ECONOMIC MONITOR

July 2014

Prepared by:
Dr. Martin Murenbeeld &
William Tharp, Senior Economist

Dynamic Funds®
ECONOMICS

FINANCIAL MARKETS OVERVIEW

The past month has seen a combination of weaker than expected GDP growth numbers and high inflation, both relatively temporary. US growth should rebound though perhaps not as much as originally expected, depending on how the accounting for Obamacare affects the numbers. Inflation in the US appears to be leveling out but in Canada a further rise, approaching 3%, is still expected. Much of the rise in inflation has been due to higher energy prices (cold winter, global conflicts) and higher food costs (weather and disease), while the Canadian number has also been affected by an earlier fall in the Canadian dollar.

We continue to have concerns that rapid growth in North American energy production will mean lower prices. This has already materialized in the case of natural gas (recently $3.75) but geopolitical problems have kept oil prices (and the Canadian dollar) elevated thus far.

Although talk is in the air of potential future interest rate increases, presumably in Britain first, followed by the US, high energy prices continue to sap global growth at the same time as a demographic shift in the industrialized countries as well as in China is reducing longer term potential growth rates. When interest increases eventually arrive, they are apt to be small.

1. ► The **BANK OF CANADA** is likely to leave interest rates unchanged for the foreseeable future, as the trend for nominal economic growth (the sum of inflation and real growth) is apt to remain historically weak and below target, a temporary uptick in inflation notwithstanding. The Bank is rightly worried about the eventual return of disinflationary pressures.

2. ► The **FED FUNDS RATE** is expected to remain in the range of 0% to 0.25% until mid-2015, but drift toward the high end of that range in the months leading up to mid-2015. In July the Fed is expected to raise the rate to 0.5% and probably engage in large scale reverse repos to tighten the system. All this assumes that inflation stays near 2%, unemployment continues to decline and, more critically, that wage inflation accelerates well above 2%. It might not, for a variety of reasons. In any case, the Fed is expected to continue its gradual reduction of asset buying and then end the quantitative easing program entirely in October.

3. ► Longer term **BOND YIELD**S could move somewhat higher to the extent that economic growth improves, inflation remains at or above 2%, and the reduction in scale of Fed asset buying continues. But several non-temporary factors will continue to restrain yields. These include looser monetary policy in Europe and probably Japan, as well as a growing need of baby boomers to acquire assets, including fixed income, before heading for retirement. As well there is the potential for a further rise in global energy prices (though not necessarily domestic ones), which would further reduce global economic activity.

4. ► Our outlook for the **CANADIAN DOLLAR** has returned to neutral at best for the short term and turns negative by late 2014. While there are some near term positives, including a stronger Canadian housing market, a rebound in the North American economies, and higher inflation (which reduces Bank of Canada concerns about deflation), these factors are not likely to continue into 2015. There is also a potentially large negative risk should North American oil prices follow natural gas prices down.

5. ► The **US DOLLAR** is likely to be on a rising trend as QE continues to be wound down. As well, Europe and Japan are expected to add to their monetary stimulus before long but continuing delays by Europe and Japan in loosening policy are apt to make the dollar's rise an erratic one.

Updated Forecast - Base Scenario

	Actual				Projected						
	13-IV	14-I	14-II	28-Jul	Aug	Sep	Oct	14-IV	15-I	15-II	15-III
CURRENCIES	***Scenario B: Weak Eurozone Growth; Slow Chinese Growth; Modest US Improvement***										
US Dollar Index*	77.93	80.52	79.71	79.42	79.48	79.72	80.08	80.05	80.77	82.12	83.26
Can. Dollar: CDN/US	***1.049***	***1.103***	***1.090***	***1.080***	***1.077***	***1.078***	***1.079***	***1.079***	***1.080***	***1.100***	***1.115***
Can. Dollar: US/CDN	95.33	90.66	91.74	92.60	92.85	92.76	92.68	92.68	92.59	90.91	89.69
Japanese Yen	***100.20***	***103.0***	**102.4**	**101.9**	**102.3**	**102.7**	**103.1**	**103.1**	**104.5**	**105.5**	**106.5**
British Pound	161.8	165.5	168.4	169.8	169.9	169.5	168.5	168.9	167.7	166.4	165.1
Euro	***1.361***	***1.370***	***1.367***	***1.344***	***1.340***	***1.335***	***1.325***	***1.325***	***1.310***	***1.295***	***1.280***
Australian Dollar	92.78	89.66	93.32	94.09	94.34	94.25	94.16	94.25	94.44	93.00	92.02
Chinese Yuan/Rmb	***6.132***	***6.118***	***6.183***	***6.186***	***6.185***	***6.180***	***6.170***	***6.165***	***6.140***	***6.110***	***6.080***
Indian Rupee	62.05	61.78	59.81	60.06	59.50	59.00	58.70	58.60	57.75	57.45	57.20

** 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	0.95	0.95	0.95	0.95	0.95	0.95	0.98	1.00
Government Bond (10-yr)	2.56	2.42	2.29	2.12	2.30	2.40	2.50	2.60	2.75	2.80	2.95
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	1.17	1.35	1.45	1.55	1.65	1.80	1.82	1.95
United States											
Treasury Bill (90-day)	0.06	0.05	0.03	0.03	0.04	0.05	0.06	0.12	0.17	0.23	0.55
Treasury Bond (10-yr)	2.79	2.70	2.57	2.49	2.60	2.70	2.80	2.90	3.05	3.10	3.25
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***	***0.12***	***0.13***	***0.13***	***0.15***	***0.20***	***0.25***	***0.25***	***0.50***
Spread: 10-yr - T Bills	2.73	2.65	2.54	2.46	2.56	2.65	2.74	2.78	2.88	2.87	2.70
Interest Rate Differential (Canada-US)											
Treasury Bill	0.86	0.83	0.91	0.92	0.91	0.90	0.89	0.83	0.78	0.75	0.45
Bonds-10yr	-0.23	-0.28	-0.28	-0.37	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30

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.

The End of QE and The Beginning of Monetary Policy Normalization: A Descriptive Analysis

by Chantelle Schieven and Martin Murenbeeld

The reader is aware that the Fed is in the process of "tapering" its third iteration of Quantitative Easing (QE3). The Fed is currently purchasing Treasury and Government-Sponsored Enterprise (GSE) debt at a rate of $35 billion per month, which is down from $85 billion per month at the end of "Operation Twist" in December 2012. It is widely expected that the rate will be cut to $25 billion per month at the July 29-30 meeting and that purchases will stop entirely after the October 28-29 meeting.

With the end of QE3 attention has accordingly turned to "monetary policy normalization". Since the bankruptcy of Lehman Brothers in September 2008 the Federal Reserve has pumped more than $3 trillion into the economy through a variety of programs (see Table 1 for more details). The question therefore arises as to how this massive stock of assets sitting on the Fed's balance sheet might be reduced to more normal levels and, concomitantly, just when and how the Fed is able to raise its federal funds target rate, which has been set at a range of 0.00-0.25% since December 2008.

The federal funds rate – the rate at which banks lend excess reserve balances to each other on an overnight basis – has been the main interest rate tool the Fed has used in the past to carry out its monetary policy objectives. The Fed sets a target federal funds rate and then trades in government securities to move the federal funds market rate up (or down) to the target rate. (If the Fed wishes to raise the fed funds market rate it will sell government securities to its primary dealers, thereby taking liquidity out of the market; if the Fed wants to lower the fed funds market rate it buys government securities from its primary dealers, thereby adding liquidity to the market. Collectively these actions are known as "open market operations".) The target for the fed funds rate is the rate the Fed believes will keep - or nudge - the economy in the direction of the Congressionally-mandated dual objective: stable prices and maximum employment.

Here is the problem: given that some $2.5 trillion of the Fed's $4 trillion balance sheet is now sitting in "excess reserves" of the banks that maintain a Federal Reserve account, it is not clear whether any bank will need to borrow excess reserves from another bank. A change in the target for the federal funds rate may therefore have little meaning, or monetary policy impact, in the current environment.

So how will the Fed proceed? In fact, the Fed has come up with a number of proposals/ strategies:

1. ***Interest paid on excess reserves (IOER)***: The Fed commenced paying interest on reserves in October 2008. The interest rate is currently set at 0.25%.

   The Fed can increase the IOER when it deems necessary. As the economy improves, for example, and banks' loans and investments collectively rise, the banks' collective ratio of excess reserves to required reserves will decline. The money multiplier, which is the ratio of money supply (checking accounts and such) to overall reserves, will also increase. This development is desirable because it attests to a resurgent economy, but if it commences too rapidly it risks higher price inflation. Accordingly, the Fed will wish to raise the IOER to slow the process; at a higher IOER banks will be induced to hold more excess reserves and fewer loans and investments (though an individual bank may not, depending upon its particular opportunities, etc.).

Table 1
Federal Reserve Programs

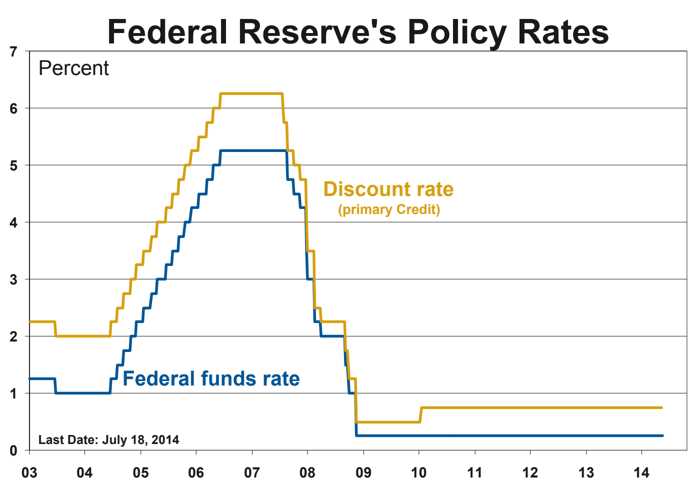
QE1*: ***September 2008 - March 2010***	Total committed or guaranteed ($ billions)
Term Auction Facility (TAF)	900
Temporary Reciprocal Currency Arrangements	583
Term Securities Lending Facility (TSLF)	75
Primary Dealer Credit Facility (PDCF)	148
Bear Stearns Bailout	29
AIG Bailout	60
Asset-Backed CP MM Fund Liquidity Facility (AMLF)	152
Commercial Paper Funding Facility (CPFF)	1800
Money Market Investor Funding Facility (MMIFF)	540
Federal Reserve purchase of mortgage-backed securities	1250
Agency debt purchases	200
Term Asset-Backed Securities Loan Facility (TALF)	1000
Purchase of longer-term Treasury securities	300
QE2: ***November 2010 - June 2011***	
Purchase of longer-term Treasury securities	600
Reinvest maturing principal into Treasury securities, agency debt and mortgage backed securities	
Operation Twist**: ***September 2011 - December 2012***	
The Fed purchases Treasury securities with maturities of 6 to 30 years and sells an equal amount with shorter maturities	667
QE3: ***September 2012 to October 2014 (?)***	Through July 16, 2014
Monthly purchases of agency mortgage-backed securities and US Treasury securities	1580

** not all the programs were utilized to the guaranteed amount*
***did not increase the Fed's balance sheet - technically not QE*
Source: Federal Reserve, DCM Economics

It follows that once the Fed raises the IOER the fed funds rate will rise too – banks will not wish to lend excess reserves at a rate that is lower than IOER. Yet we hasten to add that the federal funds rate is currently trading below the rate on excess reserves (0.12% versus 0.25%). This anomaly results from the fact some entities that lend/borrow at the federal funds market rate – institutions such as GSE's (government sponsored enterprises: Fannie and Freddie) – are actually not eligible to earn interest on excess reserves, but are eligible to lend/borrow in the federal funds market!

2. ***Fixed-rate overnight reverse repurchase agreements (ON RRP)***: The Fed is testing a new ON RRP facility. Under a reverse repurchase agreement (also known as "reverse repos") the Fed sells a security to one of its counterparties in exchange for cash and then repurchases the security the next day at a slightly higher price. The difference in price becomes the effective "interest rate" the Fed pays the counterparty in the transaction.

   "Reverse repos" remove liquidity from the market for the duration of the agreement. The Fed is also considering offering longer term "reverse repos", which would "drain" liquidity from the market for a longer period of time.



Source: Thomson Reuters Datastream

A key provision in the ON RRP facility is the expanded list of eligible counterparties, from the 22 banks and primary dealers (eligible for open market operations) to 139 counterparties, including 94 of the largest money market funds and six government sponsored enterprises. This provision allows the Fed to drain liquidity from a much wider set of institutions than before.

