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September 2016

Canadian Q2/16 GDP drops by an annualized 1.6%

A fine line: global economy moving cautiously forward

Distinct challenges shape growth across the country in 2016

econoscope

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IN BRIEF

Highlights this month

The second-quarter 2016 decline followed an upwardly revised 2.5% increase in the first quarter (2.4% previously) and was in line with market expectations for a 1.5% drop. The separately released June 2016 GDP rose by a stronger than expected 0.6% that fully reversed the 0.6% plunge in May.

Since the Great Recession, the global economy has been in a state of flux with growth forecasts tending to be cut rather than raised. Central banks are experimenting with new policy tools to support growth; however, the majority of governments are holding back on fiscal stimulus. On net, these efforts failed to revive the pace of world growth, with the average increase in output between 2012 and 2017 falling short of gains in the pre-recession period.

Statistics published so far this year continue to paint a picture of contrasting growth across provincial economies in 2016. Dependence on the oil industry remains a key distinguishing factor, with oil-producing provinces struggling amid low revenues and belt-tightening in the private and, in some cases, public sectors, while oil-consuming provinces see growing opportunities afforded by the past depreciation of the Canadian dollar, more competitively priced energy commodities, and low interest rates.

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CURRENT TRENDS

CANADIAN Q2/16 GDP DROPS BY AN ANNUALIZED 1.6%

HIGHLIGHTS

▲ The Q2/16 decline followed an upwardly revised 2.5% increase in Q1/16 (2.4% previously) and was generally in line with market expectations for a 1.5% drop.

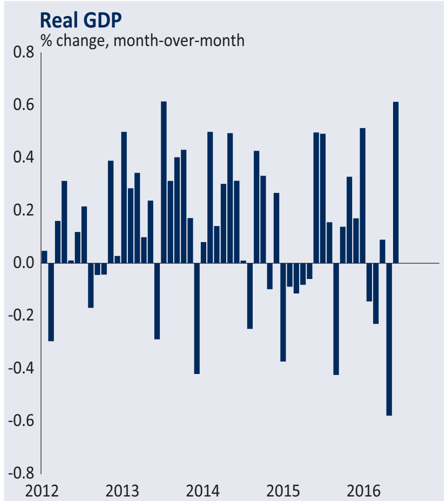
▲ The August monthly increase in employment did not fully offset the 31,200 decline in July although compared favourably to expectations for an August gain of 14,000.

▲ Canada nominal retail sales inch lower in July as gasoline station receipts decline.

▲ Housing starts slipped to an annualized 183,000 rate in August from 195,000 in July, thereby marking a second monthly decline to retrace an outsized jump in June.

▲ The trade deficit in July narrowed to -$2.5 billion from a record $4.0 billion shortfall (revised from -$3.6 billion) in June.

▲ Canadian CPI annual inflation moderates to 1.1% in August.



Source: Statistics Canada

LATEST AVAILABLE: JUNE
RELEASE DATE: AUGUST 31, 2016

The second-quarter decline followed an upwardly revised 2.5% increase in the first (2.4% previously) and was in line with market expectations for a 1.5% drop. The separately released June gross domestic product (GDP) rose by a stronger than expected 0.6% that fully reversed the 0.6% plunge in May. A sizeable decline in second-quarter GDP was expected based on earlier indications that the Alberta wildfires and attendant shutdowns of oil sands production sent May GDP downward sharply. On a quarterly expenditure basis, the shutdowns weighed on energy exports and contributed to overall exports sinking by an annualized 16.7%. With imports rising by 1.1%, net exports subtracted a sizeable 5.9 percentage points from the second-quarter annualized GDP growth rate. The shutdowns likely also limited the bounce back in inventories that still managed to contribute 2.1 percentage points to second-quarter growth. Prior to the second quarter, inventories subtracted an average of 1.4 percentage points for the past four quarters.

CANADIAN AUGUST EMPLOYMENT RISES 26,200

Source: Statistics Canada

LATEST AVAILABLE: AUGUST
RELEASE DATE: SEPTEMBER 9, 2016

The August monthly increase in employment did not fully offset the 31,200 decline in July although compared favourably to expectations for an August gain of 14,000. The unemployment rate rose to 7.0% from 6.9% in July as the labour force jumped by 42,700. The overall employment increase reflected in part service-producing jobs rising by 15,400 following the 26,900 drop in July. The increase was led by public administration employment jumping by 16,300 following the surprising 24,200 drop in July.

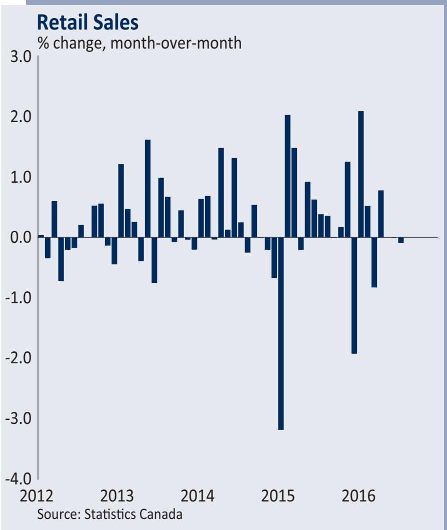
This was concentrated in a 22,000 increase in Quebec and a smaller 4,000 gain in Newfoundland and Labrador. Statistics Canada indicated that other than a decline in New Brunswick of 3,000 "there was little change in other provinces."

Canada nominal retail sales inch lower in July as gasoline station receipts decline

LATEST AVAILABLE: JULY

RELEASE DATE: SEPTEMBER 23, 2016

Nominal retail sales inched down 0.1% in July, below market expectations for a 0.1% increase. Excluding the impact of prices, volume sales inched up a more encouraging 0.3%. The dip in nominal sales in July largely reflected a 3.0% pull-back in gasoline station sales reflecting lower prices. Regionally, overall nominal sales declined in 6 provinces, led by a 6.9% pull-back in New Brunswick with the main sources of partial offset coming from a 0.8% increase in Ontario and 0.9% gain in B.C.



Canadian housing starts slipped lower again in August

LATEST AVAILABLE: AUGUST

RELEASE DATE: SEPTEMBER 8, 2016

Housing starts slipped to an annualized 183,000 rate in August from 195,000 in July, thereby marking a second monthly decline to retrace an outsized jump in June (see *Housing starts* chart on page 4). Starts hit a nine-month high in June on the strength of multi-unit construction in Ontario and British Columbia. August's reading was slightly below market expectations (for a 190,000 reading) but was broadly in line with the 185,000 permits issued a month earlier in July. The decline was led by lower starts in the Prairies (-22%) and multiple-unit led declines in British Columbia (-11%) and Ontario (-4%). Quebec starts provided offset rising by 15.7% while starts in Atlantic Canada were little changed on balance.

