ECONOMIC MONITOR

January 31, 2015

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

Dynamic Funds®
ECONOMICS

HIGHLIGHTS

Financial Markets Overview (Page 2)
Economic conditions continue to disappoint and central banks are making unannounced moves to compensate. The IMF once again revised down its global economic outlook and already low inflation continues to decline as oil prices plummet.

The Eurozone - Is There Any Hope? (Page 4)
There has been very little economic growth in the Eurozone since the Great Recession. Economic and political turmoil continue to plague the southern half, giving rise to anti-austerity and anti-euro political parties. This article explores scenarios under which the Eurozone stays intact and a scenario where the Northern Eurozone countries split from the Southern countries.

The Canadian Dollar, Commodity Prices, and More Interest Rate Cuts? (Page 10)
The Bank of Canada is likely to follow its January 21 interest rate cut with at least one more in March. The decline in the Canadian dollar will help boost non-energy exports, which will help offset some of the decline in revenue from energy related exports.

The Impact of Lower Oil Prices on the Canadian Economy (Page 11)
Lower oil prices have both costs and benefits to an economy, but since the Canadian economy is a net exporter of oil, the costs outweigh the benefits. Our analysis, suggests that the decline in oil prices will cost the Canadian economy $60bn in foregone export revenue in 2015.

Also Inside:
Canadian Economic Charts (Page 12)
US Economic Charts (Page 24)
Commodity Price Charts (Page 37)
Equity Market Charts (Page 39)

Financial Markets Overview

Economic and financial conditions are changing so quickly that central banks have been moving without giving forward guidance. The Swiss dropped their franc/euro cap without warning recently, leading to a sharp rise in the franc. They also deepened their negative interest rate on foreign deposits. Then the Bank of Canada unexpectedly cut rates, and the dollar tumbled further.

In the Swiss case, the sudden change appeared to be largely the result of expected quantitative easing by ECB (confirmed last week: €60 billion per month through September 2016 – €1.14 trillion in total). In the Canadian case, the interest rate cut came on the back of the plunge in oil prices.

The IMF and other forecasting agencies have downgraded the 2015 outlook furthermore. The one oasis amongst the industrialized countries is the US economy; the IMF expects growth to improve in 2015. Some of the latest US data have been unexpectedly weak however. Yes, lower gasoline prices will encourage more household spending, but a disproportionate amount of US job creation in recent years came from the expanding energy sector. And the US dollar has risen rapidly, which will hamper growth in the trade sector.

1. ► Given the rapidly evolving international developments the **BANK OF CANADA** may not be satisfied with a single rate cut. We could accordingly see at least one more (in March). The plunging loonie will help boost headline inflation however, which is the objective of the Bank's actions.

2. ► The **FED FUNDS RATE** is expected to remain in the range of 0% to 0.25% in 2015. We expect the Fed will not be pleased with upcoming data on inflation, on wage growth, and on economic growth. We also doubt that the Fed will want to encourage a further surge in the US dollar by raising interest rates.

3. ► Longer term **BOND YIELDS** will probably slip further over the next six months or so on the back of weaker inflation and somewhat slower growth. Foreign investors may also wish to take advantage of North America's relatively higher yields, and the safety of US assets.

4. ► The outlook for the **CANADIAN DOLLAR** remains negative; weaker energy prices have now morphed into a looser monetary policy, meaning the dollar ought to break below 80 cents very soon.

5. ► The **US DOLLAR** is forecast to continue rising against most currencies; most countries are cutting interest rates or loosening monetary policy (QE). Even without Fed interest rate hikes the US should continue to attract capital inflows.

Updated Forecast - Base Scenario

	Actual				Projected						
	14-II	14-III	14-IV	22-Jan	Feb	Mar	April	15-II	15-III	15-IV	16-I
CURRENCIES	***Scenario B: Very Weak Eurozone and Slowing Chinese Growth; Modest US Improvement***										
US Dollar Index*	79.62	81.08	87.09	93.93	95.57	96.57	97.53	98.23	99.97	100.3	100.7
Can. Dollar: CDN/US	***1.091***	***1.094***	***1.136***	***1.239***	***1.265***	***1.280***	***1.290***	***1.300***	***1.325***	***1.310***	***1.300***
Can. Dollar: US/CDN	91.66	91.41	88.03	80.70	79.05	78.13	77.52	76.92	75.47	76.34	76.92
Japanese Yen	***102.1***	***104.3***	***114.8***	***118.2***	***120.0***	***120.5***	***121.0***	***122.0***	***124.0***	***126.0***	***128.0***
British Pound	168.3	166.9	158.2	150.2	148.2	146.3	143.9	143.2	141.6	140.7	139.7
Euro	***1.371***	***1.325***	***1.249***	***1.137***	***1.125***	***1.110***	***1.090***	***1.085***	***1.065***	***1.050***	***1.035***
Australian Dollar	93.30	92.48	85.53	80.60	78.66	77.34	76.36	75.77	74.34	75.19	75.77
Chinese Yuan/Rmb	***6.158***	***6.160***	***6.154***	***6.211***	***6.210***	***6.220***	***6.230***	***6.235***	***6.245***	***6.250***	***6.225***
Indian Rupee	59.80	60.61	61.92	61.37	61.05	60.60	60.15	59.75	59.25	58.75	58.25
** Index based on CDN$, Euro, Pound, Yen*											
INTEREST RATES	***Scenario B: Growth Modest - Inflation Well Below Target***										
Canada											
Treasury Bill (91-day)	0.94	0.94	0.90	0.63	0.62	0.42	0.42	0.42	0.43	0.45	0.47
Government Bond (10-yr)	2.29	2.12	1.92	1.42	1.35	1.25	1.25	1.25	1.40	1.55	1.75
Prime	3.00	3.00	3.00	3.00	2.75	2.50	2.50	2.50	2.50	2.50	2.50
Target Overnight Rate	***1.00***	***1.00***	***1.00***	***0.75***	***0.75***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***
Spread: 10-yr - T Bills	1.35	1.18	1.02	0.79	0.73	0.83	0.83	0.83	0.97	1.10	1.28
United States											
Treasury Bill (90-day)	0.03	0.03	0.02	0.02	0.03	0.03	0.03	0.03	0.03	0.03	0.03
Treasury Bond (10-yr)	2.57	2.49	2.23	1.87	1.80	1.75	1.70	1.75	1.95	2.15	2.35
Prime	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
Fed Funds Target	***0.09***	***0.09***	***0.10***	***0.13***	***0.13***	***0.13***	***0.13***	***0.13***	***0.13***	***0.13***	***0.13***
Spread: 10-yr - T Bills	2.54	2.46	2.21	1.85	1.77	1.72	1.67	1.72	1.92	2.12	2.32
Interest Rate Differential (Canada-US)											
Treasury Bill	0.91	0.91	0.88	0.61	0.59	0.39	0.39	0.39	0.40	0.42	0.44
Bonds-10yr	-0.28	-0.37	-0.31	-0.45	-0.45	-0.50	-0.45	-0.50	-0.55	-0.60	-0.60

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 Eurozone - Is There Any Hope?

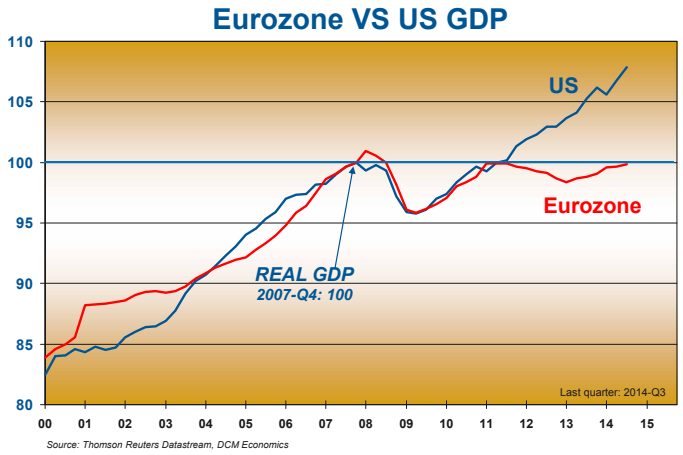
by Martin Murenbeeld

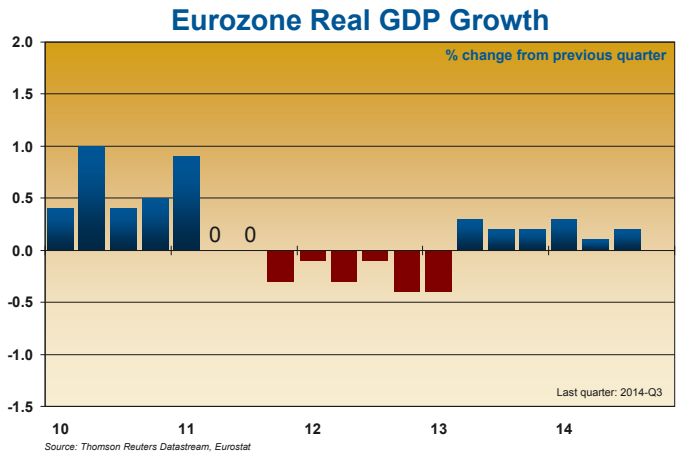
The set of charts herewith point to a sorry Eurozone story: there has been precious little growth in the Eurozone since the Great Recession! Indeed, a number of the individual economies have slipped in and out of recession in ensuing quarters. Since the borrow-and-spend policies of the southern half of the Eurozone came to an end in the aftermath of the Great Recession, growth in the Eurozone could be summarized as being almost non-existent – and mostly negative in the southern half, Spain excepted.

The high rates of unemployment in the Eurozone have thankfully leveled off, but that might say more about some people dropping out of the labor force and emigrating than about resurgent economic dynamism per se.

The reader may recall that the financial problems of Greece were the first to surface after the Great Recession; on October 20, 2009 the finance minister of the newly-elected Greek (center-left socialist) government "*disclosed that the nation's deficit would soar to almost 12.5 per cent of gross domestic product*"[1]. This was significantly higher than what had been assumed – and much higher than what had been reported by the previous government. (Recall that under EU rules the maximum allowable budget deficit was 3% of GDP, and the maximum allowable debt/GDP ratio was 60%!)

Since October 2009 developments in the Eurozone have been dismal; in 2012 it appeared that Greece would leave – or be turfed out of – the Eurozone (quite possibly along with one or two other PIIGS countries – Portugal, Italy, Ireland, Greece and Spain – depending upon the contagion crisis that would have unfolded). However, in so far as no programs had yet been introduced to "ring-fence" the financial contagion of a member's departure Merkel relented and

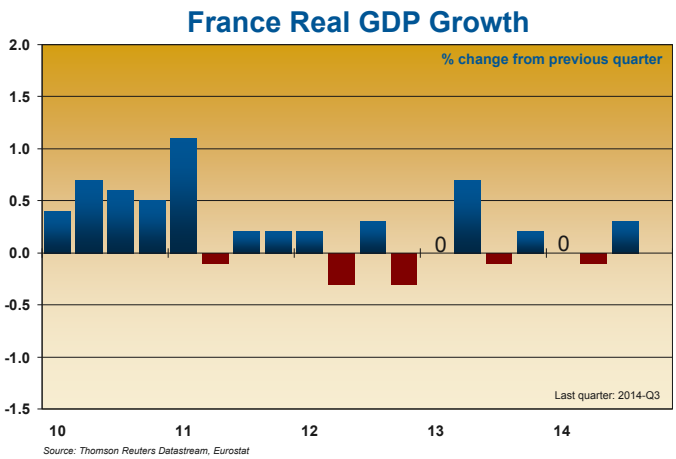


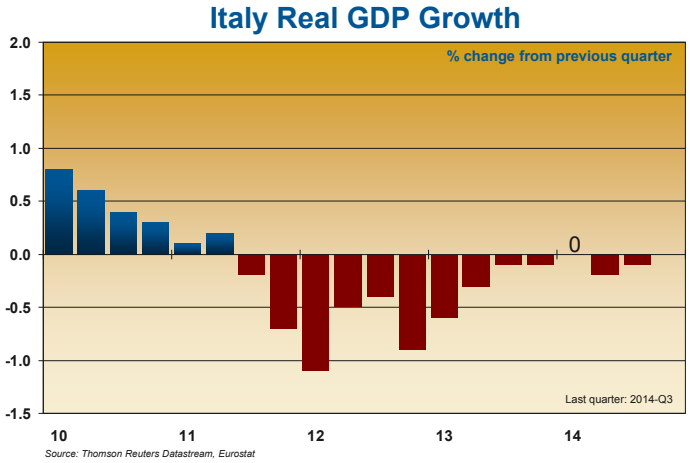


did not force the "*Grexit*" issue. After the ECB announced on July 26, 2012 that it "*would do whatever it takes*" to maintain the integrity of the euro, the probability of a Eurozone rupture – a "*Grexit*" or worse – rapidly declined. But Eurozone growth continued to stagnate!

It is now January 2015, the Eurozone still isn't expanding significantly, the levels of unemployment remain excruciatingly high, and headline inflation has dropped below zero (in part, to be sure, on account of the plunge in oil prices – but headline inflation was heading into negative territory regardless). And Greece is having another election on January 25! (Background: the current Greek government was formed after two

[1] *See Wikipedia for a timeline of Greece's debt crisis since 2009.*





elections in 2012; the May 2012 election proved inconclusive so another was held in June. These elections followed on the 2009 election which led to the above-noted revelations of serious Greek budget deficits! The Greeks, like the Italians, like to have elections!)

Leading the Greek polls is Syriza, a coalition of left wing and radical left parties (widely so described). Syriza is one of the many Eurosceptic parties; indeed, every Eurozone country has at least one Eurosceptic party (the National Front in France, the Alternative for Germany, etc.); each is a popular local alternative to the party in power. Syriza has indicated of late that it will not push for a "*Grexit*", but its professed policies (including non-payment on debts that total 175% of GDP) are sure to cause questions in this regard. Eurosceptic parties in Germany and elsewhere will conclude not only that a "*Grexit*" may indeed be in everyone's long-term best interest, but also that the departure of their own countries would be in the domestic long-term best interest.

Furthermore, now that there are an array of programs (OMT, SMP, EFSF and ESM – don't ask) purporting to limit any financial contagion of a "*Grexit*", there is also less concern over the fallout of a minor Eurozone member leaving the Eurozone – and readopting its national currency.