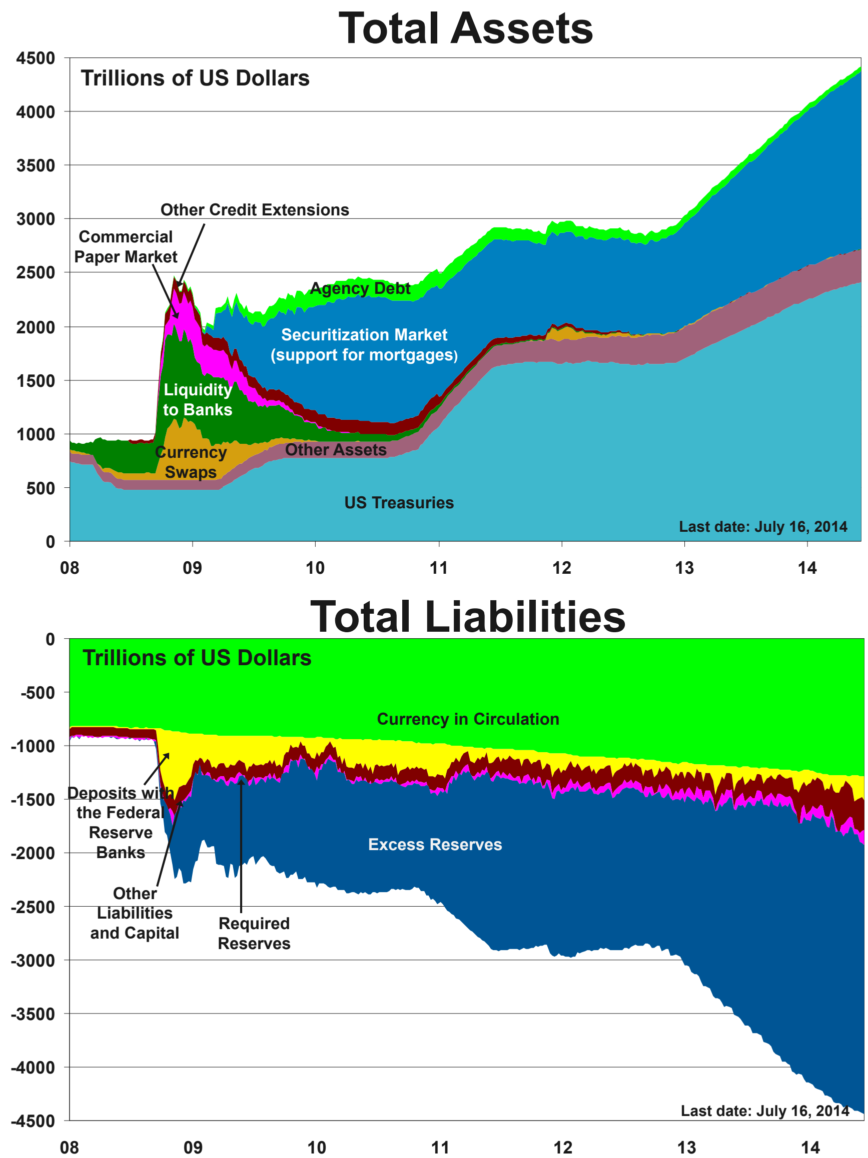
Two concerns have arisen regarding the ON RRP facility however:

- It is feared that during times of financial stress too much liquidity could be directed to the ON RRP facility and away from the market, thereby starving the market of liquidity just when the market might most need it.
- It is also of some concern that the ON RRP facility will expand the Fed's role in financial intermediation – "*too large a presence in the markets*" (as per the latest Fed minutes) – which could create unintended consequences. (A Fitch report suggested that the Fed had become the single largest provider of borrowable Treasury bonds, displacing private firms that heretofore had been lending Treasuries.)

To address these concerns ON RRP the facility is expected to have size limits, which will stop excessive use of the facility during times of financial stress. The interest rate offered on ON RRP's will likely also be below the interest rate paid on excess (and required) reserves, which should keep excess reserves from being used to participate in the ON RRP facility. Other than limiting the ON RRP facility there is little that the Fed can do directly about its large footprint in the market however.

At this stage the ON RRP is slated to be a backup program during the policy "normalization process"; it is not anticipated that the facility will become a permanent part of the Fed's framework. The FOMC seems

The Federal Reserve's Balance Sheet



Source: Thomson Reuters Datastream, Federal Reserve, DCM Economics

The Fed has added more than $3 trillion in assets to its balance sheet since September 2008, creating "excess reserves" as the offsetting accounting entry.

The Fed is working out the technical aspects of raising short-term interest rates in the context of its large balance sheet.

desirous of returning the federal funds rate to its earlier central role in monetary policy.

3. ***Balance sheet asset sales:*** The selling of medium and long-term securities outright from the Fed's balance sheet is not a "normalization" policy directly targeted to help manage short-term interest rates. It will however, "normalize" the balance sheet! (Some 70% of the Fed's balance sheet is tied up in assets of longer than five year maturation – owing to QE2, Operation Twist, and QE3 to date.)

The Fed has no current plans to sell securities from its balance sheet, but it has discussed discontinuing its policy of reinvesting the principle payments when assets mature. The timing thereof is being debated internally, but appears unlikely to start before the Fed has first raised short-term interest rates. Once it discontinues rolling over principle payments the Fed's balance sheet will automatically decline over time.

We do not expect significant, outright sales from the Fed's balance sheet over the next 3-4 years, if only because such selling risks raising interest rates more than would be deemed healthy for the rather modest economic environment expected in the near future. (The Fed's latest forecasts point to GDP growth in a range of 2.2-3.2% through 2016 and 1.8-2.5% over the longer term.)

4. ***Higher Reserve Requirements***: raising banks' reserve requirements will not necessarily lead to a "normalization" of the Fed's balance sheet, but it will immediately shrink the amount of excess reserves in the banking system. (Total reserves are required reserves plus excess reserves; raising required reserves immediately reduces excess reserves.) And it will in all likelihood raise short-term interest rates, because excess reserves available to be lent out will decline. A change in the reserve requirements effect financial institutions differently and It is it difficult to estimate the effect a change in reserve requirements will have on each financial institutions and it could potentially cause liquidity problems in some smaller institutions. The Fed rarely changes reserve requirements for this reason and it is unlikely to be the main strategy the Fed uses in its "normalization" process, but it is a possibility down the road.
5. ***Discount Rate:*** The discount rate is a "penalty" rate at which a financial institution can borrow from the Fed; hiking the discount rate is another Fed policy option. The primary discount rate was last set at 0.75% on February 19, 2010; but with market rates well below this rate, we do not envision any bank borrowing at the relatively "punishing" discount rate – unless it is in financial difficulties and has no alternative to ready liquidity. (We include the discount rate here only for the sake of completeness. We do not expect the discount rate to be an important policy tool in the next few years.)

So these are the key Fed options and they will form the basis of Fed strategies going forward. The Fed's fundamental challenges are to develop methods which will entice banks to continue holding excess reserves at the Fed as the economy improves and to reduce its $4 trillion+ balance sheet over time without market disruption. The recent focus of Fed discussions has been on IOER and ending the policy of principle payment reinvestment. We'll see how it goes.

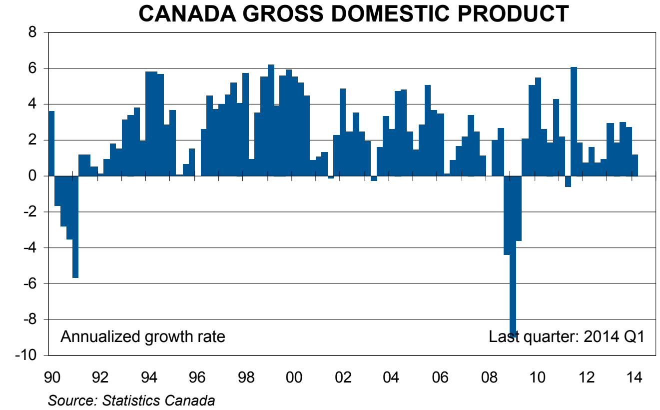
Before concluding we should point out that in the event (an event which worried markets in 2013 and led to the "tapering tantrum") long-term interest rates rose faster than the Fed deemed desirable, the Fed also has several options. The first option is to adopt QE4, buy Treasuries in the market and bring long-term rates down to a more desirable level. An "outside the box" variation of QE4 would be the direct targeting of long-term interest rates (which was not uncommon before 1950 during times of stress). The Fed can set a target yield for 10-year Treasuries, much like it sets a target rate for the federal funds rate, and then perform "open market operations" to move the actual 10-year yield in the direction of the target yield.

To be sure, we'd expect there to be a lot of opposition to the heavy-handed policy of targeting long-term interest rates, or capping them. Those who currently worry about the Fed's footprint in the market will worry much more. But unusual times call for unusual policies, and we are in unusual times!

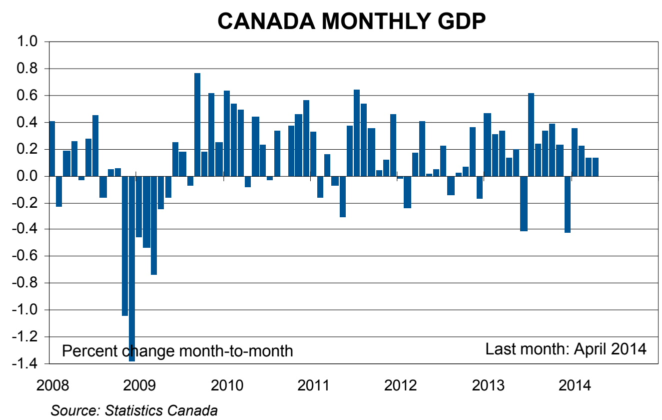
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Growth for the full year may be a disappointing 2.2% – and even less in 2015!

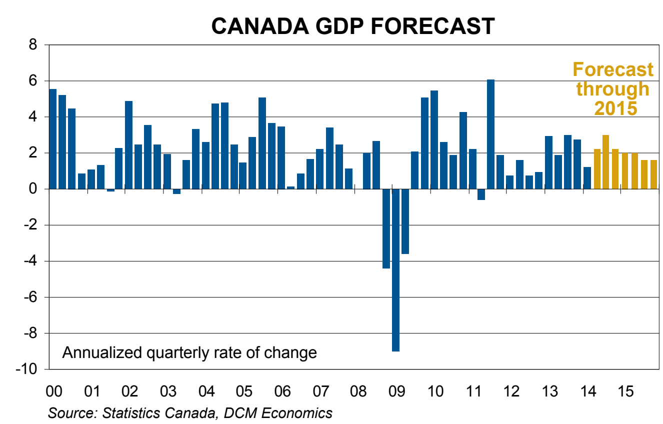
First quarter growth was only 1.2%.



The last two months have not been impressive either.



Growth this year may be only 2.2%.

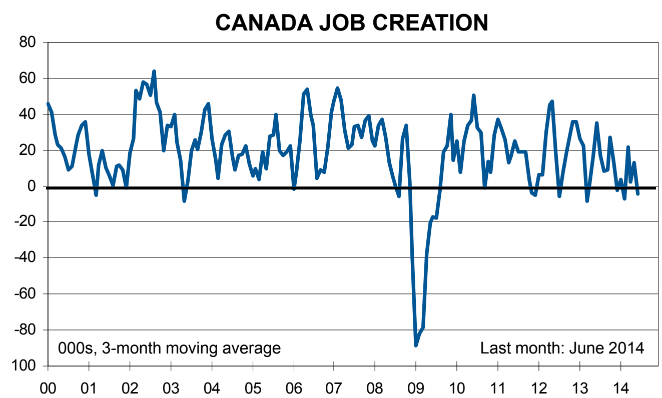


MONTHLY REVIEW ► CANADA – ECONOMIC GROWTH

Industrial production has been surprisingly strong, aided by strong North American auto demand and a cheaper Canadian dollar.

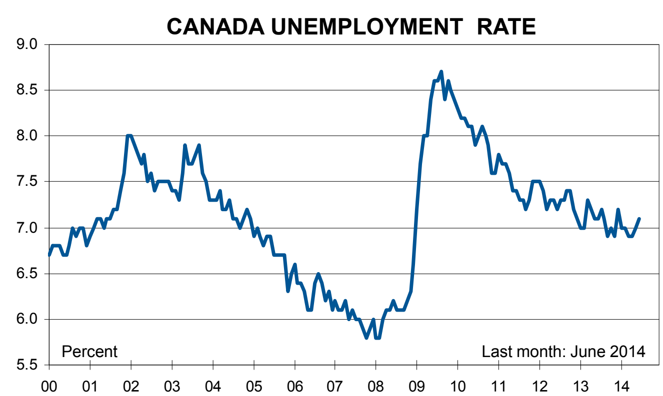
Source: Statistics Canada

The Canadian economy has lost jobs in four of the last seven months however ...



Source: Statistics Canada

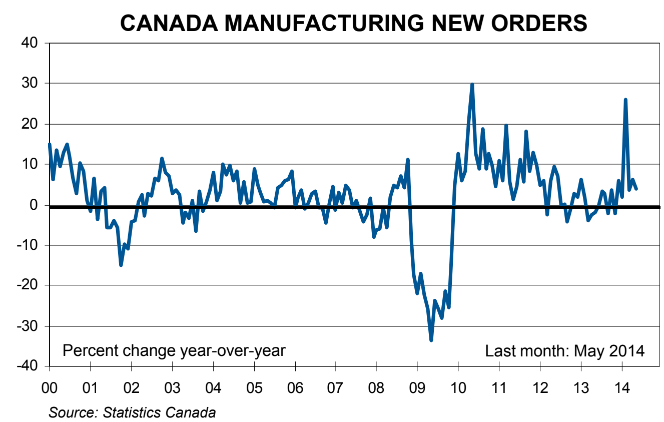
... and the unemployment rate is having trouble getting under 7%. (The Canadian unemployment rate is higher than the US rate, which continues to fall.)



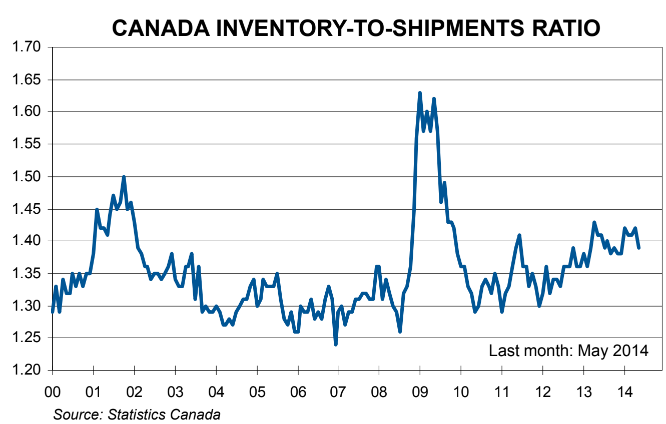
Source: Statistics Canada

Manufacturing shipments growth is accelerating ...

