ECONOMIC MONITOR

September 2014

Prepared by:
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HIGHLIGHTS

Financial Markets Overview (Page 2)

Global growth continues to show divergent patterns; the US and Canada have shown some signs of strength but the Eurozone and Japan are struggling. Growth in China also appears to be slowing. The ECB and Bank of Japan are attempting to combat worryingly low inflation with yet looser monetary policies. However, this is unlikely to help growth significantly and any benefit will likely come through currency devaluation.

Global Growth Revised Down (Page 4)

The OECD downgraded its world GDP growth forecast in September from its May projections and the IMF has said it will also have some downward revisions in its October World Economic Outlook. This article explores the implications of slow economic growth on commodities, inflation, currencies and investments and what policies could be implemented to improve growth prospects.

Canadian Economic Charts (Page 8)

Second quarter GDP growth rebounded to 3.1% from 0.9% in the first quarter. Our forecast for the full year is a modest 2.0% to 2.5%. Headline consumer price inflation has retreated from 2.4% in June to 2.1% in August, but the core rate has been rising lately. Headline inflation will likely resume rising in coming months before falling back. The Bank of Canada is unlikely to raise interest rates in the foreseeable future. The Canadian dollar is expected to decline further.

US Economic Charts (Page 20)

Growth in the first half of 2014 was rather weak, and our forecast for the full year calls for only about 2.0%. Consumer price inflation fell back to 1.7% in August, after moving just over 2% earlier this year. The Fed is set to end its asset purchase program in October 2014 and is forecast raise interest rates from the current range of 0.00%-0.25% to the range of 0.25%-0.50% towards mid-2015 – assuming inflation stays close to the Fed’s 2.0% target and the labour market continues to improve. The dollar is likely to continue rising against most currencies as the Fed reduces stimulus while the ECB and Bank of Japan add to stimulus.

Financial Markets Overview

by William Tharp

The global economy is currently characterized by divergent growth trends – some strengthening in the US and Canada, relatively firm in Britain, soft and probably weakening in Europe and Japan, and continuing to weaken in China. Despite massive support from monetary policy in many countries, inflation remains weak and stands to weaken further on declining oil prices. Europe is keen to avoid deflation, while Japan is wary of falling back into a deflationary rut. Consequently both Europe and Japan are attempting more monetary policy stimulation, but this is unlikely to help growth drastically and will work primarily through currency devaluation. Any growth gains coming from currency depreciation will however come at the expense of US growth. Consequently we don't expect the current upswing in US GDP to last more than a few quarters. This raises questions as to whether the Fed will still be contemplating an interest rate increase toward mid-2015. We shall see!

1.► The **BANK OF CANADA** is likely to leave interest rates unchanged for the foreseeable future. While both growth and inflation are picking up for the moment, these trends are unlikely to prevail for a sufficient length of time as to warrant an interest rate increase. The Bank remains worried about the eventual return of disinflationary pressures.

2.► The **FED FUNDS RATE** is expected to remain in the range of 0.00%-0.25% until mid-2015, but drift higher within that range until mid-2015. In July the Fed is expected to raise the range to 0.25%-0.50%. But all this assumes that inflation stays near 2% (it has already fallen back below this level), unemployment continues to decline and, more critically, that wage inflation accelerates well above 2%. The Fed is expected to end its QE program entirely in October. We have left a mid-2015 rate hike in the forecast but little by little we are seeing the odds of an increase receding.

3.► Longer term **BOND YIELDS** could move somewhat higher to the extent that economic growth improves, inflation remains near 2%, and Fed asset buying ends. But several factors will continue to restrain any rise in yields. These include looser monetary policy in Europe and Japan, a firm US dollar, as well as a growing need of baby boomers to acquire assets, including fixed income, before heading for retirement.

4.► Our outlook for the **CANADIAN DOLLAR** has become more negative with the recent decline in oil prices. We expect both to continue to weaken, though not necessarily in a straight line. The dollar's decline will be tempered by an improving domestic economy plus a temporary rise in inflation. Global conflicts might also boost international oil prices. Expect the dollar's decline to be bumpy.

5.► The **US DOLLAR** is likely to continue to rise against most currencies as QE concludes. As well, Europe and Japan are adding to their monetary stimulus while the US is thinking of subtracting stimulus. Whether or not such plans come to fruition, the greenback will be firm for the time being.

Updated Forecast - Base Scenario

	Actual				Projected						
	13-IV	14-I	14-II	24-Sep	Oct	Nov	Dec	15-I	15-II	15-III	15-IV
CURRENCIES	***Scenario B: Very Weak Eurozone and Slowing Chinese Growth; Modest US Improvement***										
US Dollar Index*	77.93	80.52	79.76	83.70	83.92	84.24	84.61	85.02	86.09	87.03	87.99
Can. Dollar: CDN/US	***1.049***	***1.103***	***1.091***	***1.107***	***1.110***	***1.115***	***1.120***	***1.125***	***1.135***	***1.145***	***1.155***
Can. Dollar: US/CDN	95.33	90.66	91.66	90.33	90.09	89.69	89.29	88.89	88.11	87.34	86.58
Japanese Yen	***100.20***	***103.0***	**102.4**	**108.9**	**109.0**	**109.2**	**109.5**	**110.0**	**111.0**	**111.5**	**112.0**
British Pound	161.8	165.5	168.3	163.4	163.2	163.2	162.8	162.5	160.5	158.4	156.0
Euro	***1.361***	***1.370***	***1.367***	***1.279***	***1.275***	***1.270***	***1.265***	***1.260***	***1.240***	***1.220***	***1.200***
Australian Dollar	92.78	89.66	93.32	88.83	88.02	87.62	87.23	87.11	87.22	86.90	87.45
Chinese Yuan/Rmb	***6.132***	***6.118***	***6.158***	***6.137***	***6.135***	***6.128***	***6.120***	***6.110***	***6.090***	***6.070***	***6.050***
Indian Rupee	62.05	61.78	59.80	60.93	60.50	60.00	59.50	59.00	58.50	58.00	57.50

** Index based on CDN$, Euro, Pound, Yen*

INTEREST RATES	***Scenario B: Growth Modest - Inflation Near Target***										
Canada											
Treasury Bill (91-day)	0.92	0.88	0.94	0.92	0.95	0.95	0.95	0.95	0.95	0.98	1.00
Government Bond (10-yr)	2.56	2.42	2.29	2.18	2.26	2.35	2.40	2.45	2.50	2.55	2.60
Prime	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Target Overnight Rate	***1.00***	***1.00***	***1.00***	***1.00***	***1.00***	***1.00***	***1.00***	***1.00***	***1.00***	***1.00***	***1.00***
Spread: 10-yr - T Bills	1.64	1.54	1.35	1.26	1.31	1.40	1.45	1.50	1.55	1.57	1.60
United States											
Treasury Bill (90-day)	0.06	0.05	0.03	0.01	0.05	0.06	0.08	0.13	0.17	0.45	0.70
Treasury Bond (10-yr)	2.79	2.70	2.57	2.54	2.60	2.65	2.70	2.80	2.90	2.95	3.00
Prime	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.50
Fed Funds Target	***0.09***	***0.07***	***0.09***	***0.11***	***0.13***	***0.14***	***0.16***	***0.19***	***0.23***	***0.50***	***0.75***
Spread: 10-yr - T Bills	2.73	2.65	2.54	2.53	2.55	2.59	2.62	2.67	2.73	2.50	2.30
Interest Rate Differential (Canada-US)											
Treasury Bill	0.86	0.83	0.91	0.91	0.90	0.89	0.87	0.82	0.78	0.53	0.30
Bonds-10yr	-0.23	-0.28	-0.28	-0.36	-0.34	-0.30	-0.30	-0.35	-0.40	-0.40	-0.40

Source: Wall Street Journal, Federal Reserve, DCM Economics

This is our "baseline" scenario for the next four quarters. It is updated monthly. For alternative scenarios the reader should consult the Currency and Interest Rate Forecast.

Global Growth Revised Downward!

by Martin Murenbeeld

The OECD's Interim Economic Assessment, issued on September 15, lowered the economic outlook for almost all countries under review. Chart 1 tells the sorry story; the OECD's May 2014 outlook for the US economy called for a 2.6% growth rate in 2014 and a 3.5% growth rate in 2015, but the OECD now projects 2.1% for 2014 and 3.1% for 2015. Italy had been forecast in May to post a modest 0.5% and 1.1% growth rate in 2014 and 2015 respectively, but the OECD now projects -0.4% in 2014 and 0.1% in 2015. (Indeed, Italy has either slipped into its third recession or – in our view – remains in depression.)

Japan has also been downgraded – though less dramatically than the Eurozone. The good news is that China was not downgraded (which may prove to be a forecast error in so far as we think the Chinese economy is turning perceptibly softer), and India was actually upgraded – from 4.9% to 5.7% for 2014.

Not to be overlooked, the IMF served notice in recent days that its October WEO (World Economic Outlook), normally issued prior to its annual meeting in Washington, will see some downward revisions as well.

Implications:

1. Commodities

The implications of weaker global growth for commodities are negative; there is no way to finesse this conclusion! Chart 2 links global growth with commodity prices; its message is that when world economic growth (as tabulated by the IMF) drops below 4% inflation-adjusted commodity prices are very likely to decline. To get an 80% probability that real commodity prices will rise, world growth needs to be in excess of 5%!

2. Inflation

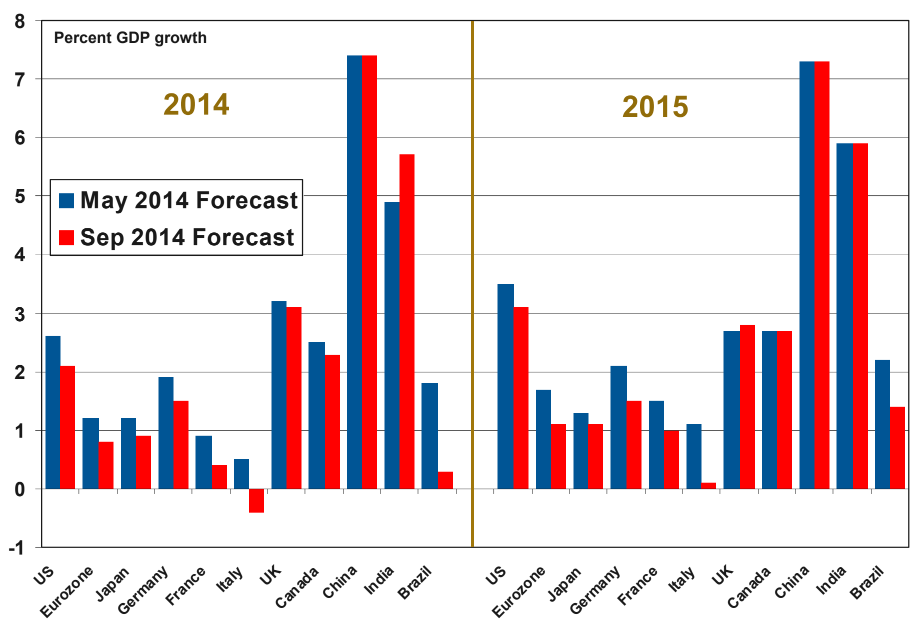
As a general conclusion, inflation at the industrial and consumer price levels will be lower for longer. Obviously this conclusion is dependent upon economic policy choices, currency movements, and specific supply conditions. But weaker demand will – all else constant – reduce upward price pressures in an economy when growth falters.

3. Currencies

As a general rule, the currencies of "weaker" economies will tend to decline against the currencies of "stronger" economies. But there has been so much currency manipulation during the last decade that it is difficult to draw hard and fast conclusions here. Yet the Eurozone and Japan have recently been quite verbal about wanting the euro and yen down against the dollar, and Chart 3 suggests they are meeting with some success!

Chart 1: OECD GDP Growth Forecast

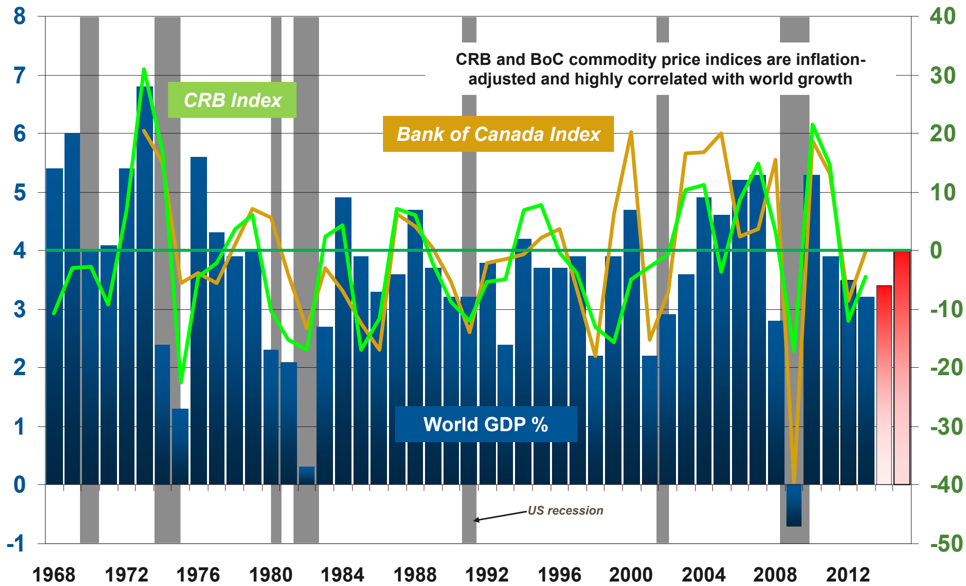
Recent revisions mostly downward



Source: OECD Interim Economic Assessment – September 2014

Chart 2: Commodities

Commodities decline when world growth < 4%



Source: IMF, Bank of Canada, Thomson Reuters Datastream, DCM Economics

In a world where growth is hard to come by because (1) monetary policy has lost its punch (because of a "liquidity trap", "debt-deflation", a "balance sheet recession", excessive debt levels, an unwillingness to lend or borrow or both, etc. – different economists' explanations of why monetary policy has lost its punch), and (2) fiscal policy is ruled out because government debt levels are already too high and/or there is substantial political opposition to fiscal policy stimulus, then (3) currency devaluation becomes the policy of choice.

