ECONOMICS | **RESEARCH**

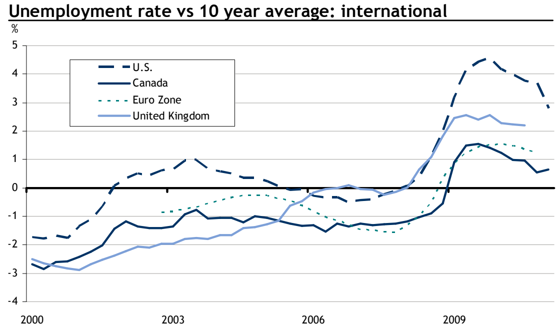
# ECONOMIC AND FINANCIAL MARKET OUTLOOK

June 2011

**Real GDP growth**

| | Canada (CAD) | United States (USD) | United Kingdom (GBP) | Euro Zone (EUR) |
|---|---|---|---|---|
| Latest GDP growth rate Q/Q AR | +3.9% (Q1 2011) | +1.8% (Q1 2011) | +2.0% (Q1 2011) | +3.4% (Q1 2011) |
| Latest vs pre-recession peak | +1.9% (Q3 2008) | +0.6% (Q2 2008) | -4.1% (Q1 2008) | -2.1% (Q1 2008) |
| Latest versus recession trough | +5.7% (Q2 2009) | +4.9% (Q2 2009) | +2.5% (Q3 2009) | +3.5% (Q2 2009) |

**Unemployment rate vs 10 year average: international**




Source: Bureau of Labor Statistics, Statistics Canada, Statistical Office of the European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## Taking Stock

- World economies are still growing.
- Global turmoil causes concerns about sustainability.
- Monetary policy still supportive, and central banks remain cautious about reducing stimulus.
- Inflation pressures are benign outside food and energy sectors.

## Risks abound but world economy soldiers on

Nervousness about the longevity of the economic expansion is evident in the violent reaction in financial markets to each data release. To be sure, data have been volatile; however, the underlying trends remain consistent with a global economy that is in expansion mode. Reviewing the performance of four of the major economies that RBC covers shows that Canada's economy has been the star performer. This is not to say that the US, UK or Euro zone economies have not posted impressive gains relative to their lows during the economic downturn. Beside Canada, however, the only economy that has regained all output lost during the recession is the US where the level of real GDP stands 0.6 % above its pre-recession peak. The UK and Euro zone economies still have to make up some ground to recover the full output lost during the recession. Based on our forecasts, both will fully recoup these losses, with Euro zone back in the black in the second quarter of 2012 and the UK by year-end 2012.

## Running with excess capacity

Real GDP output is growing although these economies are still running with large output gaps. The amount of excess capacity shows up in fairly elevated unemployment rates with the most significant labour market slack evident in the US where the unemployment rate stands almost 3 percentage points above its 10-year average. Canada, once again, is the economy that is furthest along in terms of returning to pre-recession conditions. As of January 2011, all jobs lost during the recession were recovered with an additional 111,000 more employed by April. Canada's unemployment rate fell to 7.6% in April although it remains above its 10-year average by 0.5 percentage points.

## Elevated commodity prices pump up headline inflation rates

The slack within these economies have, to differing degrees, limited upward pressure on core price inflation, which excludes both food and energy prices. In Canada, the headline inflation rate stands at 3.3%, above the upper end of the Bank of Canada's target range. Core inflation remains quiescent, however. Central bankers are watching the gyrations in inflation with most giving leeway to moves in the headline rates above their inflation targets, because they consider these increases to be transitory and likely to reverse next year when commodity prices stop rising.

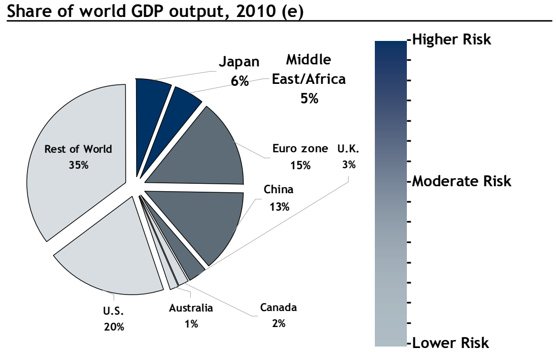
## Policy remains supportive for growth

Persistent excess capacity and generally high unemployment rates mean that central banks are feeling limited urgency to reduce monetary policy stimulus. The European Central Bank raised the policy rate by 25 basis points in April

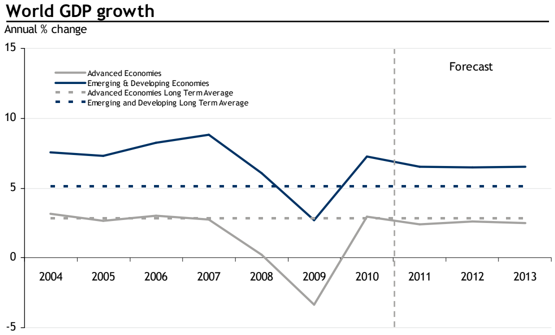
Headline inflation rate: international

Source: Statistics Canada, Bureau of Labor Statistics, RBC Economics Research

Share of world GDP output, 2010 (e)

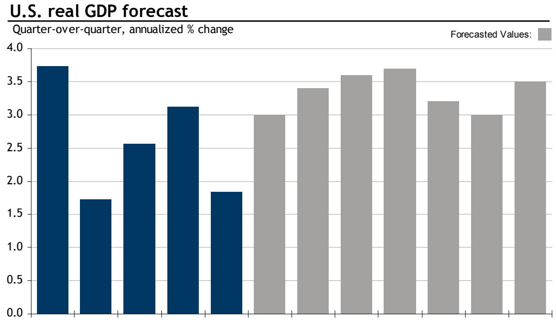



World GDP growth



Source: IMF, RBC Emerging Markets, RBC Economics Research

U.S. real GDP forecast



Source: Bureau of Economic Analysis, RBC Economics Research

to stave off inflation expectations; however, given the myriad of fiscal challenges faced by the area, further reductions to monetary policy support will be slow to materialize. Similarly, the Bank of Canada's approach has been to reduce policy stimulus very gradually, and after 75 basis points of tightening implemented between June and September 2010, the Bank has held the overnight rate steady at 1.00%.

