern. Recent softening in global growth won't be entirely reversed by tariff relief, and recession risk is elevated with some economies in the late stages of the business cycle. But there is reason to think an ugly December 2018 won't be the start of a broader downturn.

Central bank near-term bias

Lower oil prices were a major factor in the BoC marking down their 2019 growth forecast. But they still see rates moving higher over time, and if there is enough evidence the non-energy economy is continuing to expand, we think their pause will be relatively brief.



The Fed is increasingly sensitive to market volatility and becoming more cautious as rates approach neutral. We expect two further hikes this year, but the data (and markets) will have to play along to see a move as soon as March.



The Bank of England maintained their guidance for "gradual and limited" rate hikes, but Brexit uncertainty is keeping them from following through. We don't see a rate hike until August, and that is if a damaging 'no deal' Brexit can be avoided.

Euro area growth has disappointed but labour market trends are a bit more encouraging. If activity picks up over the first half of this year as we expect, modest rate increases are likely to follow in H2/2019.

Tightening financial conditions, global growth concerns, and a challenging environment for consumers are expected to keep the Reserve Bank of Australia on the sidelines for a while longer.

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Highlights

▲ US survey data disappointed in December with both manufacturing and services readings posting sizeable declines.

▲ Consumer confidence also declined but remains elevated, and job market trends have been positive.

▲ Markets did not take the Fed's December rate hike in stride…

▲ …and with the central bank sounding more cautious, we now expect just two rate increases this year.

US business sentiment deteriorated in December…

December was a month of disappointing survey data in a number of economies and the US was no exception. The ISM manufacturing index fell by more than 5 points, its worst monthly decline since the recession, as businesses reported weaker production growth and sharp slowing in new orders. Firms pointed to uncertainty over trade policy and the economic outlook. To put things in perspective, the index is now only slightly below its post-recession average and points to continued expansion. Manufacturing output grew at its best pace in six years in Q3, but does appear to have lost momentum toward the end of 2018.

The ISM non-manufacturing index was also softer than expected, falling 3 points in December. Business activity slowed, but unlike the manufacturing sector, new orders held up at a solid pace and firms' comments were broadly positive. The index itself remains above its post-recession average and is up from a year ago. The recent decline looks more like a correction from recent elevated levels than a sharp deterioration in sentiment. We are less concerned about the growth signal from this survey than its manufacturing counterpart which covers a much smaller slice of the US economy. All told, we think these data are consistent with more moderate, but still solid growth heading into 2019.

…and consumer confidence came off recent highs

Consumer confidence also saw a sizeable decline in December. Households were less optimistic about the future, possibly interpreting sharp equity market declines as a sign of softer economic conditions to come. But again context is important—consumer confidence is coming off a multi-decade high and remains well above levels that have prevailed throughout the recovery. It's hard to be overly concerned about the consumer backdrop, particularly in light of recent labour market trends. Despite being in the late stages of the economic cycle, job growth picked up to its best pace in three years in 2018. And labour demand remains strong with job openings exceeding the ranks of unemployed (a first in records going back to 2001). Competition to attract and retain workers has lifted wage growth above 3%, and real earnings are improving thanks to lower energy prices. Recent equity market declines will bring negative wealth effects, but we doubt that will be enough to derail another solid year for US consumers.

Fed sounding more cautious amid market volatility

The Fed's December rate hike was widely expected but still drew a negative response from investors. Those hoping market volatility and global growth concerns would see the Fed signal a pause in their tightening cycle were disappointed. While the Committee said they'll be keeping an eye on global economic and financial developments, they still indicated "some" further rate hikes are likely. The 'dot plot' shifted to a slightly more shallow tightening path but nonetheless pointed to rates rising to the upper end of most neutral estimates over the next two years. Chairman Powell was a bit more cautious in his press conference, noting a high degree of uncertainty about future rate increases and the Fed's ability to be patient in raising rates. But that wasn't enough to placate investors' concerns that monetary policy, including balance sheet reduction, is on autopilot. Equities fell sharply after the December meeting and over the following days.

