ECONOMIC MONITOR

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HIGHLIGHTS

Financial Markets Overview (Page 2)

The three uncertainties we outlined last month remain. The Fed still sounds keen to raise interest rates this year, but economic data may not be strong enough. Greece is still negotiating terms for additional funding, and although oil prices have rebounded, questions remain about possible increasing supply putting downward pressure on prices.

Economic Outlook – Mid-year Update (Page 5)

The geopolitical and economic risks we outlined in December 2014 have not been realized thus far. However, the calm of 2015-H1 could disappear at any time, as many of the underlying issues have not been resolved. World economic growth in 2015 and 2016 is expected to continue the less than stellar pace of recent years, with risks to the downside. Sluggish global growth is a major headwind for commodity prices. The US dollar is expected to remain strong, which is also a headwind for commodity prices. US equity markets have been on a roll and a correction is overdue. It could come in the fall, particularly if the Fed raises interest rates at that time.

The Canadian Economy (Page 12)

Economic growth could be as little as 1.6% in 2015, down from 2.5% in 2014. The decline in the Canadian dollar has been pushing food and other import prices up, offsetting some of the impact of lower oil prices.

The US Economy (Page 22)

The US is forecast to expand at a modest 2.3% in 2015 and 2016. The US continues to face both short-term and medium to longer term headwinds. Some of the short-term headwinds include a high dollar and sub-par business investment. Some of the more obvious medium to longer term headwinds are inefficient tax/spend policies, poor infrastructure, high levels of entitlement, and low quality of primary education.

Also Inside:

Commodity Price Charts (Page 39)
Equity Market Charts (Page 41)

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Financial Markets Overview

Last month we mentioned three significant uncertainty areas. An updated view follows:

The Fed continues to raise expectations that it will raise interest rates at some point over the next 15 months, but remains vague as to when and by how much. We have, rather reluctantly, reintroduced a rate increase into the forecast but while the Fed Funds rate rises gradually throughout the forecast, there is no US prime rate increase until mid-2016. The Fed has indicated that any rate increases will be modest and the timing will be data dependent. We continue to think that the chances of a rate increase over the forecast period are not materially different from 50-50, however. Growth may be starting to rebound from another severe winter but the rate of growth for 2015 looks like it will be even lower than our earlier below consensus view – hardly impressive in other words. Meanwhile the latest core PCE deflator fell further to just 1.2%. And wage growth, measured on a month-over-month basis, appears to be decelerating. While we do expect inflation, on a consumer price basis, to move back up to near 2% by early 2016, it may have trouble sticking that "high".

Greek debt negotiations continue to drag on. While it continues to be our view that something will be worked out and that Greece will remain within the euro currency bloc, this is not a sure thing. And Greece will likely default on its debt (again) sooner or later. Repeating what we said last month "The potential for market disruption is much less than a few years ago; Greek developments are no longer surprising, the ECB has become more pro-active (and is currently enacting its own form of QE – €60 billion/month through September 2016), and the foreign private sector has had plenty of time to reduce its exposure to Greece (about 78% of Greek debt is now owned by official institutions such as the IMF, the ECB and other Eurozone governments).

The euro may fall further, depending on the specific sequence of events, and bond yields may suffer from time to time; but we don't expect to see huge or destabilizing interest rate movements. There will, however, be lessons for other southern European countries, and investors need to be cautious about future developments elsewhere. For example, Italy has large debts and little economic growth and Spain could have, like Greece, a less cooperative government by the end of the year."

Oil prices seem to be stabilizing around $60 with the Saudis increasing production and the US under pressure to reduce production. It is unclear whether Iranian oil will return to market or for how long the Chinese will be adding to their strategic reserves. Nonetheless, with Chinese (and hence global) growth still looking suspect, the risks for oil prices still seem to be tilted to the downside.

1. ► The BANK OF CANADA may give us another rate cut during the forecast period but possibly not until early 2016 when inflation is expected to fall back. Recent economic data have looked surprisingly poor, with the exception of housing sector data for a few large cities.

2. ► The FED FUNDS RATE is expected to rise gradually over the forecast period, eventually culminating in a prime rate increase (though probably not until next year). We expect economic data for April, May and perhaps June to rebound from the dock strikes and poor winter weather but then settle down at a much more modest pace with a significant risk that wage growth will slow further,

curbing consumer spending. Headline inflation is likely to remain close to zero for the next few months and then rise (subject to what oil prices do).

3. ► Longer term BOND YIELDS may continue to oscillate somewhat depending on the outlook for Greek debt/austerity negotiations. An eventual increase in US inflation towards early fall will likely support a modest rise in North American yields, though weak yields abroad are likely to restrain that rise.

4. ► We continue to have a negative bias toward the CANADIAN DOLLAR. We don't think energy prices will move much higher, Chinese commodity demand looks tepid and Canada's manufacturing sector probably needs a much bigger currency decline than we have seen to date. Think of the impact of Mexico on Canada's auto sector prospects, for example.

5. ► The US DOLLAR is expected to continue to rise against most currencies because most other countries want to maintain looser monetary policies while the Fed still sounds keen to tighten. If the Fed eventually decides against raising interest rates, the US dollar will find less support but the dollar still enjoys relatively high bond yields which will attract capital inflows. For now investors are likely to continue to gravitate to European equities (subject to Greek developments) and away from the US, giving the euro a certain degree of support.

Updated Forecast - Base Scenario

	Actual				Projected						
	14-III	14-IV	15-I	25-Jun	Jul	Aug	Sep	15-IV	16-I	16-II	16-III
CURRENCIES	***Scenario B: Moderate US Growth - Mild Eurozone Pick Up - Commodity Prices Flat***										
US Dollar Index*	81.08	87.08	94.33	95.14	95.36	95.64	95.83	96.74	97.63	98.66	99.52
Can. Dollar: CDN/US	***1.094***	***1.136***	***1.242***	***1.239***	***1.245***	***1.250***	***1.250***	***1.258***	***1.270***	***1.280***	***1.288***
Can. Dollar: US/CDN	91.41	88.03	80.52	80.71	80.32	80.00	80.00	79.49	78.74	78.13	77.64
Japanese Yen	***104.3***	***114.8***	**119.1**	**123.9**	**124.5**	**125.0**	**125.8**	**126.5**	**127.5**	**129.0**	**130.0**
British Pound	166.9	158.3	151.5	156.9	157.5	157.5	157.5	155.3	153.8	152.3	150.7
Euro	***1.325***	***1.249***	***1.127***	***1.120***	***1.125***	***1.125***	***1.125***	***1.105***	***1.095***	***1.080***	***1.065***
Australian Dollar	92.52	85.59	78.61	77.20	77.11	76.80	76.80	76.31	75.59	75.00	74.53
Chinese Yuan/Rmb	***6.160***	***6.138***	***6.138***	***6.208***	***6.208***	***6.210***	***6.220***	***6.220***	***6.230***	***6.230***	***6.230***
Indian Rupee	60.61	61.93	62.24	63.57	63.30	62.85	62.60	62.30	62.00	61.50	61.00

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

INTEREST RATES	***Scenario B: Growth Modest - Inflation Below Target - Fed Hikes in 2016***										
Canada											
Treasury Bill (91-day)	0.94	0.90	0.57	0.58	0.63	0.63	0.63	0.63	0.60	0.55	0.52
Government Bond (10-yr)	2.12	1.92	1.33	1.82	1.80	1.84	1.88	1.96	2.00	2.05	2.10
Prime	3.00	3.00	2.85	2.85	2.85	2.85	2.85	2.85	2.80	2.60	2.60
Target Overnight Rate	***1.00***	***1.00***	***0.75***	***0.75***	***0.75***	***0.75***	***0.75***	***0.75***	***0.67***	***0.50***	***0.50***
Spread: 10-yr - T Bills	1.18	1.02	0.76	1.24	1.17	1.21	1.25	1.33	1.40	1.50	1.58
United States											
Treasury Bill (90-day)	0.03	0.02	0.03	0.02	0.03	0.04	0.06	0.09	0.15	0.22	0.32
Treasury Bond (10-yr)	2.49	2.23	1.87	2.41	2.40	2.45	2.50	2.60	2.65	2.70	2.75
Prime	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.50	3.50
Fed Funds Target	***0.09***	***0.10***	***0.11***	***0.14***	***0.16***	***0.17***	***0.20***	***0.23***	***0.26***	***0.31***	***0.39***
Spread: 10-yr - T Bills	2.46	2.21	1.84	2.39	2.38	2.41	2.44	2.51	2.50	2.48	2.43
Interest Rate Differential (Canada-US)											
Treasury Bill	0.91	0.88	0.54	0.56	0.61	0.59	0.57	0.54	0.45	0.33	0.20
Bonds-10yr	-0.37	-0.31	-0.54	-0.59	-0.60	-0.61	-0.62	-0.64	-0.65	-0.65	-0.65

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.

Outlook – Mid-Year Update!

by Martin Murenbeeld

The last update of our views appeared in the December 18, 2014 Economic Monitor. Six months later we can say that the risks described at that time – geopolitical and economic – have not been realized, yet. Russia has remained relatively docile despite the lower oil price, Greece has not left the Eurozone (but may soon), the crises in the Mid-East have not threatened world growth and world order, and there have been no "black swans" this year to date. (One "black swan" we alluded to was a direct attack on Saudi oil production facilities and on the Kingdom's political order. With Iran now meddling in Yemen such a development would no longer be considered a "black swan" but an event of calculable probability.)

The relative calm of 2015-H1 can disappear at any time, of course, because the underlying issues (Russia's meddling in Ukraine, for example) have not been resolved – they just haven't blown up into debilitating economic/financial crises.

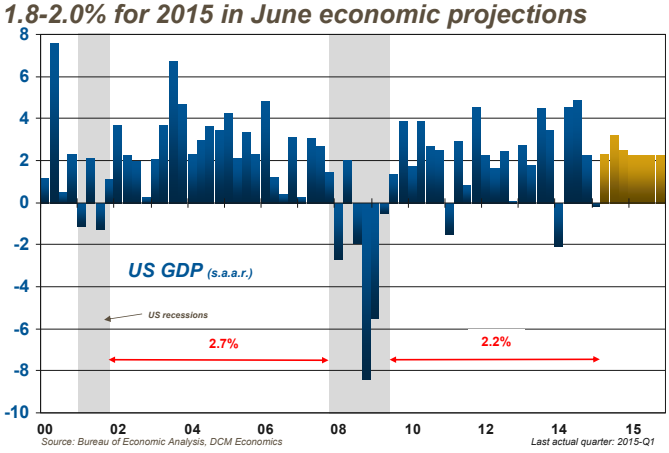
On the immediate horizon is the issue of Greece and the Eurozone. This has been a 3-5 year festering problem. (Greece should have been encouraged to leave the Eurozone in 2012, when we had forecast it would!!) At the time of writing Greece was still hoping to receive the last installment of its aid package, €7.2 billion, despite refusing to promise all that its creditors have demanded. A "Grexit", and its attendant geo-financial risks, therefore remains a significant probability for 2015-H2.

The Chinese economy is slowing down, but the PBoC has lowered rates and appears very cognizant of any immediate dangers – excessive local government debt and falling house prices, in the main. China appears to have become increasingly belligerent in the South China Sea, but rationality argues it will not unduly antagonize other interests in the region. In the event China's hopes of having the yuan/RMB included in the SDR basket are dashed later this year then we could see a further change for the worse in China's discourse with the West.

Meanwhile currency wars continue, the US has shown no great tendency to implement protectionist legislation, and Canadian house prices remain high and Canadian debt levels continue to worry the Bank of Canada.

US Economy

Difficult to see sustained growth > 2.5% … FOMC projects 1.8-2.0% for 2015 in June economic projections



THE US ECONOMY

The US economy contracted by 0.2% (s.a.a.r.) in 2015-Q1, after expanding by 2.2% in 2014-Q4. The Fed of Atlanta's GDPNow forecast for 2015-Q2 has risen to nearly 2% (see: *https://www.frbatlanta.org/cqer/research/gdpnow.aspx*), which suggests that the economy is "recovering" once again from the impact of another severe winter.

Our view is that the US economy is facing a number of headwinds; short-term headwinds include an excessively high dollar and sub-par capex (business investment remains weak).

Medium and long-term headwinds include inefficient tax/spend policies, poor infrastructure, too high levels of entitlement, low quality primary education, and too much unskilled labor – to list the more obvious.

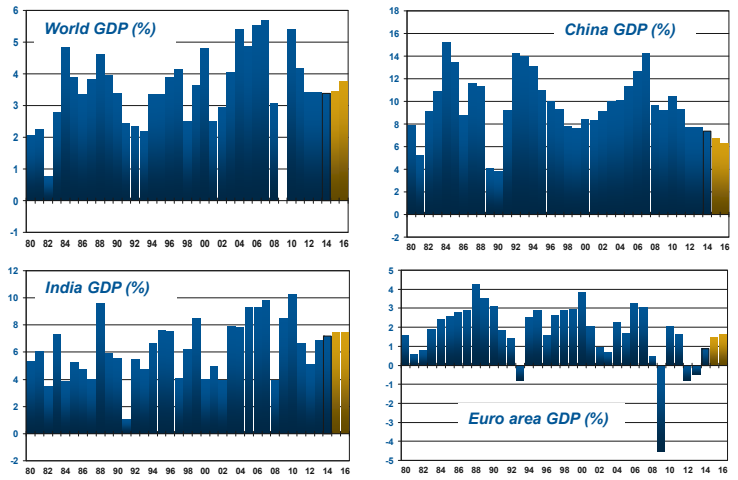
For the remainder of 2015 and through 2016 we expect the US economy to expand by 2.4% on average, which is insignificantly higher than the 2.2% growth rate it has averaged since the Great Recession.

THE GLOBAL ECONOMY

The global economy has been mostly downgraded as 2015 has progressed. The World Bank, for example, downgraded its 2015 outlook in June from that in January – not least because the emerging economies are facing diminished capital flows and the benefits of lower oil prices are taking their time to play out. In November 2014 the OECD had projected a 3.7% growth rate for the world economy 2015 but revised this downward to 3.1% in its June 2015 report. The IMF however did not downgrade its 2015 outlook further in April (versus that in January) and kicked up its 2016 outlook by 0.1% to 3.7%.

The World Economy

The IMF projects 3.5%-2015; and 3.8%-2016



Source: IMF, April 2015

Suffice it to say, the high probability scenario is that 2015 and 2016 will post a similar modest growth profile to that of recent years. Here is how the World Bank put it in its June 2015 *Global Economic Prospects* on page 6:

"*Global risks to growth remain tilted to the downside. Deflation risks in the Euro Area remain but have receded as inflation expectations have picked up. The beneficial effects of lower commodity prices on activity may yet materialize more strongly than currently expected. However, new risks have arisen. The likelihood of disruptive exchange rate adjustments in developing countries may have increased, as market expectations have continued to differ from those of U.S. Federal Reserve policy makers. In addition, U.S. growth may turn out to be more fragile than anticipated and slower than expected as a result of the broad-based dollar appreciation.*"

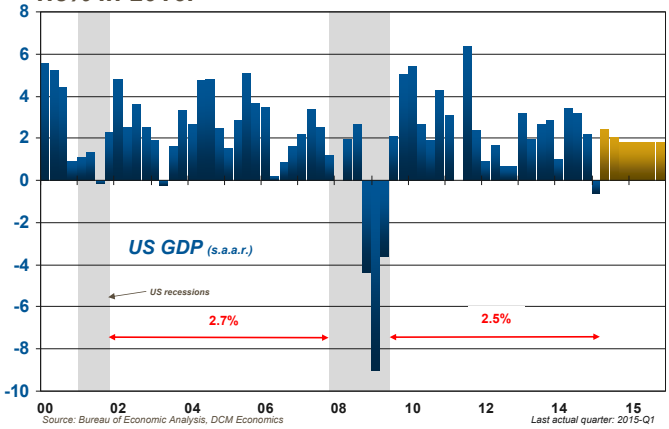
Is it any wonder that both the World Bank and the IMF have very recently suggested the Fed should forgo raising interest rates this year?