Part of the rationale for this slow moving approach to the unwinding of policy stimulus stems from the large and growing list of downside risks to the global economic outlook. Our chart (second at left) attempts to grade the risks to the outlook; however, this list is constantly in flux. Furthermore, risks associated with the rise in energy costs have negative connotations for some areas of the global economy and net benefits for others. There are two main channels by which the rise in energy affects the outlook. The first is through the reallocation of resources with both businesses and households having a finite amount of capital to spend, and a bigger bite coming from energy consumption necessarily means less spending on other items. In countries like the US, the hit to the economy is usually to the downside, while in Canada, the support from higher energy prices for producers largely offsets the damage to the pocketbooks of households and businesses. Secondly, the prospect of ongoing increases in energy prices may weigh on confidence causing households and businesses to pull back on spending.

## Two-speed global economy

Data support the view that the emerging economies will expand at a faster pace than the advanced economies. Many advanced economies remain bogged down by debt, either private or public—and in some cases both. The debt dynamics in the advanced economies are consistent with a below-average recovery period, while the emerging economies are expected to maintain strong momentum with an average growth rate of 6.5%, which is above the long-term mean of 5.1%. Growth in the advanced economies is forecasted to average 2.5%, which is shy of the long-term average pace of 2.8% per year.

## US economy moves into expansion

The US economy moved into the expansion phase of the business cycle in the final quarter of 2010. By the end of the first quarter of 2011, real GDP output exceeded the pre-recession peak level by 0.6%. The pace of growth in the first quarter was disappointing because real GDP expanded at a moderate 1.8% annualized pace, which was much slower than the 2.9% average increase in previous two quarters. There were special factors that weighed on growth in early 2011 that explain much of the unanticipated slowing. Poor weather conditions dampened spending by both households and businesses with the pace of business fixed investment dropping to 2.1% from 6.8% in the previous quarter. Consumption also slowed with the weather-related pullback exacerbated by a moderation in spending after the surge recorded in the final quarter of 2010. Another factor that tempered growth in the quarter was a sharp drop in government spending on defence, which posted the swiftest pace of decline since late 2005. As these one-off factors reverse, growth in the US economy is forecast to reaccelerate with real GDP growing at a 3.0% pace in the second and 3.4% in the third quarter of 2011. These growth rates are lower than in our previous forecast given the pause in hiring in May and more cautious outlook for other global economies. For the year, the US economy is now projected to grow by 2.7% with the momentum rising in 2012 and real GDP expanding by 3.4%.

## Financial Conditions are Easy

Measures of financial conditions in the US show an easier stance since the Fed announced that it was ready to do another round of US Treasury bond purchases or QE2 as it is known. The financial conditions index is a compilation of information tracking interest rates, the currency, and stock markets combined with readings on lending standards. The fact that a comprehensive measure of financial conditions made up of 100 variables showed a steady easing after Fed Chairman Bernanke mentioned another round of bond purchases in an August 2010 speech was deemed by the central bank as evidence of success of the QE2 program. Furthermore, the US trade-weighted dollar lost 8% since August 27, 2010. While long lags exist between movements in the trade-weighted currency and trade volumes, the persistent decline in the US dollar sets up for the drag on the pace of growth from the trade sector to fade away as exports rise more rapidly than imports.

## Tax cuts and job gains to support consumer revival

The US consumer finally showed signs of life in late 2010 when spending increased at the fastest pace since late 2006. Spending slowed in early 2011; nevertheless, the combination of payroll tax cuts boosting purchasing power and an improving labour market will likely see US consumers pull out their wallets again. In 2011, our forecast assumes that almost three-quarters of the 2.7% rise in real GDP will be attributable to consumer expenditure. This amount will take up the slack from a slowing in business inventory investment that did much of the heavy lifting in 2010. US companies have started to rebuild their labour force with private non-farm payroll employment increasing by 908,000 so far this year. Job growth between February and April was robust although the May report showed a slowing in the pace of hiring. The unemployment rate, however, remains historically high at 9.1% as of May 2011, and although we expect a gradual decline to 8% during the next 18 months, the rate will remain significantly above its long-term average.

## Companies have the means and the motivation

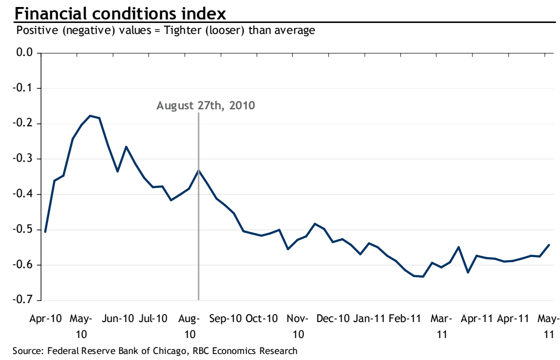
US companies had a good year in 2010 with pre-tax profits rising 29% above the 2009 level. Some of these gains have been put to work as business investment in equipment and software increased at double-digit rates in four of the past five quarters. The majority of this spending was on information technology. We expect businesses to continue to spend on capital goods, therein taking advantage of affordable borrowing conditions and using their accumulated cash holdings. Construction spending, be it residential or non-residential, is weak, and we expect this to be the part of the US economy that will continue to languish in 2011. Housing market activity remains lacklustre, and prices are declining again. We expect the pace of housing starts to remain historically low in 2011 with a 2012 recovery likely, if labour market conditions improve and interest rates remain historically low as we expect.

