FINANCIAL MARKETS MONTHLY

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Inside…

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Oil, oil everywhere

The outlook for the world economy in 2015 is being dominated by concerns about the implications of the sharp drop in oil prices. On balance, lower energy prices are deemed to be a net positive for the global economy, with the IMF estimating that the recent drop in oil prices alone could provide up to a 0.7 percentage point boost to growth this year. At the same time, lower energy prices will put downward pressure on headline inflation rates, and oil-exporting countries will see energy companies' profits and governments' revenues fall. The uncertainty generated by the decline in oil prices shook investor confidence, thereby resulting in a downdraft in world equity prices in December 2014 and early January 2015, and declines in government bond yields, which benefitted from safe-haven flows and increased fears of deflation. Taking into account the unexpectedly strong rally in government bond markets, we lowered our yield forecasts for 2015. We expect the drop in yields to prove short lived as strengthening economic data prevent core inflation rates from declining. Furthermore, oil prices are likely partially to recover in the second half of 2015 as supply adjusts lower while energy demand is stable to higher.

Global measure of economic activity pulled back in December

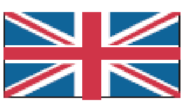
The global composite purchasing managers' index, a barometer of business activity, slipped in December 2014 contributing to the 2.1 percentage point drop in the fourth quarter's average to 53. This decline followed three successive increases in the global measure and is consistent with slower, but still firm, growth in the fourth quarter. Despite this slower end to 2014, the combination of lower energy costs and persistently low interest rates are teeing up for reacceleration in the pace of economic activity in 2015. Although headline inflation rates will fall due to sharply lower energy prices, core inflation is likely to be underpinned by stable to stronger growth and improving labour market conditions.

Central bank near-term bias

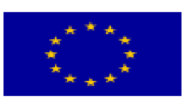
Three-months out, policy rate

↔ Even with less slack than previously estimated and underlying inflation having "edged up", the BoC's policy announcement and MPR on January 21 will likely maintain a cautious tone as the Bank incorporates the fall in oil prices into its forecast.

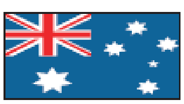
↔ The Fed altered its forward guidance (it will now be "patient" in beginning to normalize policy) but was careful to emphasize that the change did not indicate a shift in policy intentions.



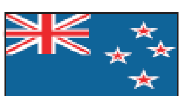
↔ UK inflation has fallen faster than expected, but with wage growth set to pick up in 2015, we expect the BoE will be comfortable hiking the Bank Rate in June even if spot inflation remains below target.



↔ In response to weak growth and the continued threat of deflation, we expect the ECB to announce a broadening of its asset purchase program to include sovereign debt later this quarter.



↔ Given continued concern about a lack of balanced growth in the economy, we expect the RBA will hold policy rates steady at an historic low at least during 2015.



↔ Near-trend growth in New Zealand will do little to increase inflationary pressure in 2015. This should leave the RBNZ's tightening cycle on hold throughout the year.

Highlights

▲ Concerns about the effect of volatility in the energy market on the global economy exerted downward pressure on equities...

▲ ...and government bond yields fell as investors ran to safer assets.

▲ The US economy entered 2015 on firm footing, with December's labour report showing the unemployment rate fell to a new post-recession low.

▲ The Fed intends to "look through" the decline in the headline inflation rate, as it reflects the drop in energy prices rather than any underlying easing in price pressures. A June rate hike is still expected.

US economy leaves 2014 in good standing...

The US economy likely posted the third consecutive quarter of above-potential growth to end 2014 with real gross domestic product (GDP) forecasted to expand at a 3.2% annualized pace. The is a step-down from the robust gains of 4.6% and 5.0%, respectively in the second and third quarters; however, it marks a significant improvement from the average 2.2% rise in 2013. The strong growth reflects a significant improvement in domestic demand, with consumer spending on track to post the fastest quarterly gain in four years accompanied by another rise in business investment.

The manufacturing and non-manufacturing Institute for Supply Management (ISM) indices showed a pullback in December; however, both remained at historically high levels on average in the fourth quarter. The indices' subcomponents denoted broad-based strength consistent not only with above-potential growth being sustained in the final quarter of the year but also implying that strong momentum carried over into 2015. This was echoed in the December labour data with non-farm payroll employment expanding by 252,000, which was slower than November's extraordinary 353,000 surge in hiring but still indicating labour market conditions continued to tighten. The unemployment rate inched downward to 5.6%, which was more than a full percentage point below December 2013 to mark a post-recession low.

