ECONOMIC MONITOR

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ECONOMICS

Financial Markets Overview

The global economic outlook has been revised downward in recent weeks by the IMF and OECD, and the G-20 Communique of February 27 called for more policy initiatives to boost growth. (Some policy options are discussed in an essay herewith commencing on page 4.)

Disappointing economic growth, low oil prices, and concerns over the financial/economic stability of China have continued to be major headwinds for North American equity markets. At the time of writing equity markets have rebounded somewhat, as immediate concerns have ebbed. US economic growth in 2015-Q4 was revised upwards to 1.0% and Canadian economic growth surprised by posting a 0.8% rate for 2015-Q4.

The charts commencing on page 10 highlight just how the Canadian and US economy have fared in recent months; in short it has been spotty. Business investment is not contributing to growth in either Canada or the US; the net-exports category (weak import demand) is making the single largest contribution to Canadian growth, whereas household consumption is the single largest contributor to US growth.

The lower Canadian dollar is expected to help the Canadian manufacturing sector in 2016, but the US will not likely benefit from US dollar weakness; indeed, the US dollar is expected to remain quite firm.

The forecasts this month call for:

1. ► The **FED** to hike the federal funds rate only once in 2016 – September.
2. ► The **BANK OF CANADA** to stand pat on interest rates in 2016.
3. ► **BOND YIELDS** to rise very modestly over the next four quarters on the back of some increase in the rate of headline inflation; low yields abroad will dampen any upward pressure on North American yields.
4. ► The **CANADIAN DOLLAR** to trade in a somewhat higher range than forecast last month; but oil remains a wild card: lower oil prices threaten the Canadian dollar directly – though we think oil prices have about bottomed.
5. ► The **US DOLLAR** to remain firm over the next four quarters, though we have flattened out the baseline forecasts for the yen, euro, and RMB; “Brexit” is the wild card in June and a Trump victory the wild card in November.

Updated Forecast - Base Scenario

	Actual				Projected						
	15-II	15-III	15-IV	1-Mar	Mar	Apr	May	16-II	16-III	16-IV	17-I
CURRENCIES	***Scenario B: Modest US Growth - China Struggles - Energy Prices Bottom - No Brexit***										
US Dollar Index*	94.68	97.26	98.50	97.82	98.4	99.1	98.8	98.6	98.0	98.3	98.1
Can. Dollar: CDN/US	***1.229***	***1.310***	***1.335***	***1.341***	***1.365***	***1.380***	***1.380***	***1.385***	***1.395***	***1.400***	***1.390***
Can. Dollar: US/CDN	81.37	76.35	74.92	74.58	73.26	72.46	72.46	72.20	71.68	71.43	71.94
Japanese Yen	***121.3***	***122.3***	***121.5***	***114.0***	***114.0***	***115.0***	***115.0***	***115.0***	***115.0***	***115.0***	***115.0***
British Pound	153.3	155.1	151.8	139.5	140.6	141.7	144.1	145.4	151.6	152.6	153.4
Euro	***1.105***	***1.119***	***1.095***	***1.087***	***1.090***	***1.090***	***1.100***	***1.110***	***1.140***	***1.130***	***1.120***
Australian Dollar	77.83	72.58	72.02	71.74	72.53	71.74	71.74	70.76	69.53	69.29	69.78
Chinese Yuan/Rmb	***6.120***	***6.264***	***6.389***	***6.552***	***6.550***	***6.570***	***6.590***	***6.580***	***6.600***	***6.600***	***6.600***
Indian Rupee	63.47	64.98	65.92	67.60	68.50	68.50	68.20	68.20	67.60	67.30	67.00

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

INTEREST RATES	***Scenario B: Fed Hikes Once in 2016 - Bank of Canada Stays Pat***										
Canada											
Treasury Bill (91-day)	0.63	0.41	0.44	0.46	0.45	0.43	0.41	0.42	0.40	0.40	0.40
Government Bond (10-yr)	1.68	1.47	1.49	1.24	1.25	1.30	1.35	1.35	1.50	1.55	1.60
Prime	2.85	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70	2.70
Target Overnight Rate	***0.75***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***
Spread: 10-yr - T Bills	1.05	1.06	1.05	0.78	0.80	0.87	0.94	0.93	1.10	1.15	1.20
United States											
Treasury Bill (90-day)	0.02	0.04	0.13	0.31	0.35	0.35	0.35	0.38	0.46	0.65	0.65
Treasury Bond (10-yr)	2.18	2.15	2.21	1.83	1.85	1.92	2.00	2.00	2.15	2.25	2.35
Prime	3.25	3.25	3.29	3.50	3.50	3.50	3.50	3.50	3.58	3.75	3.75
Fed Funds Rate	***0.12***	***0.14***	***0.16***	***0.38***	***0.40***	***0.40***	***0.40***	***0.40***	***0.48***	***0.65***	***0.65***
Spread: 10-yr - T Bills	2.16	2.11	2.08	1.52	1.50	1.57	1.65	1.62	1.69	1.60	1.70
Interest Rate Differential (Canada-US)											
Treasury Bill	0.61	0.37	0.31	0.15	0.10	0.08	0.06	0.04	-0.06	-0.25	-0.25
Bonds-10yr	-0.50	-0.68	-0.72	-0.59	-0.60	-0.62	-0.65	-0.65	-0.65	-0.70	-0.75

Source: Wall Street Journal, Federal Reserve, Dundee Economics

This is our “baseline” scenario for the next four quarters. It is updated monthly. See pages 45-46 for our alternative scenarios.

The Canadian Dollar Model

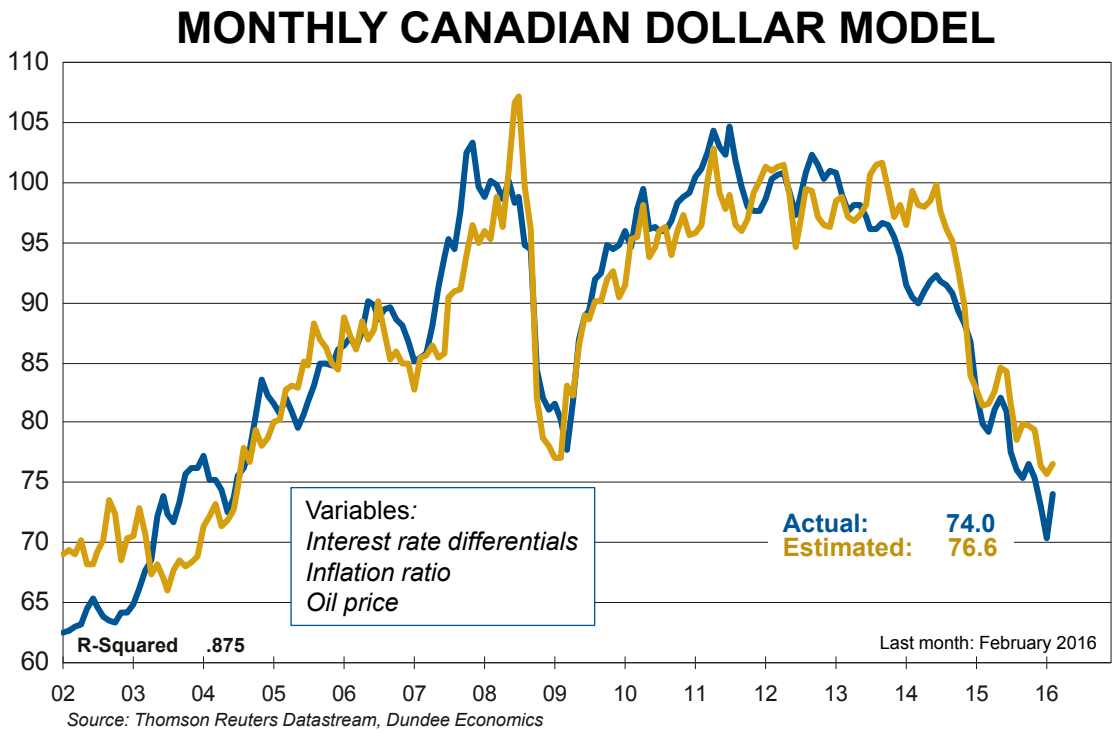
by Rasim Jafarov

The Canadian dollar has been hit hard by the collapse of commodity prices in recent years and notably by the collapse of oil prices since 2014. Commodity prices are the most influential variables in our Canadian dollar model, which also includes such variables as the US/Canada short-term and long-term interest rate spreads and inflation differentials.

At February month-end, the model estimated that the fair value range for the Canadian dollar was 72.5 to 80.5 US cents, with 76.5 cents as the middle point of the range. We do not expect the Canadian dollar to rise to the middle point of this estimate soon, especially if oil prices remain at current levels (see our latest CAD forecasts in this *Economic Monitor*); models over/under-estimate reality all the time – see the chart below.

Yet, the model is still useful in providing us with a numerical range for "fair value", and in providing some sense of how sensitive the dollar might be to changes in oil prices. A variation of the model below suggests that a 10% percent decline (rise) in the price of oil leads to a 2.8% decline (rise) in the Canadian dollar (i.e. a rise of about $3.00 in the oil price would add about 2 cents to the Canadian dollar, all else equal).

We'll see how it goes. It's not clear that the full weight of the commodity price/oil price plunge has yet worked its way through the Canadian economy. This means that interest rate developments in the US and Canada could yet lower the model's estimate of "fair value" as the year progresses.



Source: Thomson Reuters Datastream, Dundee Economics

Slow World Growth and Policy Options

by Martin Murenbeeld

IMF Forecasts for world growth in 2016 have come down again; the IMF January Update forecast a 3.4% growth rate, which is down from 3.6% it forecast in its (Fall 2015) World Economic Outlook. (Readers may remember that anything below 4.0% is not helpful for commodity prices, because these typically decline year-over-year, inflation-adjusted, when world growth is less than 4.0%.) The OECD, too, revised downward the outlook in its February update. Together with other uncertainties, not least of which the outlook for oil prices, these downgrades have taken their toll on global equities.

The IMF's January Update forecast the US economy will expand by 2.6% in 2016, and the Canadian economy by 1.7%. The OECD's February Update forecast a 2.2% and 1.4% expansion for the US and Canadian economy respectively. Our expectations are modestly lower: in simple round numbers we look for 2.0% and 1.0% respectively. In short the outlook for the North American economy is also somewhat anemic.

How can policy help boost growth in North America – and in the US specifically? To organize the answer to this question we simplify the following discussion by classifying all policies as being either monetary, fiscal, or exchange rate. ("*Restructuring*", a catchall for all other policies including, for example, legal changes in labor market legislation, falls outside of the present discussion – though is no less important.)

Quick Review of Recent Policies in the US and Canada

In recent years, to keep economic growth from potentially contracting, US policymakers have relied heavily on monetary policy. But it has been difficult, and monetary policy has increasingly turned "unconventional". The success however can be seen in the fact that the US economy has expanded by an average of 2.1% since the Great Recession ended (all data are quarterly, seasonally adjusted at annual rates). Yes, this is low by post-recession standards, and attests to the severity of the Great Recession, but is positive – unlike what has been recorded in Europe and Japan.

Fiscal policy did provide significant support for the US economy during the Great Recession, but the Administration and Congress have not been able to forge a meaningful consensus on fiscal policy since then. The US budget deficit contracted once the economy began to expand again, and was a drag on US economic growth thereafter. Since 2010 the government sector's contribution to quarterly economic growth averaged a minus .26%.

With the US dollar's exchange value set abroad (by the Peoples' Bank of China and other central banks – not by the US Treasury), US policymakers did not have the benefit of a lower dollar to help counter sluggish domestic growth in recent years. Indeed, US policymakers do not normally have an exchange rate policy option – unlike other policymakers. Net exports have subtracted an average .2% from quarterly US growth since the Great Recession.

Canadian policymakers have had a significant advantage over US policymakers; both monetary and exchange rate policies have been employed to deal with sluggish growth. Yes, the Canadian dollar floats freely, but that is a policy choice the Bank of Canada and the Government of Canada have made – and it has been an extremely beneficial policy choice. (Need we note that the Bank of Canada has "nudged" the Canadian dollar lower at propitious points in time?) The Canadian dollar declined dramatically during the Great Recession. It recovered as commodity prices around the world responded to improved global growth but recently, as oil and commodity prices have plunged, the dollar

has declined again. And, of course, the Bank has cut interest rates when required, though not yet to zero. Because of the highly flexible dollar, the Bank of Canada has not needed to adopt more "unconventional" monetary policies.

Canadian fiscal policy was supportive for the economy during the Great Recession, but the Harper government preferred an early return to balanced budgets as the Canadian economy basked in the sun of rising commodity prices. (Indeed, the government sector's contribution to quarterly economic growth since 2010 has averaged exactly zero!) Demands for "fiscal stimulus" have escalated in recent quarters however as the Canadian economy has weakened on the back of plunging commodity prices; we accordingly expect the new Trudeau government to go "all in" on fiscal policy in coming quarters.

Monetary Policy

In the following sections we will discuss the three policies in turn – with a view on what options are available.

Policymakers in the US, Canada, and abroad have relied heavily on monetary policies in recent years; first in response to the Great Recession, and thereafter to its disinflationary aftermath, to the continuing structural problems in Europe and now to the collapsing investment bubbles in many parts of Asia/China. In a sequence of stages, interest rates around the world have been cut to historic lows; unconventional policies, QE (the outright purchases of financial assets on the open market), have been adopted; and a number of countries have now introduced negative interest rates (NIRP – negative interest rate policies) - all to help boost consumption, investment and growth.

(Even the Fed allowed recently that NIRP was not off the FOMC's table - that it had been discussed. The probability of the Fed actually adopting NIRP must be considered quite small at this stage however.)

It is doubtful NIRP will do much that near-zero interest rates and QE did not accomplish. Indeed some see NIRP as a "*calamitous misadventure*" (Ambrose Evans-Pritchard, writing in the Telegraph, February 17). One reason is that the efficacy of NIRP is enhanced in a "cashless" financial system (where money is in the form of electronic bank entries only). But no country runs a "cashless" financial/banking system! This means the public is able to escape NIRP by hoarding cash (in large-denominated bills for convenience).

But there are other reasons for NIRP to be less effective than advertised: banks have been loath to pass negative interest rates (levied on part of their reserves with the central bank) on to their depositors. NIRP will likely also encourage retiring baby boomers to spend less because their assets need be stretched over their remaining lives; household savings rates are likely to rise instead. Fourth, if/when the central banks decide to charge fees on issuing bank notes (on the issuance of $100 bills and €500 bills for example) the public will be encouraged to hoard "near-money" assets like gold outside of the banking system.

(Expecting the removal of large-denominated bills, some observers have opined that governments will quickly abolish private-sector hoarding of gold again, along with other "near-money" assets. If this happened public distrust in government and the financial system will grow dramatically! For example, public distrust in the Indian government and the Indian financial system is widespread, which is why gold hoarding is an entrenched fact of life. And as the Indian government has discovered with import duties and now its gold monetization schemes, gold hoarding, and the lack of confidence in the monetary system, is not easily reversed.)

So what monetary policy might come after NIRP? Some have suggested "helicopter money" is next! (We wrote in the February 19th *Gold Monitor*: "'*Helicopter money' … is a reference to pumping money – liquidity – directly into the financial system outside of the banking system. Milton Friedman famously suggested in 1969*

(tongue-in-cheek?) that the Fed could always distribute money by distributing cash from helicopters for the public to gather up and spend".) To quote AEP, cited above, helicopter money is "*an injection of money directly into the veins of the real economy through fiscal stimulus … [paid for by] central bank transfers rather than government debt issuance*".