It follows that unless the US also employs measures to "devalue" the dollar (i.e., "talk it down", intervene in FX markets directly in opposition to overseas intervention, block/tariff subsidized imports, etc., all of which the Obama Administration has been loath to do) the dollar will rise against most, if not all, overseas currencies.

It follows from point 1 above that the commodity currencies – the Canadian and Aussie dollars – will also be under pressure to decline against the US dollar.

4. The US Economy

The US economy was already facing significant headwinds as a hangover from the Great recession (growth since that recession has averaged just over 2%). To this can be added the headwinds of slow growth in US export markets and a rising US dollar.

The rising dollar, specifically, complicates the Fed's attempts to raise domestic inflation rates. US import prices will tend to deflate, which together with more aggressive foreign competition (heightened by weaker overseas currencies) will dampen domestic US prices – and wage rates in particular. Even assuming that the US unemployment rate continues to decline, **the Fed is very likely to have problems achieving its inflation target.** Unless and until the US dollar is devalued against overseas currencies, the implication is that the Fed will have to "remain looser for longer".

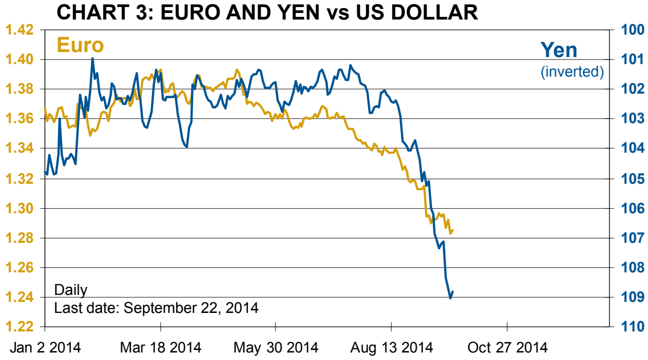
5. Interest Rates

It follows from point 4 that **the eventual hike in US interest rates will come later** rather than sooner. More FOMC members will note that US inflation is subdued, and the committee may accordingly decide to "wait and see" before pulling the interest rate trigger. "Lower for longer" US interest rates will spill over into Canada, meaning Canadian interest rates will not rise soon. (Our forecast calls for Canadian interest rates to rise *after* US rates have begun to rise.)

6. Investments

An outlook calling for subdued growth, very low inflation, low US interest rates and a rising US dollar favors (non-commodity) equities that will

CHART 3: EURO AND YEN vs US DOLLAR



Source: WSJ

"The Return of the Currency Wars:

When a country's economy grows too slowly, the standard short-term remedies are to increase government spending, cut taxes or reduce interest rates. When none of those options is available, governments often resort to pushing down their currencies to make their exports more attractive to foreigners (and, these days, to push up import prices and thus bring inflation back up to desired levels)."

(David Wessel - blogs.wsj.com/economics/2014/09/15/the-return-of-the-currency-wars)

benefit from low interest rates and/or have very specific, attractive, characteristics that cannot be undone by a rising US dollar. A good chunk of the Canadian equity market - materials and energy - will not benefit directly from this kind of environment. Income-dividend plays should benefit disproportionately from the kind of low-rate environment that appears to lie ahead.

Policies to Boost the World Economy

There are policy options to boost growth, and I am always hopeful that these may be adopted. Most policies fall under the general heading of "Restructuring"; they are easier to describe than to implement, but that doesn't mean they shouldn't be implemented. Indeed, without policy changes the world economy is headed for an extended period of slow growth, intermittent recessions, monetary debasement, "beggar-thy-neighbor" trade and currency policies, and increased geopolitical turmoil (with the risk of full-blown war).

For many investors, benefitting from generally high asset prices on the back of the ultra-low interest rates required to keep economies "above water", the environment seems quite pleasant – until it suddenly does not!

1. Stop Restricting Imports

Opening an economy to more imports is one of the single best ways to force "restructuring" onto an economy. Rather than "protecting" domestic industries governments should euthanize them – by way of foreign competition. This is particularly necessary in Europe and Asia; if their protectionist policies keep US goods out their markets US trade deficits will remain huge (with the byproduct that foreign buying of US Treasuries will remain equally huge) - no matter how weak the US dollar might be (and we think that the US dollar should be fundamentally much, much weaker).

A byproduct of foreign protectionism is higher US unemployment levels and lower US consumer price inflation – exactly what the Fed is obligated to counter under its dual mandate!

(The reader may ask: "What protectionism?", but there are new examples of protectionism almost on a daily basis. For example, from *ChinaDaily.com* on September 23, 2014: "*China's growing security concerns over overseas-made smartphones will translate into business opportunity for local vendors, analysts said on Monday. Handsets introduced by Huawei Technologies Co Ltd, ZTE Corp and Lenovo Group Ltd are ready to take market share away from Apple Inc. and Samsung Electronics Co Ltd as industry insiders look into the possibility of a government-led ban on global brands in the name of national security.*")

China needs to speed up restructuring –domestic demand as a percent of GDP should rise, and investment as a percent of GDP should decline; there should be less investment-led growth and more domestic supply should be absorbed domestically (as opposed to being dumped in international markets). A high/rising RMB/yuan would help this process along; a weak RMB/yuan continues to promote more exports, weak domestic demand for foreign products, and more investments with poor payoffs.

Japan has other issues; it has a vibrant, world class export industry. But a large chunk of the economy is inefficient. 50% of the population, women, are making only a modest contribution to the economy; food is exorbitantly expensive, and distribution channels are massively inefficient. (Last time I was there – admittedly some years ago – the prices of those Japanese-produced goods I checked were higher in Tokyo than in Vancouver.) Were the yen to decline on the back of massive increases in imports from abroad (including agricultural imports) I would cheer it along. But that is not the present scenario.

2. Split the Eurozone

"*The solution to Italy's woes is quite simple – leave the euro*"; I have said this often in so many words, but this quote is from Roger Bootle (head of *Capital Economics*, writing in *the Telegraph*, September 21). The Eurozone is fostering deflation on itself and its major trading partners, including the US. My preferred split is North/South with France leading the Southern half and the ECB moving to Paris.

3. Cut Entitlements

There is no room in most developed countries' budgets for defense, infrastructure and entitlements. Choices have to be made. Entitlements and the culture it inculcates are literally "killing" the western economies. Other than the US and the UK, NATO spends too little on defense (i.e., less than 2% of GDP). And the US infrastructural deficit is criminal (see *http://www.infrastructurereportcard.org/* from the American Society of Civil Engineers).

4. US Policy Actions

To help point 1 along the US should devalue the dollar against a host of currencies. Historically, "forced" devaluations have been nasty – in August 15, 1971 President Nixon imposed a 10% tariff on all goods coming into the US, which was repealed only after there was a general agreement on dollar devaluation. Markets were volatile for several weeks! However, it's patently unfair that the rest of the world buys its own growth at the expense of the US economy.

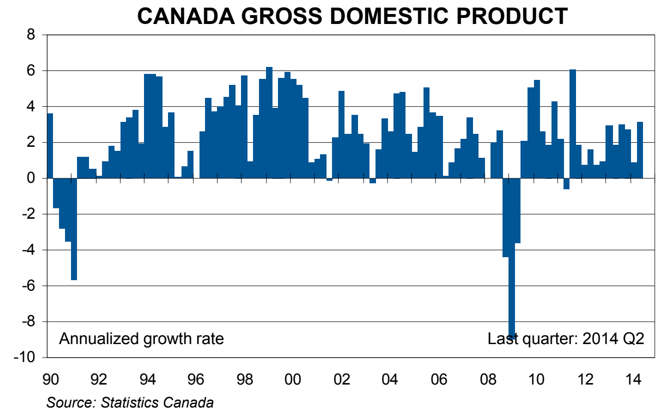
Secondly, the US needs to overhaul its fiscal policies. Current policies favor more consumption, not production. Corporate taxes need to be lowered (ideally eliminated altogether); consumption taxes and a flat income tax should take their place. All tax expenditures should be eliminated (tax breaks add up to roughly $900 billion and disproportionately favor the "well connected"). All economies benefit from a simple tax schedule but the US economy will benefit notably because its tax code has become far too complicated.

There are many other areas of the US economy (and Canadian economy) where some common sense would do wonders – in the health sector, the education sector, and in the legal system, for example - but we are keeping it simple here. The OECD and IMF forecasts should be seen as wake-up calls; bad policies of the past need to be scrapped regardless of how politically difficult that will be.

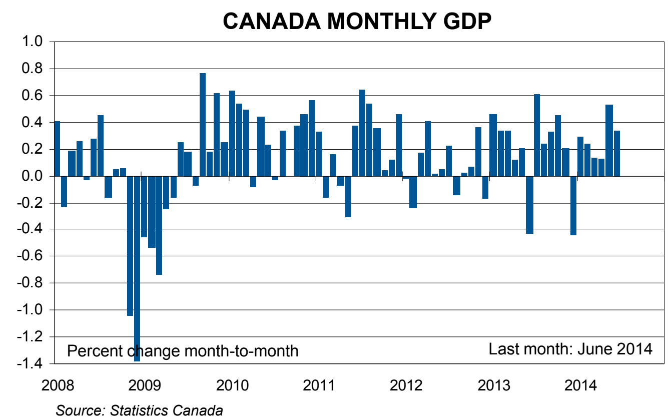
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Growth for the full year should be a modest 2.0-2.5%. The outlook for 2015 is more modest yet.

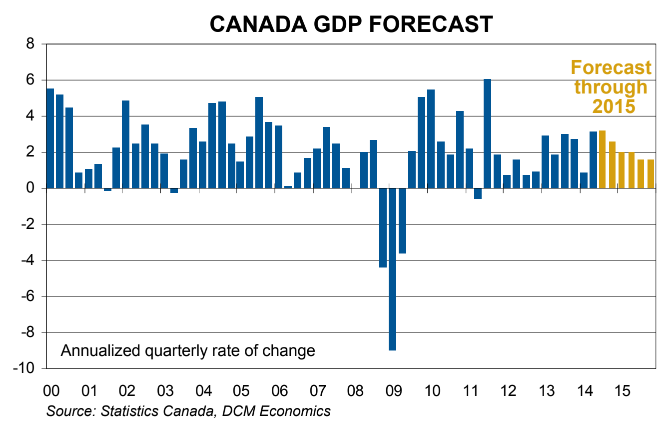
The second quarter saw growth rebound to 3.1%.



The last two months have seen fairly strong growth.

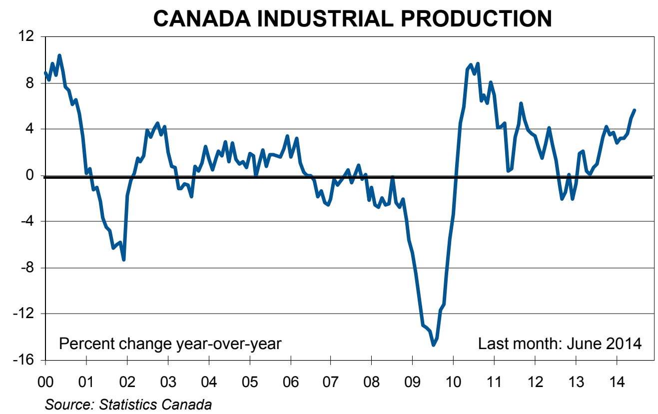


After the next three to six months growth is likely to trail off.

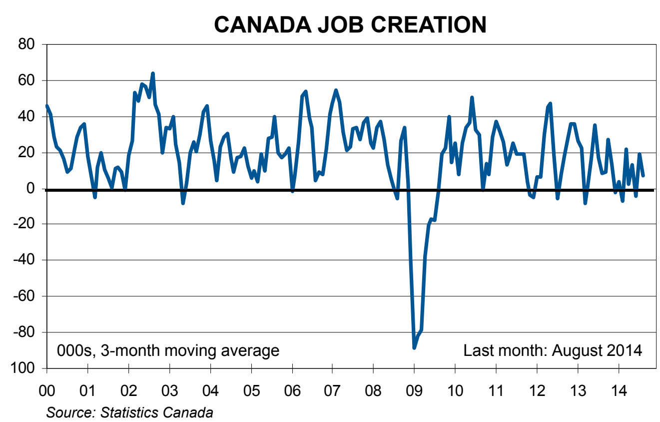


MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

The depreciated Canadian dollar and strong auto demand on both sides of the border have given industrial production a lift.



The trend of job creation has been slowing, though it's very erratic from month-to-month.



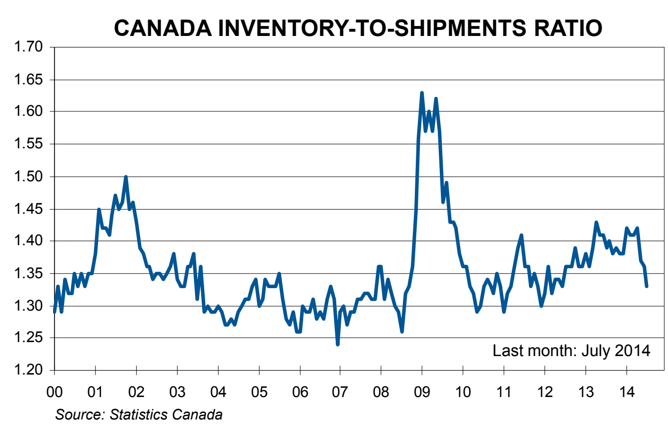
The unemployment rate remained at 7.0% in August.

MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Manufacturing shipments have strengthened considerably, with the weak loonie playing a role.