Early in the New Year, Powell elicited a more positive market reaction when he emphasized Fed policy will be flexible (even on the balance sheet) and proceed cautiously. Our forecast continues to assume another rate increase in March, though we'll need to see stability in equity markets and another round of solid economic data for the Fed to move again so soon. Beyond that, we have trimmed our fed funds forecast and look for just two rate hikes in total in 2019. While the economic backdrop remains strong, the Committee is clearly becoming more tentative as policy approaches a neutral setting. Given the challenge of raising rates in a slowing growth environment, it's hard to see fed funds rising above 3% in the near term—as long as inflation remains quiescent.

Canadian GDP growth hitting a soft patch…

Canadian GDP rebounded by a solid 0.3% in October following September's disappointing 0.1% decline. But that improvement will be short-lived, with rotating postal strikes having weighed on economic activity in November. We'll also start to see the hit from lower oil prices. Producers began trimming supply in response to earlier sharp discounts on Western Canadian oil, which weighed on energy exports in November. Drilling activity tapered off toward the end of the year, likely in preparation for production cuts mandated by the Alberta government, and oil output will decline when those cuts take effect in January. All told, we're hitting a soft patch for growth with GDP gains expected to average just over 1% in Q4/18 and Q1/19. But much of that slowdown reflects challenges in the energy sector. Other economic indicators point to the rest of the economy performing well toward the end of last year.

…but labour markets and business confidence are holding up

While it looks like GDP growth slowed in Q4, the same cannot be said for Canada's labour market. The economy added 115,000 jobs in the quarter—the fastest hiring pace in a year—and the unemployment rate fell 0.3 percentage points to a 44-year low. For 2018 as a whole, employment growth averaged a solid 14,000 per month (all full-time positions) and three-quarters of industries recorded job gains. Surveys point to the labour market continuing to improve in 2019. The Bank of Canada's *Business Outlook Survey* showed labour shortages intensifying over the second half of last year and more than half of firms surveyed plan to increase headcount. In general, business sentiment remained positive in Q4 with sales growth expected to stabilize at a decent pace and investment intentions remaining solid amid capacity pressures. Unsurprisingly, the outlook was more subdued in the oil-producing Prairie provinces. Still, we think the BOS and labour market data serve as evidence that Canada's economy is performing better than incoming growth figures are likely to indicate.

BoC rate hikes delayed but not canceled

The Bank of Canada held rates steady in January and struck a fairly balanced tone in light of some recent, negative trends: sharply lower oil prices, tighter financial conditions, and slowing global growth. Governing Council took note of all three but it was oil prices that had the most significant impact on their economic outlook. With price assumptions trimmed by $20 per barrel, the bank expects weaker near-term GDP growth, slower energy sector investment, and more slack in energy-producing provinces. The BoC suggested lower oil prices will weigh on the Canadian economy to the tune of 1/2 percent of GDP by the end of 2020. That is about 1/4 of the impact seen during the 2014-16 oil price shock, reflecting a less significant price drop and a smaller, more efficient energy sector this time around.

But while the energy sector slowdown is set to delay further interest rate hikes, the BoC continues to think rates will have to rise to a neutral level "over time" to keep inflation on target. That view is underpinned by their forecast for a return to above-trend growth later this year, with non-energy exports and business investment—aided by CUSMA, tax breaks, solid foreign demand, a weaker Canadian dollar, and capacity pressures—expected to support activity. We think the recent deterioration in financial conditions and slowing global growth have created some downside risk to the outlook for those sectors. But as noted above, indicators outside the energy sector have been positive. If that trend holds up, we think the BoC might come off the sidelines as soon as Q2. For the year as a whole, our forecast continues to assume two rate increases, which would leave policymakers just short of their 'neutral' destination at the end of 2019.