.....and is set to lead the global economy in 2015

The sustained improvement in labour market conditions has yet to generate upward pressure on wages; however, the increase in employment was sufficient to bolster consumer spending activity in 2014. We expect wage growth to accelerate in 2015, as slack in the labour market gradually disappears. Furthermore, the unanticipated savings from lower gasoline prices will provide a lift to incomes in 2015 that by our estimate will add $86 billion to consumers' purchasing power. (See ***Accounting for the Impact of Lower Oil Prices on the Canadian Economy***, January 5, 2015). This combination should lift real consumption growth to 3.2% in 2015, which would be the quickest clip since before the recession. These conditions should also support a pickup in housing market activity even if interest rates start to move higher as we expect. In turn, the stronger growth momentum will increase business investment. Our forecast is that US GDP growth will average 3.5% in 2015, a percentage point faster than 2014's 2.5% pace.

Inflation rates to diverge

The strengthening in economic activity will support underlying price pressures in 2015, and we expect the core consumer price index (CPI) measure to trade around 2.0%. The headline rate conversely will be pushed downward by sharply lower energy prices, and we are projecting an average increase of just 1.1% in 2015. Our assumption that the per-barrel price of West Texas Intermediate (WTI) oil will recover in the second half of 2015, as supply adjusts lower, is consistent with the headline inflation rate bottoming in the middle of 2015. On average, we look for the price of WTI oil to be $65.00/barrel in 2015 and $74.00/barrel in 2016, markedly above sub-$50.00/barrel currently. Despite the prospect of headline inflation falling, survey data show longer-term inflation expectations have held steady. The University of Michigan's survey of expected inflation for the next five years stood at 2.8% in December, thereby matching the average of the previous year.

Fed to look through transitory effect of falling energy prices

In December, US Federal Reserve Chair Yellen suggested that as in the past, policy makers view the depressing effect of energy prices on the headline inflation rate as a transitory factor that will not influence inflation expectations. The projections provided at the meeting showed the headline and core personal consumption expenditure (PCE) inflation measures forecasted to be between 1.7% and 2.0% in 2016 with the risks to the economy and labour market outlook remaining "nearly balanced". The Fed made some tweaks to the language regarding its forward policy guidance, but otherwise, the statement was consistent with the previously articulated plan of a gradual withdrawal of policy support. We expect that underlying economic conditions will support the Fed raising the policy rate in June 2015.

For Canada's economy, oil price drop is more complicated

The sharp and persistent drop in oil prices ignited debate about the implications for Canada's economic outlook. The Bank of Canada, in its December statement, said that lower oil and other commodity prices would "weigh" on the economy with the Governor later specifying that a 0.3 percentage point hit to 2015 growth was likely. A more detailed assessment will be provided in the Bank's upcoming *Monetary Policy Report*. To be sure, the drop prompted announcements by energy companies of cutbacks to their investment spending plans for 2015. Given the heft of investment by oil and gas companies in recent years, this will have a meaningful, negative effect on this component of GDP. Additionally, with energy being a major export, the drop in prices means that Canadian purchasing power of imported goods and services will diminish, thereby leading to weaker corporate profits and government revenues.

Benefits of lower energy prices will offset negatives

Our assessment is that the negative factors listed above will be offset by the positive effect that lower energy prices will have on the US economy and domestic consumption. As discussed earlier, the drop in gasoline prices will provide US consumers with an unanticipated boost to their disposable income, much of which, we expect, they will spend on other goods and services. US businesses similarly will benefit from the reduction in the cost of production, which will support investment spending in industries outside of energy. In turn, demand for Canadian exports is likely to strengthen, abetted by the weakening in Canada's currency in recent months providing additional incentive to US buyers of Canadian products. As in the US, lower fuel costs will provide consumers and businesses (outside energy) with funds to spend and invest. In summation, we expect the drop in oil prices to have very little effect on overall growth in Canada in 2015, although this masks divergent performances among the provinces (see ***Provincial Outlook*, December 2014**).

Slow drip of fourth-quarter data point to steady growth

Canada's economy started the fourth quarter on a firm note with October real GDP posting a stronger than expected 0.3% gain. This built encouragingly on September's robust 0.4% rise and teed up for the economy to post another above-potential growth rate in the fourth quarter. Subsequent data were mixed, however, and on balance support our forecast for growth of 2.7% in the final quarter of 2014. Beyond 2014, we project the above-potential pace to be maintained in 2015, with the weight from lower oil prices on investment offset by stronger activity elsewhere as discussed above.