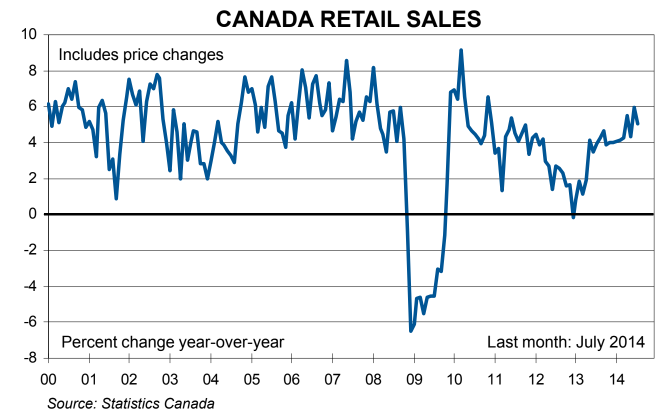
New orders have also been strong.

The inventory ratio has fallen as sales have strengthened.

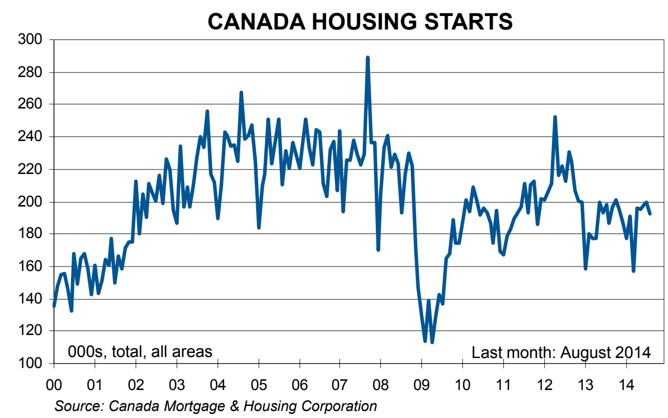


MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

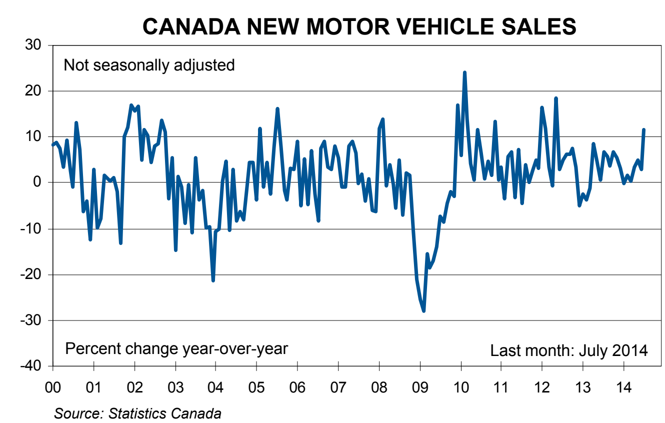
Retail sales have been strong. (The weaker Canadian currency is keeping more buyers at home!?)



Housing starts have been relatively strong (despite some slippage in August) - though mostly because of condos.



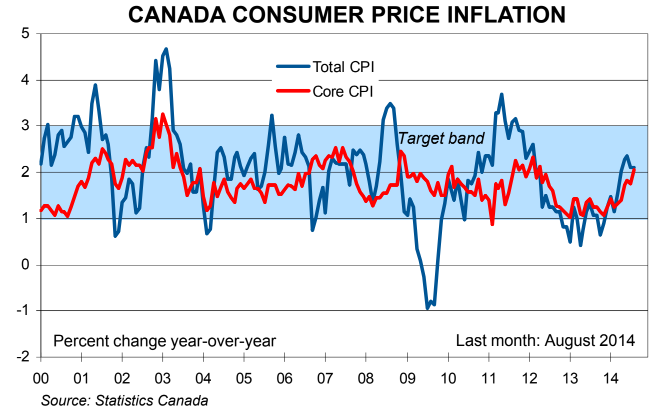
Vehicle sales have been stronger of late.



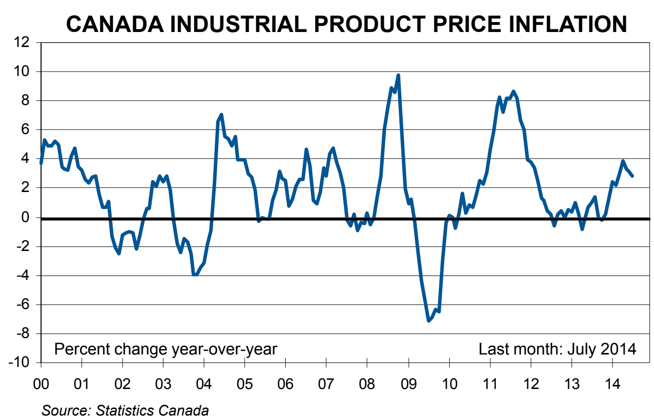
MONTHLY REVIEW ►
CANADA – INFLATION

Headline inflation is being pushed higher by a variety of factors that we believe are temporary. It could reach 2.7% toward year-end before falling back.

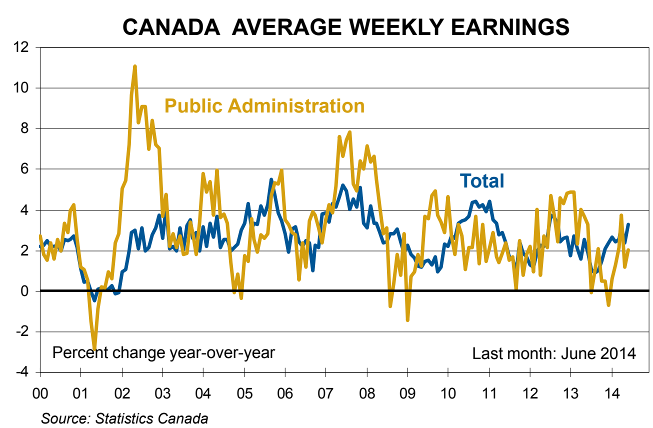
Headline CPI was 2.1% in both July and August, down from 2.4% in June. The core rate was also 2.1% in August but has been rising lately. (The Canadian dollar's recent depreciation has temporarily boosted inflation.)



Industrial product price inflation has fallen for several months but was still a fairly high 2.9% in July.

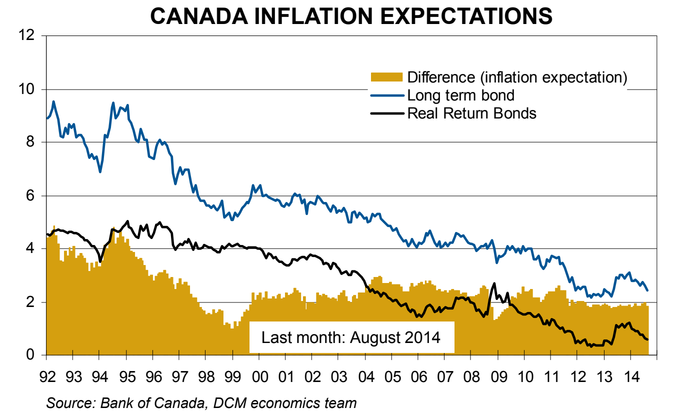


Average weekly earnings have been increasing at a near 3% pace in Canada.

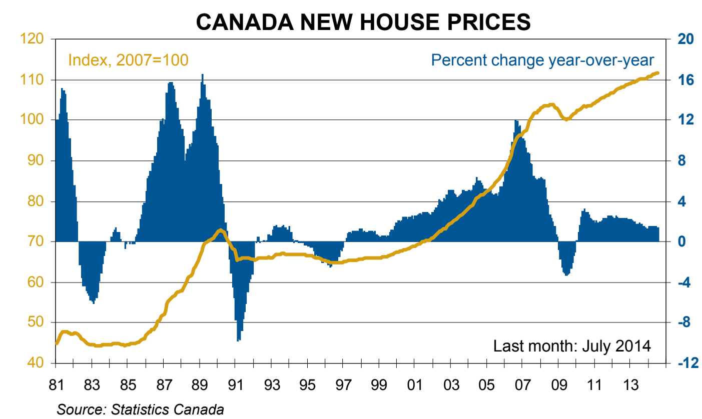


MONTHLY REVIEW ► CANADA – INFLATION

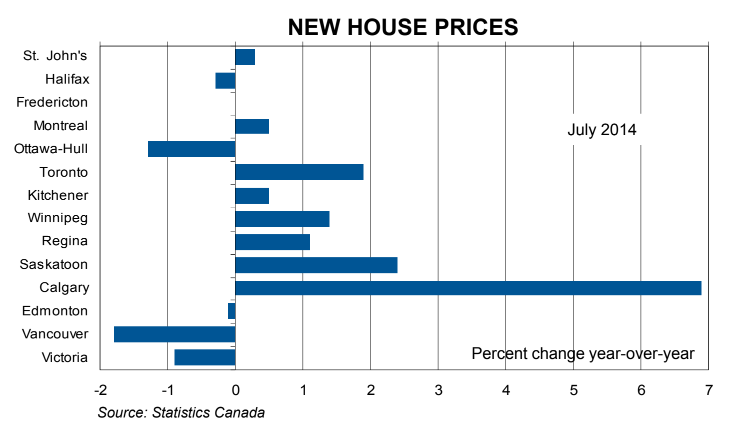
Inflation expectations remain near 2%.



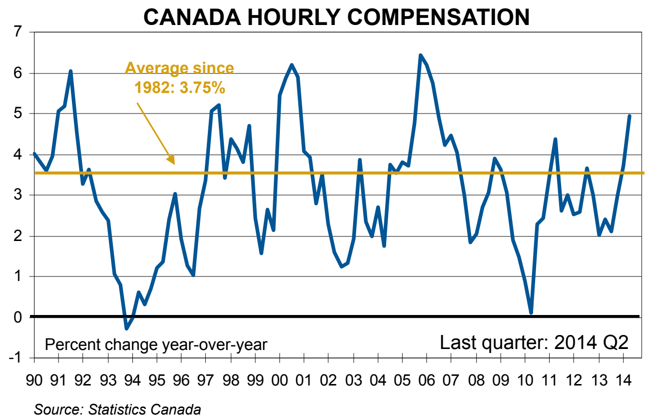
New home prices were rising at a 1.4% pace in July.



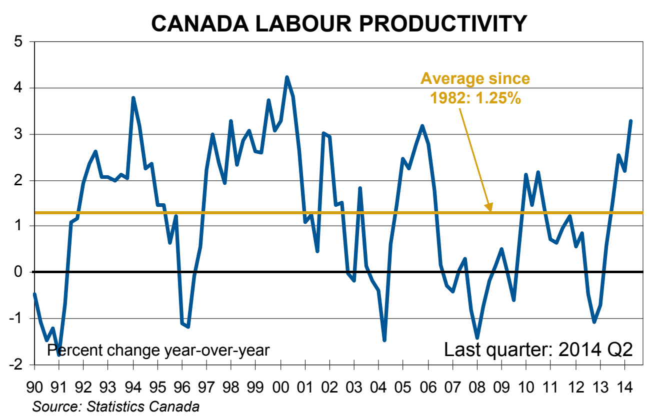
Apart from Calgary (where rebuilding continues after last year's flood) price increases for new homes appear minor. (But this is deceptive as smaller homes are being built to deal with the affordability issue.)



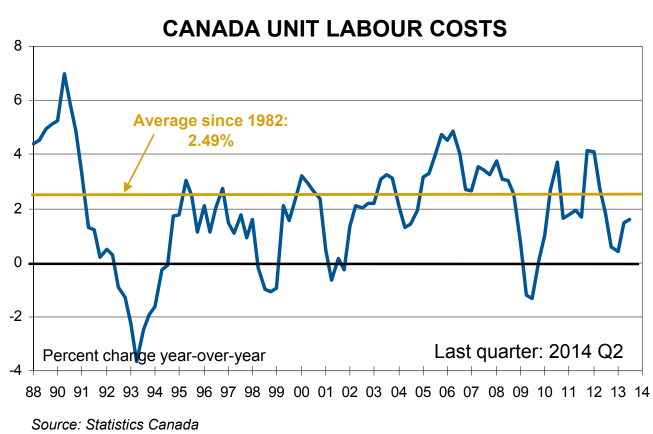
Hourly compensation growth has averaged 3.4% over the last twelve months.



Productivity increases have averaged 2.4% over the past year, much stronger than normal.



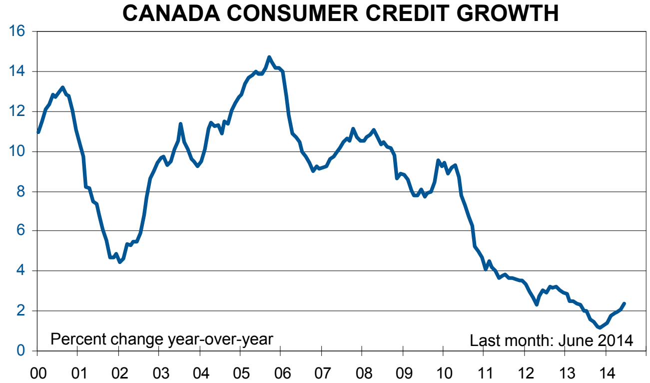
Unit labour costs have therefore risen only a modest 1.0% over the last year.



MONTHLY REVIEW ►
CANADA – DEBT AND CREDIT

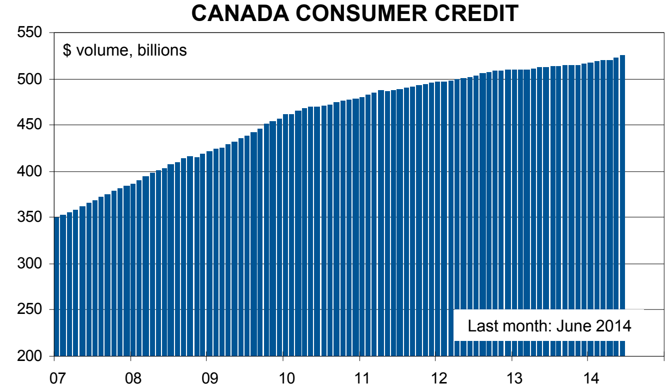
Consumer credit growth is slow but accelerating; mortgage credit growth remains modest while business credit growth has been strong.