Highlights

- ▲ Canadian GDP growth is likely to average just over 1% in Q4/18 and Q1/19…
- ▲ …but labour market data and business surveys still point to a solid economic backdrop
- ▲ The BoC cut their 2019 growth and inflation forecasts on the back of lower oil prices, but bumped up 2020 growth.
- ▲ Rates are still expected to rise to neutral "over time" but it looks like the BoC is hitting pause for now.

Highlights

▲ UK Parliament is finally set to vote on May's Brexit deal, but it isn't expected to pass.

▲ Meanwhile, surveys continue to show the UK economy taking a hit from Brexit uncertainty.

▲ Germany's industrial sector faced further difficulties in Q4 and other major euro area economies had their own issues.

▲ We think the currency bloc as a whole grew at a disappointing 0.2% pace for a second consecutive quarter.

Still looking for clarity on Brexit…

Another month closer to the March 29 deadline and we still have little clarity on how (and even when) the UK will exit the EU. Parliament is finally set to vote on PM May's Brexit deal on January 15. But it isn't expected to pass, in which case the prime minister will have less than a week to return with an alternative plan—not much time to come up with fresh assurances on the thorny Irish border issue. If May can't put together a workable Plan B, options including a no confidence vote, fresh elections, a second referendum, and a 'no deal' Brexit remain on the table. We think there is enough opposition to the latter that lawmakers will be able to avoid that scenario. The alternatives might necessitate the UK asking the EU for an extension of the Article 50 withdrawal deadline to allow for further negotiations, or even taking back notice to leave the EU (which would likely be 'Brexit delayed' rather than 'Brexit denied'). An extension, depending on the timeframe, could mean a longer period of uncertainty, but that still looks favourable relative to the UK crashing out of the EU without an agreement.

Brexit uncertainty continues to weigh on business sentiment. The UK's services PMI fell sharply in Q4, while its manufacturing counterpart performed a bit better thanks to stockbuilding in anticipation of potential border disruptions. GDP figures painted a slightly different picture, however, with manufacturing output tracking a Q4 decline while the services industry looks set for a moderate, if unimpressive, gain. So despite the recent deterioration in survey readings, it looks like GDP growth held steady at 0.3% in Q4. That pace of growth over the second half of the year was enough to keep unemployment close to 4%. A tight labour market is, in turn, putting upward pressure on wages with average weekly earnings growth hitting a new cycle high. It is those conditions that have the Bank of England maintaining their guidance that "gradual and limited" rate hikes will be needed to keep inflation on target. If the way forward on Brexit can be sorted out by March 29, and a 'no deal' scenario avoided, we expect the BoE will next raise rates in August.

…and waiting on a rebound in the euro area

Recent data have dashed hopes that euro area GDP would rebound from Q3's disappointing 0.2% increase, which was the slowest since 2014. Expectations rested on a pickup in Germany's industrial sector after temporary disruptions in the auto industry contributed to the country's GDP declining for the first time in several years. But November's soft industrial production figures, with weakness no longer confined to the auto sector, raised the prospect of another contraction in Q4. Other transitory factors reportedly exaggerated the decline, but recent deterioration in survey data (including in the services sector) also point to a slower pace of growth in the currency bloc's largest economy. And Germany is not the only country that has seen sentiment deteriorate. Disruptions from ongoing protests pushed France's PMI readings into contractionary territory in December. And while a budget deal with the EU might help boost economic activity in Italy early this year, it looks like Q4 was another soft quarter for growth. All told we expect another sub-par 0.2% GDP gain to close out 2018. That would leave growth for the year at 1.8%, down from 2017's decade-high 2.5% pace.