... new orders for manufactured goods are looking better too ...

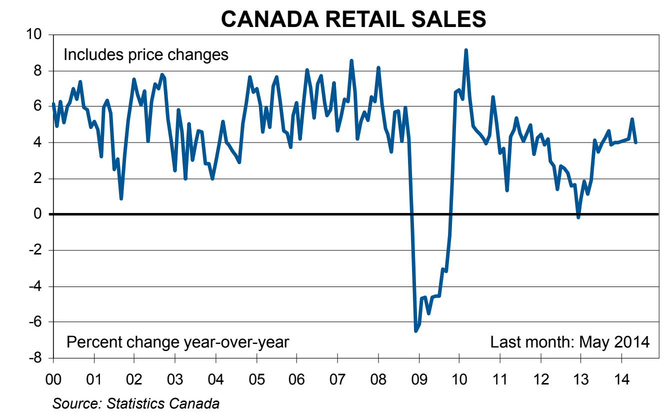


... but the inventory ratio still looks high.

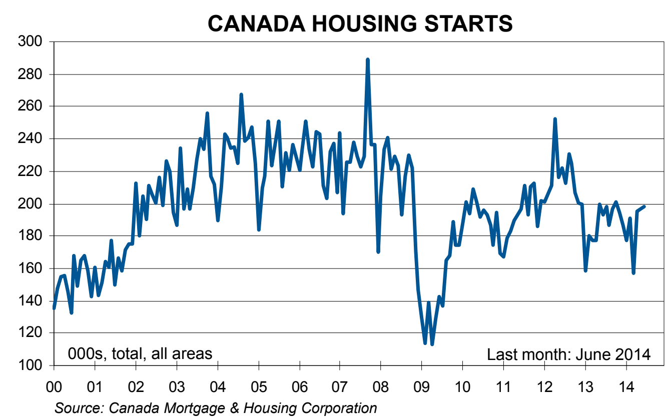


MONTHLY REVIEW ▶ CANADA – ECONOMIC GROWTH

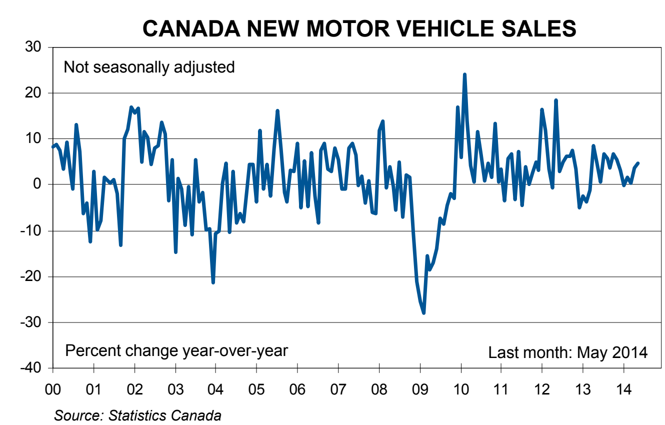
Retail sales have been somewhat stronger in recent months. The lower Canadian dollar means fewer sales have been lost to the US.



Housing starts have strengthened, helped by lower mortgage rates. But starts may trend lower again starting this fall - affordability has been a growing problem.



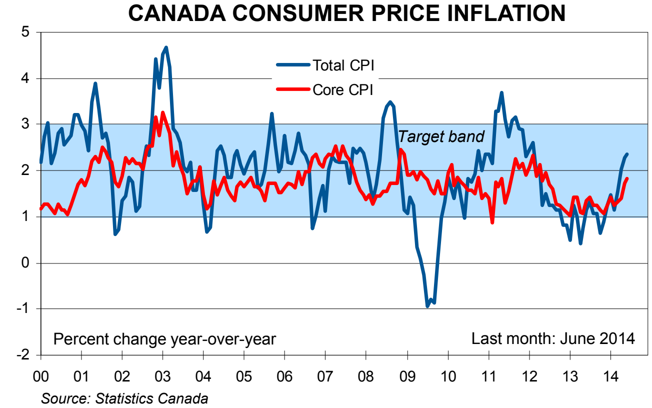
Vehicle sales have also picked up recently.



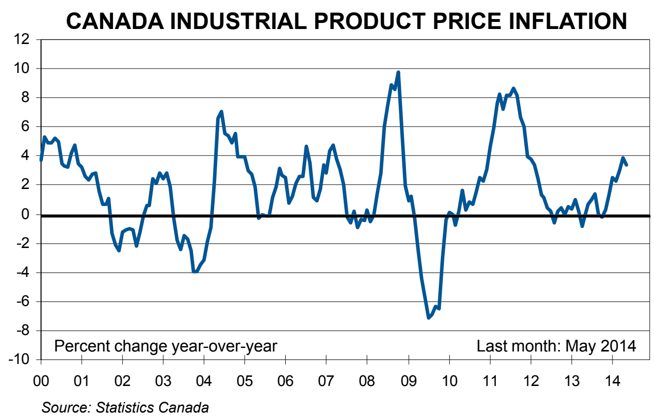
MONTHLY REVIEW ►
CANADA – INFLATION

Headline inflation is being pushed higher by a variety of factors that we believe are temporary, but could reach 3.0% later this year before falling back.

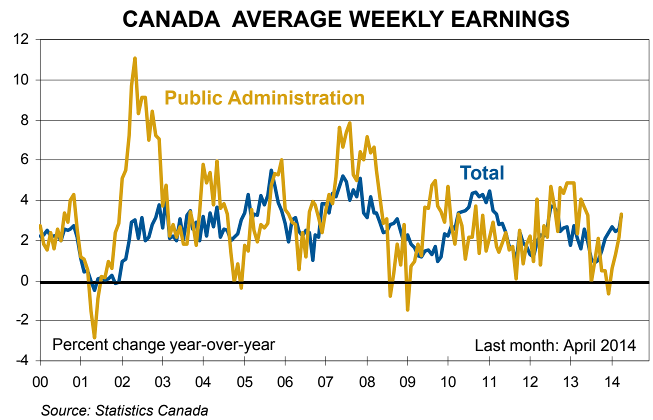
Headline inflation reached 2.4% in June, with the core rate up slightly to 1.8%. Higher food and energy prices, as well as the impact of the lower dollar, could see CPI peak near 3% in December, then fall back to 2% or less next year.



IPPI fell back to 3.4% in May from 3.9% in April.

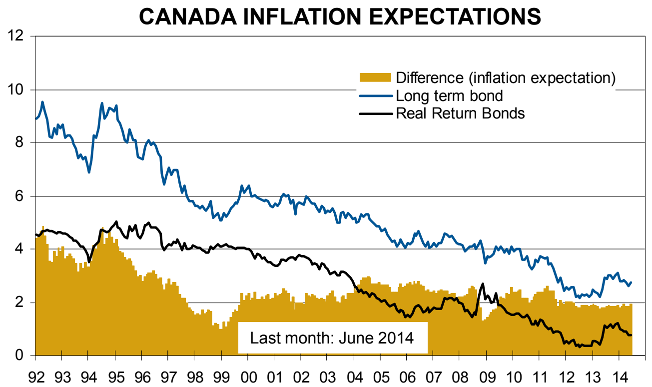


The increase in average weekly earnings, a very volatile number, bounced up to 3.3% in April.



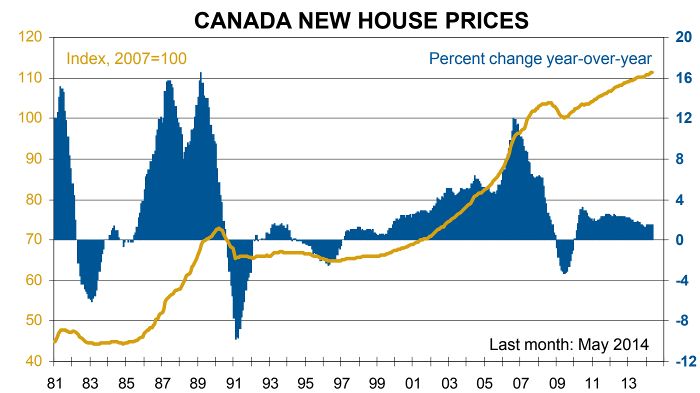
MONTHLY REVIEW ► CANADA – INFLATION

Inflation expectations remain contained below 2%.



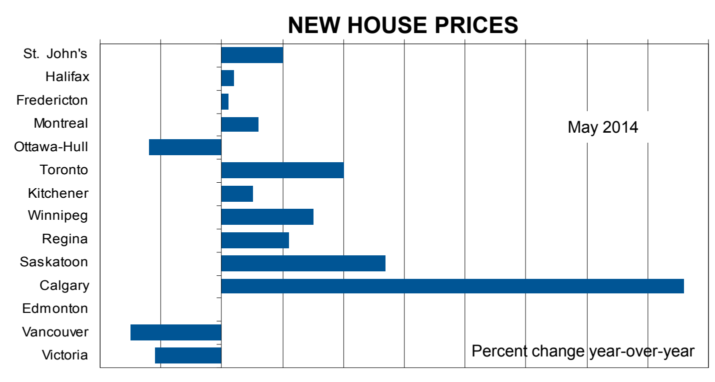
Source: Bank of Canada, DCM economics team

Calgary is the run-away leader in new house price increases, as reconstruction after the flood is straining resources.



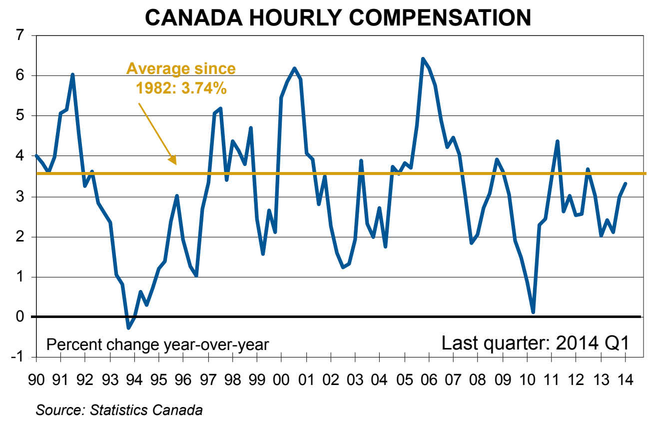
Source: Statistics Canada

New house price increases are decelerating nationally however, partly because smaller units are being constructed on smaller lots.

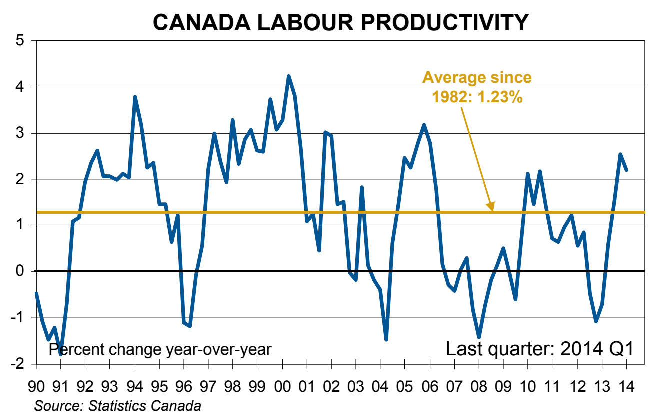


Source: Statistics Canada

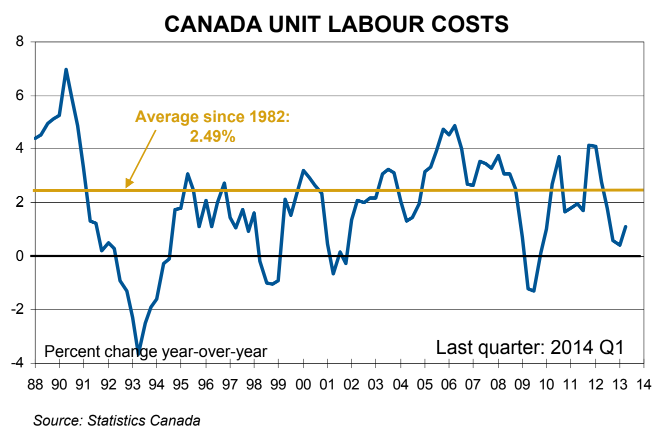
Hourly compensation increased just over 3% in 2014-Q1 ...



... but productivity has seen a recent spike ...

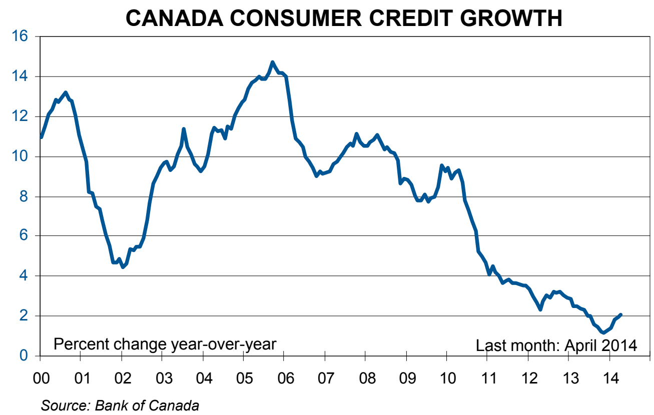


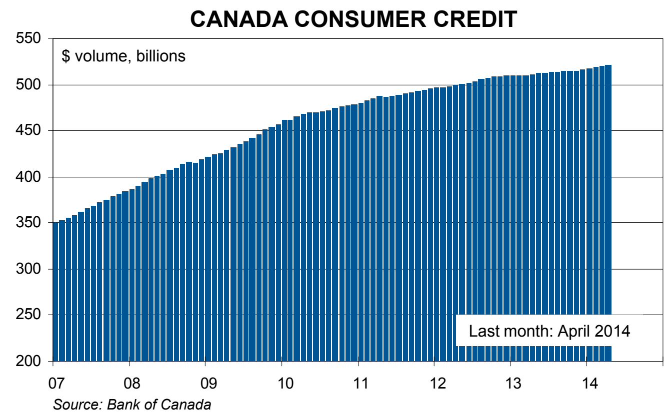
... which leaves unit labour costs up a modest 1.1% over the latest 12 month period.