THE CANADIAN ECONOMY

The Canadian economy, because of its openness (foreign trade being so important to the economy) and because of it being an oil exporter,

Canadian Economy

Bank of Canada projects 1.9% for 2015 … We have 1.8% in 2016!



Source: Bureau of Economic Analysis, DCM Economics

Last actual quarter: 2015-Q1

is critically dependent upon developments abroad. The sharp decline in oil prices encouraged the Bank of Canada to cut interest rates on January 21, but so did the related decline in the inflation outlook and the relatively modest outlook for the world economy. The Bank furthermore hinted it would be quite happy to see the Canadian dollar somewhat lower (and indeed it declined, skirting the 78 cent level in ensuing weeks).

The economy contracted in 2015-Q1 by nearly 1% annualized, on the back of a sharp decline in business investment. While the economy has expanded at an average rate of 2.5% since the Great Recession (slightly better than the US economy) this number will be difficult to achieve for 2015. In fact, the Bank revised its projection for 2015 down to 1.9% in its April Monetary Policy Report (from 2.1% in its January Report) – almost entirely because of the downward revision in business investment projections. (Even the 1.9% may be revised downward further on account of the unanticipated negative first quarter!)

In the Bank's assessment of the financial risks facing Canada (see the *Financial System Review*, June 2015) some of the themes we have discussed were also mentioned: transmission of economic/financial stress from China and other EM's and financial stress from the Euro area. The Bank continues to worry about high domestic debt levels and "imbalances" in the housing market – which translates into plain English as follows: Canadians have borrowed too much to buy over-priced houses. Accordingly, an unlikely, but possible, surge in interest rates, and/or an unlikely, but possible, sharp decline in employment means households' ability to service debt will create serious problems for the already weak economic expansion.

COMMODITIES

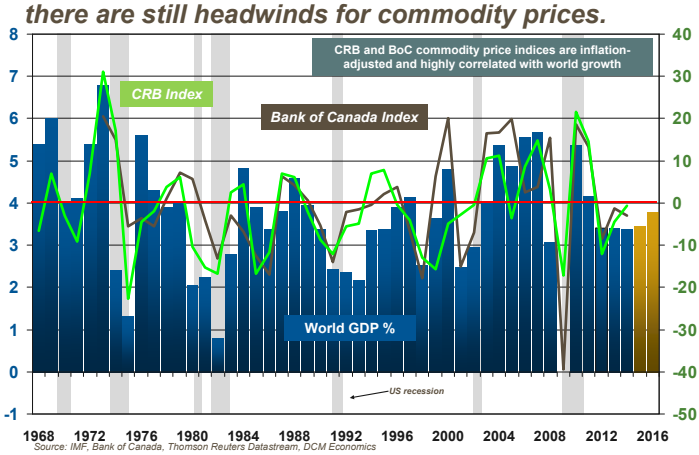
World growth is important in our assessment of commodity prices. The good news is that the IMF did raise its 2016 outlook a little (though the OECD lowered it by an equal amount and the World Bank retained its earlier forecast for 2016). As readers know, our "break-line" is 4%; world growth above 4% is positive for (inflation-adjusted) commodity prices, whereas growth below 4% is not typically positive (see chart below).

A number of commodity prices, specifically oil prices, have fallen significantly in recent quarters – to the point where it has become questionable whether these prices will decline further. Indeed, our bias is to look for commodity prices bottoming this year. Macroeconomic policy is ultra-supportive of higher growth and higher inflation, and we expect that slowly but surely there will be more success on this front. This will help commodity prices.

An eventual decline in the US dollar's cross-rates against a host of currencies would also help commodity prices. With commodity prices quoted in US dollars a decline in the dollar would be particularly beneficial. We expect dollar weakness

Commodities

Commodities typically decline when world growth < 4% … there are still headwinds for commodity prices.

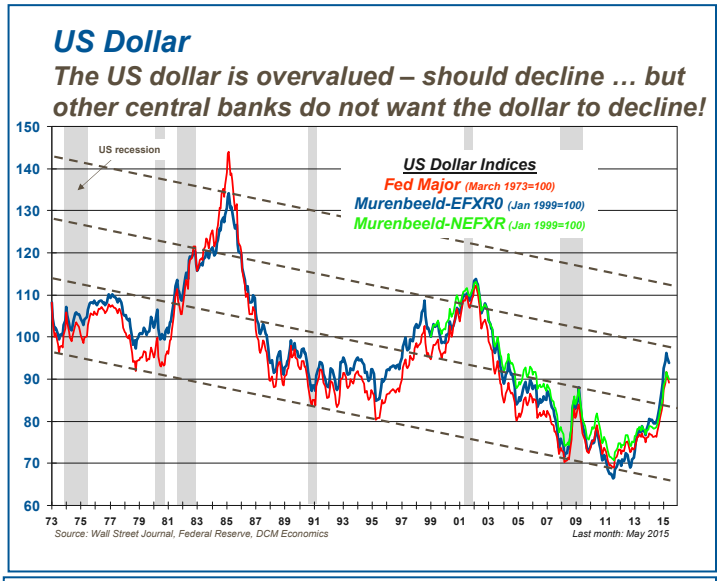


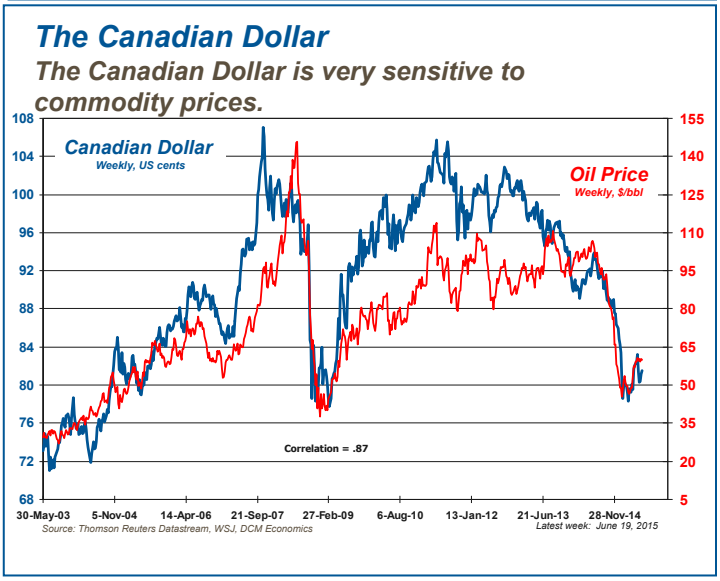
Source: IMF, Bank of Canada, Thomson Reuters Datastream, DCM Economics

to develop over the course of the next 18 months, but if the Fed is too aggressive on the interest rate front later this year-early next year dollar weakness will be towards the end of the 18-month period.

CURRENCIES

It follows from our assessment of the US and Canadian economies that the US dollar will be quite firm for the time being, and that the Bank of Canada has little interest in encouraging the Canadian dollar to strengthen. With headline inflation still below 2% the Bank of Canada might be expected to encourage more weakness in the dollar instead. (The dollar is currently around 81.30.)





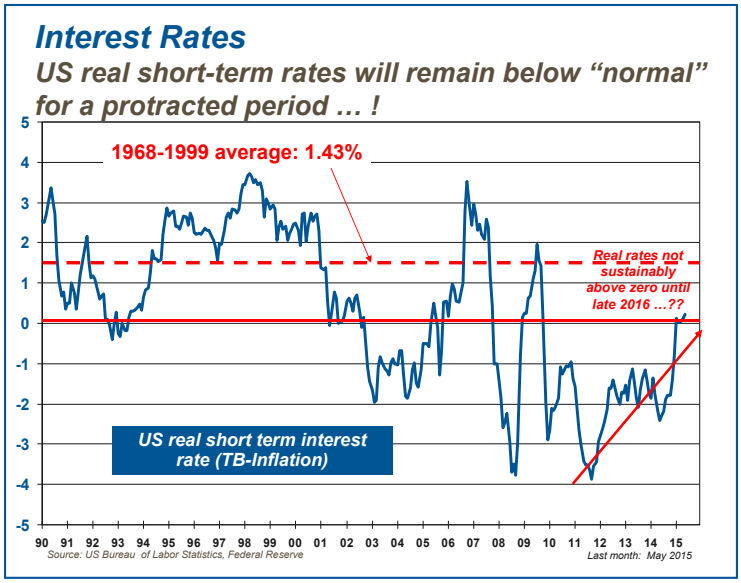
The *Currency Wars* continue; the yen bounced off 125 after an official suggested maybe the decline should be halted (for the time being). But no official is interested in seeing the yen strengthen. The euro started the year around 1.20 and declined in subsequent months to a low of 1.05 before recovering to 1.12. In the event the Greek crisis escalates (and a "Grexit" looms) the euro will weaken further. (We think a "Grexit" would be in the best interest of the Greek economy, but that is a different discussion. The new drachma will decline by at least 30% against the euro!)

The underlying issue for the euro is that EU policymakers are very happy with, and periodically calling for, a further decline in the euro's dollar value. One might argue that on account of EU weakness this is as it should be, except that Germany now has the largest current account surplus in the world!

The Asian currencies need to rise, but that is still not likely to happen given the slowdown in the Chinese economy. Suffice it to say that the global currency imbalance will continue for the time being, which serves the mercantilist economies well (Asian economies in the main, but the German economy too), and this will continue to serve as a major headwind for growth and inflation in the US and Canada.

INTEREST RATES

The question that most of us are tired of addressing is when/whether the Federal Reserve will raise its target interest rate (nominally the FF-rate but in truth the IOER – the interest rate on excess reserves). No one knows, but the market is "guessing" it will have happened by year-end – in September and/or December. (I don't rule out October; the FF forward rate is at .255% for



October.)

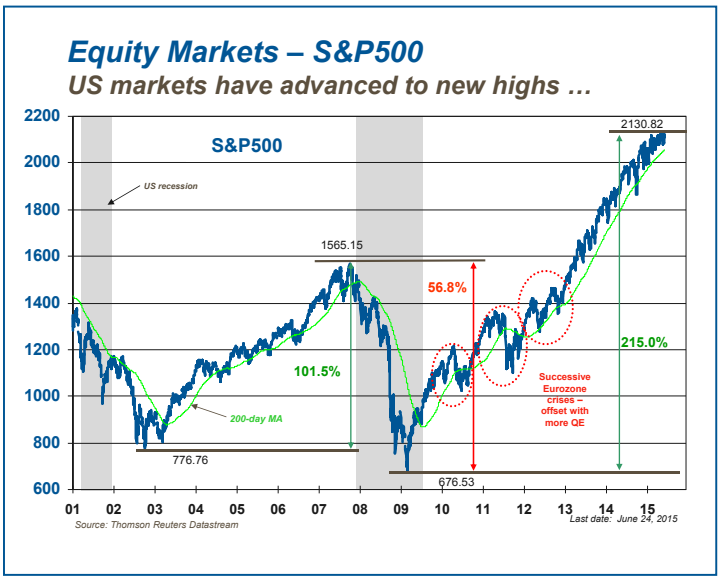
The Fed doesn't know when it will raise interest rates either. Going by recent speeches, the FOMC is split; the majority on the Committee think "soon" (i.e. before year-end), some holdouts think in 2016. In truth, it may only matter to equity markets in the end, which have given all the appearance of wanting to "correct" (more on which below).

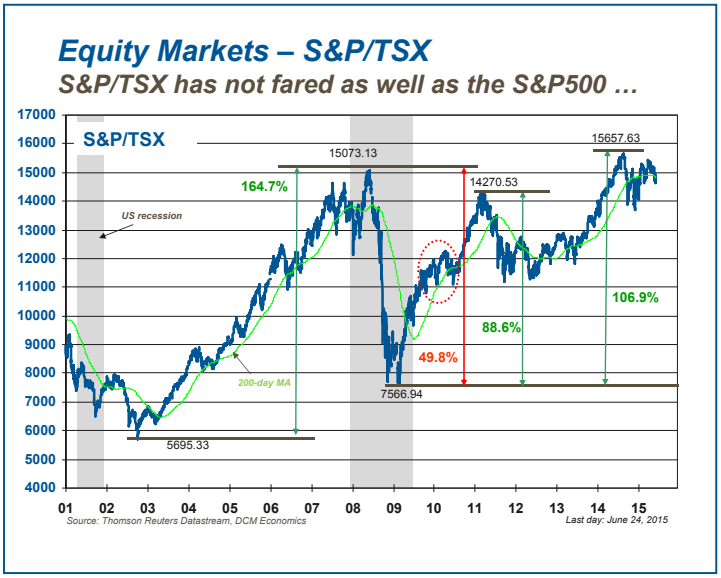
Interest rates abroad will most likely be cut where they can be cut (China and India), or kept near the ZLB (zero lower bound) where they cannot be cut further. It is only the Fed among major central banks that is expected to raise interest rates later this year.

Long-term rates are not so directly controlled by central banks, which the surge in German rates in recent months – despite the ECB policy of QE (€60 billion per month) – has once again made very clear. We are of the opinion that long rates have bottomed, but that doesn't mean these cannot roll over and fool us again. Given the substantial monetary stimulus by key central banks, the end of sharply declining oil prices, the possibility of tightening labor markets in the US, and improved economic activity in Europe, we expect global headline inflation rates to creep higher in 2016. This will tend to push long yields upwards. The rise in long-yields should not be too dramatic however.

EQUITY MARKETS

The S&P500 has been on a roll; the last time the index dropped below its 200-day MA was seven days in October 2014. Previous to that was seven days in November 2012. "Corrections", in other words, have been few and far between in recent years. Since the end of 2011 there





Equity Markets

The S&P has not had a 20% correction since March 2009

have been three instances – for a total of 18 days – when the index was below its 200-day moving average. This is less than 2% of the time! Since 1950 the S&P500 index has been below its 200-day MA just over 29% of the time however!?

A correction is overdue, and we expect one this fall particularly should the Fed hikes its target short-term interest rate. Large corrections tend disproportionally to occur in the fall of the year, furthermore, and with the Fed expected to hike interest rates this fall one has to factor a correction in the outlook. (Of course, other developments could also trigger a correction. A Grexit could initiate a correction for example, or a sudden collapse in the Chinese equity market "bubble".)

We are not anticipating a "bear market" in equities; these typically come in the run-up to a recession and we are not expecting a US economic recession in 2015-16. Regardless of any hike in US rates this fall, US monetary policy will still remain very loose, which will help keep equity markets buoyant into 2016. The last equity market forecast, issued May 13, 2015, projected a relatively flat (probability-weighted) profile for 2015-16 – with a 25% probability that the S&P will break 2300 in late 2016.

GOLD

The gold market has been flat this year, up somewhat in 2015-Q1 and down somewhat in 2015-Q2 to date ($1219 versus $1194 respectively – averages for the quarter). The forecast for 2015 has not changed appreciably; early this year we forecast the price to average about $1250 for the year. This forecast was based on a scenario probability-weighted average of about $1225 for 2015, to which we then added $25 for geopolitical and geo-financial (a potential Grexit) crises. By and large this remains the forecast for 2015.

To date gold has averaged $1208; it did benefit briefly from the January election in Greece (and violations of the Minsk agreement) but gold has not reacted much to the (more modest) background noise and crises since then (ISIS has had no discernible impact on the price of gold for example, nor would it expect to have unless it staged a brazen attack on Saudi Arabia for example).