Slower activity over the second half of 2018 and weak sentiment heading into 2019 challenge our expectation that the ECB will begin raising their still-negative policy rate in the second half of this year. While a number of transitory issues conspired to weigh on euro area growth in 2018, we'll need to see confirmation of a return to trend growth (or stronger) in 2019. Labour market data provide some hope in that regard. The unemployment rate continued to drift gradually lower throughout 2018, suggesting the underlying pace of activity wasn't as weak as recent GDP figures indicate. And an improving labour market should keep wages on an upward trend—growth in compensation per employee hit a cycle high of 2.5% in Q3. That is an important indicator for the central bank, supporting the idea that core inflation won't be perpetually stuck at 1%. As long as economic and price trends are pointing to an eventual return to the ECB's inflation target, we think they'll be able to start the move toward non-negative policy rates this year. Markets, however, see that as a 2020 prospect.

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	2.00	2.25	2.25	2.50	2.50	2.50	2.50
Three-month	1.10	1.26	1.59	1.64	1.65	1.95	2.15	2.20	2.45	2.45	2.45	2.45
Two-year	1.78	1.91	2.21	1.86	2.00	2.30	2.40	2.40	2.55	2.50	2.50	2.50
Five-year	1.97	2.07	2.34	1.89	2.10	2.45	2.60	2.55	2.65	2.55	2.55	2.55
10-year	2.09	2.17	2.43	1.97	2.20	2.55	2.65	2.60	2.70	2.65	2.60	2.60
30-year	2.23	2.20	2.42	2.18	2.30	2.65	2.75	2.70	2.75	2.70	2.65	2.65
United States												
Fed funds**	1.75	2.00	2.25	2.50	2.75	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Three-month	1.73	1.93	2.19	2.45	2.65	2.90	2.90	2.90	2.90	2.90	2.90	2.90
Two-year	2.27	2.52	2.81	2.48	2.90	3.25	3.20	3.15	3.10	3.10	3.10	3.05
Five-year	2.56	2.73	2.94	2.51	2.95	3.30	3.30	3.20	3.20	3.20	3.15	3.10
10-year	2.74	2.85	3.05	2.69	3.05	3.40	3.40	3.30	3.25	3.25	3.20	3.15
30-year	2.97	2.98	3.19	3.02	3.25	3.60	3.60	3.50	3.45	3.40	3.35	3.30
United Kingdom												
Bank rate	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50
Two-year	0.82	0.72	0.82	0.75	0.80	0.85	1.10	1.15	1.30	1.40	1.45	1.55
10-year	1.34	1.28	1.57	1.27	1.50	1.70	1.85	2.00	2.10	2.15	2.20	2.20
Euro area												
Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	-0.10	0.00	0.00	0.00
Two-year	-0.59	-0.69	-0.55	-0.59	-0.50	-0.50	-0.40	-0.30	-0.10	0.10	0.25	0.25
10-year	0.50	0.31	0.47	0.25	0.40	0.45	0.65	0.80	0.90	0.95	1.00	1.00
Australia												
Cash target rate	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.75	2.00	2.00	2.00	2.00
Two-year	2.00	2.00	2.02	1.89	2.05	2.15	2.30	2.40	2.40	2.40	2.40	2.40
10-year	2.60	2.63	2.67	2.32	2.55	2.90	3.00	3.00	2.95	3.00	2.95	2.90
New Zealand												
Cash target rate	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
Two-year swap	2.21	2.14	2.02	1.96	2.05	2.15	2.15	2.15	2.15	2.15	2.15	2.15
10-year swap	3.06	3.02	2.89	2.64	2.95	3.25	3.20	3.15	3.10	3.10	3.05	3.00
Yield curve*												
Canada	31	26	22	11	20	25	25	20	15	15	10	10
United States	47	33	24	21	15	15	20	15	15	15	10	10
United Kingdom	52	56	75	52	70	85	75	85	80	75	75	65
Eurozone	109	100	102	84	90	95	105	110	100	85	75	75
Australia	60	63	65	43	50	75	70	60	55	60	55	50
New Zealand	85	88	87	68	90	110	105	100	95	95	90	85