We expect headline inflation will continue to decline following the 0.4 percentage point drop to 2.0% in November although anticipate that the core measure will remain around the 2% target reflecting the reduction in the economy's spare capacity over 2014.

In early December, the Bank of Canada issued a somewhat less dovish statement pointing to stronger exports, investment, and employment as laying the groundwork for a return to "balanced and self-sustaining growth." The Bank also suggested that the output gap at the end of the third quarter was smaller than it had estimated in October; however, the downside risks associated with the decline in energy prices prevented the Bank from making any substantive changes to the policy outlook. In the near term, a falling headline inflation rate will give the Bank some cover to avoid talking about the eventual rise in interest rates; however, as growth continues at an above-potential pace and labour markets tighten, the more difficult this will become. Our assessment that Canada's economy will continue to grow at an above-potential pace supported by strong exports and rising investment by companies outside the energy sector should result in the output gap being fully eliminated in the middle of 2015, and we expect the Bank to raise the overnight rate soon thereafter.

Highlights

▲ The Bank of Canada thinks lower energy prices will "weigh" on the economy, while our analysis suggests that any weakening in investment will be offset by stronger US demand for Canadian exports and firm consumer spending.

▲ Recent data point to another quarter of above-trend growth in the fourth quarter of 2014. We expect the strong growth momentum to be maintained early this year, thereby resulting in a closure of the output gap in the mid-2015. This will likely result in the Bank of Canada raising the policy rate late in the third quarter.

Highlights

▲ We expect the ECB will announce sovereign debt purchases in the first quarter of 2015.

▲ For the UK, 2014 was a year of strong growth and significant improvement in the labour market.

▲ We expect both the RBA and RBNZ will hold policy rates steady throughout 2015.

'Grexit' redux?

Euro area growth looks to have remained lacklustre at the end of 2014. Purchasing Managers' Index (PMI) readings improved slightly between November and December but remained below levels that prevailed earlier in 2014. Recent surveys are consistent with our forecast for a second consecutive quarter of 0.2% growth in the fourth quarter, which would leave the 2014 annual gain at just 0.8%. We expect slightly faster but still modest expansion of 1.0% in 2015 as the economy benefits from currency depreciation, lower commodity prices, stronger US growth, and less drag from fiscal consolidation. Euro area inflation slipped into negative territory in December with a -0.2% year-over-year reading, down from 0.3% in November, although the decline was largely due to lower energy prices with core inflation managing to edge upward to 0.8%. The negative headline print should not change the European Central Bank's (ECB) thinking, as it defines deflation as "a broad-based, self-fulfilling, self-feeding fall in prices." Given the slow economic recovery and continued threat of deflation, we expect the ECB will broaden the remit of its asset purchase program to include sovereign debt, with an announcement likely to be made in the first quarter of 2015. Purchasing a broader array of both private- and public-sector assets should allow the ECB to increase the pace at which its balance sheet grows and ultimately make its €3 trillion balance sheet target easier to achieve. Political risk has increased as fears of a Greek exit from the euro area resurfaced following lawmakers' failure to choose a president, which triggered a snap election that will be held January 25, 2015. There is concern that a new government will seek to renegotiate Greece's bailout terms and restructure Greek debt. This has led to an increase in Greek bond yields, but unlike previous 'Grexit' episodes, yields in other peripheral economies have not followed suit, as the prospect of quantitative easing and reduced contagion risk has kept rates low in Spain, Italy, and Portugal.

UK economy losing some momentum at the end of a strong year

The UK economy appeared to lose a degree of momentum as 2014 came to a close with PMI readings falling across all three major sectors (manufacturing, services, and construction) in December, thereby pushing the composite measure to a 19-month low. The surveys remain consistent with further expansion in activity and support our expectation that growth continued at an above-trend pace in the quarter. The labour market also lost some of its steam, with the official unemployment rate holding steady at 6.0% for a third consecutive month in October following consistent monthly declines earlier in 2014, which brought the unemployment rate down by a cumulative 1.2 percentage points. Those prior employment gains seem to be finally showing up in wages with ex-bonus pay growth picking up to a two-year high in October, albeit at a modest pace. Headline inflation fell to 1.0% year over year in November and is expected to moderate further as lower oil prices weigh on an already-benign core inflation rate (1.2% in November). We expect faster wage growth in 2015 will provide some support to underlying price pressure, but our forecast assumes headline inflation will remain below the Bank of England's (BoE) 1-3% target range in the first half of 2015. Notwithstanding a fairly benign inflation outlook, we expect continued above-trend growth and further absorption of labour market slack will prompt the BoE to begin gradually tightening monetary policy this year. Given political uncertainty with a general election expected in May, our forecast assumes the BoE will hold off until June before making its first rate hike.