The headwinds for gold have not changed significantly; the strong US dollar and buoyant equity markets hurt the gold price directly and by way of deflecting investment interest towards the equity markets. Weak global growth is not positive for jewelry consumption, nor does it excite the investor looking to gold for an inflation hedge. And of course there is the likelihood of a Fed hike that could raise the real interest rate profile somewhat.

Most of these headwinds are of a short-term nature, though some are of a more medium-term nature (subdued global growth). Against that are aligned stimulative monetary policies (including Fed policy) extending far out onto the forecast horizon on account of excessive debt levels in the global economy, a US dollar that

Gold – Bearish Factors for 2015-16

1. *US dollar will remain firm in 2015-16*
   - *The US is losing the currency war …*
2. *The Fed must eventually tighten policy*
   - *The Fed has ended QE …*
   - *… and will likely raise rates in 2015*
3. *The world economy will remain sluggish*
   - *The oil price will be depressed …*
   - *Meaning inflation will remain low …*
4. *The S&P500 will continue to compete with gold*
   - *Financial assets are in demand (equities/debt)*
5. *ETF tonnage still substantial – more to be sold?*

Gold – Bullish Factors for 2015-16

1. *Asian physical demand will continue to expand*
   - *Oil savings to India/China >$100 billion*
2. *Central banks will continue to buy gold*
3. *The global debt crisis will worsen*
   - *Debt will expand faster than nominal GDP*
   - *Monetary policy will remain "loose" – even Fed policy*
4. *The US dollar is fundamentally overvalued*
   - *It must come down or global imbalances will worsen*
5. *The commodity cycle will run many more years*
   - *India, China, etc., need "stuff" for years to come*
6. *Geopolitical/financial crises will multiply*
   - *Greece, Russia/Ukraine, ISIS, Saudi/Yemen etc.*

Gold – Forecast – March 27, 2015 Update

Gold Price Scenarios

		2015-avg	2015-end	2016-avg
Scenario A:	p = 20%	$1139	$1067	$1035
Scenario B:	p = 55%	$1225	$1233	$1272
Scenario C:	p = 25%	$1301	$1405	$1517
Weighted		**$1229**	**$1260**	**$1310**
For geopolitical/financial crises		**$25**	**$25**	**$25**
Final		**$1254**	**$1285**	**$1335**

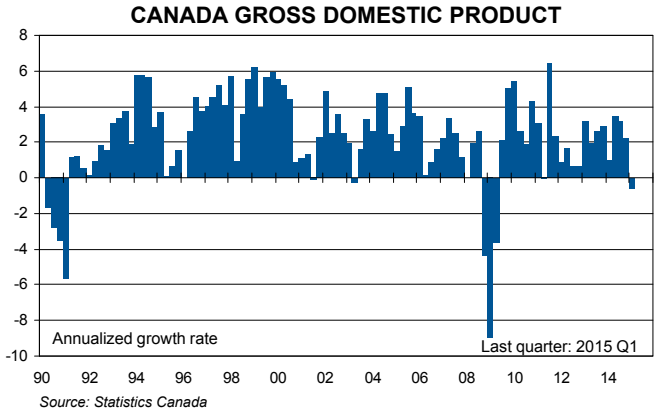
must eventually decline against other major currencies, ongoing demand in Asia and from the central bank sector, and a number of potential geo-political/financial crises starting with a Grexit.

One should not overlook, furthermore, the seasonality of gold; it tends to rise in the fall (June-August are the worst months for the metal), and in so far there are a number of potential trigger points to a sudden surge in the gold price – an equity market "correction", continuing Eurozone/Greek problems, the failure of the Minsk Agreement to stop warring factions in Ukraine, to name three – 2015-H2 should see somewhat firmer gold prices, despite a hike in the FF-rate before year-end.

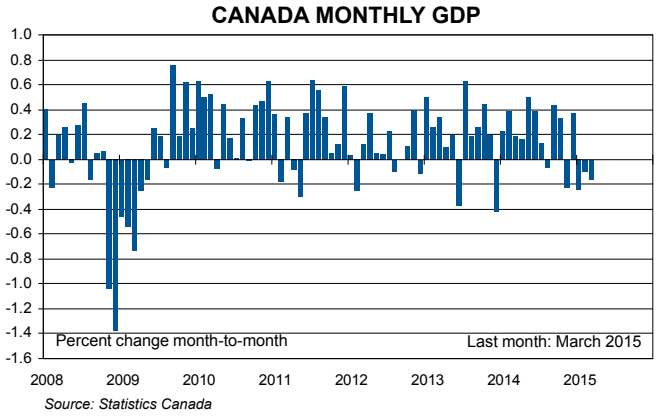
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Economic growth may be as little as 1.3% this year on a December over December basis (1.6% year over year).

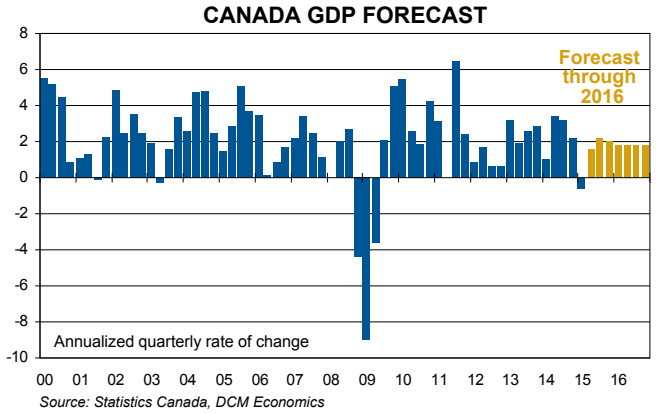
The economy shrank by -0.6% in the first quarter, reflecting a slumping energy sector and weak US demand.



Monthly GDP has seen a string of negatives recently.

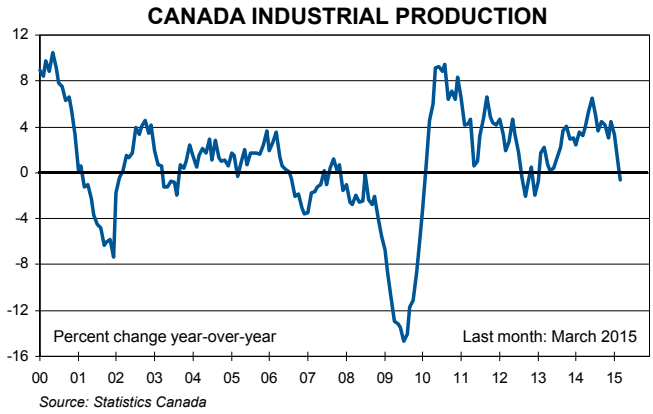


Canada's underlying sustainable rate of economic growth will likely slip to just 1.8% by the end of 2015.

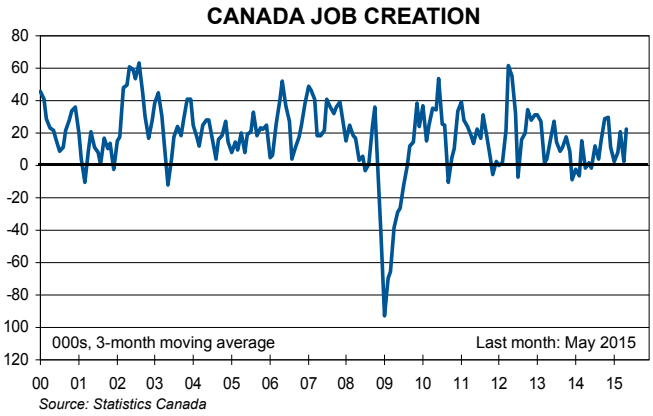


MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Industrial production has been very weak, with the slumping energy sector a major influence.



Although job creation rebounded in May, it has been relatively soft over the past year averaging 16,000 per month.



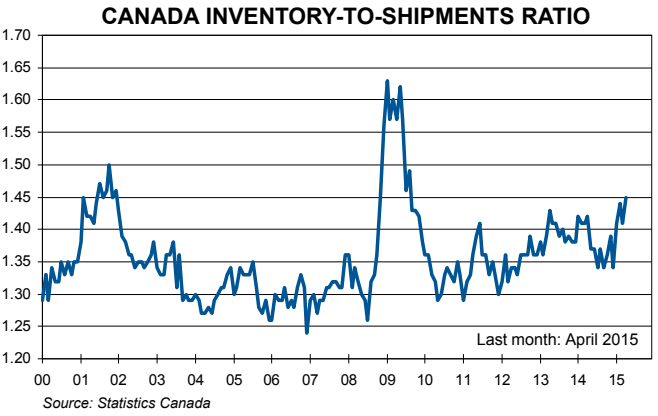
The unemployment rate has risen somewhat.

MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Canadian manufacturing shipments have been very weak, despite the lower Canadian dollar.

New orders look recessionary.

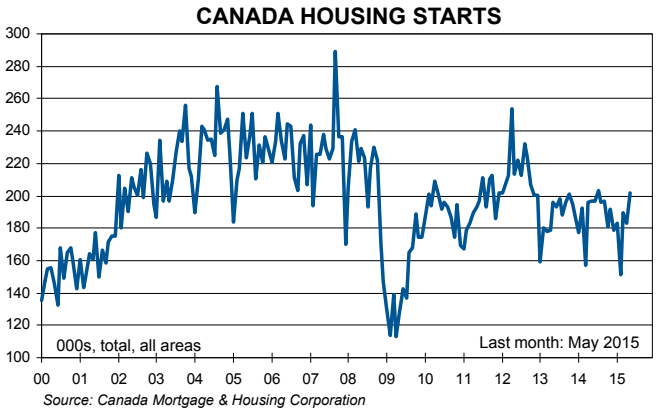
Inventories are too high and rising.



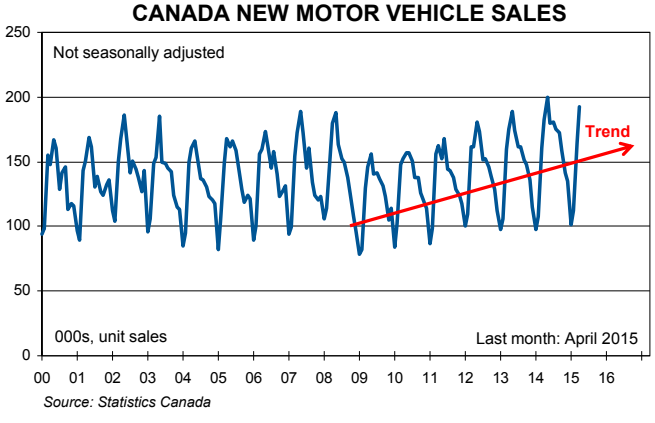
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Retail sales have been reasonably good, allowing for the impact of lower gasoline prices on sales totals.

Housing starts were unexpectedly strong in May.



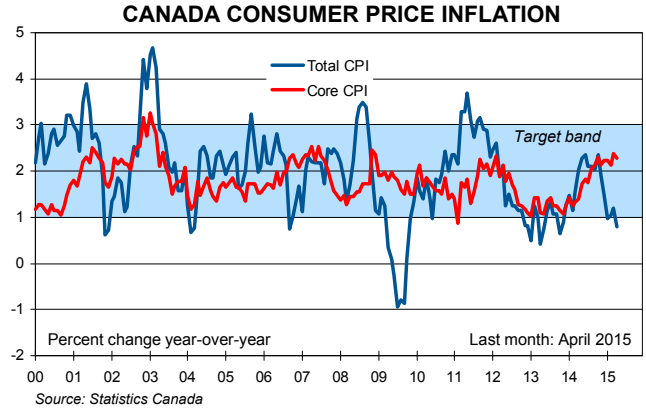
Vehicle sales remain strong as shoppers are being lured by sales incentives, including extended loan terms.



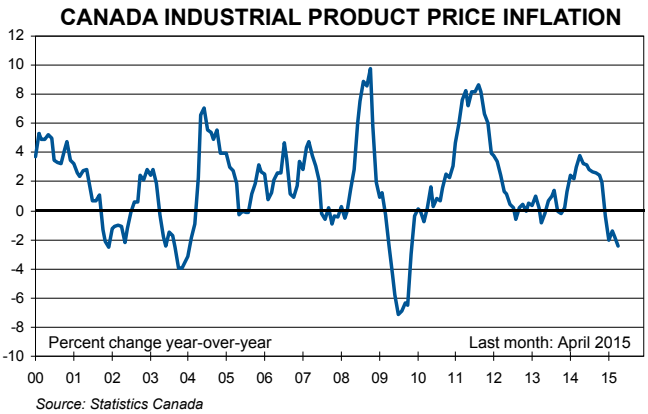
MONTHLY REVIEW ►
CANADA – INFLATION

Rising food and other import prices (because of a declining Canadian dollar) are helping to offset the impact of lower gasoline prices.

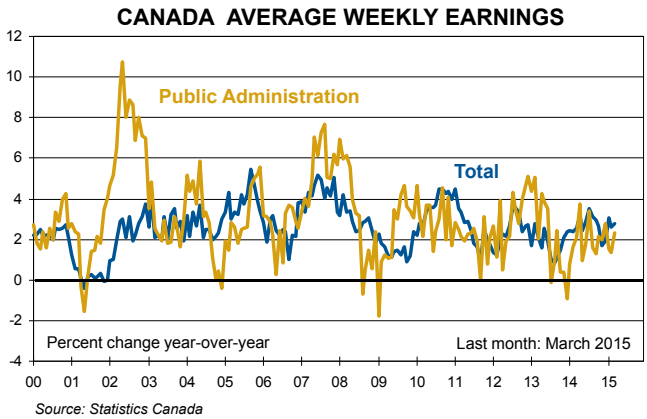
Core inflation remains above 2%, thanks to rising export prices (lower Canadian dollar). But the headline rate, whipsawed by the ups and downs of gasoline and natural gas prices, is back under 1%.



Industrial product prices were down 2.4% in the 12 months through April, a reflection of weak commodity prices.

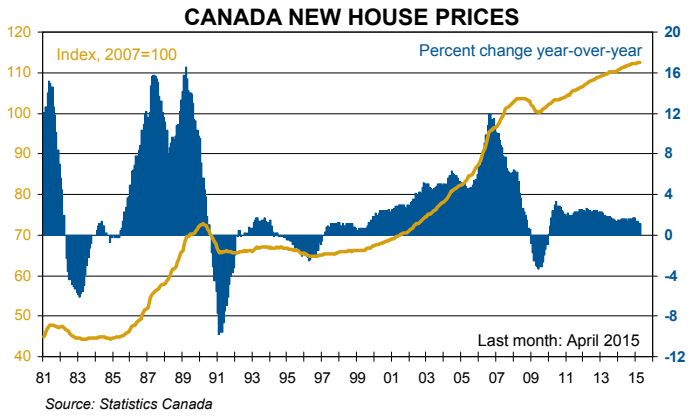


Average weekly earnings were up 2.8% in the 12 months through March.

