ECONOMIC MONITOR

July 2015

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

Dynamic Funds®
ECONOMICS

FINANCIAL MARKETS OVERVIEW

The Fed continues to raise expectations that it will raise interest rates this fall – September most likely, but December as an alternative. (The Fed has press conferences after those meetings, not the others.) We continue to put a fairly high probability on no rate hike this year – for purely economic reasons, but recognize that the Fed wants to commence "normalizing" monetary policy, and get the FF rate off the ZLB (zero lower bound).

At his stage we would prefer the Fed to hike, if only to get speculation out of the way and have markets focus on more important things. A 25 basis-point hike will not affect the economy meaningfully; more importantly, the Fed will not soon be raising rates again.

The Bank of Canada cut rates again to stimulate a weaker than expected Canadian economy. With oil prices falling further, a third cut this year cannot be ruled out – although we have it forecast for January 2016.

The Canadian dollar is now besieged on all sides – falling oil, copper, and gold prices, further Bank of Canada easing expected, possible Fed tightening and an approaching election (with some polls giving the NDP the lead). We have chopped our dollar forecast accordingly. If manufacturing is to take over from a depressed energy sector the economy may well need a dollar closer to 70 cents.

Greek debt problems have been "resolved" for now, but without debt forgiveness there will be renewed financial difficulties within two years.

As it stands, Greece faces a possible election this fall, but unless the probability of a "Grexit" suddenly surges once more it will not affect markets significantly.

1. ► The **BANK OF CANADA** is forecast to cut rates again. Most recent economic data continue to look poor and oil prices are sliding again.

2. ► The **FED FUNDS RATE** is expected to rise gradually over the forecast period. We expect GDP growth rebounded in 2015-Q2, but will grow less than robustly in Q3 and Q4. Headline inflation is likely to remain close to zero in the next few months and the outlook for wage growth is subdued.

3. ► Longer term B**OND YIELDS** may move a little higher based on a modest rise in inflation later this year (depending upon oil prices), provided the Fed also raises interest rates.

4. ► We have a significant negative bias toward the **CANADIAN DOLLAR**. Chinese commodity demand looks tepid and Canada's manufacturing sector may well need a bigger dollar decline. An end to Iranian oil sanctions and more oil on world markets will keep oil prices depressed too.

5. ► The **US DOLLAR** is expected to rise further against most currencies. Were the Fed to decide against raising interest rates the US dollar could sell off momentarily, but the dollar still enjoys relatively high bond yields that will attract capital inflows.

Updated Forecast - Base Scenario

	Actual				Projected						
	14-IV	15-I	15-II	23-Jul	Sep	Oct	Nov	15-IV	16-I	16-II	16-III
CURRENCIES	***Scenario B: Moderate US Growth - Mild Eurozone Pick Up - Commodity Prices Stay Weak***										
US Dollar Index*	87.08	94.33	94.72	97.79	98.74	99.17	99.67	99.67	101.2	102.4	103.9
Can. Dollar: CDN/US	***1.136***	***1.242***	***1.229***	***1.304***	***1.335***	***1.345***	***1.355***	***1.355***	***1.380***	***1.400***	***1.429***
Can. Dollar: US/CDN	88.03	80.52	81.37	76.71	74.91	74.35	73.80	73.80	72.46	71.43	69.98
Japanese Yen	***114.8***	***119.1***	***121.6***	***123.9***	***124.5***	***125.0***	***125.2***	***125.2***	***127.5***	***129.0***	***130.0***
British Pound	158.3	151.5	153.4	155.1	156.4	156.4	155.7	155.7	155.3	153.9	151.8
Euro	***1.249***	***1.127***	***1.106***	***1.099***	***1.105***	***1.105***	***1.100***	***1.100***	***1.090***	***1.080***	***1.065***
Australian Dollar	85.59	78.61	77.84	73.56	71.91	71.38	70.85	70.85	69.57	68.57	67.18
Chinese Yuan/Rmb	***6.138***	***6.138***	***6.150***	***6.213***	***6.208***	***6.210***	***6.220***	***6.220***	***6.230***	***6.230***	***6.230***
Indian Rupee	61.93	62.24	63.45	63.92	63.65	63.50	63.40	63.40	63.00	62.00	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)	0.90	0.57	0.62	0.42	0.40	0.38	0.36	0.36	0.20	0.20	0.20
Government Bond (10-yr)	1.92	1.33	1.68	1.50	1.58	1.61	1.65	1.65	1.75	1.80	1.80
Prime	3.00	2.85	2.85	2.70	2.70	2.70	2.70	2.70	2.55	2.55	2.55
Target Overnight Rate	***1.00***	***0.75***	***0.75***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.25***	***0.25***	***0.25***
Spread: 10-yr - T Bills	1.02	0.76	1.06	1.08	1.18	1.23	1.29	1.29	1.55	1.60	1.60
United States											
Treasury Bill (90-day)	0.02	0.03	0.02	0.03	0.03	0.04	0.06	0.09	0.15	0.22	0.32
Treasury Bond (10-yr)	2.23	1.87	2.20	2.27	2.40	2.45	2.50	2.50	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	***0.10***	***0.11***	***0.13***	***0.16***	***0.22***	***0.22***	***0.22***	***0.22***	***0.26***	***0.31***	***0.39***
Spread: 10-yr - T Bills	2.21	1.84	2.18	2.24	2.38	2.41	2.44	2.41	2.50	2.48	2.43
Interest Rate Differential (Canada-US)											
Treasury Bill	0.88	0.54	0.60	0.39	0.38	0.34	0.30	0.27	0.05	-0.02	-0.12
Bonds-10yr	-0.31	-0.54	-0.52	-0.77	-0.82	-0.84	-0.85	-0.85	-0.90	-0.90	-0.95

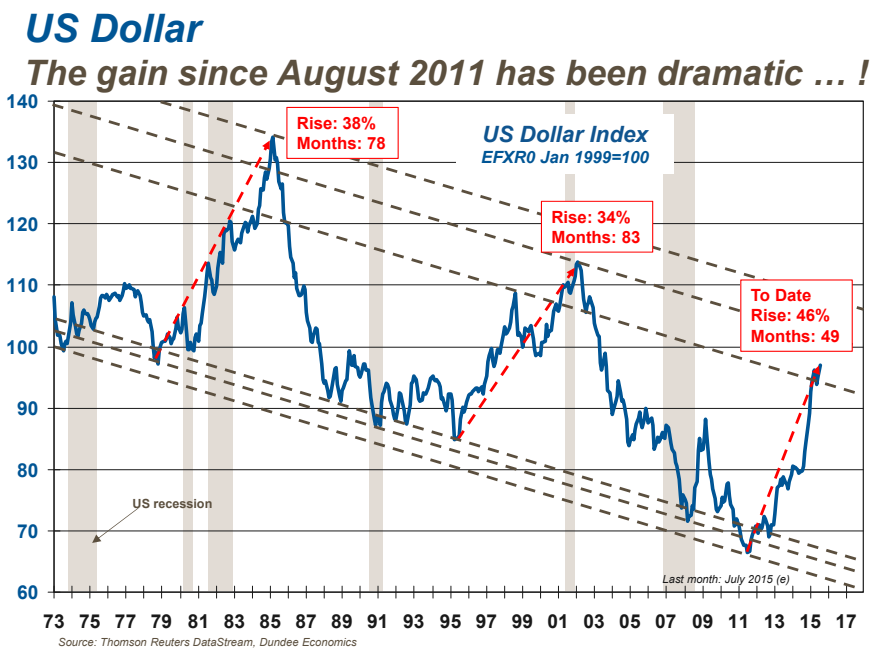
Source: Wall Street Journal, Federal Reserve, Dundee Economics

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 US Dollar

by Martin Murenbeeld

The US dollar last bottomed in August 2011, based on our in-house indices. (The DYX dollar index bottomed in April of that year!) Since 2011 the dollar has embarked upon a remarkable surge, the steepness of which exceeds the two previous surges (see chart). It's an historic surge in other words, and based on factors quite different from those underpinning the two previous surges.



The 1980-85 surge was underpinned by excruciatingly high real US interest rates (Volcker was the Fed Chair), and a popular president by the name of Ronald Reagan. The 1995-2001 surge was underpinned by global demand for US technology equities, culminating in the NASDAQ bubble ("irrational exuberance", remember?).

This surge, the third, is more difficult to sum up. The end of QE in the US, the adoption of QE in Japan and the Eurozone, the fear of a Eurozone breakup and a more robust US economy than elsewhere (despite the US economy's underwhelming performance) all factor into this dollar surge. Who knows but 20 years from now we will just reflect on this period as "the end of QE"? We'll see!

Regardless, this third dollar surge is playing havoc with commodity prices; commodity price baskets are down sharply in US dollar terms, and while we do not look upon gold as a typical commodity, it too has suffered from the surge in the US dollar. Since September 2011 gold is off some 42%, or almost as much as our US dollar index has risen. (Not all the decline in commodity prices – note oil prices – is due to the strong dollar of course, but the dollar is a major contributor!)

One might hope that commodity demand at these lower dollar prices would pick up, but 1) commodity prices have fallen much less in local currency terms and 2) global demand remains weak (the IMF puts world growth at no more than 3.3% for 2015).

With commodity prices down the Canadian dollar and the Aussie dollar are down too. And weak commodity prices depress the S&P/TSX, in so far as the Materials sector is overweight in the index (as compared with the sector's weight in global equity indices). Meanwhile, the Financials sector, another overweight sector in the S&P/TSX, is exposed directly and indirectly to activities related to the development of Canada's commodity resources; hence this sector also feels the heat of the strong US dollar.

We think the US dollar is grossly overvalued, and it will – as before – undergo a protracted decline. But we are not able to say just when such a decline will commence, unfortunately.

China – Some Macroeconomic Facts of Life: "*There Will Be Blood!*"

by Martin Murenbeeld

In the July 10th *Gold Monitor (Quarterly Forecast Update)*, we noted the following: "*it has become increasingly clear that China's 'mercantilist' model of economic development has run into serious problems*." We suggested that domestic investment (in productive machinery and capital, and in buildings, apartments, and houses) had vastly outstripped the demand for the stream of goods and services produced by all this investment. Most of us have seen pictures of newly-built cities, devoid of inhabitants, and have wondered just how the rent on all these buildings was being paid; indeed, we all have wondered just how the debt undertaken to build these cities was being serviced.

In truth, we don't know. We presume the Chinese employ the time-honored method of "extend and pretend", where new debt is issued in order to make payments on existing debt. What we do know is that diminishing cash flows from all this new capital makes the servicing of underlying debt increasingly problematic; the Chinese press of late has reported numerous bankruptcies, defaults, and debt restructurings.

In our view rising debt-service problems lie at the root of recent domestic equity market volatility. The Chinese government may be able to dampen this volatility but it cannot wish the fundamental problem away: assets that generate diminished cash flow will inevitably be re-priced in a free market environment. This fact also underpins the substantial price correction in China's real estate market.

The Chinese economy has fundamental problems that can not be easily analyzed in great detail by someone as removed from the Chinese market as we are. There are local rules and practices that someone not intimately familiar with Chinese economic and financial regulations will simply not see or understand. Yet we can provide a bird's-eye view of China's macroeconomic trends that will highlight some of the obvious problems now facing that economy.

(It is our strongly held view that had currency markets been allowed to operate properly in years past many of China's current problems could have been avoided, or at least mitigated. But currency markets did not operate freely; accordingly, China now has to make some very painful macroeconomic adjustments over the next five years or so, and the global economy will be directly affected.)

A good place to start is with the basic GDP identity: GDP = C+I+G+(X-M); in plain English GDP is the sum of C - household consumption, I - investment (in productive capital, buildings, residential structures, etc.), G - government expenditures and investment, and X-M - the net foreign trade balance: exports less imports. It follows that GDP growth comes from C, and/or I, and/or G, and/or X-M, as we have often noted in discussions of US GDP developments.

China's growth has come mainly from I - investment, whereas US growth has come mainly from C - consumption. Charts 1-4 overleaf show this clearly; Chinese investment has been rising as a percent of GDP and Chinese consumption has been declining as a percent of GDP. For the US it is the other way around; investment has been declining and consumption has been rising. Indeed, the contrast is stark!

A country with a high level of consumption must perforce have a low level of savings. The reader may remember that GDP also equals C+T+S, where C is consumption (as before), T is taxes, and S is savings. (This is the "income" side of GDP; all income is allocated to consumption, taxes, or savings). This identity implies that if C rises, and T remains constant, then S must decline!