CANADA CONSUMER CREDIT GROWTH



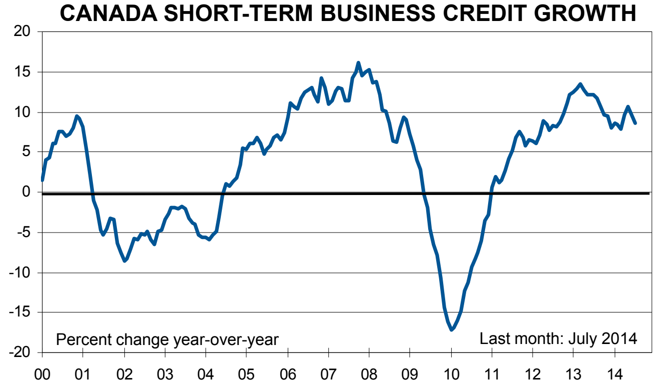
Source: Bank of Canada

CANADA CONSUMER CREDIT



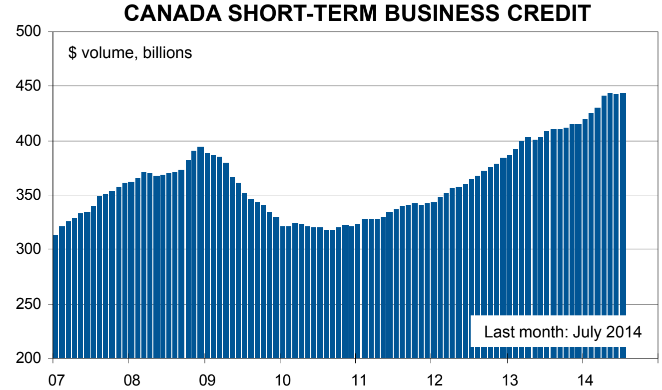
Source: Bank of Canada

CANADA SHORT-TERM BUSINESS CREDIT GROWTH



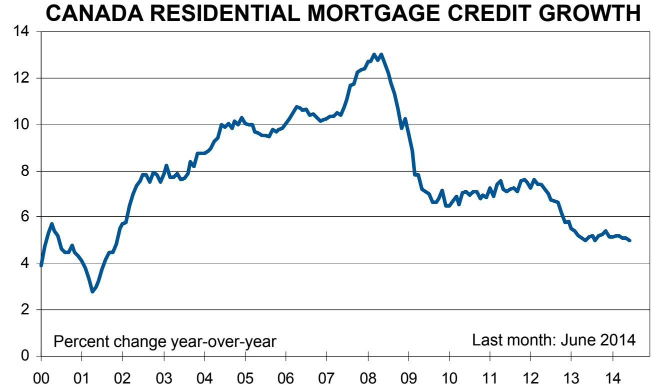
Source: Bank of Canada

CANADA SHORT-TERM BUSINESS CREDIT



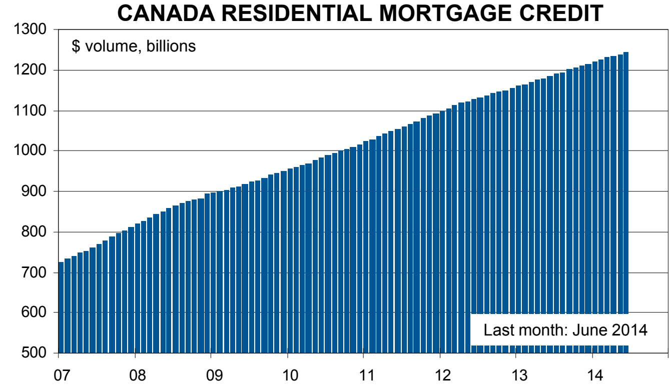
Source: Bank of Canada

CANADA RESIDENTIAL MORTGAGE CREDIT GROWTH



Source: Bank of Canada

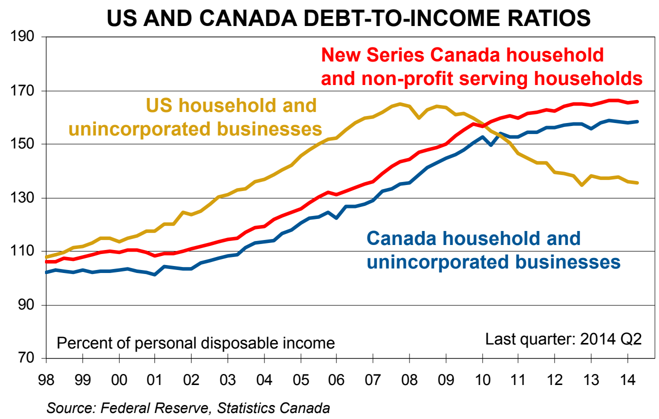
CANADA RESIDENTIAL MORTGAGE CREDIT



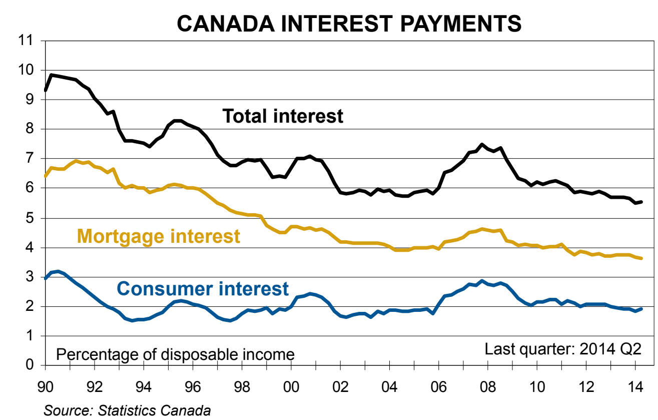
Source: Bank of Canada

MONTHLY REVIEW ►
CANADA – WEALTH CREATION

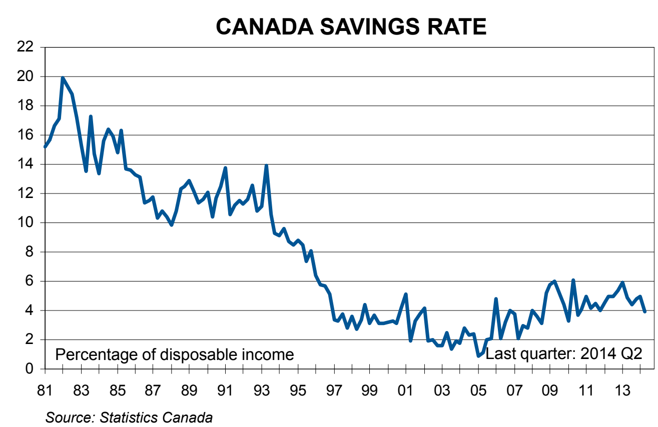
Canada's household debt ratio is finally flattening out, but remains substantially above that in the US.



Canadian aggregate mortgage interest payments are still falling.

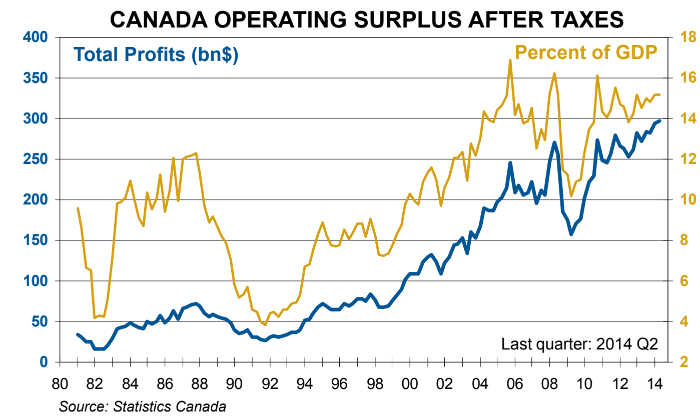


The Canadian savings rate has declined in recent quarters.

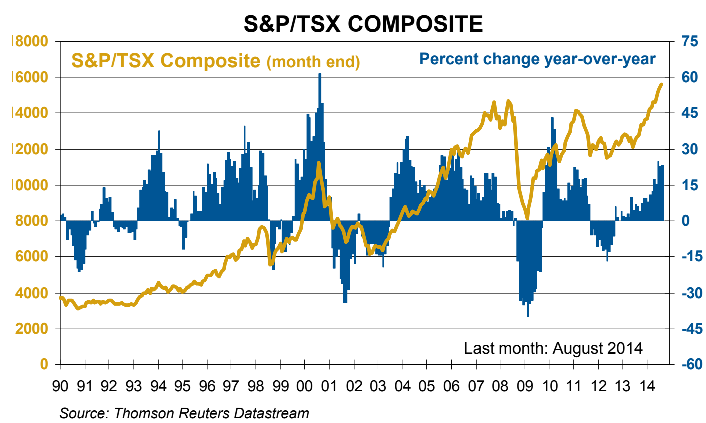


MONTHLY REVIEW ►
CANADA – WEALTH CREATION

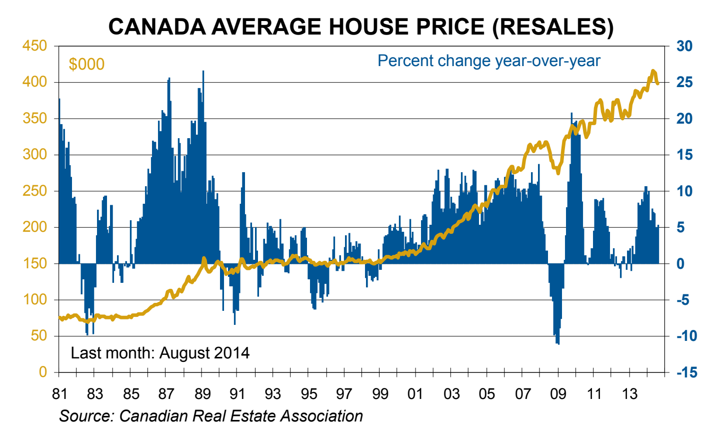
Canadian profits were rising through the second quarter but the pace has likely weakened somewhat since then.



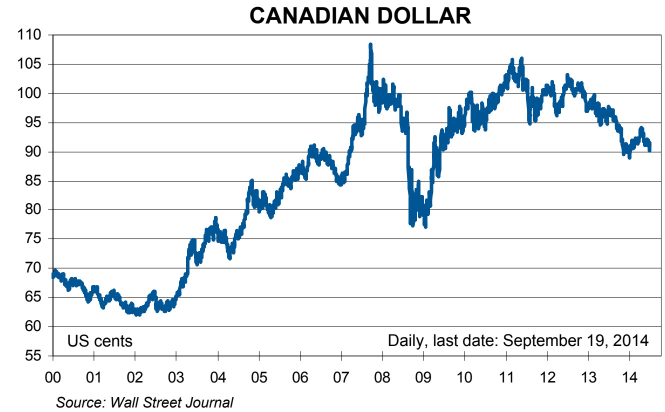
The S&P/TSX did well through August but the resource sector has since stumbled.



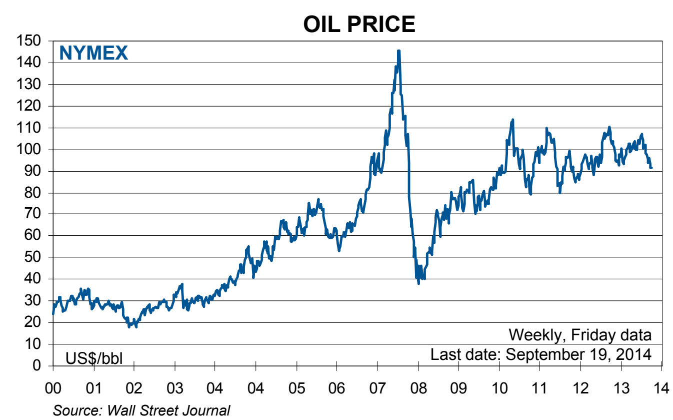
Resale house price gains appear to be slowing.



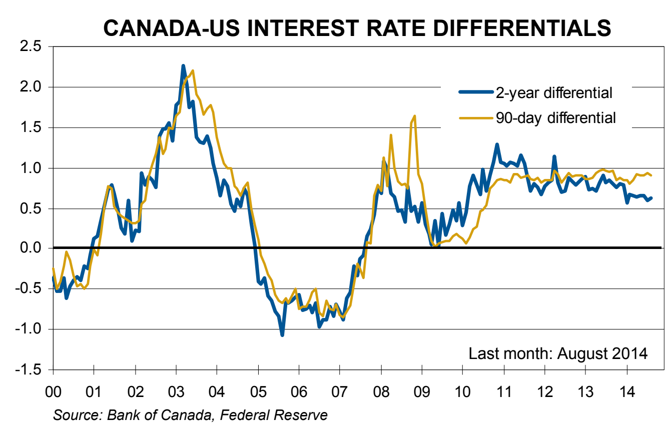
The Canadian dollar is expected to fall further ...



... because, in part, weak global demand and increased North American production have undermined oil prices...

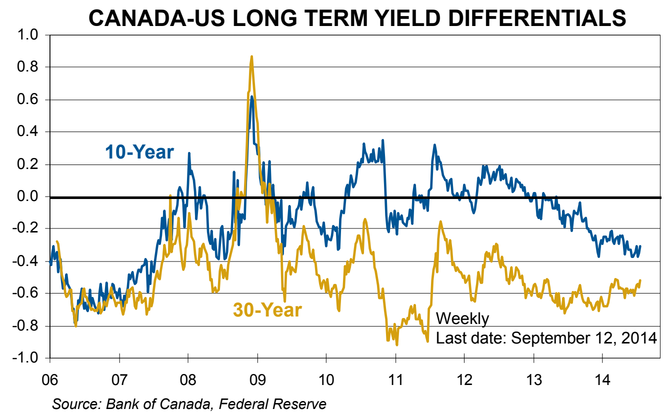


... but short-term interest rates spreads are helpful for the Canadian dollar.

