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Happier New Year!

2011 started with a spate of stronger U.S. data indicating that, at long last, the economy is out of the woods and on a sustainable growth path. In other nations, the direction was not as clear, although on balance the data indicate that growth is the on the menu for 2011. Canadian reports came out on the low side of expectations although are still consistent with the economy having accelerated from the third quarter of 2010's soft pace. Australia and New Zealand showed signs that their economies flagged late in the year while Euro-zone data continue to highlight the divergence in country performance with Germany's economy still producing smoking-hot results. Through the ups and downs in the data, investor confidence that the global recovery will continue in 2011 increased with the world stock market index marching to its highest level since September 2008 in early January and with commodity prices firming. The tide has turned on the economic outlook; however, we do not expect clear sailing given the lingering uncertainty about how Europe's debt situation will play out. Central banks are likely to proceed cautiously with little action expected in the first quarter of 2011.

Better news whets investors' appetite for risk

As investors' appetite for risk rose, so did interest rates with 10-year yields in the US up 43 basis points (bps) since December 1, 2010. 10-year Canadian yields inched up by 6 bps, EZ rose 13 bps and U.K. gilts yields increased by 16 bps. The late-year rise in yields partially reflected the improved tone and brighter outlook for the U.S. economy, given the passage of the tax package, reverberating into upgrades to global economic forecasts. We estimate that this good news

Central bank near-term bias

Bias three-months out



We expect the BoC to hold rates steady at its January policy meeting and again in March, following the recent round of somewhat disappointing data.



With the Fed viewing progress on inflation and employment as "disappointingly slow", it is unlikely that the Fed will raise the policy rate in 2011.



Next week's MPC meeting is not expected to see any change in monetary policy. Despite high inflation and rising expectations, the uncertain outlook makes a near-term move unlikely.



The ECB is not expected to make any changes to monetary policy in next week's meeting of the Governing Council, and we continue to expect interest rates to stay on hold until next year.



The RBA views its current policy stance as "appropriate" and we do not expect it will make a case for further tightening until Q2/11.



We continue to expect that the RBNZ will raise policy rates in Q2/11; however, the data will likely need to show improvement during Q1/11 for this to come to fruition.

Highlights

- ▲ Data swing in favour of a stronger global economy.
- ▲ Investors shift into riskier asset markets...
- ▲ ...trading in some of their fixed-income holdings, and yields of government bonds rise.
- ▲ Lingering concerns about the European debt crisis are likely to keep central banks on the sidelines and cap near-term upside on government bond yields.
- ▲ U.S. economy got back on a firmer growth path in late 2010.
- ▲ Inflation and unemployment rates still outside of the Fed's comfort zone: meaning no change to policy in the near term.

has largely been priced into bond markets, and we expect interest rates to remain range bound in the first quarter of 2011. The potential for another bout of European fiscal unrest cannot be discounted therein leaving the door open to investors diving back into the safety of fixed-income assets, which could cap the near term upside for rates.

U.S. economy comes fighting back!

U.S. data reports in the past month have been surprisingly strong with the manufacturing purchasing managers' index recovering from its mid-year weak spot while the service sector's measure of business activity hit the highest level since August 2005. The labour market also ended 2010 on an up note with the economy producing the largest quarterly increase in private payrolls since the recovery began. Consumer spending roared back in late 2010 bolstered by rapid auto sales, and we now expect consumption growth of 4% in the fourth quarter. The firmer consumer spending activity, along with indications that net trade could act as a stronger support to growth than we had previously expected, led us to make a sizeable upgrade to our fourth-quarter 2010 real GDP forecast to 3.5% from 2.2%. As a result, our forecast for U.S. growth in 2010 is now 2.9% with the stronger starting point for 2011 filtering into a 0.1 percentage point (ppt) rise in the annual forecast to 3.4%.

Fed still cautious

The minutes of the December meeting hammered home that the Fed still saw significant risks to the outlook and viewed the progress on inflation and employment as likely to remain slow even against a mildly improved outlook for growth. As indicated, our assessment is that recent economic reports indicate that the U.S. economy pulled out of the doldrums in the final quarter of 2010 growing at the fastest pace since the first quarter of the year. Furthermore, we expect the economy's momentum to accelerate as the government's tax package keeps consumers spending and businesses investing. Even with this stronger growth profile, however, the scope for a significant rise in core inflation is limited. Our forecast assumes that October's 0.6% core inflation rate will mark the low point for the cycle; nevertheless, given the yawning output gap and slack labour market, wages and prices will not accelerate rapidly. Our forecast is for the core inflation rate to rise steadily in 2011 averaging 1.2% in the fourth quarter, double its recent low but still below the Fed's assumed target of about 2%.