Canadian exports bounced back in July

LATEST AVAILABLE: JULY

RELEASE DATE: SEPTEMBER 2, 2016

The trade deficit in July narrowed to -$2.5 billion from a record $4.0 billion shortfall (revised from -$3.6 billion) in June. Exports jumped by 3.4%, and imports dipped by 0.1% in July. The export gain was led by broadly based strength outside of the energy sector with nine of 11 sections reporting increases. Even in the energy sector, a 0.8% dip in the month was due to lower prices, with shipment volumes up by 3.2%. Overall, volume exports were up by 3.4% with non-energy

ECONOMY AT A GLANCE

% change from:	Latest month	Previous month	Year ago
Real GDP	Jun	0.6	1.1
Industrial production	Jun	2.6	-1.3
Employment	Aug	0.1	0.4
Unemployment rate*	Aug	7.0	7.0
Manufacturing			
Production	Jun	1.8	0.9
Employment	Aug	0.2	-1.0
Shipments	Jul	0.1	-2.6
New orders	Jul	-2.9	-7.7
Inventories	Jul	1.0	-2.1
Retail sales	Jul	-0.1	2.3
Car sales	Jul	-5.6	-3.3
Housing starts (000s)*	Aug	182.4	214.0
Exports	Jul	3.4	-7.0
Imports	Jul	-0.1	-2.6
Trade balance ($billlions)*	Jul	-2.5	-0.5
Consumer prices	Aug	-0.2	1.1

* Levels are shown for the latest period and the same period a year earlier.
Source: Statistics Canada, RBC Economics Research

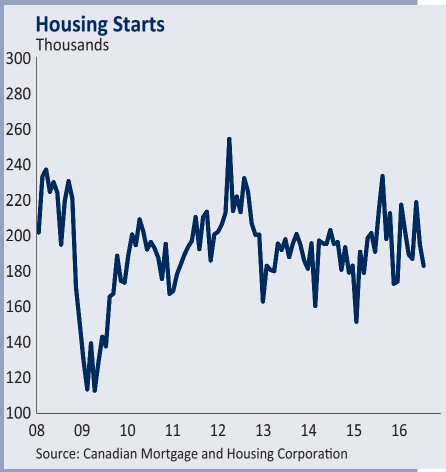
shipments rising at a similar pace. The dip in imports in July, although positive in an accounting sense for the net trade balance, was somewhat more disappointing, particularly given a pullback in industrial equipment imports that, if sustained, would bode poorly for business investment in the quarter.

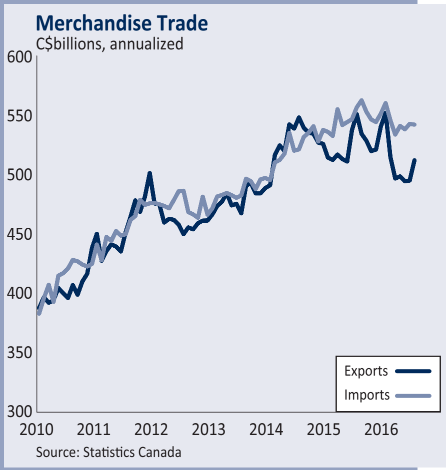
Sticky Canadian CPI annual inflation moderates to 1.1% in August

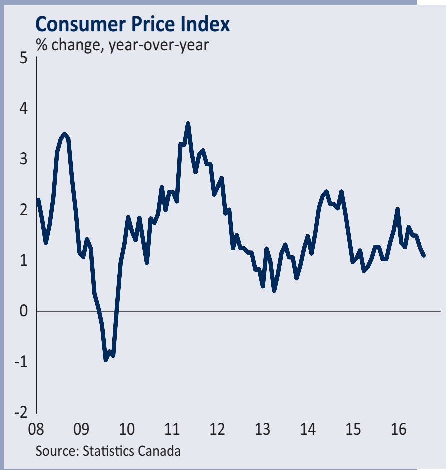
LATEST AVAILABLE: AUGUST

RELEASE DATE: SEPTEMBER 23, 2016

Going into the report expectations were for inflation to remain unchanged at July's annual rate of 1.3%. The annual increase in core inflation unexpectedly moderated as well to 1.8% in August from 2.1% in July. On a monthly basis the overall CPI dropped 0.2%. Gasoline prices were down in the month though by a relatively modest 0.9%. More unexpected was the 3.2% drop in fuel oil. Core prices provided no offset to declines elsewhere as they remained unchanged in August relative to July.







CRAIG WRIGHT, DAWN DESJARDINS,
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ECONOMICS AND FINANCIAL MARKETS OUTLOOK

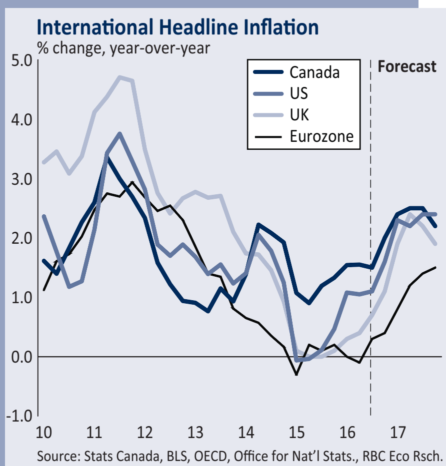
A FINE LINE: GLOBAL ECONOMY MOVING CAUTIOUSLY FORWARD

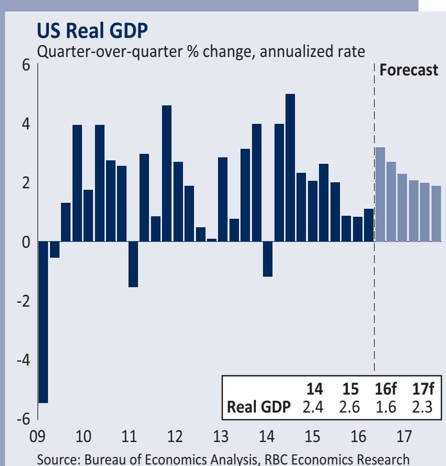
Since the Great Recession, the global economy has been in a state of flux with growth forecasts tending to be cut rather than raised. Central banks are experimenting with new policy tools to support growth; however, the majority of governments are holding back on fiscal stimulus. On net, these efforts failed to revive the pace of world growth, with the average increase in output between 2012 and 2017 falling short of gains in the pre-recession period.