If anyone is surprised by recent Eurozone events, it is not us! We have been skeptical of the Eurozone arrangement for some years and certainly felt (even erroneously forecast) that Greece should have left the Eurozone in 2012, if not immediately after its financial troubles surfaced in 2009. (We also argued in the February 17, 2012 edition of Canada's *National*

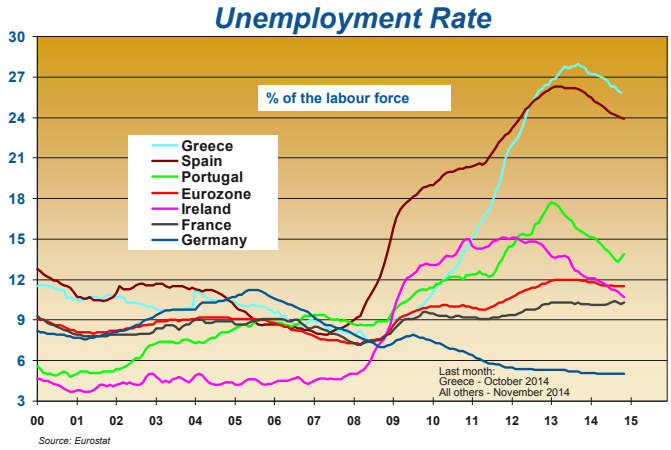
Post that it should be Germany and the three or so other AAA countries which should leave the Eurozone, instead of Greece and the other PIIGS.)

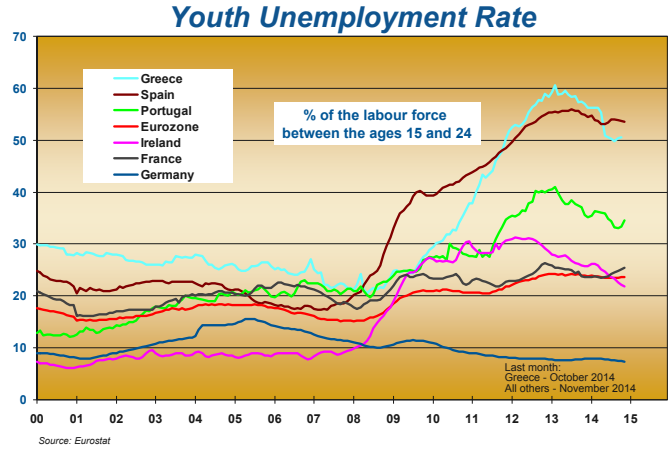
We have however consistently underestimated the commitment of politicians (notably Merkel) and Eurozone voters (Dutch, Greek, and others) to keeping the Eurozone intact – despite the obvious economic suffering this has entailed for a number of countries (and will entail in coming years because problems in France and Italy are also building). In truth, the probability of a "*Grexit*" this year is probably quite small; despite Syriza leading the polls over 70% of Greek voters say they want to remain in the Eurozone.

But if there is no "*Grexit*" in 2015 the issue is certain to return in 2016 or 2017. Greek debts total 175% of GDP and regardless of how much the new Greek government can get the Eurozone (and Troika) to write-down Greek debt the remaining debt will hamper the Greek economy for many years to come. (At this point it is worth reminding the reader that an estimated $130 billion of Greek debt was already "written off" in 2012; this was the largest debt write-down in history!)

In my view the Eurozone, assuming it remains intact, will be lurching from crisis to crisis for the foreseeable future; each member needs to realign itself with Germany, and that is a nearly impossible task within the straightjacket of the currency union.

(Some years ago the British press asked whether any country could actually survive being in a currency union with Germany. And we have noted often that European currencies were regularly devalued against the deutschemark in the years prior to the euro introduction in 1999. The French franc was devalued 75% over the period 1957-1998 for example, and the Greek drachma 96%. Only by devaluing could European countries maintain some semblance of competitive equality with Germany during that period. And it isn't just labor costs that deviate





over time which need readjusting; it is everything from the differential growth of bureaucracies to business culture/practices and government social policies that lead some countries down the wrong competitive path. The hard truth is that to remain competitive Greece and other countries really do have to become more like Germany – or Germany has to become more like the Eurozone's southern half. And how likely is the latter? As it now stands, with no currency devaluation since 1999, a number of Eurozone countries must regain some competitive balance with Germany, and the adjustment must perforce come by way "restructuring" and downward adjustments in domestic prices, taxes, and social policies.)

We could take a positive view of the Eurozone, and imagine that it survives and thrives in the years ahead within the straightjacket of the euro.

We have suggested in past reports that the Eurozone will then need to become more like Canada. Canada has 10 provinces that each issue their own debt (and each pays a different interest rate on its debt); but Canada also has a central government that issues debt on behalf of the "collective" (Government of Canada bonds). There is one central bank, the Bank of Canada, and it may buy/sell Canada bonds as part of its monetary policy operations. Canada also has one bank regulator for the "collective" (which, to be sure, the EU is working to establish in the Eurozone), and – very important – Canada has a system of centrally planned equalization payments where "have" provinces make payments to "have-not" provinces. It is furthermore implicit in the Canadian arrangement that if any one province were to slide into financial crisis the others would, by way of the central government and the central bank, financially backstop that province.

The Eurozone has no "*Eurobond*" issued by Brussels on behalf of the Eurozone "collective", so the ECB cannot buy these as part of its monetary policy operations. While the ECB must of necessity buy debt as part of its monetary policy operations (money supply and base money need to expand as an economy expands), the ECB is expressly forbidden from buying government debt on a first issue basis. The latter would be regarded as the "monetary financing" of individual government expenditures. The ECB gets around this nuanced regulation by buying government debt in the secondary market – a distinction that lies at the center of the legalities surrounding the ECB's proposed Outright Monetary Transactions – OMT – and on which the European court has yet to make a final ruling. (A preliminary opinion has agreed OMT falls within the ECB's mandate, just!)

In short, as the Eurozone is currently constituted the central bank of each member country is more or less that country's financial backstop (but it will incur a debt to the system of central banks when it relies on ECB support). The European Stability Mechanism (ESM) was established in October 2012 – after the Greek crisis that year – to provide "*financial assistance to countries experiencing financial difficulties*", but the ESM is not a system of "equalization payments" as we in Canada know it. Each country availing itself of financial assistance is fully expected to pay it back (something which Syriza is proposing not to do after it is elected).

Without transfer payments from the "North" to the "South" and without the domestic "flexibility" required to adjust to a competitive standard set by Germany for the Eurozone, it is extremely difficult to see how the Eurozone is not going to have crisis after crisis.

The Eurozone could have had an easier time of it these last five or so years. In theory, even while each member adopts a single currency and leave to a single central bank, the ECB, all monetary policy decisions, each member still has control over its own fiscal policy. So each member has some direct policy flexibility. However, to safeguard the Eurozone from the exact problems in which it now finds itself, each member agreed upon joining to set limits on domestic fiscal policy – i.e. to limit its budget deficit (<3% of GDP) and its overall debt levels (<60% of GDP). Obviously, if those limits had been upheld during 1999-2009 the Eurozone would not be in quite the economic state it in which it now finds itself. But then of course in order to comply with these fiscal limits each member would have had to be "restructuring" constantly throughout 1999-2009. (This is the essence of the German argument, and we have some sympathy for this argument!)

In reality things always go wrong, sometimes terribly wrong; rules are made to be broken! Greece lied about its deficits and debt, for example. The market mispriced the debt of the southern Eurozone countries in 1999-2009 when global pools of capital were surging and looking for a home (as the result of a massive buildup in FX reserves and oil-fed sovereign wealth

funds). Structural imbalances developed; German competitiveness continued to improve while bureaucratic bungling, corporate featherbedding, and lax social and labor policies undermined competitiveness elsewhere. Indeed, the fiscal policies of many Eurozone members, policies that were promised to become synchronous with that in Germany upon entry, proved to be as lax as those policies followed before the Eurozone was formed – and which necessitated currency devaluation to correct.

From my perspective, only an economic fool would assume that structural imbalances will not occur among countries in a fixed exchange rate system. The history of the international monetary system is colored with economic imbalances that necessitated gut-wrenching currency devaluations at regular intervals. Such imbalances develop naturally, be it from an asymmetric economic or political shock, divergent fiscal or social policies, technological changes, or sudden shifts in economic policies by a new government.

For example, the greatest economic shift in the history of the world has come about because of changes in policy by the Chinese government. (China's entry on the global economic stage might properly be dated as December 11, 2001 when China officially joined the World Trade Organization). Many observers keep forgetting just how China's emergence has necessitated major adjustments in Europe, in the US, in Canada, everywhere in fact! And China's emergence coincided approximately with the introduction of the euro – which made the Eurozone less flexible and accordingly less able to adjust to this development. (The many imbalances resulting from China's entry on the world economic stage are ongoing, and will continue to require difficult adjustments!)

The long and short of this essay comes down to the manner in which countries adjust to economic imbalances as they develop. For Canada the adjustment process includes, among other things, transfer payments to help with internal adjustment and a floating dollar to help with external adjustment. (Need it be pointed out again now that the dollar is at 80 cents just how a floating dollar tempers the "pain" of low oil prices in western Canada and boosts the competitive position of manufacturers in eastern Canada?)

So, the essential question for the Eurozone is how it will – and must – adjust to domestic imbalances? Germany is applauding itself as we write on having "*achieved a balanced budget earlier than planned*" (WSJ.com, 01/13). "'*This is a day of joy' said a senior finance ministry official*". But a balanced German budget does not make adjustment within the Eurozone any easier! Germany can help by expanding fiscal policy – not contracting fiscal policy; but Germany is unfortunately hard-wired to fight fiscal profligacy. Germany runs one of the biggest trade surpluses in the world economy precisely because 1) that's the way it likes it and 2) any loss of foreign market share means German workers will bear down and "*do more for less*" in order to regain lost market share.

How does Greece go up against that? How does Italy … without a lira that can be devalued as needed?

In short, Germany should not be in a currency union with Greece or Italy!

Ergo, in my view Eurozone crises are baked into the cake. My preferred solution is a split in the Eurozone, with Germany and a few others (the Netherlands, Finland, Austria?) departing the Eurozone and adopting a new currency – DM2. The ECB may then move to Paris and take up its duties as the central bank for those remaining in the Eurozone (France, Spain, Italy and other, smaller countries including Greece). The ECB may print to its heart's desire, and devalue the euro against the DM2. 40% would be a good devaluation! Euro-denominated debt owed to the DM2-block will not change, but the value of this debt will obviously decline in DM2 terms. *C'est la vie* – Germany et al are not going to receive full value for what has been lent; no one should

doubt this. But the southern half has a chance of growing out of its depression in this instance (which is also what the economic history books tell us about how countries escaped the Great Depression in the 1930s).

Update …

1. Since the above comments were penned the ECB introduced a larger-than-expected package of monetary stimulus (it's version of quantitative easing), which will increase the ECB's balance sheet by 50% or so. The ECB will buy €60 billion of debt monthly, starting in March and it will continue to do so through at least September 2016. So, the question is: Will this help the Eurozone?

Unfortunately, it will do little more than buy more time for governments to address the fundamental problems of competitiveness. Assuming this QE results in somewhat higher inflation and somewhat higher growth rates in the Eurozone, it should get the voters off the backs of governments and allow policymakers to refocus on restructuring, if they choose to do so. If not, ECB QE will come to naught.

We wrote in the Gold Monitor of January 23 that "*the fundamental problem is inter-Eurozone competitiveness, and ECB largesse does little to tackle this problem directly. As the euro declines, it makes Greek goods more competitive internationally, but also German goods. Greek goods do not become more competitive relative to German goods … a cheaper euro will boost foreign demand for Eurozone goods, but not German demand for Spanish, Italian, or Greek goods*".

The final paragraph of the ECB statement kind of sums it up: "*Monetary policy is focused on maintaining price stability over the medium term and its accommodative stance contributes to supporting economic activity. However, in order to increase investment activity, boost job creation and raise productivity growth, other policy areas need to contribute decisively. In particular, the determined* ***implementation of product and labour market reforms*** *as well as actions to* ***improve the business environment*** *for firms needs to gain momentum in several countries. It is crucial that* ***structural reforms*** *be implemented swiftly, credibly and effectively as this will not only increase the future sustainable growth of the euro area, but will also raise expectations of higher incomes and encourage firms to increase investment today and bring forward the economic recovery*" (bolding added).

2. Greece elected a new government on January 25. Although the last votes were still being counted at the time of writing, Syriza looks to have won 149 seats in the Greek parliament – just shy of the 151 seats needed for an outright majority. Mr. Tsipras, the Syriza party leader, will have three days to form a coalition government before the mandate passes to the New Democracy, which won 76 seats, the second most. Thereafter the mandate passes to the party with the third most votes (Golden Dawn?). If no party is able to form a coalition government a new election will have to be called.

Assuming Mr. Tsipras is able to form a coalition government, he will become Greece's prime minister. Over the last several weeks, Mr. Tsipras had softened his stance on anti-austerity measures and on exiting the euro. However, he still plans to renegotiate the terms of the €322bn debt Greece owes (see table herewith), which amounts to 175% of GDP. It's too early to tell what will unfold but Mr. Tsipras is adamant about reducing debt payments and rescheduling debt, while the Troika is adamant that this cannot happen, so we will wait and see.

Greece's Debt **(in billions of Euros)**

225	**Total loans from public sector**
53	Loans from Eurozone governments
143	Loans from EFSF
29	Loans from IMF
97	**Bonds held by private sector, NCBs & ECB**
322	**Total Debt Outstanding**

Source: IMF, European ***Commission, and DCM Economics***

The Canadian Dollar, Commodity Prices, and More Interest Rate Cuts?

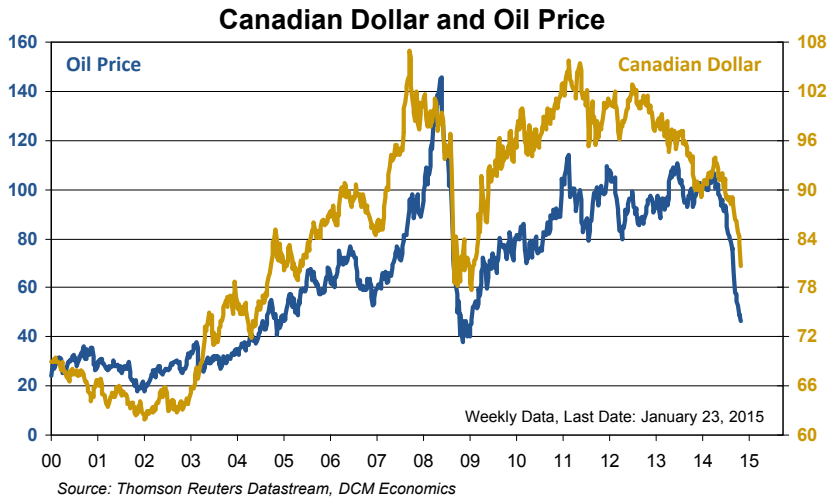
by William Tharp

The boom is over for oil and natural gas. Energy is for Canada what iron ore is for Australia. Australia cut interest rates seven times between November 2011 and August 2013 as the effects of waning Chinese growth on iron ore (and commodity prices) began to curb Australian growth.