Labour market improvement is the key

The U.S. labour market recovery proved very disappointing in 2010, although private-sector hiring increased steadily each quarter. This boosted our confidence that 2011 will see businesses add to payrolls at a faster clip. After private payrolls increased by a 1.35 million in 2010, we forecast a 2.9 million increase in 2011. These gains sound impressive; however, in the context of the 8.5 million private-sector jobs lost during the recession, it means that only one-half of those jobs will have been recovered. This forecast is also consistent with a gradual decline in the unemployment rate to 9.0% from its recent peak of 10.1%. Thus, while conditions will improve, the U.S. unemployment rate will still be at a level that is inconsistent with the Fed's mandate of bringing the economy back to full employment. Against this backdrop, policymakers are unlikely to raise the policy rate this year. Rather, should the economy build momentum as expected, we look for any reduction in policy stimulus to begin with the expiry of the asset purchase program, followed by the ending of the program to reinvest the proceeds of maturing holdings and eventually, the sale of bonds held by the Fed. Assuming that the unwinding of these measures does not jar the economy from its stronger growth path, we expect the first increase in the official policy rate in early 2012.

Canada—down but not out!

The news on Canada's economy soured mid-year 2010 with real GDP expanding at a paltry 1.0% annualized pace in the third quarter. Fourth-quarter 2010 reports fared slightly better although not enough to support our 2.9% forecast, and we have accordingly shaved it to 2.3%. Canadian consumers scaled back late in the year after providing solid support for growth in the early days of the recovery while business spending showed signs of slowing after the rapid expansion in the third quarter of 2010. In all, this spells a softer quarter for domestic demand and slower import growth. Exports conversely jumped in October and the solid increase in U.S. auto sales throughout the quarter augurs well for firm export sales in the final months of the year. Our 2010 real GDP growth projection was also revised down to 2.9%. Our forecast for 2011, however, remains unchanged at 3.2% with the strengthening in U.S. demand forecasted to boost net exports while low interest rates and accommodative financial conditions support both consumer and business spending this year. Unlike in 2010, when both the housing market and inventories provided support to the economy's expansion, these sectors are expected to cool and restrain real GDP growth.

Labour market blues

Touted as a leader in terms of the pace of recovery, Canada's labour market faded in the second half of 2010 with only 60,100 jobs created, paling in comparison to the 308,400 increase from January to June. Despite the slowing pace of job gains, the unemployment rate continued to edge lower into year-end 2010 as only 9,000 workers entered the labour force in the second half of the year. A full recovery in terms of the number of employed and a 0.8 ppt decline in the unemployment rate in 2010 is indisputably good news for the economy even if proportionately more jobs are part-time in the post-recession period. Looking at 2011, a revival in the pace of job gains will be necessary if the pace of consumer spending is to be sustained. To date, consumers have made a strong contribution to the expansion. Although we are assuming some moderation in support from this sector, the importance of sustaining domestic spending in 2011 will likely result in the Bank of Canada reducing policy accommodation very slowly.

Canada to rebuild growth momentum

We are assuming that the Bank of Canada will leave the overnight rate unchanged at 1.00% in the first quarter of 2011 after coming off the recent round of disappointing data. Our call is that Canada's slow-growth period is about to end with the U.S. economy moving into a faster gear and domestic financial conditions supportive. The combination of dissipating stress outside of Canada's borders and firming domestic conditions will set the stage for the Bank of Canada to resume its program of reducing monetary policy stimulus. With the U.S. economy already showing signs of strength, the Bank's attention will turn to the domestic data flow. Our assumption that Canada's economy will accelerate sharply (real GDP of 3.5% annualized pace) in the first quarter of 2011 is the underpinning for our call that the Bank will raise the overnight rate in the second quarter. A more subdued bounce back raises the prospect that the Bank will remain on the sidelines slightly longer than in our baseline forecast.