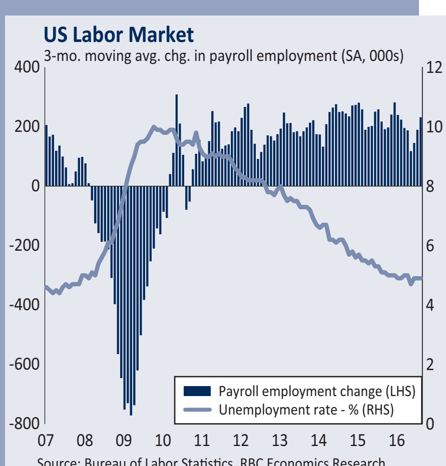
Factors that are beyond the control of today's policymakers have played a role in the slowdown in economic activity, with the aging population changing the composition and growth of the labour force. Additionally, global economies and financial markets are much more closely integrated, thereby raising the risk that policy actions in one country will have adverse effects on others. The UK's recent decision to leave the European Union sparked concerns about knock-on effects via a weakening in trade or a disruption in financial markets. Certainly, these concerns looked well placed in the immediate aftermath of the vote as the world stock market recorded a 5% loss in a two-day period, and government bond yields in some advanced countries hit or tested all-time lows. Financial markets regained their stride quickly, thereby allaying concerns about the near-term global growth outlook; however, as the Brexit process unfolds, the potential for further rounds of financial market volatility will keep downside risks to the outlook alive.

Given the knee-jerk reaction in financial markets, the ultimate effect of the UK's decision is difficult to gauge. In the near term, we expect countries like Canada and the US to experience little pressure. In the UK, conversely, reports on activity in the post-referendum period indicate a significant slowing in economic activity. Given strong increases in output in the first half of 2016, we have made a relatively small cut to our 2016 UK growth forecast. In 2017, we expect the UK economy will barely register any growth, which is a massive downgrade from our previous projection for a 2.1% increase. With the UK economy stalling, its largest trading partners in the euro area economies will also see growth slow, and we revised downward our forecasts for trade and business investment. The effect of Brexit does not feature as prominently in our forecasts for Canada and the US, given the proportionately smaller amount of trade with the UK. We have, however, incorporated a slightly weaker profile for investment in 2017 reflecting concerns about a hit to confidence that results in businesses putting off expanding into either the UK or European markets.

This latest wave of uncertainty reinforced central banks' propensity to keep policy very accommodative. Not surprisingly, the Bank of England acted aggressively to increase policy stimulus by introducing a multifaceted plan aimed at reducing interest rates and in turn getting low-cost funds to borrowers. The US Federal Reserve







and Bank of Canada are unlikely to see the need to change course in response to developments in the UK. That said, policymakers will guard against any unwarranted tightening in financial conditions that results from renewed volatility in global financial markets.

Inflation conundrum

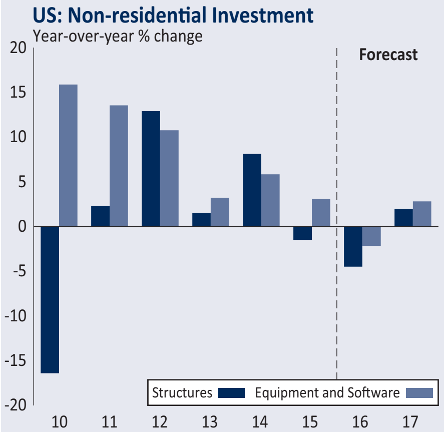
Overall, price pressures remain limited with headline inflation rates holding below 2% and weighed down by low energy costs. Excluding energy, prices are between 0.4 and 1.1 percentage points above the all-items rate, thereby flagging the powerful effect of the drop in fuel prices. We expect the recovery in oil prices that began in mid-February to continue, as supply and demand are moving closer to balance; however, price gains will be gradual as the market works through the record level of stored product. Still, with the lows for oil prices likely in the past, the easing of this weight on consumer prices will result in headline rates in Canada and the US likely to top 2% early next year. In the UK and euro area, the persistence of economic slack should keep inflation rates running below the 2% target throughout 2017.

US labour market strength gets consumers spending

US real GDP growth averaged just 1% in the first half of 2016, a disappointing result largely due to weakness in business fixed investment and inventories. On average, these two components took three-quarters of a percentage point off growth in the first half of 2016. Conversely, consumer spending ramped up in the first half of 2016, thereby lifting economic output by an average 2 percentage points, with consumption posting the second-fastest gain in the post-recession period in the second quarter of 2016. Underpinning the US consumers' spending spree was an additional firming in labour market conditions. Year-to-date, employment gains averaged 182,000 per month, which has been a strong showing as this includes May's meagre 24,000 increase. The unemployment rate remains very close to what is deemed full-employment, and wage growth finally started to accelerate as 2016 progressed. This supportive backdrop combined with low financing rates tees up for the US consumer to continue to be a large contributor to growth in the quarters ahead.

Recalibrating expectations

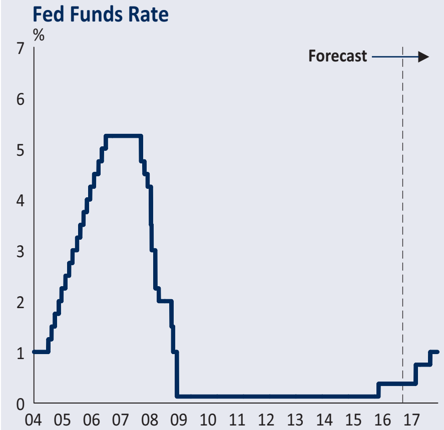
Looking forward, we expect the pace of hiring to slow, although this does not represent an impediment to growth, because it reflects what is happening to the supply of labour rather than a weakening in demand. On the supply side, participation rates are declining as an increasing number of baby boomers reach retirement age. What this means is that the economy needs to generate fewer jobs to put downward pressure on the unemployment rate. Furthermore, there are signs of a persistent tightening in the labour market conditions with the number of discouraged workers and those working part-time because they cannot find full-time employment falling. This tightening labour market is creating pressure on wages, thereby resulting in gains running at the fastest clip since 2009.