The following is one example of "helicopter money", taken from "*The ECB's original sin and Franco Modigliani's long view*" (Voxeu.org, 02/19):

"*The ECB has proven unable to raise inflation through its QE program. Higher price dynamics cannot be achieved if the monetary stimulus fails to reach the real economy. When the latter is in deep recession or deflation, and fiscal space is limited, only monetary finance can be effective as it allows* ***newly created money*** *to be* ***transformed into additional (public or private sector) spending without raising public debt****. One way to apply money finance at the whole EZ level would be through an initiative whereby the European Investment Bank would issue bonds to finance a large investment plan for the area, and the* ***ECB would purchase the EIB bonds with newly created money****. Through such initiative, money finance would pursue the inflation target by stimulating demand and reducing unemployment*."(Bolding added.)

In other words, "helicopter money" is the direct financing of public investment by the central bank, in infrastructure, defense, and other projects that will spin off employment and growth. The trick is to keep the debt purchased by the central bank off the books of the government, so as to ensure the government's budget deficit and its overall debt level do not rise, and that the government isn't on the hook for more interest payments. (Presumably that is why the authors above have the European Investment Bank borrowing from the ECB - not the Greek or German government.)

It must be noted here that "helicopter money", the central bank financing (directly or indirectly) of government policies, is how Zimbabwe and most Latin American countries at one time or another slipped into hyper-inflation - and then went bust. But we shouldn't get carried away just yet; the FT's Martin Wolf noted recently "*the economic forces that have brought the world economy to zero real interest rates and, increasingly, negative central bank rates are, if anything, now strengthening … Policymakers must prepare for a new 'new normal' in which policy becomes more uncomfortable, more unconventional, or both*" (see "*Helicopter drops might not be far away*", FT.com, 02/23).

Fiscal Policy

Which brings us to fiscal policy: in my view central bank financing of public infrastructure, defense, and other public assets crosses the line between monetary and fiscal policy. Any entity (i.e. the European Investment Bank) initiating infrastructural investment funded by the central bank is almost certain to be a public-sector entity. This means the liability of that entity to the central bank must perforce be a government liability (similar to other "unfunded" government liabilities that are not recorded in the annual budgetary accounts).

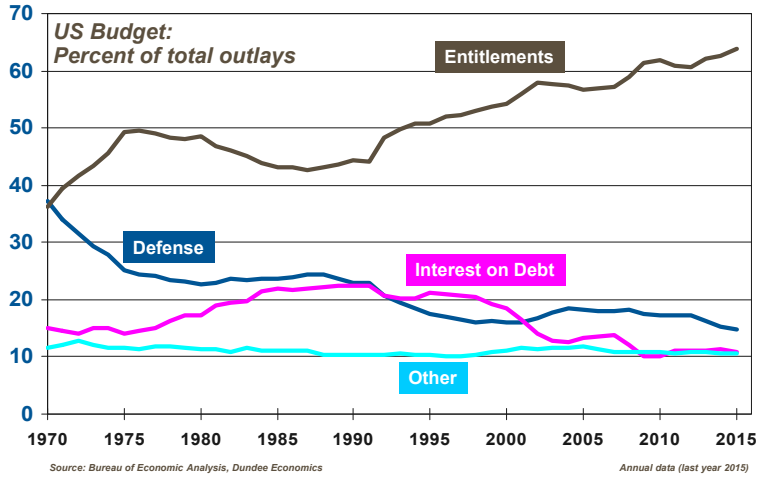
(If the entity were a private-sector entity then the central bank in question will have crossed a Rubicon of sorts; for example, the Bank of Canada and the Federal Reserve are not, to my knowledge, permitted to buy the debt of private entities directly. If a private-sector entity's project is deemed important enough to be funded directly by the central bank, then elected officials and the finance ministry will of necessity be involved.)

Our view is that fiscal policy should be making more of a contribution to growth. If ever there was an argument for Keynesian policy stimulation it is presently! (Keynesian economics was borne out of the Great Depression, and the global economy is about as close to the Great Depression experience as is possible without actually being in a Great Depression.) Keynes argued that when the private sector exhibits insufficient demand, the public sector must step up to the plate – and I agree.

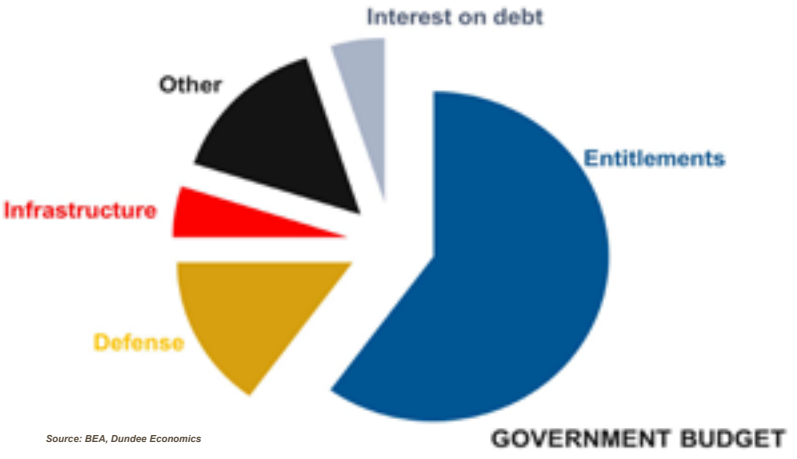
There is no limit to the projects in which governments can invest. (For a summary of necessary US infrastructural investments the reader can consult the American Society of Civil Engineers' 2013 report card on US infrastructure: http://www.infrastructurereportcard.org/.) The market is also sending the government a message: when the US government is able to borrow hundreds of billions of dollars for 10 years at less than 2%, the US government ought to be able to find infrastructure and defense-related projects that will have an economic return to the economy exceeding 2%!

The reason fiscal policy has not made a contribution to growth is highlighted in the charts herewith: heavy spending on entitlements has left little room for infrastructural and defense-related spending. The combination of massive spending on entitlements with politically-mandated balanced budgets (or at the very least, modest budget deficits) negates large spending in the more traditional "*make-work/boost-demand*" areas of infrastructure and defense upgrades. A majority of politicians agree that North American infrastructure needs upgrading, but many are unwilling to incur the large budget deficits that come with infrastructural spending. Hence, the option of "helicopter money": central bank funding of necessary projects outside of the fiscal (political) process!

Entitlements dominate fiscal expenditures …



Leaving no room for defense and infrastructure



The obvious solution is not "helicopter money" however, but fiscal policy restructuring! Room has to be found in budgets for infrastructure spending, defense upgrades, and other publicly important assets. (We may, and will, debate how much infrastructural investment should be done by the public sector versus how much by the private sector, because the public sector typically runs inefficient and high-cost operations, but the time horizon on public projects is generally longer than the private sector is willing to undertake without some form of public-sector guarantee.)

Even so, western governments must reduce "entitlements" and make room for more important fiscal initiatives. Excessive entitlements, defined simplistically as a government payment for which no work need be performed, has been instrumental in the present economic malaise for at least two reasons: entitlements reduce the fiscal room for more growth-oriented fiscal initiatives and entitlements increase the unhealthy, economically-regressive, attitude among the public that the government is responsible for an individual's well-being.

We have argued in favor of a flat income tax, a consumption tax, zero corporate tax, a suitably high minimum income before the flat tax kicks in, and a withholding tax on interest and dividend payments to non-residents (with zero corporate taxes the government will lose revenues on such payments to non-residents; such payments to residents will be included in their income and will incur the flat tax). We have also argued that "tax expenditures", which in the US total over $1 trillion and include mortgage interest rate deductibility (for a quick summary of US tax expenditures please see: http://www.gao.gov/key_issues/tax_expenditures/issue_summary), should be cut back dramatically, because they are/were politically-motivated and distort the market's process of resource allocation.

With respect to entitlements, the government should replace public sector provisions with private sector insurances at its earliest opportunity, and repeal the programs that do little more than enrich the bureaucracies that oversee such programs.

(Yes, US medical care costs more than elsewhere, but it is also the best medical care for those who can afford it. Tort reform would do wonders for lowering the cost of medical care, however, as would legal action against entrenched monopolies. But let me quote Milton Friedman on health care: "*Two simple observations are key to explaining both the high level of spending on medical care and the dissatisfaction with that spending. The first is that most payments to physicians or hospitals or other caregivers for medical care are made not by the patient but by a third party - an insurance company or employer or governmental body. The second is that nobody spends somebody else's money as wisely or as frugally as he spends his own*", taken from "*How to Cure Health Care*" in The Public Interest, winter 2001. My point is that there are serious market distortions in the provision of "entitlements" that do nothing other than raise the costs thereof.)

One last comment on fiscal policy! Bernie Sanders is a very likeable individual, undoubtedly; but his fiscal policies (with which most Canadians are already well versed) will absolutely worsen the economic malaise that now grips the US economy. Canada, in its good fortune, has had the benefit of periodic commodity cycles to "hide" its governments' destructive fiscal policies (at both federal and provincial levels), but Canada's lack of a credible military force, with credible military equipment, is an obvious sign of rot in the fiscal system. Europe is worse; its entitlement structure is gigantic and it must accordingly depend upon the US for defense. Were it not for the US entrepreneurial class' massive contribution to economic well-being the US, too, would find itself unable to maintain its military expenditures at current levels. US infrastructural spending is, of course, already woefully inadequate.

Exchange Rate Policy

Few economists think of "*exchange rate policy*", though Canadian economist more than most. (Some of the more famous "international" economists were Canadian!) In my opinion, Canada has the ideal exchange rate policy: the Canadian dollar floats … freely. When demand for Canadian resources threatens to balloon domestic inflation the rise in the dollar helps to moderate the pressure. Currently, a weaker dollar helps to (1) keep inflation near 2% and (2) contain unemployment levels as the economy shifts from resource production to the production of other goods and services. And the Bank of Canada has been spared from adopting negative interest rates.

The US dollar "floats", though not freely; its exchange value is set by other central banks – those that manage their currencies closely. This has always been a problem for the US; it has no direct control over its currency's value. (This was understood and accepted by the US, but was weighed against the advantage of issuing the world's reserve currency.) Accordingly, there have been periods in recent history when the US has had to force dollar devaluation onto the global system. (The natural tendency of most countries

is to manipulate their currencies lower against the US dollar – which then has to be corrected.)

From an economic point of view, the US dollar is seriously overvalued today. This has led to massive downward pressure on US inflation, employment and growth – which the Fed has acknowledged many times in recent years. Some of the US economic malaise is therefore due to the dollar's overvaluation against the RMB (other SE Asian currencies), the yen, and the euro.

A weaker dollar would also help address the structural problems of China and Japan. China needs to orient its production to domestic consumption – not foreign consumption; but it won't thank the US in the event the US was able to devalue the dollar against the RMB. Europe has massive structural problems, some of which are alleviated by the massively undervalued euro. But this too comes at a significant cost in US growth and employment.

In short, there are a number of structural problems that underlie the dollar's overvaluation – and we have said nothing about the structural "problem" of excessive US consumption (which would be corrected with consumption taxes and a flat income tax). These structural problems all feed into the underperformance of the US economy.

So what is to be done? Republicans appear intent upon redressing the situation. I have said elsewhere that a Donald Trump administration will devalue the dollar – one way or another. One way is with another Plaza Accord. ("*The Plaza Accord or Plaza Agreement was an agreement between the governments of France, West Germany, Japan, the United States, and the United Kingdom, to depreciate the U.S. dollar in relation to the Japanese yen and German Deutsche Mark by intervening in currency markets. The five governments signed the accord on September 22, 1985 at the Plaza Hotel in New York City*", Wikipedia.) It is doubtful that China, Japan and the EU would agree to such an accord today however.

The other way to devalue the dollar is with import tariffs/duties/taxes! This doesn't help US exporters, but it certainly helps import-competing firms. It also puts other countries on notice that if they want access to US consumers they have to adopt "fair trade" practices.

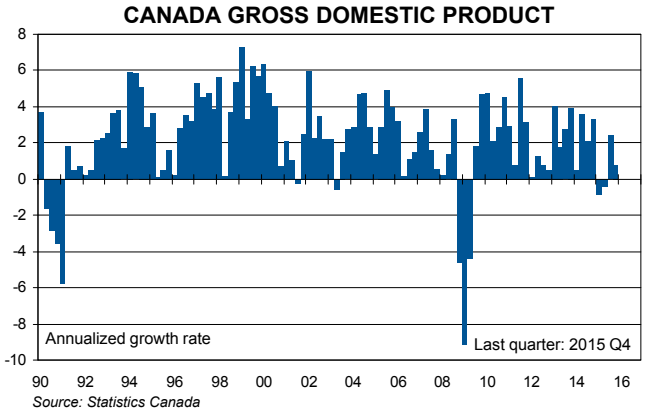
("Fair trade" is often a euphemism for protectionism, but one can also think of it as reciprocal-trade fairness: "*Do unto trade partners what they do to you*". It's a slippery slope and the US has been loath to adopt many of the trade policies widely used abroad, but redressing an inherent unfairness in international trade is important when the overriding concern in the US is "secular stagnation".)

Conclusion

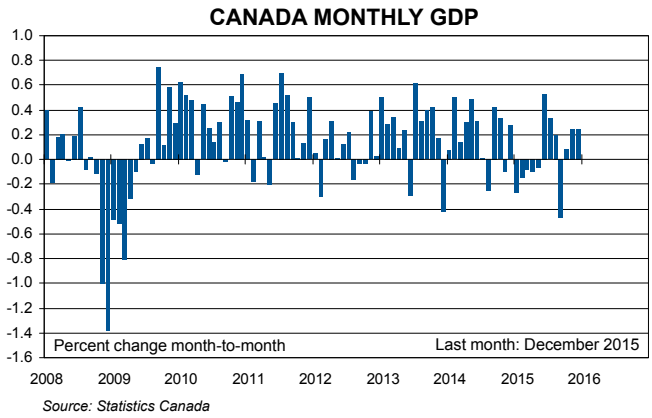
Without some important shifts in fiscal and exchange rate policies western economies face a lengthy period of weak, quasi-recessionary growth. We do not think a global recession is highly probable, nor a US economic recession, in the next several years. But a better set of policies would reduce the probability of recession and most certainly lead to better economic outcomes. The need for a major cutback in the "entitlement" system, which now overrules expenditures in the more traditional (if not also more important) areas of infrastructural and defense expenditures, is of paramount importance, in our opinion. So are the aforementioned tax policy changes. And the global system has to come to some agreement on currency realignment, if not also a system of penalties to refrain currencies from becoming seriously over/undervalued. Prolonged currency misalignment breeds protectionism – in its worst forms.

MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

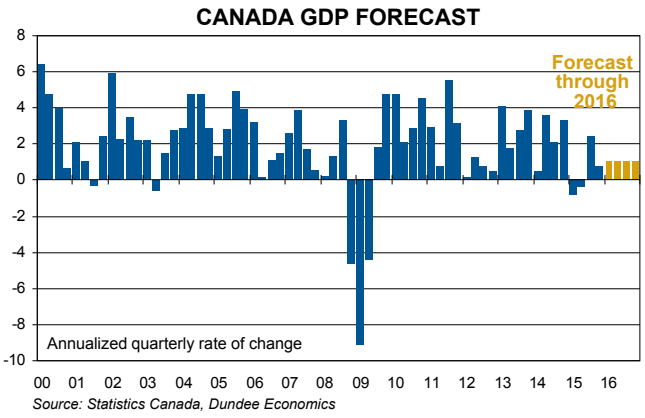
The Canadian economy grew at 0.8% (annualized) in the fourth quarter and averaged 0.5% for the four quarters of 2015.