Chart 1

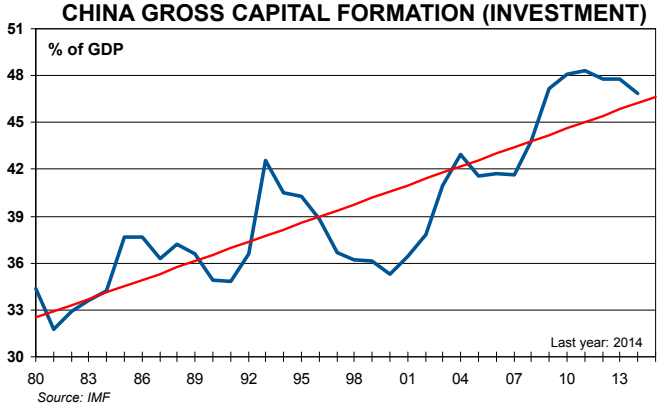


Chart 2

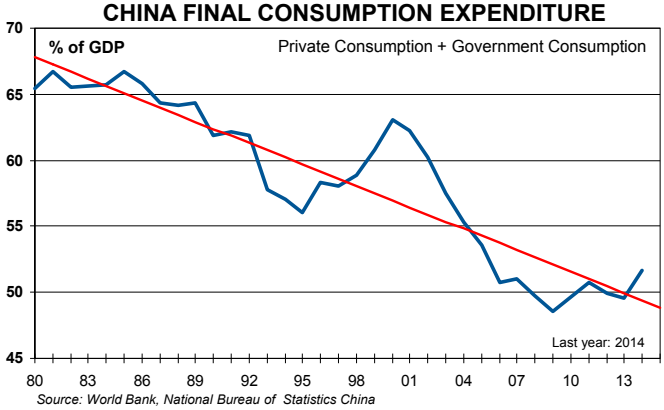


Chart 3

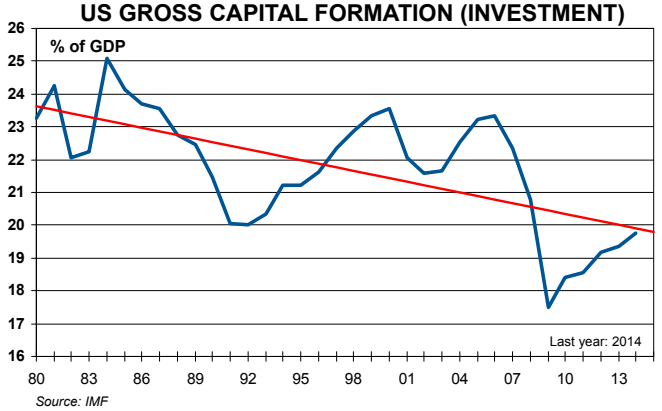
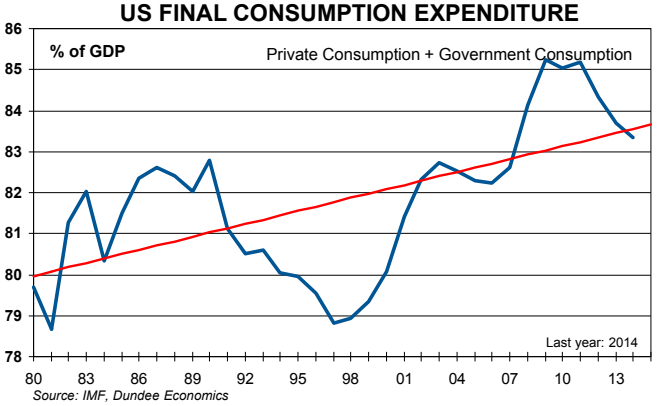


Chart 4



The reader may also recall that domestic investment, I, is generally funded with domestic savings, S. This is only partly true however; a country with a high I may still have a low S, but this means that the "extra" S will have come from abroad, i.e. that domestic investment is funded from both domestic plus foreign savings.

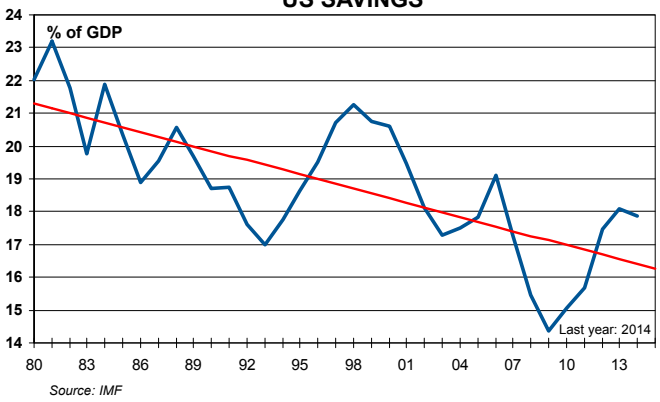
The two GDP identities can be reorganized to produce the following: (S-I) + (T-G) = (X-M). If we assume that the government has a balanced budget (i.e. taxes are equal to expenditures: T-G=0) then S-I must equal X-M. In plain English, if a country's investments exceed a country's savings (I>S), imports will exceed exports (M>X); there will be a trade deficit/current account deficit. (Of course, if a country's savings exceed investments then the country will have a trade surplus!)

Charts 5 & 6 highlight savings in China and the US. The reader can see that China's savings have been rising as a percent of GDP while US savings have been declining; this is exactly what one would expect when China's consumption is declining and US consumption is rising.

China's massive savings (which includes household, corporate and government saving – with China's FX reserves included in the latter) has been more than sufficient to fund China's domestic investment. In fact, some of China's savings have leaked abroad and helped fund US investment! We know this not only because China is a very large holder of US Treasuries (China has FX reserves of around $3.7 trillion), but also because over the last 15-20 years China has run a trade surplus (X-M>0) and the US has run a trade deficit (X-M<0).

Chart 5

Chart 6



Charts 7 & 8 highlight current account (CA) balances for China and the US; no surprise, China has surpluses and the US has deficits. There is some good news in these two charts however; recently China's CA surplus and the US CA deficit have both declined. One might hope that in China's case this is the result of a pickup in Chinese domestic consumption (along with a decline in Chinese savings and a decline in Chinese investment), but the data are not conclusive. Ditto, one might hope the decline in the US CA deficit is the result of less consumption, higher savings, and higher investment, but the data here are not conclusive either.

The Great Recession, and its after-effects, has seriously distorted long-run trends. Is the US current account deficit really in a long-run downtrend or will an up-trend reemerge as forecast by the IMF and others? We know that some of the decline in China's foreign trade surplus in 2008-2011 (maybe all of it) was the direct result of recession abroad. And we know that China took up the slack in foreign demand with increased domestic investment!

Indeed, to repeat ourselves, for many years now the Chinese strategy has been to boost growth 1) by way of the foreign sector (with a bigger trade surplus), and 2) by way of investment (more roads, buildings, apartments, productive capacity, etc.).

Which brings us to the nub of China's current problem: at 45-48% of GDP China's investment is much too large a share of GDP, while Chinese consumption, at just over 50% of GDP, is much too low a share of GDP. China's investment, other than in infrastructure, is furthermore directed to producing goods and services for export markets. (Even though investment in domestic

Chart 7

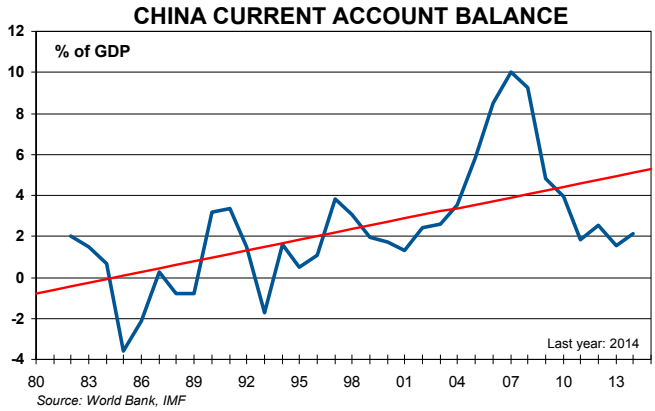
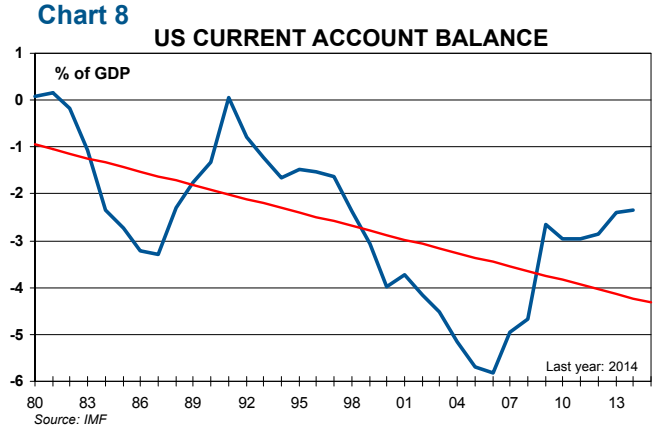


Chart 8



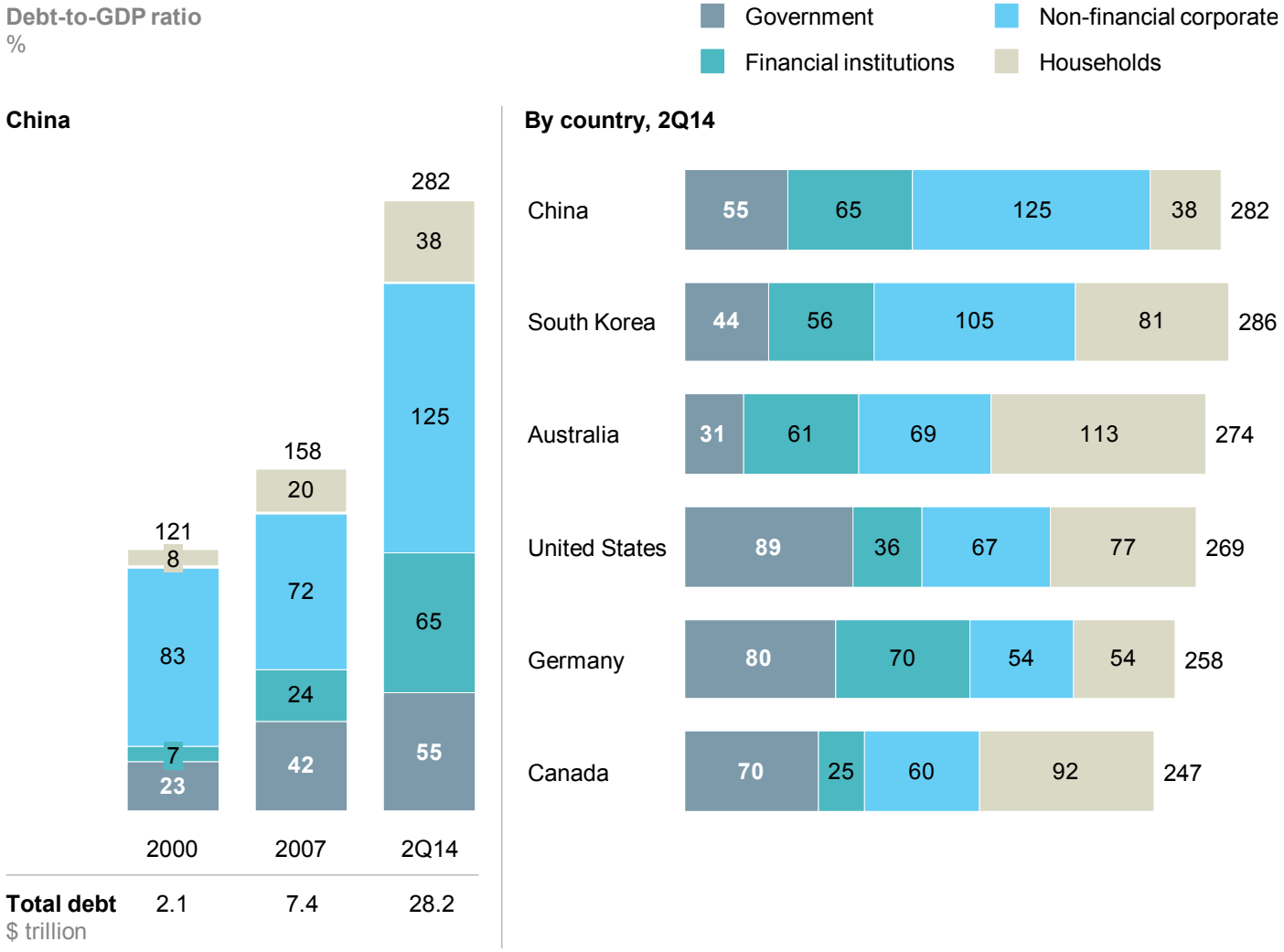
infrastructure requires commodity-related imports, the low renminbi has assured that exports will exceed imports).

But China is now running into significant limits to this strategy. 1) The foreign sector is too weak to take up all of China's excess production (and policies abroad are becoming more protectionist – in some instances mirroring China's own policies), and 2) debt levels underpinning Chinese investment have reached uncomfortably high levels.

With respect to the latter, China's mountain of debt was highlighted in a McKinsey report entitled "*Debt and (Not Much) Deleveraging*", February 2015. The following chart appeared in the February 6th issue of the *Gold Monitor* and is taken from the McKinsey report:

Which brings us back to our main point: China is

China's debt reached 282 percent of GDP in 2014, higher than debt levels in some advanced economies



NOTE: Numbers may not sum due to rounding.

SOURCE: MGI Country Debt database; McKinsey Global Institute analysis

suffering from “excess” investment and “excess” production. Domestic demand is insufficient to soak up all the available infrastructure/buildings/apartments, and foreign demand is insufficient to soak up all available exports. In turn, this reduces returns on Chinese investment and adds to the problems of servicing the underlying debt! The bottom line is that there must then be a re-rating of the value of Chinese assets – a “deflation” of Chinese assets.

We have contrasted China with the US because they are literally two sides of the same coin – not unlike the southern Eurozone and the northern Eurozone. For global economic harmony, and the avoidance of more global dislocations and crises, China must 1) consume more of its own output, 2) reduce its high savings rate, 3) reduce investment, and 4) reduce its current account surplus. The US, on the other hand, must 1) consume less, 2) save more, 3) invest more, and 4) reduce its current account deficit.

(The same applies to northern Europe and Southern Europe. Germany has a massive CA surplus for example, which must come down in order that the Eurozone might achieve a better macroeconomic balance, and the pressure for a “Grexit” may diminish.)

All this is easier said than done, of course. So, what steps need to be taken to correct the diametrically opposed Chinese and US economic trends? One conclusion in the book by Michael Pettis, “*Avoiding the Fall – China’s Economic Restructuring*” (published September 2013) is that Chinese households need to receive a much larger share of national wealth. Chinese households suffer from financial repression, relatively low incomes, a non-existent social safety net, and limited availability of consumer goods for domestic consumption (outside of the rich urban sectors) .

The US needs to correct the favorable treatment of consumption over savings in its tax system; it needs to simplify its tax code to favor investment and it needs to tax everyone fairly by eliminating a myriad of tax “expenditures”. A flat tax and a consumption tax would do wonders for the US economy, as would a massive reduction in corporate taxes.

We have argued for many years now that the US dollar should have been allowed to decline naturally against the Asian currencies – that currency markets should have been allowed to do “their job”; currency prices should have been set according to demand and supply pressures, which would have helped bring the disparate trends seen in the charts herewith back towards equilibrium.

The reader may not remember that the renminbi was 3.2 to the US dollar in 1986, but then was devalued sharply in stages to 8.7 by 1994. These devaluations made China hugely competitive in the late 1990s and the 2000s, and have directly contributed to the imbalance between investment and exports on the one hand, and consumption and savings on the other.

Had the renminbi been allowed to “float upwards” over the last 15 years or so on the back of trade surpluses and foreign capital inflows for production/export purposes, much of the “excess” investment in China would have been choked off. Overseas corporations would have been slower to move production facilities to China, exports from China would have been lower, and Chinese households would have had a stronger currency with which to buy, had the government encouraged it, more domestically-produced and foreign-produced goods.