Source: Bureau of Economic Analysis, RBC Economics Research

Investment in housing rises while businesses sit back

US home sales increased at a double-digit pace in the second quarter, thereby providing a strong handoff to activity in the final half of 2016. Prices are increasing at a slightly slower pace than in 2015, thereby containing deterioration in affordability and opening the door for sales and building to continue. Outside residential investment, 2016 should mark another weak year of business investment in part due to energy company cutbacks. Even excluding energy, spending by business remains lacklustre, with companies pulling back on investing in non-residential structures and machinery in 2016. A temporary, modest tightening in financial conditions combined with the bout of market volatility after the UK's Brexit vote likely weighed on spending plans in the first half of 2016, and we expect a modest pickup to follow. This recovery is forecasted to continue in 2017, as oil and gas companies come back on line, benefitting from higher prices, while companies outside energy start to expand capacity on the back of firmer demand.



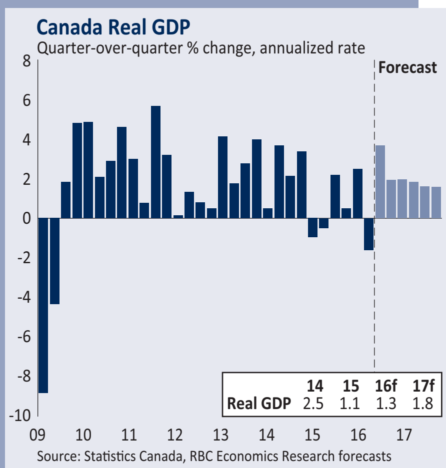
Source: Federal Reserve Board, RBC Economics Research

US dollar rally stalls

The US dollar faded this summer and stood just above levels recorded in August 2015. The weaker than expected growth that sapped expectations that the Fed will tighten in 2016 took some of the lustre off the US currency. In the near term, uncertainty about who will be the next president of the US may result in periodic increases in volatility. We are maintaining our positive outlook for the US dollar, anticipating modest gains versus the euro, Canadian dollar, and sterling, with the US Federal Reserve likely to be the first central bank to raise the policy rate.

Fed waiting for opportunity

The Fed provided a more optimistic assessment of economic conditions at its July meeting and deemed that the risks to the near-term outlook had diminished. This sentiment was echoed by Chair Yellen in her address at the Jackson Hole Economic Symposium. Despite striking a more upbeat note, the Federal Open Market Committee (FOMC) has yet to signal that a consensus for a near-term rate hike has been reached. The Committee appears to be holding out for a pickup in inflation to accompany the tightening in labour market conditions. Additionally, policymakers seem reticent to hike given the uncertainty about global growth and the potential for further financial market volatility. A solid rebound in growth in the second half of



2016 should push the labour market even closer to full employment that combined with a pickup in inflation, due to wage pressures and a rebound in energy prices, should motivate the Fed to get into action in the first half of 2017.

We expect the Fed to implement increases at a measured pace in 2017 with the fed funds target rising by 50 basis points. Limited US Treasury supply and ongoing demand for US government bonds by investors looking for a yield pickup against European, UK, and Canadian securities should keep 10-year yields historically low. Our forecast looks for the 10-year Treasury bond yield to end 2017 at 2.10%.

Canada struggling to get back on track

The economy hit another pothole in the second quarter of 2016 as the effect of the wildfires in Alberta reverberated through the economy. The sharp, but temporary, pullback in oil sands production in the wake of wildfires in Alberta in May was the key factor underpinning the 1.6% annualized decline in real GDP in the second quarter. Part of the weakness came from sharp deterioration in net exports that subtracted 5.9 percentage points from the overall quarterly growth rate. Consumer spending and residential investment were little affected while business investment continued to be weighed down by another drop in spending by energy companies.

While the unfortunate event interrupted the economy's momentum after a solid first quarter, the recovery is forecasted to spur a very sharp rebound in real GDP in the third quarter. The resumption of oil production and rebuilding homes and businesses that were devastated by the wildfires will play a role in bumping up third-quarter growth. Further gains are forecasted to come from a snapback in exports and firm consumer spending. Just as the 1.6% drop in output was an outlier, our forecast for a 3.7% rebound in the third quarter will not be sustained. That said, we anticipate that the economy will grow at an above-potential pace in the latter part of 2016 and during 2017.

Growth supports in place

The combination of low interest rates and rising energy prices will provide support to Canada's economy next year. For consumers, the pain from rising energy costs will be more than offset by a firming in labour market conditions and the persistence of available, affordable credit. For businesses, the recovery in oil prices would prevent further declines in investment in the energy industry. Additionally, the prospect that the economy would no longer struggle under the weight of a collapse in energy investment combined with firming domestic demand will likely boost confidence in other sectors, thereby resulting in an increased willingness of Canadian firms to put current cash holdings to work. Fiscal stimulus by the federal government via both tax changes and increased spending will also underpin growth next year. Our forecast calls for real GDP growth of 1.3% in 2016 accelerating to 1.8% in 2017.

Exports disappoint…

The drop in exports in the second quarter can be partly traced to the large pullback in energy sales due to the wildfires, and we expect a reversal to come in the third quarter. Still, export growth of 0.7% in 2016 represents a downward revision to our forecast. We anticipate modest strengthening in 2017 with exports rising by 2.4% backed by an anticipated pickup in US industrial production, a slightly lower Canadian dollar, and assuming continuation of modest global trade growth.

Our analysis of the export sector suggests that there are several reasons why exports will likely remain on a more modest growth path than we assumed previously. The Canadian dollar lost close to 20% against the US dollar since mid-2014; however, it has posted much smaller losses or even gains against other countries that are vying to satisfy US import demand, thereby reducing or even eliminating this competitive advantage. Additionally, US growth is being driven by household spending that tends to have a lower Canadian import content compared to areas like business investment, while weak demand for US exports reduced demand for Canadian-sourced intermediate production inputs. Also at work is the slowing in global trade activity, as the process of integrating global supply chains ebbs.