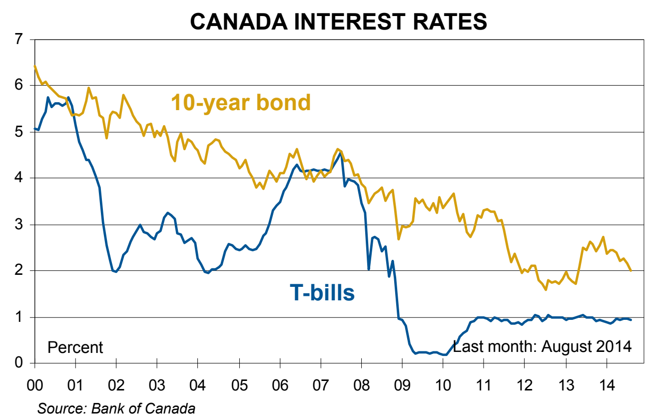


MONTHLY REVIEW ▶ CANADA – FINANCIAL MARKETS

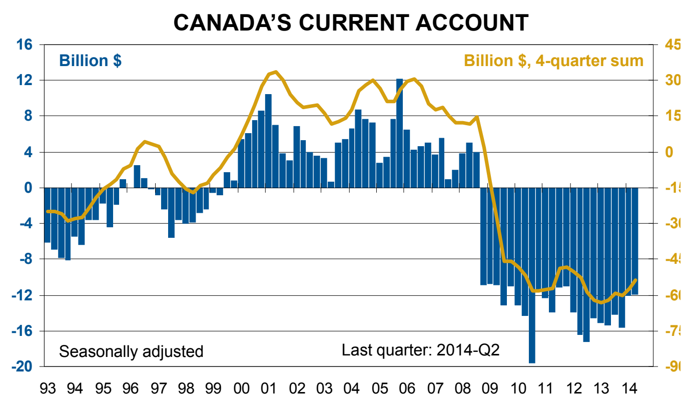
Longer-term interest rate spreads are unfavourable for the Canadian dollar.



Little change is forecast in Canadian rates for the next four quarters.



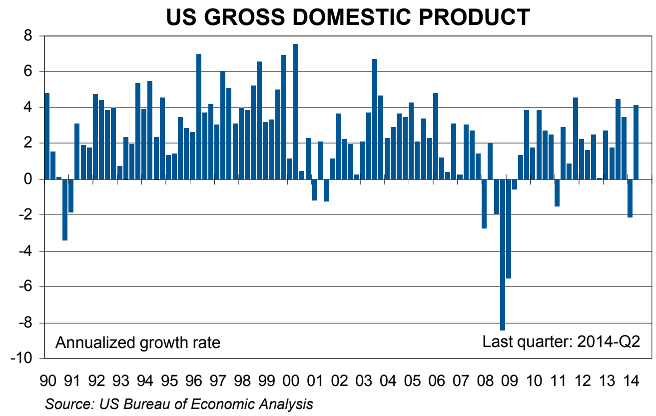
The current account deficit has shrunk lately, but not yet by much.



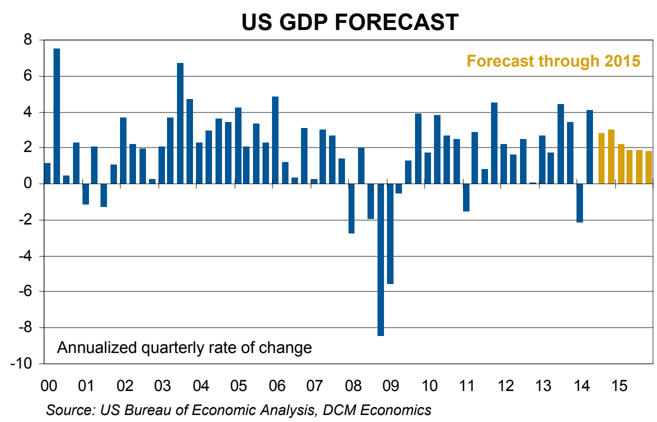
MONTHLY REVIEW ►
UNITED STATES - ECONOMIC GROWTH

Growth for 2014 may be only 2.0%. We don't expect much better in 2015! The second half of this year will likely come in close to 3.0%.

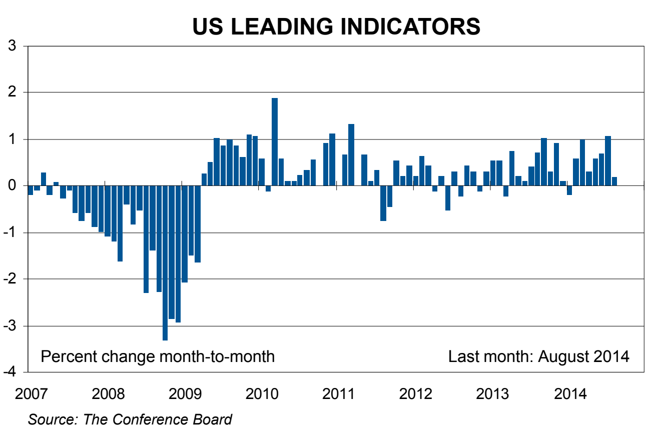
First half growth was rather weak.



The new health care system appears to have reduced spending on services, although there may be upward revisions at some point.

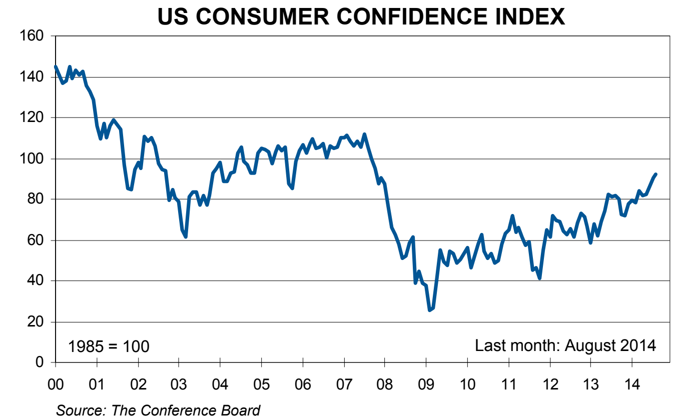


The increase in the leading indicators decelerated for August (though perhaps only temporarily).

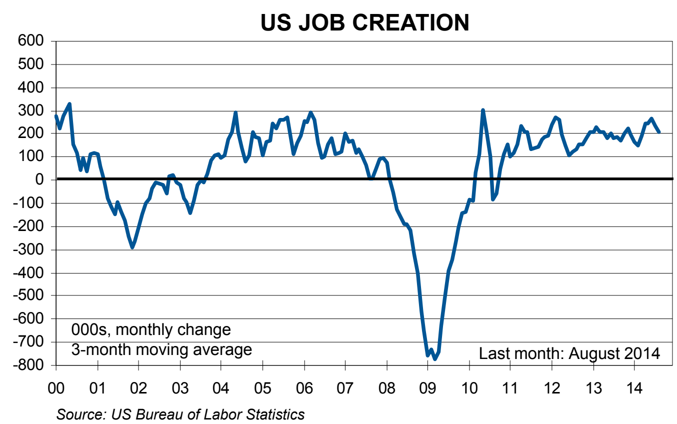


MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

Consumer confidence continues to strengthen.



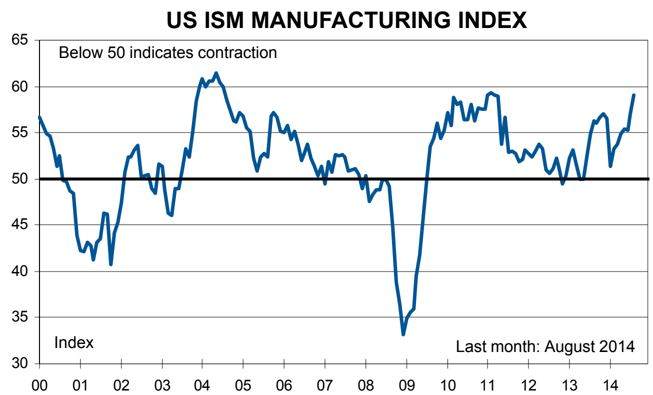
Job creation has been quite strong, given the changing demographics.



The unemployment rate has fallen swiftly, though partly because ageing baby boomers are dropping out of the labour force.

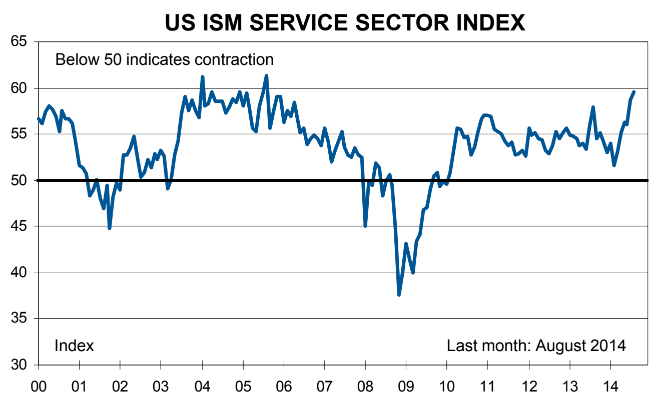
MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

The manufacturing index has been surprisingly robust ...



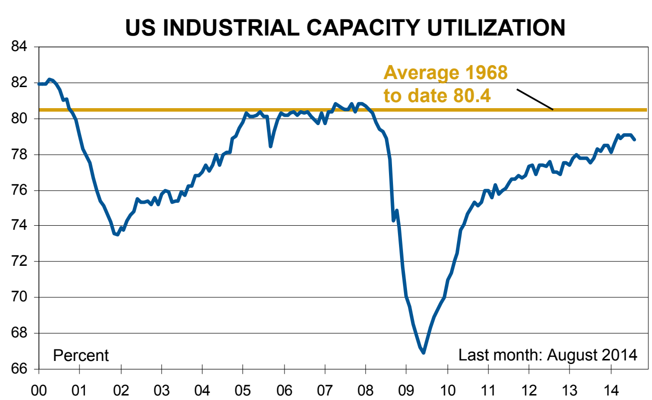
Source: Institute for Supply Management

... as has the purchasing managers' index for the service sector.



Source: Institute for Supply Management

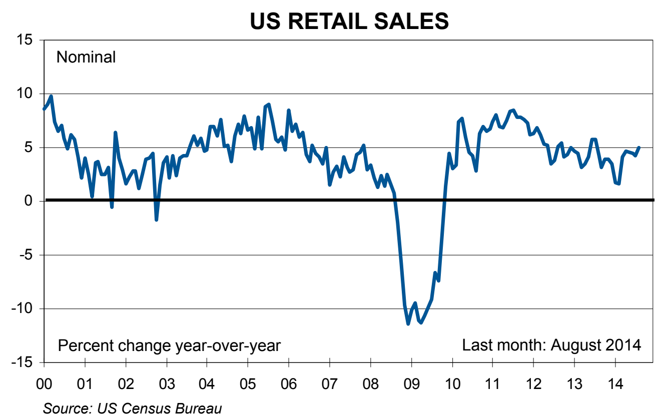
Industrial capacity utilization appears to have stopped rising however!



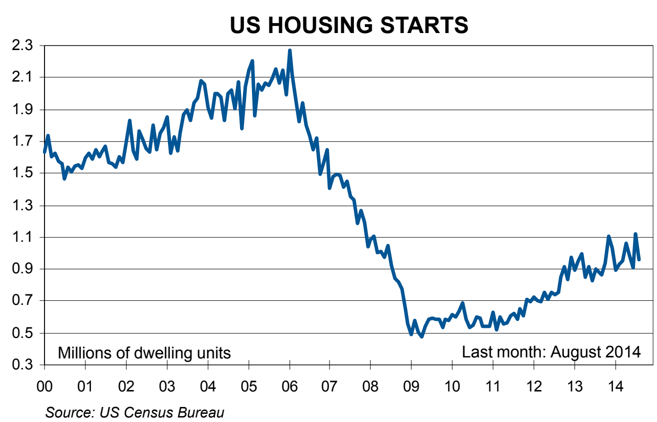
Source: Federal Reserve

MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

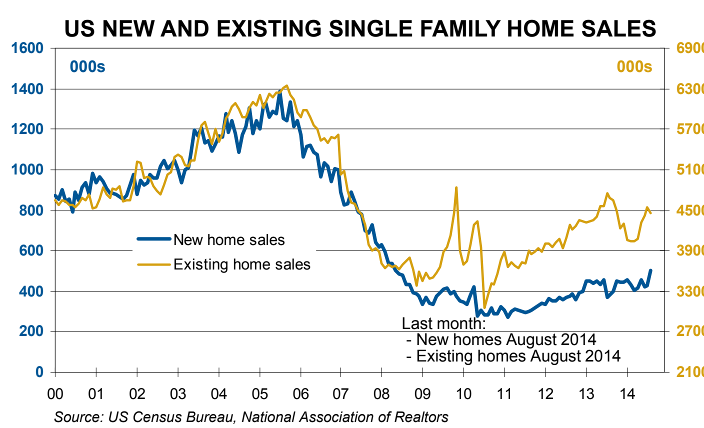
Retail sales strengthened in August ...



... but housing starts fell back in August, continuing a recent pattern of oscillation that has seen the housing recovery slow.



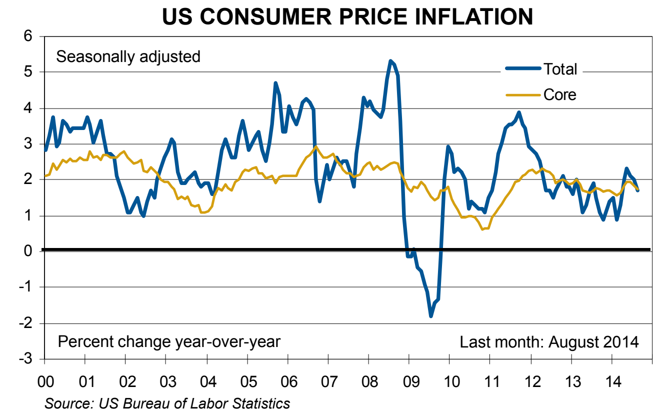
Existing home sales have improved recently but new home sales have struggled.