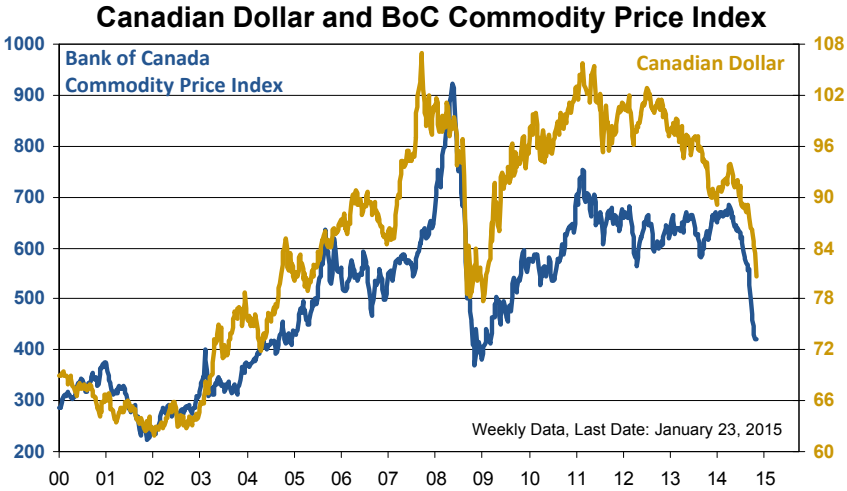
Canada in contrast has room for only three more cuts. With the US economy still reasonably strong (though that strength is becoming suspect), Canada might not need to use up all her ammunition. We are expecting a second rate cut in March but more cuts might follow if inflation is below zero from April to November, oil does not find a bottom near $45 or if Chinese and global growth continue to ebb as 2015 progresses.

The weaker dollar should boost growth in manufacturing and help exports, as well as increase import prices to discourage imports. Some of the developing energy sector weakness should accordingly be offset by stronger growth in Eastern Canada.

Current conditions could see the loonie falling to 75 cents, as forecast in our baseline scenario. In the event the Fed raises rates (not forecast in the baseline scenario) then the Canadian dollar may well go lower yet. With the IMF having downgraded the global economy, most commodity prices (except gold) will continue to be a major headwind for the loonie.



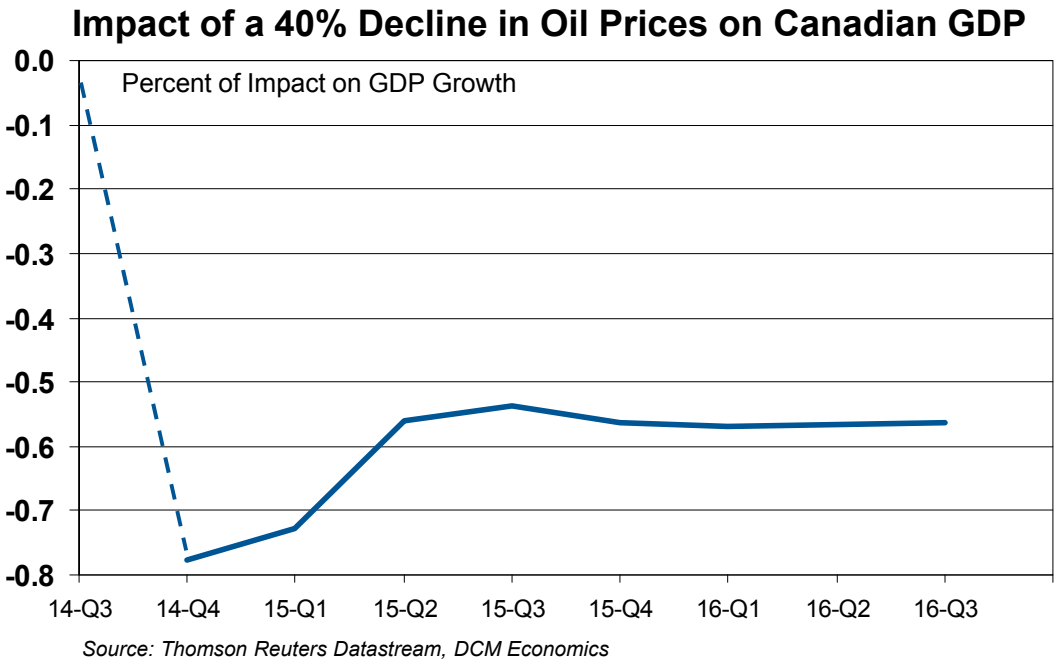
Source: Thomson Reuters Datastream, DCM Economics



Source: Thomson Reuters Datastream, DCM Economics

The Impact of Lower Oil Prices on the Canadian Economy

by Rasim Jafarov



Source: Thomson Reuters Datastream, DCM Economics

The collapse in oil prices in recent months has undermined not only the Canadian dollar but also growth prospects for the Canadian economy. If the oil price remains at current levels for the next year, and assuming that the country will export the same volume of crude oil in 2015, the collapse in the oil price will cost the Canadian economy about $60 billion in lost export revenues in 2015 (which amounts to roughly 3.0% of nominal Canadian GDP).

The chart above was first featured in our November 5, 2014 *Market Note*, in which we discussed the impact of a 18.5% decline in the oil price after 2014-Q3. However, the chart above has now been updated to account for a 40% decline in oil prices.

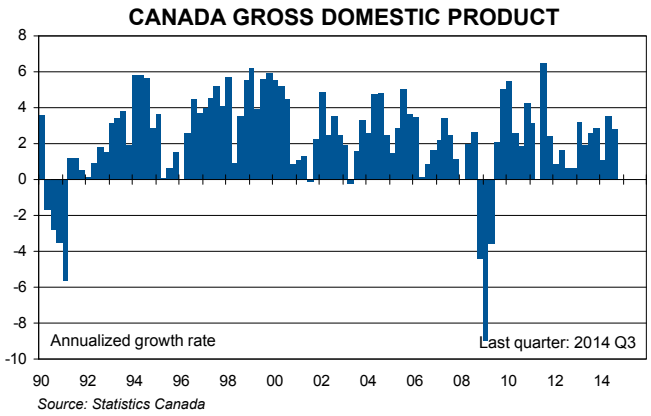
The chart indicates that Canadian growth is affected (versus what it would have been) by -0.7% and -0.8% respectively in the first two quarters after 2014-Q3. Thereafter the impact is expected to narrow to about -0.6% because of the anticipated rise in consumers' (non-energy) disposable income.

These estimated impacts on GDP growth are significant given the already meager growth rates in recent quarters (2.5% on average over the first three quarters of 2014). The Bank of Canada will have completed a similar analysis, which will have been one of the deciding factors in the move to cut interest rates on January 21.

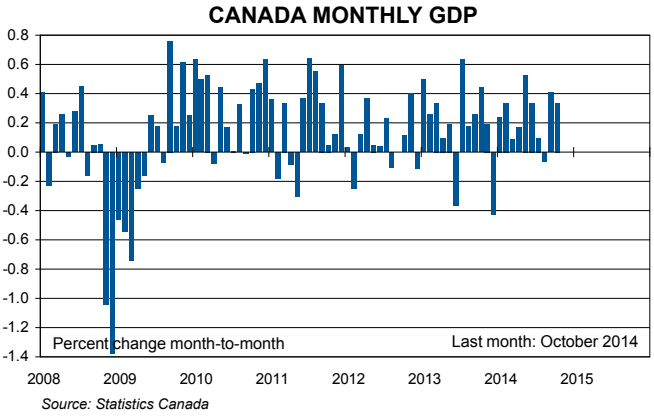
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Full year 2014 economic growth is expected to be 2.5% and a modest 2.0% in 2015.

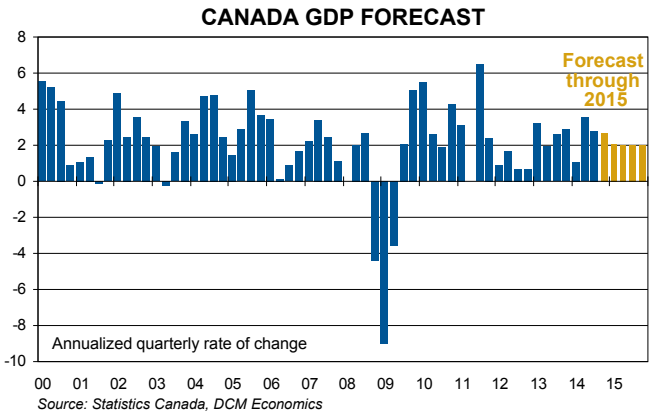
Growth was above trend in the second and third quarters, partly the result of a rebound from a depressed first quarter.



For the twelve months ending in October growth was 2.3%.



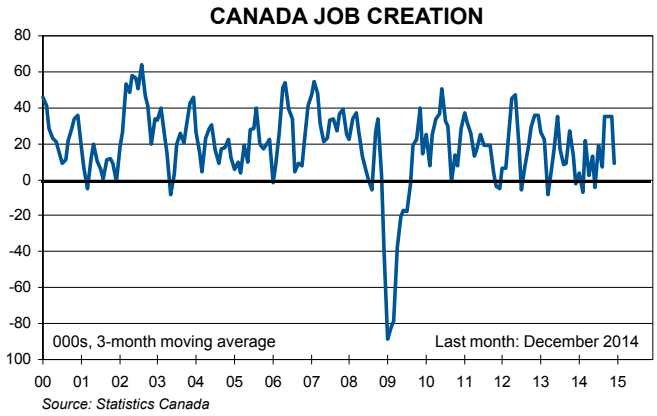
In 2015 we expect an average growth rate of 2%. The lower Canadian dollar will help but resource sector investment is apt to be sharply lower.



MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Over the latest twelve months industrial production was up 3.4%, down from 3.8% in September.

Job creation appears to be weakening.



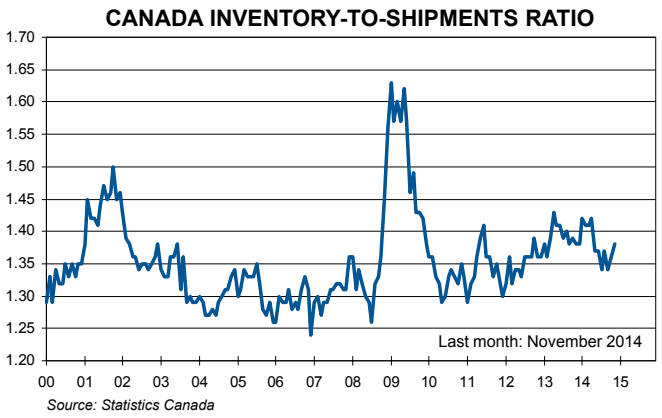
The unemployment rate was 6.6% in both November and December, up slightly from its low to date.

MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Further weakening of the loonie will help shipments, but slowing global growth will be a challenge.

New orders show signs of weakening.

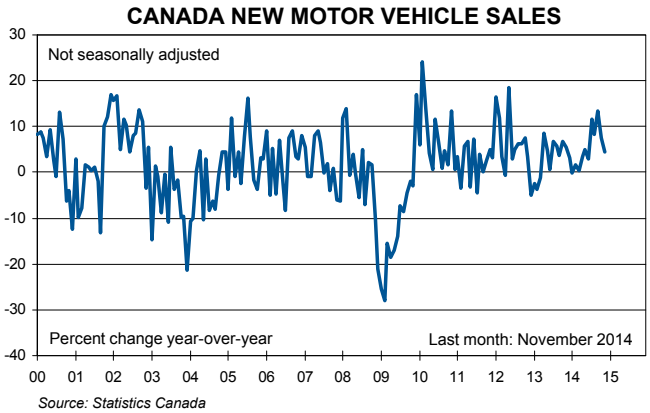
The inventory ratio looks a touch high.



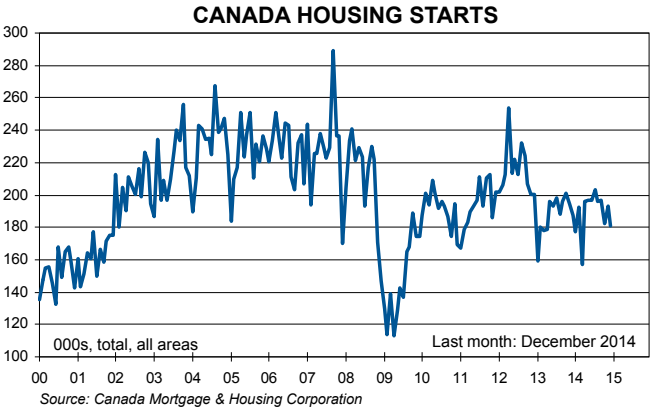
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Retail sales have been stuck at the same level for the last five months ...

... and the growth in car sales has come down.



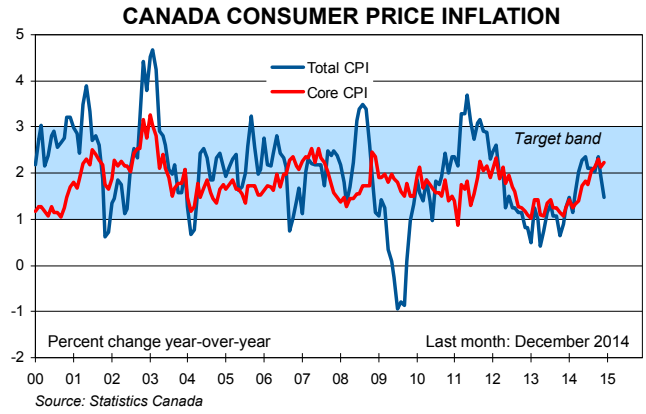
Housing starts appear to be cooling as well, as sales are beginning to slip.



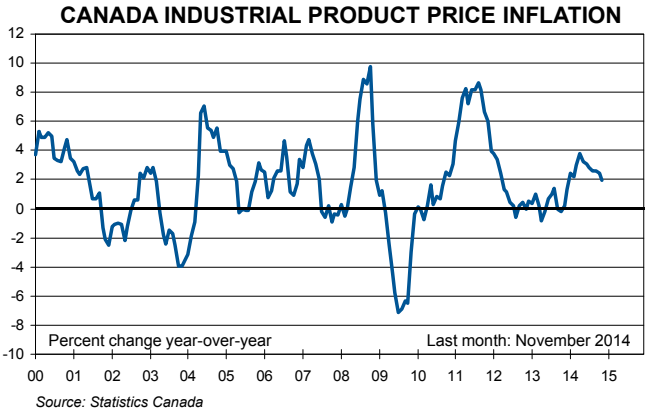
MONTHLY REVIEW ►
CANADA – INFLATION

With oil prices falling more than originally expected, headline inflation will be very low in 2015.