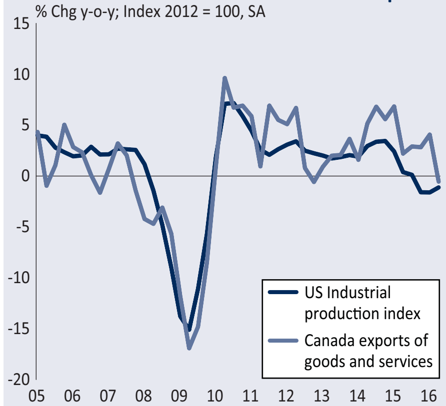
Canadian dollar riding the ranges

After recovering from its mid-January tumble, the Canadian dollar settled into a tight range against its US counterpart this summer, weathering gyrations in oil prices and the ebb and flow of expectations about a near-term Fed rate hike. Looking forward, the currency is likely to weaken modestly as softer Canadian growth keeps the Bank of Canada sidelined while a gradual strengthening in the US would put a rate hike by the Fed in closer focus. Our forecast that oil prices will gradually rise to just over $50.00/barrel by the end of 2016 is unlikely to provide a significant lift to Canada's dollar, although a stronger gain in 2017 toward $60.00/barrel would limit the weakening in the currency that is likely to result as the Fed raises the funds target by a projected 50 basis points.

Headwinds and tailwinds

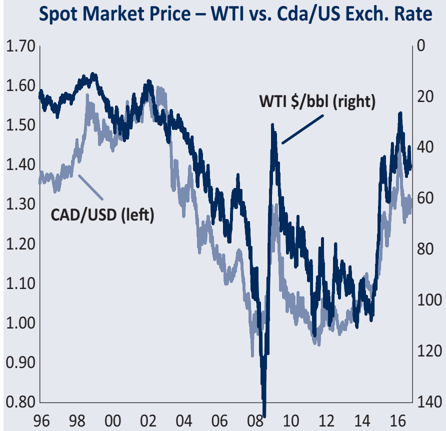
The sharp pullback in investment in 2015 and 2016 acted as a severe headwind to growth that we expect will ease in 2017. Recovering oil prices and growing capacity constraints are forecasted to support a small increase in investment by Canadian

US Industrial Production & Canadian Exports



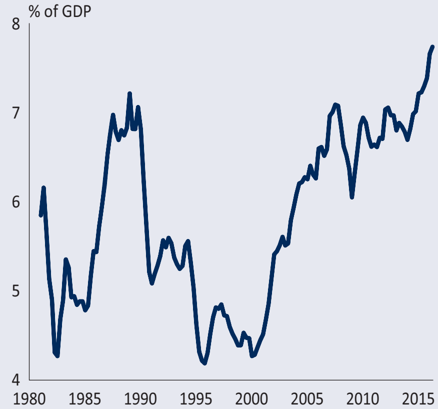
Source: Federal Reserve Board, Statistics Canada, RBC Eco Research

Spot Market Price – WTI vs. Cda/US Exch. Rate



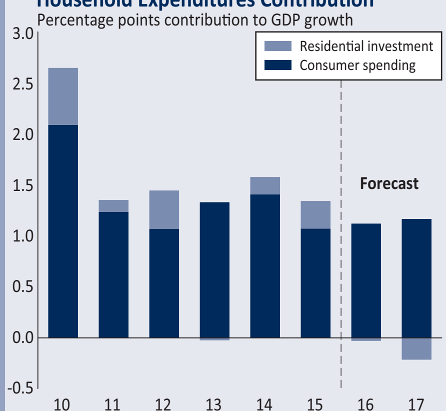
Source: EIA/CME, BoC/Haver, RBC Economics Research

Canada: Residential Investment



Source: Statistics Canada, RBC Economics Research

Household Expenditures Contribution



Source: Statistics Canada, RBC Economics Research

firms next year. Conversely, residential investment that includes new construction, sales commissions, and renovations has been a constant source of strength and is likely to weaken.

Housing complex

Canada's housing market maintained solid momentum heading into 2016, and sales in the first seven months have run at an elevated 538,000 unit pace. Underneath this strong headline, however, are signs of an easing in activity. In British Columbia, there was a significant slowing in sales activity driven by a sharp turnaround in Vancouver where serious affordability challenges had developed. Policy announcements aimed at cooling the BC housing sector including the collection of data on home purchases by foreign nationals and the end of self-regulation in the real estate industry also played a role. Most recently, the government announced a 15% tax on home purchases by foreign nationals in Vancouver. This tax came into effect on August 2, 2016, and early reports showed housing market activity slower further. To that end, we revised our forecast downward for home sales in British Columbia, although earlier strength means 2016 will still be a record year.

Although sales at the national level cooled from May to July, limited supply is keeping upward pressure on prices, with another 6.1% gain forecasted for 2016. Sales are forecasted to decline by 3.5% in 2017, thereby resulting in an easing in market imbalances and the slowest pace of price increase since 2009.

Keeping an eye on household balance sheets

Robust housing activity underpinned demand for mortgages in the first half of 2016, with the anticipated slowing in sales setting up for an easing in the pace of credit accumulation. The growth in debt balances during the past several years offset the effect of low interest rates on debt-service payments, which remained relatively steady at 14 cents per dollar of disposable income. That said, the larger pool of debt means that household balance sheets are more sensitive to increases in interest rates, and we estimate that mortgage payments would eat up an additional 6% of disposable income for each percentage point increase in mortgage rates, compared to increasing costs by 3% in 2000.

Labour market is doing okay

Worries about the state of household balance sheets are being tempered by the ongoing reduction in labour market slack. While the pace of employment gains slowed in the year to August, job cuts in the oil-producing provinces were partly responsible. Also at play are demographic factors that are reducing the pace of growth of the working-age population and commensurately lowering the number of positions that need to be created to absorb unemployed workers. Despite the slowing in the average pace of job creation, Canada's unemployment rate is holding around 7%, which is just slightly above its estimated full-employment level.

Consumer – stalwart for economy

Against this backdrop, Canadian consumers will likely continue to do more than their fair share in supporting economic growth. Even with investment in residential construction likely to slow in 2017, our forecast assumes households will be responsible for more than 60% of economic activity. A healthy labour market, low interest rates, and the implementation of the federal government's childcare benefit should provide consumers with the wherewithal to spend. The other tranche of the government's stimulus plan should also support growth, with the recent announcements of infrastructure initiatives auguring well for payments to start to hit the economy this fall and continue throughout 2017. Given that the funds are only reaching users in the latter part of the year, our forecast assumes a 0.2 percentage point addition to growth in 2016 and a stronger 0.3 percentage point lift in 2017. These assumptions fall slightly short of the government and Bank of Canada's estimates of a 0.5 percentage point lift in each year.