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

Source: Reuters, RBC Economics Research

Central bank policy rate

%, end of period

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

Source: Bloomberg, Reuters, RBC Economics Research

Economic outlook

Growth outlook

% change, quarter-over-quarter in real GDP

	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4	2017	2018F	2019F	2020F
Canada*	1.7	2.9	2.0	1.1	1.2	2.2	1.9	1.7	2.0	1.7	1.7	1.6	3.0	2.0	1.7	1.8
United States*	2.2	4.2	3.4	2.5	1.6	2.6	2.2	1.8	1.8	1.8	1.7	1.5	2.2	2.9	2.4	1.9
United Kingdom	0.1	0.4	0.6	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.3	1.8	1.4	1.5	1.6
Euro area	0.4	0.4	0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.4	0.3	0.3	2.5	1.8	1.4	1.5
Australia	1.0	0.9	0.3	0.8	0.8	0.6	0.7	0.6	0.6	0.7	0.7	0.7	2.4	3.0	2.8	2.6

*annualized

Inflation outlook

% change, year-over-year

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

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

Inflation tracking

Inflation Watch

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	CPI ex food & energy[1]	Nov	0.1	1.7	1.7	1.8
United States	Core PCE[1,2]	Nov	0.1	1.9	1.5	1.8
United Kingdom	All-items CPI	Nov	0.3	2.3	2.8	2.6
Euro area	All-items CPI[1]	Dec	-0.3	1.6	1.2	1.9
Australia	Trimmed mean CPI[1]	Q3	0.4	1.8	N/A	N/A
New Zealand	All-items CPI	Q3	0.9	1.9	N/A	N/A

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

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

Currency outlook

Level, end of period

	Actuals				Forecast							
	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4
Canadian dollar	1.29	1.31	1.29	1.33	1.35	1.34	1.33	1.33	1.34	1.33	1.31	1.30
Euro	1.23	1.17	1.16	1.13	1.10	1.10	1.13	1.16	1.17	1.18	1.20	1.21
U.K. pound sterling	1.40	1.32	1.30	1.27	1.24	1.22	1.24	1.25	1.26	1.28	1.32	1.34
Chinese Renminbi	6.3	6.6	6.9	6.9	7.1	7.3	7.4	7.5	7.5	7.6	7.7	7.8
Japanese yen	106.3	110.8	113.7	114.0	117.0	119.0	122.0	125.0	124.0	123.0	121.0	120.0
Australian dollar	0.77	0.74	0.72	0.72	0.68	0.67	0.67	0.67	0.67	0.67	0.66	0.66

Canadian dollar cross-rates

	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4
EUR/CAD	1.59	1.53	1.50	1.50	1.49	1.47	1.50	1.54	1.57	1.57	1.57	1.57
GBP/CAD	1.81	1.73	1.68	1.69	1.67	1.64	1.65	1.66	1.69	1.71	1.73	1.75
CAD/CNY	4.86	5.04	5.32	5.17	5.26	5.41	5.56	5.64	5.60	5.71	5.88	6.00
CAD/JPY	82.4	84.3	88.1	85.7	86.7	88.8	91.7	94.0	92.5	92.5	92.4	92.3
AUD/CAD	0.99	0.97	0.93	0.96	0.92	0.90	0.89	0.89	0.90	0.89	0.86	0.86

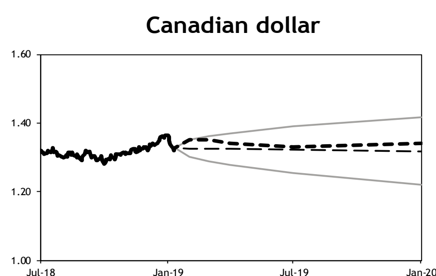
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

Source: Bloomberg, RBC Economics Research

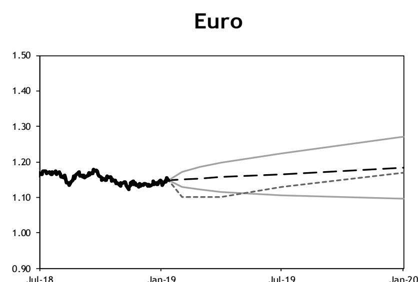
RBC Economics outlook compared to the market