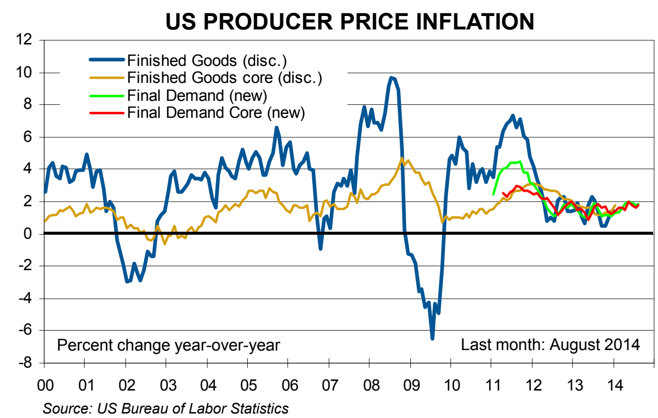
MONTHLY REVIEW ►
UNITED STATES – INFLATION

After moving above 2% earlier this year, CPI has since fallen back.

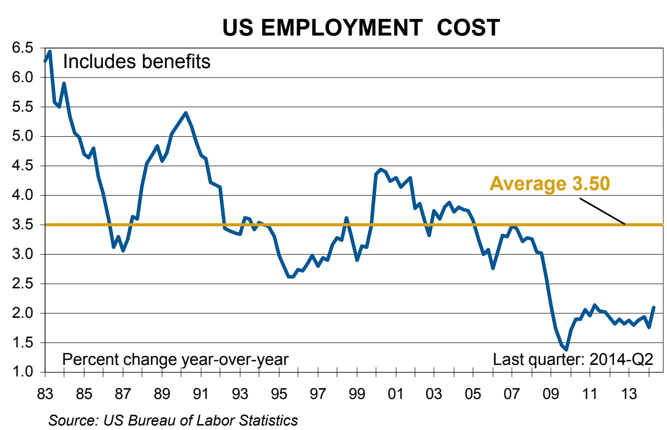
Headline CPI was down to 1.7% in August, and core also fell back to 1.7%.



Producer prices were up 1.8% in August, little changed from July.

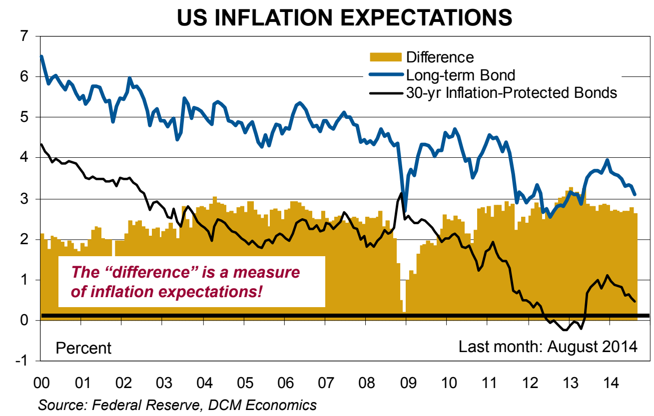


Employment costs remain contained, increasing about 2%.

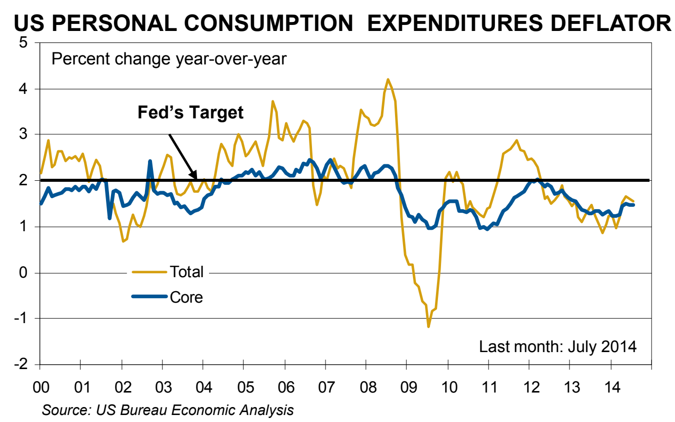


MONTHLY REVIEW ►
UNITED STATES – INFLATION

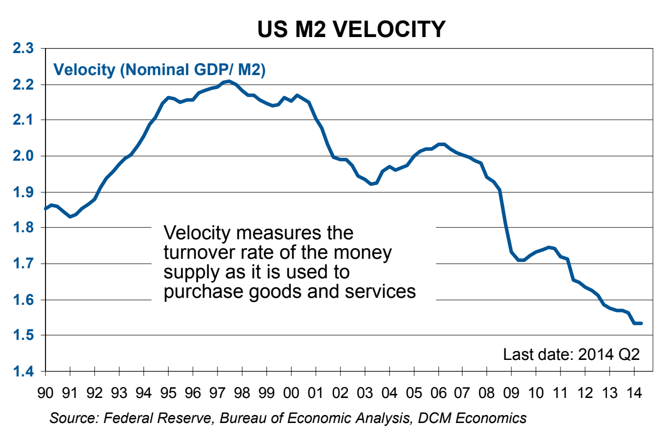
Inflation expectations have begun to retreat.



The PCE deflator remains well below the Fed's preferred 2%.



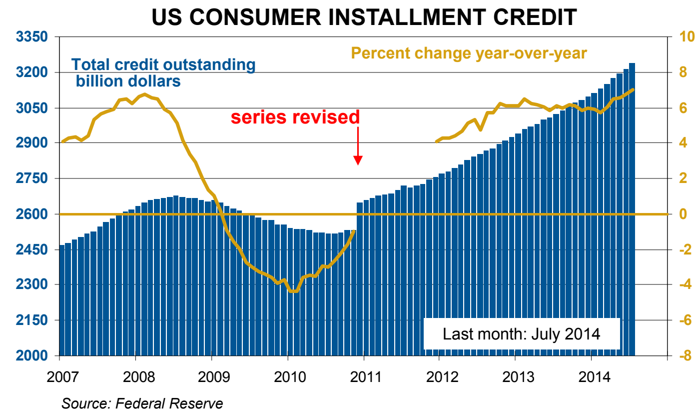
Money velocity remains very slow (not much help from mortgage lending).



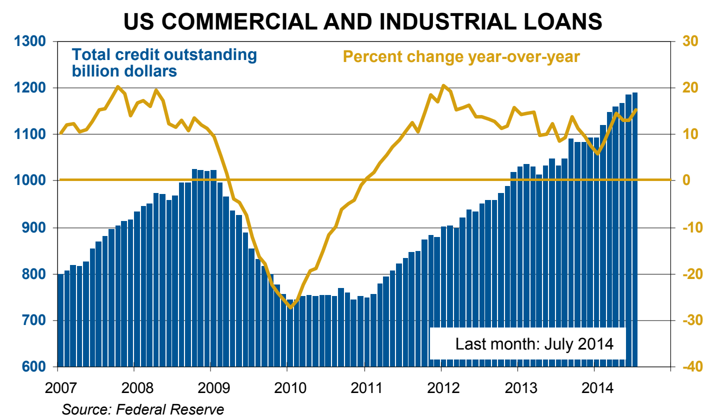
MONTHLY REVIEW ►
UNITED STATES - CREDIT GROWTH

Credit growth remains somewhat limp compared with past cycles. The key mortgage sector is not growing, consequently the leverage effect is missing from the economy (see money velocity chart).

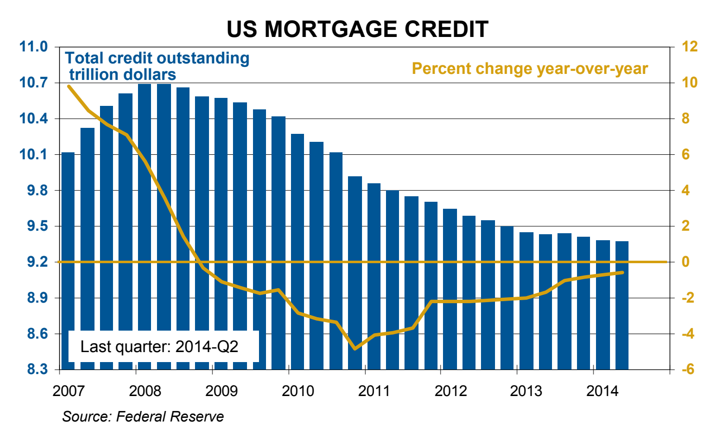
Consumer credit has been growing a bit faster ...



... C&I loan growth has accelerated ...

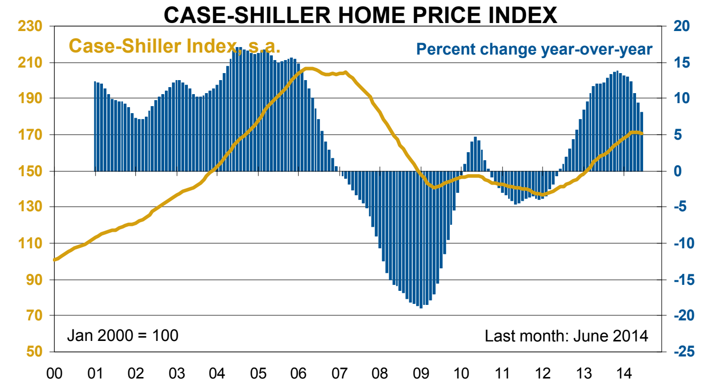


... but mortgage credit growth remains in the doldrums.



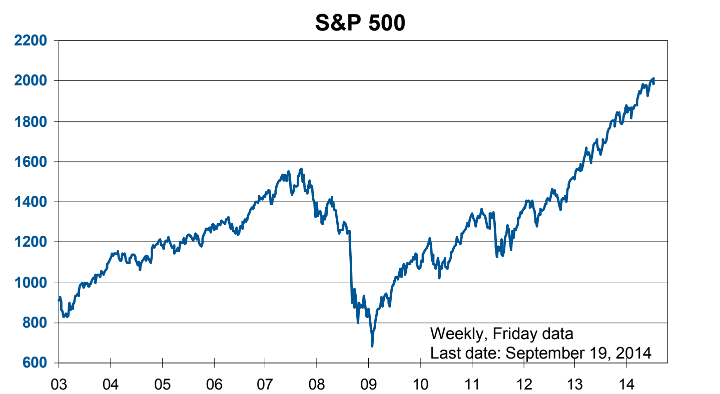
MONTHLY REVIEW ►
UNITED STATES - WEALTH CREATION

The home price index has fallen month-to-month for three successive months, bringing down the year-over-year gains.



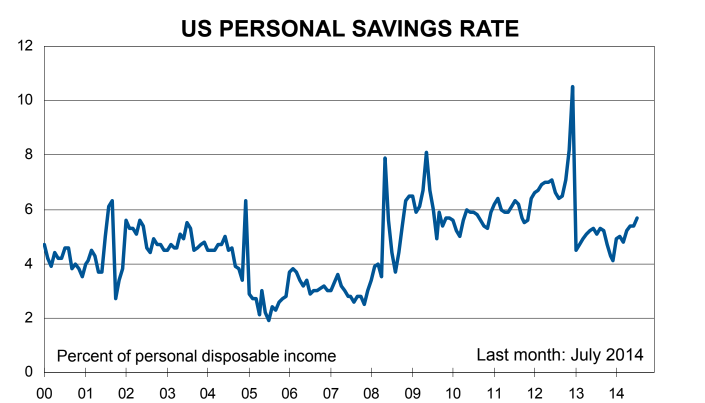
Source: Thomson Reuters Datastream

But stock prices continue to rise.



Source: Thomson Reuters Datastream

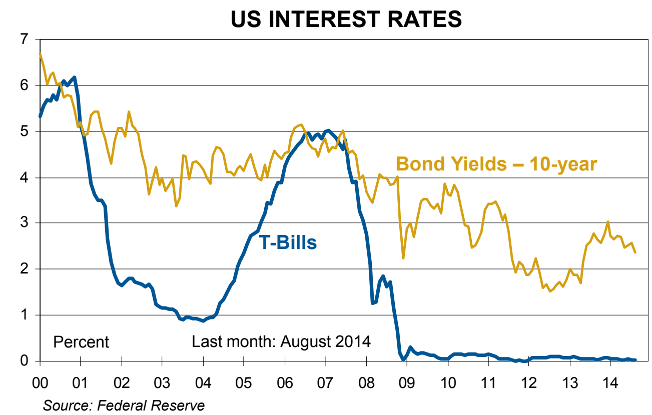
The savings rate has been rising again, despite considerable growth in vehicle loans.



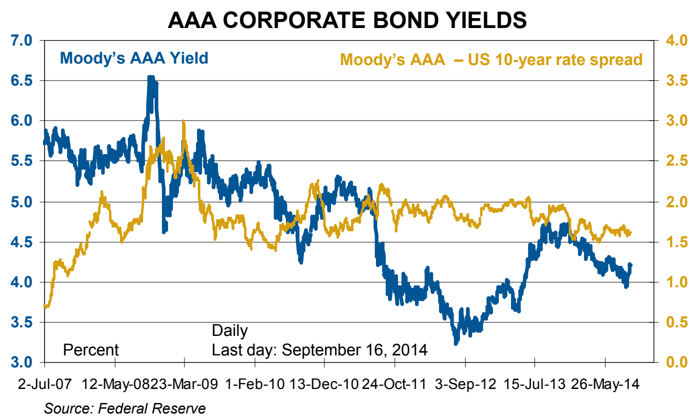
Source: US Bureau of Economic Analysis

MONTHLY REVIEW ►
UNITED STATES – FINANCIAL MARKETS

If wage growth continues to rise and inflation returns to 2%, the Fed will likely raise interest rates in the middle of 2015. But the issue is still clouded by considerable uncertainty - with parts of the economy under-performing and inflationary pressures weak.

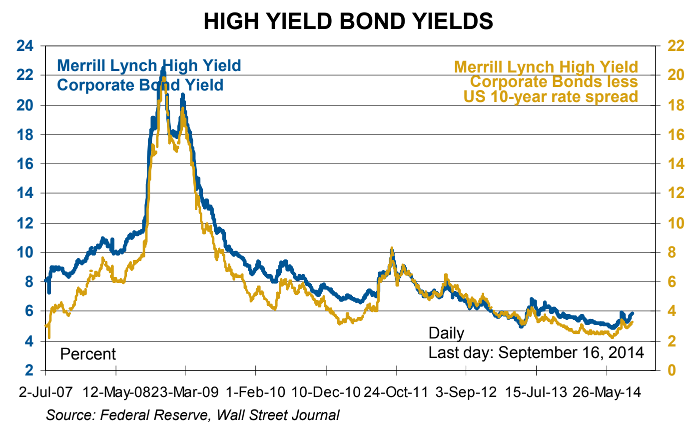


AAA yield spreads have not budged much in recent months ...