Bank of Canada – no need for action

So far this year, Canada's core inflation rate has only fallen below 2% for one month. The Bank of Canada attributes some of the rise in prices to the pass-through from the currency's weakness and reasons that a stable currency sets up for this effect to lessen going forward. Of the myriad of factors at work on the headline rate, the Bank assigns a significant portion of the below-target performance to declining energy prices. Heading into the latter part of 2016, as energy prices rise, the effect should reverse lifting the headline rate although doing little to shift the core measure from 2%. Given the close proximity of the merging of headline and core measures at the 2% target, we see little reason for the Bank to react to the volatility in the growth numbers related to the effect of the wildfires. Furthermore, reducing interest rates would undo some of the necessary cooling in housing market activity that is occurring because of the pressure on affordability. Given these factors, we expect the Bank to hold the overnight rate at 0.50% not only for the remainder of 2016 but for 2017 as well.

Bank of Canada Overnight Rate

Source: Bank of Canada, RBC Economics Research forecasts

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PAUL FERLEY, ROBERT HOGUE, GERARD WALSH

PROVINCIAL OUTLOOK

Distinct challenges shape growth across the country in 2016

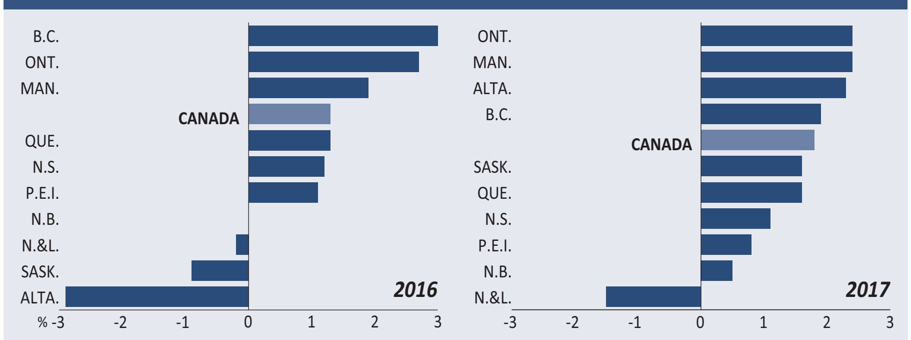
A mixed bag in 2016

Developments to date in 2016 can best be described as a mixed bag for provincial economies. To be sure, there was some encouraging news including impressive employment gains in British Columbia and, to a lesser extent, Ontario, as well as indications that consumers kept the wallets open in several provinces; however, the news remained predominantly grim in parts of the country struggling with a recession. In Alberta, the wildfires in May delivered yet another blow to an economy already facing one of its steeper downturn in modern times. Beyond the challenges continuing to plague oil-producing provinces, momentum appeared to slow this spring in several oil-consuming provinces, including Ontario, Quebec, and Manitoba. Accordingly, we have revised our 2016 growth forecasts downwardly for eight provinces.

Broader growth in the cards for 2017

Nonetheless, our view remains that growth will broaden across the country in 2017. We expect the recessions to end in Alberta and Saskatchewan, supported in part by gradually rising oil prices—our working assumption is that the West Texas Intermediate (WTI) benchmark will increase to an average of US$59/barrel in 2017 from $45/barrel in 2016—fiscal stimulus in these two provinces, and enhanced in Alberta with rebuilding work in Fort McMurray. That said, our outlook for 2017 still shows Newfoundland and Labrador's economy contracting amid a ramping down of major capital investment projects.

REAL GDP GROWTH



Source: Statistics Canada, RBC Economics Research

HIGHLIGHTS

- ▲ Statistics published so far this year continue to paint a picture of contrasting growth across provincial economies in 2016.
- ▲ Dependence on the oil industry remains a key distinguishing factor, with oil-producing provinces struggling amid low revenues and belt-tightening while oil-consuming provinces see growing opportunities afforded by the past depreciation of the Canadian dollar, more competitively priced energy commodities, and low interest rates.
- ▲ We expect the economies of Alberta (real GDP falling by 2.9%), Saskatchewan (-0.9%), and Newfoundland and Labrador (-0.2%) to contract further this year.
- ▲ With the exception of New Brunswick, we expect all other provinces to continue to expand in 2016, albeit varying paces—quite brisk in the case of British Columbia (3.0%) and Ontario (2.7%), but more moderate for Manitoba (1.9%), Quebec (1.3%), Nova Scotia (1.2%), and Prince Edward Island (1.1%).
- ▲ We project New Brunswick's economy to be flat (0.0%) in part because of setbacks in its export sector following the shuttering of a mine.
- ▲ Downside risks to growth remain present in Alberta, Saskatchewan, and Newfoundland and Labrador; however, in Alberta, we expect some of the recent weakness attributable to the wildfires in Fort McMurray to start to reverse during the second half of 2016.
- ▲ Our outlook for 2017 shows more balanced growth profiles across the country compared to 2016, with Alberta and Saskatchewan returning to positive growth at one end of the spectrum and moderation of growth in British Columbia at the other end.

Forecast detail – Canada

RBC FORECASTS OF THE ECONOMY AND FINANCIAL MARKETS

= Forecast (shaded columns: 2016 Q3–2017 Q4, Annual 2016–2017)