Antipodean rates on hold in 2015

The Australian economy continues to undergo a slow transition from mining-driven investment to non-resource activity. We expect further difficulty achieving balanced growth will keep the economy expanding at a slightly below-trend pace in 2015, or little changed from 2014. A stagnant labour market should leave employment costs subdued, helping keep core inflation comfortably in the lower half of the Reserve Bank of Australia's (RBA) 2-3% target range in the coming quarters. Given this outlook, we expect the RBA will keep rates steady at least in 2015. There is some risk of an easing bias or rate cut, particularly if the stubbornly high currency fails to weaken. In New Zealand, we expect the recovery will lose some momentum in 2015, which along with fairly strong supply-side growth, should keep inflation below 2% for 2015. As such, our forecast assumes the Reserve Bank of New Zealand (RBNZ) will also be on hold in 2015.

Interest rate outlook

%, end of period

	Actuals				Forecast							
	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4
Canada												
Overnight	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.50	1.75	2.00	2.25	2.75
Three-month	0.90	0.94	0.92	0.91	1.10	1.10	1.35	1.60	1.90	2.15	2.40	2.75
Two-year	1.07	1.10	1.13	1.01	1.10	1.35	1.75	2.00	2.25	2.45	2.60	2.90
Five-year	1.71	1.53	1.63	1.34	1.45	1.75	2.05	2.30	2.70	2.85	3.00	3.20
10-year	2.46	2.24	2.15	1.79	1.95	2.30	2.50	2.70	3.10	3.30	3.40	3.55
30-year	2.96	2.78	2.67	2.34	2.45	2.70	2.90	3.05	3.50	3.60	3.75	3.90
United States												
Fed funds	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.50	2.00	2.50	3.00
Three-month	0.05	0.04	0.02	0.04	0.10	0.40	0.65	0.90	1.40	1.90	2.40	2.80
Two-year	0.45	0.47	0.58	0.67	0.75	1.10	1.60	2.00	2.25	2.50	2.80	3.20
Five-year	1.74	1.62	1.78	1.65	1.65	1.95	2.20	2.50	3.00	3.15	3.30	3.50
10-year	2.73	2.53	2.52	2.17	2.25	2.65	2.90	3.10	3.55	3.70	3.85	4.00
30-year	3.55	3.34	3.21	2.75	2.85	3.25	3.50	3.75	4.10	4.25	4.35	4.50
United Kingdom												
Bank rate	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.25	1.50	1.50	1.75
Two-year	0.71	0.87	0.84	0.45	0.65	0.75	1.00	1.25	1.40	1.60	1.95	2.15
10-year	2.73	2.68	2.43	1.76	1.80	2.20	2.40	2.50	2.75	2.90	3.10	3.30
Eurozone												
Refi rate	0.25	0.15	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Two-year	0.17	0.03	-0.07	-0.11	-0.10	-0.10	-0.10	-0.10	0.00	0.00	0.10	0.20
10-year	1.57	1.25	0.95	0.54	0.75	0.80	0.90	1.10	1.20	1.35	1.50	1.65
Australia												
Cash target rate	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
Two-year	2.78	2.80	2.61	2.19	2.30	2.40	2.40	2.60	2.60	2.70	2.75	2.75
10-year	4.08	4.00	3.48	2.81	3.00	3.35	3.60	3.70	4.15	4.30	4.35	4.50
New Zealand												
Cash target rate	2.75	3.25	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.75	4.00	4.00
Two-year swap	4.01	3.90	4.04	3.54	3.75	3.75	3.90	3.90	4.00	4.25	4.25	4.25
10-year swap	4.62	5.00	4.53	3.67	4.50	4.70	4.90	5.00	5.10	5.30	5.40	5.60
Yield curve												
Canada	139	114	102	78	85	95	75	70	85	85	80	65
United States	228	206	194	150	150	155	130	110	130	120	105	80
United Kingdom	202	181	159	131	115	145	140	125	135	130	115	115
Eurozone	140	122	102	65	85	90	100	120	120	135	140	145
Australia	130	120	87	62	70	95	120	110	155	160	160	175
New Zealand	61	110	49	13	75	95	100	110	110	105	115	135