Economic data in the UK show inflation up, growth down

The minutes of the December rate meeting indicated that the Monetary Policy Committee (MPC) judged both risks to the downside (related to slowing economic activity) and those to the upside (related to rising inflation) had increased, and recent data have reinforced these opposing views. Real GDP in the third quarter of 2010 was unexpectedly revised down with details providing less encouragement for the rebalancing of the U.K. economy than previously thought. The most recent employment data indicate that job growth declined for the first time since March 2010, and the unemployment rate moved

▲ Canada's economy to pick up momentum in 2011...

▲ ...after fatigue set in mid-year 2010.

▲ The labour market made a full recovery in 2010 with large gains in first half of the year.

▲ A brighter U.S. outlook allays part of the BoC's concerns.

▲ Now, it is time for the domestic economy to show its stuff!

Highlights

▲ U.K. inflation continues to stay elevated, and inflation expectations are on the rise.

▲ Positive aggregate data for the Euro area continue to mask the stark differences between the core and peripheral economies

▲ New Zealand real GDP growth came in weaker than expected in Q3/10, declining by a non-annualized 0.2% on a production basis.

▲ The RBA appears to be content to sit on the sidelines in Q1/11.

to a six-month high at 7.9%. With respect to prices, November inflation came in stronger than expected with CPI rising by 3.3% year-over-year (core up 2.7%) and RPI growth accelerating to 4.7%. The MPC argues that the elevated inflation rate stems from the pass through of currency depreciation and increases in the VAT, and that downward pressure from the output gap will eventually prevail. The public, however, is proving sceptical, and recent surveys indicate inflation expectations are on the rise. This month's rise in the VAT (to 20.0% from 17.5%) will further complicate matters if it pressures inflation expectations upward. Against this uncertain backdrop, we expect that the Bank of England will maintain its current policy stance next week and will likely hold rates steady until the final quarter of 2011.

The song remains the same in the Eurozone

Despite the spotlight shining on the continued weakness within the peripheral Euro area economies, the aggregated economic data for the Eurozone as a whole have been surprisingly upbeat. One main reason for this is the strength of the core economies, particularly Germany, which despite accounting for less than one-third of Euro area output likely accounted for roughly two-thirds of the region's increase in real GDP for 2010. The divergence between the core and peripheral economies will continue to be a theme throughout 2011 as Germany and less fiscally challenged economies experience solid growth while the peripheral nations face considerable headwinds from fiscal and structural adjustments. The bifurcated growth profile combined with increasing price pressures (Euro area inflation in December was above the ECB's implicit target for the first time in two years) will make the Central Bank's job more difficult. We expect that next week's meeting of the Governing Council will not yield any changes to monetary policy and anticipate that rates will remain on hold during 2011 as policymakers weigh the downside risk to the periphery if tightening starts too soon.

Faltering recovery to extend RBNZ's policy pause

New Zealand's economy contracted by a non-annualized 0.2% (production basis) in the third quarter of 2010, providing evidence that the recovery is faltering. Our baseline forecast for 2011 assumes consumer spending will remain muted as households repair balance sheets, and excess capacity in the economy will limit business investment. With that said, the construction sector is expected to receive a significant boost from rebuilding efforts, and soft commodity exports should receive support from continued strength of New Zealand's major trading partners, thereby leading the economy to expand by 2.2% in 2011. This pace of growth will not result in much progress in reducing the sizable output gap, and we expect inflation (absent the effect of October's VAT increase) to rise only modestly year end. The persistent excess capacity in the economy places little impetus for a change in policy stance, and we expect the current pause to extend into the second quarter of 2011 before the Reserve Bank of New Zealand resumes hiking rates, with the official cash rate finishing 2011 at 3.75%.

Flooding to have a significant impact on Australian economy

The overall tone in the minutes from the Reserve Bank of Australia's December rate meeting confirmed that the Central Bank is comfortable with the current mildly restrictive policy stance and that there is no urgency for further rate increases. Since that meeting, severe flooding in the Queensland region has caused significant disruption to bulk commodity production (the region is country's the largest coal exporter) and damaged crops. The Bank's board member, Donald McGauchie, said that "the consequence for export income could be quite substantial" and may have a "significant impact" on the nation's economy. Indeed, we have downgraded our near-term forecast for real GDP growth and now anticipate that growth for 2011 to come in at 2.8% (from 3.3% previously). We expect that the Bank will sit tight until the extent of the damage can be fully assessed and do not expect it to raise rates until the second quarter of 2010.