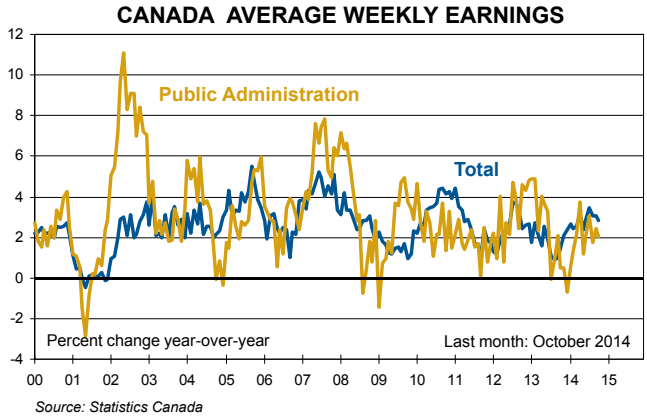
Headline inflation fell from 2.0% in November to 1.5% in December. It will likely be lower yet by spring.



Industrial product price inflation fell to 1.9% in November and will likely be close to 1.0% for December.

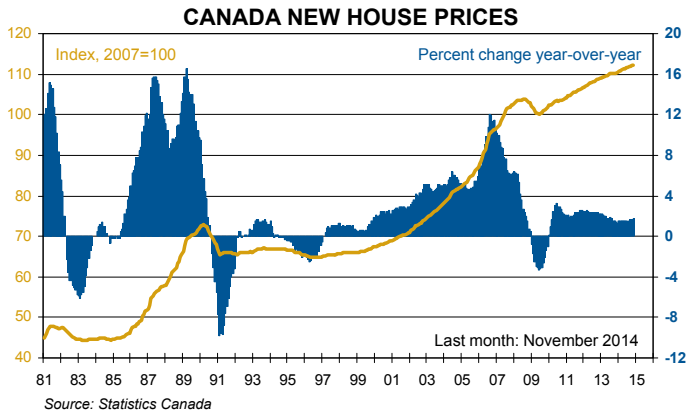


Average weekly earnings slipped back to 2.8% in October.

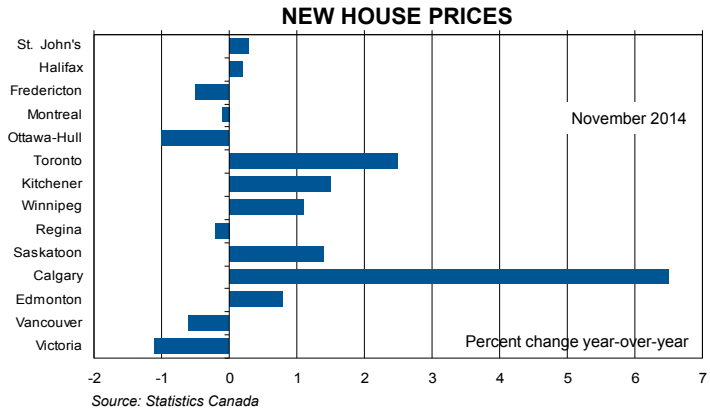


MONTHLY REVIEW ► CANADA – INFLATION

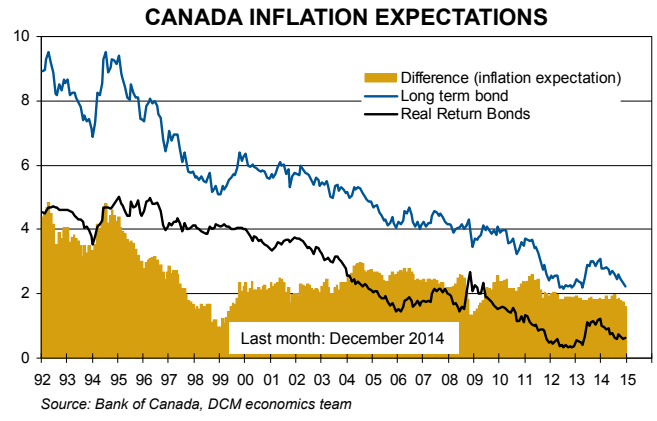
New home prices rose 1.7% in November from a year earlier, but the month-over-month rate of increase is slowing.



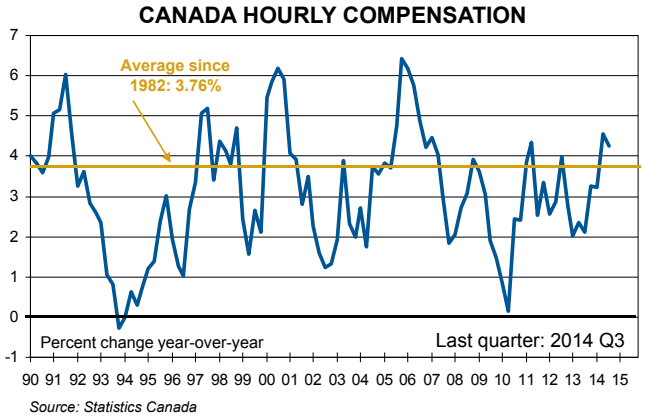
Calgary leads the pack for new house price increases, but activity is slowing sharply as the oil boom turns to bust.



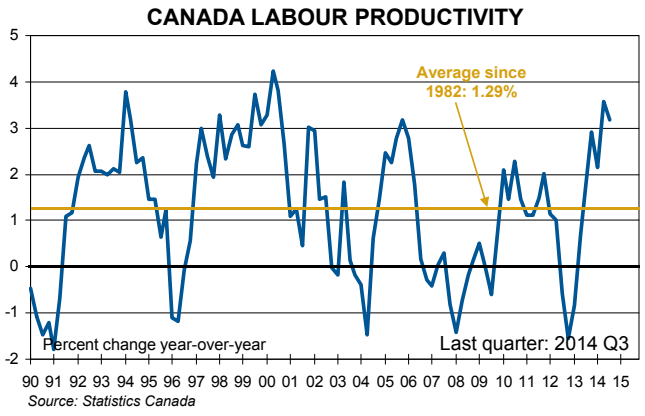
Inflation expectations are falling back.



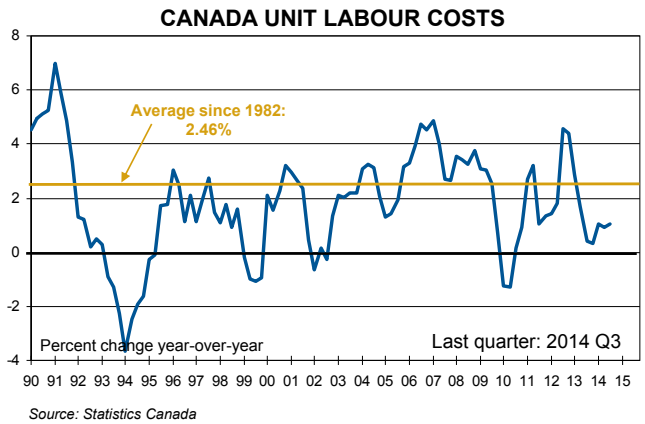
Hourly compensation increases averaged 3.8% over the last four quarters.



Labour productivity increased 3.0% over the last four quarters ...



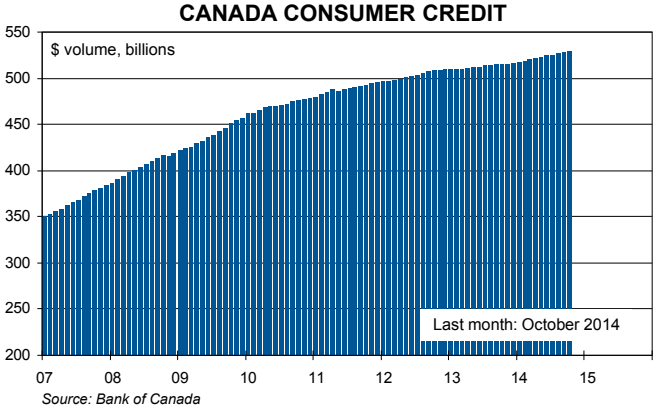
... leaving unit labour costs up only 0.8%.



MONTHLY REVIEW ►
CANADA – DEBT AND CREDIT

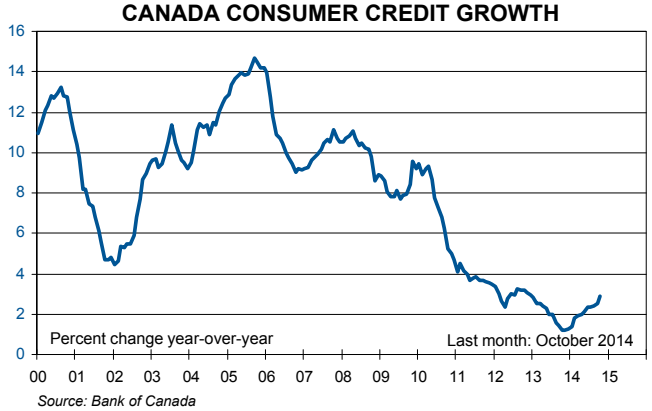
Consumer credit growth is slow but accelerating; mortgage credit growth remains modest while business credit growth has been strong.

CANADA CONSUMER CREDIT



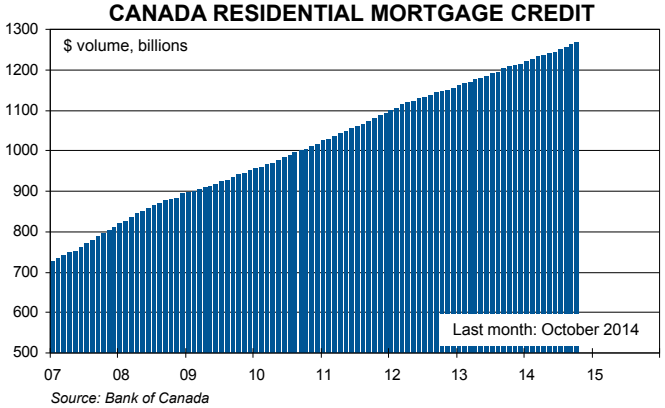
Source: Bank of Canada

CANADA CONSUMER CREDIT GROWTH



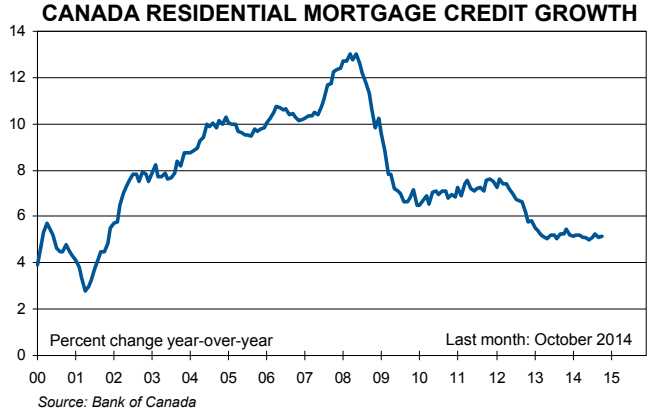
Source: Bank of Canada

CANADA RESIDENTIAL MORTGAGE CREDIT



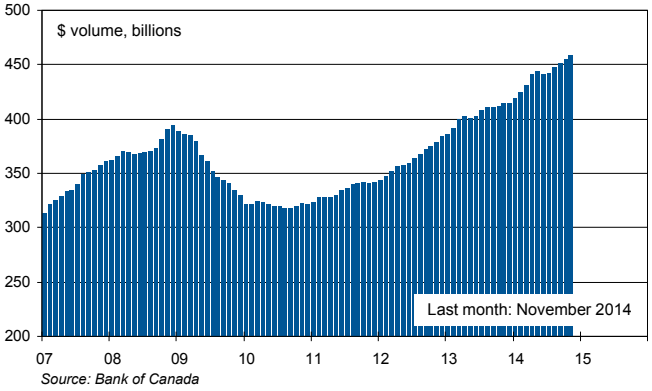
Source: Bank of Canada

CANADA RESIDENTIAL MORTGAGE CREDIT GROWTH



Source: Bank of Canada

CANADA SHORT-TERM BUSINESS CREDIT



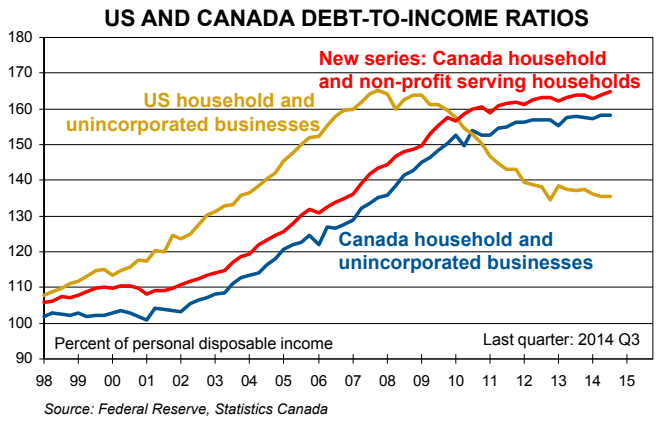
Source: Bank of Canada

CANADA SHORT-TERM BUSINESS CREDIT GROWTH

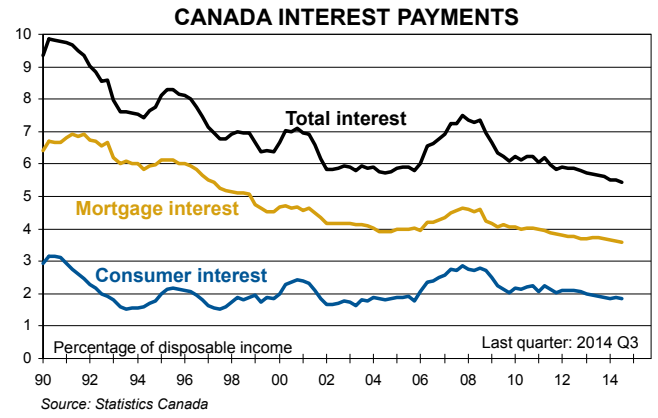
Source: Bank of Canada

MONTHLY REVIEW ►
CANADA – WEALTH CREATION

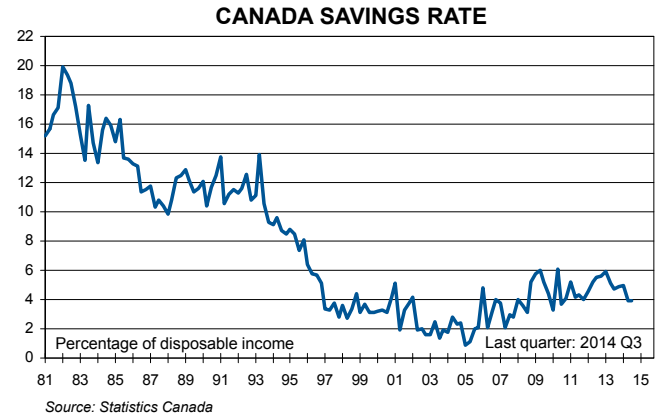
Canadians' ratio of debt-to-income is still rising thanks to low interest rates.