* Two-year/10-year spread in basis points

Source: Reuters, RBC Economics Research

Central bank policy rate

%, end of period

		Current	Last	
United States	Fed funds	0.0-0.25	1.00	December 16, 2008
Canada	Overnight rate	1.00	0.75	September 8, 2010
United Kingdom	Bank rate	0.50	1.00	March 5, 2009

		Current	Last	
Eurozone	Refi rate	0.05	0.15	September 10, 2014
Australia	Cash rate	2.50	2.75	August 7, 2013
New Zealand	Cash rate	3.50	3.25	July 24, 2014

Source: Bloomberg, Reuters, RBC Economics Research

Economic outlook

Growth outlook

% change, quarter-over-quarter in real GDP

	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4	2014F	2015F	2016F
Canada*	1.0	3.6	2.8	2.7	3.0	2.7	2.3	2.2	2.0	1.9	1.9	2.1	2.5	2.7	2.1
United States*	-2.1	4.6	5.0	3.2	3.3	3.1	3.0	2.9	3.0	2.8	3.0	2.7	2.5	3.5	2.9
United Kingdom	0.6	0.8	0.7	0.6	0.6	0.5	0.8	0.6	0.6	0.5	0.5	0.4	2.6	2.6	2.4
Euro Area	0.3	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.8	1.0	1.4
Australia	1.0	0.5	0.3	0.8	0.8	0.6	0.8	0.9	0.8	0.7	0.8	0.7	2.8	2.7	3.1
New Zealand	0.9	0.7	1.0	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5	3.2	2.7	2.3

*Seasonally adjusted annualized rates

Inflation outlook

% change, year-over-year

	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4	2014F	2015F	2016F
Canada	1.4	2.2	2.1	1.9	1.2	0.9	1.0	1.6	2.3	2.3	2.2	2.0	1.9	1.1	2.2
United States	1.4	2.1	1.8	1.2	0.8	0.8	1.1	1.9	2.3	2.2	2.2	2.2	1.6	1.1	2.2
United Kingdom	1.7	1.7	1.5	1.0	0.6	0.9	1.2	1.6	1.8	1.9	2.0	2.0	1.5	1.1	1.9
Eurozone	0.7	0.6	0.4	0.2	0.4	0.6	0.6	1.0	1.1	1.1	1.1	1.1	0.4	0.6	1.1
Australia	2.9	3.0	2.3	2.1	2.3	2.5	2.7	2.8	2.8	2.8	2.7	2.6	2.6	2.6	2.8
New Zealand	1.5	1.6	1.0	1.2	1.5	1.6	1.7	1.8	1.8	1.9	2.0	2.0	1.3	1.7	1.9

Source: Statistics Canada, Bureau of Labor Statistics, Bank of England, European Central Bank, Reserve Bank of Australia, Reserve Bank of New Zealand, RBC Economics Research

Inflation tracking

Inflation Watch

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	Bank of Canada core CPI[1]	Nov.	0.0	2.2	1.9	2.4
United States	Core PCE[2]	Nov.	0.0	1.4	1.3	1.6
United Kingdom	All-items CPI	Nov.	-0.2	0.9	0.7	1.1
Eurozone	All-items CPI	Nov.	-0.1	0.3	0.2	0.3
Australia	Trimmed mean	Q3	0.4	2.5	N/A	N/A
New Zealand	CPI	Q3	0.3	1.0	N/A	N/A

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

Source: Statistics Canada, US Bureau of Labor Statistics, Bank of England, European Central Bank, Reserve Bank of Australia, Reserve Bank of New Zealand, RBC Economics Research