Monthly GDP also advanced 0.3% in November and December.



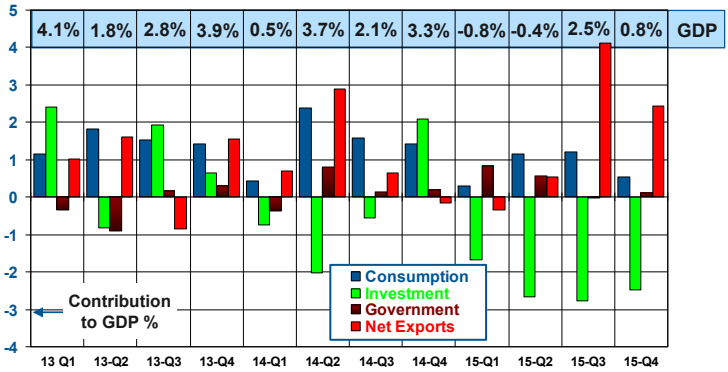
Our GDP forecast calls for 1.0% growth in 2016, which is an improvement over 2015.



MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

Net-exports made the largest contribution to GDP in 2015-Q4. Business investment continued to be a major drag on GDP growth.

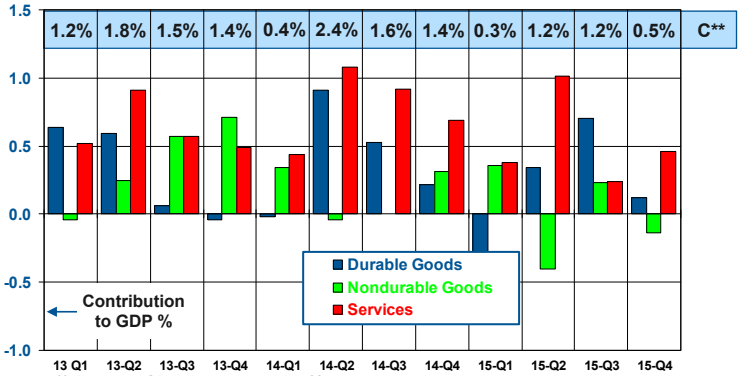
CONTRIBUTION TO GDP IN RECENT QUARTERS



*** Average of last 12 quarters: 2.02%*

Source: Statistics Canada

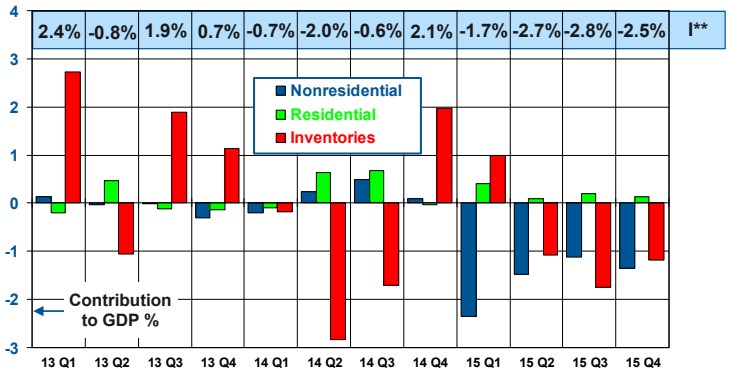
C: HOUSEHOLD CONSUMPTION



*** Average of last 12 quarters: 1.24%*

Source: Statistics Canada

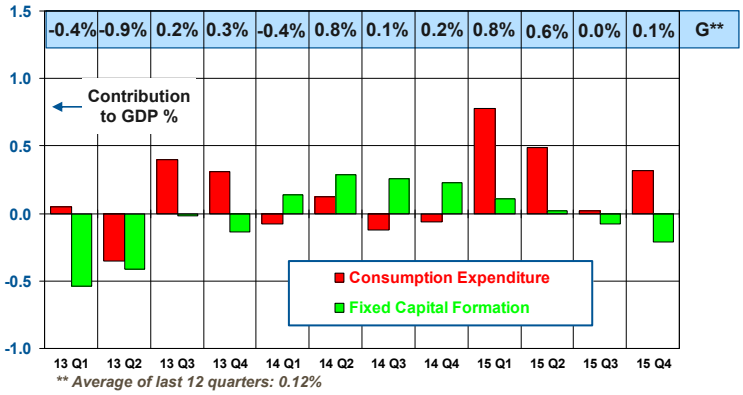
I: INVESTMENT



*** Average of last 12 quarters: -0.56%*

Source: Statistics Canada

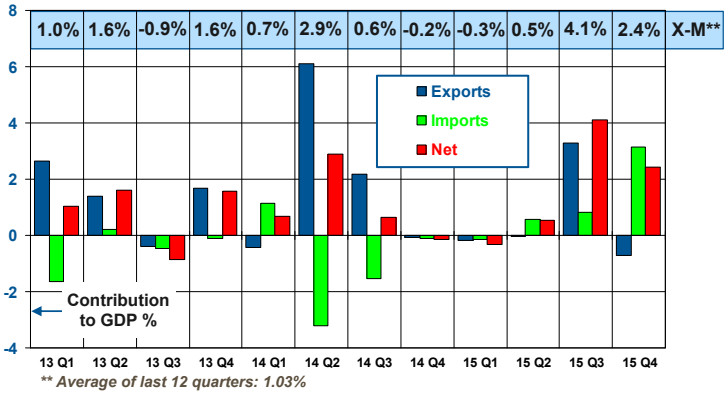
G:GOVERNMENT



*** Average of last 12 quarters: 0.12%*

Source: Statistics Canada

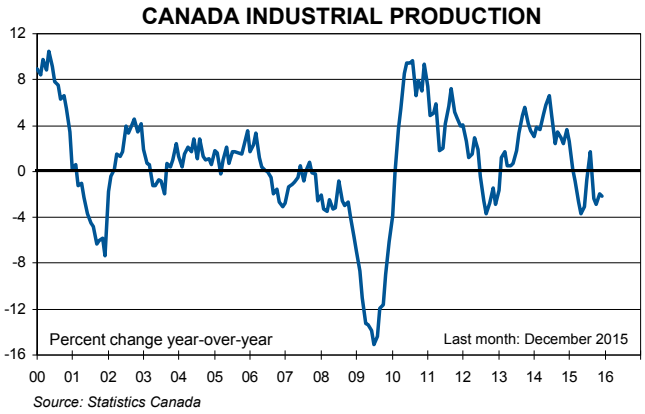
X-M: FOREIGN BALANCE



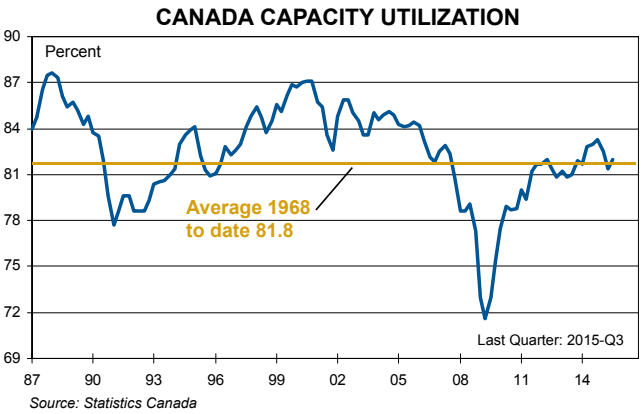
*** Average of last 12 quarters: 1.03%*

Source: Statistics Canada

Industrial production has been negative year-over-year for the last four months and is likely to remain depressed for some time to come.



Capacity utilization will likely also decline somewhat further in 2016.

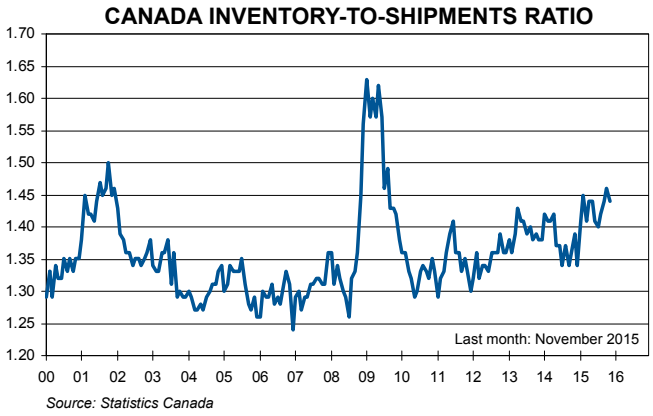


The growth in retail sales has averaged a modest 2.3% for the last six months.

MONTHLY REVIEW ►
CANADA – ECONOMIC GROWTH

The manufacturing sector remains weak.

The inventory ratio continues to trend upwards ...



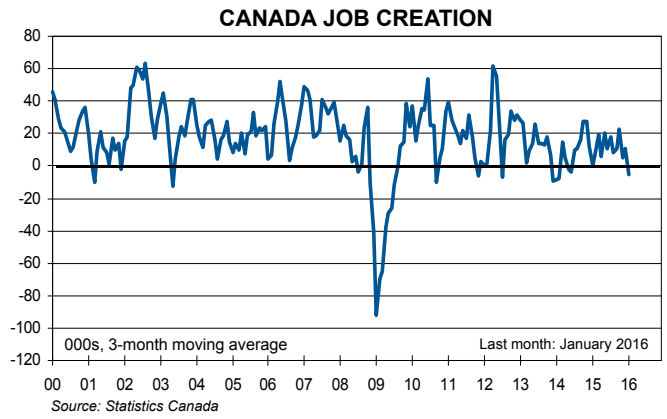
... shipments have averaged a negative 1.5% for the last 12-months (year-over-year) ...

... and new orders have averaged a negative 4.0% for the last 12-months.

MONTHLY REVIEW ►
CANADA – LABOUR MARKET

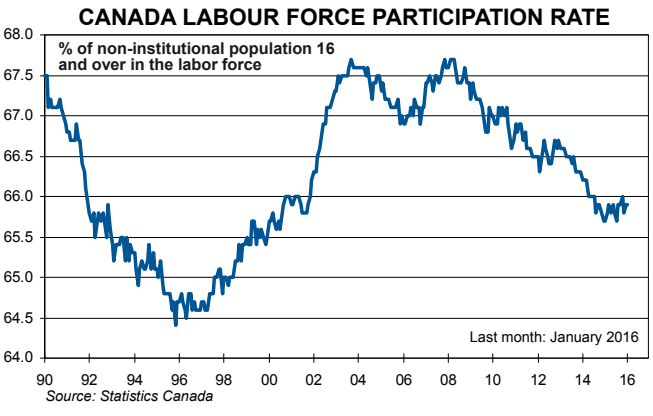
Canada's labour market remains weak.

Job creation was negative in January ...



... the unemployment rate ticked up to 7.2% in January (from 7.1% in December) ...

... and the labour force participation rate remains below 66%.

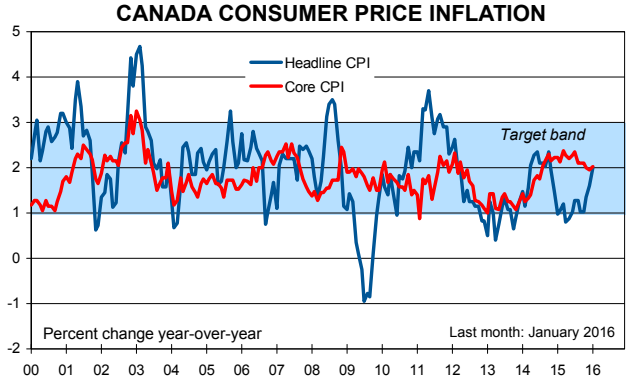


MONTHLY REVIEW ► CANADA – INFLATION

Headline CPI increased to 2.0% in January from 1.6% in December on the back of higher food prices, however inflation expectations declined further in February.

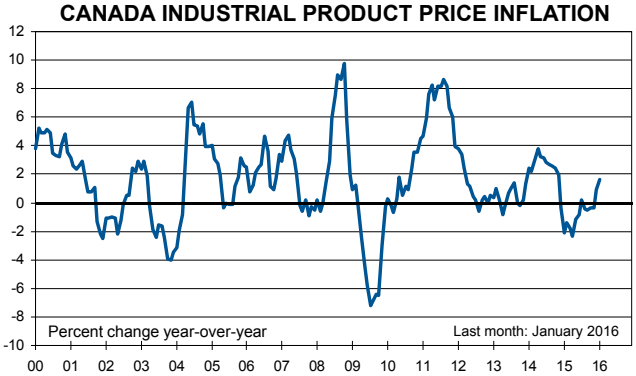
We do not expect inflation to be an issue for the Bank of Canada in 2016.

CANADA CONSUMER PRICE INFLATION



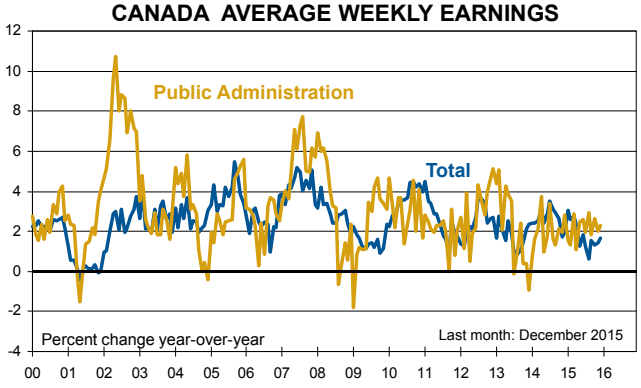
Source: Statistics Canada

CANADA INDUSTRIAL PRODUCT PRICE INFLATION



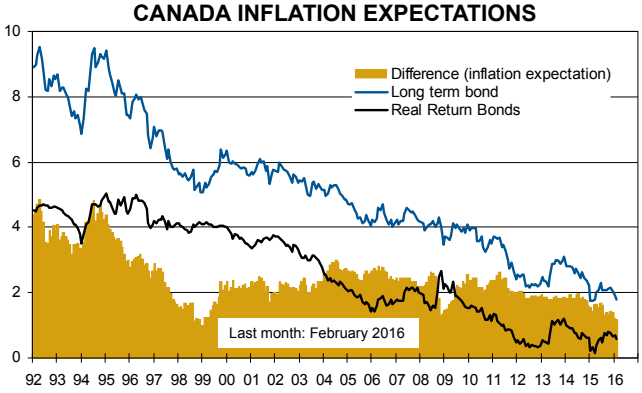
Source: Statistics Canada

CANADA AVERAGE WEEKLY EARNINGS



Source: Statistics Canada

CANADA INFLATION EXPECTATIONS

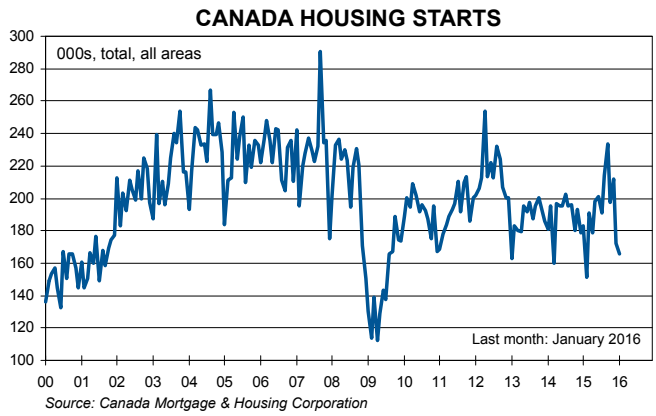


Source: Bank of Canada, Dundee Economics

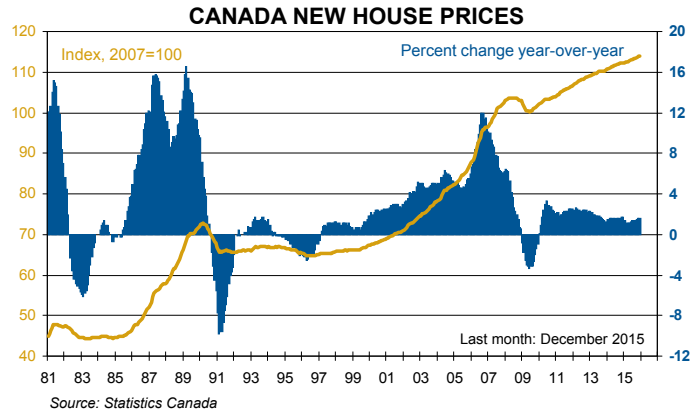
MONTHLY REVIEW ►
CANADA – HOUSING MARKET

Canada's housing market is mixed.