Even with debt balances increasing, total interest paid is still declining however.

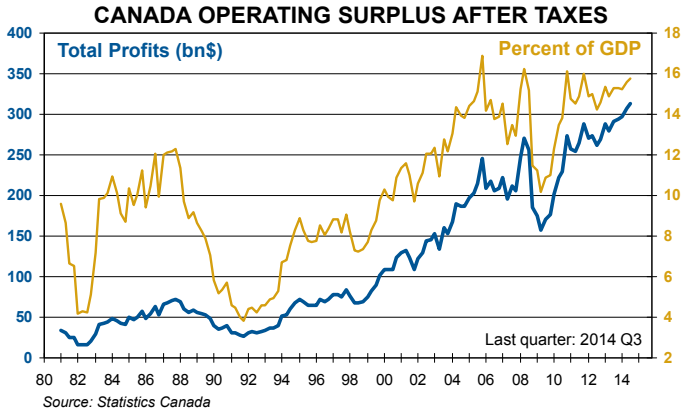


The savings rate has also been declining lately.

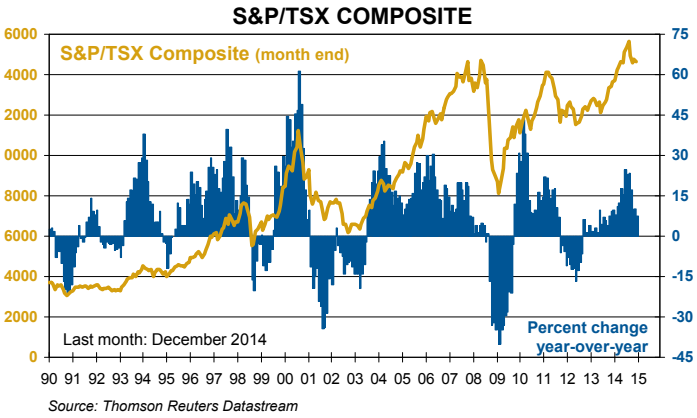


MONTHLY REVIEW ►
CANADA – WEALTH CREATION

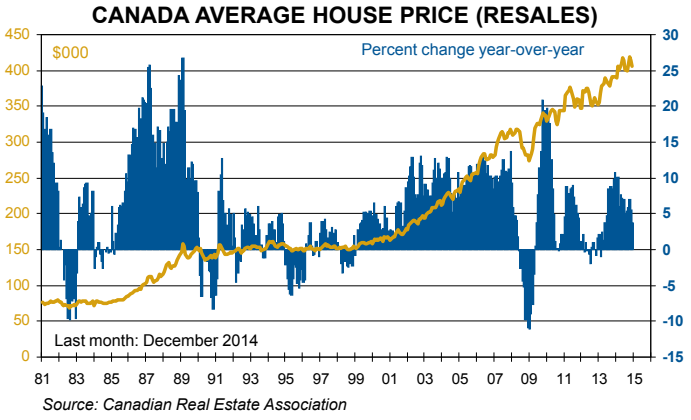
Profits were rising through the third quarter (the falling loonie is helping) but conditions are becoming tougher for the natural resource sector – and probably for banking too.



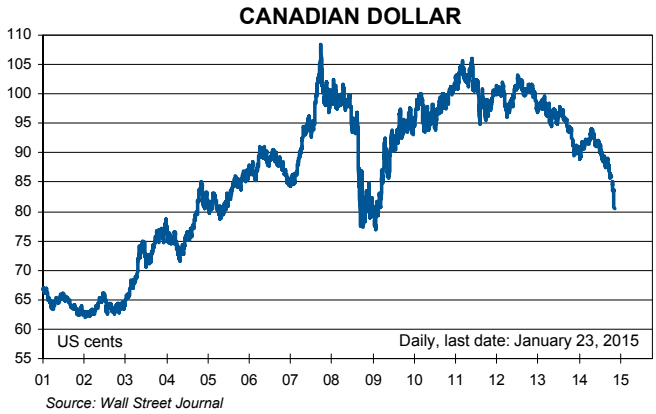
The TSX has stumbled lately, though the recent interest rate reduction provides a cushion.



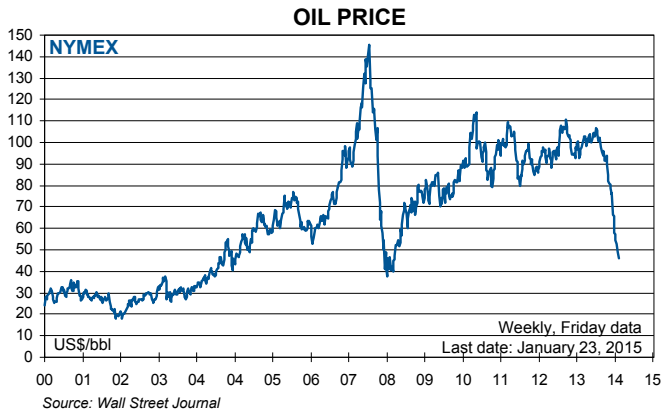
Resale house price increases appear to be slowing.



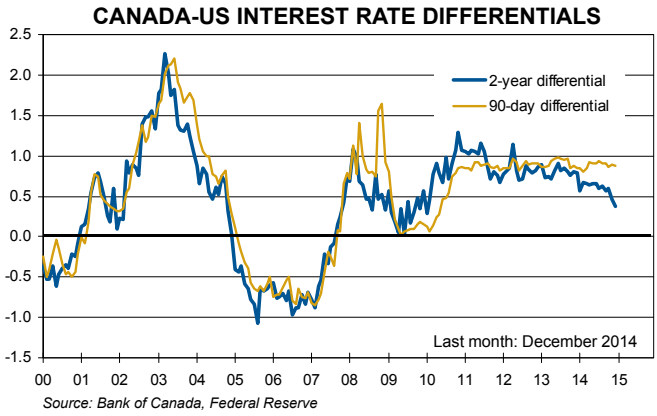
The Canadian dollar continues to plummet. Not only are commodity prices falling but interest rates are falling too!



Oil prices likely haven't bottomed yet. The weakness has spread to natural gas prices.

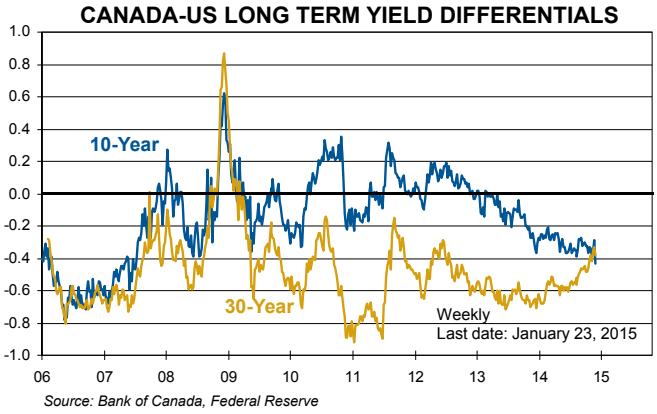


Canada retains an advantage in short-term rates but this is now being eroded.

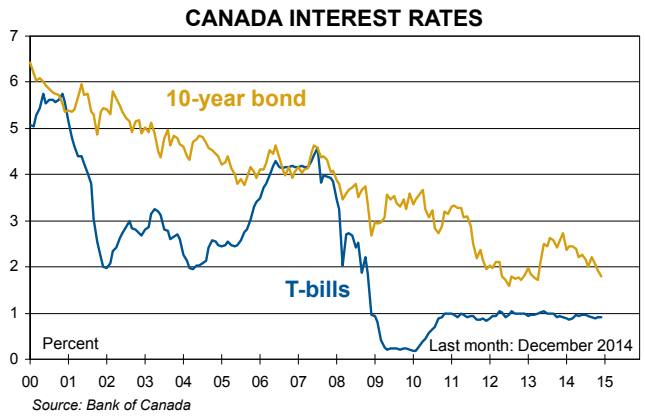


MONTHLY REVIEW ►
CANADA - FINANCIAL MARKETS

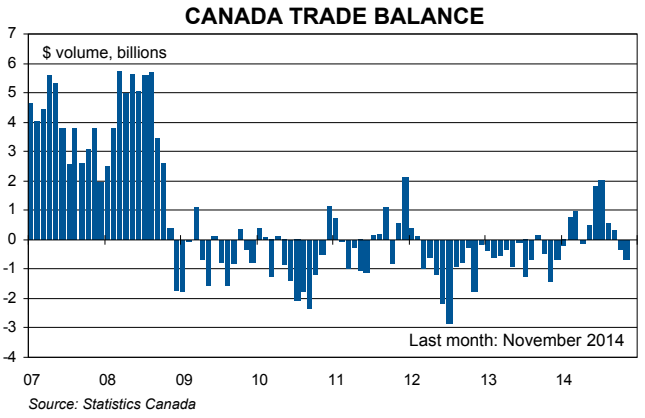
Longer-term yields remain lower in Canada, and are setting new historic lows.



The rate cut on January 21 could well be followed by one in March.



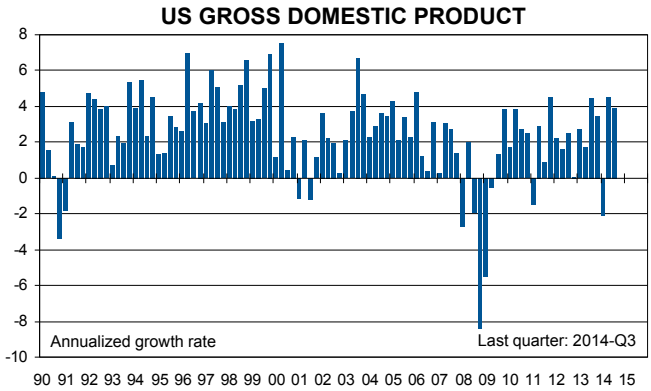
Canada's trade balance has fallen back into the red.



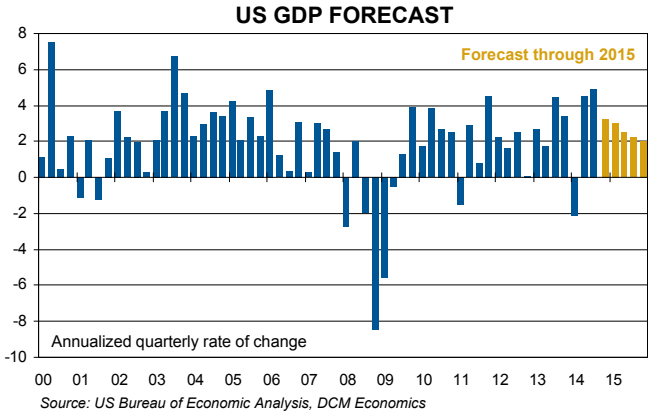
MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

Growth for 2014 will likely be about 2.4%, with a similar pace in 2015.

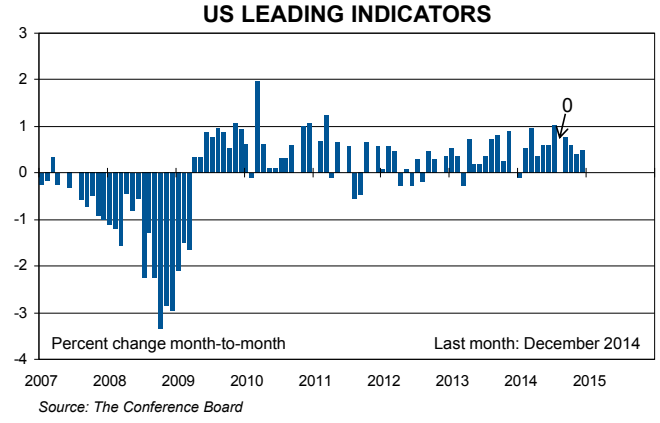
Third quarter growth was revised up to 5.0%. Despite two successive strong quarters average growth for the first three quarters was only 2.4%, which suggests much of the improvement represented a catch-up following a weak first quarter.



Future growth is apt to be slower – initially above potential (which may be about 2.2%) but eventually succumbing to weaker energy investment and weaker net trade.

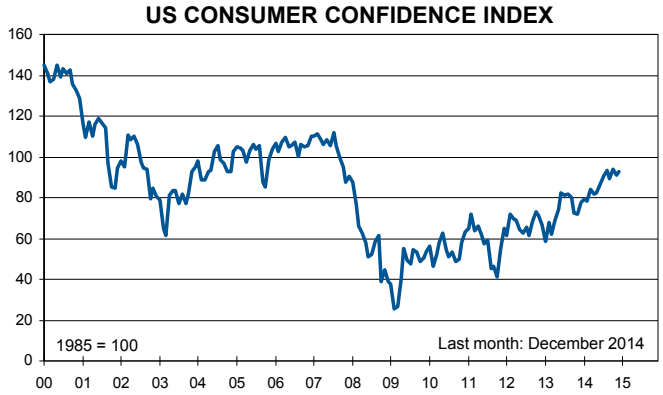


The leading indicators have been moderately strong but over-reliant on equity market gains which signal strong baby boomer investment needs, rather than a strong economy.



MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

Consumer confidence has moved sideways in recent months ...



Source: The Conference Board

... even though job creation has been strong ...

Source: US Bureau of Labor Statistics

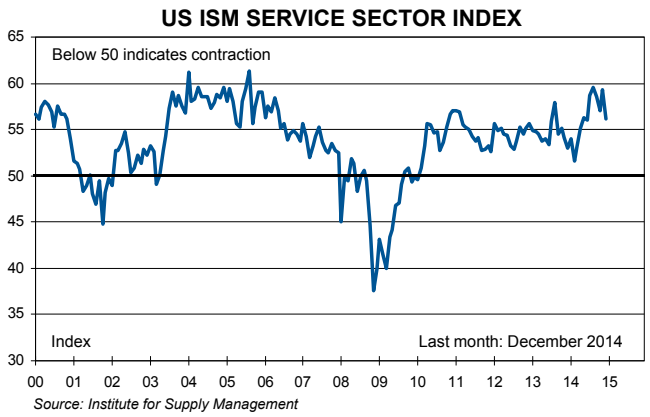
... and the unemployment rate continues to sink.