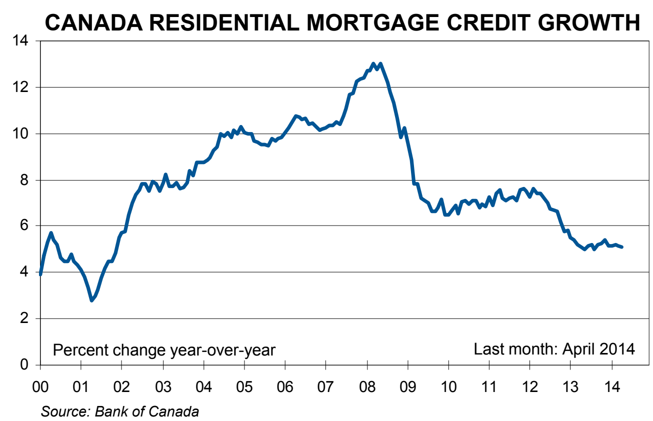


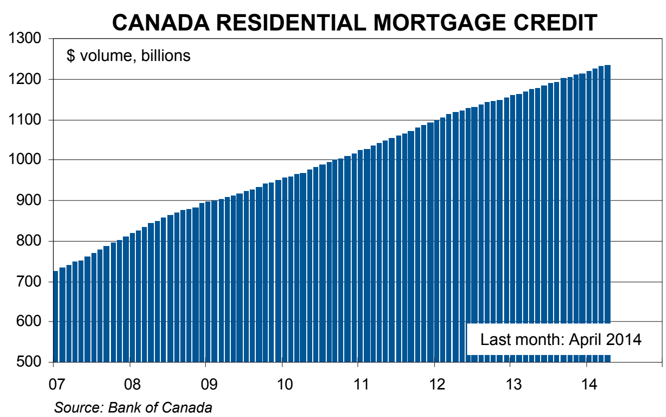
MONTHLY REVIEW ► CANADA – DEBT AND CREDIT

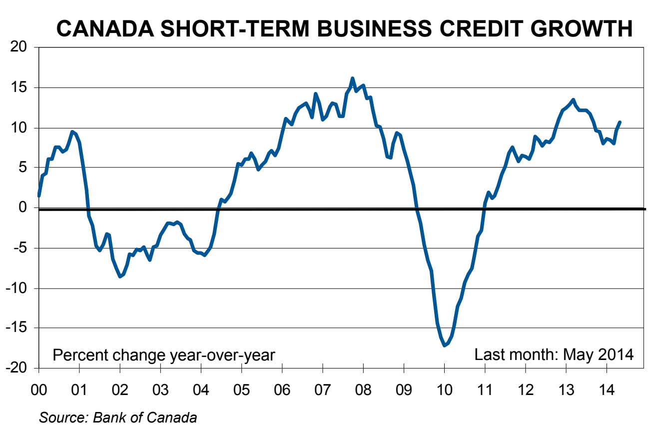
Consumer credit growth is slow but creeping higher; mortgage credit growth remains modest while business credit growth has been accelerating.

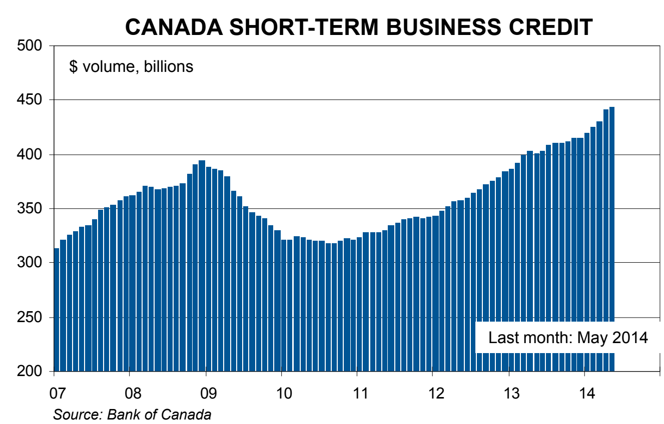




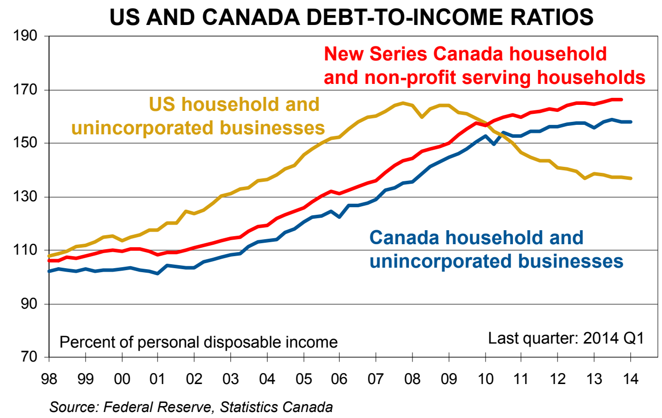




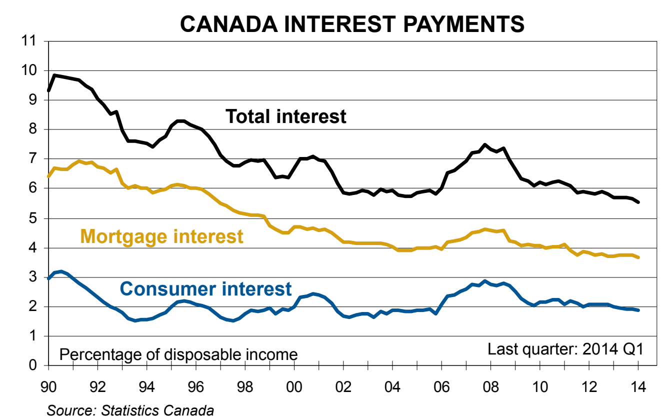




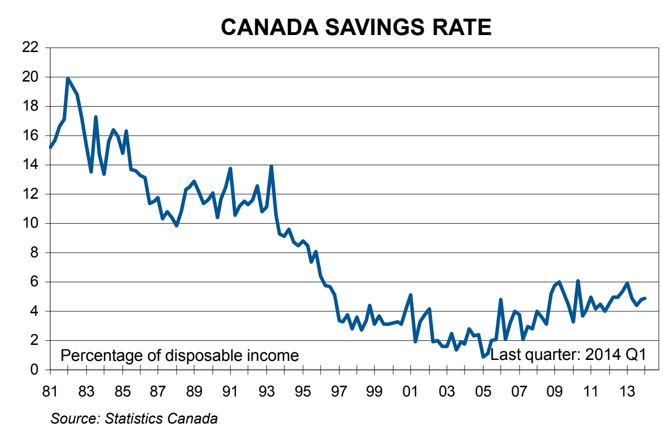
The Canadian household debt ratio shows signs of flattening out - likely a prelude to rolling over.



Yet, the interest portion of debt repayment is the lowest in decades, despite record debt levels.

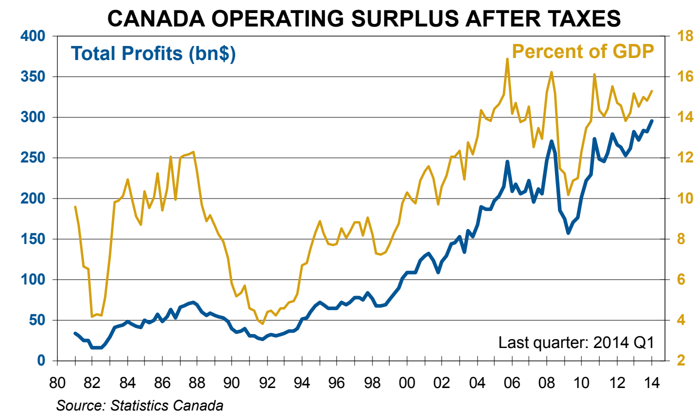


Canada's savings rate has been rising.



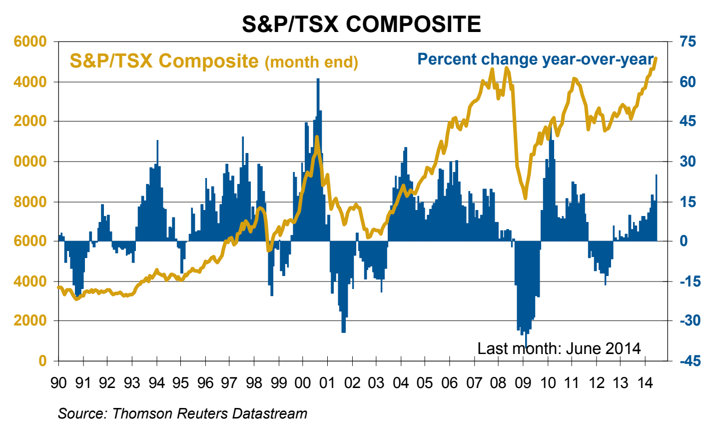
MONTHLY REVIEW ►
CANADA – WEALTH CREATION

Profit growth has been solid ...

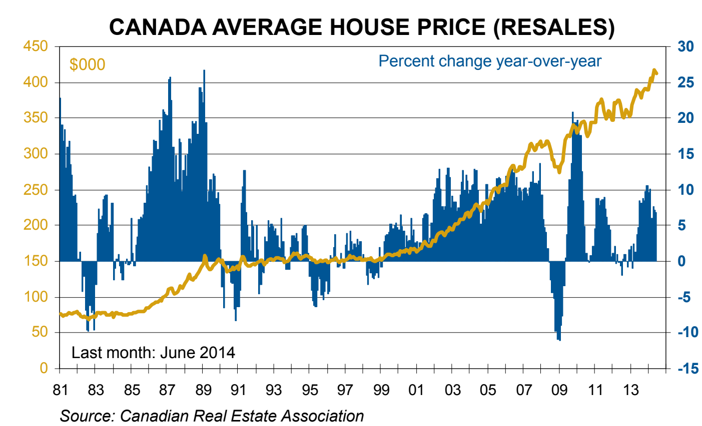


... helping stocks rise.

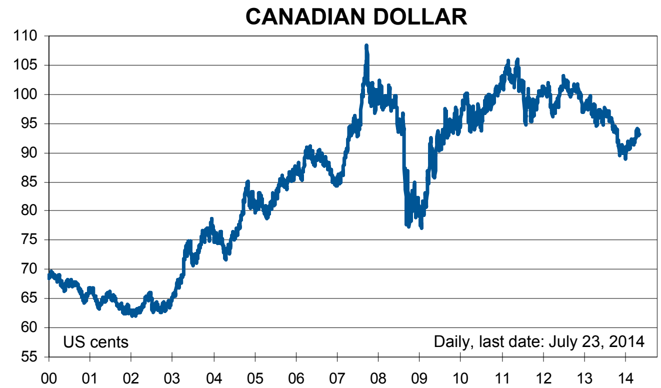
Soon-to-retire baby boomers are also boosting demand for equity investment.



And average resale house prices continue to rise.

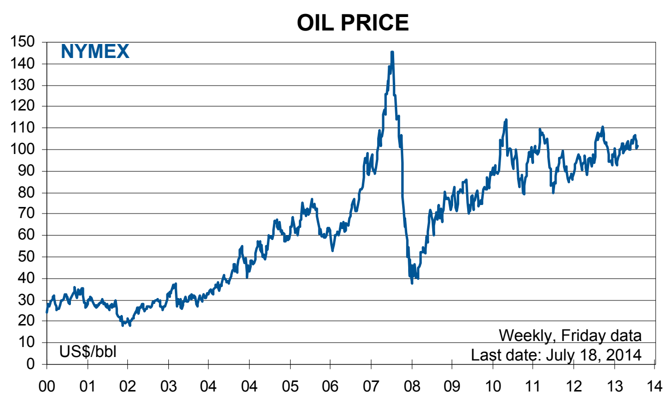


Conflict abroad has raised Canada's profile as a decent place to invest - especially in the energy and financial sectors.



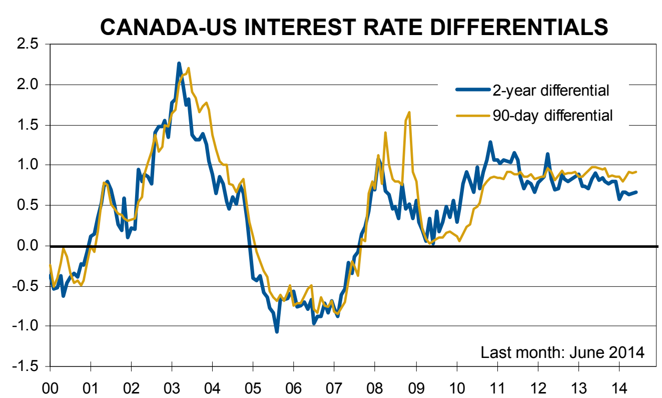
Source: Wall Street Journal

The price of oil remains high, giving the dollar a boost too.