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

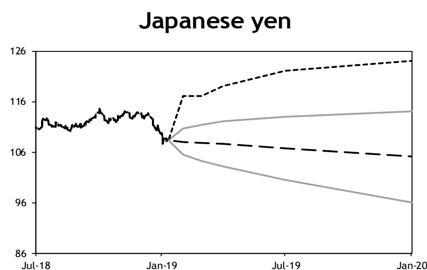
Canadian dollar



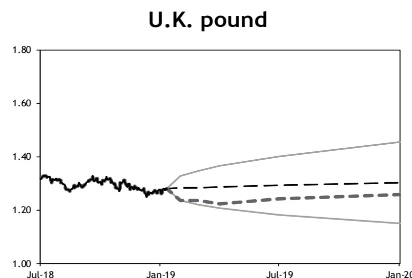
Euro



Japanese yen



U.K. pound

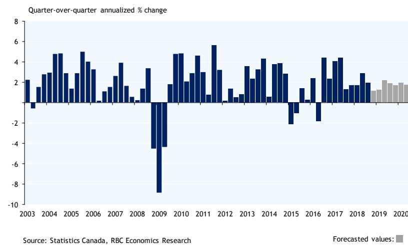


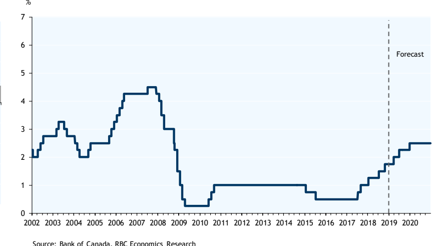
Central bank watch

Bank of Canada

Canadian GDP growth likely slowed to around 1% in Q4/18, and we expect a similar gain to start this year. A slowdown in the energy sector is largely to blame for this soft patch.

The BoC maintained their tightening bias but lower oil prices are causing a 'detour' on the path back to neutral interest rates. We don't think they'll pause for too long, and expect two rate hikes this year.

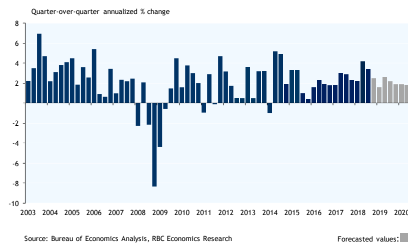


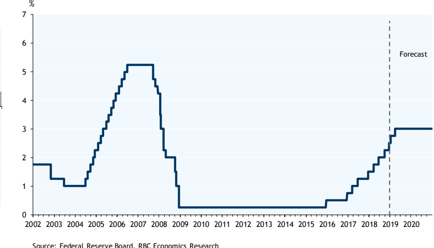


Federal Reserve

US GDP growth is slowing from last summer's impressive pace, but Q4/18 should come in at a solid 2.5%. We think 2019 will be another year of above-trend growth.

The Fed is sounding increasingly cautious, and with inflation remaining close to their objective, they look set to slow the pace of tightening in 2019. We now expect just two rate increases this year.

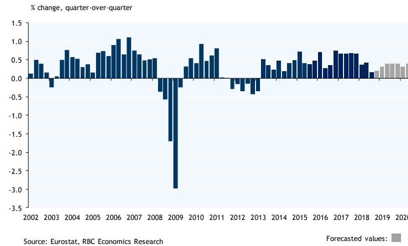


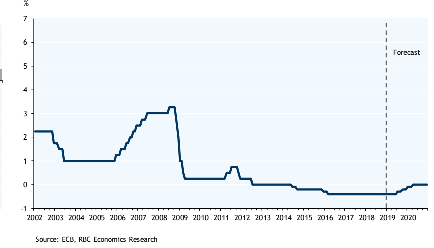


European Central Bank

Euro area growth remained subdued in late-2018 with Germany's industrial sector weakening further and sentiment remaining subdued in France and Italy. We expect another 0.2% gain in Q4/18.