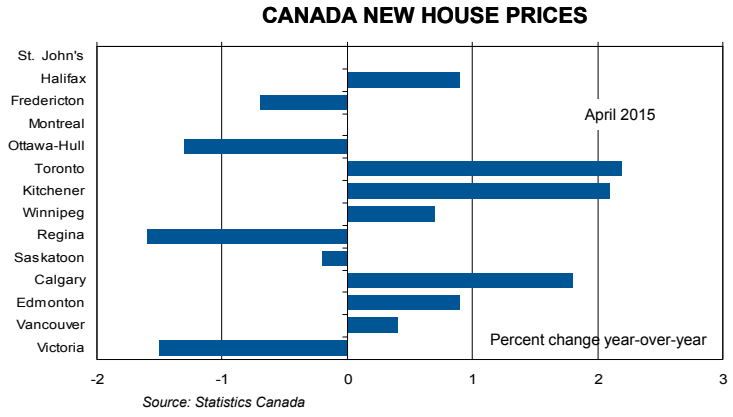


MONTHLY REVIEW ►
CANADA – INFLATION

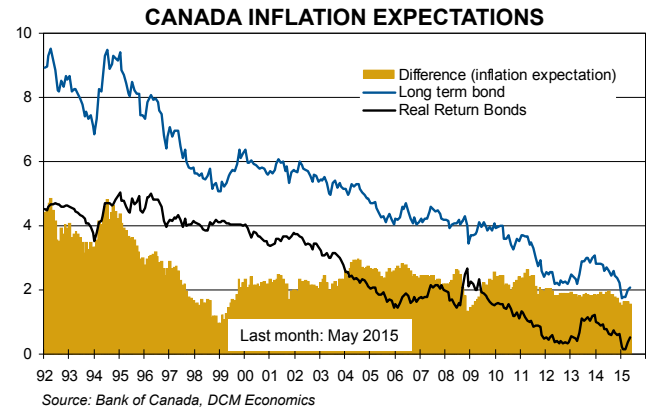
New house prices, up 1.1% in April, are barely rising.



Calgary has lost its lead in new house prices to Toronto.



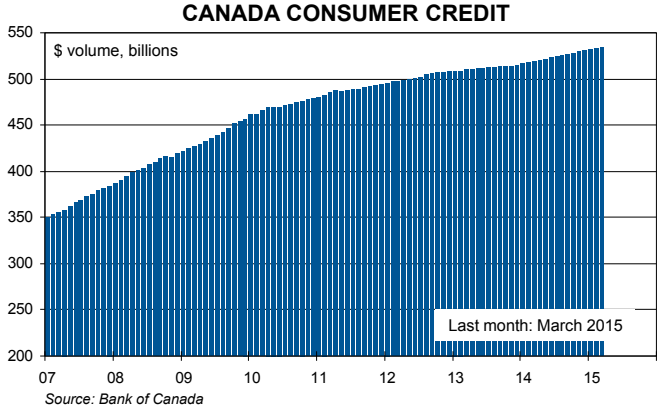
Inflation expectations remain moderate.



MONTHLY REVIEW ►
CANADA – DEBT AND CREDIT

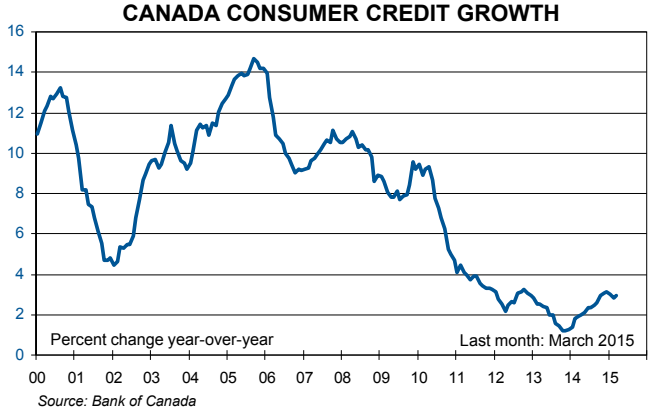
Consumer credit growth has been modest; mortgage credit growth shows a slight tendency to rise, while business credit growth has been strong but slowing.

CANADA CONSUMER CREDIT



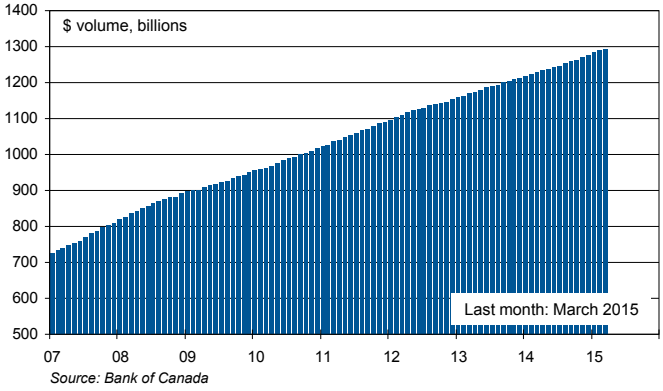
Source: Bank of Canada

CANADA CONSUMER CREDIT GROWTH



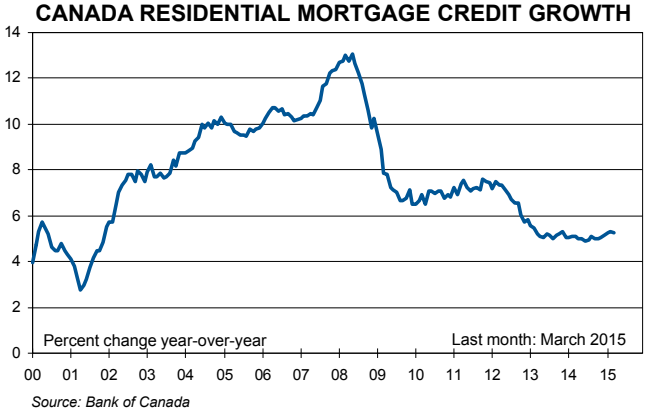
Source: Bank of Canada

CANADA RESIDENTIAL MORTGAGE CREDIT



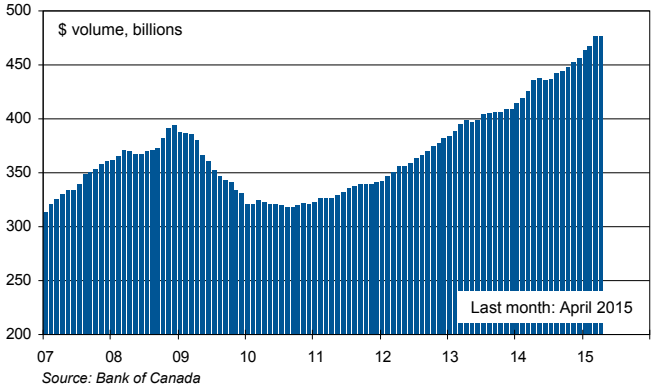
Source: Bank of Canada

CANADA RESIDENTIAL MORTGAGE CREDIT GROWTH



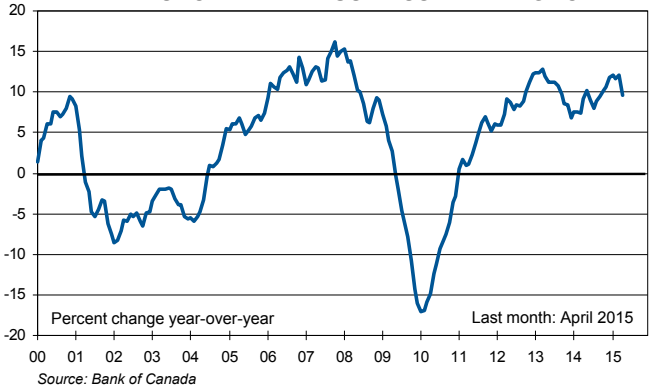
Source: Bank of Canada

CANADA SHORT-TERM BUSINESS CREDIT



Source: Bank of Canada

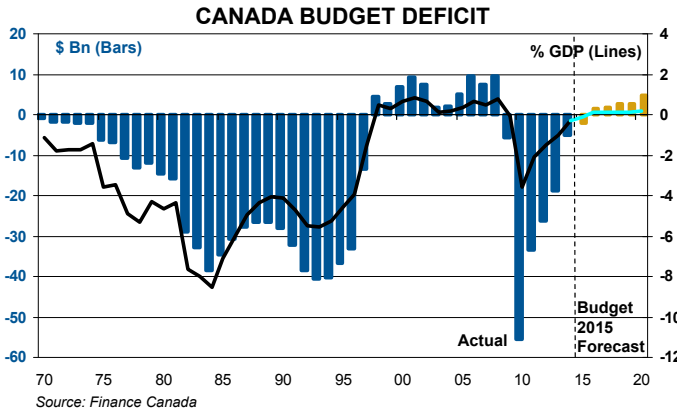
CANADA SHORT-TERM BUSINESS CREDIT GROWTH



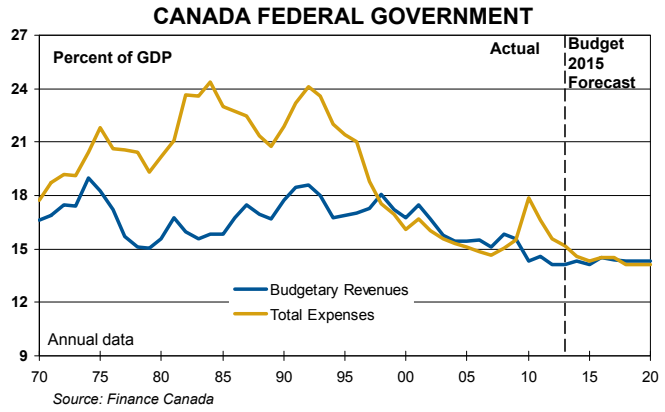
Source: Bank of Canada

MONTHLY REVIEW ►
CANADA - FISCAL UPDATE

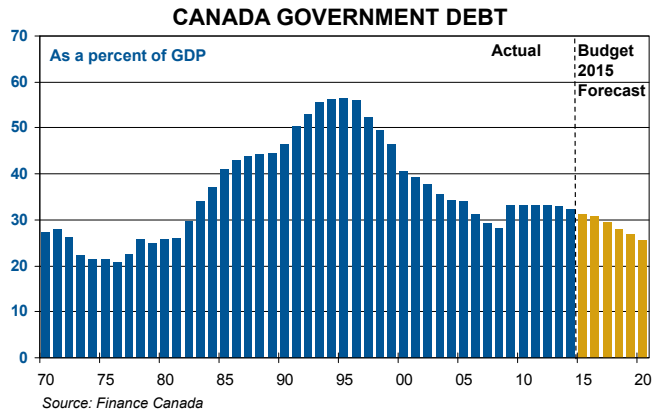
Canada has made good fiscal progress, virtually balancing the budget this year.



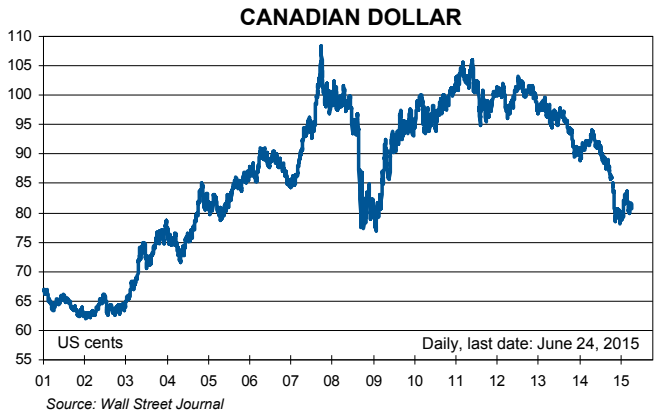
Expense growth has been curbed.



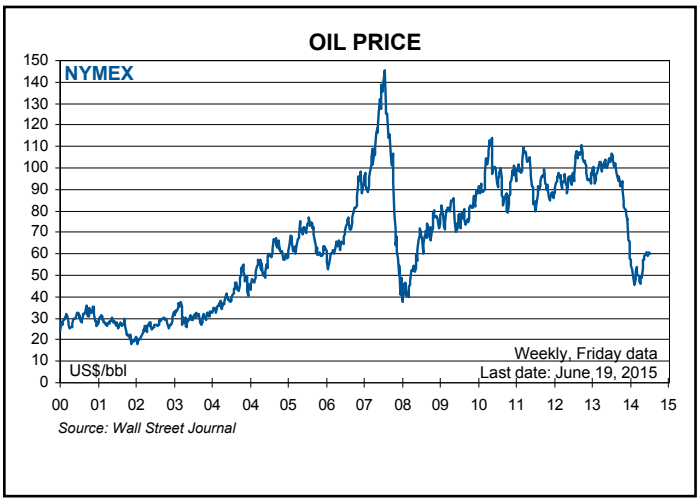
Federal debt continues to fall relative to GDP.



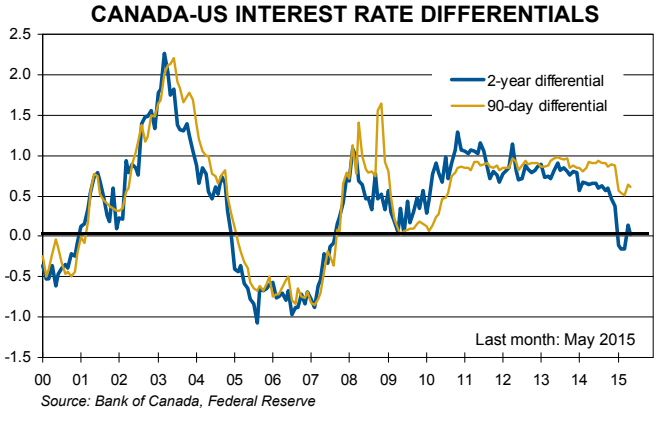
The Canadian dollar has been marking time a bit above 80 cents but we expect it to retreat eventually.



Oil is showing a degree of stability around $60 as Saudi production rises but US production is expected to slip.

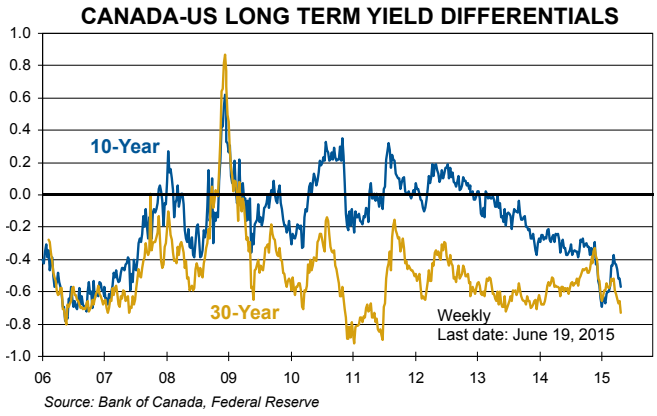


Short-term interest rate differentials still favour Canada, though less so for the two-year term.

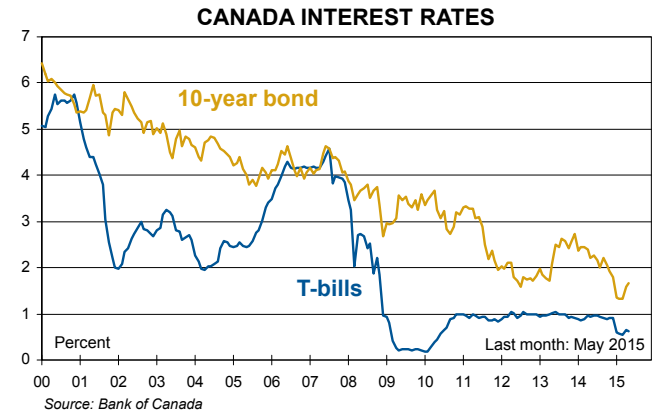


MONTHLY REVIEW ►
CANADA – FINANCIAL MARKETS

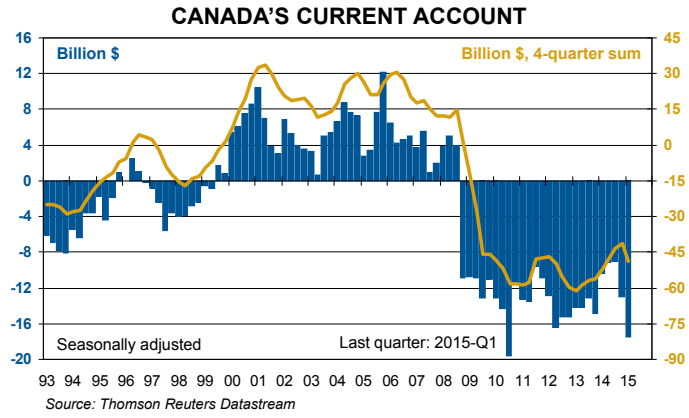
Long-term yield differentials continue to favour the US.