Source: Wall Street Journal

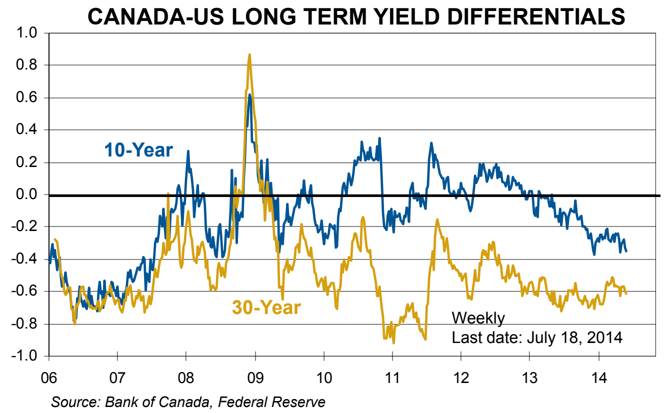
Short-term interest rate differentials favour Canada - another plus for the dollar!



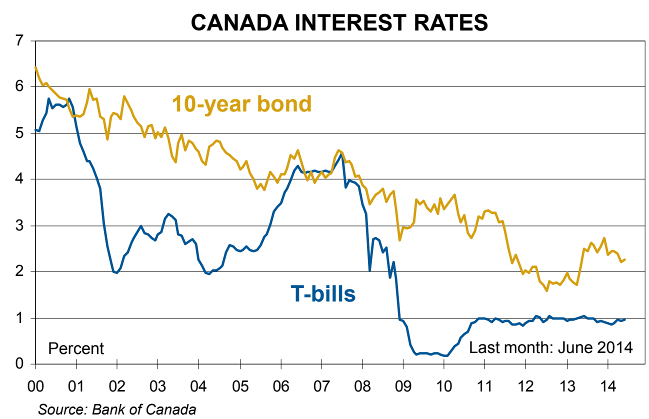
Source: Bank of Canada, Federal Reserve

MONTHLY REVIEW ►
CANADA - FINANCIAL MARKETS

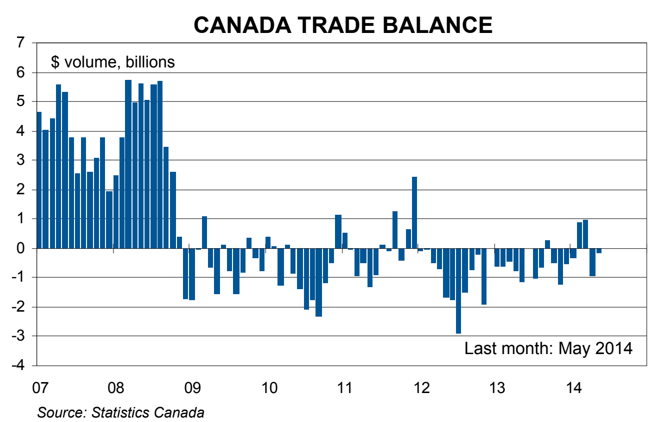
The US holds the advantage when it comes to longer term rates.



The Bank of Canada is unlikely to raise interest rates anytime soon however, as it too expects the recent rise in inflation to be temporary.



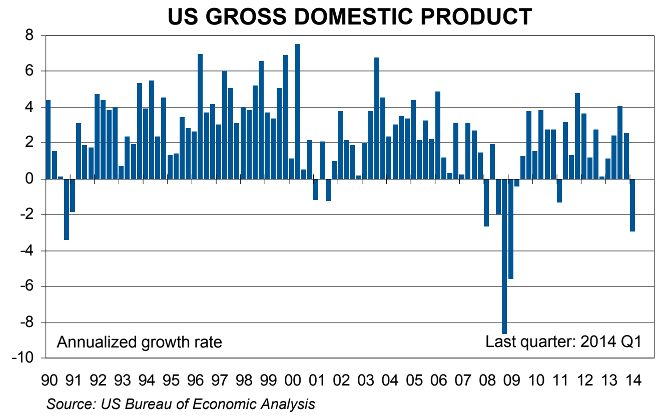
Canada's trade deficit is not particularly dollar-positive.



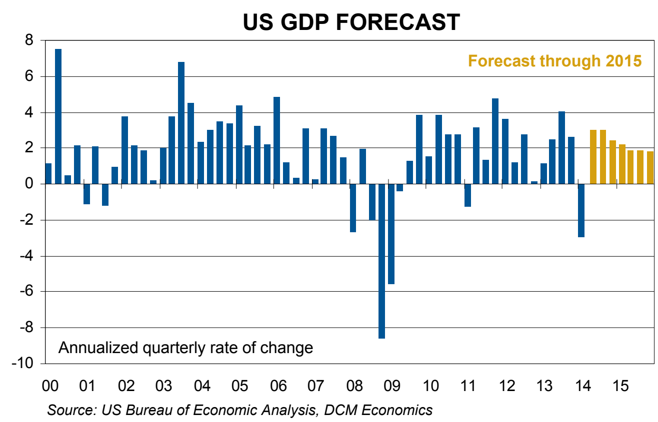
MONTHLY REVIEW ►
UNITED STATES - ECONOMIC GROWTH

With the latest revision, growth could be below 2.0% this year. (The IMF now forecasts 1.7%!)

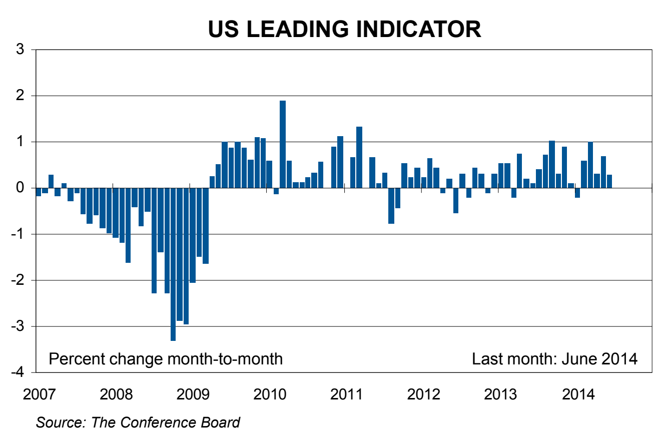
The large downward revision to first quarter growth in recent months will make it difficult to reach 2% this year.



Uncertainty surrounding the accounting for Obamacare (the main factor behind the first quarter revision) makes it difficult to estimate growth accurately over the next few quarters.

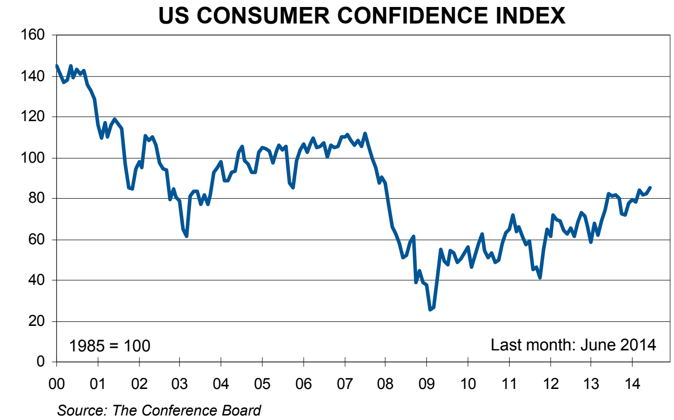


The leading indicators point to only modest growth ahead.

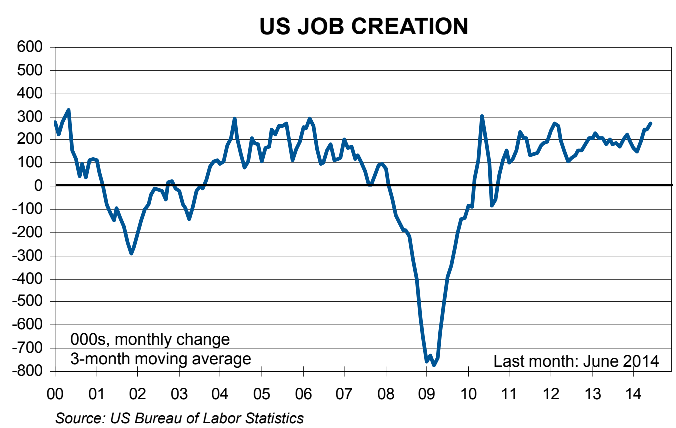


MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

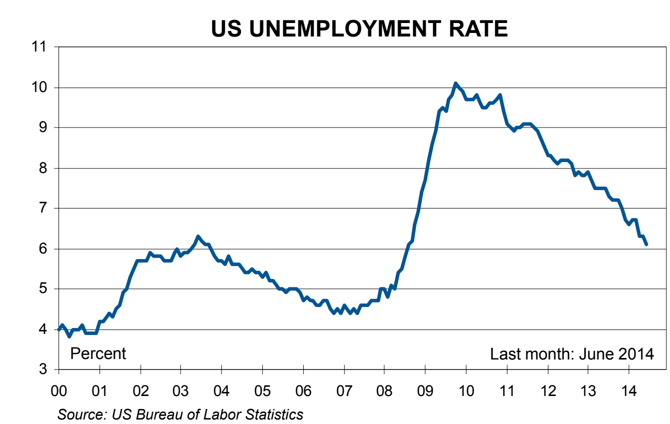
Rising equity and home prices, and decent employment prospects, are raising consumer confidence however.



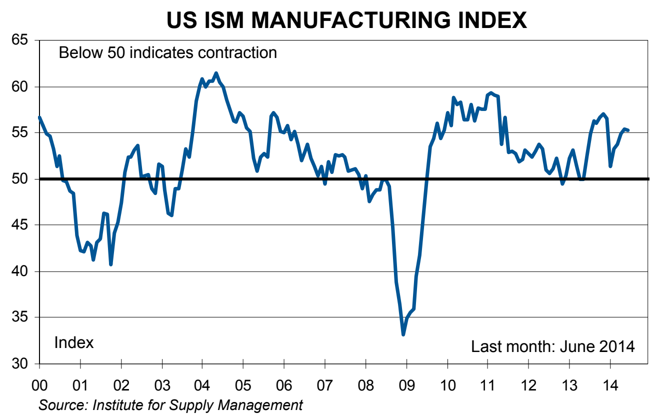
Job creation has certainly picked up ...



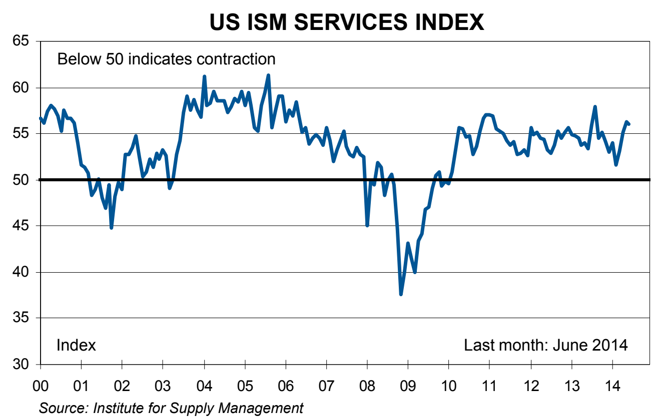
... and the unemployment rate continues to slip (although partly because of baby boomer retirements).



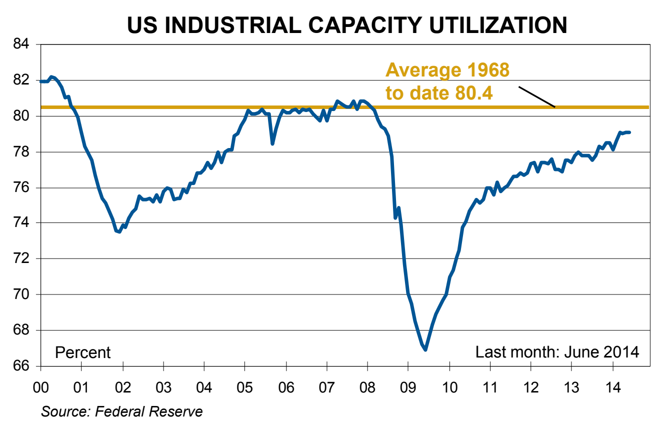
Manufacturing appears to have recovered from a harsh winter.



The service sector is also reasonably strong, though still less robust than before 2007. (Housing has not fully recovered and probably won't!)

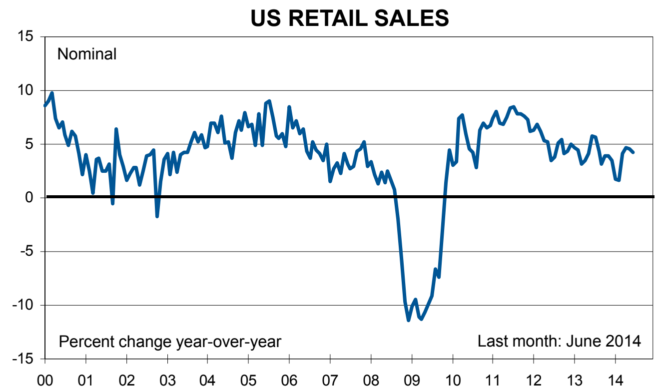


The capacity utilization rate remains below average, implying reduced inflationary pressures for the time being.



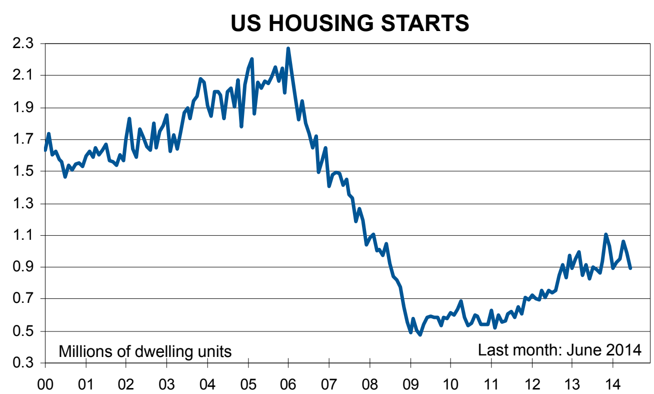
MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

June retail sales were somewhat disappointing.