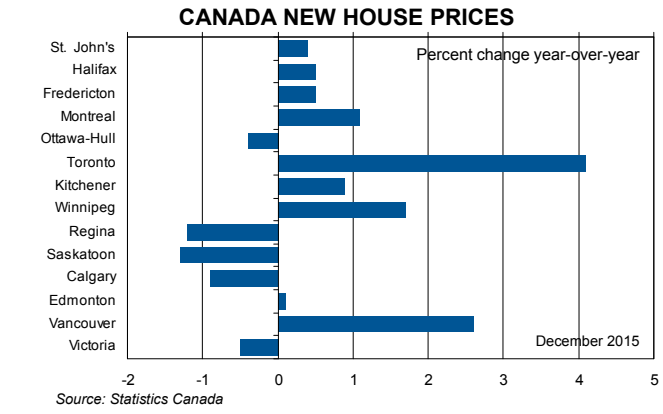
Housing starts declined sharply in December and January ...



... but new house prices continue to increase at a 1.5% rate ...



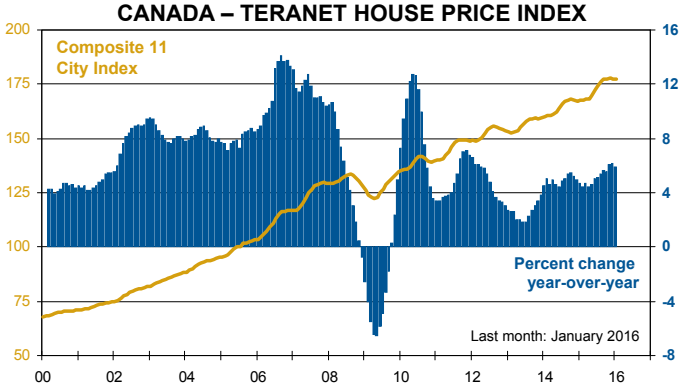
... with Vancouver and Toronto driving the increase in house prices.



MONTHLY REVIEW ►
CANADA – HOUSING MARKET

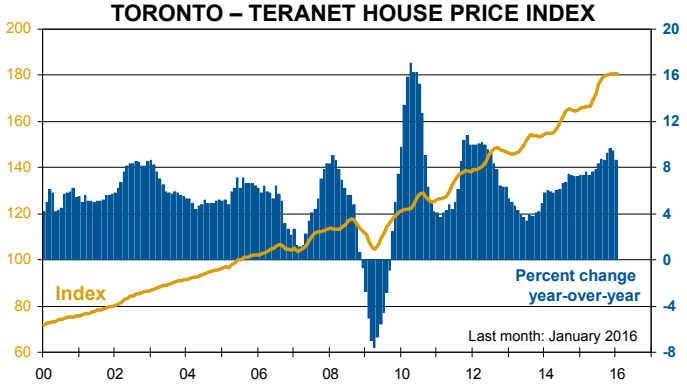
According to the Teranet 11 city composite house price index, existing house prices continued to increase by over 6% in January (year-over-year). House prices in Calgary are looking increasingly depressed however.

CANADA – TERANET HOUSE PRICE INDEX



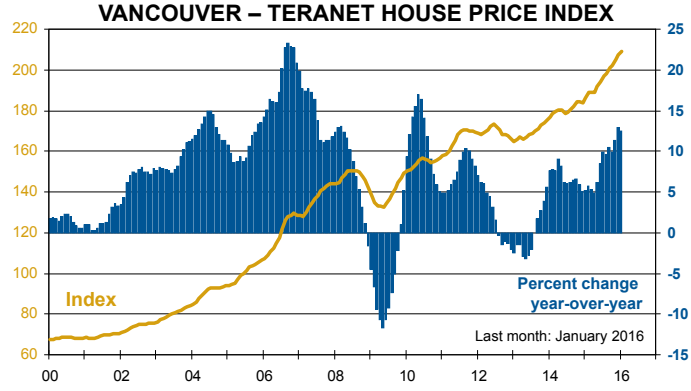
Source: Teranet (National Bank)

TORONTO – TERANET HOUSE PRICE INDEX



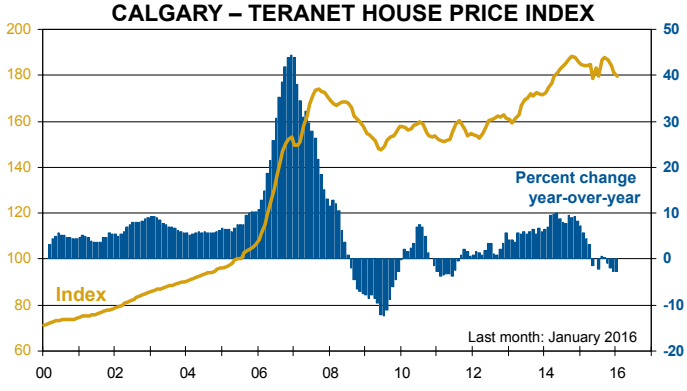
Source: Teranet (National Bank)

VANCOUVER – TERANET HOUSE PRICE INDEX



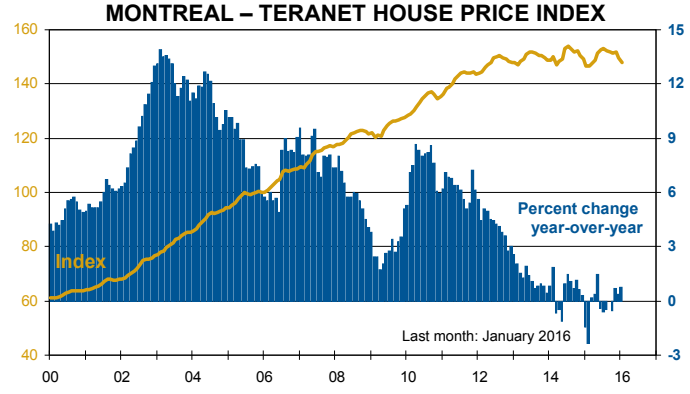
Source: Teranet (National Bank)

CALGARY – TERANET HOUSE PRICE INDEX



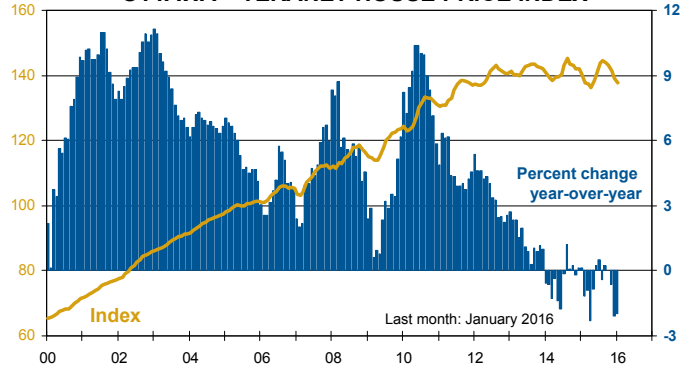
Source: Teranet (National Bank)

MONTREAL – TERANET HOUSE PRICE INDEX



Source: Teranet (National Bank)

OTTAWA – TERANET HOUSE PRICE INDEX



Source: Teranet (National Bank)

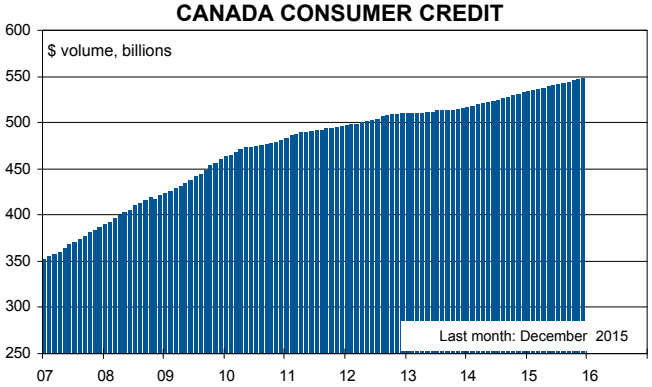
MONTHLY REVIEW ►
CANADA – CREDIT AND DEBT

Consumer credit growth appears to be stabilizing around 3%; mortgage credit and total business credit growth are both in excess of 6% however.

CANADA CONSUMER CREDIT GROWTH

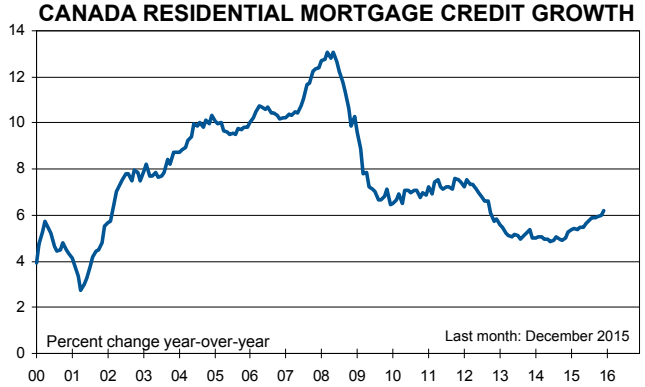
Source: Bank of Canada

CANADA CONSUMER CREDIT



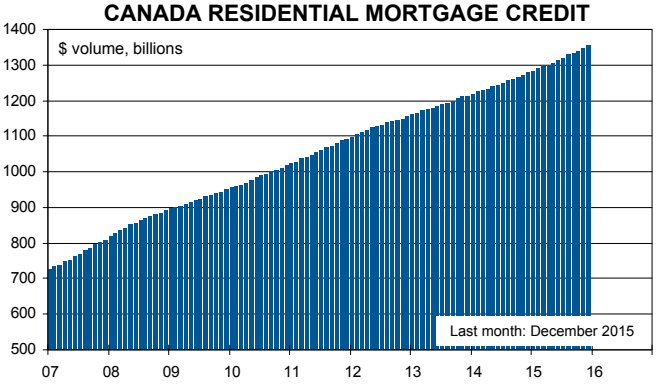
Source: Bank of Canada

CANADA RESIDENTIAL MORTGAGE CREDIT GROWTH



Source: Bank of Canada

CANADA RESIDENTIAL MORTGAGE CREDIT

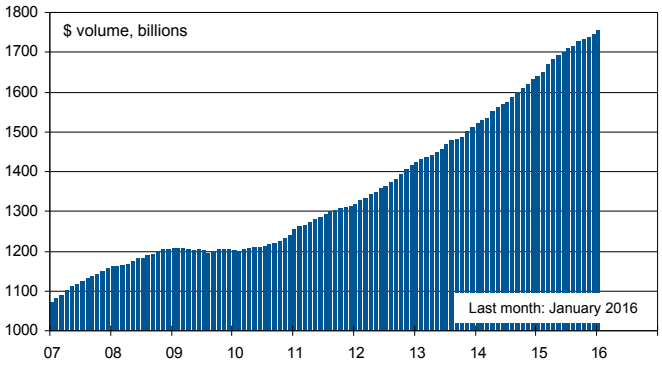


Source: Bank of Canada

CANADA TOTAL BUSINESS CREDIT GROWTH

Source: Bank of Canada

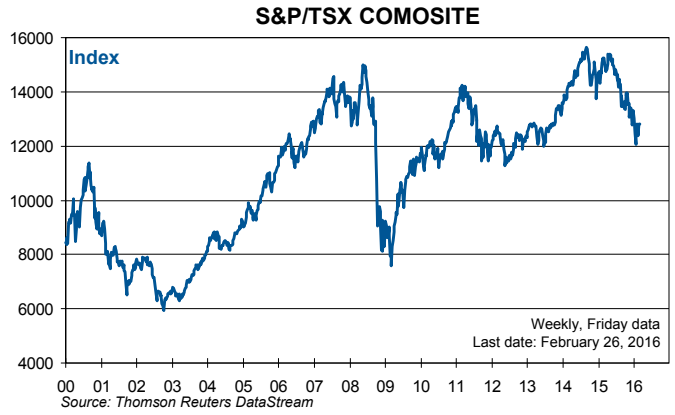
CANADA TOTAL BUSINESS CREDIT



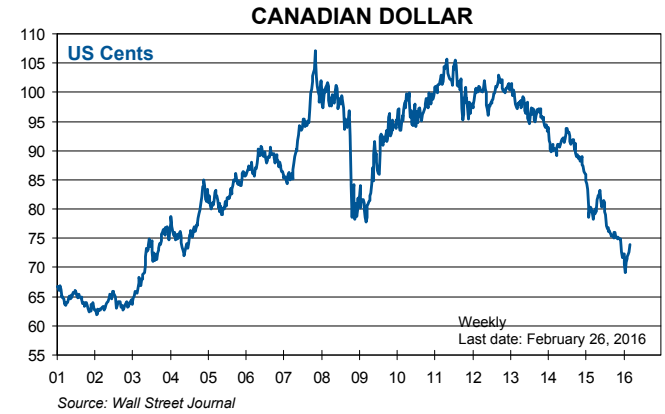
Source: Bank of Canada

MONTHLY REVIEW ►
CANADA – ASSET PRICES

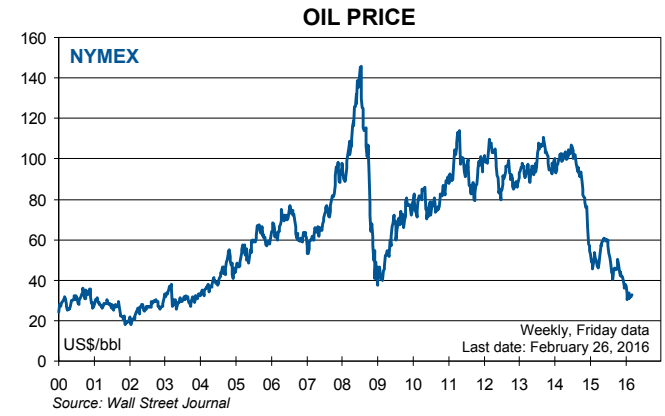
The S&P/TSX composite index remains volatile, and is still down from its April 2015 highs.