The odds of a Canadian policy rate cut this year are rising again as the economy under-performs.



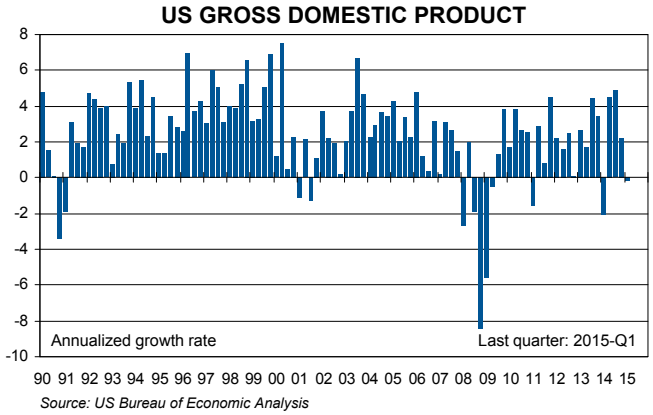
Canada's current account has fallen deeper into the red, thanks to lower energy prices.



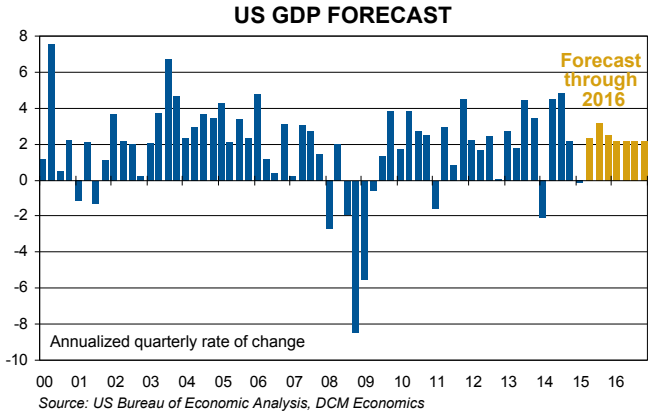
MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

Growth for 2015 is expected to be around 1.8% on a December-over-December basis (2.1% on a year-over-year basis).

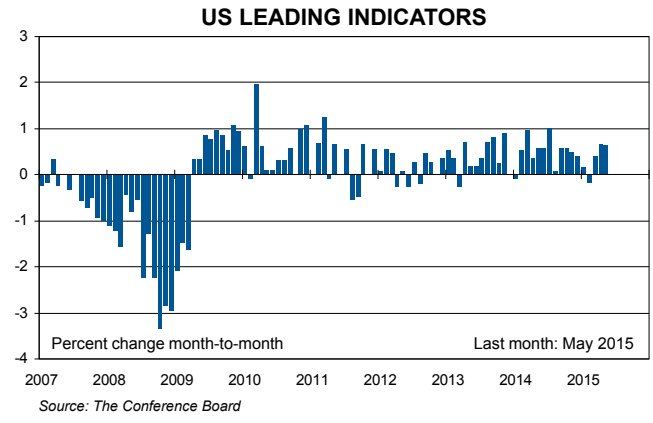
First quarter growth was revised down to show a 0.2% contraction.



The economy is having difficulty gaining enough traction to convince the Fed to raise interest rates.

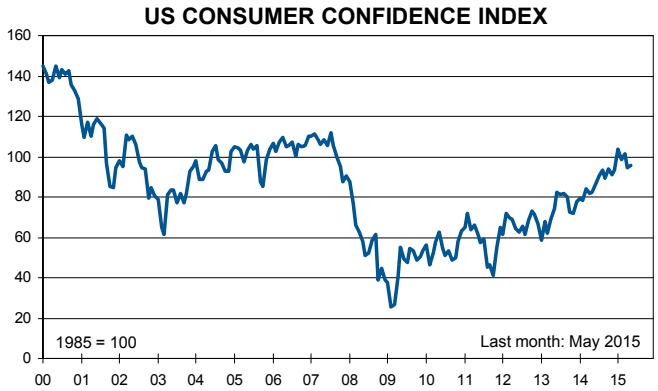


The leading indicators were fairly strong for a second straight month in May, but are probably overestimating future growth.



MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

Consumer confidence, a little weaker than expected recently, is probably still trending higher.

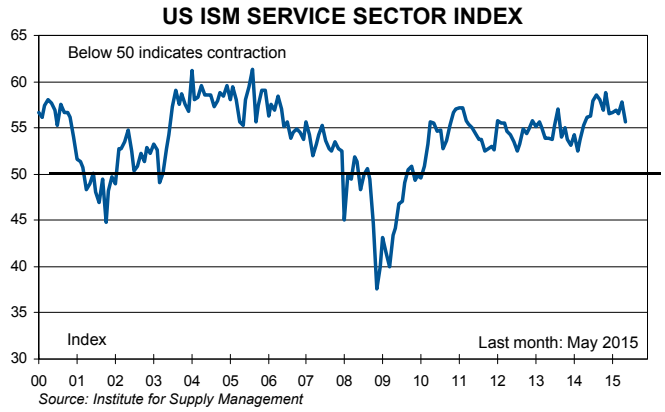


The average pace of job creation has been a little slower but is still quite strong.

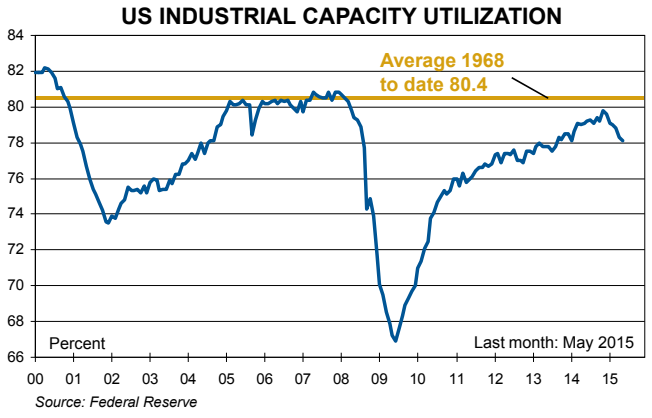
Unemployment remains fairly low.

Manufacturing has been depressed by the energy sector slump as well as by a rising US dollar.

The service sector is looking less robust.

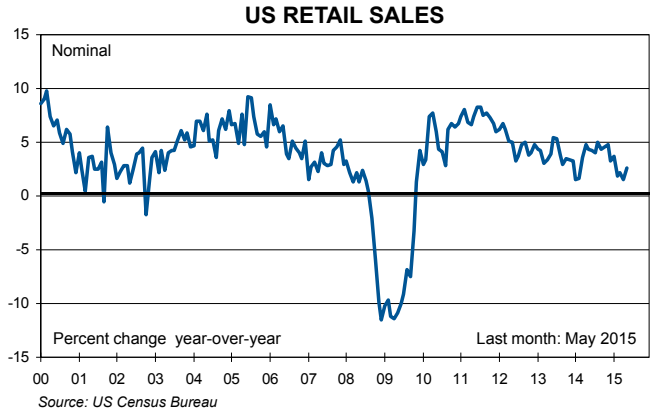


Capacity utilization has been trending down of late. Only some of the reversal was because of winter weather problems.

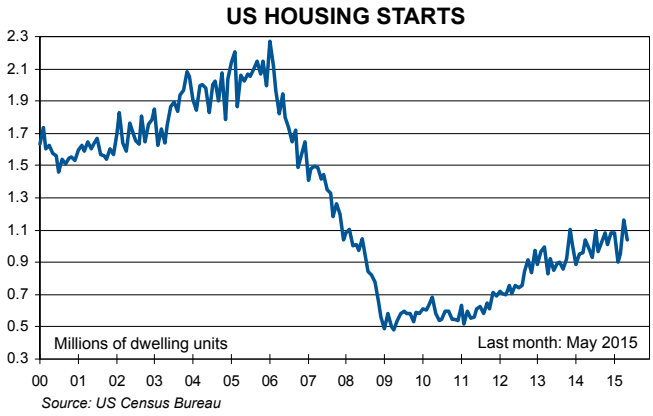


MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

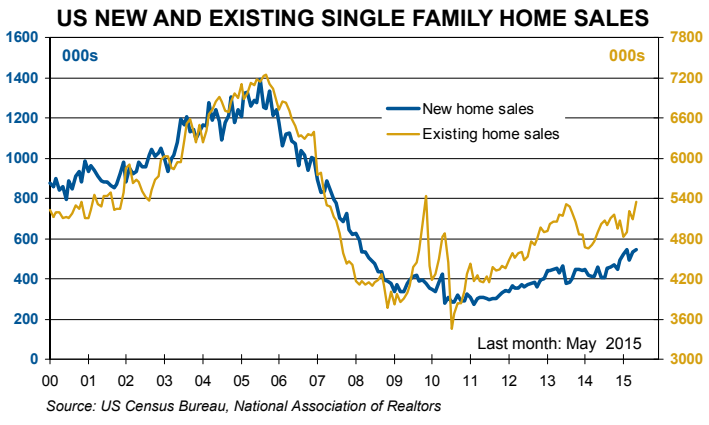
Retail sales rebounded in May to an all time high. They would have been higher if oil/gasoline prices hadn't fallen considerably.



Housing starts are showing a very weak rising trend.



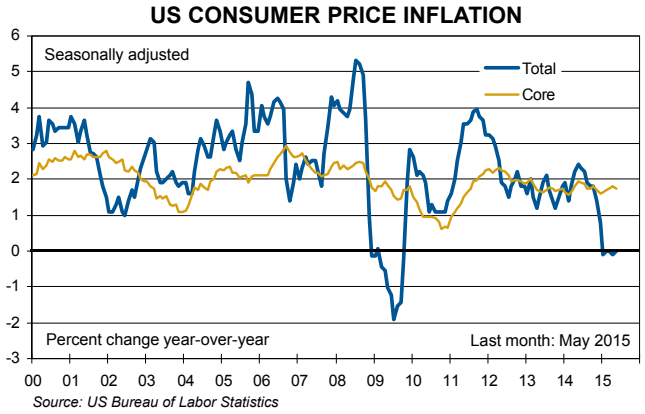
New home sales look a little better but sales of existing homes have been less buoyant.



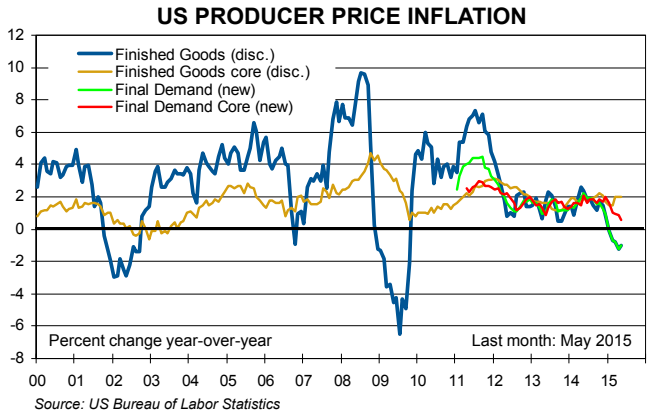
MONTHLY REVIEW ►
UNITED STATES – INFLATION

Headline inflation is expected to be close to zero through August, then rise. Core inflation, may rise if health insurers succeed in getting big price increases.

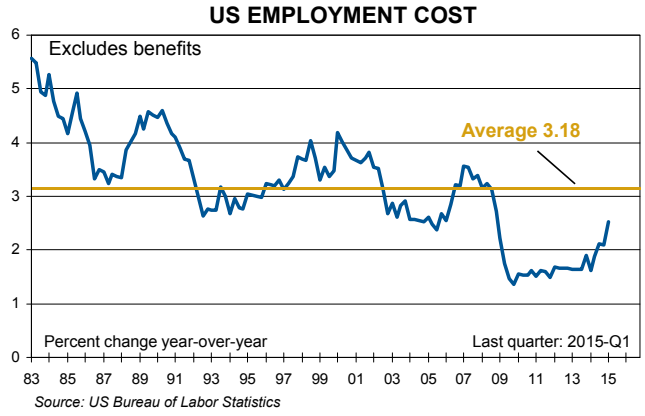
Headline inflation remains near zero but should rise to about 2% by January 2016. The core rate, which isn't whipsawed by the ups and downs of energy prices, unexpectedly slipped to 1.7% in May from 1.8% in April.



Producer prices were down 1.0% in the 12-months through May.

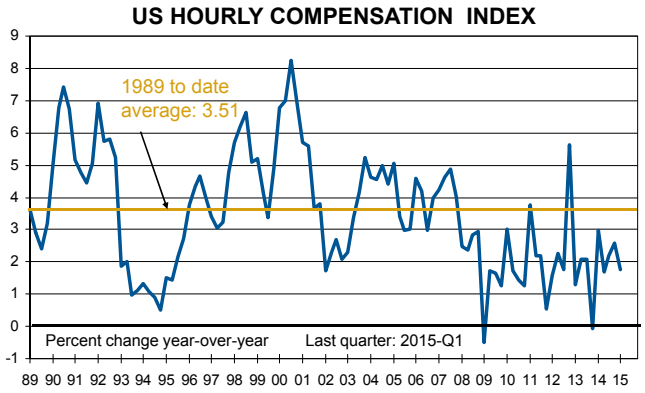


Employment costs have been moving up on a year-over-year basis. However recent month-to-month wage gains have seen deceleration.

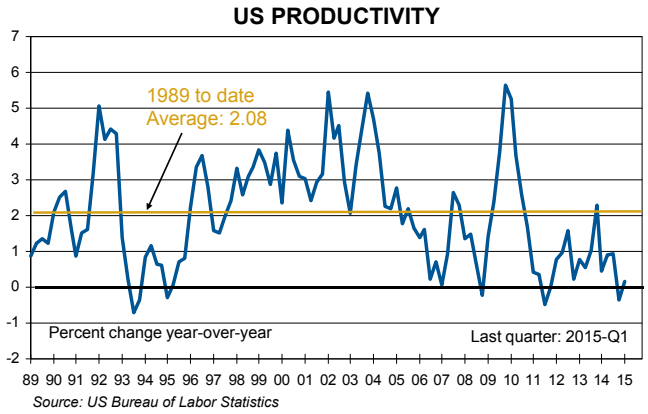


MONTHLY REVIEW ►
UNITED STATES – INFLATION

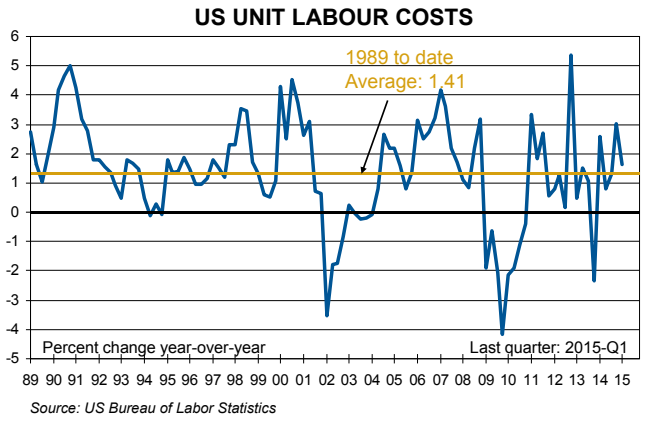
Hourly compensation gains have averaged 2.05% over the last few quarters (but were up only 1.76% in the first quarter.)