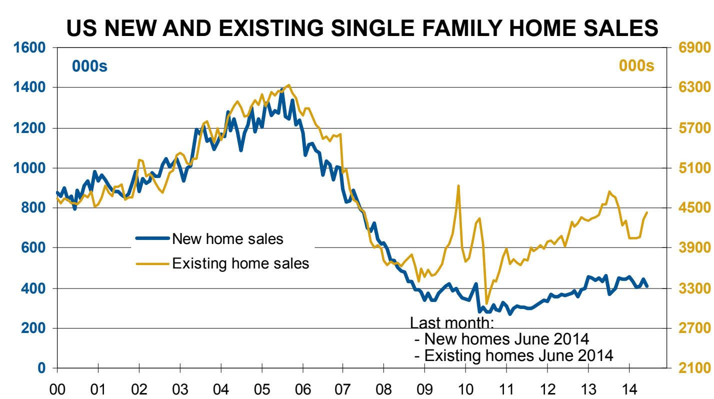
Source: US Census Bureau

Housing starts, while volatile, appear to be trending sideways. Affordability is becoming an issue, especially with wage increases low.



Source: US Census Bureau

New home sales data are trending modestly higher as are existing home sales data.

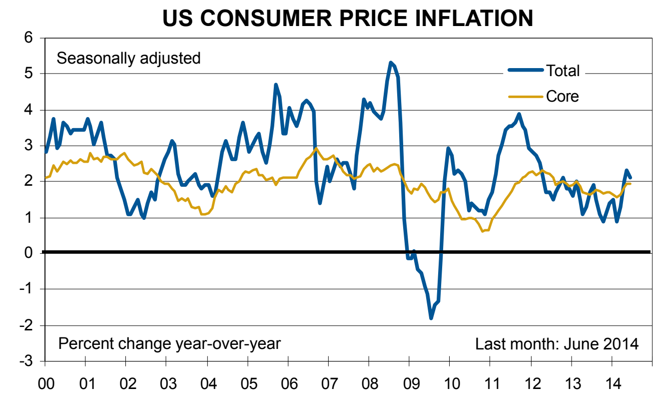


Source: US Census Bureau, National Association of Realtors

MONTHLY REVIEW ►
UNITED STATES – INFLATION

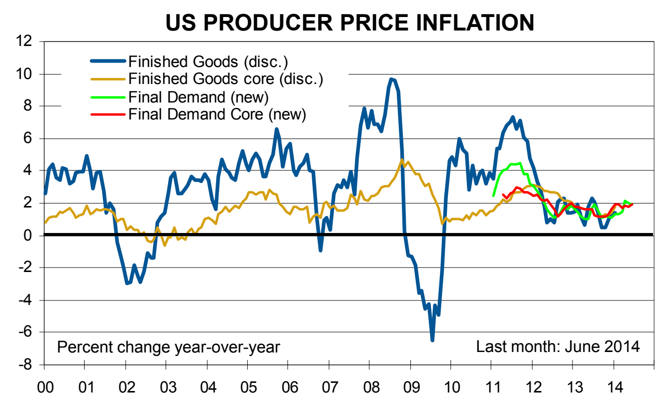
Higher food and energy costs have pushed headline inflation above 2%. It could remain there until early 2015, then slip back.

Although inflation slipped back in June, headline CPI could remain above 2.0% until next spring.



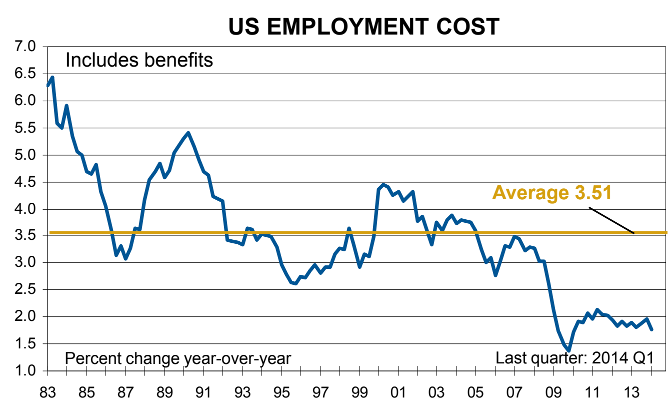
Source: US Bureau of Labor Statistics

PPI also slipped back from 2.3% to 2.0% in June.



Source: US Bureau of Labor Statistics

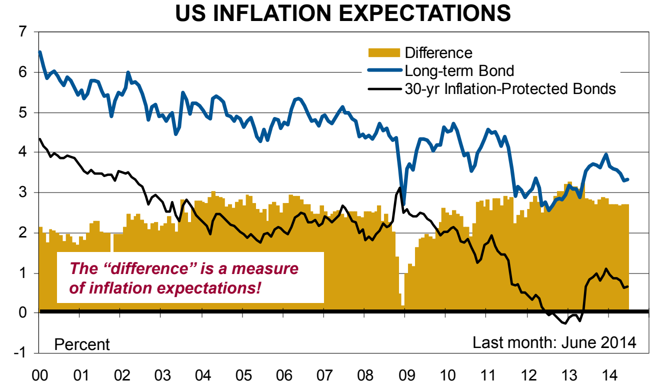
Employment costs remain tame, slipping in the first quarter in fact.



Source: US Bureau of Labor Statistics

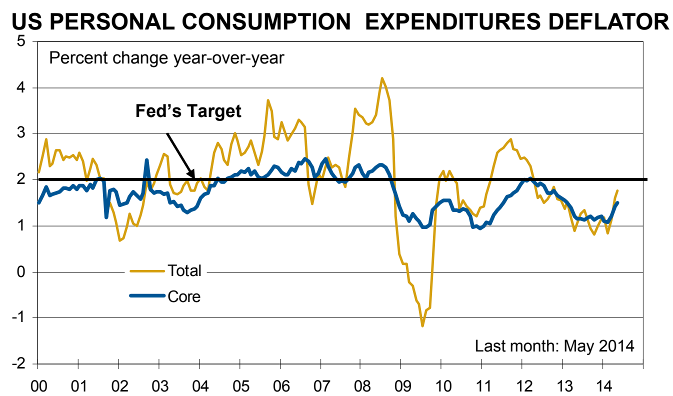
MONTHLY REVIEW ►
UNITED STATES – INFLATION

Inflation expectations remain contained, decreased a bit in fact in recent months.



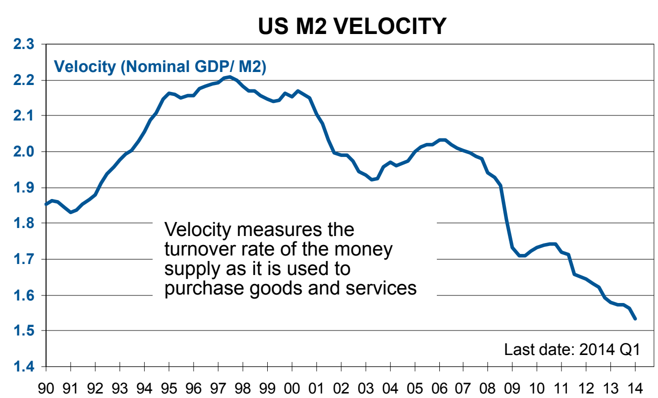
Source: Federal Reserve, DCM Economics

The PCE version of inflation (which the Fed prefers) was still under 2% in May.



Source: US Bureau Economic Analysis

The rate with which money turns over continued to sink in the first quarter.

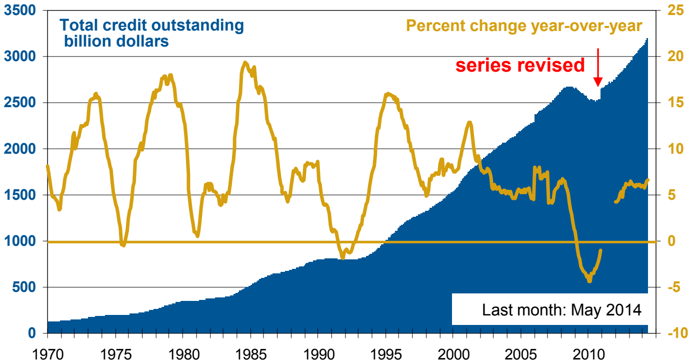


Source: Federal Reserve, Bureau of Economic Analysis, DCM Economics

UNITED STATES - CREDIT GROWTH

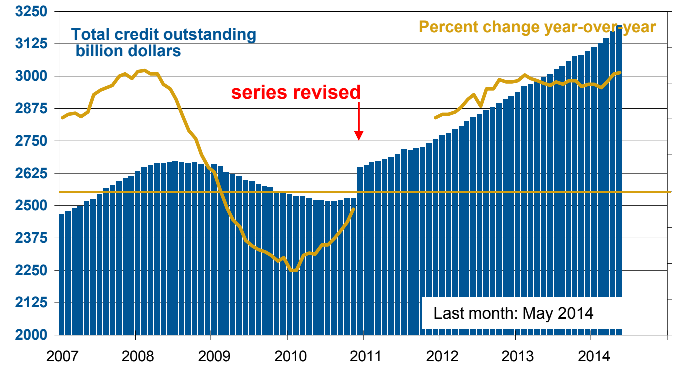
Credit growth remains somewhat limp compared with past cycles. Mortgage credit outstanding contracted in 2014-Q1.

US CONSUMER INSTALLMENT CREDIT



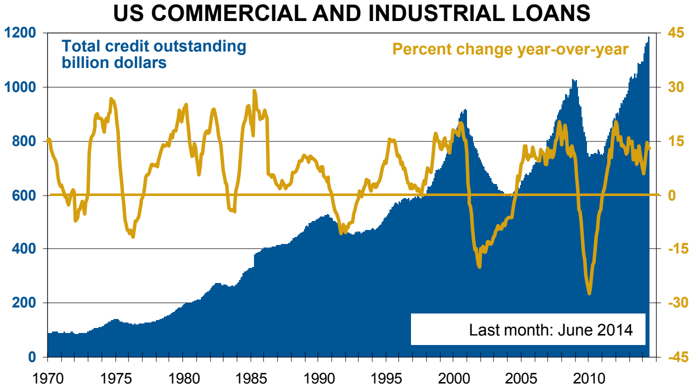
Source: Federal Reserve

US CONSUMER INSTALLMENT CREDIT



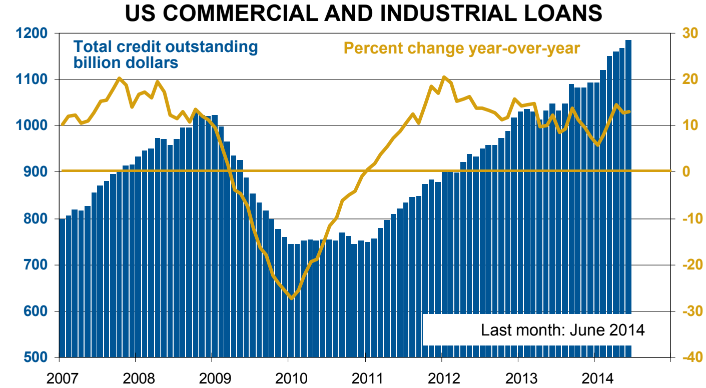
Source: Federal Reserve

US COMMERCIAL AND INDUSTRIAL LOANS



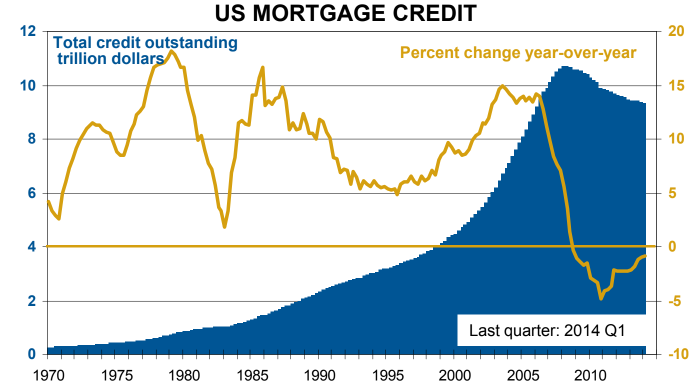
Source: Federal Reserve

US COMMERCIAL AND INDUSTRIAL LOANS



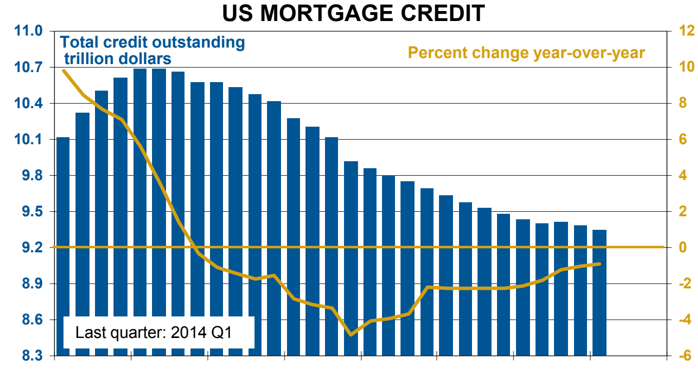
Source: Federal Reserve

US MORTGAGE CREDIT



Source: Federal Reserve

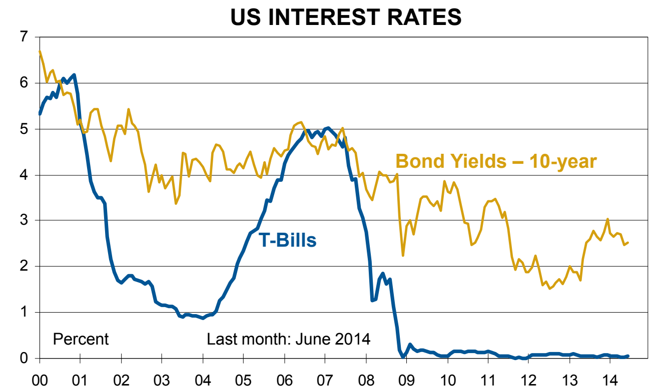
US MORTGAGE CREDIT



Source: Federal Reserve

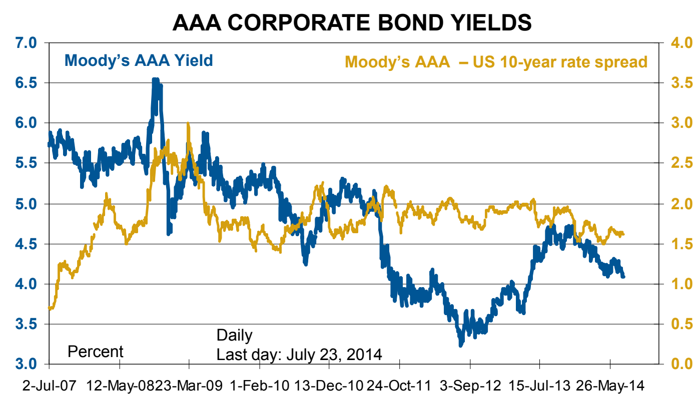
MONTHLY REVIEW ►
UNITED STATES – FINANCIAL MARKETS

The Fed is expected to raise interest rates around mid-2015, provided wage growth picks up and inflation sticks around 2%. Neither of these conditions is guaranteed however.