	2015				2016				2017				Annual			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2014	2015	2016	2017
GROWTH IN THE ECONOMY PERIOD-OVER-PERIOD ANNUALIZED PERCENT CHANGE UNLESS OTHERWISE INDICATED																
Household consumption	-0.1	2.3	2.3	1.8	2.4	2.2	1.7	2.2	2.1	2.0	1.8	1.7	2.6	1.9	2.1	2.0
Durables	-8.0	5.6	10.2	4.2	4.2	-1.8	0.3	2.8	1.5	1.5	1.5	1.0	4.3	2.9	3.3	1.3
Semi-Durables	-1.9	5.2	0.9	6.9	6.7	-1.9	2.0	2.2	2.5	2.1	1.8	1.8	3.1	2.5	3.1	1.7
Non-durables	2.4	-2.8	2.6	-1.0	3.2	3.0	2.5	2.2	2.2	2.2	2.0	2.0	2.4	0.8	1.8	2.2
Services	0.8	3.4	0.7	1.9	1.2	3.3	1.7	2.1	2.1	2.0	1.8	1.8	2.3	2.1	2.0	2.1
Government expenditures	4.7	2.8	0.6	0.4	2.7	4.2	2.5	2.0	1.8	1.5	1.5	1.5	0.3	1.7	2.2	2.0
Residential investment	6.6	0.1	2.6	1.8	11.3	1.2	-5.7	-3.6	-0.3	-0.5	-0.9	-0.1	2.5	3.8	2.7	-1.6
Business investment	-23.2	-15.5	-11.4	-12.5	-8.1	-1.9	-1.5	2.3	2.7	2.8	3.0	3.3	0.0	-10.6	-7.4	1.9
Non-residential structures	-31.7	-15.4	-14.2	-15.3	-12.8	-4.4	0.5	2.8	2.8	3.0	3.2	3.5	-0.4	-14.7	-9.7	2.2
Machinery & equipment	-5.1	-15.7	-6.7	-8.1	-0.7	1.9	-4.5	1.5	2.5	2.5	2.8	3.1	1.0	-2.4	-3.8	1.4
Final domestic demand	-2.2	-0.1	0.3	-0.3	1.8	2.2	1.2	2.0	2.1	1.8	1.7	1.8	1.6	0.3	1.1	1.8
Exports	0.9	1.2	9.0	-1.5	8.0	-16.7	9.0	3.8	3.5	2.7	2.0	1.9	5.3	3.4	0.7	2.4
Imports	0.9	-1.8	-2.8	-7.0	1.6	1.1	-1.0	4.7	4.0	3.5	2.9	3.1	1.8	0.3	-1.1	3.0
Inventories (change in $b)	14.6	6.8	-0.2	-5.6	-9.0	0.5	-2.0	-0.5	-0.2	1.2	2.2	3.2	9.9	3.9	-2.7	1.6
Real gross domestic product	-1.0	-0.5	2.2	0.5	2.5	-1.6	3.7	1.9	1.9	1.8	1.6	1.6	2.5	1.1	1.3	1.8
OTHER INDICATORS YEAR-OVER-YEAR PERCENTAGE CHANGE UNLESS OTHERWISE INDICATED																
Business and labour																
Productivity	1.6	-0.5	-0.6	-0.9	-0.2	0.4	1.1	1.2	1.3	1.6	0.9	0.9	2.1	-0.1	0.6	1.2
Pre-tax corporate profits	-12.1	-14.2	-17.4	-19.6	-7.6	-15.9	-2.2	3.4	5.7	19.2	4.2	4.7	7.0	-15.8	-5.7	8.1
Unemployment rate (%)*	6.8	6.8	7.0	7.0	7.2	6.9	6.9	6.8	6.8	6.8	6.7	6.7	6.9	6.9	7.0	6.8
Inflation																
Headline CPI	1.1	0.9	1.2	1.3	1.5	1.6	1.5	2.0	2.4	2.5	2.5	2.2	2.0	1.1	1.7	2.4
Core CPI	2.2	2.2	2.2	2.0	2.0	2.1	2.0	2.1	2.1	2.0	2.0	2.0	1.8	2.2	2.1	2.0
External trade																
Current account balance ($b)	-67.9	-58.0	-61.8	-62.8	-66.4	-79.4	-58.7	-58.2	-55.3	-50.9	-49.4	-47.1	-44.9	-62.6	-65.7	-50.7
% of GDP	-3.4	-2.9	-3.1	-3.2	-3.3	-4.0	-2.9	-2.8	-2.7	-2.4	-2.3	-2.2	-2.3	-3.2	-3.2	-2.4
Housing starts (000s)*	175	193	213	194	198	198	186	188	186	181	179	178	189	196	192	181
Motor vehicle sales (mill., saar)*	1.84	1.92	1.99	1.99	2.01	1.99	1.93	1.90	1.86	1.86	1.83	1.82	1.89	1.94	1.96	1.84
INTEREST AND EXCHANGE RATES %, END OF PERIOD																
Overnight	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00	0.50	0.50	0.50
Three-month	0.55	0.58	0.43	0.51	0.45	0.48	0.50	0.50	0.50	0.50	0.55	0.60	0.91	0.51	0.50	0.60
Two-year	0.50	0.48	0.52	0.48	0.54	0.52	0.55	0.60	0.60	0.65	0.70	0.80	1.01	0.48	0.60	0.80
Five-year	0.77	0.82	0.80	0.73	0.67	0.57	0.65	0.75	0.80	0.95	1.15	1.35	1.34	0.73	0.75	1.35
10-year	1.36	1.69	1.43	1.40	1.23	1.06	1.15	1.25	1.40	1.60	1.75	1.90	1.79	1.40	1.25	1.90
30-year	1.98	2.31	2.20	2.15	2.00	1.72	1.80	1.90	2.05	2.25	2.45	2.65	2.34	2.15	1.90	2.65
Canadian dollar	1.27	1.25	1.33	1.38	1.30	1.29	1.31	1.33	1.31	1.31	1.30	1.30	1.16	1.38	1.33	1.30