In short, Chinese consumption would have been higher, investment would have been lower, savings would have been lower, and the foreign

surplus would have been lower! (Whether this all would have worked as seamlessly as suggested here is questionable, of course, but the massive investment-savings-consumption imbalance would have been significantly reduced.)

Today China is reaching the point where its preferred economic policies have to be scrapped. If China does not alter course, if China persists in continuing to look for more growth by way of debt-fueled investment and low-renminbi-induced exports, the two barriers to growth already visible could quickly sink the Chinese economy into outright recession.

One barrier is the “debt wall”; it will lead to plunging investment and massive deflation in asset prices. The government will then naturally wish to devalue the renminbi in order to generate some growth on the back of more exports. But then the next barrier is likely to kick in: the rest of the world will put a limit on Chinese imports. China will then be unable to “dump” its structural imbalances on the backs of foreign consumers!

In the end, China must and will consume more of its own output. The real issue is whether the shift to more domestic consumption occurs smoothly (by way of correct price signals in the currency markets and improved domestic price signals in domestic goods and financial markets – i.e. less financial repression of the household sector), or whether it occurs after a serious domestic recession. No one can be sure that the latter will be avoided.

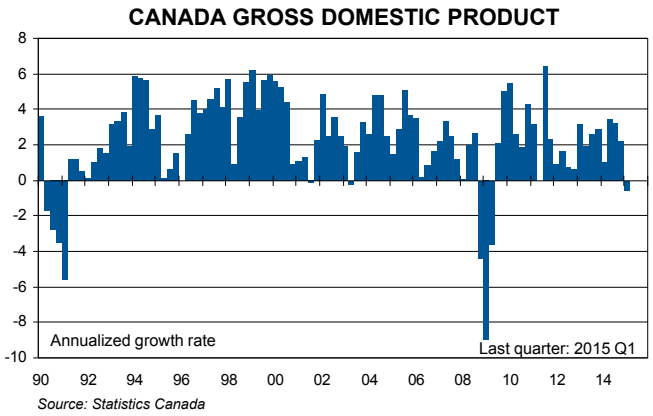
As China restructures, and growth rates decline, the investor might consider the following:

1. The global economy will remain weaker for longer – global growth may remain below 4% for some time to come
2. Commodity prices will remain weak and/or weaken further on the back of very weak Chinese demand (and SE Asian demand) and subdued global growth
3. The US dollar will remain strong/overvalued; this will depress US inflation rates and US employment gains
4. Global interest rates will remain “abnormally” low for an extended period of time, and the Fed will be extremely reluctant to follow up the initial interest rate hike in 2015 with successive hikes in 2016 and 2017
5. Because of the large size of the US domestic market, US equities with exposure to domestic demand will continue to be the asset of choice for many investors.

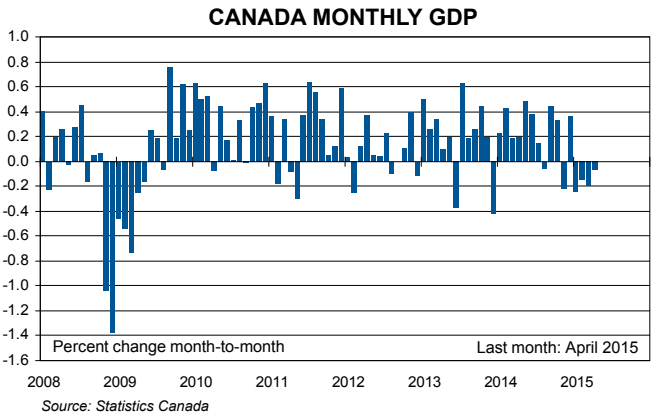
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Economic growth may be as little as 0.8% this year on a December-over-December basis (1.2% year-over-year).

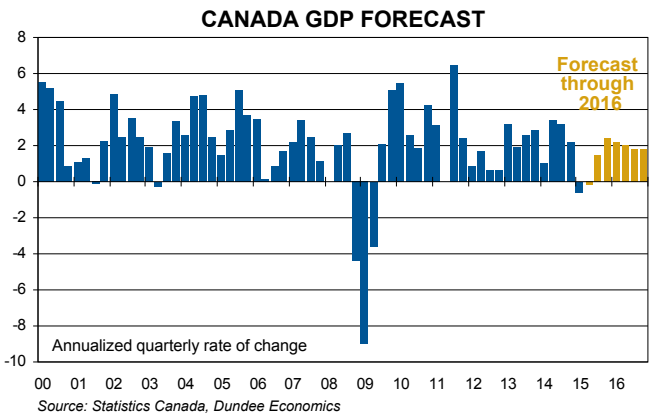
The Bank of Canada is predicting that the economy shrank again in the second quarter, after contracting 0.6% in the first quarter. Technically this counts as a recession even if much of the downturn is in Alberta.



April saw a small month-to-month contraction.

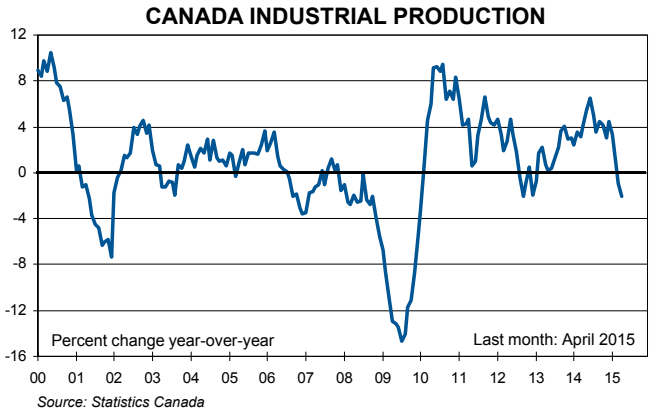


Canada's potential growth rate is currently about 1.8% over the next few years but is declining. The numbers assume annual productivity gains of at least 1.0% but these may be hard to come by.



MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Industrial production is very weak thanks to the slumping energy sector.



There was a small net loss of jobs in June.

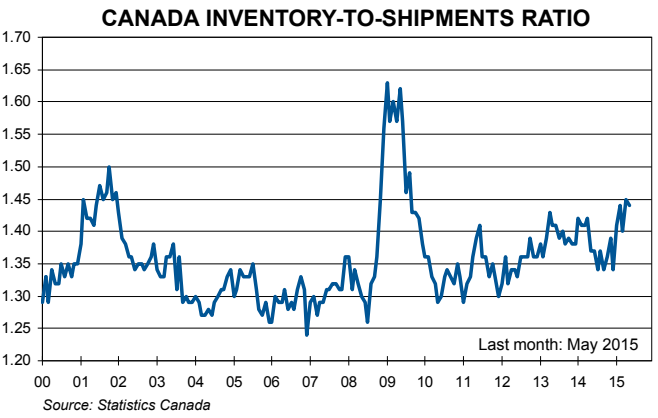
The unemployment rate has been flat at 6.8% for five months.

MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Despite the lower Canadian dollar, manufacturing shipments have been disappointingly soft. This may cause the Bank of Canada to cut rates again as early as September.

New orders have not been rising

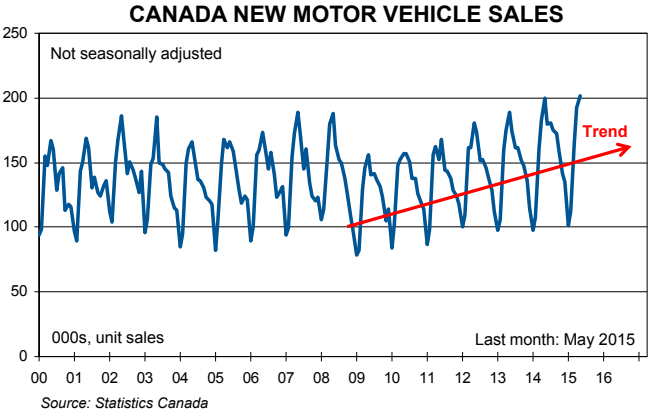
The inventory ratio is reminiscent of a small recession.



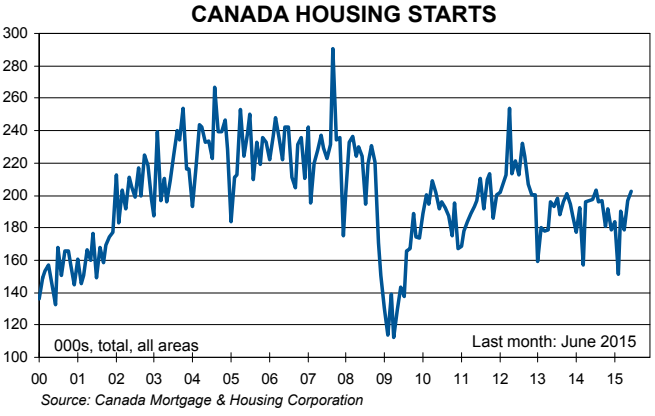
MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Retail sales have been reasonably firm, with strength in vehicle sales. The numbers look depressed because of lower gasoline prices.

Without seasonal adjustment the vehicle sales numbers are very volatile. But the trend has been strong with May setting a multi-year peak (thanks to cheap financing).



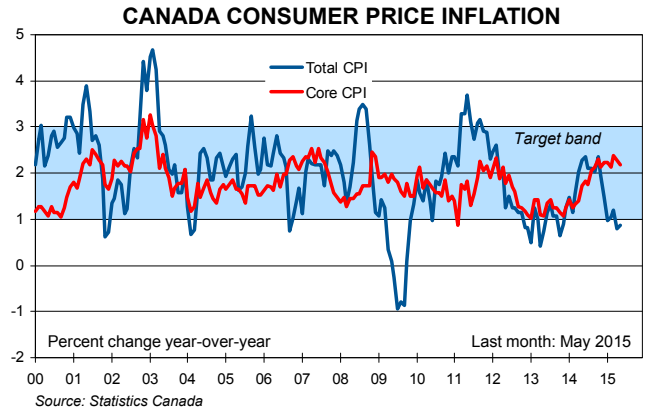
Housing starts have seen unexpected strength lately and will be helped by the recent interest rate cut.



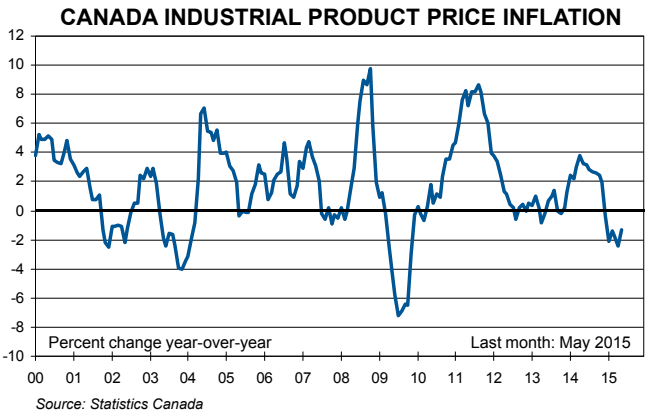
MONTHLY REVIEW ►
CANADA – INFLATION

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

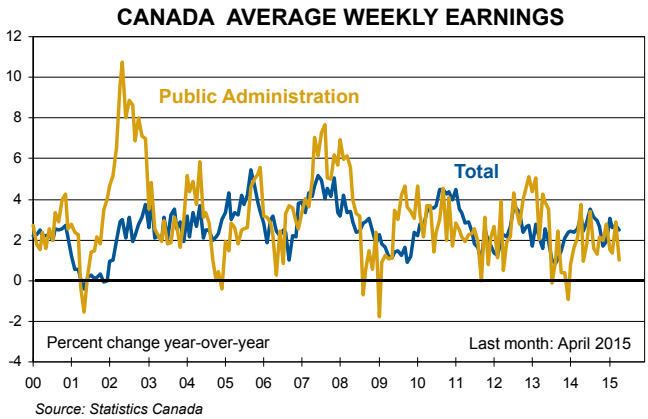
Core inflation remains above the 2% target but the Bank of Canada considers this to be the transitory result of the Canadian dollar's decline. The headline rate has been under 1% because of low gasoline prices which may fall again in the autumn.



Industrial product price inflation is still negative thanks to weak commodity prices.

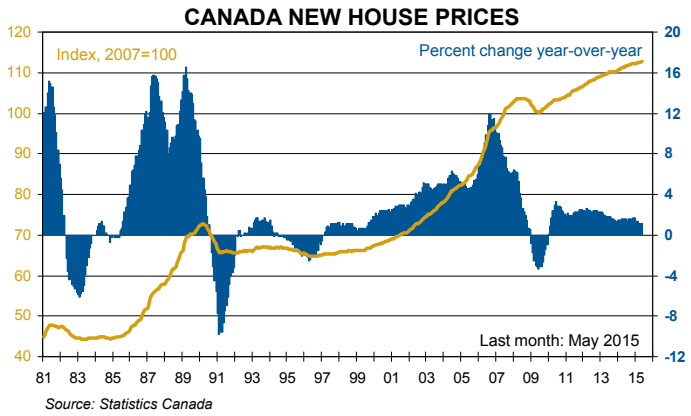


Average weekly earnings growth appears to be starting to react to low headline inflation and will likely be dragged lower.

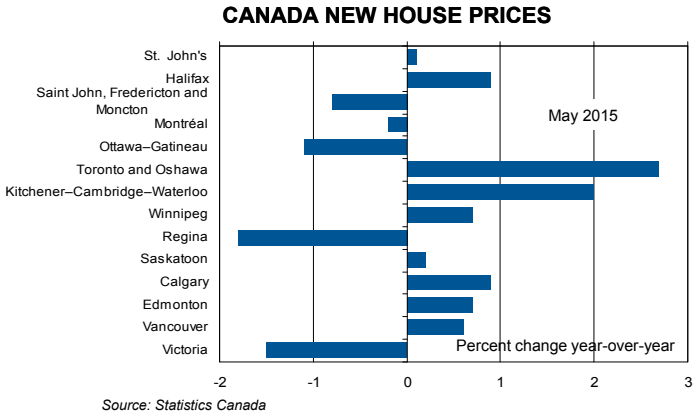


MONTHLY REVIEW ►
CANADA – INFLATION

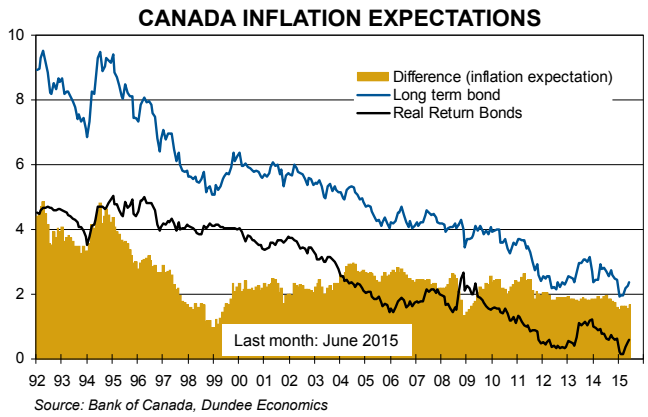
New house prices are rising but barely more than 1%.