Currency outlook

Level, end of period

	Actuals				Forecast							
	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4
Canadian dollar	1.16	1.17	1.12	1.15	1.16	1.17	1.17	1.18	1.19	1.20	1.21	1.22
Euro	1.20	1.19	1.26	1.23	1.20	1.19	1.18	1.17	1.15	1.13	1.11	1.10
U.K. pound sterling	1.54	1.51	1.62	1.58	1.54	1.51	1.46	1.43	1.44	1.45	1.46	1.49
New Zealand dollar	0.87	0.88	0.78	0.77	0.76	0.75	0.74	0.74	0.73	0.72	0.71	0.71
Japanese yen	103.2	101.3	109.7	120.0	123.0	126.0	129.0	132.0	129.0	126.0	123.0	120.0
Australian dollar	0.93	0.94	0.87	0.83	0.82	0.81	0.80	0.80	0.79	0.78	0.77	0.77

Canadian dollar cross-rates

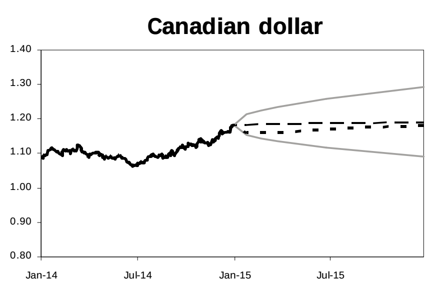
	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4
EUR/CAD	1.52	1.46	1.41	1.41	1.39	1.39	1.38	1.38	1.37	1.36	1.34	1.34
GBP/CAD	1.84	1.83	1.82	1.81	1.78	1.76	1.70	1.68	1.71	1.74	1.77	1.81
NZD/CAD	0.96	0.93	0.87	0.89	0.88	0.88	0.87	0.87	0.87	0.86	0.86	0.87
CAD/JPY	93.4	95.0	97.9	104.3	106.0	107.7	110.3	111.9	108.4	105.0	101.7	98.4
AUD/CAD	1.02	1.01	0.98	0.95	0.95	0.95	0.94	0.94	0.94	0.94	0.93	0.94

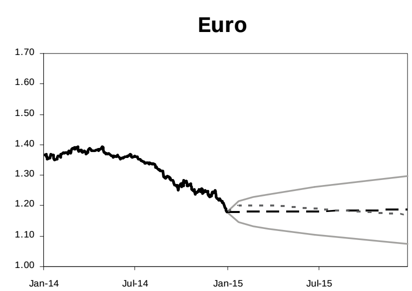
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

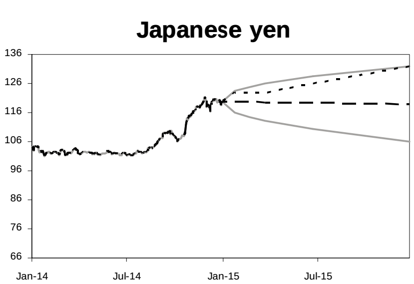
Source: Bloomberg, RBC Economics Research

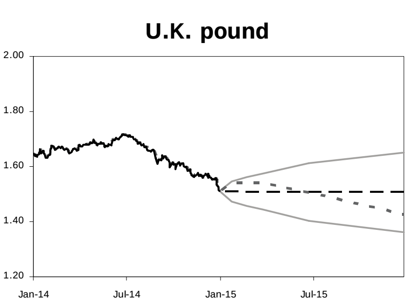
RBC Economics outlook compared to the market

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.







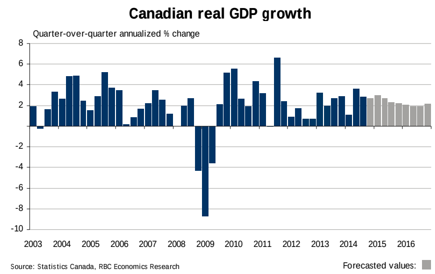


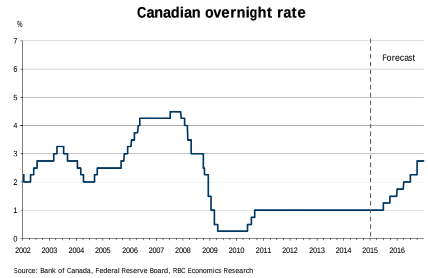
Central bank watch

Bank of Canada

A solid 0.3% increase in October GDP supports our expectation that growth remained above trend at 2.7% in Q4, slightly faster than the BoC's latest assumption.

The BoC's updated forecasts in the January MPR should clarify the expected effect of lower oil prices (RBC assumes the recent slide will have a minor, positive effect on overall GDP growth). This will be an important determinant of how quickly it sees economic slack diminishing this year.