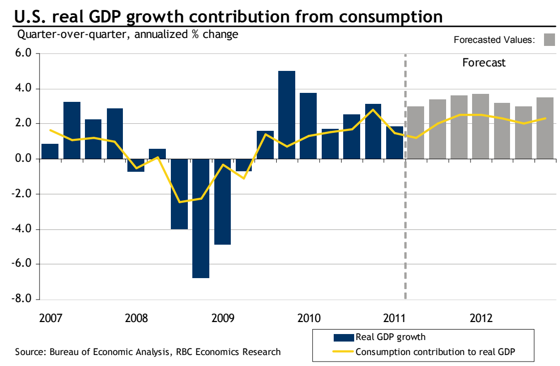
## US core inflation is low

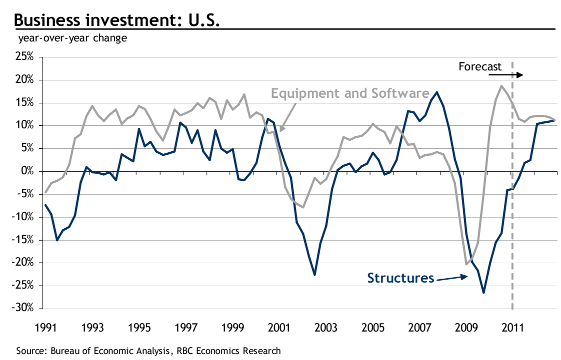
The US core inflation rate, which excludes the highly volatile food and energy components, stands at 1.3%, more than double its recent low but still well below its long-term average of 2.8%. The headline rate stands at 3.2% reflecting the effect of high commodity prices, which is likely to prove transitory. Our forecast is that the headline inflation rate will fall below 2% in 2012 as energy prices stabilize. The core inflation rate is more representative of underlying price pressures, and while some components, like air fares and owners' equivalent rent, have picked up, most other categories have shown limited movement. Against a backdrop of significant slack in the economy, particularly in the labour market, we expect core price inflation to be limited. Our analysis shows that the output gap is a meaningful driver of price changes in the economy and that the existence of this gap will mitigate upward pressure on prices seeping through from high commodity prices.

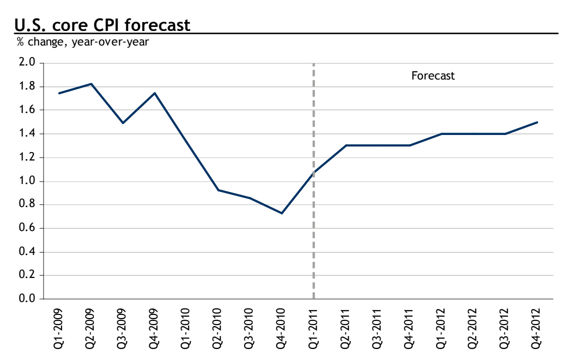
## Fed will tighten when conditions warrant

Fed Chairman Bernanke said that when economic conditions warrant tighter monetary conditions, policymakers will put them in place. Given the degree of

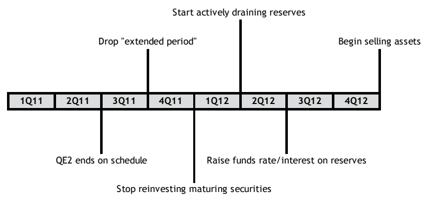


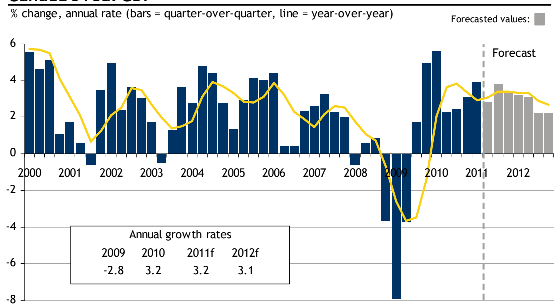
**FED timeline**




Sources: RBC Fixed Income and Currency Strategy, RBC Economics

**Canada's real GDP**

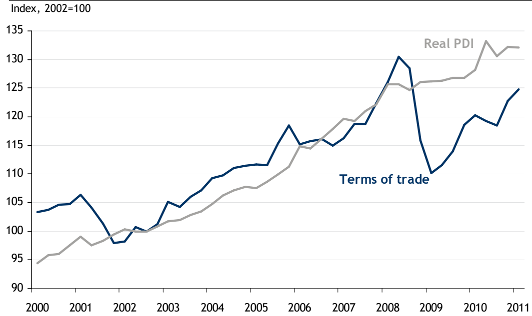
% change, annual rate (bars = quarter-over-quarter, line = year-over-year)




Source: Statistics Canada, RBC Economics Research

**Terms of trade and real PDI: Canada**

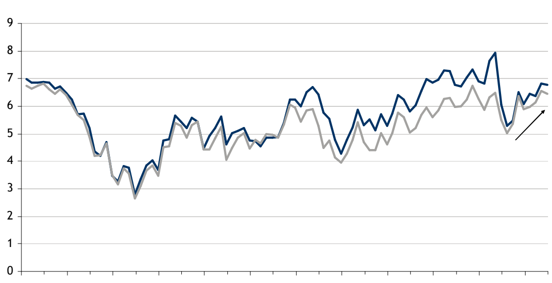
Index, 2002=100




Source: Statistics Canada, RBC Economics Research

**Profit margins in Canada**

Operating profits as % of operating income, non-financial sector



Source: Statistics Canada, RBC Economics Research

labour market slack and the low level of core inflation, there is little urgency for the Fed to tighten policy actively. This does not mean that the Fed will not start with more passive means of withdrawing policy support with the June 30, 2011 deadline for the end of QE2 acting as an inflection point for monetary policy. Once markets have adapted to the absence of Fed bond purchases, the next step is likely to be the elimination of the commitment to hold policy at extraordinarily stimulative levels for an extended period. This will be followed by the end of reinvesting funds from maturing securities and then the active draining of reserves. By mid 2012, we expect the Fed to be in position to raise the Fed funds target with sales of its balance sheet holdings to begin thereafter. This game plan is based on our view that the US expansion will build momentum, and that the degree of fiscal tightening will be limited over this time horizon. It is also premised on our assessment that the improvement in the labour market will be gradual and that inflation rates, both core and headline, will average less than 2% in 2012.

## Oh Canada!

Canada's economy has been a frontrunner in the race to expansion with real GDP output standing 2% above its pre-recession peak at the end of the first quarter of 2011. Growth in the first quarter was the fastest since early 2010 with the economy posting a 3.9% annualized rate gain. We expect the pace to slow in the second quarter of 2011 as supplies of Japanese products were disrupted by the twin disasters thereby hampering manufacturing and export activity. Looking ahead, as reconstruction occurs in Japan and Canadian manufacturers find alternative sources for these inputs, the effect of the supply-chain disruptions will lessen, meaning that the weakness in the spring quarter will likely be followed up by stronger growth in the second half of the year.