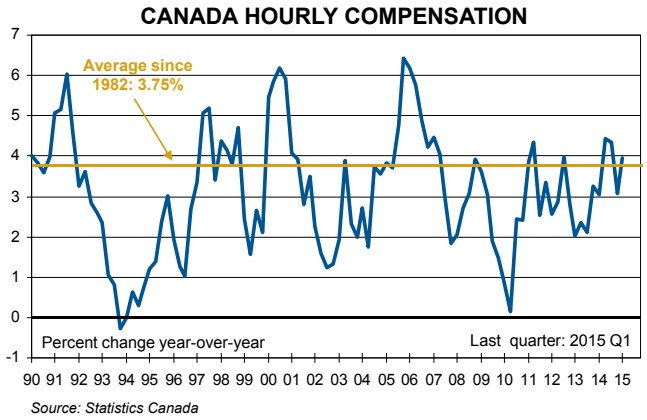
Toronto is hot, with Vancouver heating up.



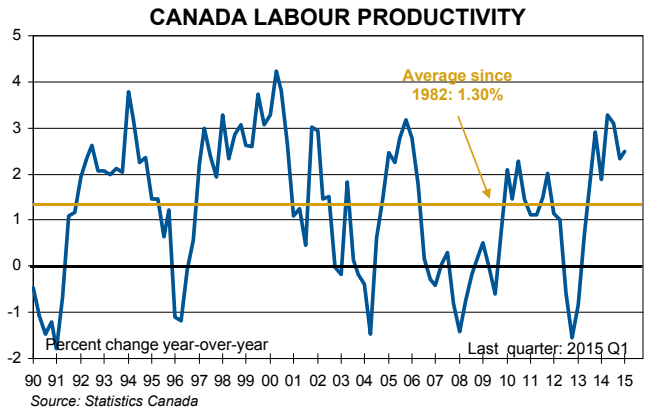
Inflation expectations remain depressed.



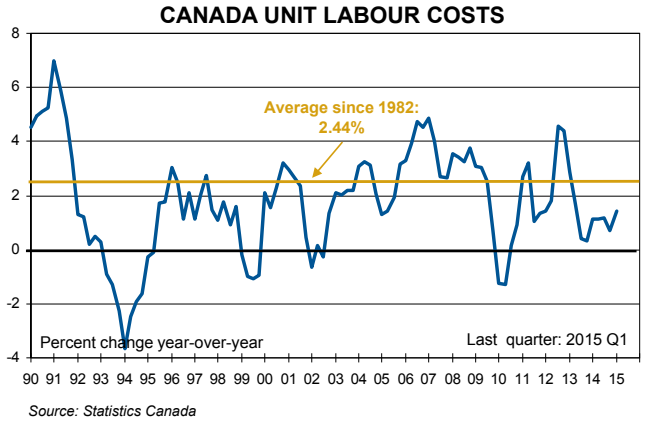
Hourly compensation rose 3.94% over the past year, according to this measure.



Productivity was well above average at 2.50% over the past year, despite falling in the first quarter.



Unit labour costs rose 1.41% over the past year, slower than average. (The data are measured in Canadian dollars; while the weaker dollar will help restore competitiveness to some degree, currencies like the Mexican peso have also fallen considerably).

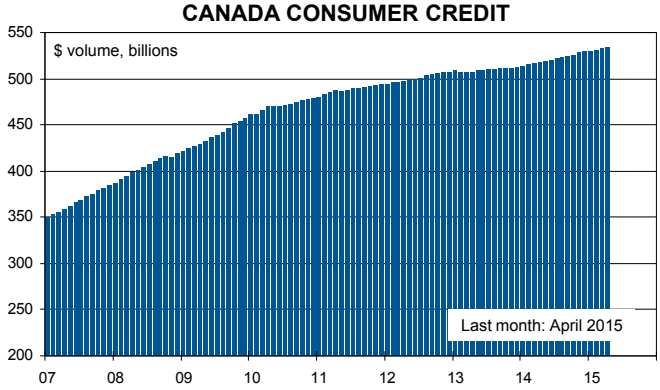


MONTHLY REVIEW ►
CANADA – DEBT AND CREDIT

Consumer credit growth and mortgage credit growth have been modest with a slight tendency to rise, while business credit growth has been strong but slowing.

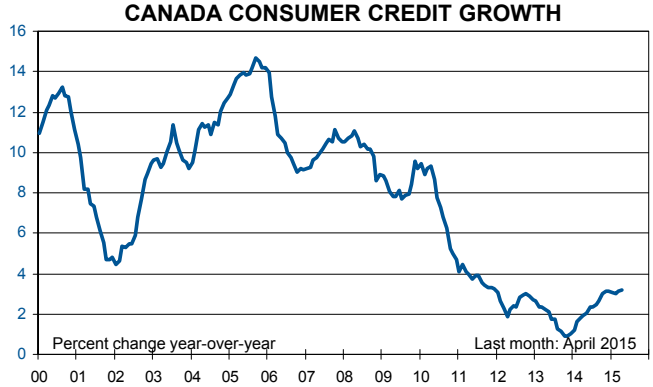
Source: Statistics Canada

CANADA CONSUMER CREDIT



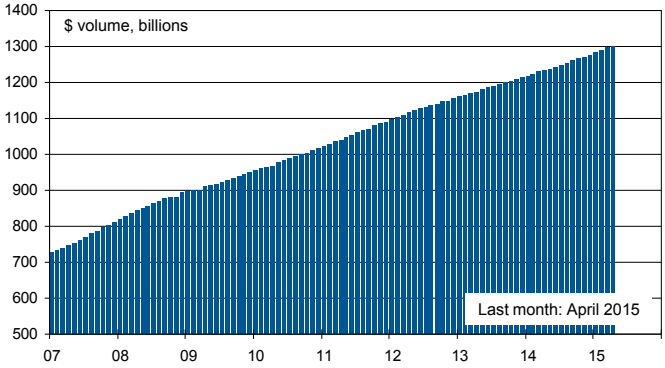
Source: Bank of Canada

CANADA CONSUMER CREDIT GROWTH



Source: Bank of Canada

CANADA RESIDENTIAL MORTGAGE CREDIT

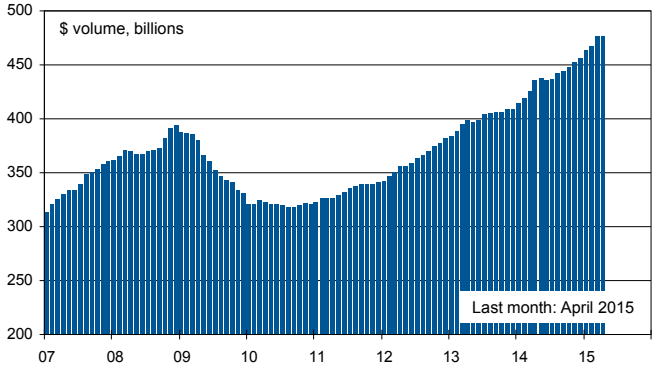


Source: Bank of Canada

CANADA RESIDENTIAL MORTGAGE CREDIT GROWTH

Source: Bank of Canada

CANADA SHORT-TERM BUSINESS CREDIT

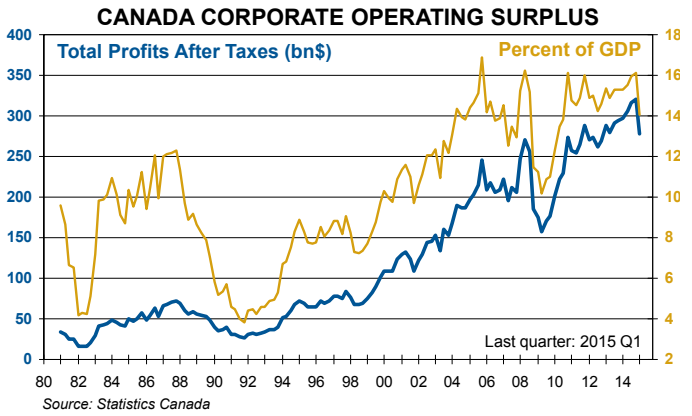


Source: Bank of Canada

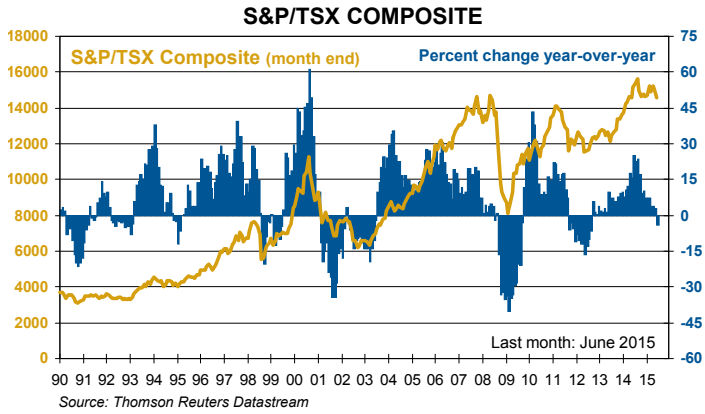
CANADA SHORT-TERM BUSINESS CREDIT GROWTH

Source: Bank of Canada

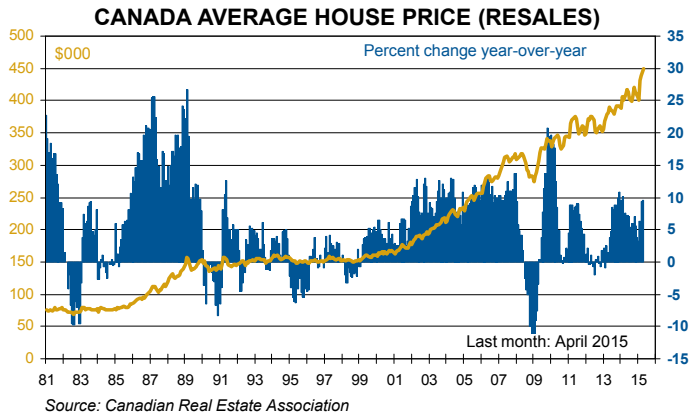
Profits are declining thanks to a sharp fall in the energy and commodity sectors.



The TSX has lost a bit of ground

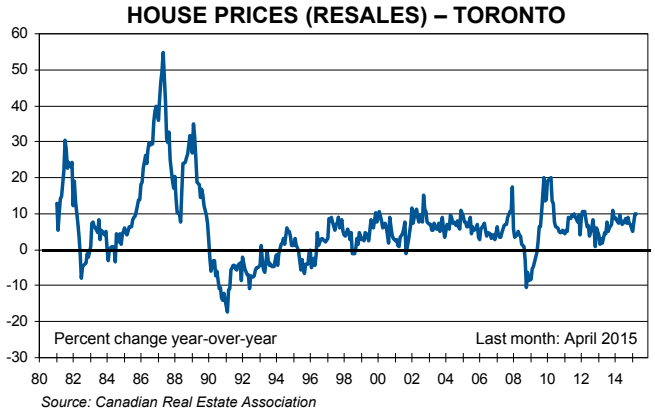


Home prices are rising faster, primarily in Vancouver and Toronto which enjoy strong immigration.

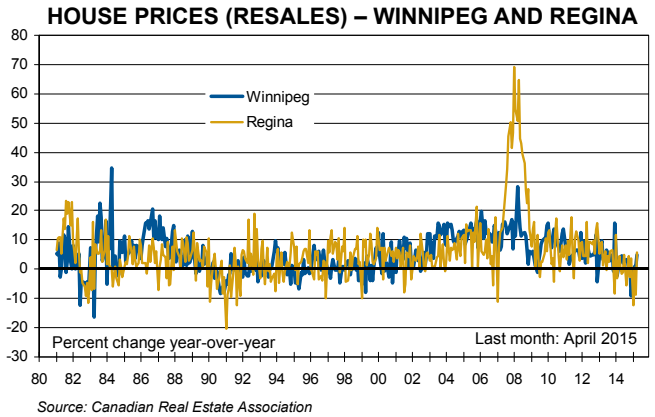


MONTHLY REVIEW ►
CANADA – WEALTH CREATION

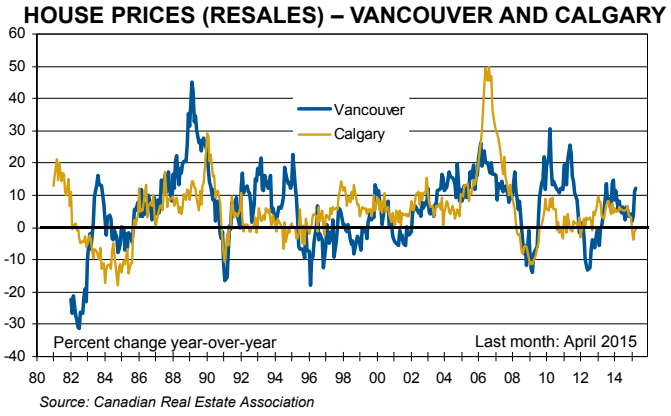
Toronto is enjoying strong price gains.



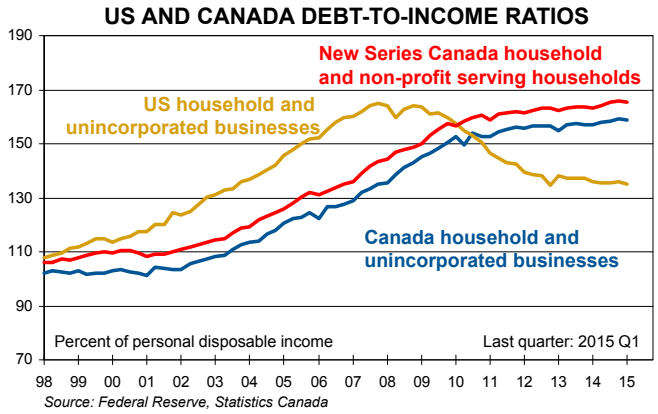
Winnipeg and Regina are seeing declining prices.