Source: US Bureau of Labor Statistics

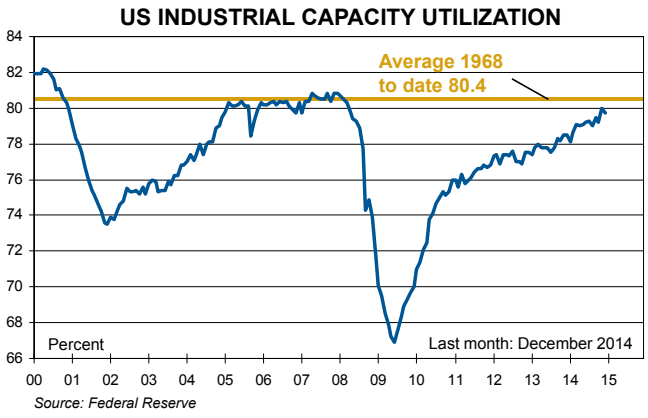
MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

The manufacturing index has fallen back considerably of late but remains at a moderately high level.

The service sector index has also fallen back.

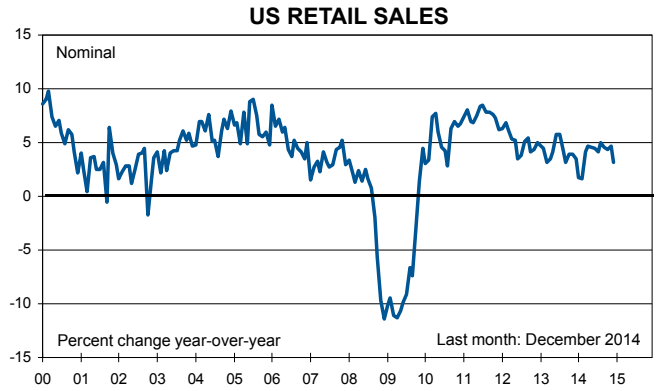


Industrial capacity utilization continues to improve.



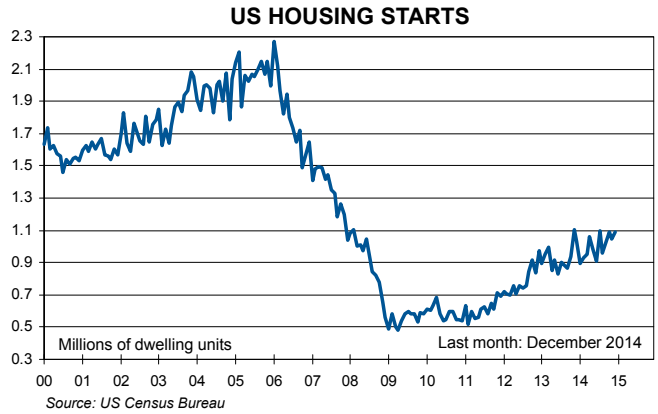
MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

Retail sales were slightly weaker than expected in November/December even after allowing for the effect of lower gasoline prices on sales totals.



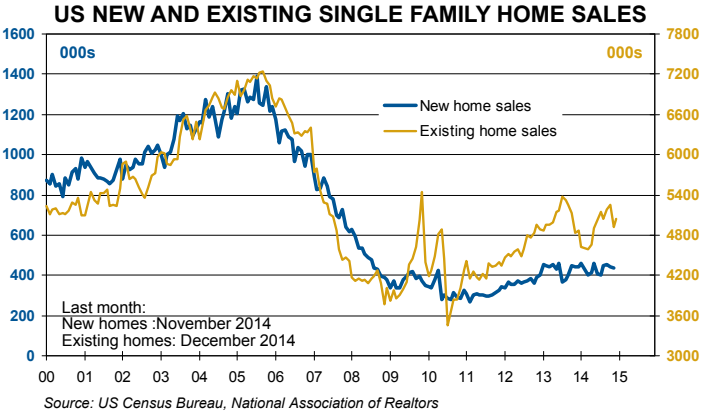
Source: US Census Bureau

Housing starts are flattening out, probably in response to rising prices. Mortgage rates are falling, however, and credit requirements are being eased.



Source: US Census Bureau

New home sales have been flat for some time; many builders are targeting upscale buyers. Existing home sales show no clear pattern.

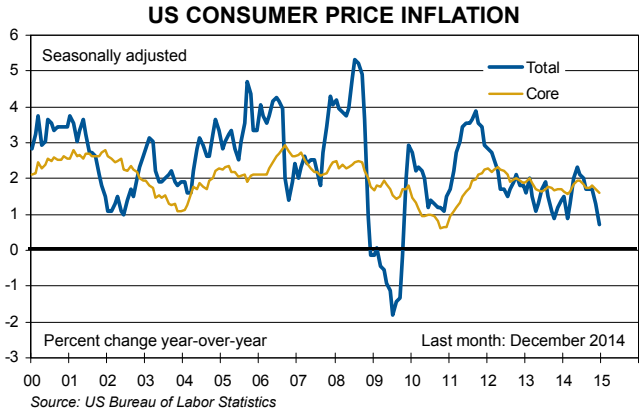


Source: US Census Bureau, National Association of Realtors

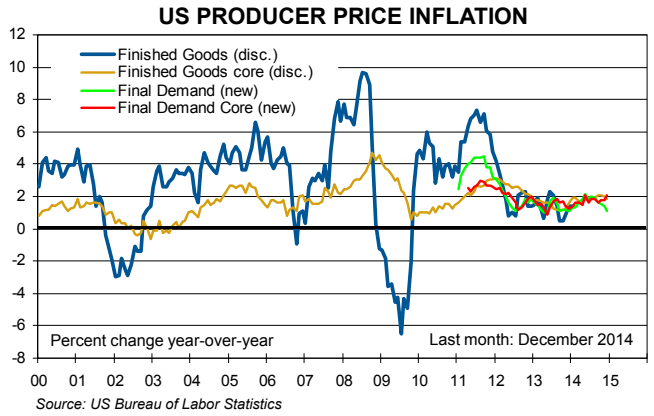
MONTHLY REVIEW ►
UNITED STATES – INFLATION

CPI looks set to turn negative for about three months this spring.

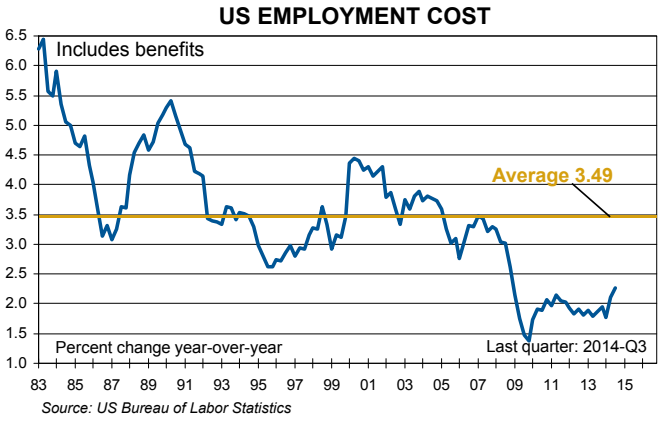
Headline inflation fell to 0.8% in December, while the core rate edged down to 1.6%.



Producer price inflation rose 1.1% over the latest twelve months (down from 1.4% in November).



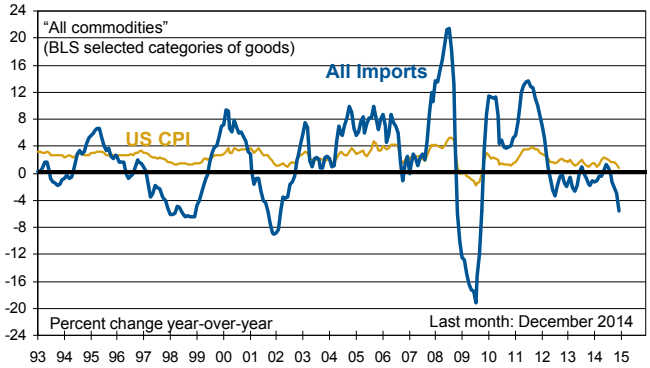
Employment costs (including benefits) rose more rapidly in the third quarter (the wage component was up 2.1%).



MONTHLY REVIEW ►
UNITED STATES – INFLATION

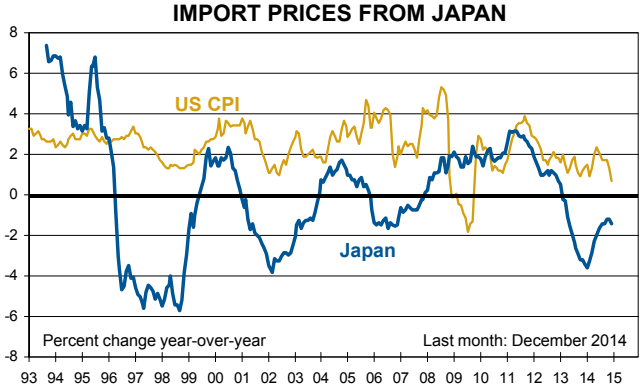
Import prices are dragging down overall inflation. But it is not just because of falling oil prices. Manufactured goods from Japan and China are contributing. And soon European import prices are likely to start falling also due to the plummeting value of the euro.

IMPORT PRICES – ALL IMPORTS



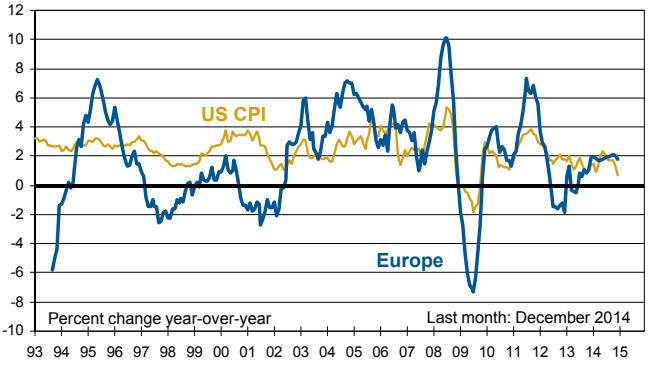
Source: US Bureau of Labor Statistics

IMPORT PRICES FROM JAPAN



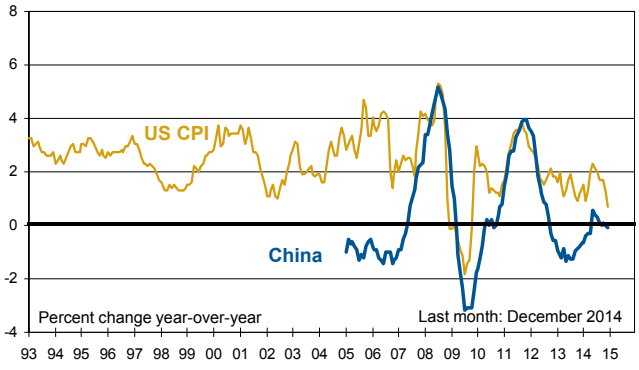
Source: US Bureau of Labor Statistics

IMPORT PRICES FROM EUROPE



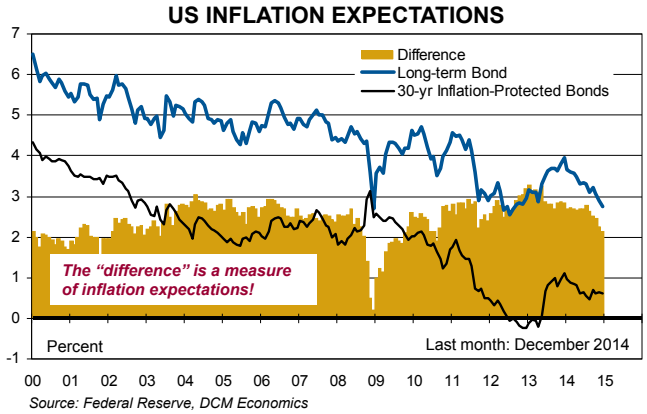
Source: US Bureau of Labor Statistics

IMPORT PRICES FROM CHINA

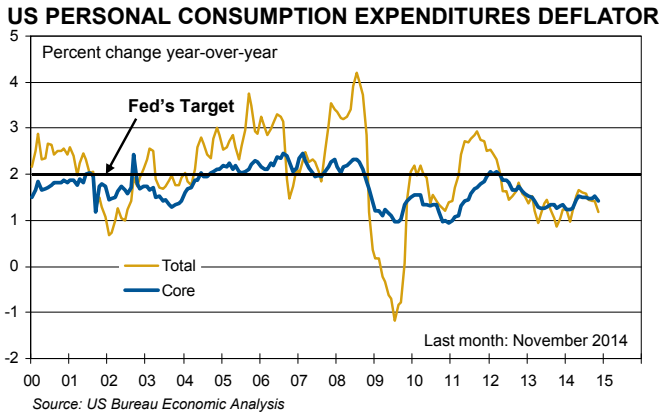


Source: US Bureau of Labor Statistics

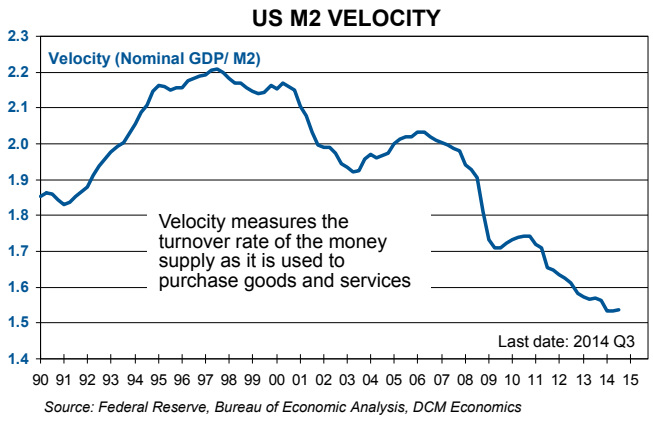
Inflation expectations continue to fall.



The PCE deflator (the Fed's favourite inflation indicator) is even lower than CPI.

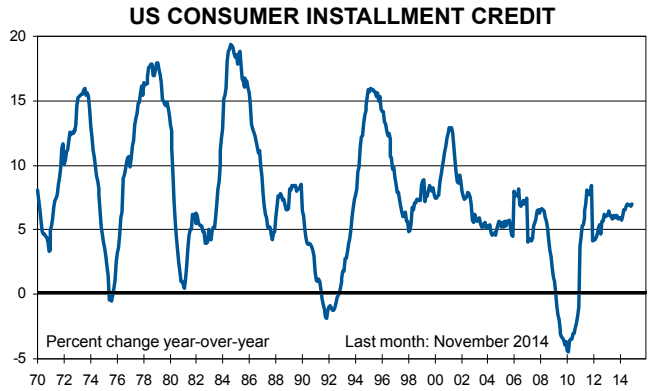


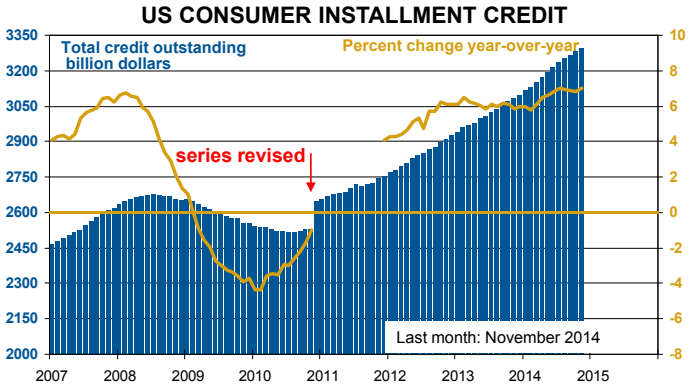
Velocity remains very weak but may be flattening out.