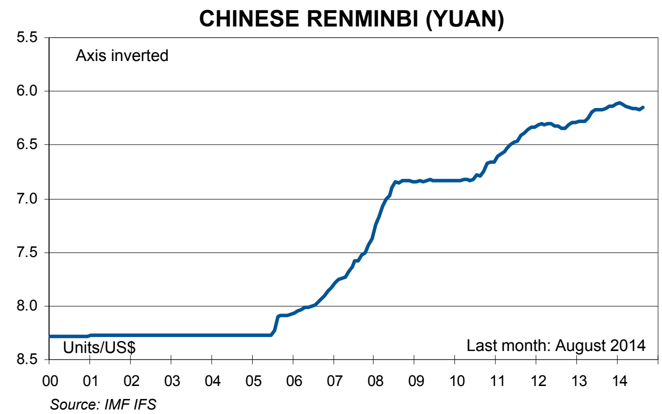
... whereas high-yield bond yields rose after the Fed expressed disapproval with ultra low yields ...

...but have since fallen back again.

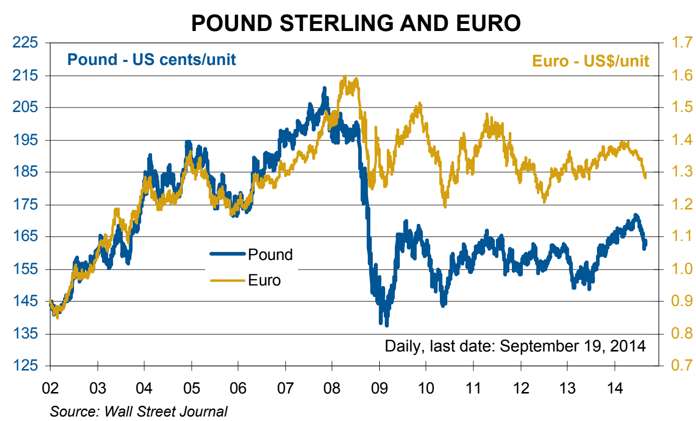


MONTHLY REVIEW ► FOREIGN EXCHANGE RATES

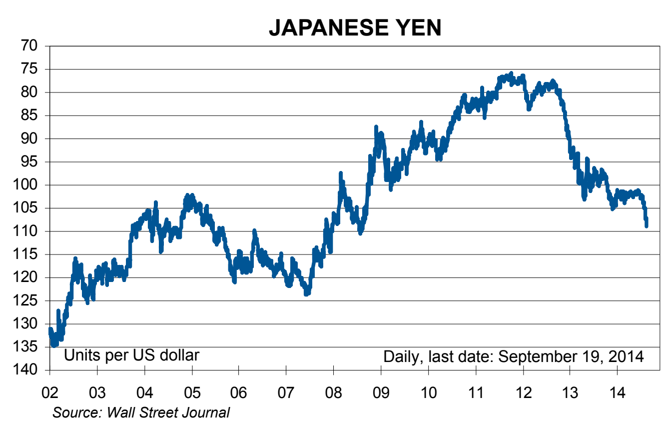
The renminbi had resumed rising recently but the fall in the yen and the euro have created uncertainty over whether the rise will continue.



Looser Eurozone monetary policy has weakened the euro - and taken the pound with it.



The yen is being encouraged to weaken again by Japanese officials.



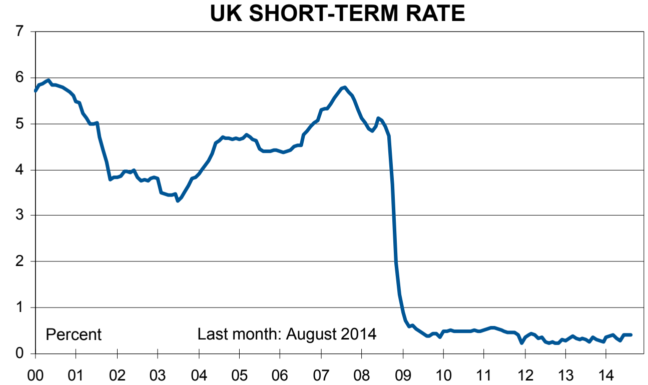
MONTHLY REVIEW ►
INTERNATIONAL SHORT-TERM RATES

Britain is poised to raise short-term interest rates in early 2015 but future concerns about the pound and already weak Eurozone demand for British exports may yet cause a rethink.

The US could raise rates toward mid-2015 provided inflation picks up!

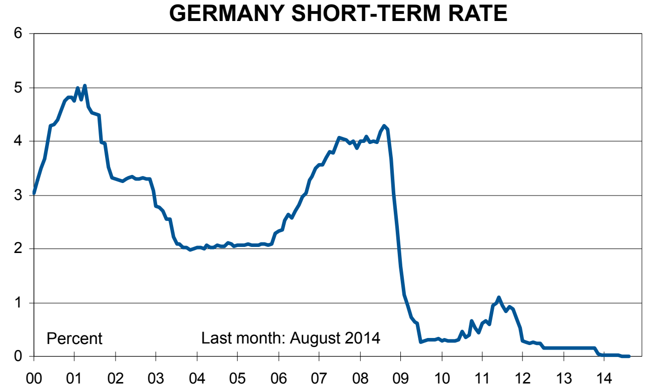
The Eurozone and Japan are expected to continue to loosen policy ... and/or at least talk their currencies down.

UK SHORT-TERM RATE



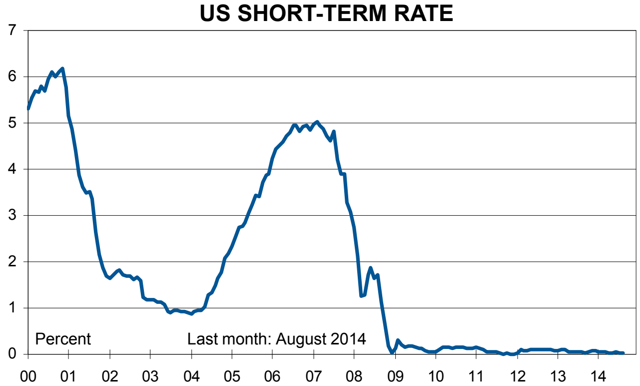
Source: Thomson Reuters Datastream

GERMANY SHORT-TERM RATE



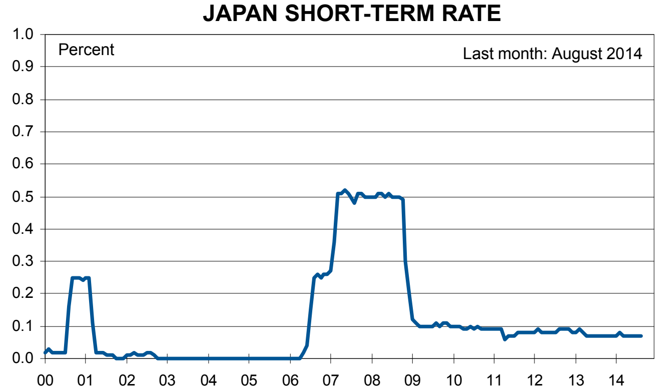
Source: Thomson Reuters Datastream

US SHORT-TERM RATE



Source: Federal Reserve

JAPAN SHORT-TERM RATE

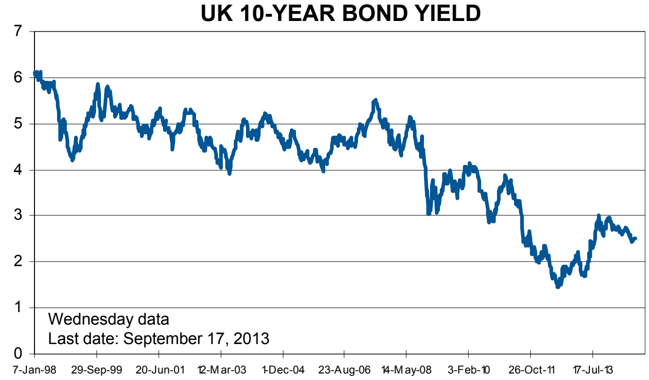


Source: Thomson Reuters Datastream

MONTHLY REVIEW ►
INTERNATIONAL 10-YEAR YIELDS

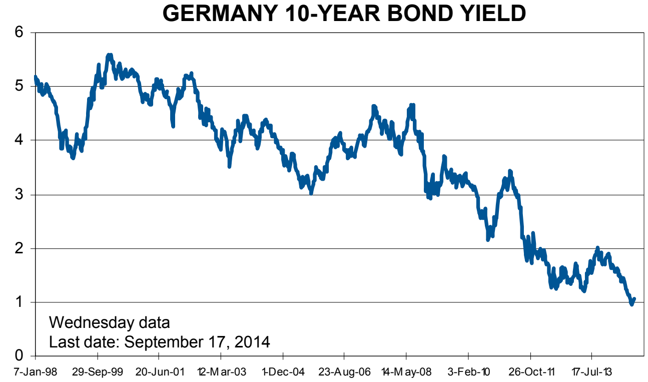
Geopolitical concerns have waned somewhat (if only temporarily), allowing some yields to rise. Strengthening US growth has also helped nudge yields higher. But a 3% 10-year Treasury yield may not be achievable against a background of low inflation and ultra-low European yields.

UK 10-YEAR BOND YIELD



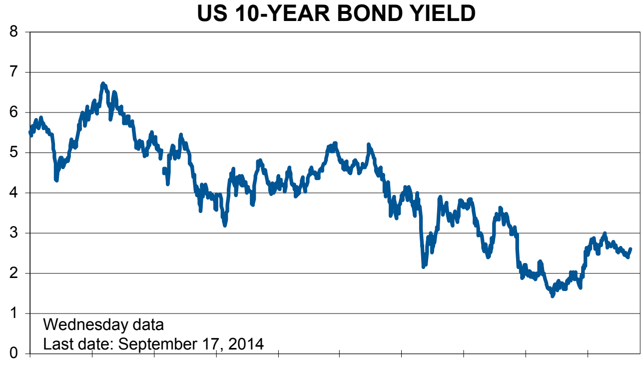
Source: Financial Times

GERMANY 10-YEAR BOND YIELD



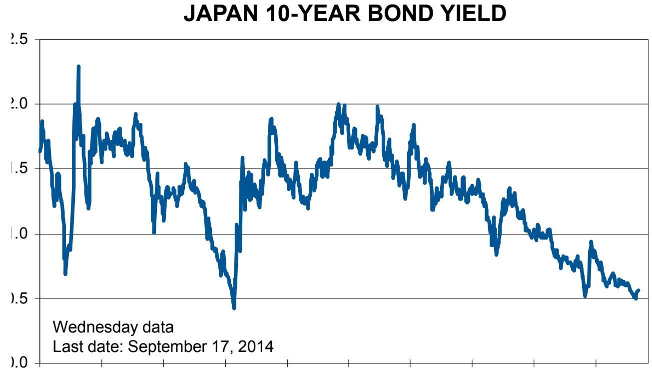
Source: Financial Times

US 10-YEAR BOND YIELD



Source: Financial Times

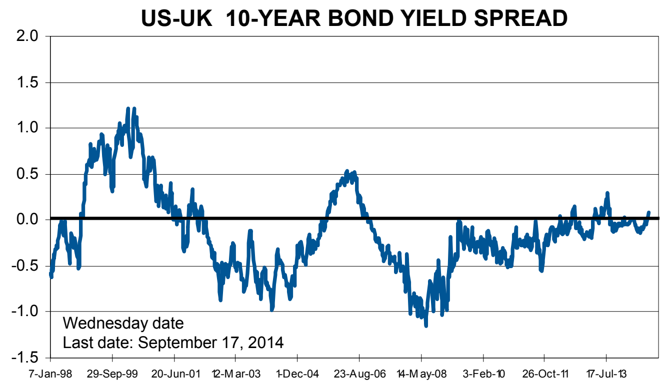
JAPAN 10-YEAR BOND YIELD



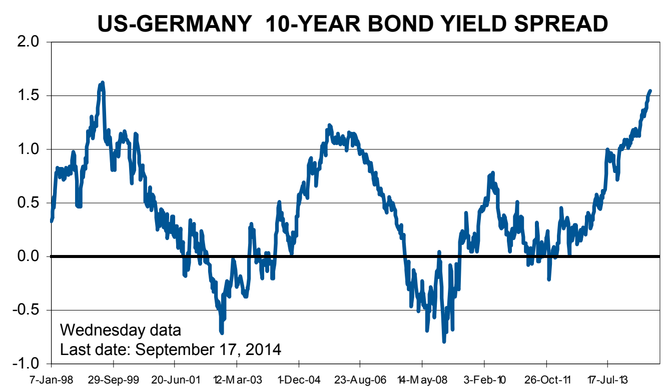
Source: Financial Times

MONTHLY REVIEW ►
INTERNATIONAL 10-YEAR SPREADS

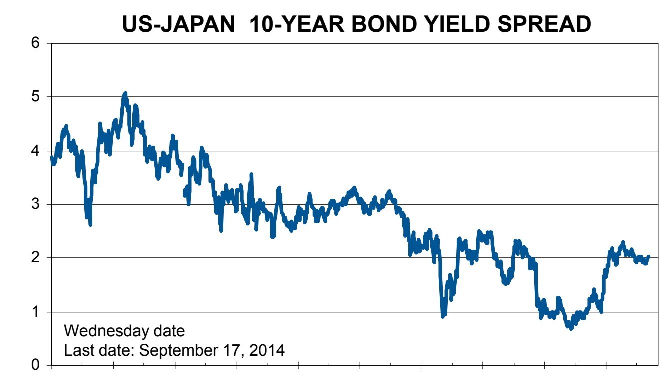
US and UK yields show little divergence.



The German 10-year yield has sunk below 1% at times in recent weeks.