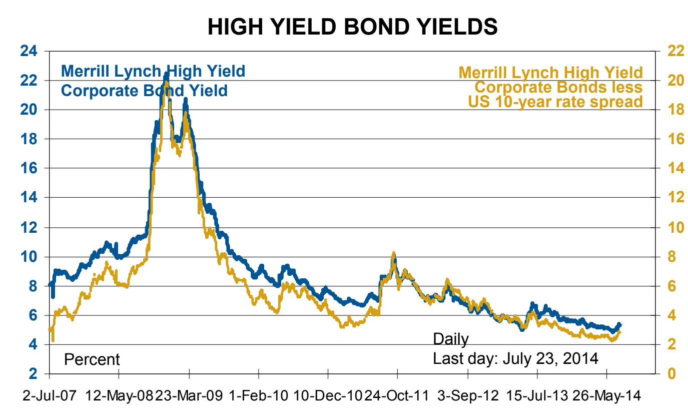
Source: Federal Reserve

Bond yields are currently somewhat depressed by geopolitical worries.



Source: Federal Reserve

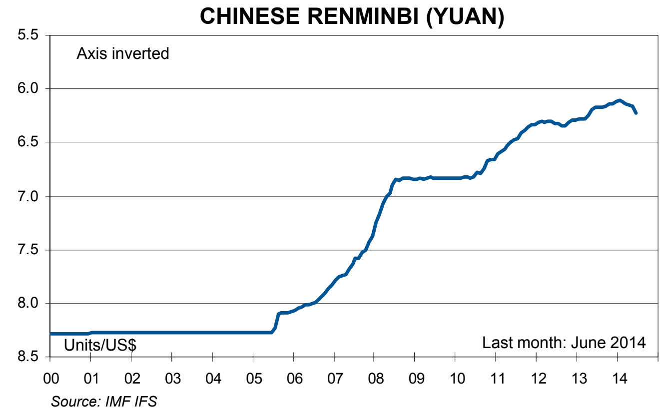
High-yield bond yields may have fallen too far. Certainly the Fed appears to think so!



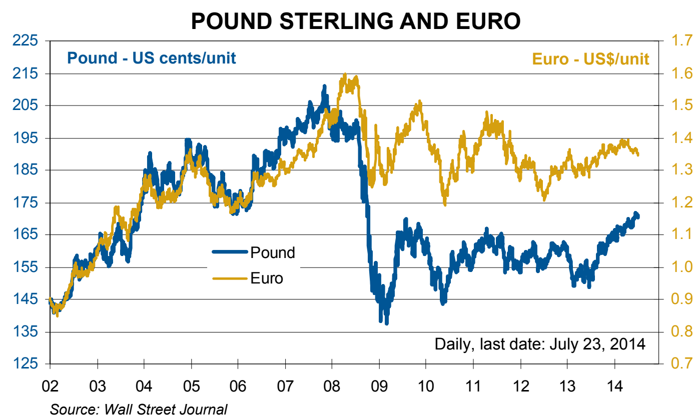
Source: Federal Reserve, Wall Street Journal

MONTHLY REVIEW ►
FOREIGN EXCHANGE RATES

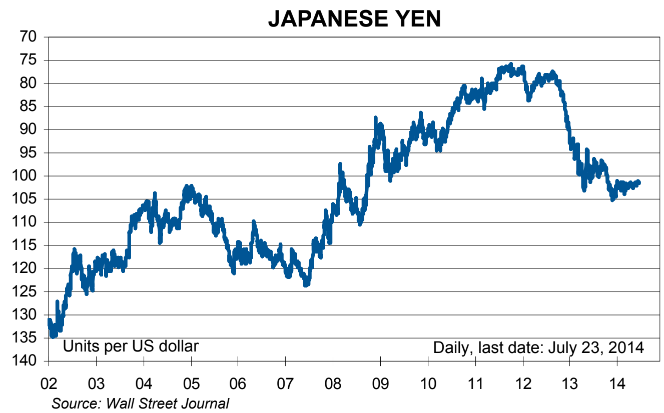
The renminbi remains somewhat depressed, which continues to vex US officials.



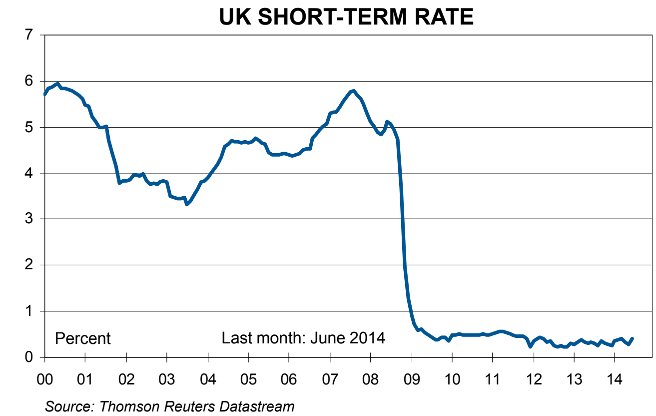
The pound has picked up on improved British economic data and the potential of higher interest rates. The euro is more flattish as the market wonders whether the ECB will eventually implement quantitative easing.



The yen has also been flat; the market has been disappointed over the lack of further monetary policy easing.

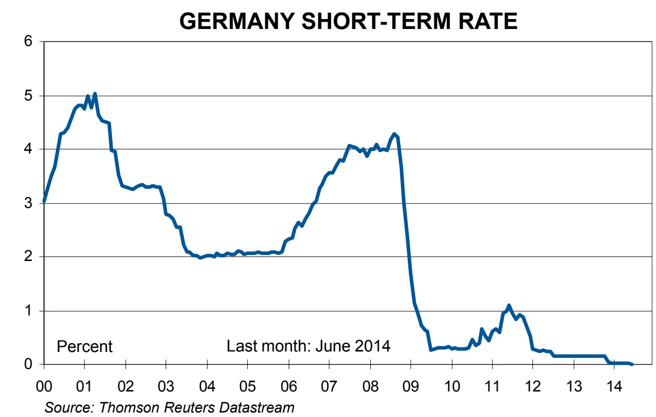


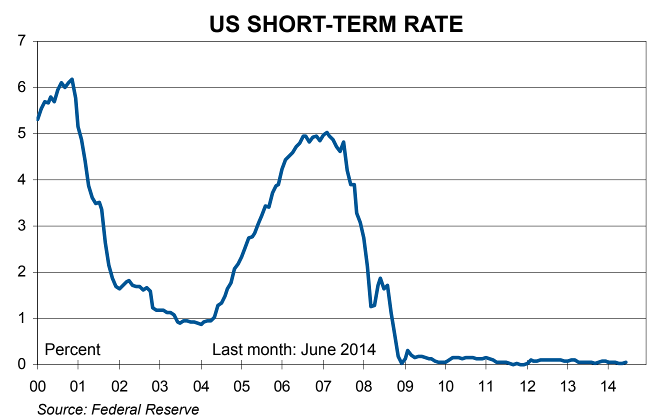
MONTHLY REVIEW ► INTERNATIONAL SHORT-TERM INTEREST RATES

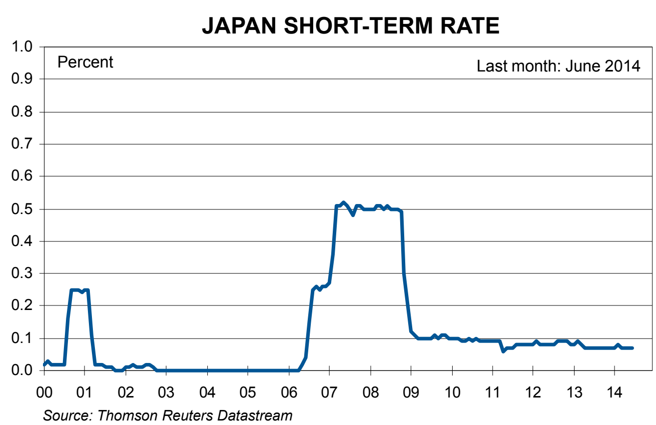


Britain will probably be the first industrialized country to raise interest rates - possibly later this year!?

The US will likely be next, though the earliest date appears to be mid-2015.

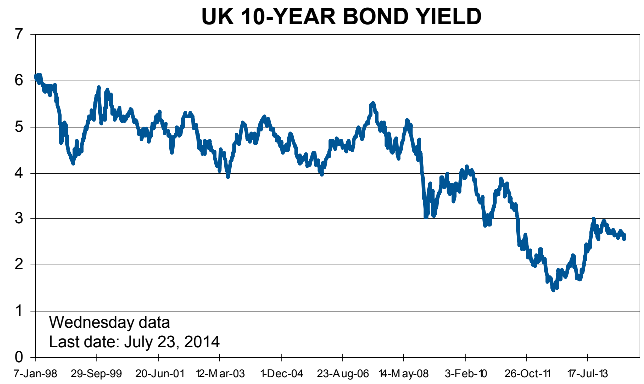




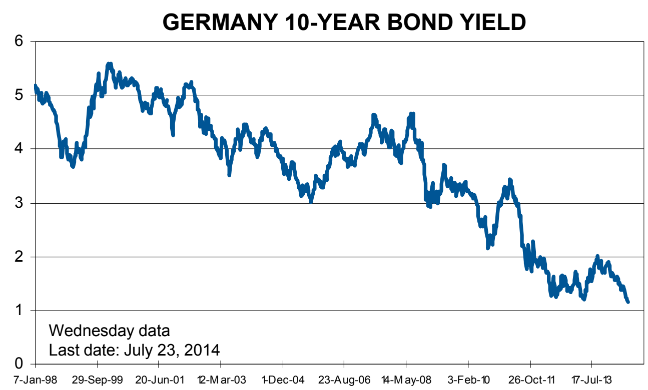


MONTHLY REVIEW ►
INTERNATIONAL 10-YEAR YIELDS

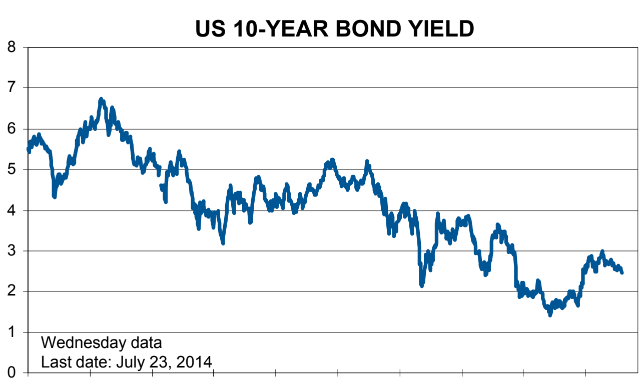
Bond yields are currently depressed by geopolitical events (Ukraine, Gaza) but if US growth improves and inflation remains around 2%, yields could move into the upper end of a 2.5% to 3% range.