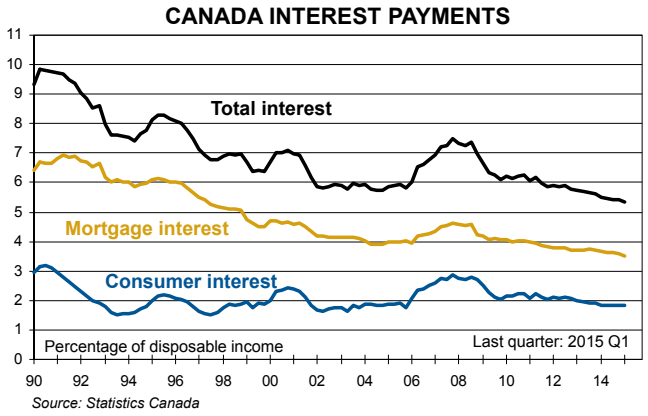
Vancouver house prices are up but Calgary prices are falling.



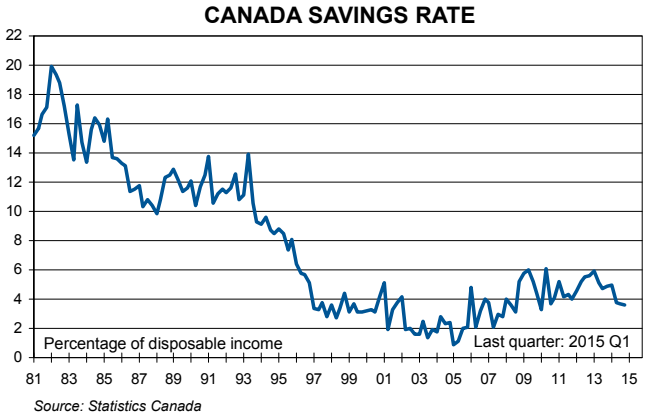
The Canadian debt to income ratio has flattened out whereas in the US it is declining marginally.



Interest rates near record lows mean that the interest portion of debt repayments is very low and falling.

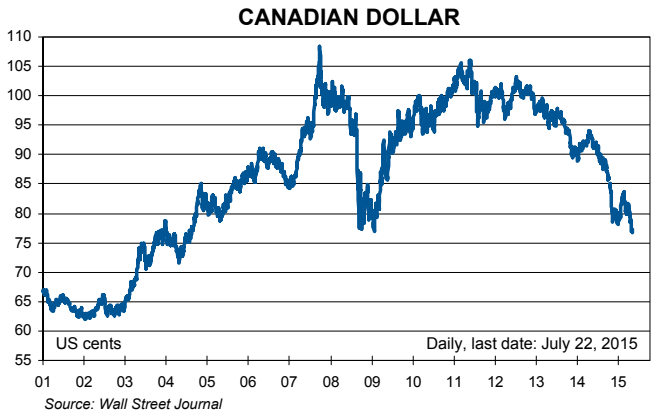


The savings rate has fallen back thanks to increased car sales.

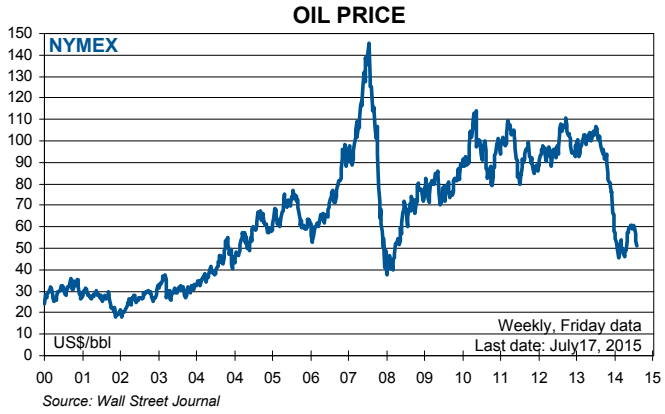


MONTHLY REVIEW ►
CANADA – FINANCIAL MARKETS

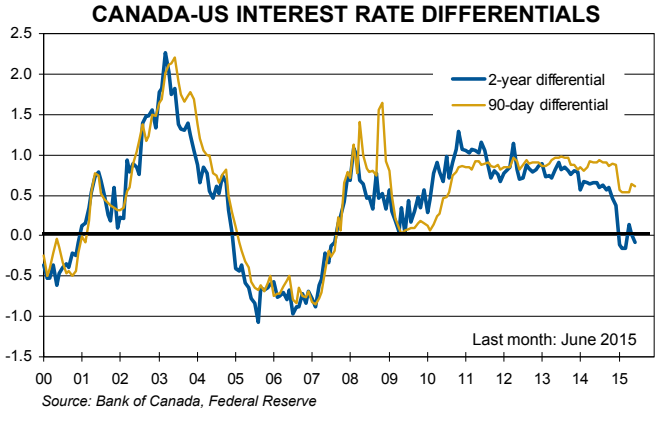
The Canadian dollar is suffering from looser Canadian monetary policy and the prospect of tighter US policy.



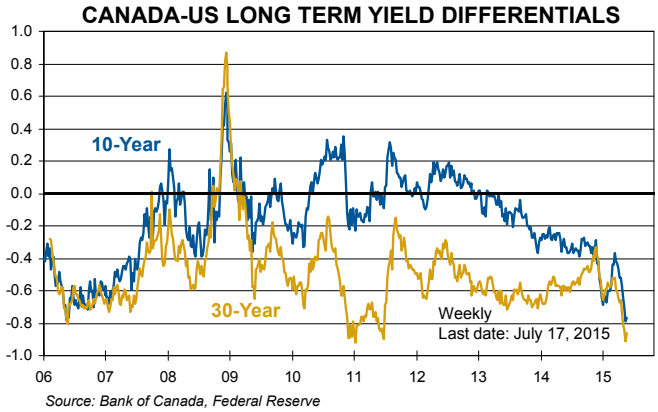
Oil prices momentarily stabilized near $60 but then fell back. Increased Iranian production prospects as well as rising OPEC production are threats.



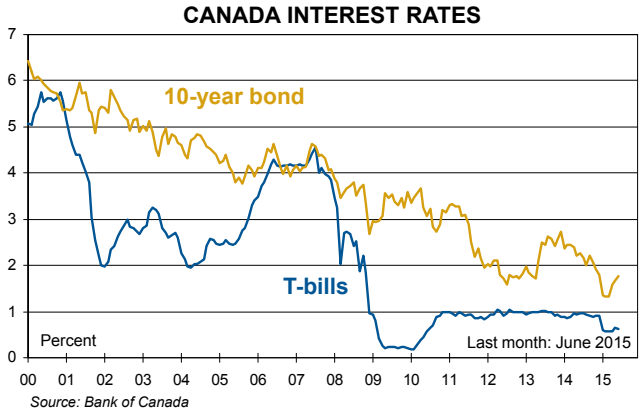
Canada is losing its short-term rate advantage.



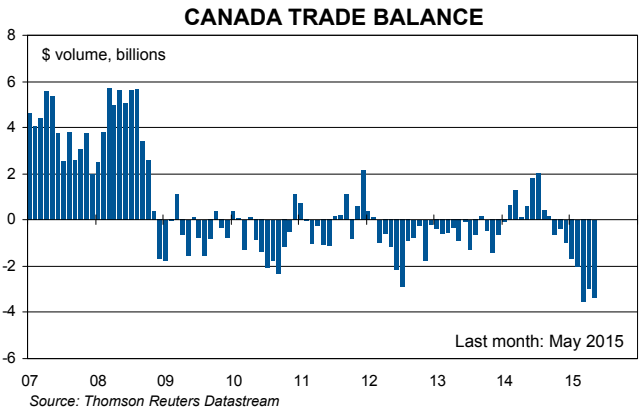
Longer-term differentials increasingly favour the US.



The probability of another Canadian rate cut (perhaps as soon as September) is well above 50%.



Canada's trade balance is abysmal as commodity prices have fallen sharply.

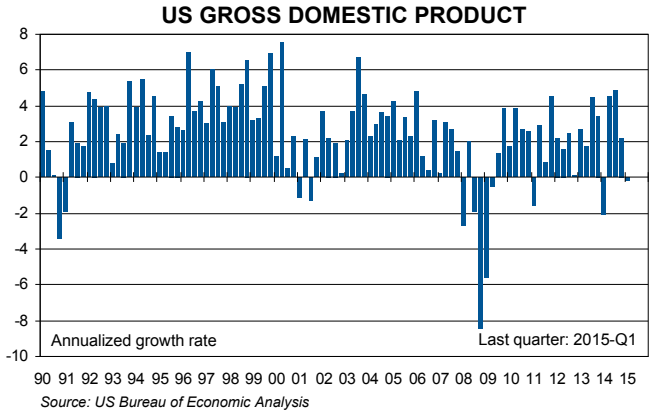


Economic Monitor

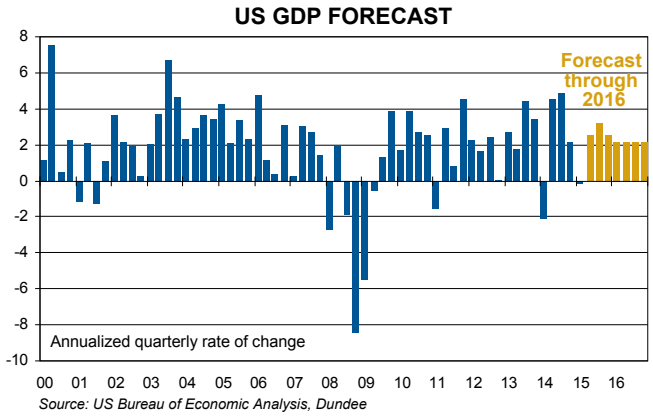
MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

Growth for 2015 is expected to be around 2.0% on a December-over-December basis (2.3% on a year-over-year basis).

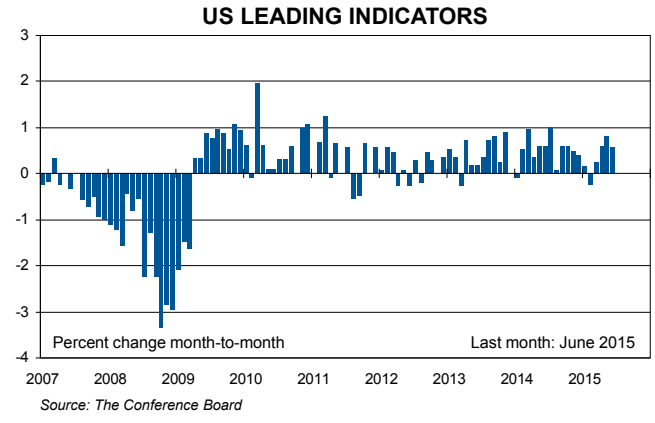
The economy contracted 0.2% during the first quarter.



Thus far the economy has not gained enough traction for the Fed to raise rates.

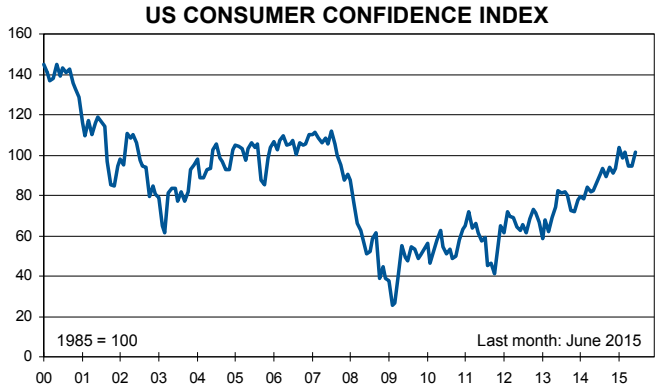


The leading indicators have shown moderate strength of late but may be overstating future growth.



MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

Consumer confidence still appears to be trending higher.



Job creation has slowed somewhat but is still fairly strong.

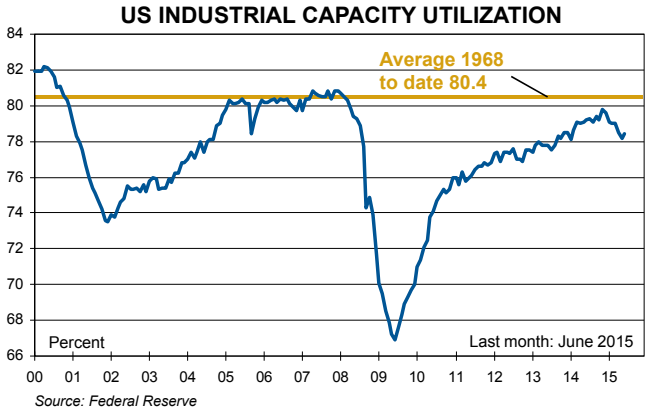
The unemployment rate continues to sink.

MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

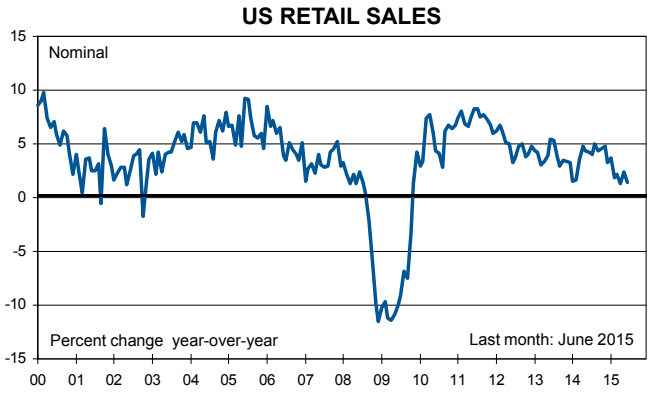
Manufacturing remains depressed by the energy sector slump as well as by the rising US dollar but is recovering from severe winter weather.

The service sector has lost steam lately.

Capacity utilization remains below average. This won't generate much inflation.