The H2/18 slowdown is concerning for policymakers but the ECB can take some solace in positive labour market and wage trends. If activity picks up in H1/19 we should still see modest rate hikes this year.

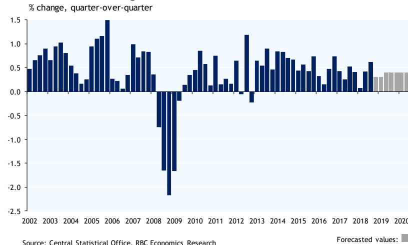


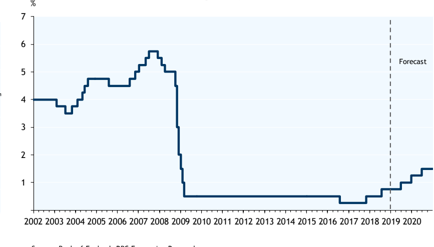


Bank of England

The UK's ugly PMI readings appear to have exaggerated the country's Q4/18 slowdown, though an expected 0.3% GDP gain is still hardly impressive.

Even if Brexit uncertainty is resolved in the near-term, the Bank of England will likely want to see some evidence that sentiment and growth are improving before they raise rates. We now think the next rate hike will be held off until August.

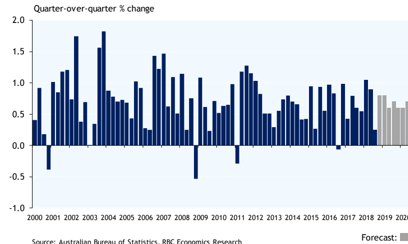


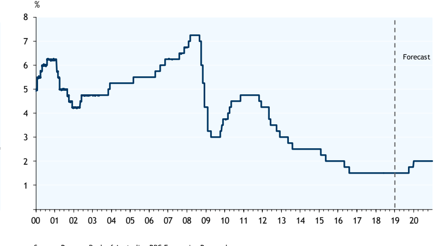


Reserve Bank of Australia

Australia's labour market continues to improve with solid job gains and falling unemployment. But under-employment measures still point to ample slack which should keep a cap on wage growth.

The RBA is in no rush to raise rates amid limited inflationary pressure. And with global central banks becoming a bit more cautious, it's hard to see the RBA coming off the sidelines anytime soon.