* Quarterly averages, level

Source: Bank of Canada, Statistics Canada, RBC Economics Research forecasts

September 2016

Forecast detail – United States

RBC FORECASTS OF THE ECONOMY AND FINANCIAL MARKETS

= Forecast

	2015				2016				2017				Annual			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2014	2015	2016	2017
GROWTH IN THE ECONOMY PERIOD-OVER-PERIOD ANNUALIZED PERCENT CHANGE UNLESS OTHERWISE INDICATED																
Consumer spending	2.4	2.9	2.7	2.3	1.6	4.4	3.0	2.4	2.3	2.1	2.0	2.0	2.9	3.2	2.7	2.4
Durables	4.2	7.6	6.2	4.0	-0.6	9.9	8.2	4.5	4.0	3.5	3.1	3.1	6.7	6.9	4.9	4.7
Non-durables	1.9	2.7	3.2	1.2	2.1	5.7	1.2	2.1	2.0	1.9	1.7	1.6	2.6	2.6	2.7	2.1
Services	2.3	2.2	2.0	2.3	1.9	3.1	2.7	2.2	2.1	2.0	1.9	1.9	2.3	2.8	2.3	2.2
Government spending	2.6	3.2	1.9	1.0	1.6	-1.5	1.0	1.8	1.5	1.2	1.2	1.0	-0.9	1.8	1.0	1.2
Residential investment	13.4	14.8	12.6	11.5	7.8	-7.7	0.0	3.1	2.4	2.5	2.1	2.0	3.5	11.7	5.0	1.5
Business investment	1.3	1.6	3.9	-3.3	-3.4	-0.9	3.4	3.2	3.3	3.3	3.5	3.5	6.0	2.1	-0.5	3.1
Non-residential structures	-12.4	-2.7	-4.3	-15.2	0.1	-8.4	6.0	2.0	2.1	2.2	2.2	2.8	10.3	-4.4	-4.5	1.9
Non-residential equipment	9.3	-0.3	9.1	-2.6	-9.5	-3.7	2.0	3.3	3.4	3.4	3.8	3.6	5.4	3.5	-2.2	2.8
Intellectual property	0.8	8.0	2.1	4.5	3.8	8.6	3.8	3.9	3.9	3.9	3.8	3.7	3.9	4.8	4.9	4.1
Final domestic demand	2.6	3.2	3.0	1.7	1.2	2.2	2.6	2.4	2.3	2.1	2.0	2.0	2.6	3.1	2.1	2.3
Exports	-5.8	2.8	-2.8	-2.7	-0.7	1.2	4.8	0.8	2.0	1.5	1.8	1.1	4.3	0.1	0.0	1.9
Imports	5.6	2.9	1.1	0.7	-0.6	0.3	4.0	2.3	4.0	2.5	2.0	2.0	4.4	4.6	1.0	2.8
Inventories (change in $b)	114.4	93.8	70.9	56.9	40.7	-12.4	10.0	27.0	39.0	41.0	39.0	39.0	57.7	84.0	16.3	39.5
Real gross domestic product	2.0	2.6	2.0	0.9	0.8	1.1	3.2	2.7	2.3	2.1	2.0	1.9	2.4	2.6	1.6	2.3
OTHER INDICATORS YEAR-OVER-YEAR PERCENTAGE CHANGE UNLESS OTHERWISE INDICATED																
Business and labour																
Productivity	1.0	0.9	0.7	0.5	0.1	-0.4	-0.6	0.4	0.9	1.4	1.4	1.3	0.6	0.8	-0.1	1.2
Pre-tax corporate profits	7.5	-2.8	-4.5	-11.2	-6.6	-4.9	-3.4	4.1	1.4	3.1	2.9	2.1	5.9	-3.0	-2.9	2.4
Unemployment rate (%)*	5.6	5.4	5.2	5.0	4.9	4.9	4.9	4.8	4.8	4.7	4.7	4.7	6.2	5.3	4.9	4.7
Inflation																
Headline CPI	-0.1	0.0	0.1	0.5	1.1	1.1	1.1	1.6	2.3	2.2	2.4	2.4	1.6	0.1	1.2	2.3
Core CPI	1.7	1.8	1.8	2.0	2.2	2.2	2.2	2.2	2.1	2.0	2.0	2.0	1.7	1.8	2.2	2.0
External trade																
Current account balance ($b)	-458	-448	-492	-454	-499	-500	-524	-539	-558	-575	-582	-595	-392	-463	-515	-577
% of GDP	-2.6	-2.5	-2.7	-2.5	-2.7	-2.7	-2.8	-2.9	-2.9	-3.0	-3.0	-3.0	-2.3	-2.6	-2.8	-3.0
Housing starts (000s)*	986	1156	1156	1135	1151	1156	1190	1203	1212	1221	1229	1237	1001	1108	1175	1225
Motor vehicle sales (millions, saar)*	16.9	17.2	17.7	17.9	17.3	17.1	17.3	17.8	17.9	18.0	18.1	18.2	16.5	17.4	17.4	18.1
INTEREST RATES %, END OF PERIOD																
Fed funds	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	0.25	0.50	0.50	1.00
Three-month	0.03	0.01	0.00	0.16	0.21	0.26	0.20	0.20	0.15	0.50	0.50	0.75	0.04	0.16	0.20	0.75
Two-year	0.56	0.64	0.64	1.06	0.73	0.58	0.70	0.80	0.90	1.00	1.15	1.25	0.67	1.06	0.80	1.25
Five-year	1.37	1.63	1.37	1.76	1.21	1.01	1.10	1.20	1.30	1.40	1.55	1.65	1.65	1.76	1.20	1.65
10-year	1.94	2.35	2.06	2.27	1.78	1.49	1.55	1.70	1.80	1.90	2.00	2.10	2.17	2.27	1.70	2.10
30-year	2.54	3.11	2.87	3.01	2.61	2.30	2.30	2.40	2.60	2.75	2.85	2.90	2.75	3.01	2.40	2.90
Yield curve (10s-2s)	138	171	142	121	105	91	85	90	90	90	85	85	150	121	90	85

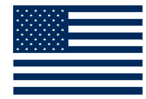
* Quarterly averages, level

Source: US Bureau of Economic Analysis, RBC Economics Research forecasts

September 2016

CURRENT ECONOMIC INDICATORS

Canada - US Comparisons



	From Preceding Month	From Year Ago	Year-To-Date	Latest Month	From Preceding Month	From Year Ago	Year-To-Date	Latest Month
Business								
Industrial production[1]	2.6	-1.3	-0.7	Jun.	-0.5	-1.1	-0.5	Aug.
Mfg. inventory - shipments ratio (level)	1.4	1.4	1.4	Jul.	1.4	1.4	1.4	Jul.
New orders in manufacturing	-2.9	-7.7	-4.0	Jul.	1.9	-3.5	-5.3	Jul.
Business loans - Banks	0.7	7.5	9.0	Jul.	-0.3	8.5	10.6	Aug.
Index of stock prices[2]	0.1	5.3	-4.9	Aug.	1.3	6.7	3.0	Aug.
Households								
Retail sales	-0.1	2.3	2.7	Jul.	-0.3	1.9	1.7	Aug.
Auto sales	-5.6	-3.3	3.4	Jul.	-5.0	-13.3	-5.3	Aug.
Total consumer credit[3]	0.3	2.7	2.8	Jun.	0.5	6.0	6.7	Jul.
Housing starts	-6.3	-14.7	3.0	Aug.	-5.8	0.9	8.4	Aug.
Employment	0.1	0.4	0.8	Aug.	0.1	1.7	1.7	Aug.
Prices								
Consumer price index	-0.2	1.1	1.3	Aug.	0.2	1.1	0.53	Aug.
Producer price index[4]	0.2	-1.3	-0.8	Jul.	-0.3	-1.9	-2.7	Aug.
Interest rates								
Policy rate	0.5	0.5	0.5	Aug.	0.38	0.13	0.38	Aug.
90-day commercial paper rates	0.8	0.6	0.8	Aug.	0.5	0.2	0.5	Aug.
Government bonds (10 years)	1.1	1.5	1.3	Aug.	1.6	2.2	-	Aug.

Seasonally adjusted % changes unless otherwise indicated. Interest rates are levels.

1 The U.S. series is an index.

2 Canada = S&P/TSX; United States = S&P 500

3 Excludes credit unions and caisses populaires.

4 Canada's producer price index is not seasonally adjusted.

September 2016

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