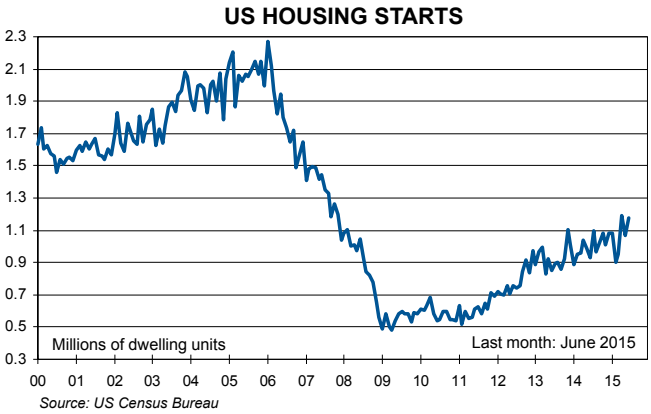


Retail sales have been somewhat disappointing. Car sales have been boosted by cheap financing but consumers haven't been spending much of their gasoline price savings.



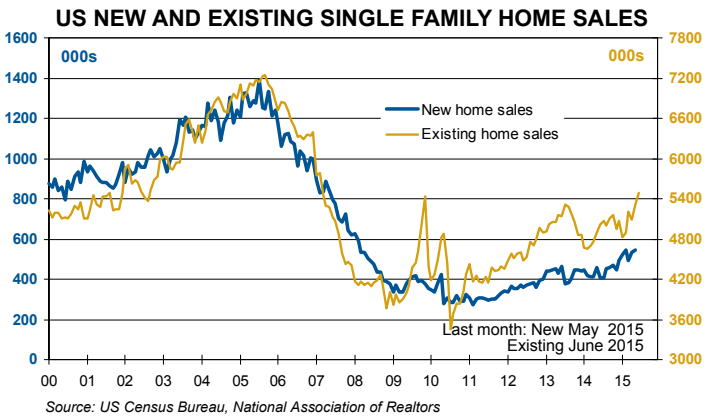
Source: US Census Bureau

Housing starts are still in a moderate uptrend with multi-family apartment building leading the way. This should eventually suppress rent increases.



Source: US Census Bureau

New and existing home sales show some improvement.

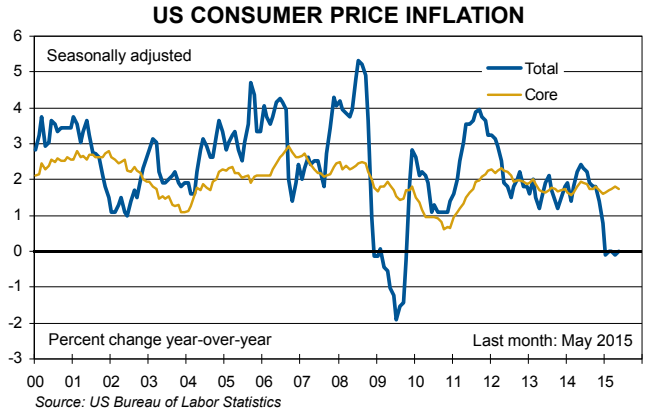


Source: US Census Bureau, National Association of Realtors

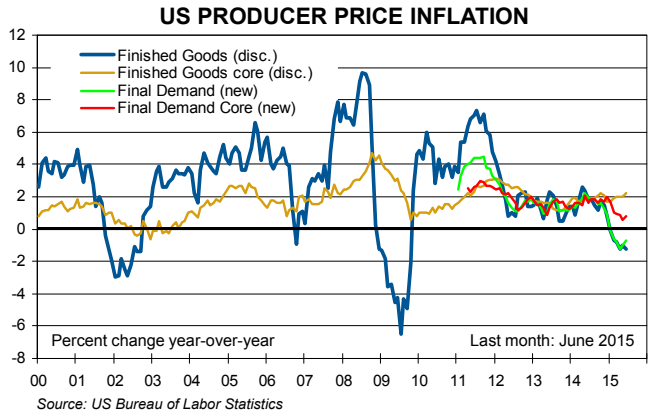
MONTHLY REVIEW ►
UNITED STATES – INFLATION

Headline inflation is expected to remain close to zero through October, then begin to rise but perhaps not quite as high as 2.0%.

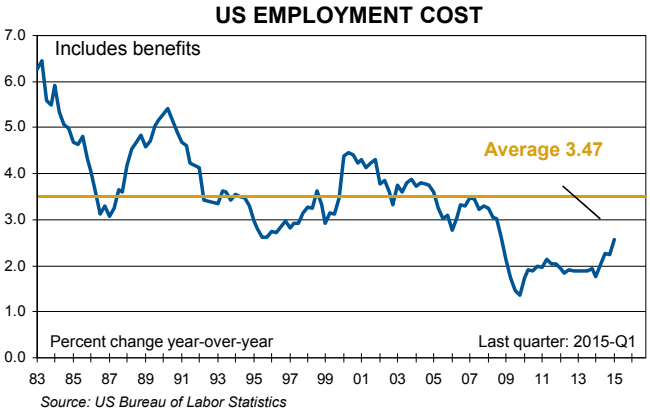
Headline inflation remains at zero, and there has been little change in the core rate, presently 1.77% (1.73% in May).



Lower commodity prices are holding down headline producer prices.

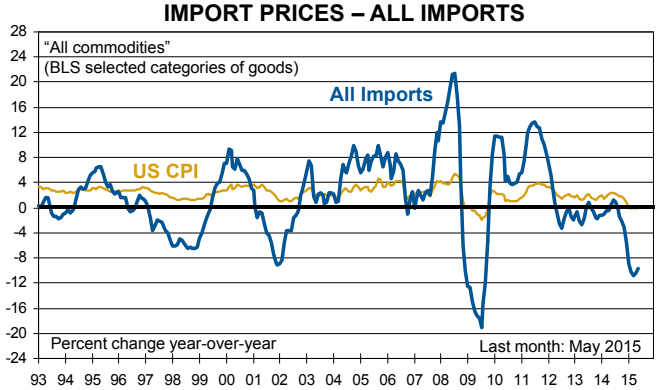


Employment costs were rising but in recent months the low rate of inflation appears to be reducing wage gains on a month-over-month basis. This may become a concern for the Fed if lower wage increases start to suppress consumer spending.



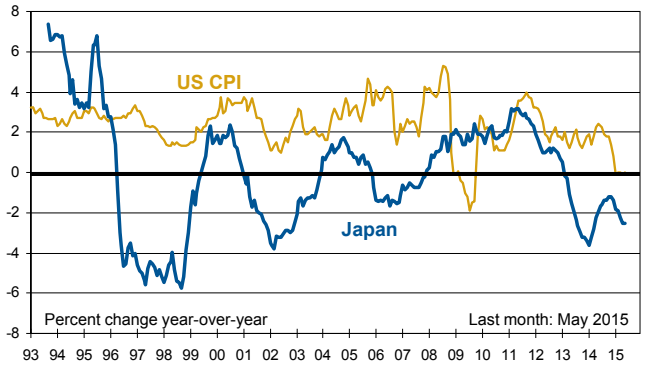
Overall import prices recently rose along with oil prices but import prices from non-oil exporters are still pulling inflation down. And oil prices are now falling again.

IMPORT PRICES – ALL IMPORTS



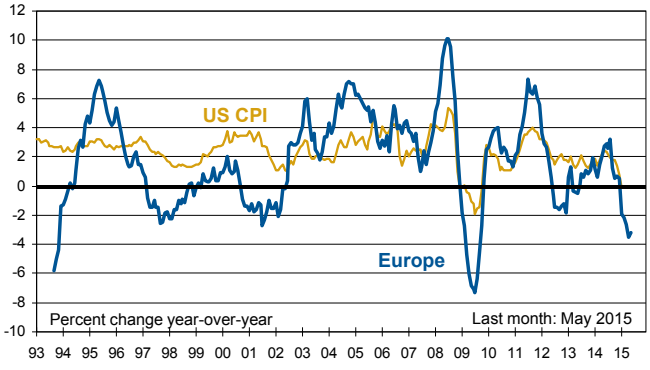
Source: US Bureau of Labor Statistics

IMPORT PRICES FROM JAPAN



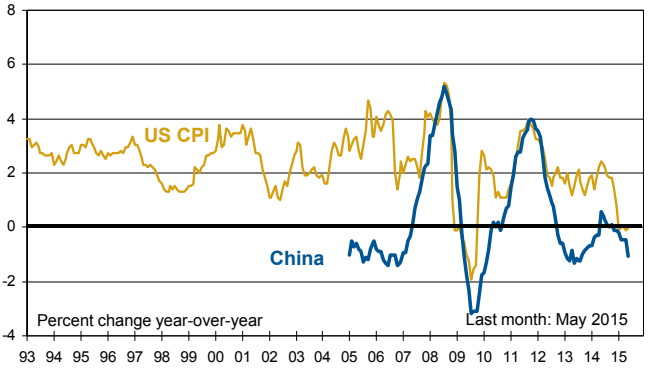
Source: US Bureau of Labor Statistics

IMPORT PRICES FROM EUROPE



Source: US Bureau of Labor Statistics

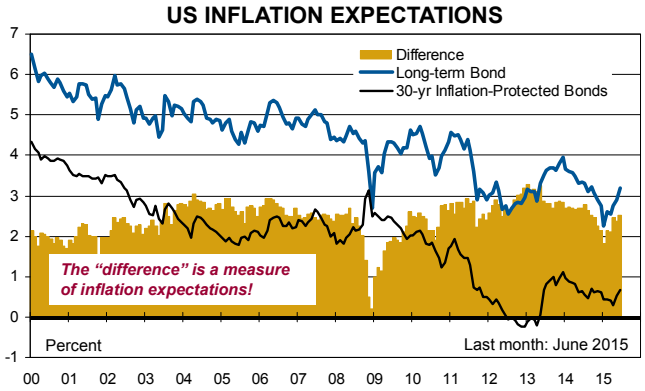
IMPORT PRICES FROM CHINA



Source: US Bureau of Labor Statistics

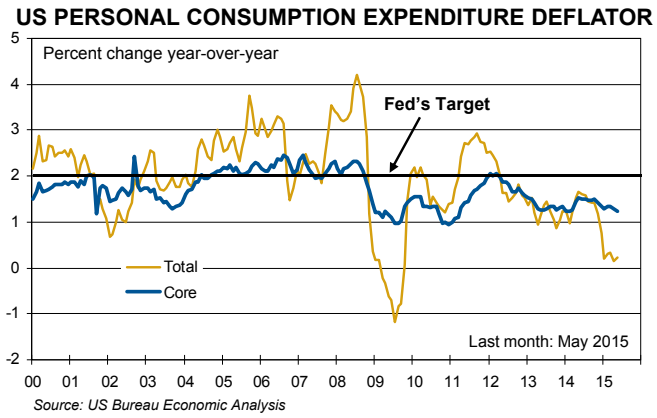
MONTHLY REVIEW ►
UNITED STATES – INFLATION

Inflation expectations appear to be up but some of this reflects bond market distortions caused by Greece.



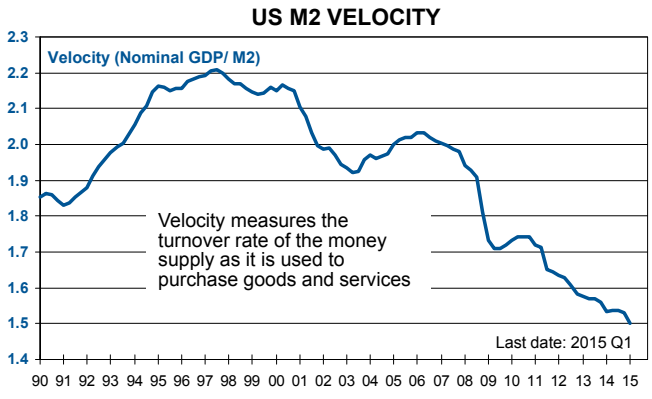
Source: Federal Reserve, Dundee Economics

The PCE measure of inflation (preferred by the Fed) is very weak with a tendency to slip through May.



Source: US Bureau Economic Analysis

Velocity (the rate of money circulation) fell again in the first quarter, dampening inflation prospects.

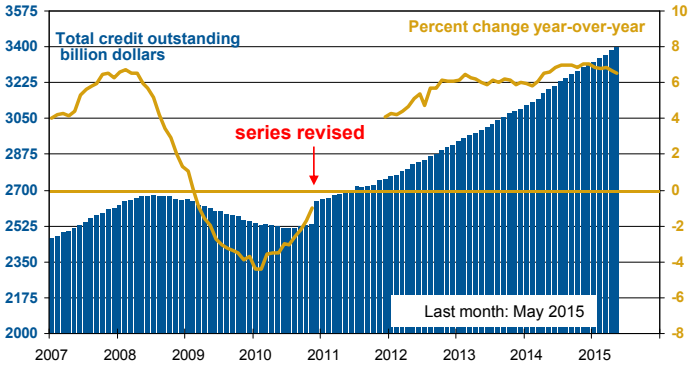


Source: Federal Reserve, Bureau of Economic Analysis, Dundee Economics

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. C & I loan growth has weakened (energy sector).