## Terms of trade boost

Part of the reason for Canada's superior economic performance can be attributed to its natural resource endowments and the benefit of rising commodity prices. The easiest way to measure this boost is to look at the terms of trade or the price of what Canada exports relative to the price of what it imports. With more than 50% of Canadian exports related to natural resources, higher commodity prices created a net wealth benefit for the economy through rising corporate profits and personal incomes. This goes some way to explaining why Canadian employment levels returned to their pre-recession peak in January 2011 and why consumers were responsible for much of the growth in 2010.

The terms of trade boost also supported a 21% jump in pre-tax profits in 2010. Companies saw their profit margins widen and the level of cash balances surge. Improved balance sheets, combined with record-low interest rates and access to financing, in both private and public markets, resulted in a jump in investment in machinery and equipment in 2010 with surveys of Canadian business pointing to another double-digit gain in 2011. This year a greater proportion of this investment will come from private companies after 2010's fiscal stimulus supported a 17.9% rise in public-sector investment.

## Add in a strong Canadian dollar

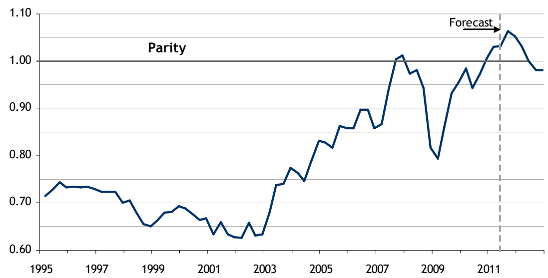
Canada's dollar breached parity with the US dollar in early January 2011, backed by the widening in short-term interest rate spreads and increased demand for commodities. Noises from the Bank of Canada about the dangers of a strong currency and unstable global economy took some of the gloss off the Canadian dollar recently, especially as commodity prices corrected. Still, Canada's currency remains stronger than the US dollar and is likely to hold its current range for the remainder of 2011. The dramatic recovery in the Canadian dollar from an all-time low in 2002 to within 6% of its all-time high resulted in the price of imported machinery and equipment falling by 26.5%.

## What the world demands, Canada has it!

This dramatic price cut for imported machinery and equipment will likely keep Canadian companies purchasing goods from abroad in an effort to update their capital stock and ultimately improve Canada's productivity performance. Imports outpaced export growth by a significant margin in 2010 resulting in the trade sector acting as a drag on the pace of growth. This year, import demand is forecasted to grow at a slower pace as this round of currency price appreciation grinds to halt. Still, our forecast for a 7.1% gain in 2011 means that imports will be growing at more than double the average pace compared to the previous decade. Canadian exports are forecasted to post healthy gains, averaging 9% per annum for the next two years. Strong demand for commodities and a revival in US demand for autos will be the key supports.

**Canadian dollar forecast**

U.S dollar per Canadian dollar




Source: Bank of Canada, RBC Economics Research

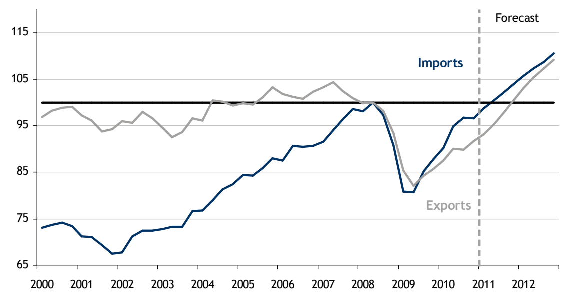
## Passing the baton from residential construction to non-residential

The combination of generational lows in interest rates and accommodative lending standards supported a sharp rise in mortgage credit demand in the early days of the recovery, as households rushed to buy houses to take advantage of these favourable conditions. This pop in demand supported a rise in housing starts activity, which totalled 190,000 in 2010 and was much firmer than 2009's 149,000 pace. This new building activity made a solid contribution to residential construction output supplemented by a jump in renovation spending. And, while residential construction activity made a sturdy 0.7 percentage point contribution to 2010 growth, construction of non-residential structures made a smaller 0.2 percentage point contribution.

The non-residential construction sector recorded a small annual increase in 2010, however, the quarterly data showed an improving pattern over the course of the year. The persistent absorption of space and declining vacancy rates in the commercial property market indicate firming demand that augurs well for positive growth in this sector in 2011 and 2012. Rising profits and a bumper-crop of bond issuance by non-financial firms in 2010, when interest rates were close to record lows, are providing Canadian companies the wherewithal to respond to the pick up in demand, so we are forecasting annual increases in non-residential construction to average about 12% in the forecast horizon.

**Imports and exports: Canada**

Index, 2008Q2=100




Source: Statistics Canada, RBC Economics Research

## Canadian households to pare back on consumption...

In the early days of Canada's recovery, consumer spending was the engine that accounted for two-thirds of 2010 GDP growth. Looking ahead, we expect consumer spending to slow as the weight of the record-high debt-to-income ratio acts as a restraint. Offsetting this factor will be a sustained rise in incomes as the labour markets continue to firm. Another saving grace for consumers has been the strong performance of the asset side of the balance sheet. Both financial asset and real estate values are up significantly from their recessionary lows. Even as debt levels rose, so did asset values thereby leaving households with a debt-to-asset ratio that is elevated but not rising. Since the low in January 2009, resale home prices are up 32% although homeowners' equity has declined to 67.7% from its peak of 71% in 2007.