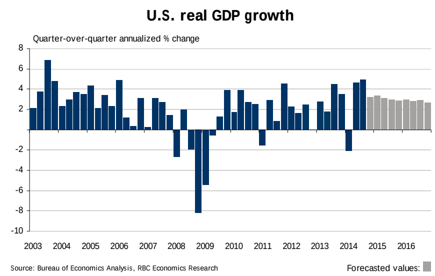


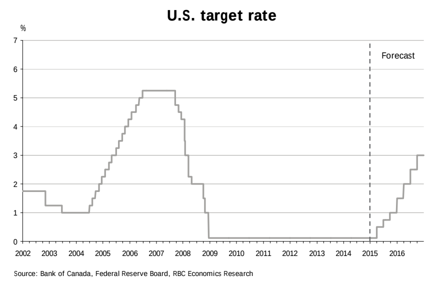


Federal Reserve

We revised upward our Q4 growth forecast to 3.2%, which would build on stellar gains in the previous two quarters.

The Fed's updated forward guidance (which implies steady rates for the "next couple of meetings") remains consistent with our view that the Fed will begin to normalize policy in June.

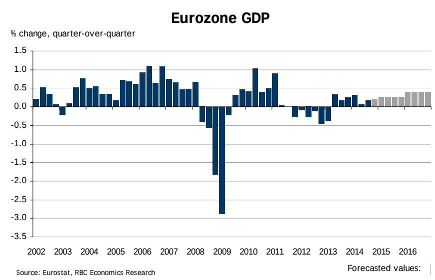


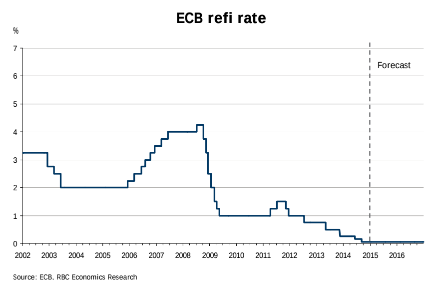


European Central Bank

We expect euro area growth of 0.2% in Q4 will cap off a lacklustre 2014. Activity is expected to pick up modestly in 2015, but the ECB is likely more concerned about the weak inflation outlook.

We expect the ECB will expand its asset purchase program to include sovereign debt, thereby making it easier to achieve its balance sheet target (and at a faster pace).

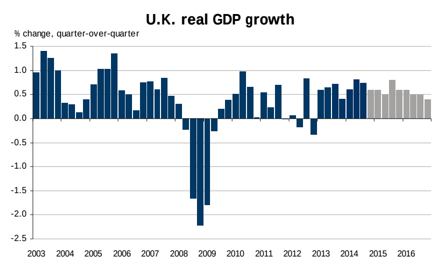


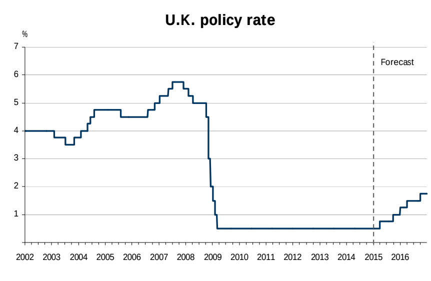


Bank of England

December's PMI readings pointed to some moderation heading into 2015, which is consistent with our expectation that growth will be closer to (but slightly above) trend in H1/15.

Inflation is set to fall below 1% in the coming months, although indications that wages are starting to pick up (as we expect) should open the door to the BoE raising the Bank Rate in June.