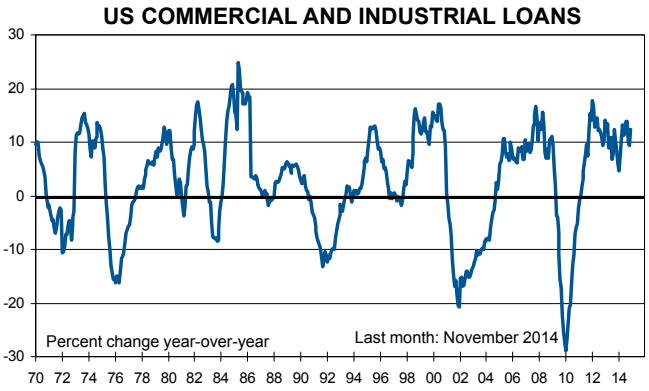


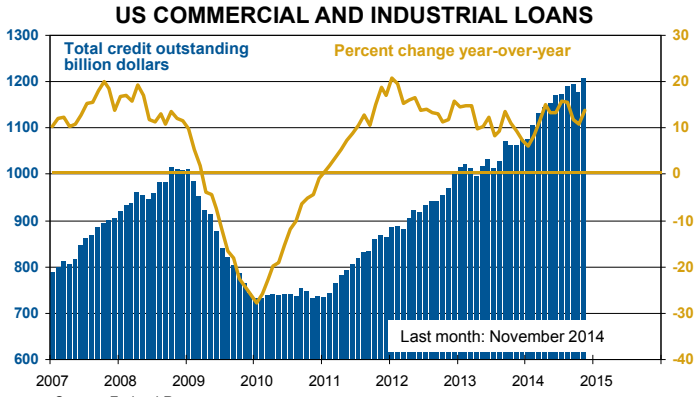
MONTHLY REVIEW ►
UNITED STATES - CREDIT GROWTH

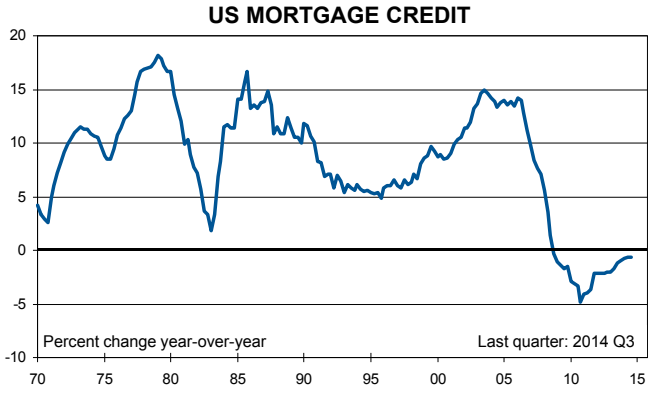
Credit growth remains somewhat limp compared with past cycles, and mortgage credit was still contracting in the third quarter.

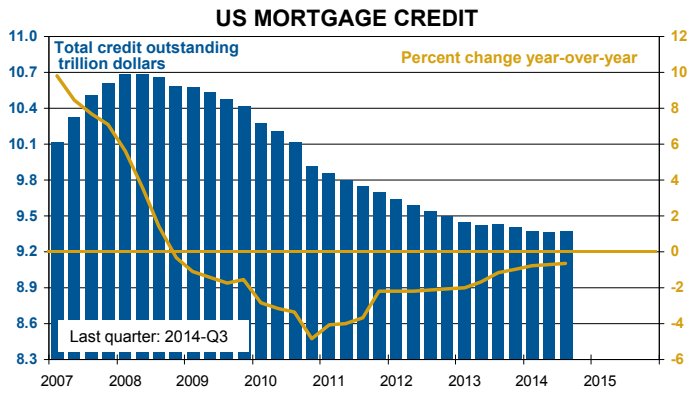








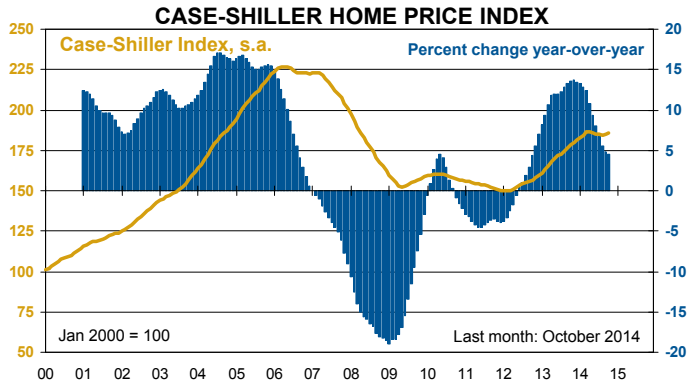




Source: Federal Reserve

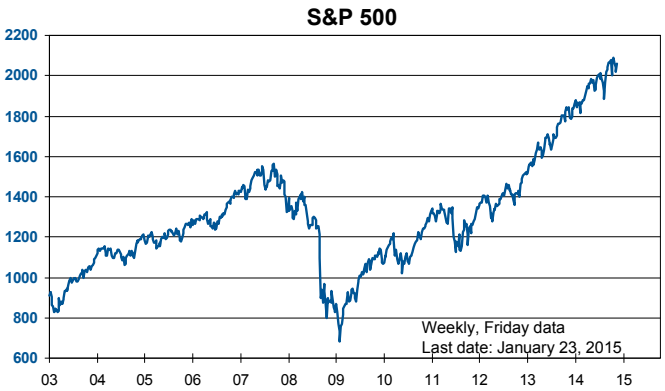
MONTHLY REVIEW ►
UNITED STATES - WEALTH CREATION

Month-to-month house prices resumed falling in October, with the year-over-year rate of increase continuing to slow.



Source: Thomson Reuters Datastream

Asset prices continue to set new highs (stocks and bonds) as baby boomers buy ahead of retirement.



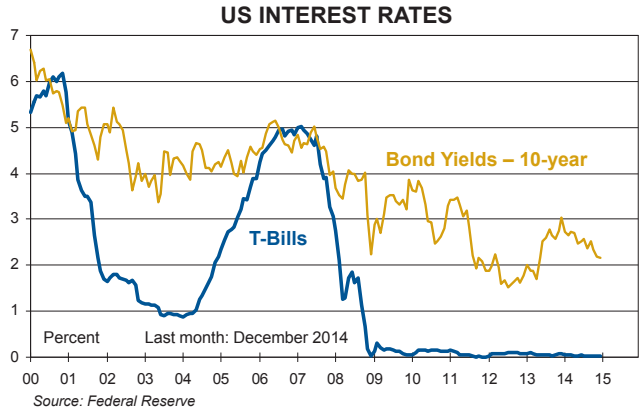
Source: Thomson Reuters Datastream

The personal savings rate continues to fall – consumers can't resist those cheap car loans. Rising student loans are also paying a role (higher tuition costs).

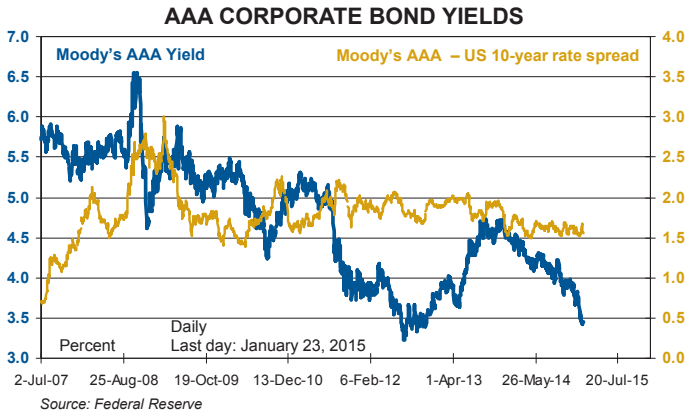
Source: US Bureau of Economic Analysis

MONTHLY REVIEW ►
UNITED STATES – FINANCIAL MARKETS

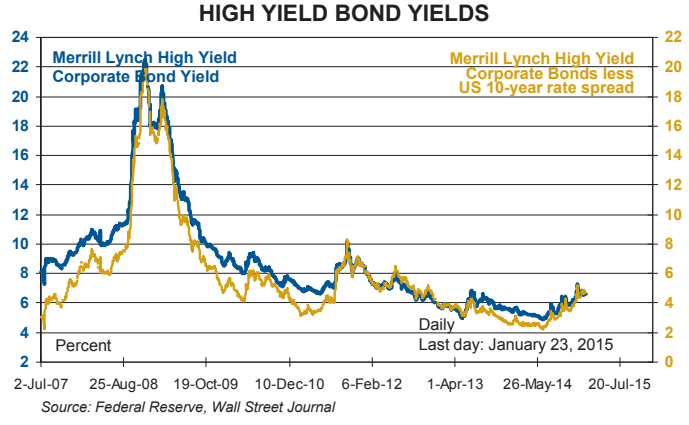
The odds of a Fed rate hike this year are below 50% and falling.



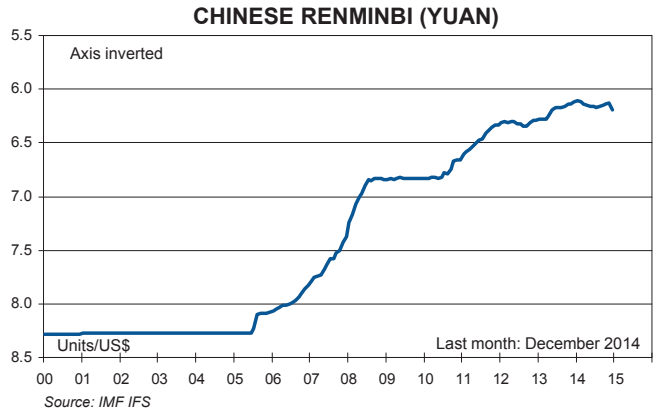
The best quality corporate bond yields are following treasury yields down.



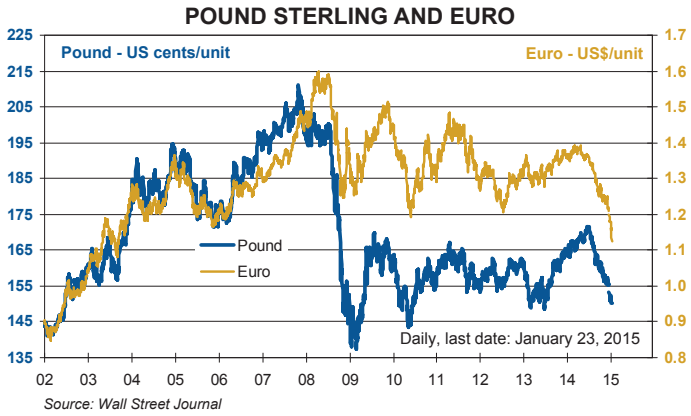
High-yielding bond yields have risen reflecting rising default risk, especially in the energy patch.



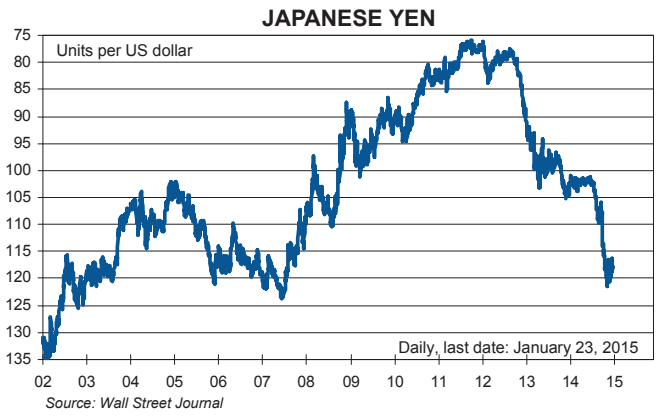
The renminbi has been allowed to fall recently amid reports of capital leaving China.



The euro continues to plunge, taking the pound with it.



The yen has “stabilized” for the moment, attracting some haven inflows (??).

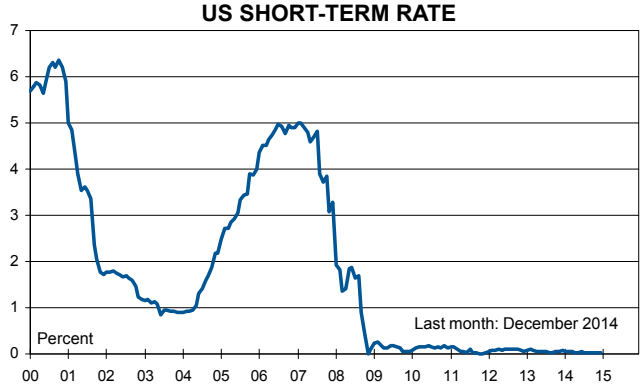


MONTHLY REVIEW ►
INTERNATIONAL SHORT-TERM RATES

Neither the US nor Britain appears likely to raise policy rates this year.

Japan and the Eurozone are still attempting to loosen monetary policy.

US SHORT-TERM RATE



Source: Federal Reserve

UK SHORT-TERM RATE

Source: Thomson Reuters Datastream

GERMANY SHORT-TERM RATE

Source: Thomson Reuters Datastream

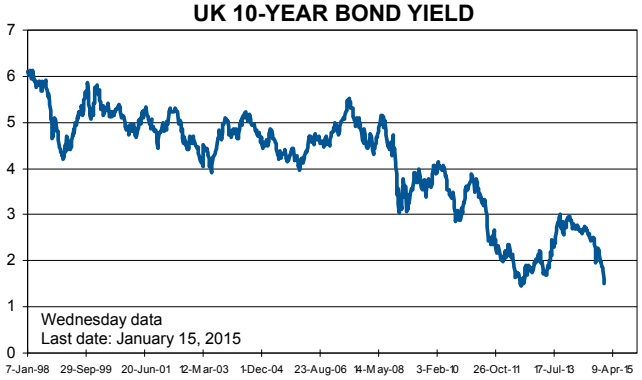
JAPAN SHORT-TERM RATE

Source: Thomson Reuters Datastream

MONTHLY REVIEW ►
INTERNATIONAL 10-YEAR YIELDS

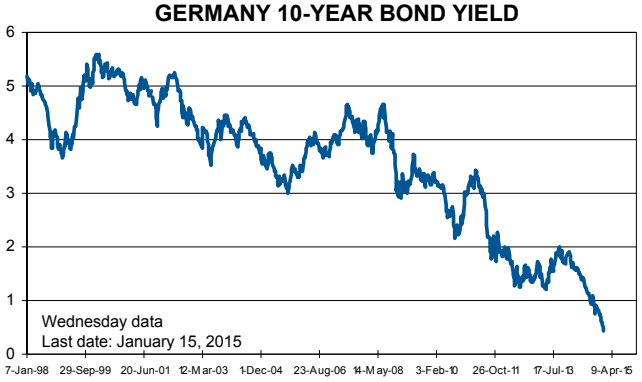
Weak growth and low inflation are pushing yields down in Europe and Japan. Low yields abroad will encourage foreign buying of US and British bonds, an important factor in holding down US and British yields.