**Canadian investment**

Indexed to GDP trough (2009-Q2)

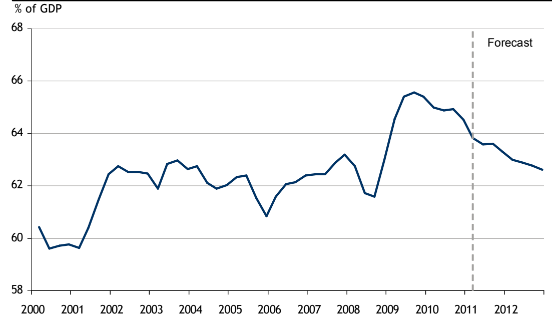

Source: Statistics Canada, RBC Economics Research

## ...and housing

As indicated above, we expect little support to come from the residential real estate market in 2011 and 2012. Housing market affordability, according to RBC's measure, deteriorated in early 2011 as house prices rose while interest rates held steady. In the past, declining interest rates acted to offset the effect of rising prices and kept affordability under control. Looking ahead, a number of conflicting factors will influence housing affordability in Canada. Interest rates are forecasted to grind higher in the second half of 2011 and in 2012. This negative hit will be largely offset by rising income levels and what we

**Consumer spending and residential investment as a % of GDP: Canada**

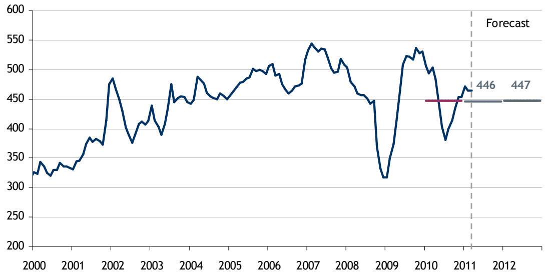
% of GDP




Source: Statistics Canada, RBC Economics Research

**Existing home sales**

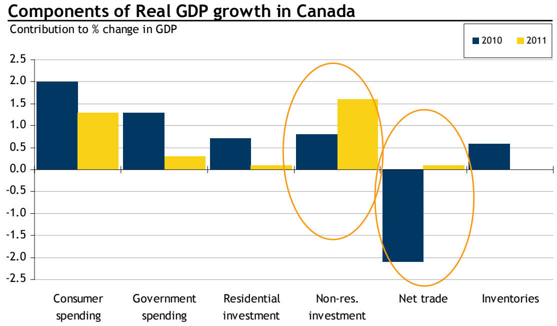
Thousand units, seasonally-adjusted at annual rate




Source: CREA, RBC Economics Research

**Components of Real GDP growth in Canada**

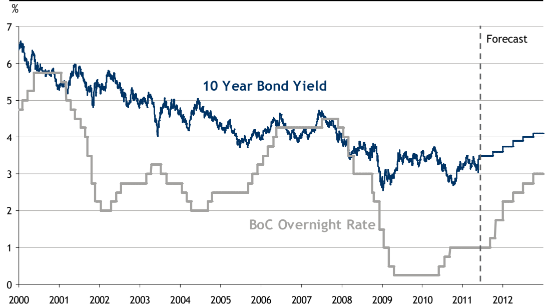
Contribution to % change in GDP




Source: Statistics Canada, RBC Economics Research

**Interest rates: Canada**

%




Source: Bank of Canada, RBC Economics Research

expect will be an environment of stable housing prices. With interest rates heading higher, we forecast that the volume of home sales will stabilize, and that prices will post a minor 0.5% gain in 2011 and 1.3% increase in 2012.

## Drivers changing but economy still in rolling along

In the final analysis, we see Canada's economy growing at an above-potential clip in 2011 and 2012. The main supports for growth will switch from being household driven to business driven. Consumer spending will provide support to the economy although to a lesser degree while residential investment is likely headed for a small increase. The slack will be taken up by stronger business investment and a significant swing in the net trade component. Our forecast is consistent with Canada's output gap being eliminated in the second quarter of 2012; at which point, we expect to see both the headline and core inflation rates gravitating toward the Bank of Canada's 2% target.

## Rate hikes in the pipeline

This forecast is based on the assumption that the Bank of Canada will raise the policy rate by 75 basis points in the second half of 2011 and a further 125 basis points in 2012. Term interest rates are also expected to increase with the 10-year yield ending 2011 at 3.80% and 2012 at 4.15%. The timing of the next rate increase is likely in the autumn. Currently, the level of uncertainty about the global economic outlook, and worries about sovereign debt and fiscal balances are likely to result in the Bank holding the policy rate at its currently stimulative 1% level. As worries about the external environment dissipate, the Bank's attention will return to domestic fundamentals, which as discussed above, we expect will be solid and support the inflation rate moving to the Bank's 2% target. Against the backdrop, the Bank is expected to raise the overnight rate to 1.75% by the end of 2011 and 3.0% at year-end 2012.

# Economic forecast detail — Canada

## Real growth in the economy

Quarter-over-quarter annualized % change unless otherwise indicated

| | | | | | | Forecast | | | | | | | | | Forecast | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 | | | | 2011 | | | | 2012 | | | | year-over-year % change | | | |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | 2009 | 2010 | 2011 | 2012 |
| Consumer spending | 4.2 | 1.4 | 2.8 | 4.4 | 0.2 | 2.4 | 3.2 | 2.5 | 2.2 | 2.2 | 2.1 | 2.1 | 0.4 | 3.3 | 2.3 | 2.4 |
| Durables | 4.0 | -7.4 | 1.6 | 11.0 | -5.6 | 3.3 | 6.8 | 5.5 | 4.7 | 4.7 | 5.2 | 5.1 | -1.9 | 4.4 | 2.0 | 5.1 |
| Semi-Durables | 19.1 | -4.5 | 5.6 | 2.9 | 1.8 | 2.0 | 3.5 | 2.2 | 1.2 | 1.5 | 1.4 | 1.4 | -2.3 | 5.0 | 2.4 | 1.8 |
| Non-durables | 1.7 | 2.7 | 2.6 | 0.9 | -1.4 | 2.7 | 3.5 | 2.1 | 1.8 | 1.8 | 1.7 | 1.7 | 0.8 | 1.8 | 1.4 | 2.1 |
| Services | 3.4 | 3.7 | 2.9 | 4.8 | 1.9 | 2.1 | 2.3 | 2.1 | 2.0 | 2.0 | 1.8 | 1.8 | 1.1 | 3.5 | 2.8 | 2.0 |
| Government spending | -0.4 | 3.3 | 0.5 | 2.7 | 0.1 | 0.3 | 0.1 | 0.1 | 0.4 | 0.1 | 0.5 | 1.0 | 3.6 | 2.4 | 0.9 | 0.4 |
| Residential investment | 19.8 | -0.4 | -5.1 | -0.9 | 9.4 | -1.0 | 3.8 | 2.5 | 1.4 | 1.6 | 1.2 | 1.1 | -8.0 | 10.2 | 1.9 | 1.7 |
| Business investment | 11.9 | 17.9 | 23.5 | 13.5 | 13.5 | 10.7 | 12.3 | 10.7 | 8.6 | 7.6 | 6.3 | 6.2 | -20.8 | 7.3 | 14.0 | 8.9 |
| Non-residential structures | 17.5 | 7.2 | 16.6 | 22.8 | 11.8 | 13.0 | 12.1 | 10.9 | 9.5 | 8.8 | 7.6 | 7.5 | -22.2 | 2.8 | 14.2 | 9.8 |
| Machinery & equipment | 6.8 | 29.4 | 30.5 | 5.0 | 15.4 | 8.3 | 12.5 | 10.4 | 7.6 | 6.3 | 5.0 | 4.8 | -19.5 | 11.8 | 13.8 | 8.0 |
| Final domestic demand | 5.3 | 3.9 | 4.3 | 4.8 | 2.3 | 2.5 | 2.9 | 2.1 | 2.1 | 2.2 | 2.2 | 2.3 | -2.1 | 4.5 | 3.2 | 2.3 |
| Exports | 8.8 | 11.9 | -1.2 | 8.8 | 6.4 | 9.5 | 11.0 | 11.9 | 9.9 | 9.4 | 7.5 | 6.9 | -13.8 | 6.4 | 7.7 | 9.8 |
| Imports | 12.3 | 21.8 | 8.4 | -0.5 | 9.1 | 7.0 | 6.9 | 8.0 | 6.3 | 6.0 | 5.8 | 6.8 | -13.4 | 13.1 | 7.1 | 6.6 |
| Inventories (change in $b) | 6.5 | 13.3 | 15.6 | 0.2 | 10.7 | 9.1 | 7.9 | 8.0 | 7.9 | 7.5 | 6.0 | 5.8 | -0.5 | 8.9 | 8.9 | 6.8 |
| **Real gross domestic product** | **5.6** | **2.3** | **2.5** | **3.1** | **3.9** | **2.8** | **3.8** | **3.3** | **3.2** | **3.1** | **2.2** | **2.2** | **-2.8** | **3.2** | **3.2** | **3.1** |