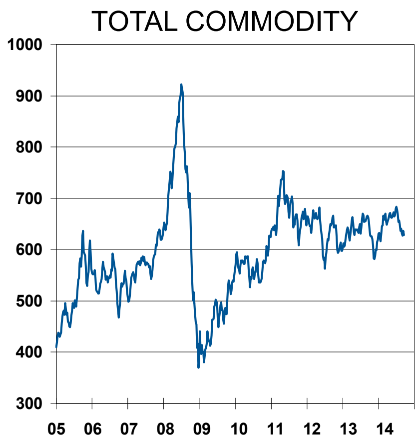


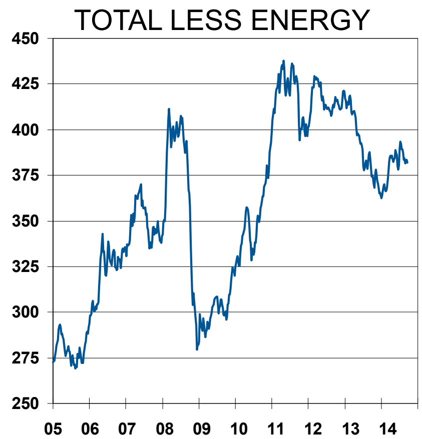
Japanese yields have risen slightly in recent weeks (from 0.50% to 0.55%).

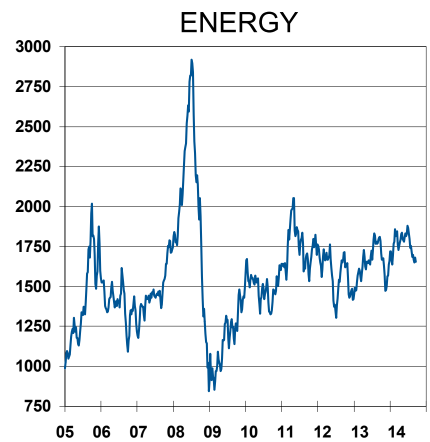


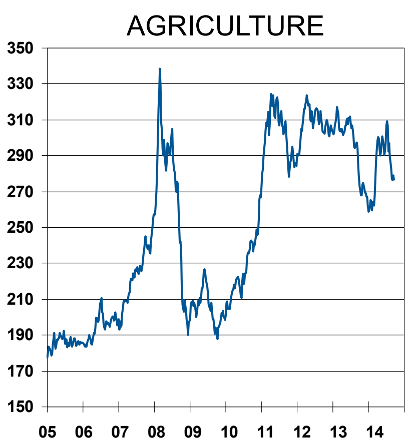
COMMODITY PRICES

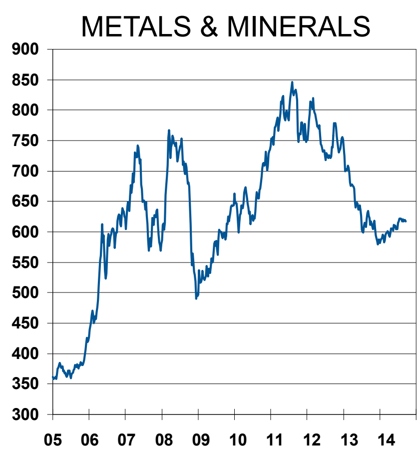
1. Bank of Canada Commodity Price Indices (Weekly data to September 19, 2014)







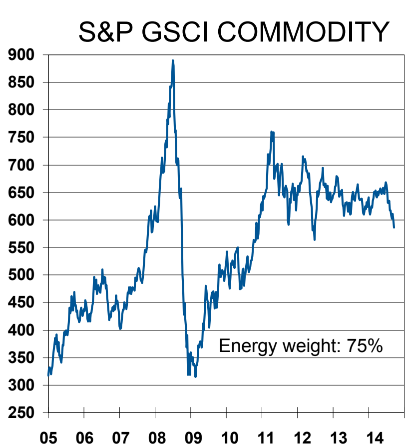


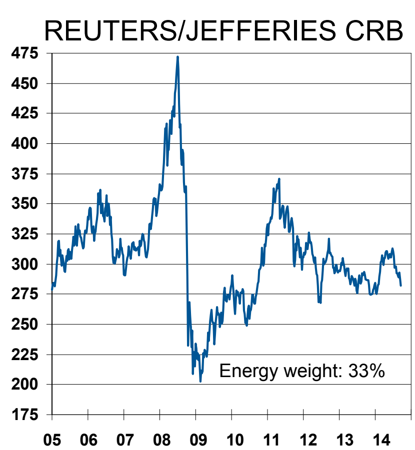


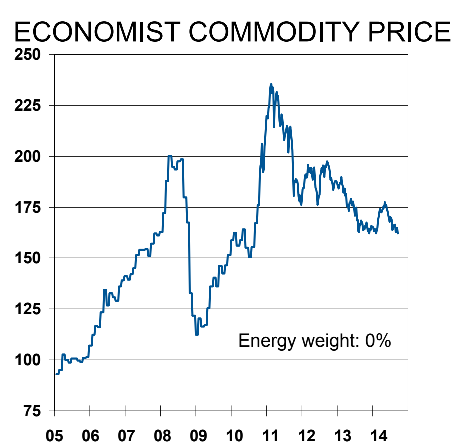
Commodity prices have run into some resistance on the back of downward revisions in the world economic outlook.

We think commodity prices are in a broad "bottoming" phase, though we need to see some economic improvements before commodity prices can turn higher.

2. Other Indices (Weekly data to September 19, 2014)





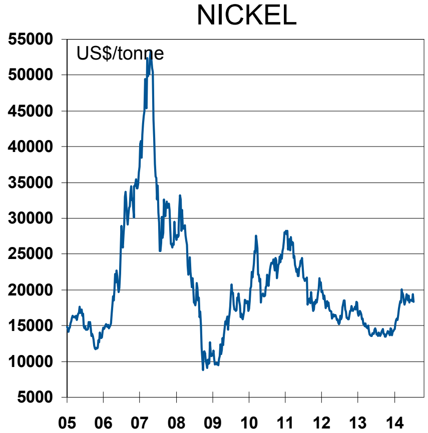


Sources: Bank of Canada, Thomson Reuters Datastream, The Economist

COMMODITY PRICES

3. Metals (Weekly data to September 19, 2014)

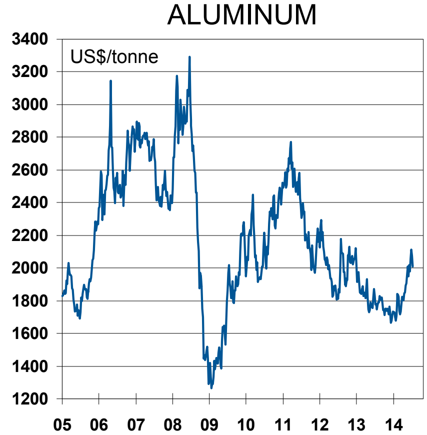
NICKEL



COPPER

ZINC

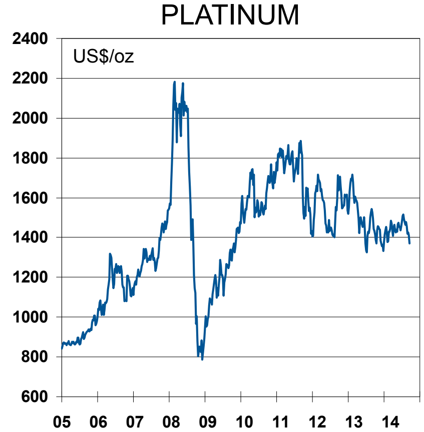
ALUMINUM



LEAD

GOLD

PLATINUM



SILVER

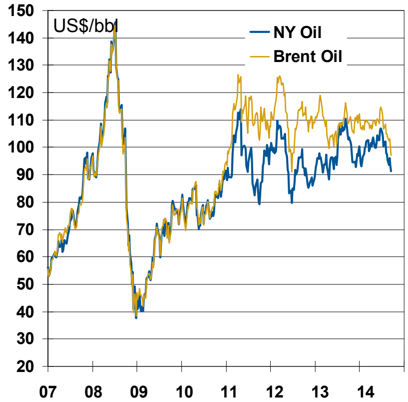
Metal prices, too, have run into resistance; all have come off in recent weeks.

Sources: LME, LBMA, Wall Street Journal

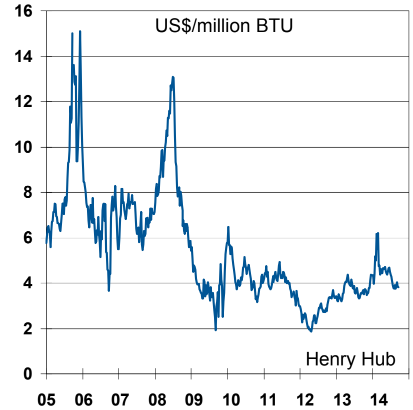
COMMODITY PRICES

4. Energy (Weekly data to September 19, 2014)

SPOT OIL PRICES



NATURAL GAS

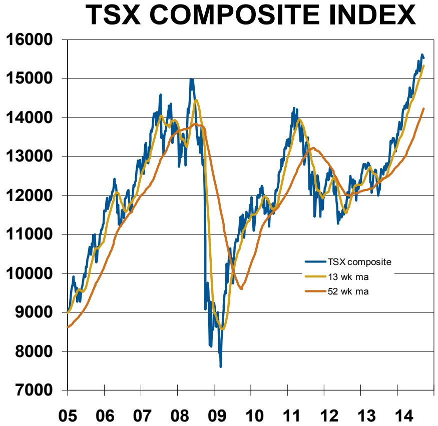


Natural gas prices have fallen back and oil prices, having benefited from geopolitical concerns, are now also slipping.

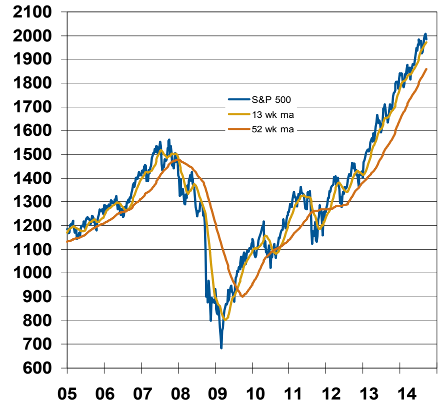
EQUITY MARKETS

5. North America (Weekly data to September 19, 2014)

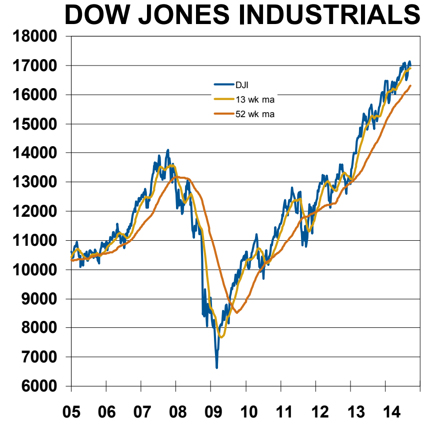
TSX COMPOSITE INDEX



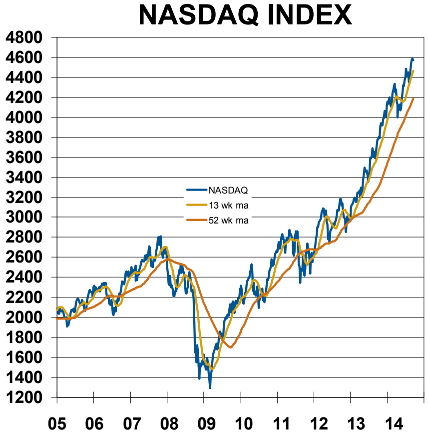
S&P 500 INDEX



DOW JONES INDUSTRIALS



NASDAQ INDEX



Source: Thomson Reuters Datastream

The outlook for North American equity markets remains broadly constructive: policy interest rates will remain low and no US recession is threatening.

That said, Fed policy concerns will create volatility in the remainder of this year and next – when the first US interest rate hike since the "Great Recession" is expected.

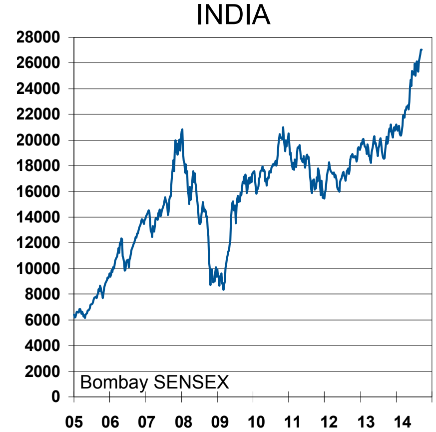
EQUITY MARKETS

6. Around the world (Weekly data through September 19, 2014)

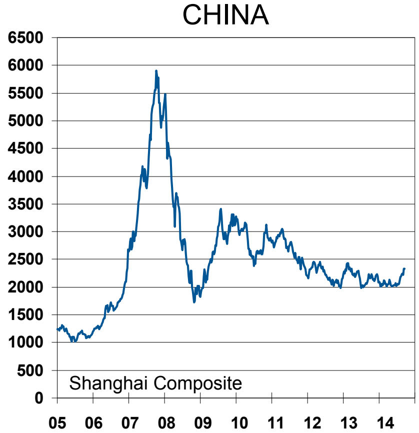
JAPAN

GERMANY

INDIA



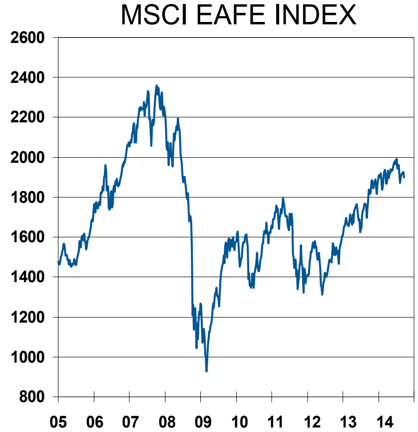
CHINA



RUSSIA

MEXICO

MSCI EAFE INDEX



BRAZIL

MSCI WORLD INDEX

Source: Thomson Reuters Datastream

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ECONOMICS