UK 10-YEAR BOND YIELD



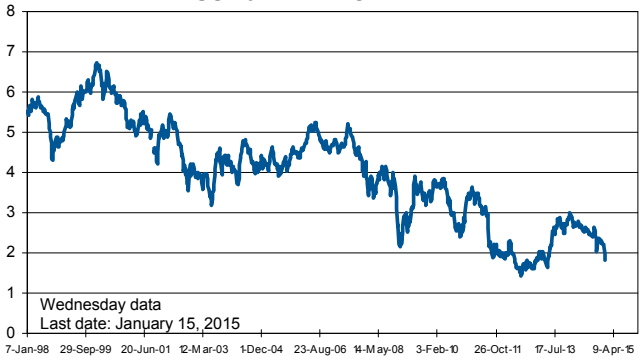
Source: Financial Times

GERMANY 10-YEAR BOND YIELD



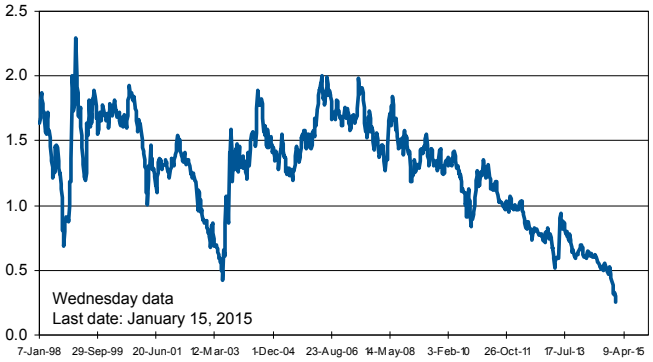
Source: Financial Times

US 10-YEAR BOND YIELD



Source: Financial Times

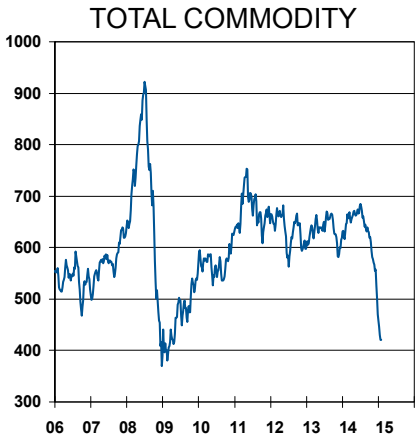
JAPAN 10-YEAR BOND YIELD

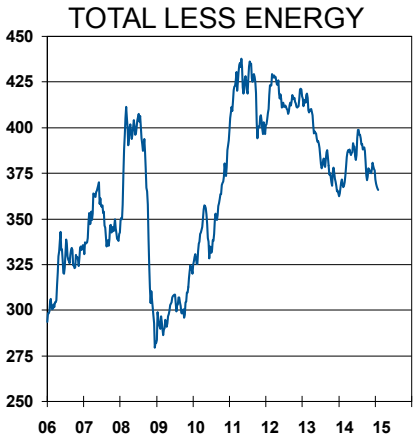


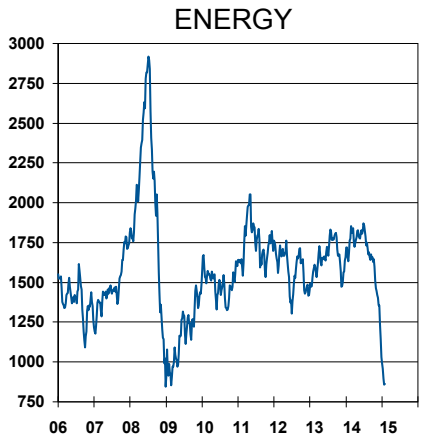
Source: Financial Times

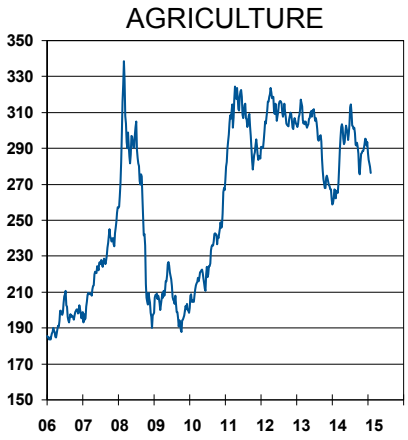
COMMODITY PRICES

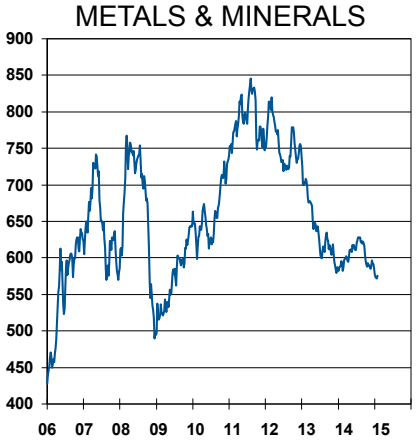
1. Bank of Canada Commodity Price Indices (Weekly data to January 23, 2015)







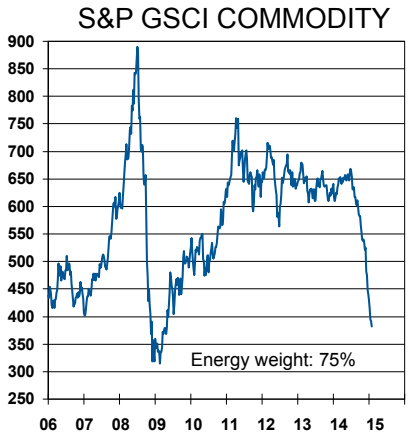


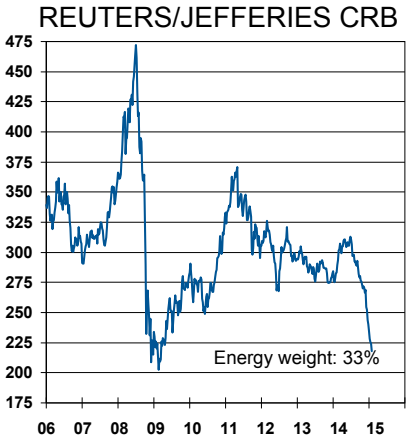


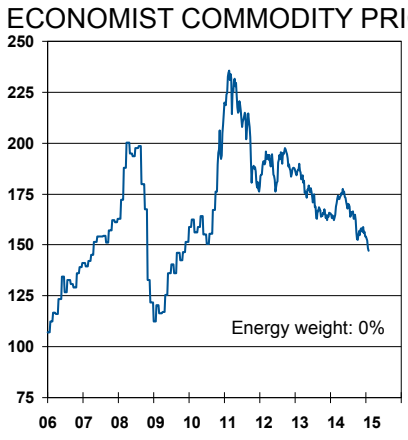
Most commodity prices are weakening in response to slowing global demand growth and rising supply.

The plunge in oil prices has pluses and minuses for other commodities: plus – potentially somewhat higher economic growth on the back increased disposable income (after energy expenses); minus – investment in the oil patch will decline and hence absorb less material resources.

2. Other Indices (Weekly data to January 23, 2015)







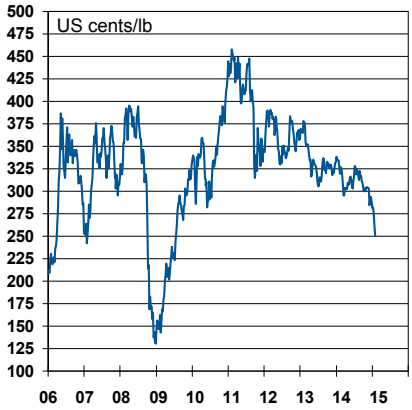
Sources: Bank of Canada, Thomson Reuters Datastream, The Economist

COMMODITY PRICES

3. Metals (Weekly data to January 23, 2015)

NICKEL

COPPER



ZINC

ALUMINUM

LEAD

GOLD

PLATINUM

SILVER

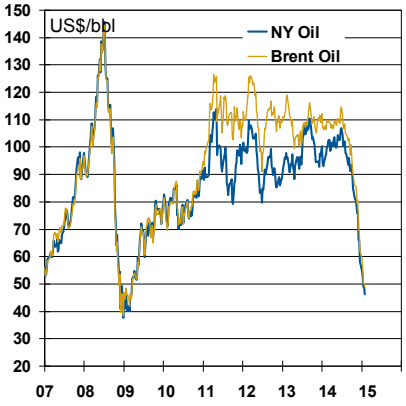
Metal prices have come down from their summer-time highs. The near-term outlook is clouded by oil price developments.

Sources: LME, LBMA, Wall Street Journal

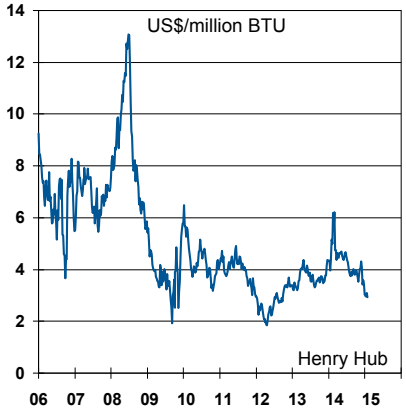
COMMODITY PRICES

4. Energy (Weekly data to January 23, 2015)

SPOT OIL PRICES



NATURAL GAS

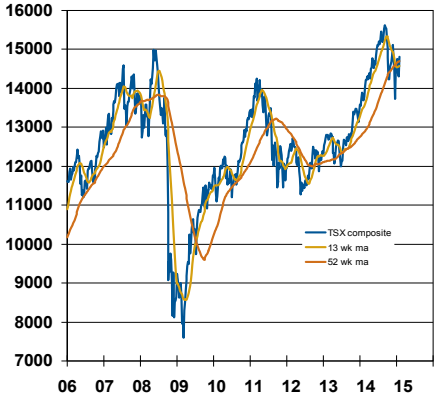


Oil prices have declined to (nearly) Great Recession lows and the outlook is precarious. Best to expect low oil prices for at least the first half of 2015!

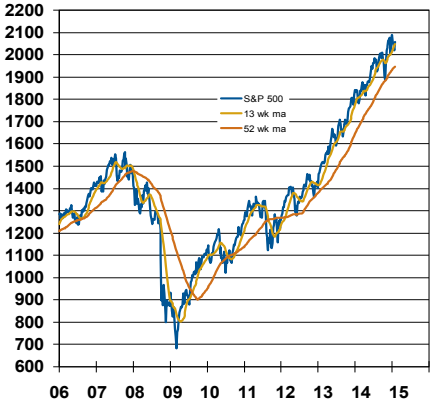
EQUITY MARKETS

5. North America (Weekly data to January 23, 2015)

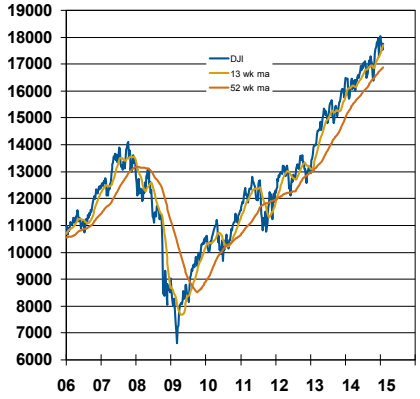
TSX COMPOSITE INDEX



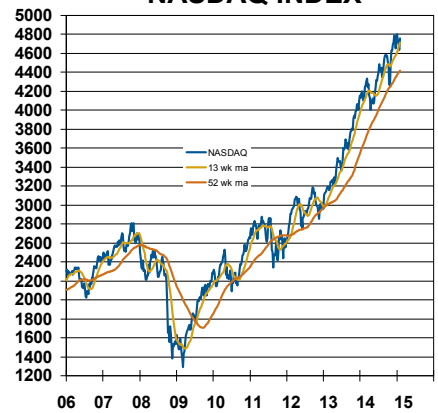
S&P 500 INDEX



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. That said, earnings growth is being revised lower and there will be volatility as the markets debate if/when the Fed will raise interest rates.

The decline in oil prices has been hard on the S&P/TSX, and we expect it to underperform the S&P500 in 2015. Overseas, large oil-importing countries have seen gains in their equity markets!

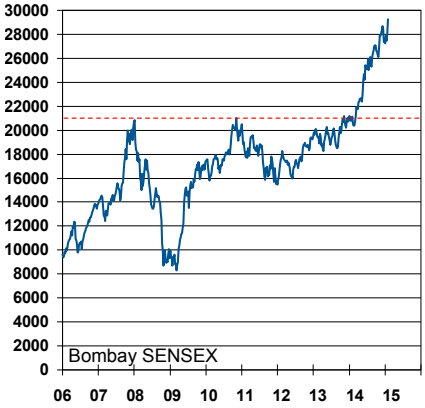
EQUITY MARKETS

6. Around the world (Weekly data through January 23, 2015)

JAPAN

GERMANY

INDIA



CHINA

RUSSIA

MEXICO

MSCI EAFE INDEX

BRAZIL

MSCI WORLD INDEX

Source: Thomson Reuters Datastream

Views contained in this report regarding a particular company, security, industry or market sector are the views of the writer and do not necessarily represent the views of Dynamic Funds, its affiliates and subsidiaries. Views expressed should not be considered a recommendation to buy or sell nor should they be relied upon as investment advice. Information contained in this report is current as of the date of publication and has been obtained from third party sources believed to be reliable. Dynamic Funds, its affiliates and subsidiaries does not warrant or make any representations regarding the use or the results of the information contained herein in terms of its correctness, accuracy, timeliness, reliability, or otherwise, and does nor not accept any responsibility for any loss or damage that results from its use.

Dynamic Funds® is a registered trademark of its owner, used under license, and a division of 1832 Asset Management L.P.

Dynamic Funds® ECONOMICS

13DWD239_DF_EcoMon_0115_EN_V1 DOP0215 MOE9463