US CONSUMER INSTALLMENT CREDIT

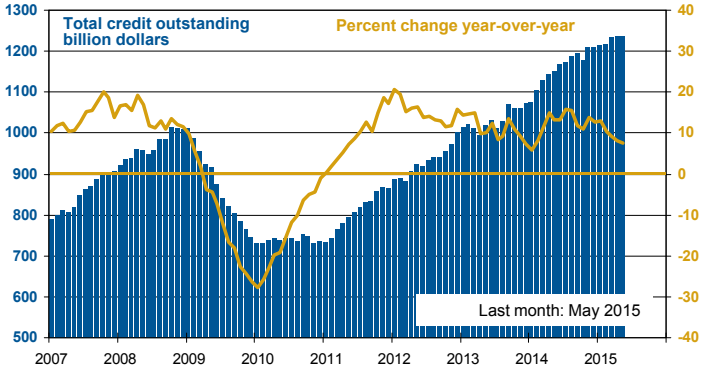


Source: Federal Reserve

US CONSUMER INSTALLMENT CREDIT

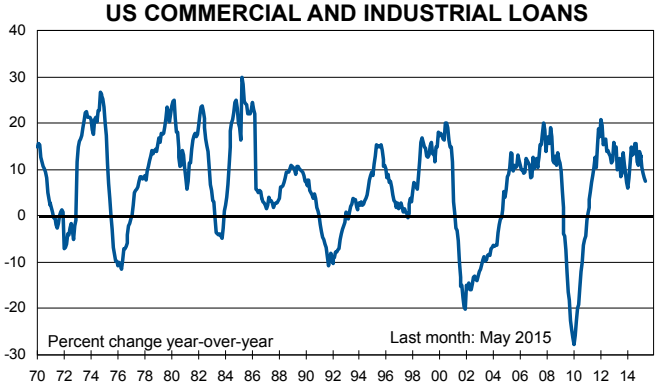
Source: Federal Reserve

US COMMERCIAL AND INDUSTRIAL LOANS



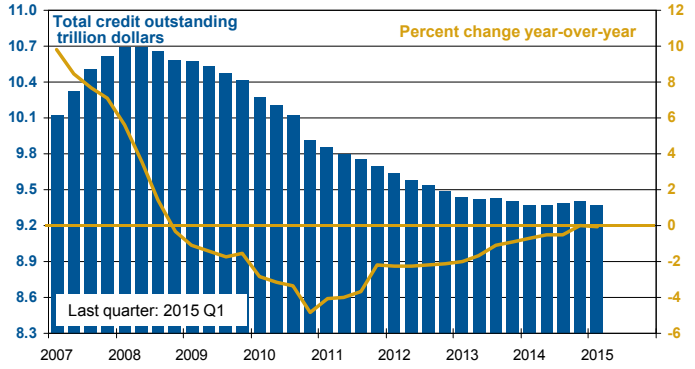
Source: Federal Reserve

US COMMERCIAL AND INDUSTRIAL LOANS



Source: Federal Reserve

US RESIDENTIAL MORTGAGE CREDIT



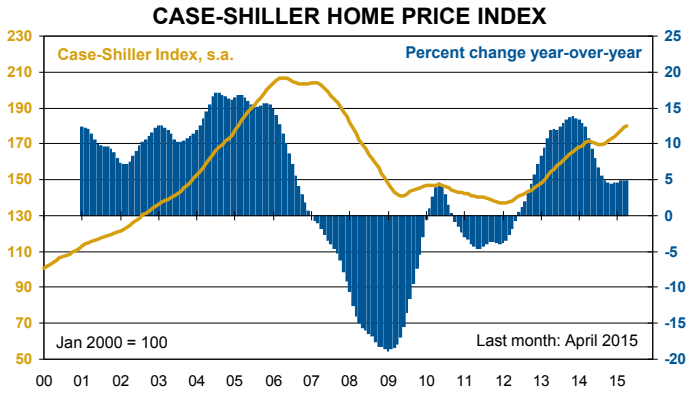
Source: Federal Reserve

US RESIDENTIAL MORTGAGE CREDIT

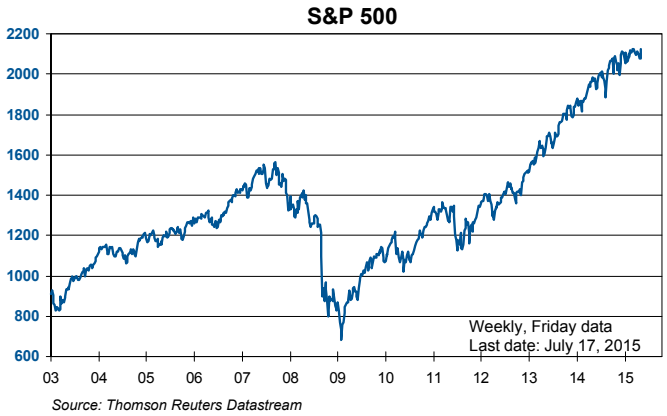
Source: Federal Reserve

MONTHLY REVIEW ►
UNITED STATES – WEALTH CREATION

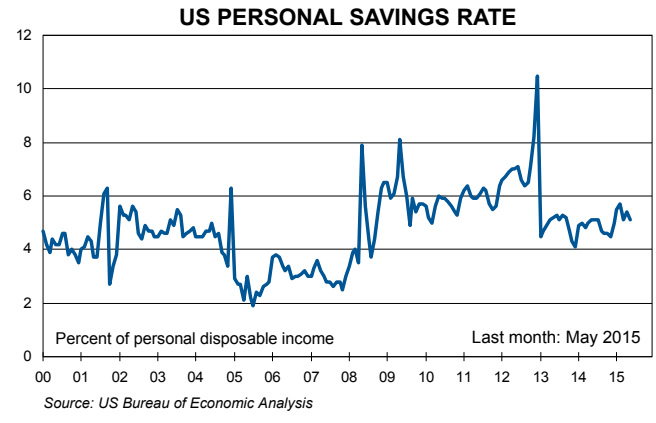
Home price increases showed an unexpected month-to-month deceleration in April.



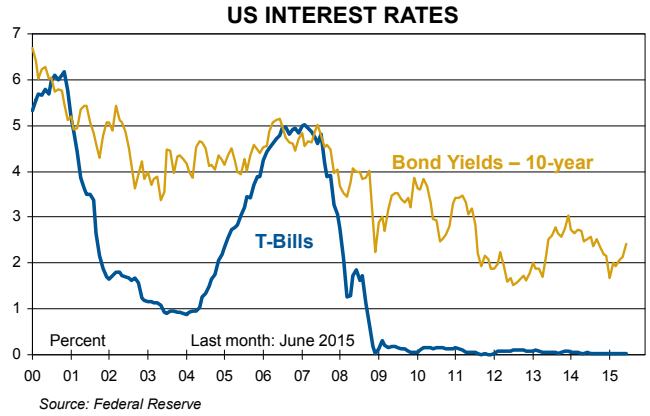
The strong dollar has inhibited corporate profit growth and stock prices, but not much.



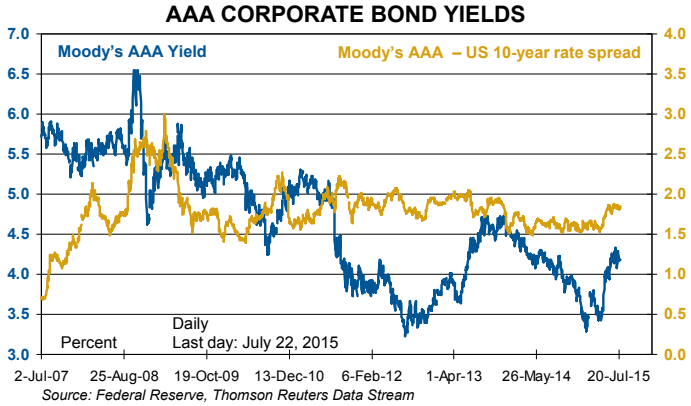
The US savings rate is (arguably) trending higher.



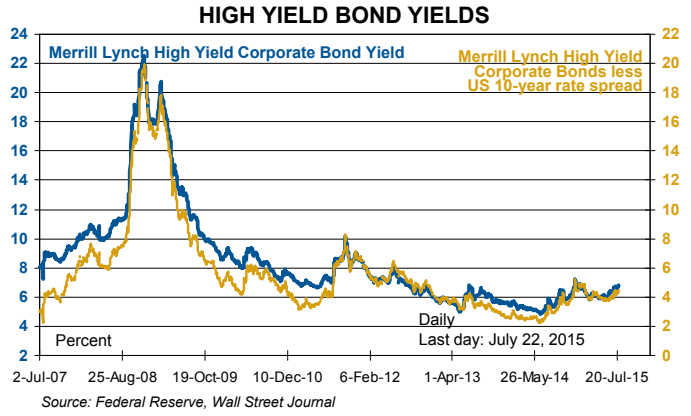
The Fed would like to raise interest rates somewhat but weak growth, low inflation and a rising US dollar have resulted in a delay so far.



Corporate bond yields are following the 10-year yield higher, partly the result of Fed intentions but also because the risks associated with Greece have abated.

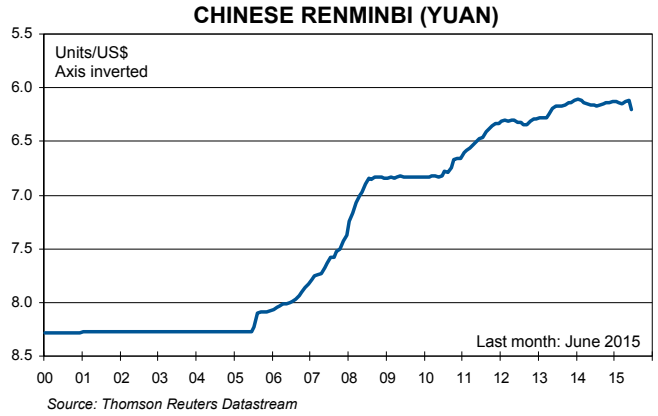


Higher yielding bonds have also seen rising yields lately.

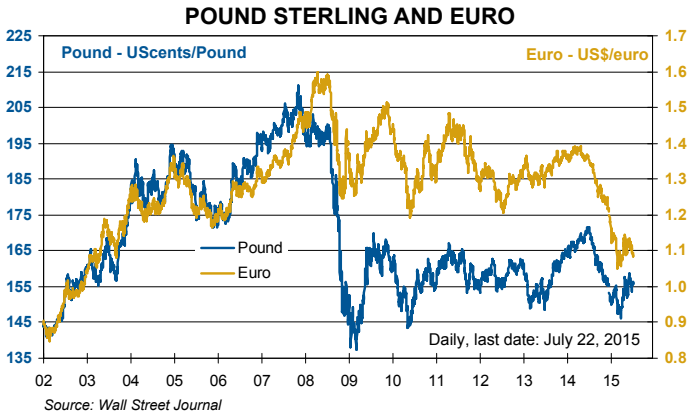


MONTHLY REVIEW ►
FOREIGN EXCHANGE RATES

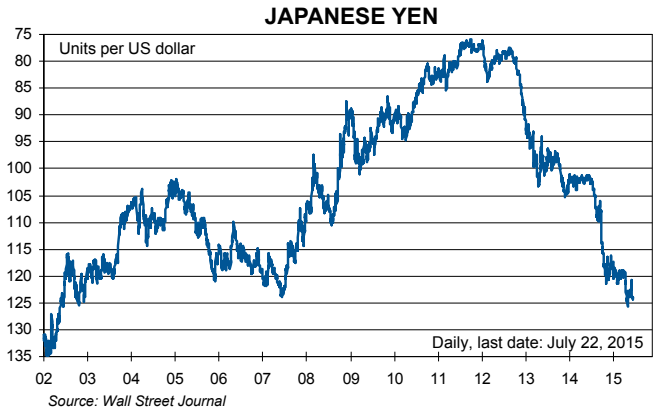
The Chinese currency has weakened slightly and is closer to 6.21 than 6.20 where it had remained for several years.



The euro has averaged around 1.10 in recent weeks but we expect it to weaken before long.



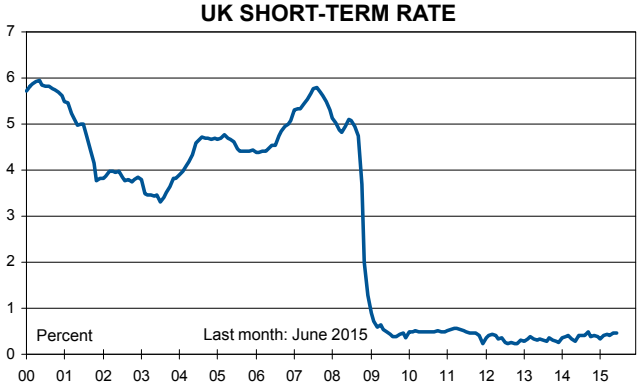
The yen will likely move past 125 (weaken) later this year.



The Fed continues to talk as if a rate hike is not far off but inflation is very low, wage gains are decelerating and the economic rebound from a severe winter is overstating the underlying growth rate. The Fed may delay any increase into 2016.

The US and other industrialized economies resemble that of Japan from the early 1990s on, so if/when rates are raised the rise might have to be reversed before long.

UK SHORT-TERM RATE

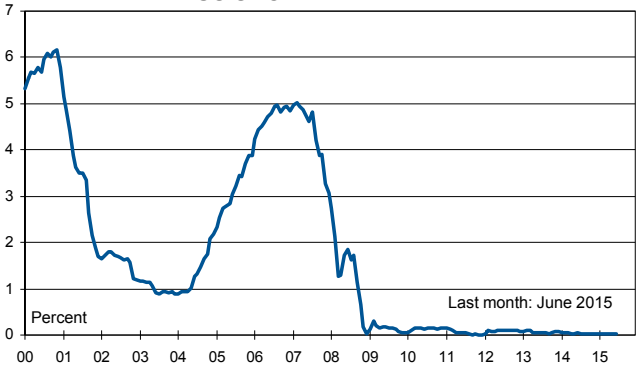


Source: Thomson Reuters Datastream

GERMANY SHORT-TERM RATE

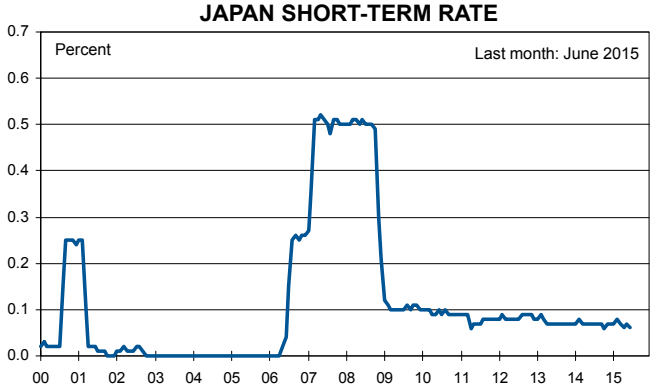
Source: Thomson Reuters Datastream

US SHORT-TERM RATE



Source: Federal Reserve

JAPAN SHORT-TERM RATE



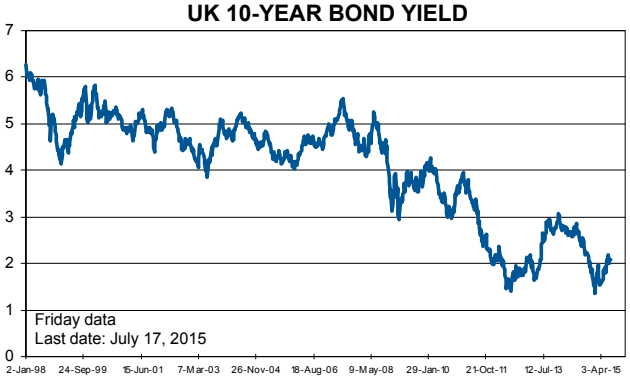
Source: Thomson Reuters Datastream

MONTHLY REVIEW ►
INTERNATIONAL 10-YEAR YIELDS

The (temporary) resolution of Greek financial problems has allowed global bond yields to rise slightly but a renewed fall in oil prices has kept that rise in check.