## Other indicators

Year-over-year % change unless otherwise indicated

| | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Business and labour | | | | | | | | | | | | | | | | |
| Productivity | 1.7 | 0.8 | 1.3 | 0.8 | 0.7 | 1.4 | 1.4 | 1.3 | 1.2 | 1.3 | 1.1 | 1.1 | 0.9 | 1.1 | 1.2 | 1.2 |
| Pre-tax corporate profits | 20.4 | 27.2 | 19.0 | 19.1 | 13.4 | 24.3 | 22.0 | 15.9 | 15.0 | 12.8 | 14.8 | 13.7 | -33.1 | 21.2 | 18.8 | 14.1 |
| Unemployment rate (%)* | 8.2 | 8.0 | 8.0 | 7.7 | 7.8 | 7.6 | 7.5 | 7.4 | 7.3 | 7.2 | 7.1 | 7.0 | 8.3 | 8.0 | 7.6 | 7.2 |
| Inflation | | | | | | | | | | | | | | | | |
| Headline CPI | 1.6 | 1.4 | 1.8 | 2.3 | 2.6 | 3.2 | 2.7 | 2.1 | 1.8 | 1.9 | 2.2 | 2.3 | 0.3 | 1.8 | 2.6 | 2.1 |
| Core CPI | 1.9 | 1.8 | 1.6 | 1.6 | 1.3 | 1.5 | 1.7 | 1.8 | 1.8 | 1.8 | 1.9 | 2.0 | 1.7 | 1.8 | 1.6 | 1.9 |
| External trade | | | | | | | | | | | | | | | | |
| Current account balance ($b) | -34.7 | -56.0 | -71.5 | -41.1 | -35.7 | -29.8 | -28.8 | -24.2 | -19.1 | -15.6 | -13.0 | -12.3 | -45.2 | -50.9 | -29.6 | -15.0 |
| % of GDP | -2.2 | -3.5 | -4.4 | -2.5 | -2.1 | -1.7 | -1.7 | -1.4 | -1.1 | -0.9 | -0.7 | -0.7 | -3.0 | -3.1 | -1.7 | -0.8 |
| Housing starts (000s)* | 198 | 198 | 192 | 179 | 178 | 185 | 184 | 183 | 182 | 182 | 180 | 179 | 149 | 190 | 182 | 181 |
| Motor vehicle sales (mill., saar)* | 1.58 | 1.55 | 1.60 | 1.59 | 1.60 | 1.61 | 1.63 | 1.64 | 1.64 | 1.65 | 1.65 | 1.66 | 1.48 | 1.58 | 1.62 | 1.65 |