Interest rate outlook

%, end of period

	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4
Canada											
Overnight	0.50	1.00	1.00	1.00	1.50	2.00	2.00	2.50	3.00	3.50	3.50
Three-month	0.50	0.88	0.97	1.10	1.50	2.00	2.05	2.55	3.05	3.50	3.60
Two-year	1.39	1.40	1.71	1.95	2.50	2.75	3.10	3.20	3.45	3.65	4.00
Five-year	2.32	2.04	2.46	2.65	3.00	3.25	3.55	3.50	3.75	4.00	4.05
10-year	3.08	2.75	3.16	3.25	3.35	3.50	3.80	3.95	4.05	4.15	4.15
30-year	3.65	3.34	3.55	3.85	4.05	4.30	4.40	4.45	4.50	4.50	4.55
United States											
Fed funds	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	0.75	1.50	2.00	2.25
Three-month	0.18	0.16	0.12	0.15	0.20	0.25	0.30	0.60	1.40	2.00	2.30
Two-year	0.61	0.44	0.61	0.80	1.25	1.45	1.85	2.00	2.30	2.60	3.05
Five-year	1.79	1.27	2.01	2.05	2.25	2.40	2.85	3.00	3.25	3.50	3.75
10-year	2.97	2.48	3.30	3.35	3.50	3.60	4.00	4.15	4.25	4.45	4.50
30-year	3.91	3.67	4.34	4.55	4.55	4.75	4.85	4.90	4.95	5.00	5.05
United Kingdom											
Repo	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.75
Two-year	0.74	0.85	1.09	1.10	1.20	1.40	1.80	1.90	2.10	2.30	2.50
10-year	3.36	3.20	3.40	3.30	3.40	3.50	3.60	3.50	3.75	4.00	4.00
Eurozone											
Minimum bid	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.50	1.75	2.00
Two-year	0.59	0.60	0.85	1.00	1.10	1.25	1.50	1.80	2.10	2.50	2.75
10-year	2.55	2.25	2.96	3.10	3.30	3.40	3.50	3.60	3.70	3.90	4.10
Norway											
Sight deposit rate	2.00	2.00	2.00	2.00	2.25	2.50	2.75	3.00	3.25	3.50	3.75
Sweden											
Repo rate	0.25	0.50	1.25	1.50	1.75	2.00	2.00	2.25	2.50	2.75	3.00
Australia											
Cash target rate	4.50	4.50	4.75	4.75	5.00	5.25	5.50	5.75	5.75	5.75	5.75
Two-year	4.44	4.40	5.16	4.90	5.05	5.30	5.60	5.70	5.80	5.80	5.80
10-year	5.10	4.75	5.57	5.65	5.75	5.75	6.00	5.95	6.00	5.95	6.00
New Zealand											
Cash target rate	2.75	3.00	3.00	3.00	3.25	3.50	3.75	4.00	4.25	4.50	4.50
Three-year	4.16	4.20	4.00	4.25	4.65	4.85	5.05	5.20	5.30	5.30	5.40
10-year	5.73	5.20	5.90	5.85	6.00	5.95	6.05	6.15	6.20	6.20	6.20
Yield curve											
Canada	169	135	145	130	85	75	70	75	60	50	15
United States	236	204	269	255	225	215	215	215	195	185	145
United Kingdom	262	235	231	220	220	210	180	160	165	170	150
Eurozone	196	165	211	210	220	215	200	180	160	140	135
Australia	66	35	41	75	70	45	40	25	20	15	20
New Zealand	157	100	190	160	135	110	100	95	90	90	80

* Two-year/10-year spread in basis points **New Zealand's yield curve: 10-year vs. three-year

Source: Reuters, RBC Economics Research

Central bank policy rate

%, end of period

		Current	Last			Current	Last		
United States	Fed funds	0.0-0.25	1.00	Dec. 16, 2008	Eurozone	Min. bid rate	1.00	1.25	May 13, 2009
Canada	Overnight rate	1.00	0.75	Sep. 08, 2010	Australia	Cash rate	4.75	4.50	Nov. 03, 2010
United Kingdom	Repo rate	0.50	1.00	Mar. 5, 2009	New Zealand	Cash rate	3.00	2.75	Jul. 29, 2010