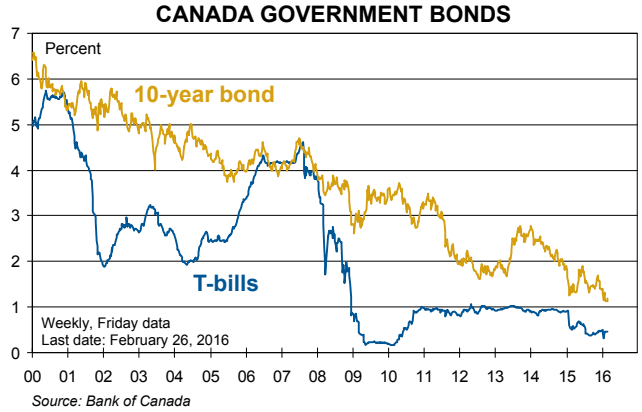
The Canadian dollar increased somewhat in February (see page 3 for Canadian dollar commentary) ...



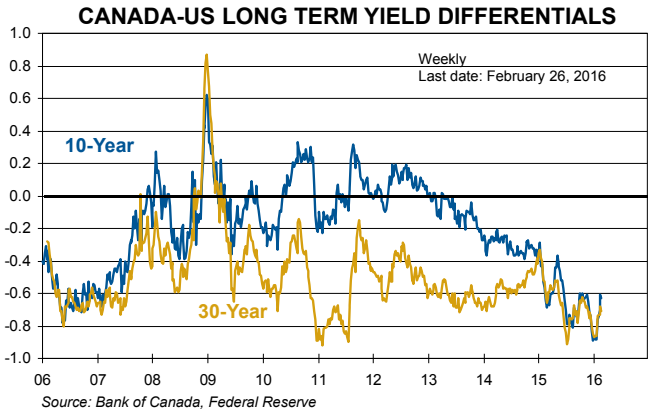
... on the back of a modest rise in oil prices.



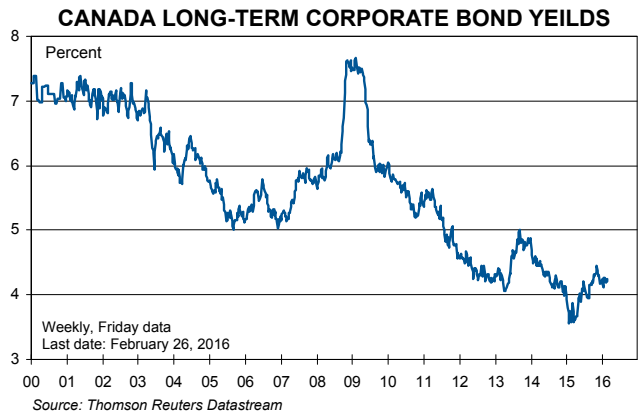
Government bond yields declined in February ...



... Canadian long-term rates remain significantly below US long-term rates ...

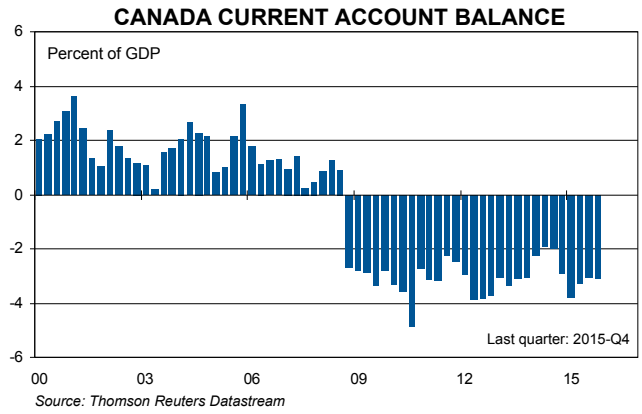


... and Canada's long-term corporate bond yields have also come down somewhat in recent weeks.

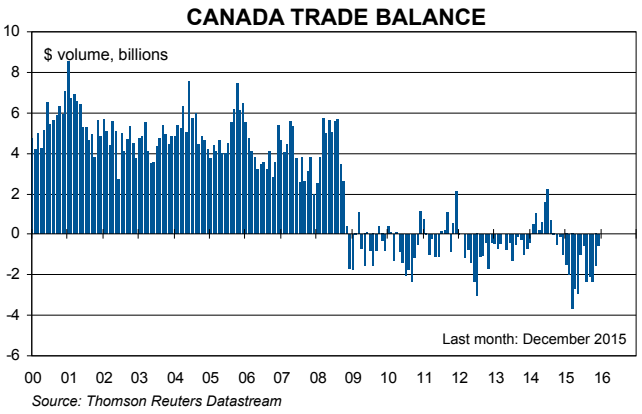


MONTHLY REVIEW ►
CANADA – CURRENT ACCOUNT AND TRADE BALANCE

The current account balance is just over 3% of GDP, and is not expected to improve significantly in the near-term.

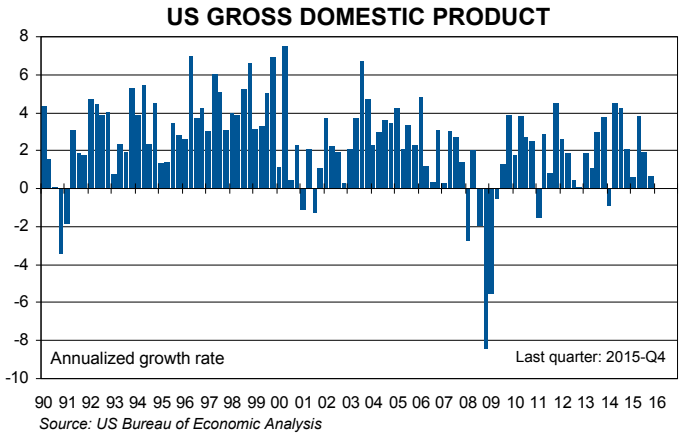


Canada's trade deficit declined in December, but is likely to remain elevated.

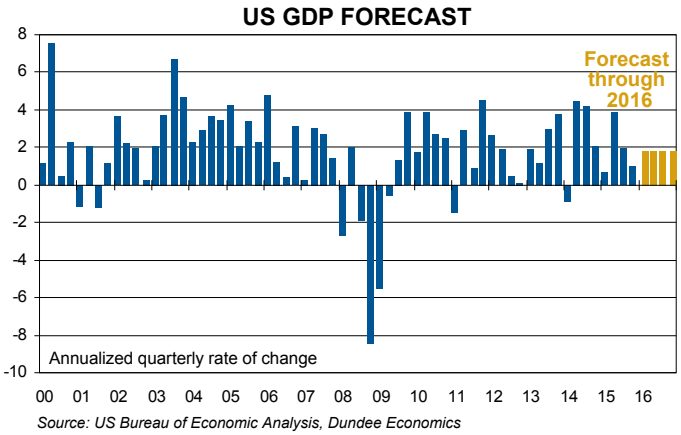


Export and import growth are near zero of late.

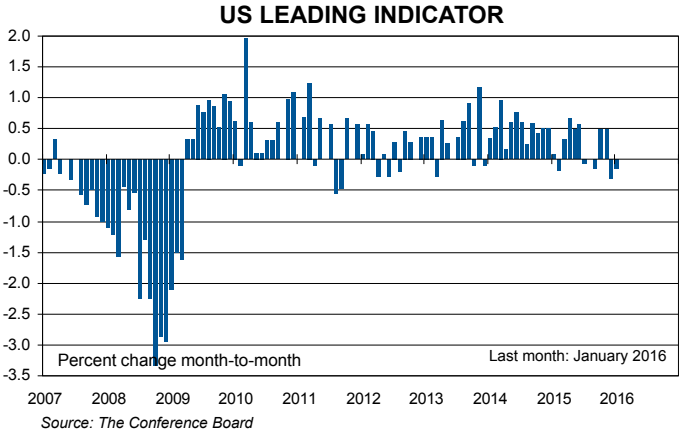
US GDP growth was revised to 1.0% from 0.7% (s.a.a.r) in 2015-Q4.



Growth in 2016 is forecast to average around 2.0%.



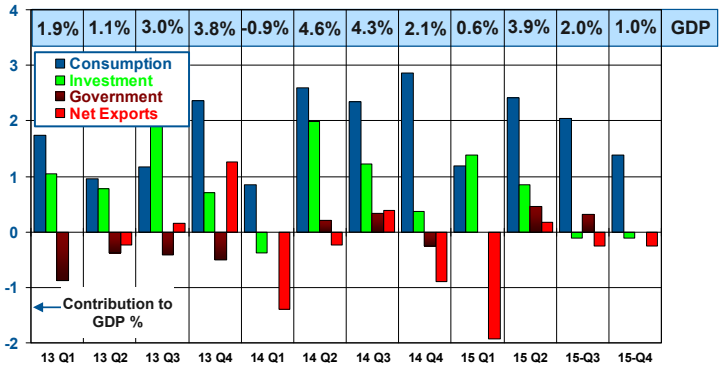
Not a good sign, the leading indicator was negative in both December and January.



MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

Net exports and business investment subtracted from GDP growth in 2015-Q4. The largest contribution to growth came from the households consumption of services.

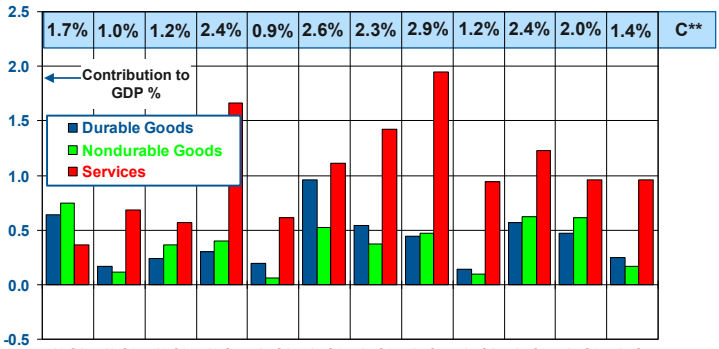
CONTRUBTION TO GDP IN RECENTQUARTERS



Source: US Bureau of Economic Analysis

*** Average of last 12 quarters: 2.3%*

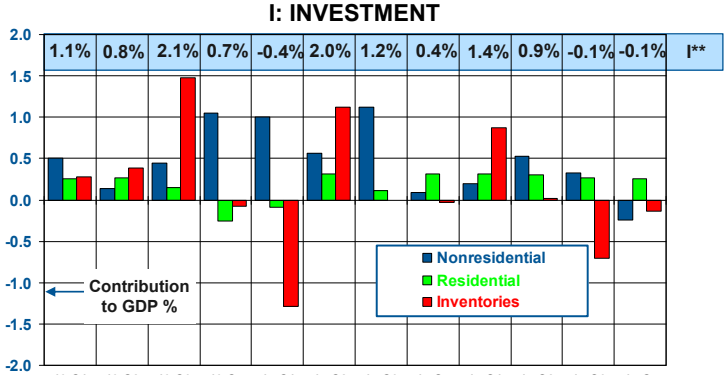
C: HOUSEHOLD CONSUMPTION



Source: US Bureau of Economic Analysis

*** Average of last 12 quarters: 1.8%*

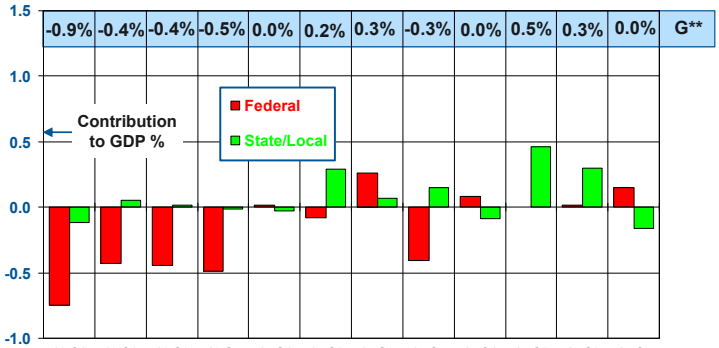
I: INVESTMENT



Source: US Bureau of Economic Analysis

*** Average of last 12 quarters: 0.8%*

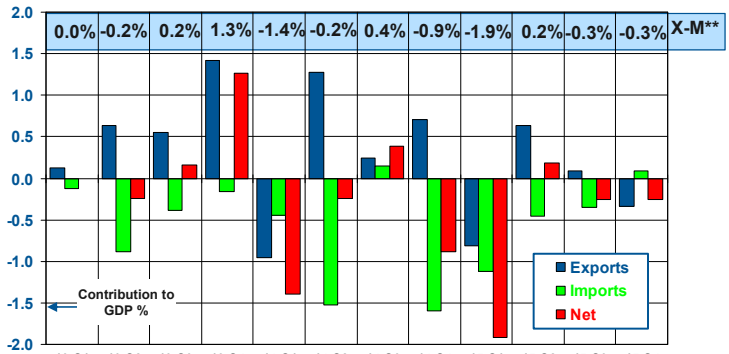
G:GOVERNMENT



Source: US Bureau of Economic Analysis

*** Average of last 12 quarters: -0.1%*

X-M: FOREIGN BALANCE



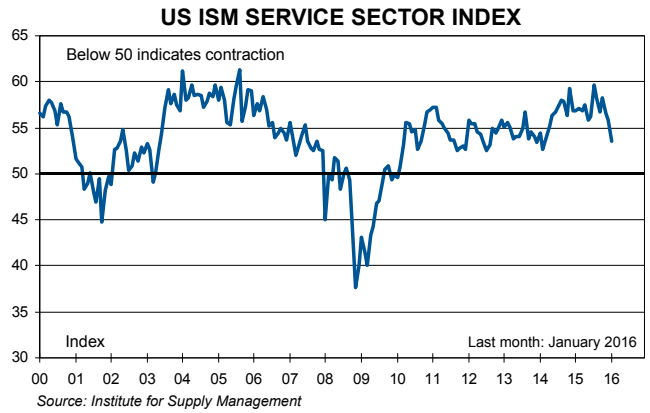
Source: US Bureau of Economic Analysis

*** Average of last 12 quarters: -0.3%*

The retail sales picked up in January year-over-year ...

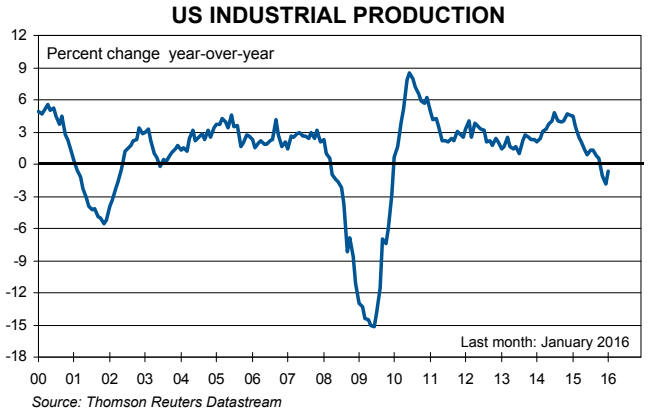
... but the ISM manufacturing index remained below 50 for the fourth month in February (indicative of contraction) ...

... while the ISM service sector index declined for the last three months, but it remains well above 50.