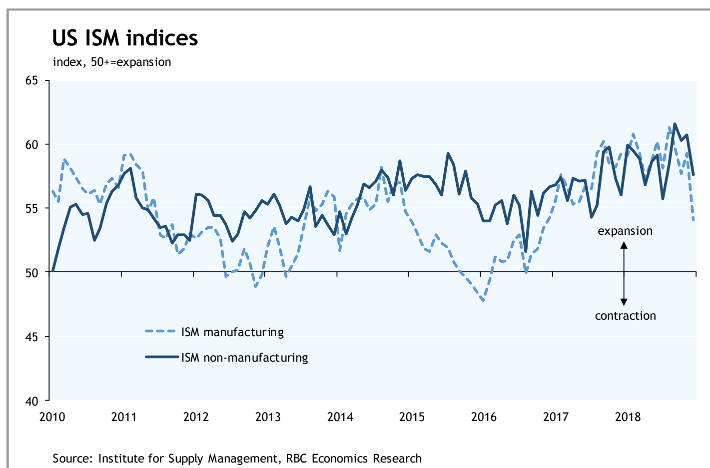


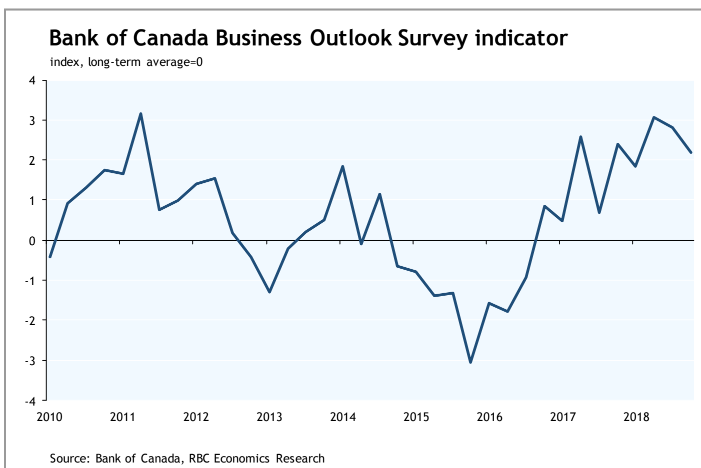


A look at sentiment indicators heading into 2019

US ISM manufacturing and non-manufacturing indices posted sizeable declines in December but remained solidly in 'expansionary' territory. The latter, in particular, points to strong growth continuing in much of the US economy.

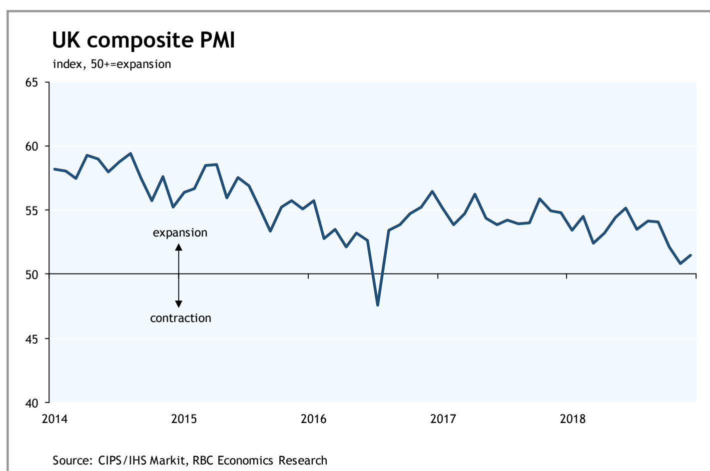
The Bank of Canada's latest *Business Outlook Survey* softened somewhat, particularly in energy-producing regions, but continued point to positive business sentiment. Investment and hiring intentions remained solid.

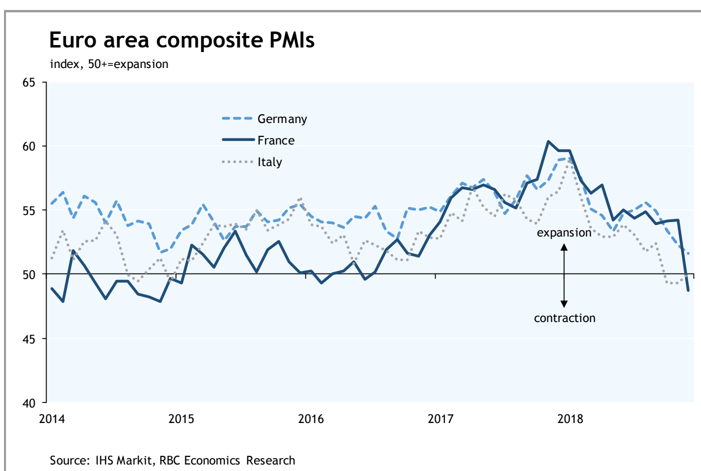




UK PMI readings deteriorated in Q4 with business sentiment hitting its weakest levels since the aftermath of the 2016 Brexit referendum. With key deadlines approaching, there is no shortage of uncertainty regarding how (and even when) the UK will exit the EU.

Q4 was an ugly one for euro area PMIs. Sentiment waned in Germany (not just in the industrial sector), while France and Italy's surveys are in contractionary territory due to labour disruptions and political uncertainty, respectively.





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