Source: Bloomberg, Reuters, RBC Economics Research

Economic outlook

Growth outlook

% change, year-over-year in real GDP

	10Q1	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	2009A	2010F	2011F	2012F
Canada	2.1	3.4	3.4	2.8	2.3	2.9	3.6	3.9	3.8	3.4	2.9	2.6	-2.5	2.9	3.2	3.1
United States	2.4	3.0	3.2	2.9	2.8	3.4	3.8	3.9	3.9	3.7	3.4	3.3	-2.6	2.9	3.4	3.6
United Kingdom	-0.3	1.7	2.8	2.9	2.7	1.9	1.9	2.0	2.3	2.6	2.4	2.4	-4.9	1.8	2.1	2.4
Eurozone	0.8	1.9	1.9	2.2	2.3	1.7	1.7	1.7	1.8	1.9	2.0	2.0	-4.1	1.7	1.8	1.9
Australia	2.3	3.1	2.7	2.3	2.1	1.9	2.6	2.9	2.8	2.7	2.5	2.7	1.3	2.6	2.4	2.6
New Zealand	1.8	1.8	1.5	1.3	1.4	2.0	2.5	2.9	2.9	2.8	2.8	2.7	-1.7	1.8	2.2	2.8

*Forecast

Inflation outlook

% change, year-over-year

	10Q1	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	2009A	2010F	2011F	2012F
Canada	1.6	1.4	1.8	2.3	2.2	2.6	2.3	1.6	1.6	1.9	2.1	2.2	0.3	1.8	2.2	2.0
United States	2.4	1.8	1.2	1.2	1.4	2.0	2.0	1.6	1.4	1.5	1.5	1.5	-0.4	1.6	1.8	1.5
United Kingdom	3.3	3.4	3.1	3.2	3.2	3.3	3.4	3.1	2.5	2.0	2.0	2.0	2.1	3.2	3.3	2.1
Eurozone	1.1	1.5	1.7	1.8	1.9	1.9	1.7	1.5	1.7	1.9	2.1	1.8	0.3	1.5	1.7	1.9
Australia	2.9	3.1	2.8	3.1	3.4	3.5	3.6	3.6	3.3	3.3	3.2	3.1	1.8	2.9	3.6	3.3
New Zealand	2.0	1.7	1.5	3.7	4.0	4.5	4.1	2.1	1.9	1.9	1.8	2.3	2.1	2.2	3.7	2.3

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	Month ago	Year ago	Three-month trend	Six-month trend
Canada	Bank of Canada core CPI ¹	Nov.	0	1.4	1.4	1.2
United States	Core PCE ²	Nov.	0.1	0.8	0.2	0.7
United Kingdom	All-items CPI	Nov.	0.3	3.2	2.2	2.8
Eurozone	All-items CPI	Nov.	0.1	1.9	2.0	1.9
Australia	Trimmed mean	Q3	0.6	2.5	N/A	N/A
New Zealand	CPI	Q3	1.1	1.5	N/A	N/A

¹ Seasonally adjusted measurement

² Personal consumption expenditures less food and energy price indices

Source: Statistics Canada, U.S. 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

	Historical				Forecast							
	10Q1	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4
Canadian dollar	1.02	1.06	1.03	1.00	0.99	0.98	0.97	1.00	1.02	1.05	1.03	1.01
Euro	1.35	1.22	1.36	1.34	1.29	1.25	1.22	1.20	1.18	1.17	1.20	1.25
U.K. pound sterling	1.52	1.49	1.57	1.56	1.57	1.60	1.58	1.56	1.53	1.50	1.54	1.58
New Zealand dollar	0.71	0.68	0.73	0.78	0.75	0.76	0.75	0.73	0.71	0.70	0.73	0.74
Japanese yen	93.5	88.4	83.5	81.2	81.0	83.0	88.0	95.0	100.0	105.0	100.0	95.0
Chinese renminbi	6.83	6.78	6.69	6.59	6.50	6.40	6.30	6.20	6.10	6.00	5.90	5.80
Australian dollar	0.92	0.84	0.97	1.02	0.97	0.96	0.95	0.94	0.92	0.90	0.93	0.95
Mexican peso	12.37	12.94	12.59	12.36	11.75	11.75	12.00	12.00	12.00	12.50	12.25	12.00