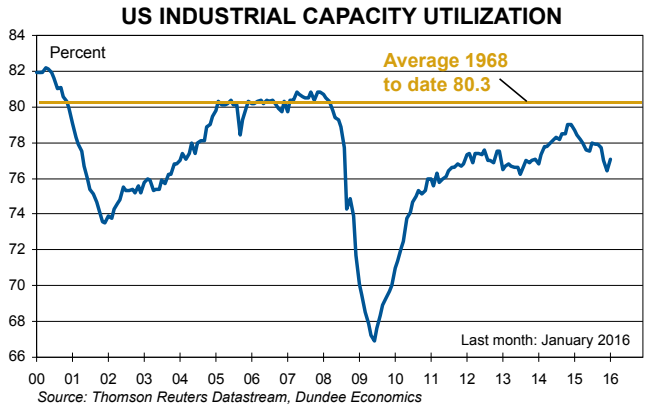


MONTHLY REVIEW ►
UNITED STATES – ECONOMIC GROWTH

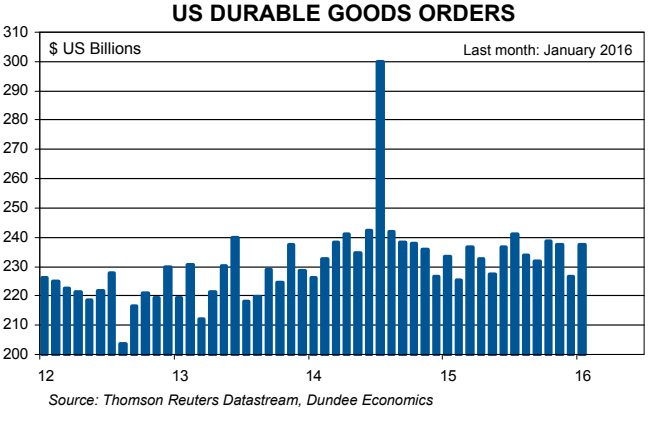
Industrial production has been negative year-over-year for the last three months ...



... but industrial capacity utilization increased in January (though remains below historical norms).



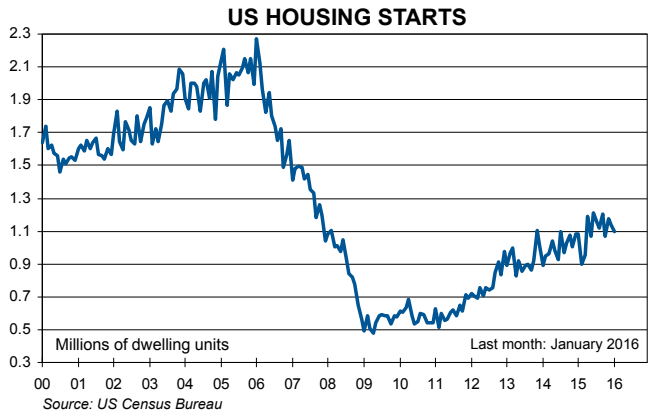
Durable goods orders increased in January, a good sign.



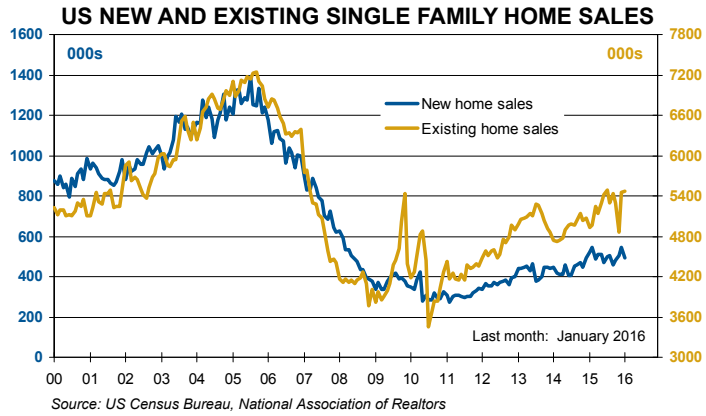
MONTHLY REVIEW ►
UNITED STATES – HOUSING MARKET

The US housing market appears to be stable.

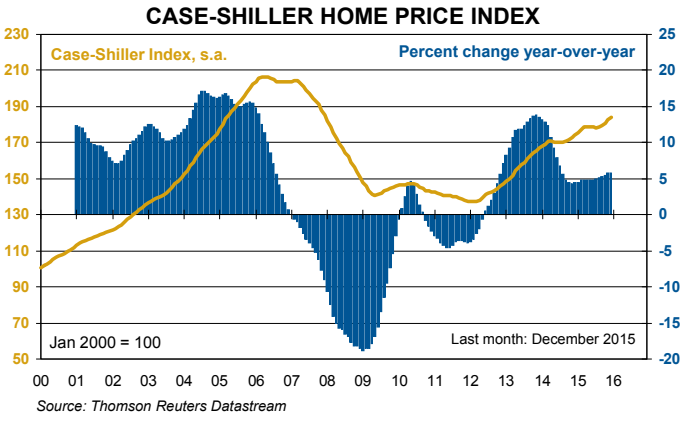
Housing starts appear to be leveling off at just over 1.1 million units.



New home sales declined in January, but existing home sales increased slightly.

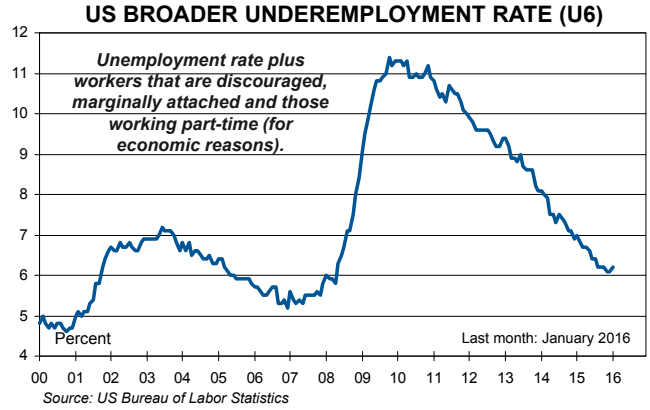


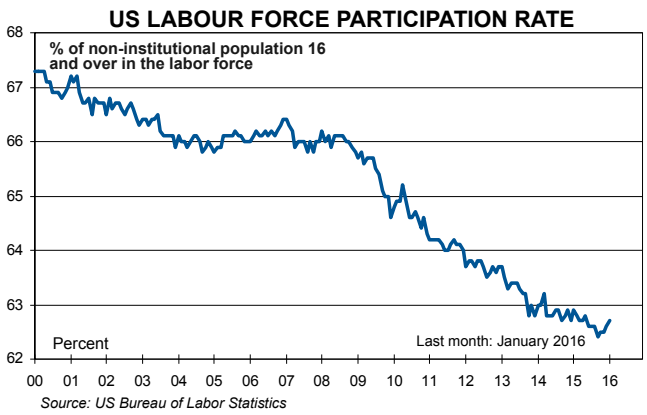
The Case-Shiller Home Price Index continues to advance at around 5.5% (year-over-year).

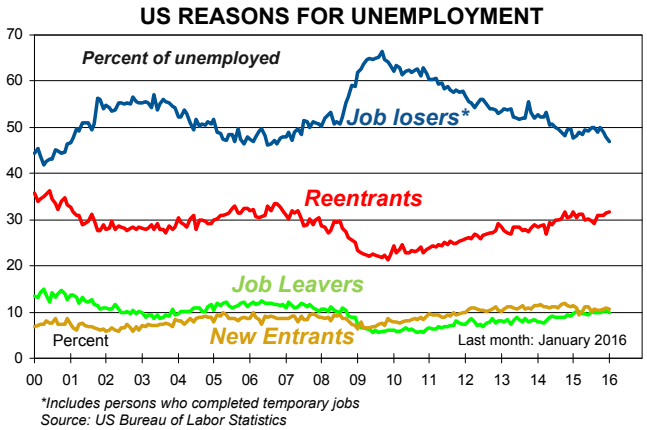


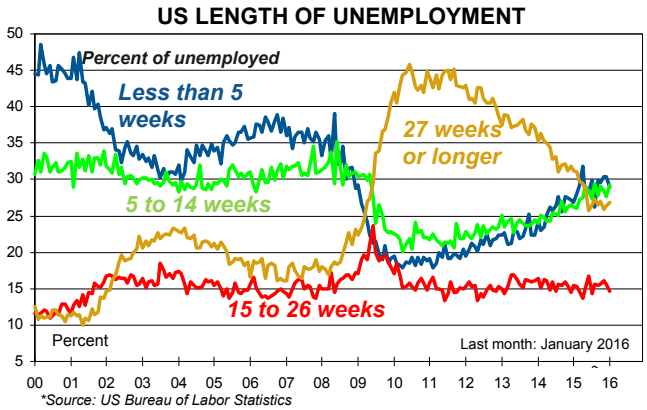
MONTHLY REVIEW ►
UNITED STATES – LABOUR MARKET

The US labour market continues to gain strength – the unemployment rate has ticked down in recent months and the labour force participation rate has ticked up in recent months.









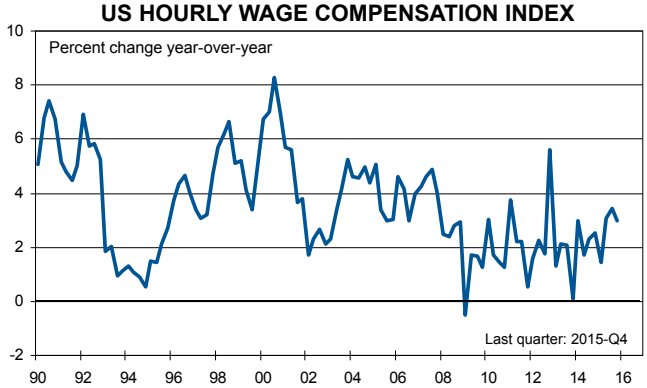
MONTHLY REVIEW ►
UNITED STATES – WAGE INFLATION

However, remaining slack in the labour market will help keep the pressure on wage increases at bay.

US HOURLY EARNINGS

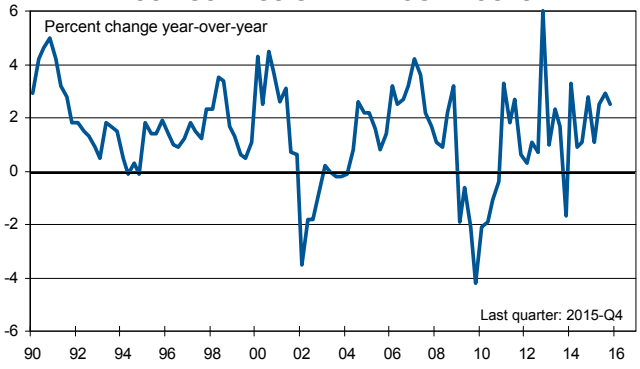
Source: US Bureau of Labor Statistics

US HOURLY WAGE COMPENSATION INDEX



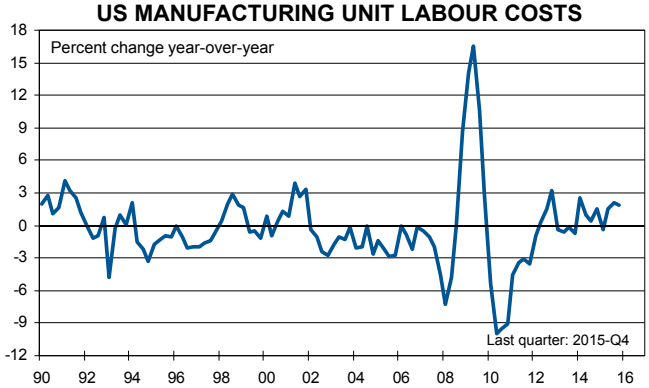
Source: US Bureau of Labor Statistics

US BUSINESS UNIT LABOUR COSTS



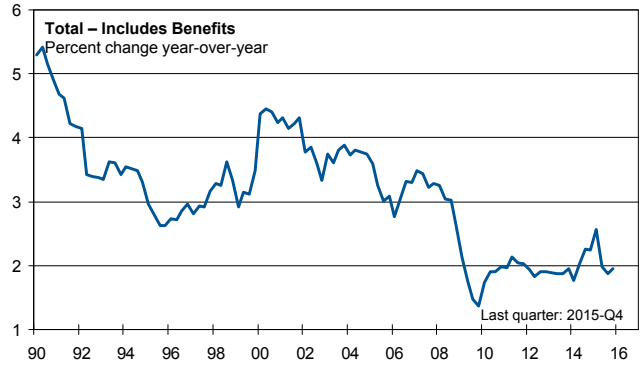
Source: US Bureau of Labor Statistics

US MANUFACTURING UNIT LABOUR COSTS



Source: US Bureau of Labor Statistics

US EMPLOYMENT COST INDEX - TOTAL



Source: US Bureau of Labor Statistics

US EMPLOYMENT COST INDEX - PARTIAL

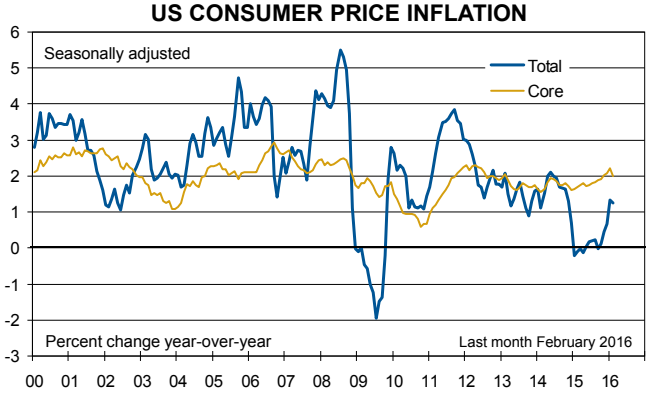
Source: US Bureau of Labor Statistics

MONTHLY REVIEW ►
UNITED STATES – INFLATION

Headline inflation is likely to remain below the Fed's 2% target in 2016, despite the less negative contribution from energy price ...

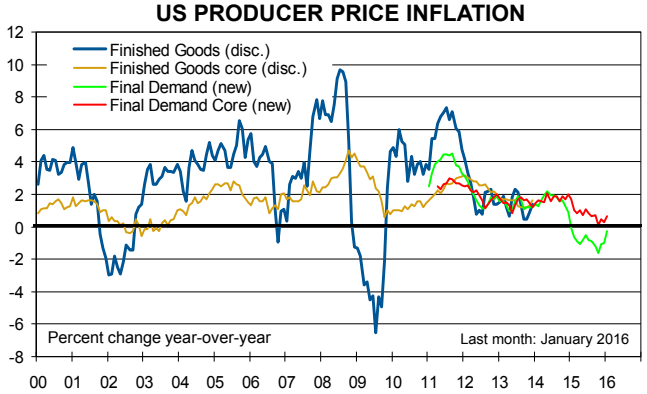
... and US inflation expectations have declined somewhat in recent months.