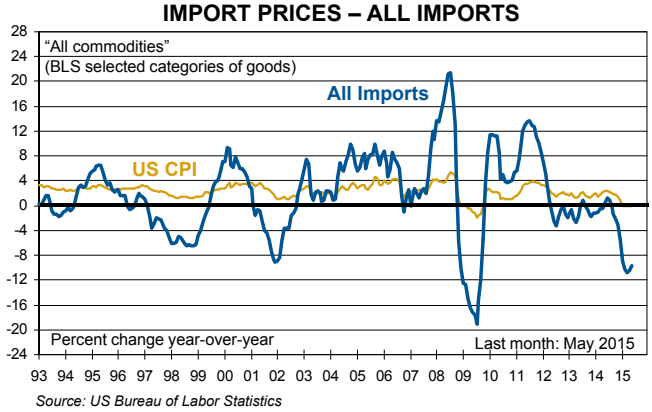
Productivity gains averaged only 0.41% over the last four quarters.



Unit labour cost increases averaged 1.69% over the last four quarters.

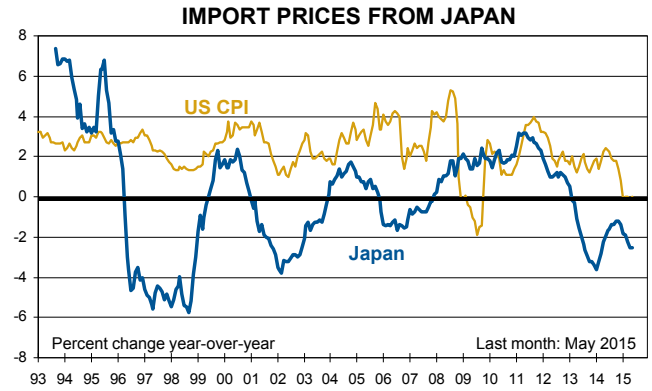


Import prices moved up slightly in May but are still undercutting overall inflation.

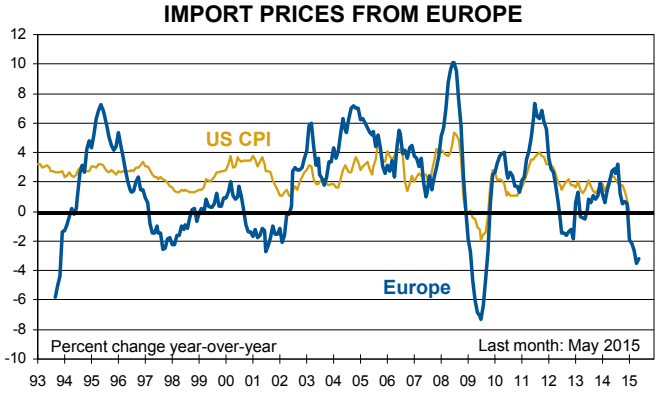


Source: US Bureau of Labor Statistics

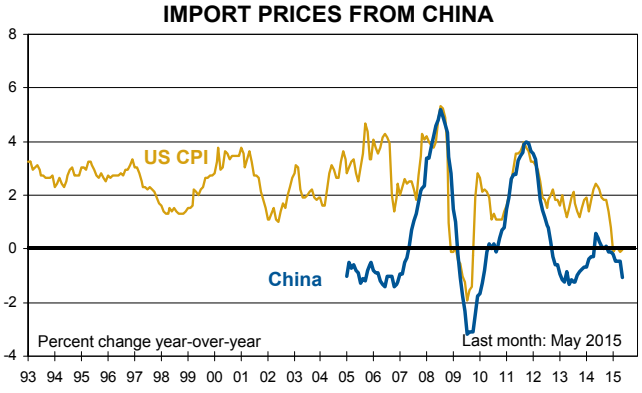
Note the drop in Chinese import prices in May.



Source: US Bureau of Labor Statistics



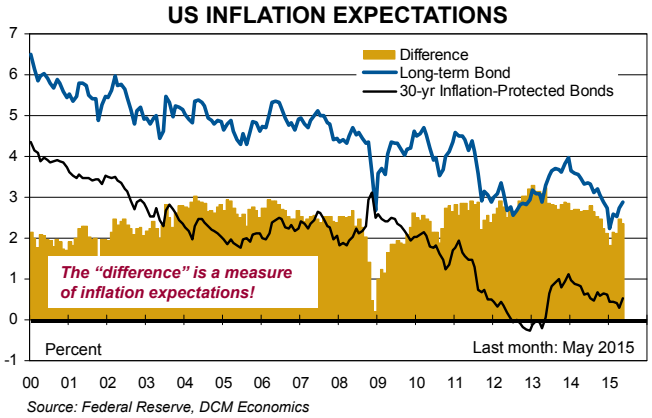
Source: US Bureau of Labor Statistics



Source: US Bureau of Labor Statistics

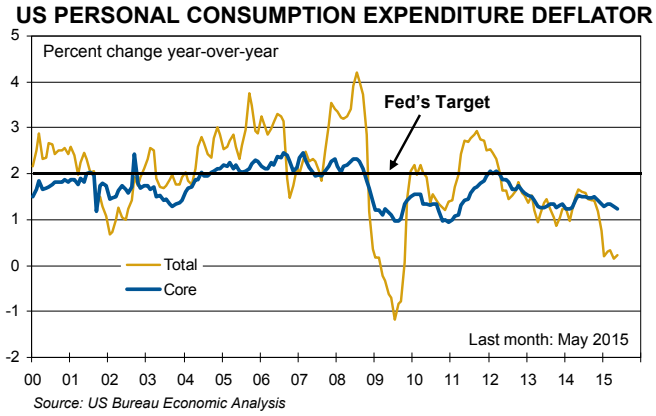
MONTHLY REVIEW ►
UNITED STATES – INFLATION

While inflation expectations appear to be up, some of the movement reflects bond market distortions.



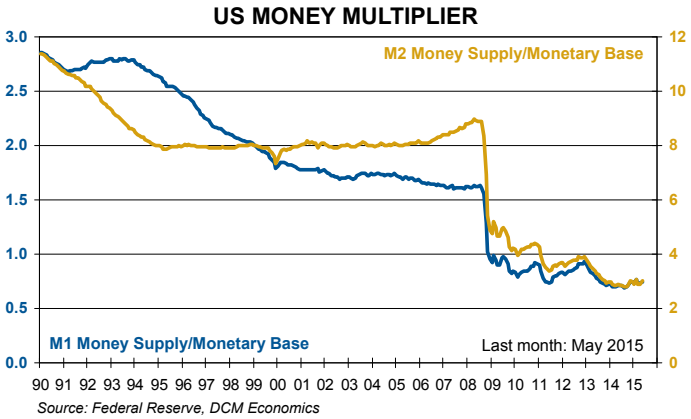
Source: Federal Reserve, DCM Economics

The PCE version of inflation (the Fed's favorite) fell further in May, the core rate was only 1.24%.



Source: US Bureau Economic Analysis

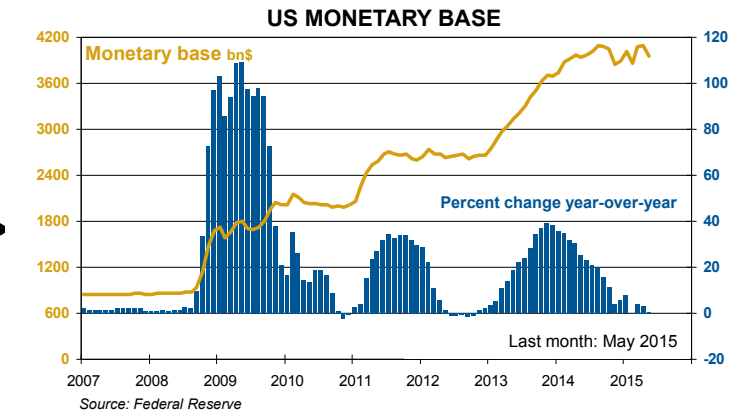
The money multiplier has flatlined.



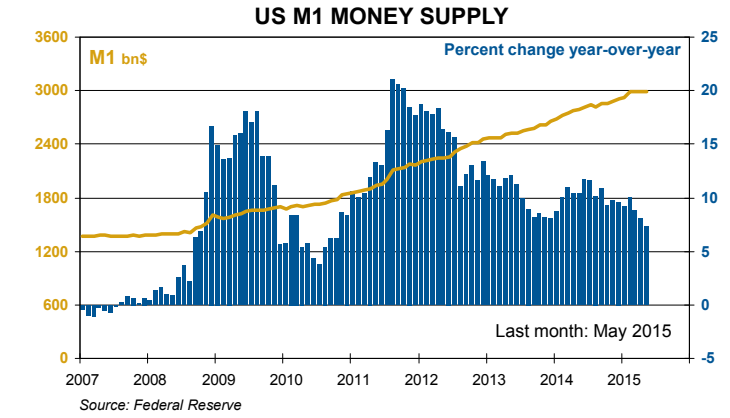
Source: Federal Reserve, DCM Economics

MONTHLY REVIEW ►
UNITED STATES – MONEY SUPPLY GROWTH

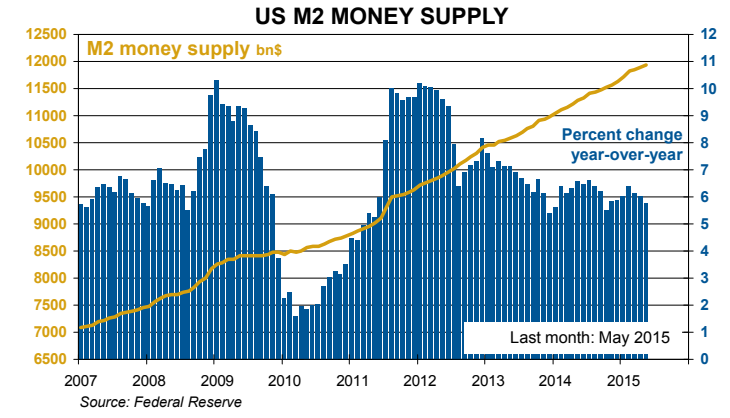
Slow.



Slowing.



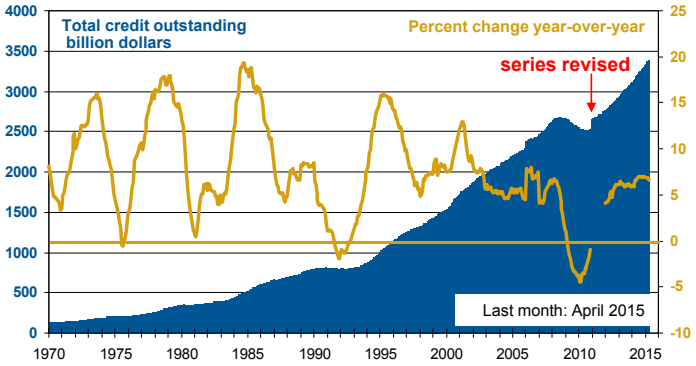
Still showing reasonable growth.



MONTHLY REVIEW ►
UNITED STATES – CREDIT GROWTH

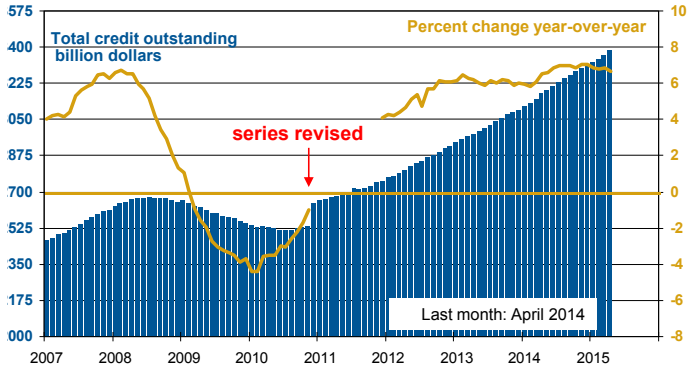
Credit growth is still fairly limp compared with past cycles, even though such consumer credit sub-categories as auto loans and student loans are growing fairly quickly. Mortgage growth is especially slow though on the cusp of rising.