Canadian dollar cross-rates

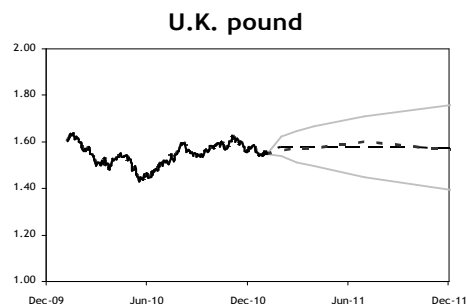
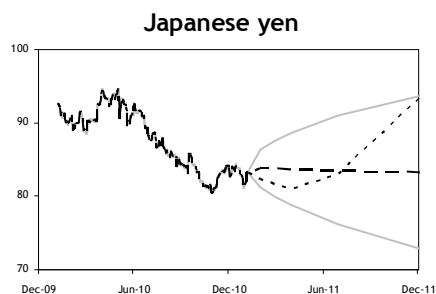
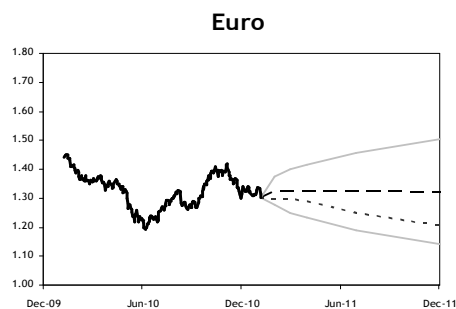
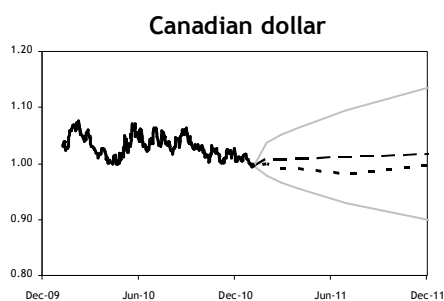
	10Q1	10Q2	10Q3	10Q4	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4
EUR/CAD	1.37	1.30	1.40	1.34	1.28	1.23	1.18	1.20	1.20	1.23	1.24	1.26
GBP/CAD	1.54	1.59	1.62	1.56	1.56	1.57	1.54	1.56	1.56	1.58	1.58	1.60
NZD/CAD	0.72	0.73	0.76	0.78	0.74	0.74	0.73	0.73	0.72	0.74	0.75	0.75
CAD/JPY	92.1	83.1	81.2	81.3	81.8	84.7	90.7	95.0	98.0	100.0	97.1	94.1
AUD/CAD	0.93	0.89	1.00	1.02	0.96	0.94	0.92	0.94	0.94	0.95	0.96	0.96

Rates are expressed in currency units per US\$ and currency units per C\$, except the euro, U.K. pound, Australian dollar and New Zealand dollar, which are expressed in US\$ per currency unit and C\$ per currency unit.

Source: Bloomberg, RBC Economics Research

RBC Economics outlook compared to the market

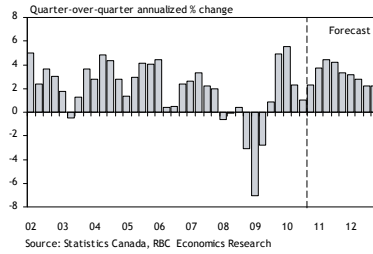
The following charts track historical exchange rates plus the forward rate (dashed line) compared to the RBC Economics forecast (dotted line) out one year. The cone for the forecast period frames the forward rate with confidence bounds using implied option volatilities as of the date of publication.



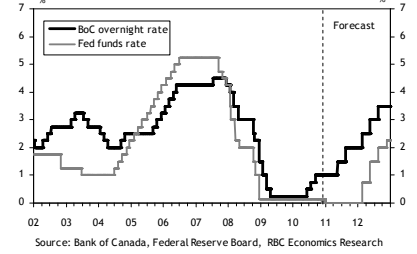
Bank of Canada

- October real GDP came in slightly below expectations but indicated that the economy rallied back after contracting in two out of the three months of Q3/10.
- The BoC is expected to maintain the overnight rate at 1.00% in its January and March rate meetings before resuming rate increases in Q2/11.

Canadian real GDP growth



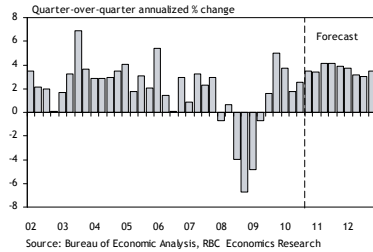
Canadian and U.S. central bank policy target rates



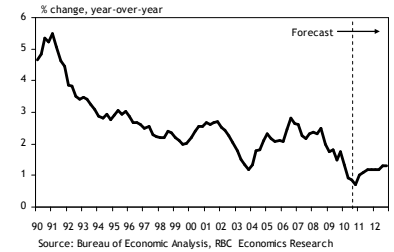
Federal Reserve

- Both the December manufacturing and non-manufacturing PMI rose, suggesting that economic momentum will carry into 2011.
- With progress on inflation and employment “disappointingly slow”, the Fed will not likely raise policy rates in 2011.