US CONSUMER PRICE INFLATION



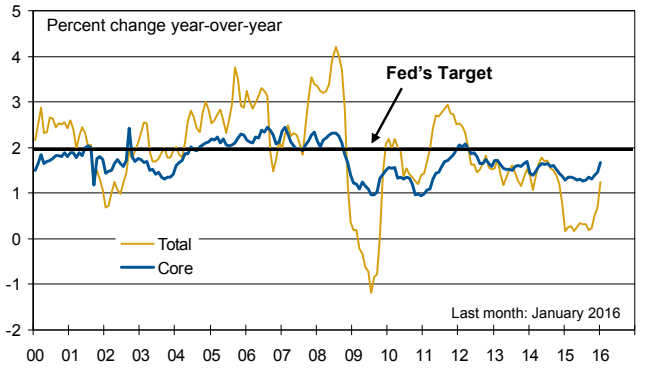
Source: US Bureau of Labor Statistics

US PRODUCER PRICE INFLATION



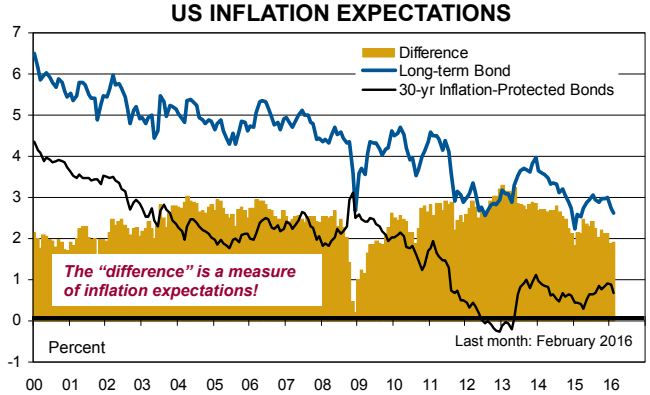
Source: US Bureau of Labor Statistics

US PERSONAL CONSUMPTION EXPENDITURE INFLATION



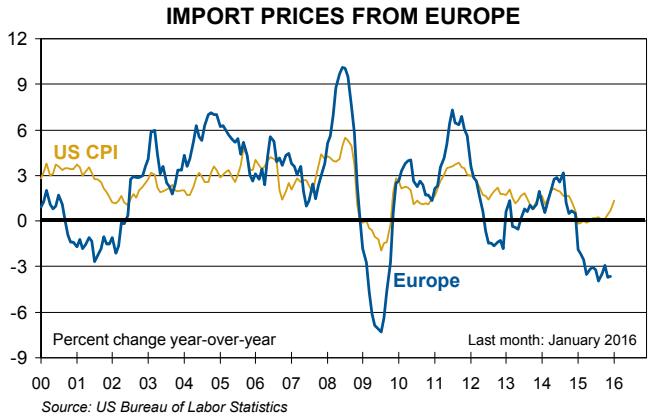
Source: US Bureau Economic Analysis

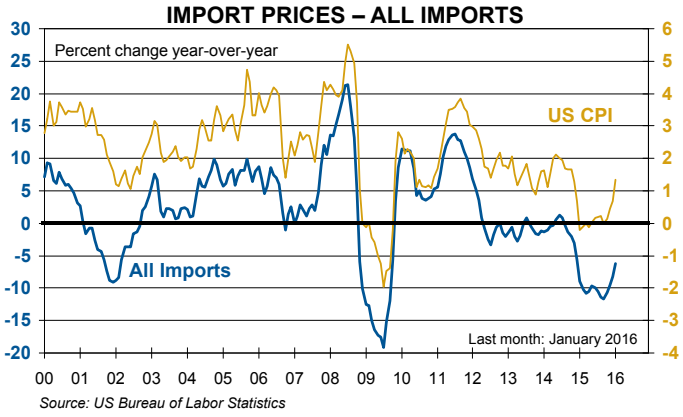
US INFLATION EXPECTATIONS

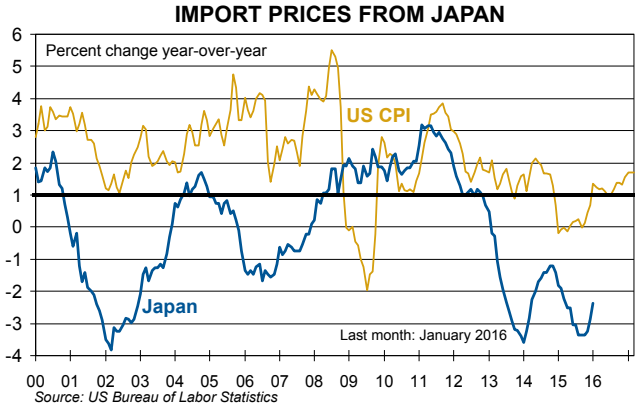


Source: Federal Reserve, Dundee Economics

Negative import prices will continue to put downward pressure on US inflation.

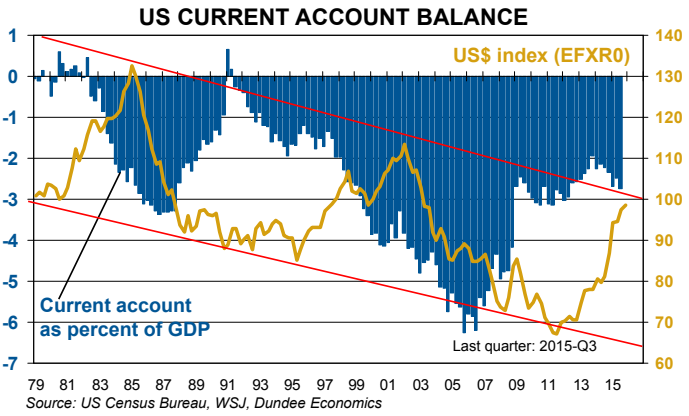




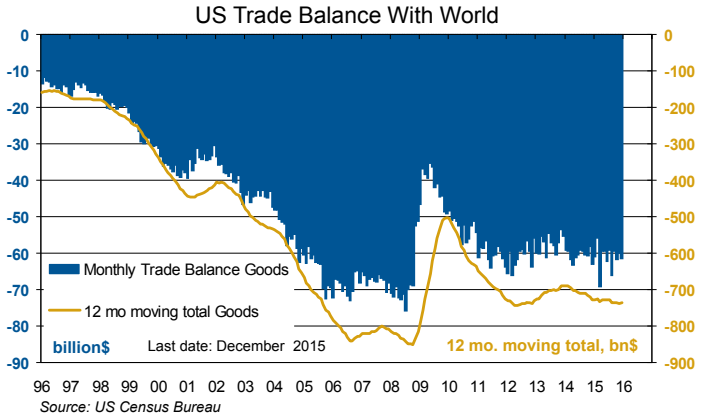


MONTHLY REVIEW ►
UNITED STATES – CURRENT ACCOUNT AND TRADE BALANCE

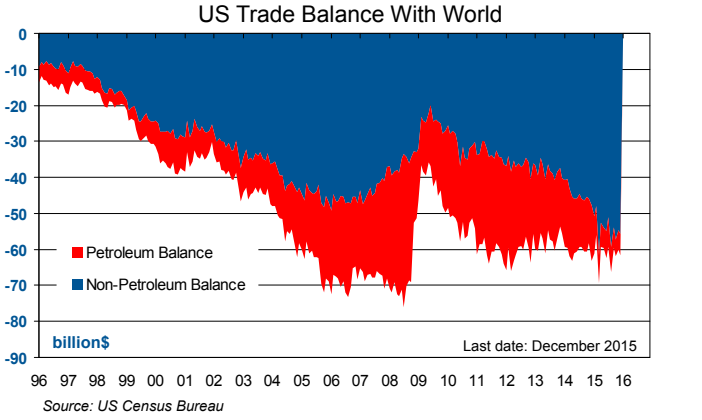
The US current account deficit is rising again, which we expect will eventually undermine the US dollar.



The US trade deficit with the world remains large ...

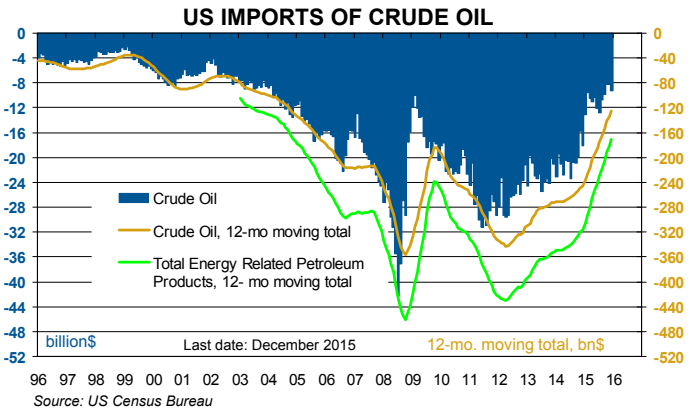


... despite the sharp decline in US petroleum imports.

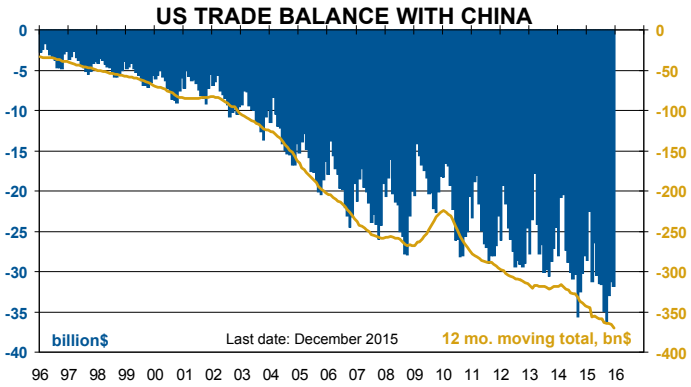


UNITED STATES – TRADE BALANCE

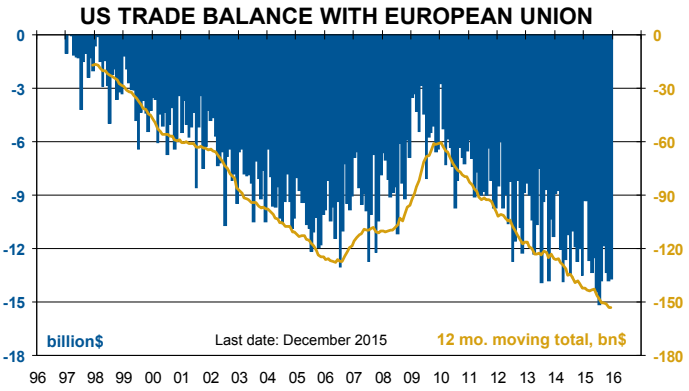
The rising trade deficit is a hot topic for Republican Presidential Candidate Donald Trump – he proposes to "renegotiate" US trade relationships under threat of import taxes.



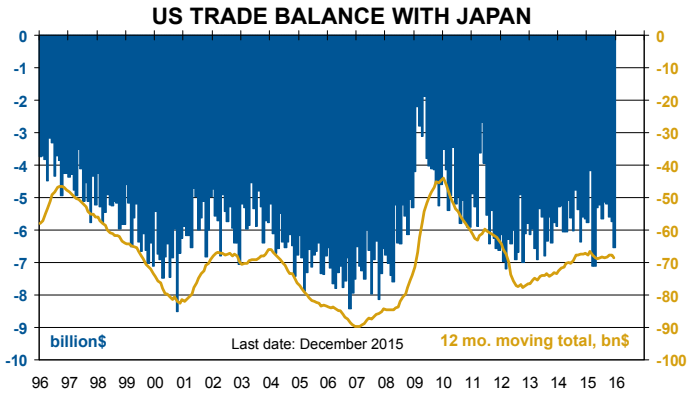
Source: US Census Bureau



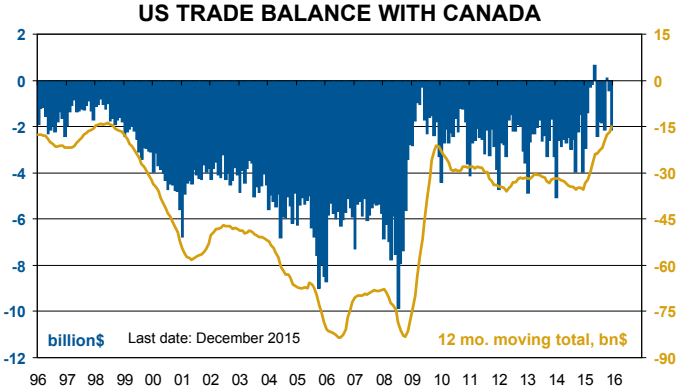
Source: US Census Bureau



Source: US Census Bureau



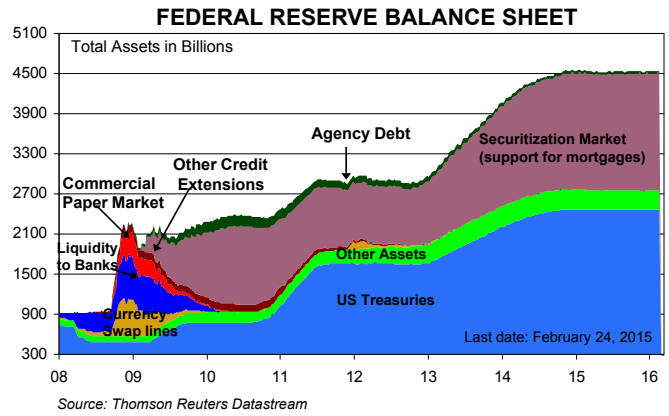
Source: US Census Bureau



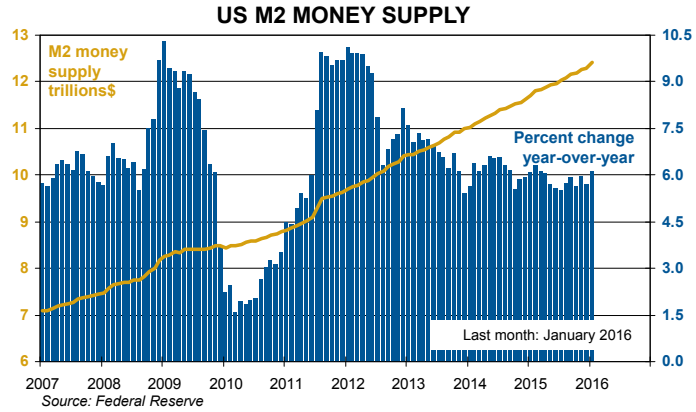
Source: US Census Bureau

MONTHLY REVIEW ►
UNITED STATES – MONETARY POLICY

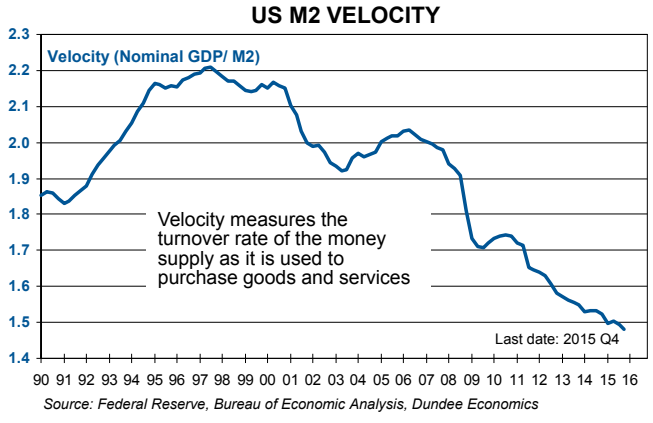
The Fed's balance sheet has stabilized at just over $4.5 trillion.



M2 money supply continues to expand at around 6.0% ...