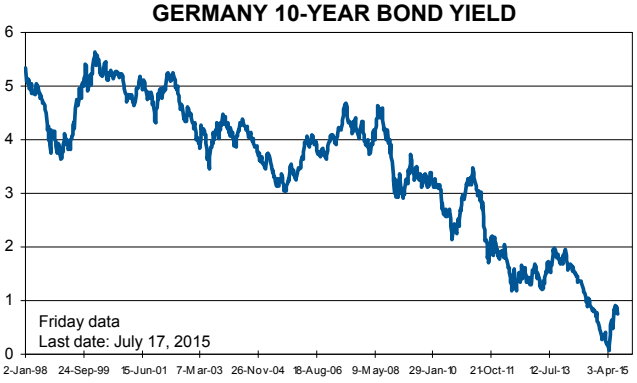
A potential Fed rate hike has been partially built into current yields.

UK 10-YEAR BOND YIELD



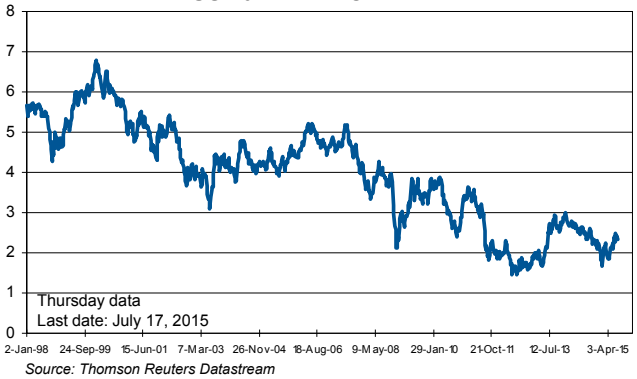
Source: Thomson Reuters Datastream

GERMANY 10-YEAR BOND YIELD



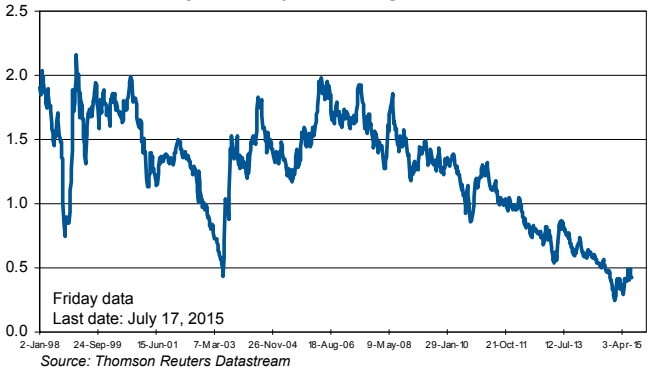
Source: Thomson Reuters Datastream

US 10-YEAR BOND YIELD



Source: Thomson Reuters Datastream

JAPAN 10-YEAR BOND YIELD

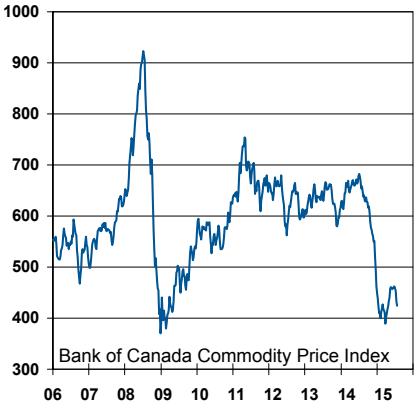


Source: Thomson Reuters Datastream

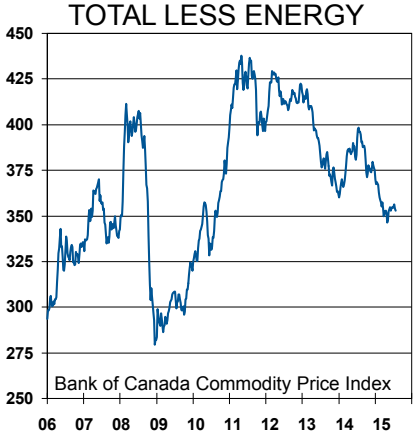
COMMODITY PRICES

1. Bank of Canada Commodity Price Indices (Weekly data to July 17, 2015)

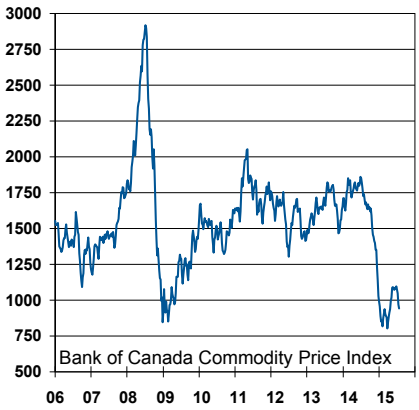
TOTAL COMMODITY



TOTAL LESS ENERGY

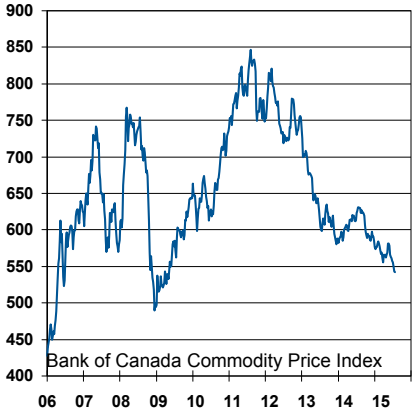


ENERGY



AGRICULTURE

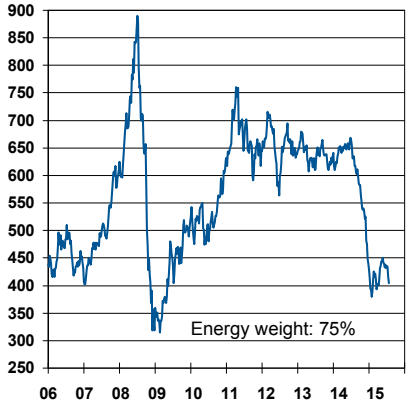
METALS AND MINERALS



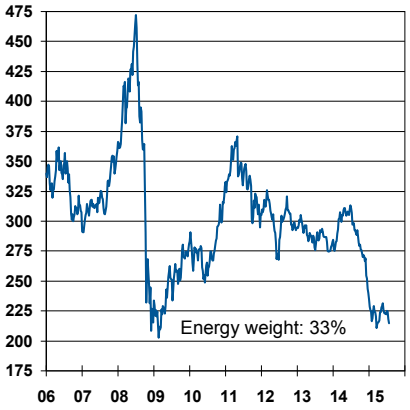
Weakening Chinese growth and growing commodity supplies continue to be problematic for most commodities.

2. Other Indices (Weekly data to July 17, 2015)

S&P GSCI COMMODITY



REUTERS/JEFFERIES CRB



ECONOMIST COMMODITY PRICE

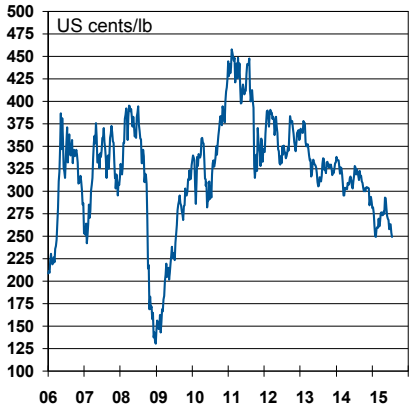
Sources: Bank of Canada, Thomson Reuters Datastream, The Economist

COMMODITY PRICES

3. Metals (Weekly data to July 17, 2015)

NICKEL

COPPER



ZINC

ALUMINUM

LEAD

GOLD

PLATINUM

SILVER

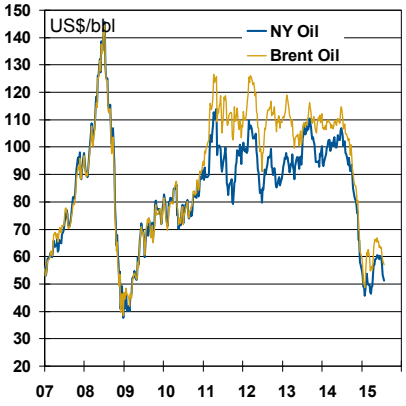
Metal prices are forecast to “bottom out” in 2015. But any upturn in 2016 is likely to be subdued!

Sources: LME, LBMA, Wall Street Journal

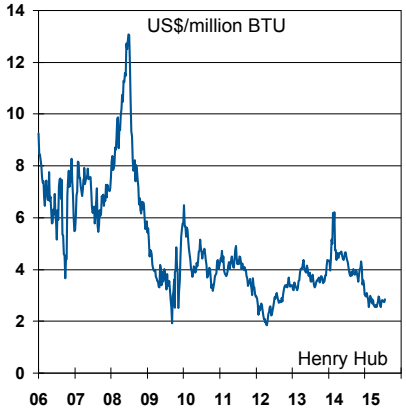
COMMODITY PRICES

4. Energy (Weekly data to July 17, 2015)

SPOT OIL PRICES



NATURAL GAS

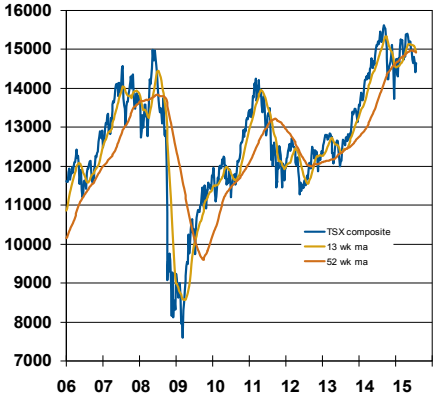


Low oil and gas prices will persist through year-end.

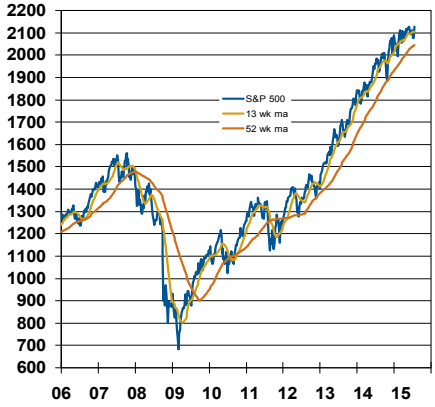
EQUITY MARKETS

5. North America (Weekly data to July 17, 2015)

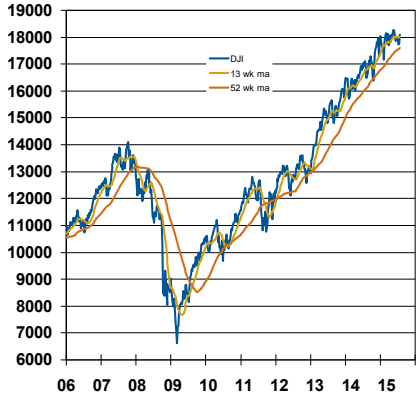
TSX COMPOSITE INDEX



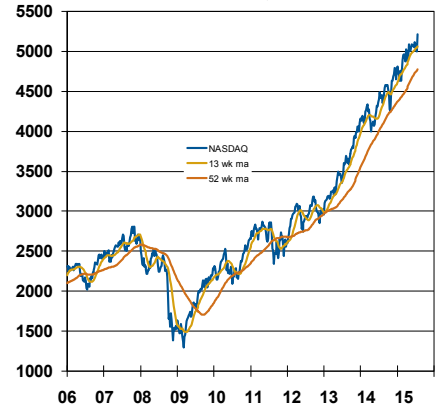
S&P 500 INDEX



DOW JONES INDUSTRIALS



NASDAQ INDEX



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 and a rising US dollar interferes with earnings growth.

Source: Thomson Reuters Datastream

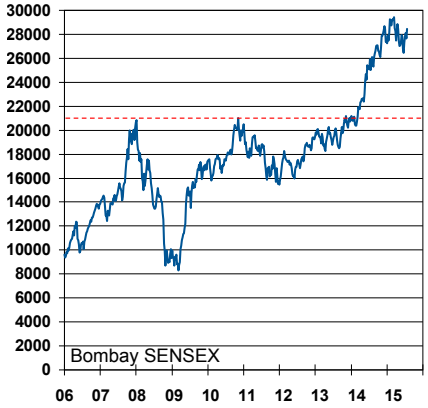
EQUITY MARKETS

6. Around the world (Weekly data through July 17, 2015)

JAPAN

GERMANY

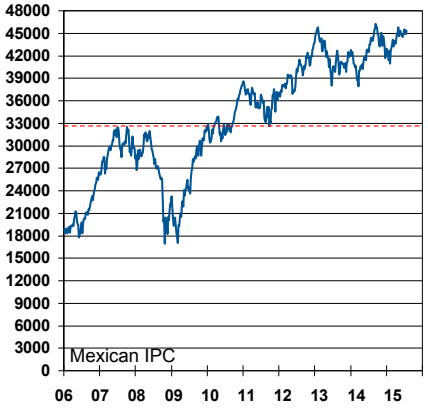
INDIA



CHINA

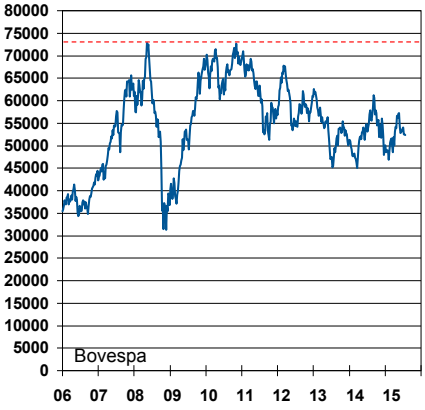
RUSSIA

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_0715_EN_V1_DOP0715 MOE9463