*Period average

Source: Statistics Canada, RBC Economics Research forecasts

# Economic forecast detail — United States

## Real growth in the economy

Quarter-over-quarter annualized % change unless otherwise indicated

| | | | | | | Forecast | | | | | | | | | Forecast | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 | | | | 2011 | | | | 2012 | | | | year-over-year % change | | | |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | 2009 | 2010 | 2011 | 2012 |
| Consumer spending | 1.9 | 2.2 | 2.4 | 4.0 | 2.2 | 1.7 | 2.9 | 3.5 | 3.6 | 3.2 | 2.8 | 3.2 | -1.2 | 1.7 | 2.6 | 3.2 |
| Durables | 8.8 | 6.8 | 7.6 | 21.1 | 8.9 | -4.5 | 8.3 | 11.1 | 8.5 | 6.7 | 6.5 | 6.7 | -3.7 | 7.6 | 8.1 | 7.4 |
| Non-durables | 4.2 | 1.9 | 2.5 | 4.1 | 1.1 | 3.8 | 2.8 | 2.9 | 2.8 | 2.8 | 2.1 | 2.8 | -1.2 | 2.7 | 2.7 | 2.8 |
| Services | 0.1 | 1.6 | 1.6 | 1.5 | 1.5 | 2.0 | 2.0 | 2.5 | 3.0 | 2.8 | 2.5 | 2.8 | -0.8 | 0.5 | 1.7 | 2.6 |
| Government spending | -1.6 | 3.9 | 3.9 | -1.7 | -5.1 | 2.2 | -0.4 | -0.8 | -1.1 | -0.9 | -0.4 | -0.1 | 1.6 | 1.0 | -0.6 | -0.6 |
| Residential investment | -12.3 | 25.6 | -27.3 | 3.3 | -3.3 | 1.8 | 10.6 | 10.3 | 13.6 | 14.2 | 16.9 | 13.2 | -22.9 | -3.0 | -0.6 | 12.4 |
| Business investment | 7.8 | 17.2 | 10.0 | 7.7 | 3.4 | 11.0 | 11.9 | 11.6 | 11.9 | 11.8 | 11.5 | 10.2 | -17.1 | 5.7 | 9.0 | 11.6 |
| Non-residential structures | -17.8 | -0.5 | -3.6 | 7.7 | -16.8 | 9.5 | 10.0 | 10.3 | 11.5 | 11.1 | 10.5 | 11.5 | -20.4 | -13.7 | -0.2 | 10.8 |
| Equipment & software | 20.5 | 24.8 | 15.4 | 7.7 | 11.6 | 11.5 | 12.6 | 12.1 | 12.0 | 12.1 | 11.8 | 9.7 | -15.3 | 15.3 | 12.2 | 11.9 |
| Final domestic demand | 1.3 | 4.3 | 2.6 | 3.2 | 0.7 | 2.7 | 3.3 | 3.6 | 3.7 | 3.5 | 3.3 | 3.5 | -3.1 | 1.9 | 2.5 | 3.4 |
| Exports | 11.4 | 9.1 | 6.7 | 8.6 | 9.2 | 10.0 | 8.9 | 9.9 | 9.3 | 9.7 | 9.7 | 8.7 | -9.5 | 11.7 | 8.9 | 9.5 |
| Imports | 11.2 | 33.5 | 16.8 | -12.6 | 7.6 | 7.9 | 8.0 | 8.5 | 9.1 | 9.5 | 9.3 | 7.5 | -13.8 | 12.6 | 6.1 | 8.8 |
| Inventories (change in $b) | 44.1 | 68.8 | 121.4 | 16.2 | 52.2 | 60.5 | 67.1 | 67.6 | 74.6 | 72.1 | 67.4 | 67.6 | -113.1 | 62.7 | 61.9 | 70.4 |
| **Real gross domestic product** | **3.7** | **1.7** | **2.6** | **3.1** | **1.8** | **3.0** | **3.4** | **3.6** | **3.7** | **3.2** | **3.0** | **3.5** | **-2.6** | **2.9** | **2.7** | **3.4** |

## Other indicators

Year-over-year % change unless otherwise indicated

| | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Business and labour | | | | | | | | | | | | | | | | |
| Productivity | 6.6 | 4.0 | 2.9 | 1.9 | 1.1 | 2.0 | 2.0 | 1.8 | 2.1 | 2.0 | 1.8 | 1.8 | 3.7 | 3.9 | 1.7 | 1.9 |
| Pre-tax corporate profits | 37.6 | 37.0 | 26.4 | 18.3 | 8.5 | 7.6 | 7.7 | 7.0 | 7.8 | 7.5 | 6.5 | 6.4 | -0.4 | 29.2 | 7.7 | 7.0 |
| Unemployment rate (%)* | 9.7 | 9.6 | 9.6 | 9.6 | 8.9 | 9.0 | 8.8 | 8.7 | 8.6 | 8.5 | 8.3 | 8.1 | 9.3 | 9.6 | 8.9 | 8.4 |
| Inflation | | | | | | | | | | | | | | | | |
| Headline CPI | 2.4 | 1.8 | 1.2 | 1.3 | 2.1 | 3.3 | 2.9 | 2.6 | 2.0 | 1.8 | 1.8 | 1.7 | -0.4 | 1.6 | 2.7 | 1.8 |
| Core CPI | 1.3 | 0.9 | 0.9 | 0.7 | 1.1 | 1.3 | 1.3 | 1.3 | 1.4 | 1.4 | 1.4 | 1.5 | 1.7 | 1.0 | 1.2 | 1.4 |
| External trade | | | | | | | | | | | | | | | | |
| Current account balance ($b) | -435 | -491 | -502 | -453 | -528 | -530 | -527 | -533 | -546 | -556 | -566 | -569 | -378 | -470 | -530 | -559 |
| % of GDP | -3.0 | -3.4 | -3.4 | -3.1 | -3.5 | -3.5 | -3.4 | -3.4 | -3.5 | -3.5 | -3.5 | -3.5 | -2.7 | -3.2 | -3.5 | -3.5 |
| Housing starts (000s)* | 615 | 602 | 584 | 539 | 580 | 576 | 600 | 653 | 696 | 769 | 833 | 897 | 554 | 585 | 602 | 799 |
| Motor vehicle sales (millions, saar)* | 11.0 | 11.3 | 11.6 | 12.3 | 13.0 | 12.4 | 13.0 | 13.5 | 14.1 | 14.2 | 14.4 | 14.5 | 10.4 | 11.5 | 13.0 | 14.3 |