U.S. real GDP growth



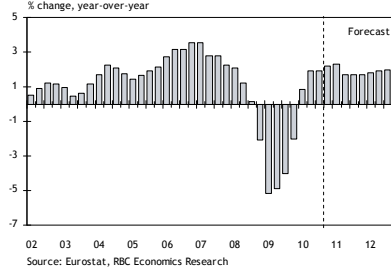
U.S. core CPI inflation



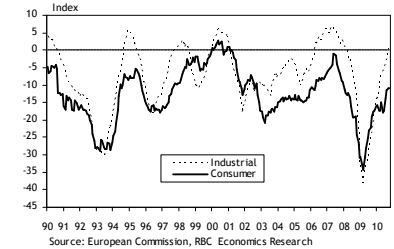
European Central Bank

- Euro area PMI data for December continue to point to solid growth for the region.
- Despite the inflation running above the ECB's implicit target for the first time since November 2008, the Governing Council is not expected to make any changes to policy at next week's meeting.

Eurozone GDP



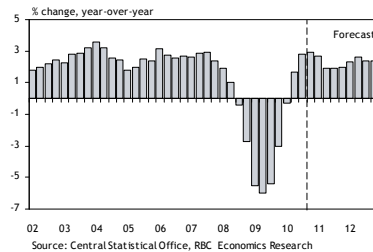
Eurozone confidence



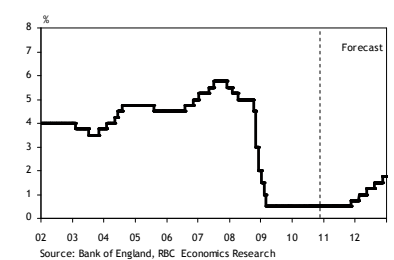
Bank of England

- The final estimate of Q3/10 real GDP was unexpectedly revised down to a non-annualized 0.7% quarterly pace of growth.
- December's manufacturing PMI jumped to its highest level since September 1994, indicating that the sector is maintaining strong momentum heading into 2011.

U.K. real GDP growth



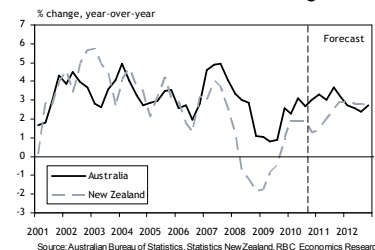
U.K. policy rate



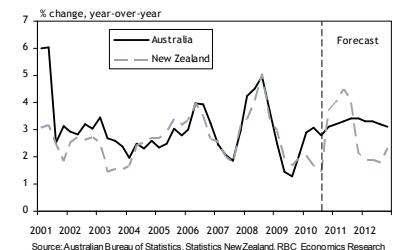
Australia and New Zealand

- Minutes from the December RBA meeting confirm that there is little urgency for policy to tighten further, and we expect rates to remain on hold until Q2/11.
- New Zealand Q3/10 real GDP fell well short of expectations, and the significant excess capacity in the economy suggests that rates could remain on hold until Q2/11 unless data improve.