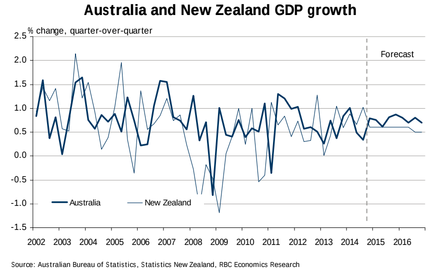


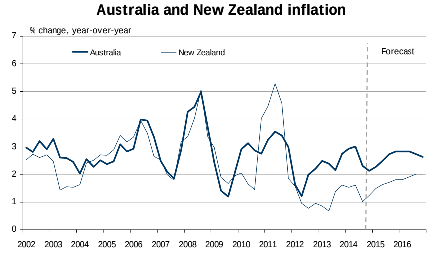


Australia and New Zealand

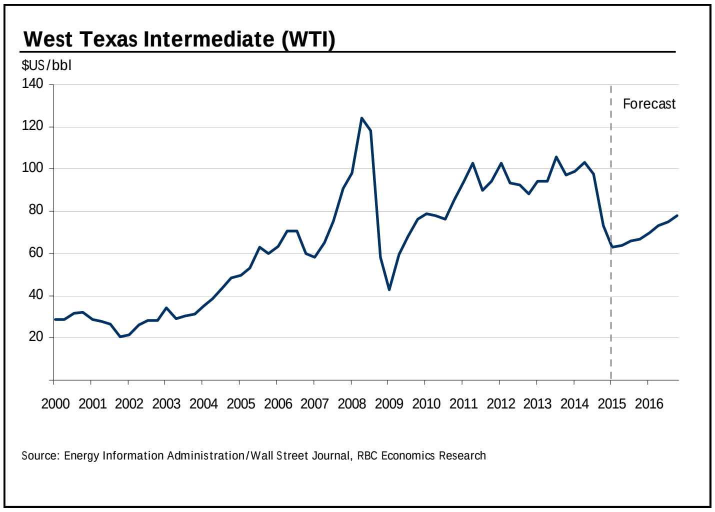
Sub-trend growth and a stagnant labour market should keep the RBA on hold at least during 2015. Without further moderation in the stubbornly high exchange rate, a rate cut could be on the table.

Inflation was weaker than expected in the second half of 2014, and near-trend growth this year would provide little upward pressure. This should keep the RBNZ's tightening cycle on hold in 2015.

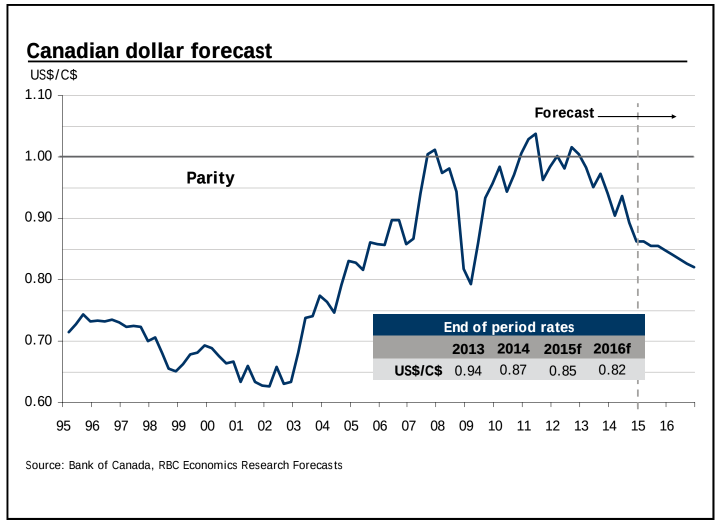




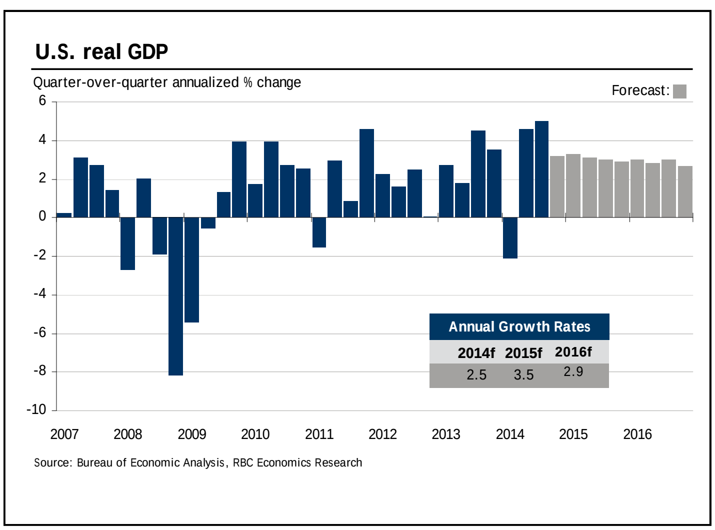
The drop in oil prices reflected both supply and demand pressures. As supply pressures ease, we expect to see oil prices recover some of the ground lost since mid-June 2014.



The weakening in the Canadian dollar is in part related to slumping oil prices but also reflects the broad-based strengthening in the US dollar.



The robust gains in economic growth in recent quarters and rising expectations that Fed rate hikes are in the pipeline have underpinned the US dollar’s recovery and…



...boosted demand for Canadian exports.