*Period average

Source: Bureau of Economic Analysis, RBC Economics Research forecasts

# Financial market forecast detail

## Interest rates

%, end of period

| | | | | | | | Forecast | | | | | | Forecast | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 10Q3 | 10Q4 | 11Q1 | 11Q2 | 11Q3 | 11Q4 | 12Q1 | 12Q2 | 12Q3 | 12Q4 | 2009 | 2010 | 2011 | 2012 |
| **Canada** | | | | | | | | | | | | | | |
| Overnight rate | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 | 1.75 | 2.25 | 2.50 | 2.75 | 3.00 | 0.25 | 1.00 | 1.75 | 3.00 |
| Three-month T-bills | 0.88 | 0.97 | 1.10 | 1.20 | 1.70 | 2.15 | 2.40 | 2.65 | 2.90 | 3.15 | 0.19 | 0.97 | 2.15 | 3.15 |
| Two-year GoC bonds | 1.40 | 1.71 | 1.85 | 1.75 | 2.15 | 2.40 | 2.80 | 3.00 | 3.35 | 3.75 | 1.47 | 1.71 | 2.40 | 3.75 |
| Five-year GoC bonds | 2.04 | 2.46 | 2.65 | 2.50 | 3.00 | 3.30 | 3.50 | 3.65 | 3.85 | 4.05 | 2.77 | 2.46 | 3.30 | 4.05 |
| 10-year GoC bonds | 2.75 | 3.16 | 3.25 | 3.25 | 3.50 | 3.80 | 3.95 | 4.05 | 4.15 | 4.15 | 3.61 | 3.16 | 3.80 | 4.15 |
| 30-year GoC bonds | 3.34 | 3.55 | 3.80 | 3.75 | 4.00 | 4.30 | 4.45 | 4.50 | 4.50 | 4.55 | 4.07 | 3.55 | 4.30 | 4.55 |
| Yield curve (10s-2s) | 135 | 145 | 140 | 150 | 135 | 140 | 115 | 105 | 80 | 40 | 214 | 145 | 140 | 40 |
| **United States** | | | | | | | | | | | | | | |
| Fed funds rate | 0 to 0.25 | 0 to 0.25 | 0 to 0.25 | 0 to 0.25 | 0 to 0.25 | 0 to 0.25 | 0 to 0.25 | 0.50 | 1.00 | 1.50 | 0 to 0.25 | 0 to 0.25 | 0 to 0.25 | 1.50 |
| Three-month T-bills | 0.16 | 0.12 | 0.15 | 0.20 | 0.20 | 0.25 | 0.35 | 0.65 | 1.25 | 1.70 | 0.06 | 0.12 | 0.25 | 1.70 |
| Two-year bonds | 0.44 | 0.61 | 0.70 | 0.80 | 0.90 | 1.10 | 1.25 | 1.60 | 2.00 | 2.50 | 1.14 | 0.61 | 1.10 | 2.50 |
| Five-year bonds | 1.27 | 2.01 | 2.10 | 2.00 | 2.30 | 2.60 | 2.80 | 3.05 | 3.40 | 3.75 | 2.69 | 2.01 | 2.60 | 3.75 |
| 10-year bonds | 2.48 | 3.30 | 3.45 | 3.25 | 3.65 | 4.00 | 4.15 | 4.25 | 4.45 | 4.50 | 3.85 | 3.30 | 4.00 | 4.50 |
| 30-year bonds | 3.67 | 4.34 | 4.50 | 4.55 | 4.60 | 4.85 | 4.90 | 4.95 | 5.00 | 5.05 | 4.63 | 4.34 | 4.85 | 5.05 |
| Yield curve (10s-2s) | 204 | 269 | 275 | 245 | 275 | 290 | 290 | 265 | 245 | 200 | 271 | 269 | 290 | 200 |
| **Yield spreads** | | | | | | | | | | | | | | |
| Three-month T-bills | 0.72 | 0.85 | 0.95 | 1.00 | 1.50 | 1.90 | 2.05 | 2.00 | 1.65 | 1.45 | 0.13 | 0.85 | 1.90 | 1.45 |
| Two-year | 0.96 | 1.10 | 1.15 | 0.95 | 1.25 | 1.30 | 1.55 | 1.40 | 1.35 | 1.25 | 0.33 | 1.10 | 1.30 | 1.25 |
| Five-year | 0.77 | 0.45 | 0.55 | 0.50 | 0.70 | 0.70 | 0.70 | 0.60 | 0.45 | 0.30 | 0.08 | 0.45 | 0.70 | 0.30 |
| 10-year | 0.27 | -0.14 | -0.20 | 0.00 | -0.15 | -0.20 | -0.20 | -0.20 | -0.30 | -0.35 | -0.24 | -0.14 | -0.20 | -0.35 |
| 30-year | -0.33 | -0.79 | -0.70 | -0.80 | -0.60 | -0.55 | -0.45 | -0.45 | -0.50 | -0.50 | -0.56 | -0.79 | -0.55 | -0.50 |

## Exchange rates

%, end of period

| | | | | | | | Forecast | | | | | | Forecast | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 10Q3 | 10Q4 | 11Q1 | 11Q2 | 11Q3 | 11Q4 | 12Q1 | 12Q2 | 12Q3 | 12Q4 | 2009 | 2010 | 2011 | 2012 |
| Australian dollar | 0.97 | 1.02 | 1.03 | 1.09 | 1.08 | 1.03 | 0.98 | 0.96 | 0.94 | 0.94 | 0.90 | 1.02 | 1.03 | 0.94 |
| Brazilian real | 1.70 | 1.66 | 1.63 | 1.65 | 1.68 | 1.70 | 1.72 | 1.73 | 1.74 | 1.75 | 1.74 | 1.66 | 1.70 | 1.75 |
| Canadian dollar | 1.03 | 1.00 | 0.97 | 0.97 | 0.94 | 0.95 | 0.97 | 1.00 | 1.02 | 1.02 | 1.05 | 1.00 | 0.95 | 1.02 |
| Renmibi | 6.69 | 6.59 | 6.55 | 6.40 | 6.30 | 6.20 | 6.10 | 6.00 | 5.90 | 5.80 | 6.83 | 6.59 | 6.20 | 5.80 |
| Euro | 1.36 | 1.34 | 1.42 | 1.45 | 1.42 | 1.35 | 1.30 | 1.30 | 1.29 | 1.29 | 1.43 | 1.34 | 1.35 | 1.29 |
| Yen | 84 | 81 | 83 | 81 | 80 | 85 | 90 | 95 | 100 | 105 | 93 | 81 | 85 | 105 |
| Mexican peso | 12.59 | 12.36 | 11.90 | 11.20 | 11.60 | 12.00 | 12.00 | 12.50 | 12.25 | 12.00 | 13.10 | 12.36 | 12.00 | 12.00 |
| New Zealand dollar | 0.73 | 0.78 | 0.76 | 0.80 | 0.77 | 0.75 | 0.73 | 0.70 | 0.69 | 0.69 | 0.73 | 0.78 | 0.75 | 0.69 |
| Swiss franc | 0.98 | 0.93 | 0.92 | 0.87 | 0.88 | 0.93 | 0.97 | 0.97 | 0.98 | 0.98 | 1.04 | 0.93 | 0.93 | 0.98 |
| U.K. pound sterling | 1.57 | 1.56 | 1.60 | 1.69 | 1.67 | 1.63 | 1.59 | 1.63 | 1.63 | 1.65 | 1.62 | 1.56 | 1.63 | 1.65 |

Source: Reuters, RBC Economics Research forecasts