US CONSUMER INSTALLMENT CREDIT



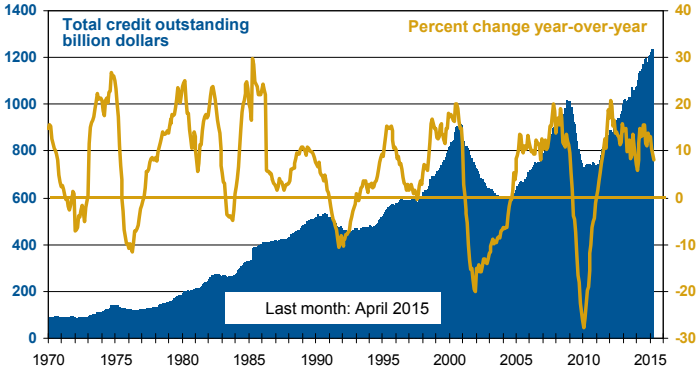
Source: Federal Reserve

US CONSUMER INSTALLMENT CREDIT



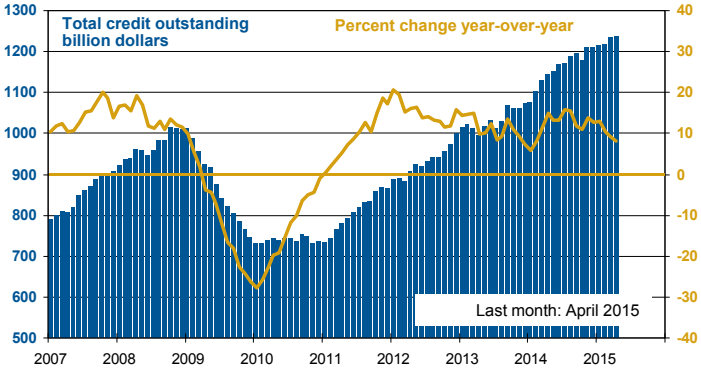
Source: Federal Reserve

US COMMERCIAL AND INDUSTRIAL LOANS



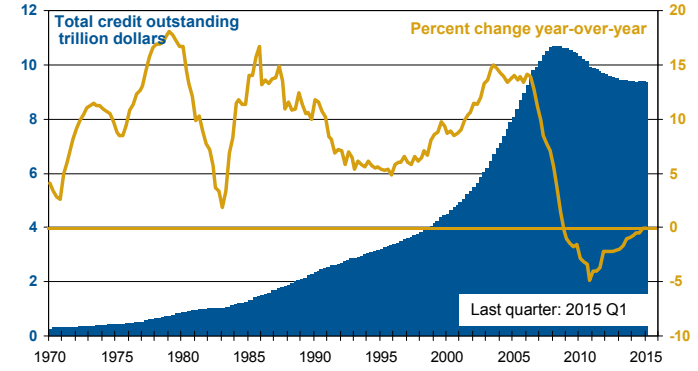
Source: Federal Reserve

US COMMERCIAL AND INDUSTRIAL LOANS



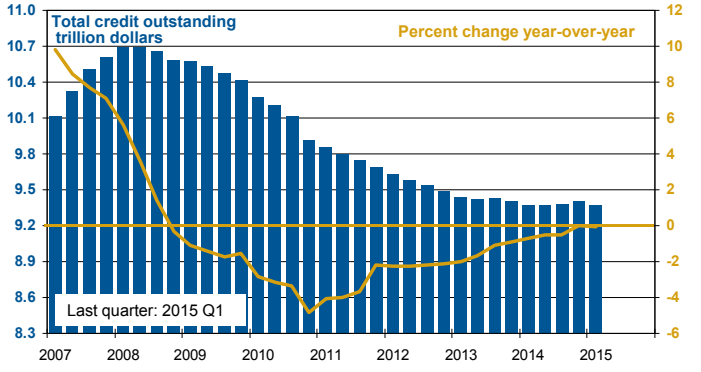
Source: Federal Reserve

US RESIDENTIAL MORTGAGE CREDIT



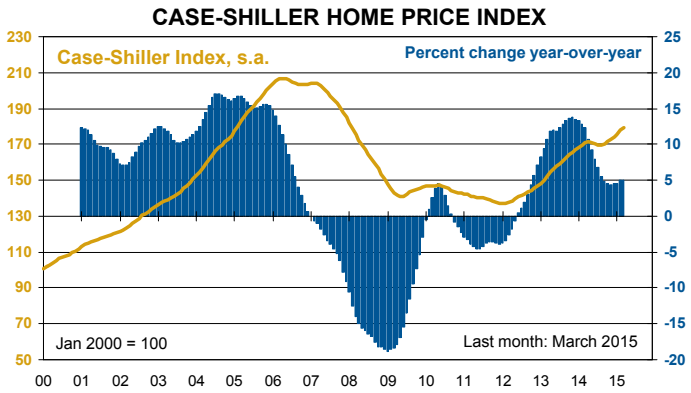
Source: Federal Reserve

US RESIDENTIAL MORTGAGE CREDIT

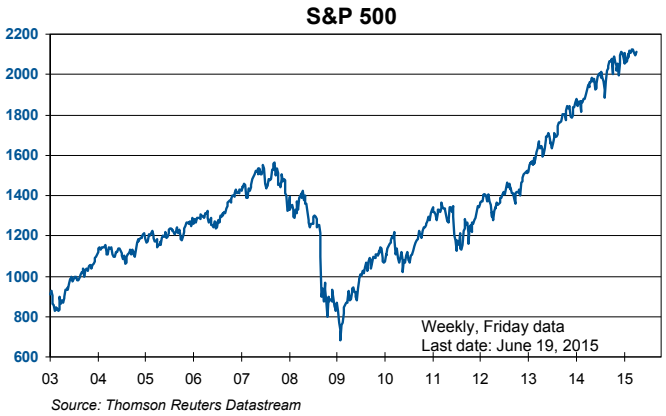


Source: Federal Reserve

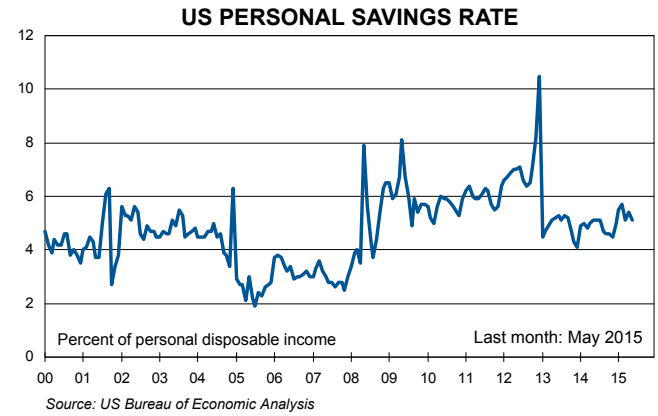
The year-over-year rate of home price increase is reaccelerating, reflecting strong month-to-month gains.



US stocks wobbled a bit last month, reflecting Fed and Greek financial uncertainties as well as weaker earnings in some cases (strong dollar, weak commodity prices).

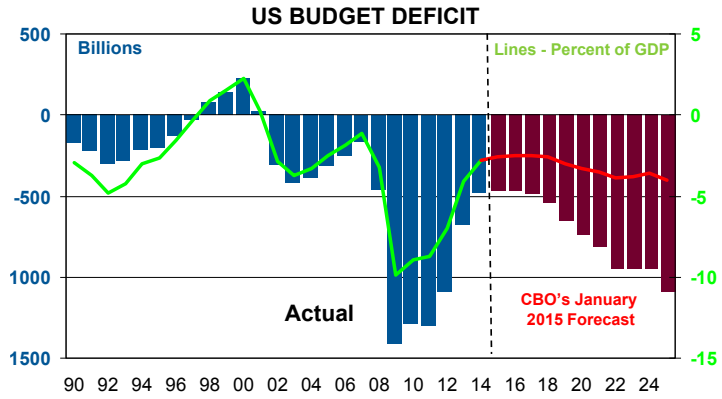


The savings rate is trending a little higher (despite strong auto loans) as consumers have been saving some of the gasoline price windfall.

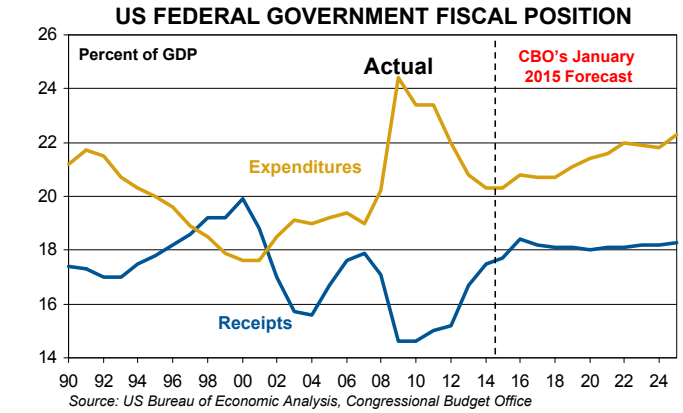


MONTHLY REVIEW ►
UNITED STATES – FISCAL UPDATE

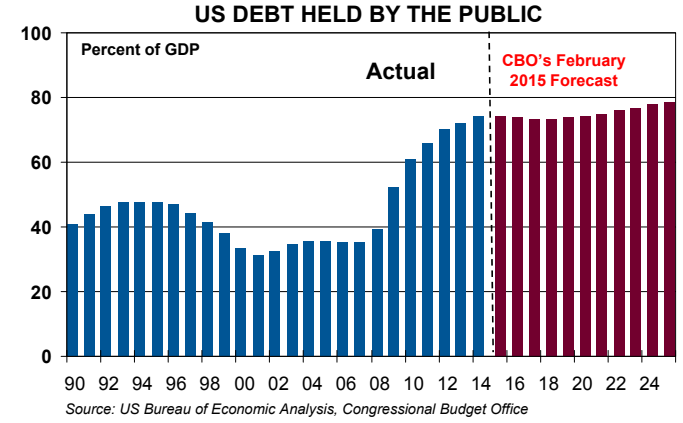
As of May 2015 the deficit was down to 2.3% of GDP – a remarkably rapid turnaround!



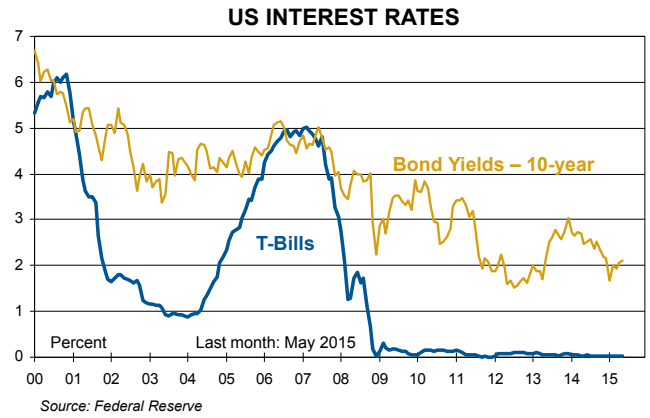
Expenditures have fallen, while receipts have grown.



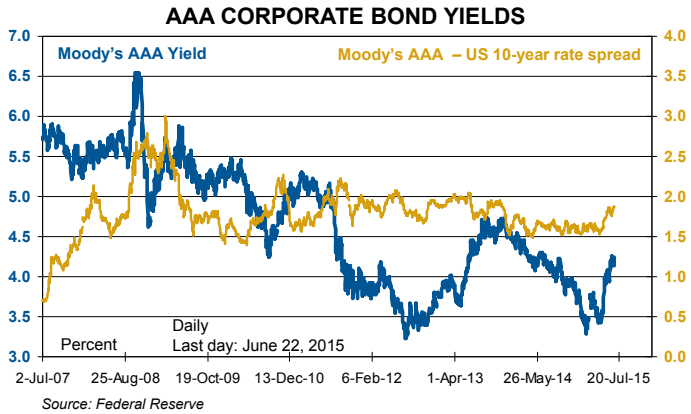
Debt is projected to flatten out as a percentage of GDP, assuming interest rates stay fairly low.



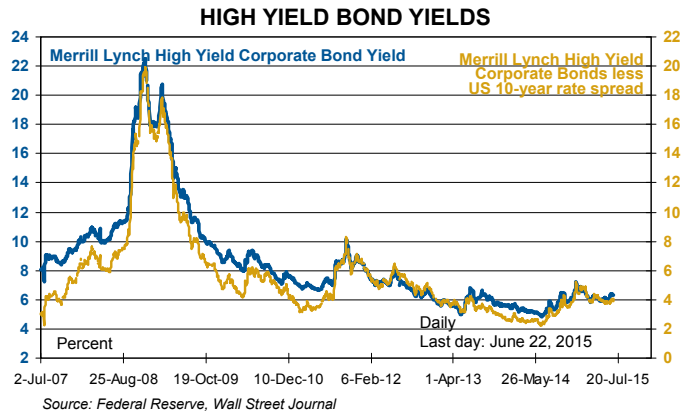
The Fed has expressed a desire to raise interest rates somewhat, but remains concerned by weak growth, low inflation and a rising currency.



Quality spreads have risen lately.

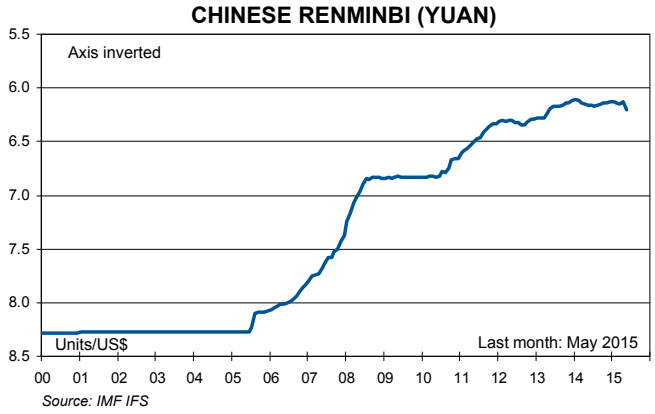


Poorer quality spreads moved up earlier this year.

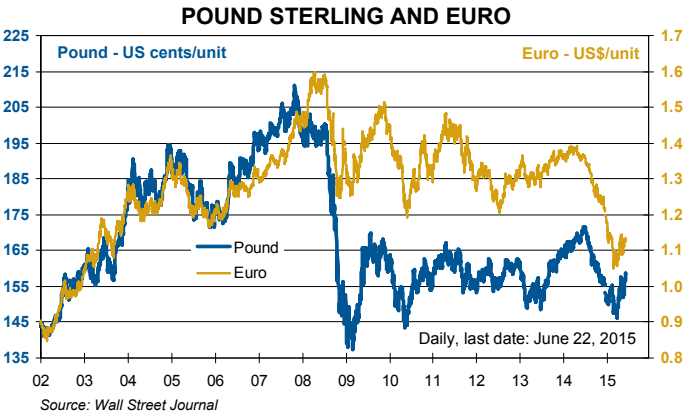


MONTHLY REVIEW ►
FOREIGN EXCHANGE RATES

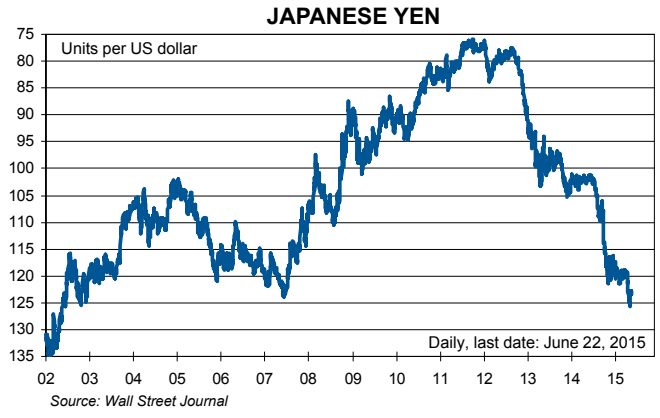
The Chinese currency has been stable near 6.20 to the US dollar recently.



Capital inflows have tended to favour the euro lately, despite worries over Greece.



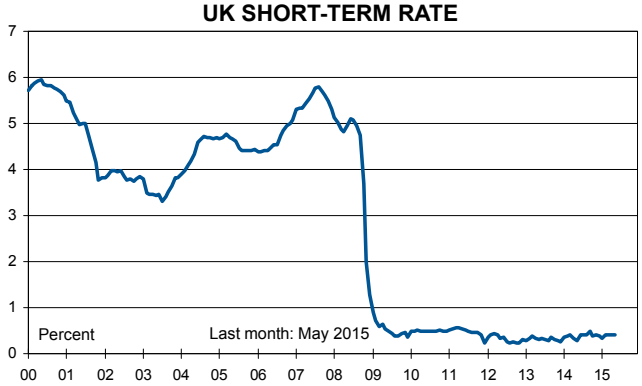
The yen's weakening trend has resumed.



The US Fed would like to raise rates soon but so far the economy and inflation have been too weak.

The US and other industrialized economies resemble that of Japan beginning in the 1990s, so if/when rates are raised it might prove to be a mistake.

UK SHORT-TERM RATE

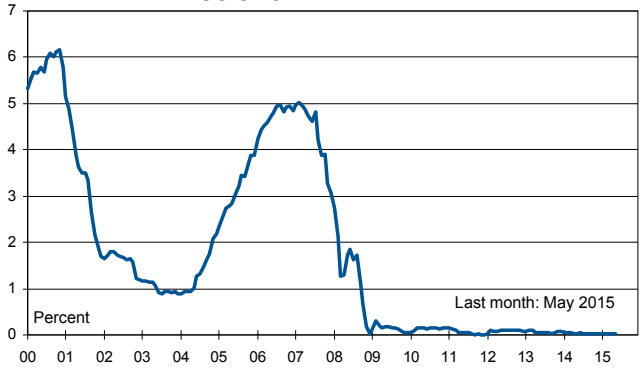


Source: Thomson Reuters Datastream

GERMANY SHORT-TERM RATE

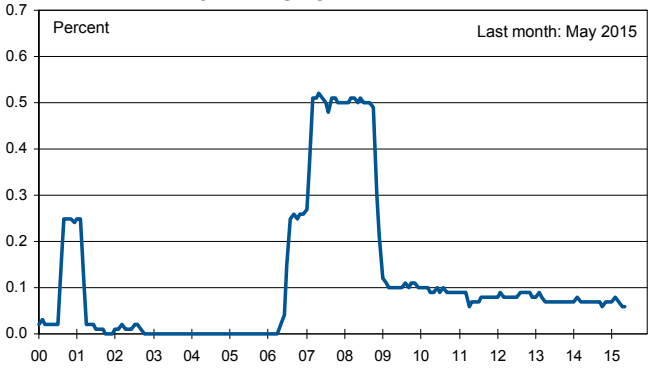
Source: Thomson Reuters Datastream

US SHORT-TERM RATE



Source: Federal Reserve

JAPAN SHORT-TERM RATE

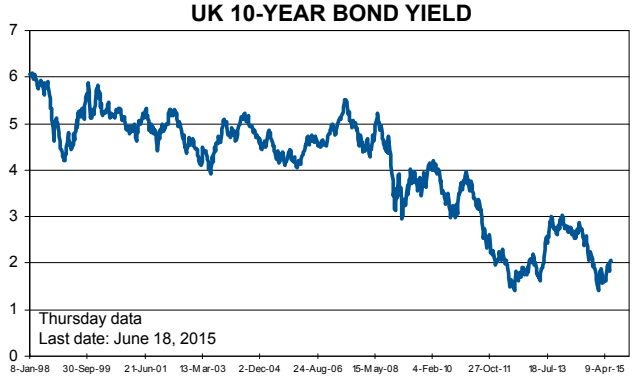


Source: Thomson Reuters Datastream

MONTHLY REVIEW ►
INTERNATIONAL 10-YEAR YIELDS

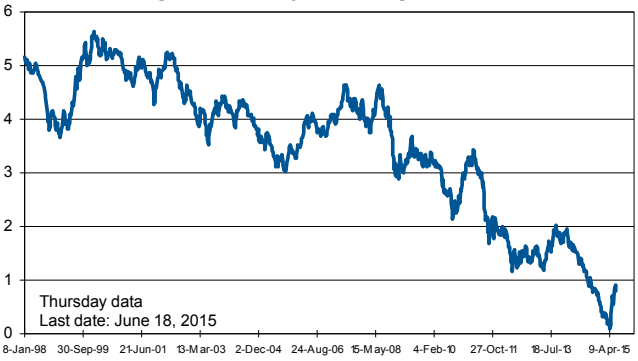
With oil prices (and thus headline inflation) somewhat recovered, yields have moved back up to trend. But the trend may well remain down during the reminder of the decade.