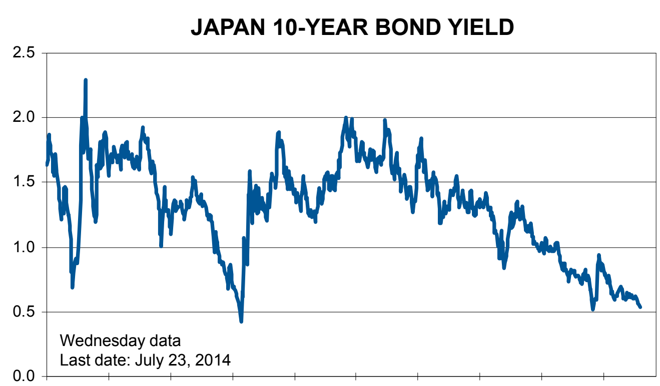
Source: Financial Times



Source: Financial Times



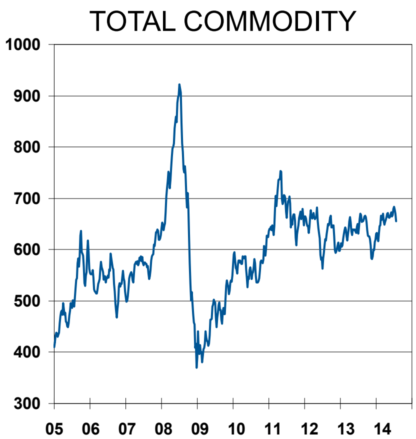
Source: Financial Times

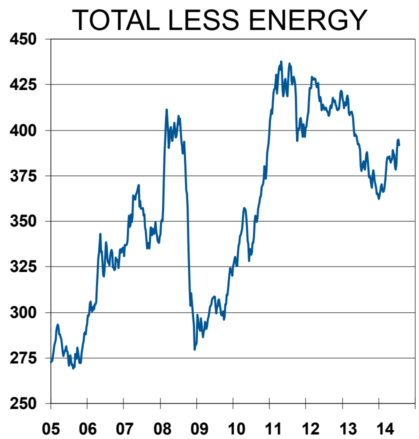


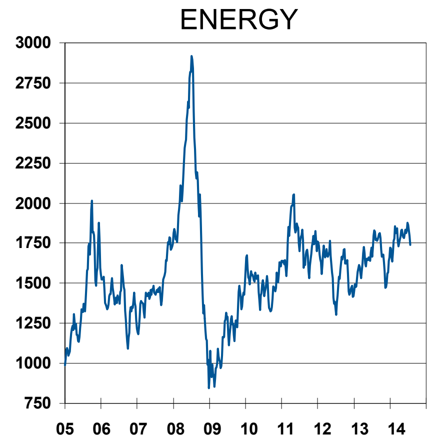
Source: Financial Times

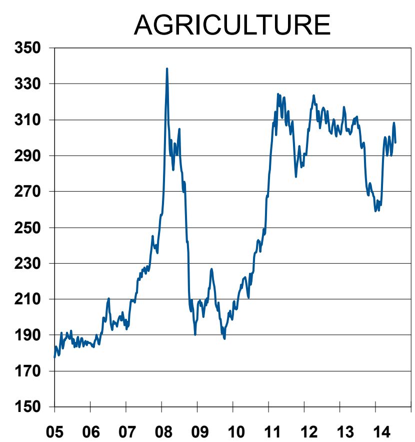
COMMODITY PRICES

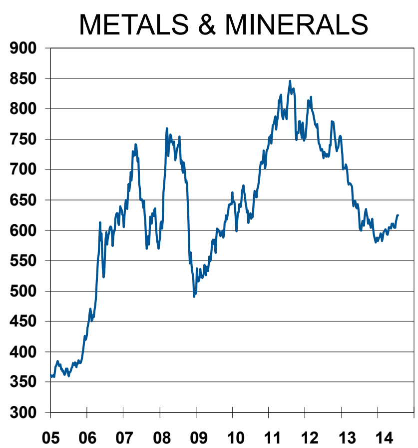
1. Bank of Canada Commodity Price Indices (Weekly data to July 25, 2014)







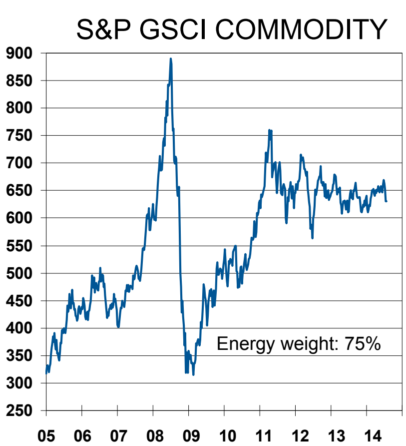


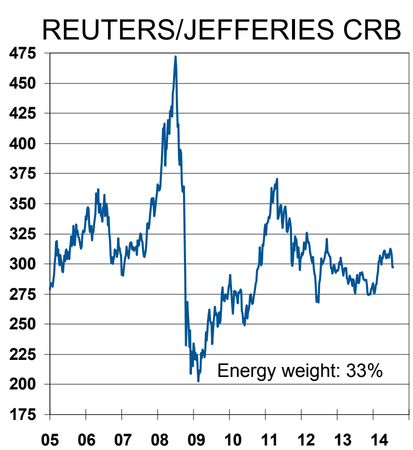


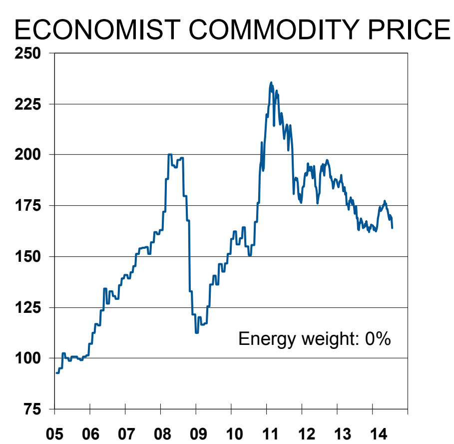
Commodity prices have continued to improve in 2014 to date.

We think commodity prices have entered a “bottoming” phase, though many uncertainties remain.

2. Other Indices (Weekly data to July 25, 2014)



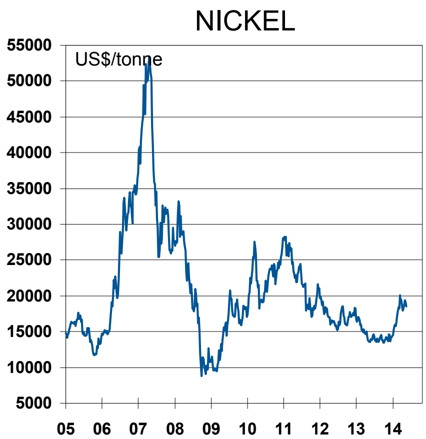


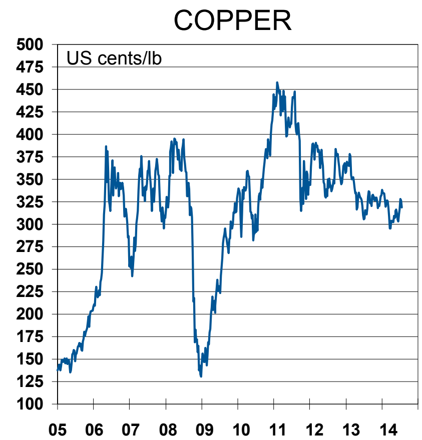


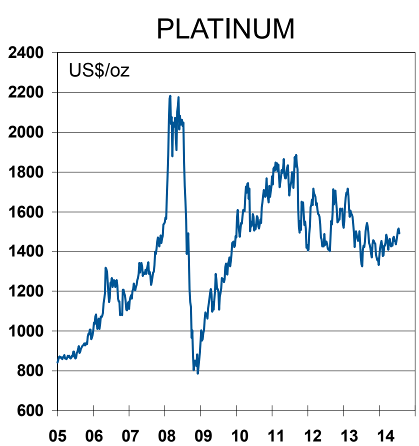
Sources: Bank of Canada, Thomson Reuters Datastream, The Economist

COMMODITY PRICES

3. Metals (Weekly data to July 25, 2014)







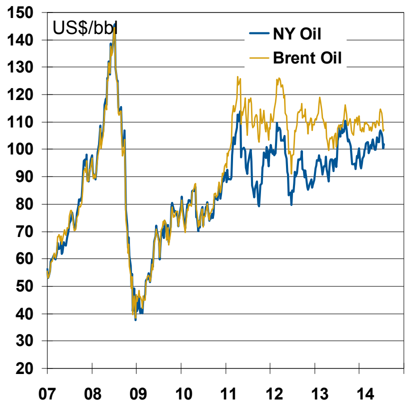
Metal prices should continue to trend sideways in 2014. We expect somewhat firmer metal prices in 2015.

Sources: LME, LBMA, Wall Street Journal

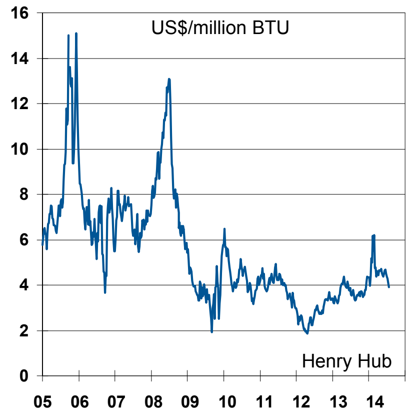
COMMODITY PRICES

4. Energy (Weekly data to July 25, 2014)

SPOT OIL PRICES



NATURAL GAS

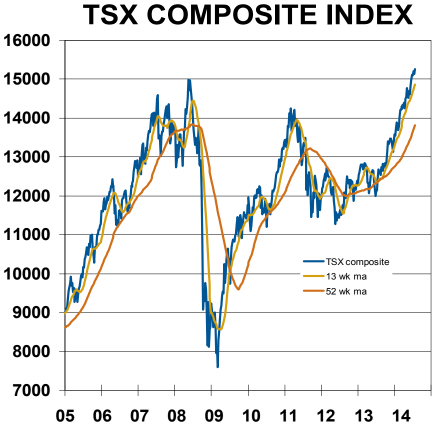


Natural gas prices have fallen back following a severe winter weather-induced spike. Oil prices continue to benefit from geopolitical concerns.

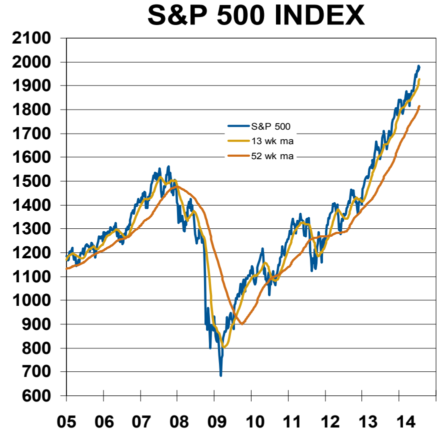
EQUITY MARKETS

5. North America (Weekly data to July 25, 2014)

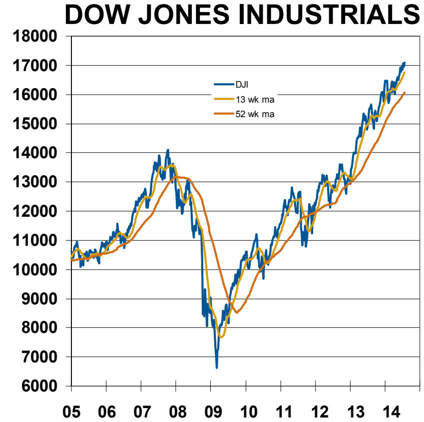
TSX COMPOSITE INDEX



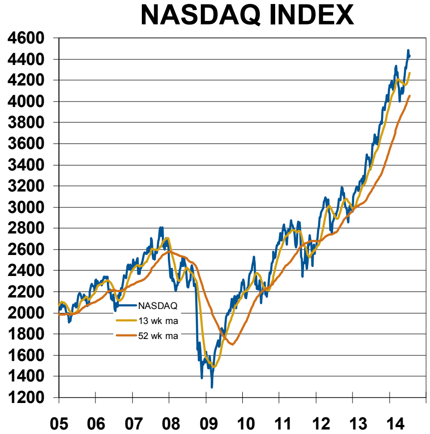
S&P 500 INDEX



DOW JONES INDUSTRIALS



NASDAQ INDEX



Source: Thomson Reuters Datastream

Our outlook for North American equity markets remains constructive: policy interest rates will remain low and no recession is threatening. We remain “long” equities, see our monthly “*Market Monitor*” (and recent equity market forecasts).

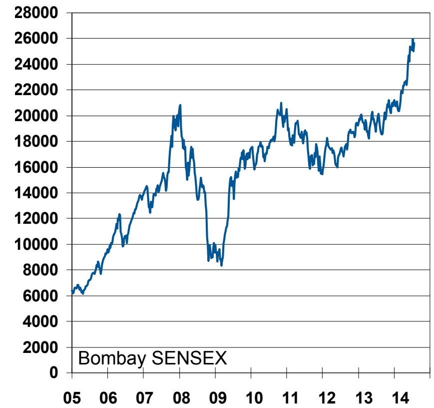
That said, there will be corrections as Fed policy concerns create unexpected volatility later this year and in 2015 – when the first US interest rate hike since the “Great Recession” is expected.

EQUITY MARKETS
6. Around the world (Weekly data through July 25, 2014)

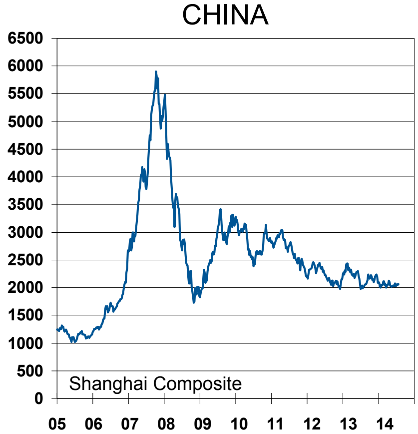
JAPAN

GERMANY

INDIA



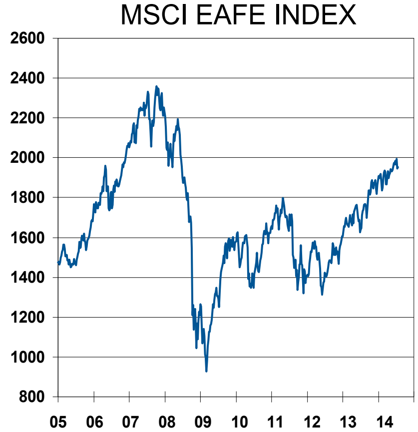
CHINA



RUSSIA

MEXICO

MSCI EAFE INDEX



BRAZIL

MSCI WORLD INDEX

Source: Thomson Reuters Datastream

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