Australia and New Zealand GDP growth

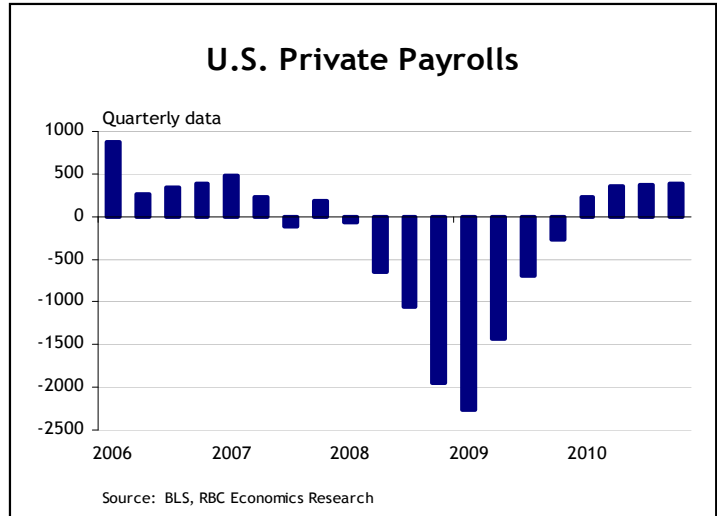
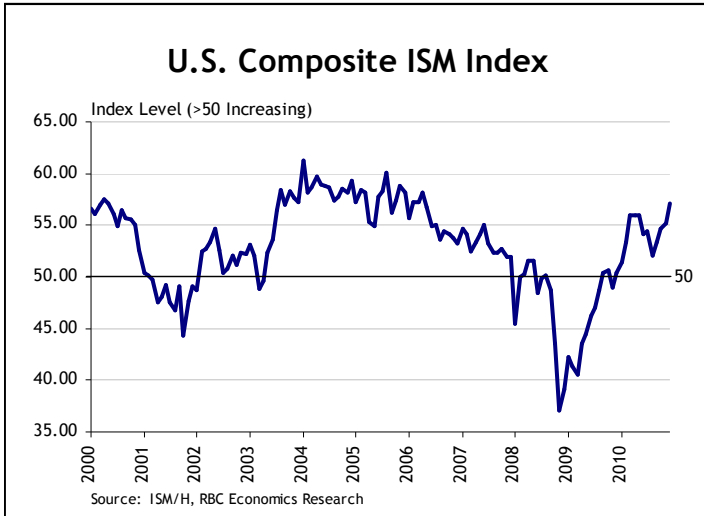


Australia and New Zealand inflation



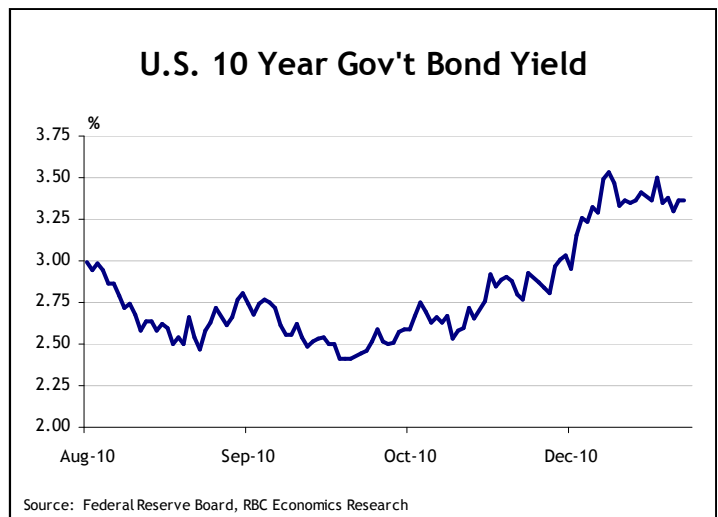
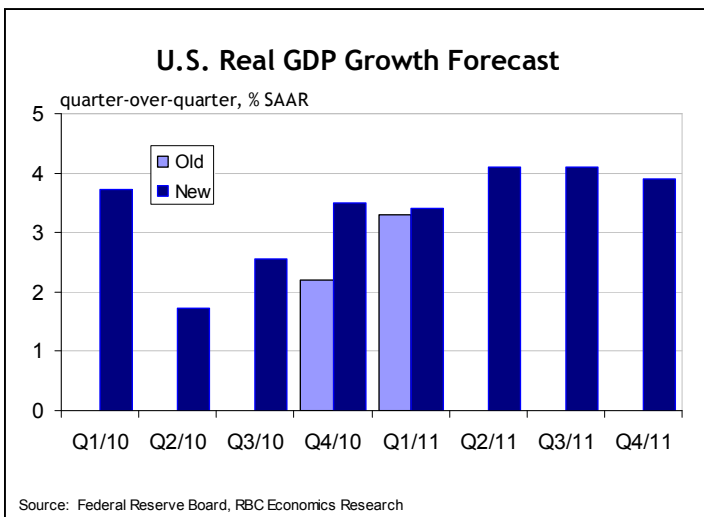
U.S. activity indicators finished 2010 on a high note showing strong momentum heading into 2011.

Private payroll increases picked up pace mildly each quarter throughout 2010.



Data for Q4/10 were stronger than we expected, so we boosted our real GDP forecast accordingly.

The bond market was quick to price in a brighter near-term outlook for the U.S. economy.



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