UK 10-YEAR BOND YIELD



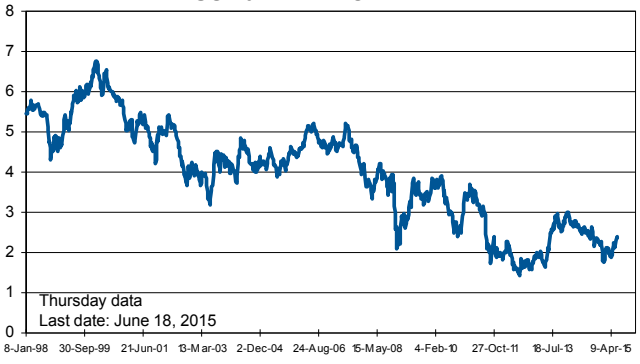
Source: Thomson Reuters Datastream

GERMANY 10-YEAR BOND YIELD



Source: Thomson Reuters Datastream

US 10-YEAR BOND YIELD



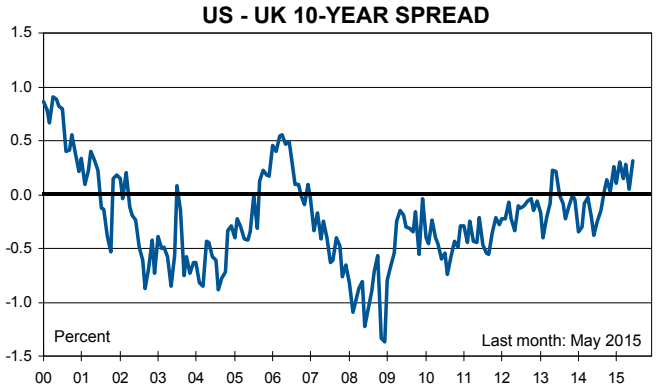
Source: Thomson Reuters Datastream

JAPAN 10-YEAR BOND YIELD

Source: Thomson Reuters Datastream

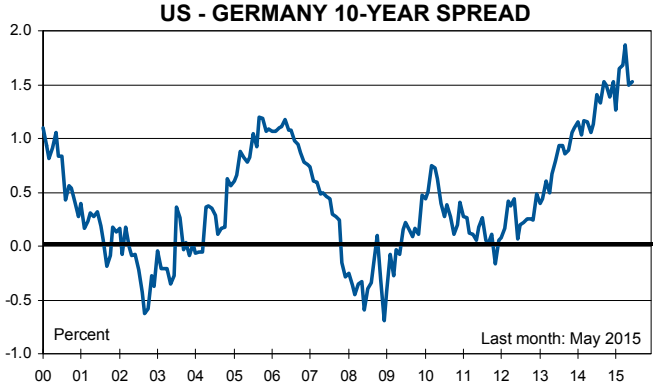
MONTHLY REVIEW ►
INTERNATIONAL 10-YEAR SPREADS

US yields have moved back above British yields.



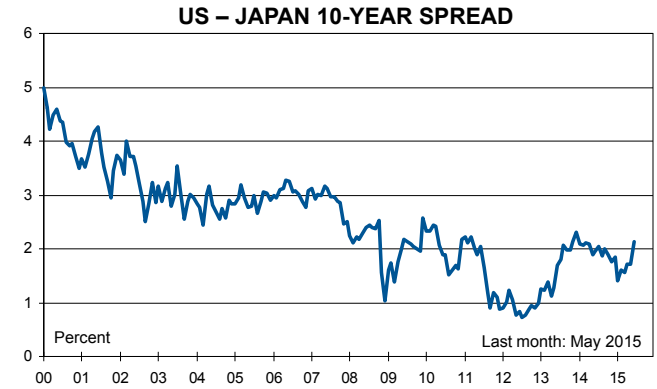
Source: Thomson Reuters Datastream

US yields are well above German yields, though a reduced Eurozone deflation threat and hopes for a Greek financial settlement have narrowed the gap.



Source: Thomson Reuters Datastream

US yields are even further above Japanese yields.

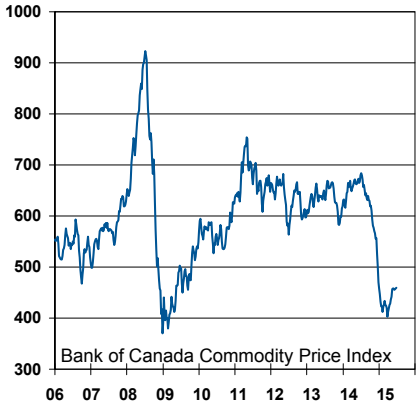


Source: Thomson Reuters Datastream

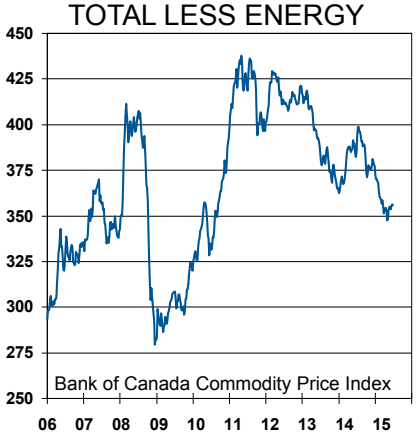
COMMODITY PRICES

1. Bank of Canada Commodity Price Indices (Weekly data to June 19, 2015)

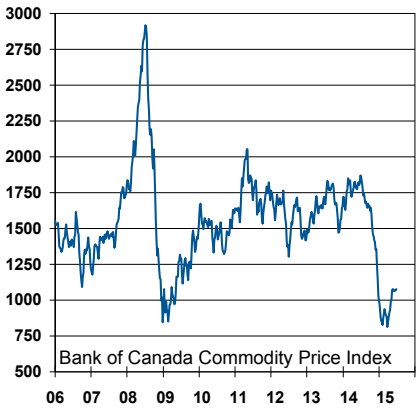
TOTAL COMMODITY



TOTAL LESS ENERGY

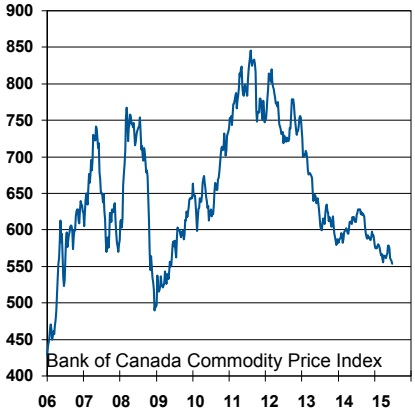


ENERGY



AGRICULTURE

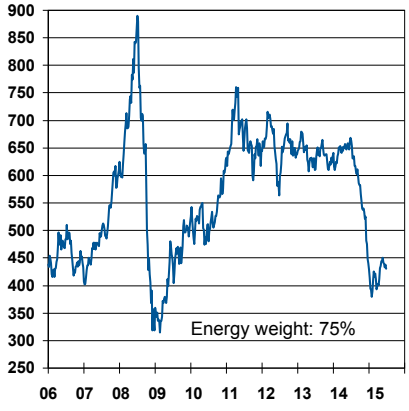
METALS AND MINERALS



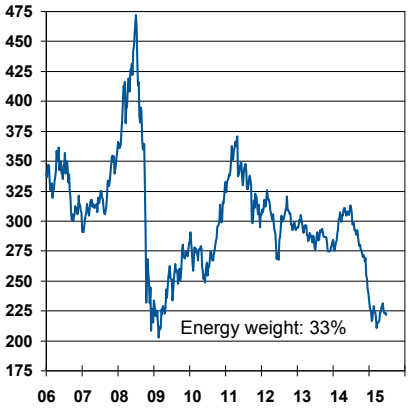
Weakening Chinese growth and growing commodity supplies continue to be problematic for most commodities.

2. Other Indices (Weekly data to June 19, 2015)

S&P GSCI COMMODITY



REUTERS/JEFFERIES CRB



ECONOMIST COMMODITY PRICE

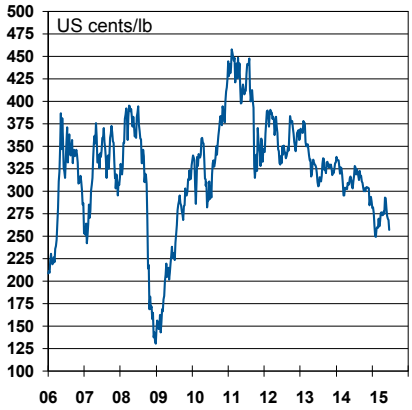
Sources: Bank of Canada, Thomson Reuters Datastream, The Economist

COMMODITY PRICES

3. Metals (Weekly data to June 19, 2015)

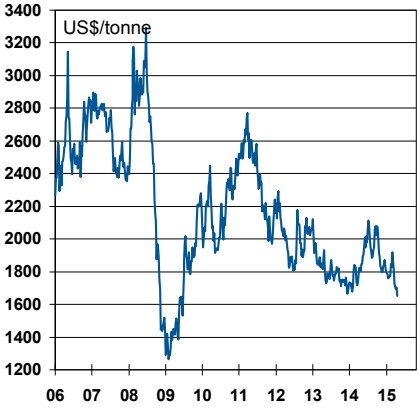
NICKEL

COPPER

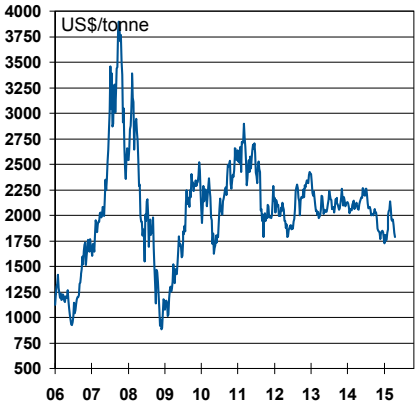


ZINC

ALUMINUM



LEAD



GOLD

PLATINUM

SILVER

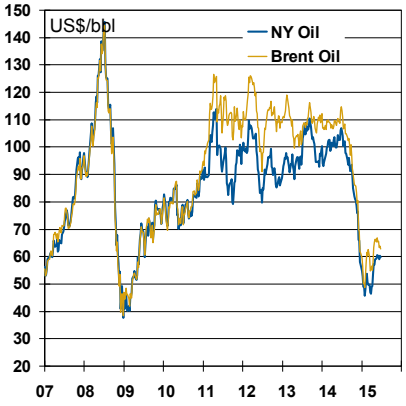
Metal prices are forecast to “bottom out” in 2015. But any upturn in 2016 is likely to be subdued!

Sources: LME, LBMA, Wall Street Journal

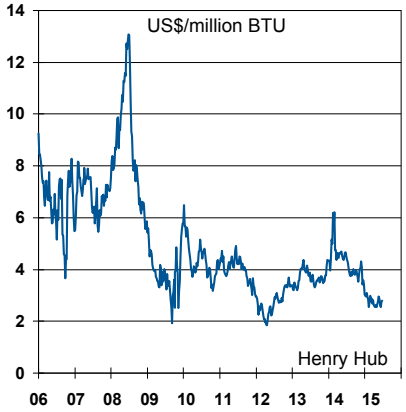
COMMODITY PRICES

4. Energy (Weekly data to June 19, 2015)

SPOT OIL PRICES



NATURAL GAS

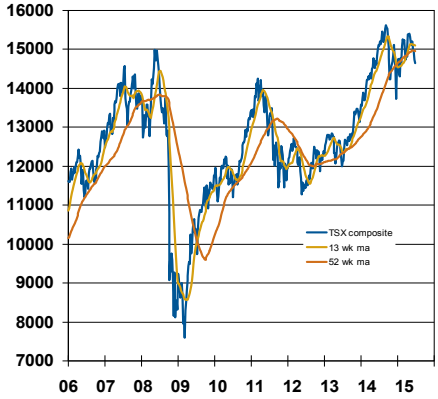


Low oil and gas prices will persist through year-end.

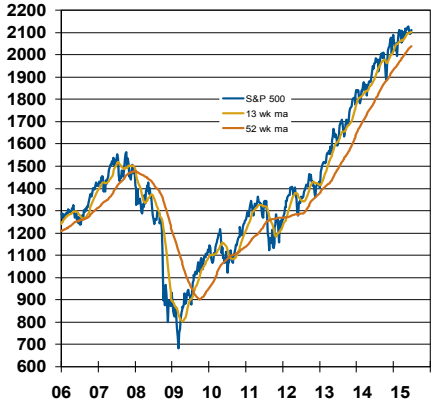
EQUITY MARKETS

5. North America (Weekly data to June 19, 2015)

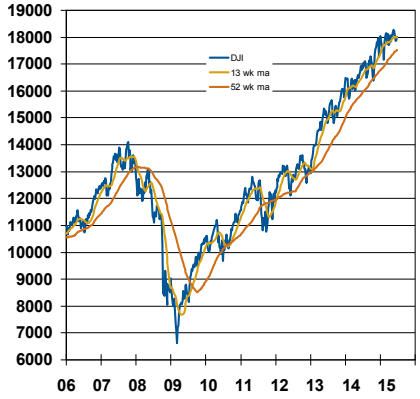
TSX COMPOSITE INDEX



S&P 500 INDEX



DOW JONES INDUSTRIALS



NASDAQ INDEX

Source: Thomson Reuters Datastream

The outlook for US equity markets remains broadly constructive; policy interest rates will remain low and a US recession is not on the horizon. We expect increased volatility to remain however as the markets continue to debate if/when the Fed will raise interest rates.

EQUITY MARKETS

6. Around the world (Weekly data through June 19, 2015)

JAPAN

GERMANY

INDIA

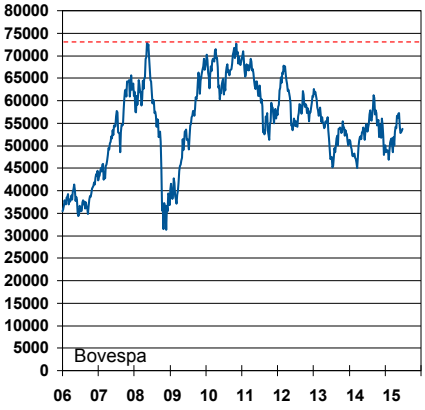
CHINA

RUSSIA

MEXICO

MSCI EAFE INDEX

BRAZIL



MSCI WORLD INDEX

Source: Thomson Reuters Datastream

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