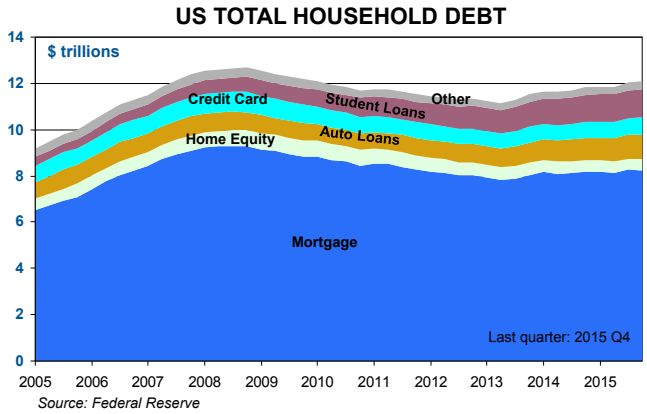


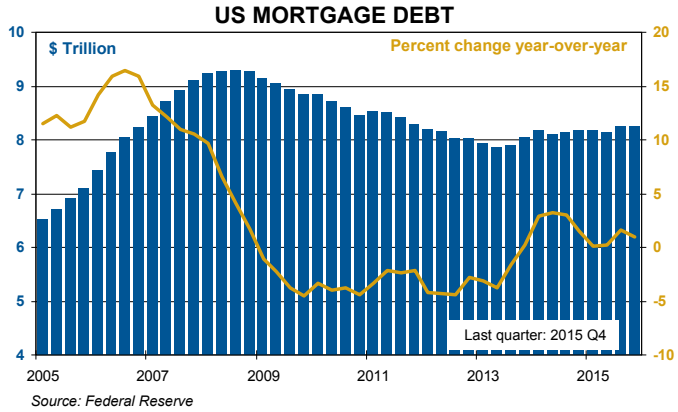
... but M2-velocity is still in a major downtrend.

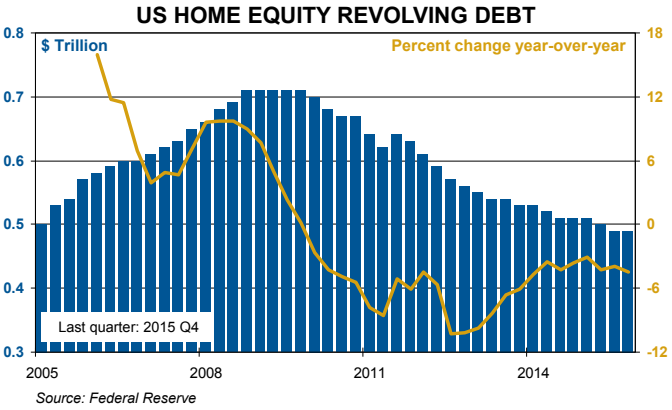


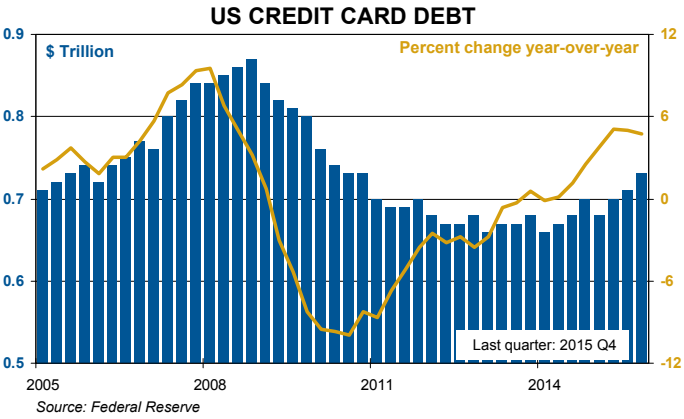
MONTHLY REVIEW ►
UNITED STATES – HOUSEHOLD DEBT

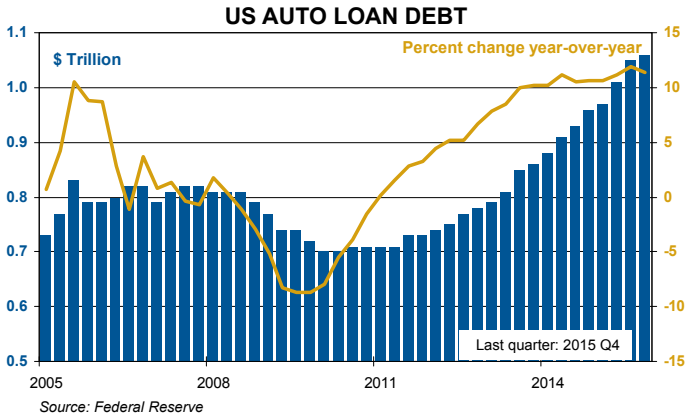
Total household debt is increasing at about 2.5% – with auto and student loans increasing the fastest.

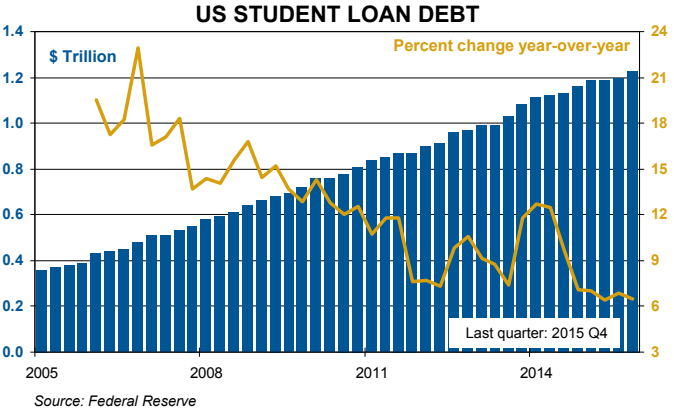






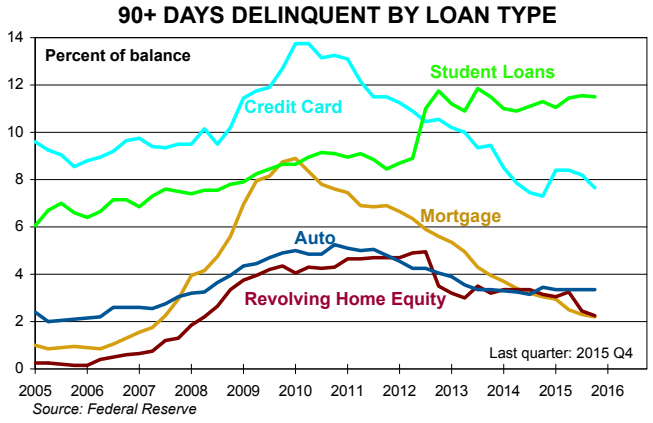




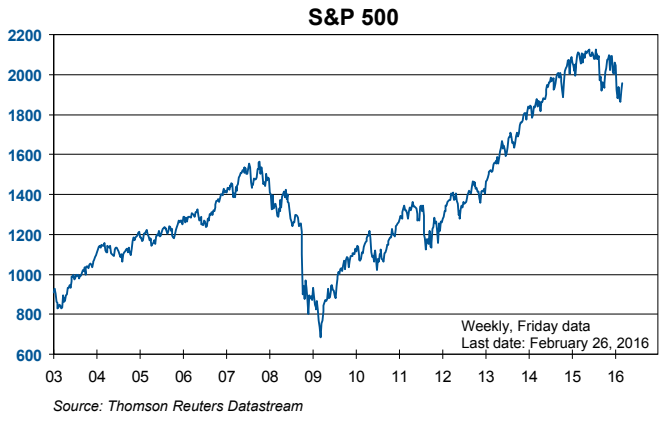


MONTHLY REVIEW ►
UNITED STATES – WEALTH CREATION

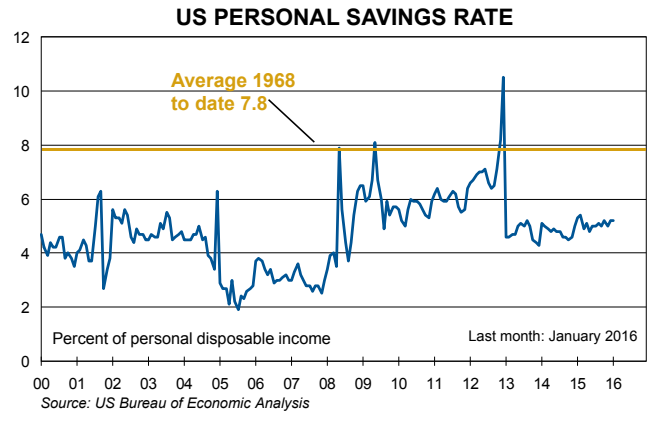
Student loans and credit card loans have the highest default rates.



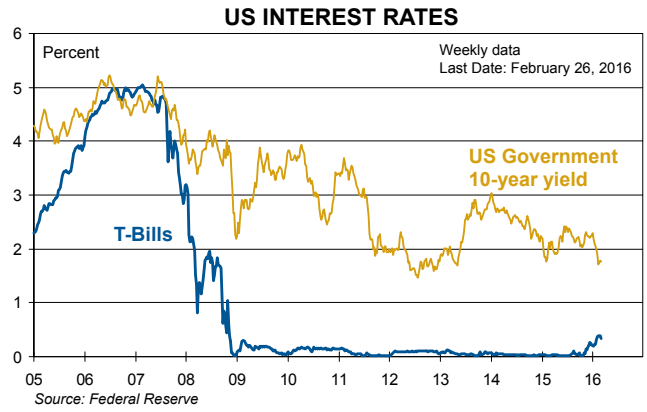
US equity markets have recovered from lows set in January, but remain well below recent highs.



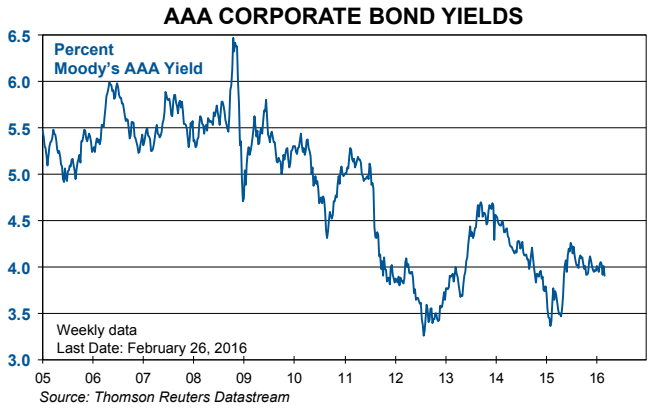
US savings as a percent of disposable income remained at 5.2% in January.



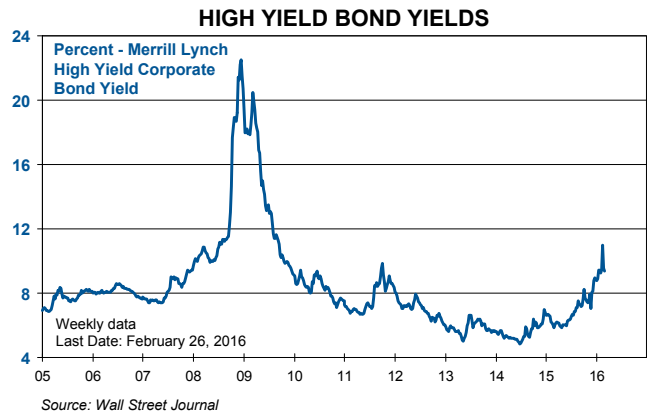
The yield on 10-year Treasuries has declined in the last two months in spite of a Fed rate increase in December ...



... the yield on AAA corporate bonds has stabilized around 4% ....

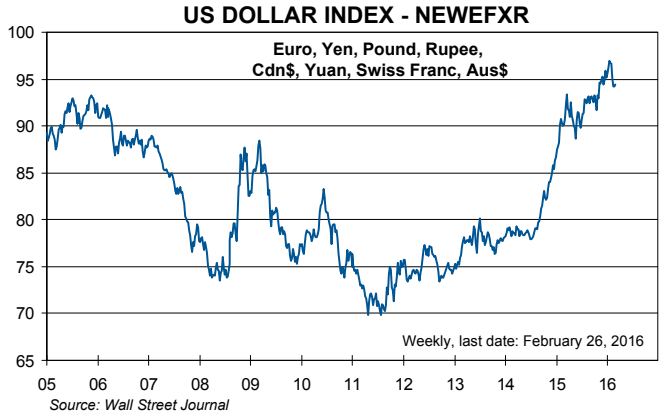


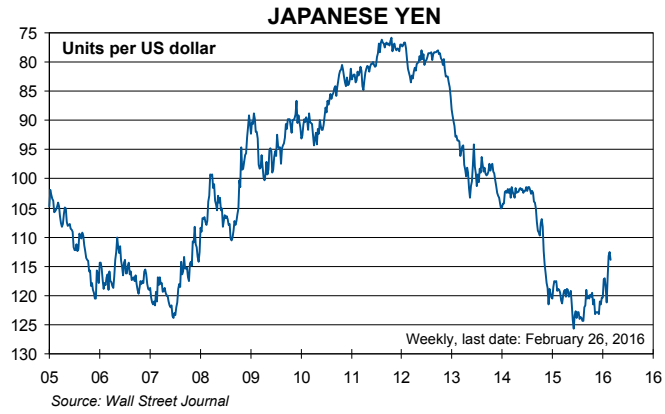
... but the yield on high yield bonds has increased significantly.

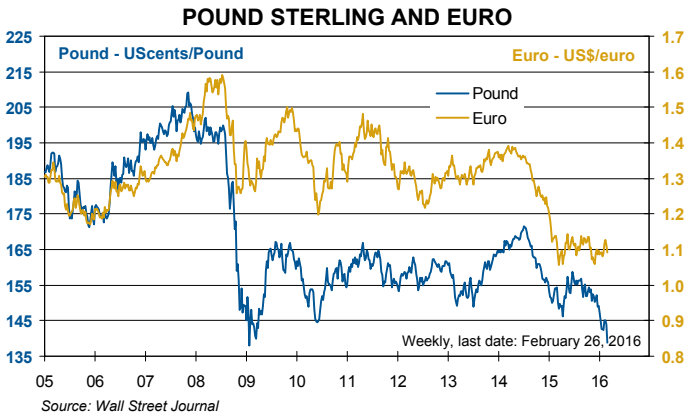


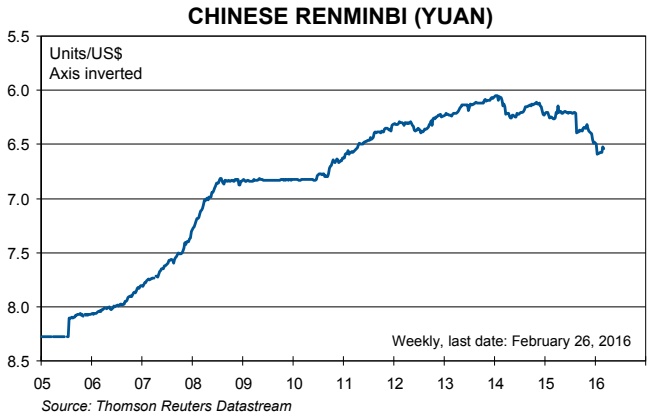
MONTHLY REVIEW ►
INTERNATIONAL – EXCHANGE RATES

The US dollar declined against most currencies in February ...







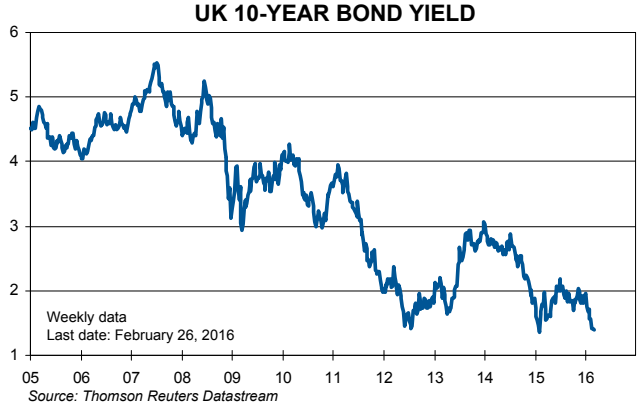


... and Government bond yields also declined in February (note Japan's 10-year rate is now negative).

US 10-YEAR BOND YIELD

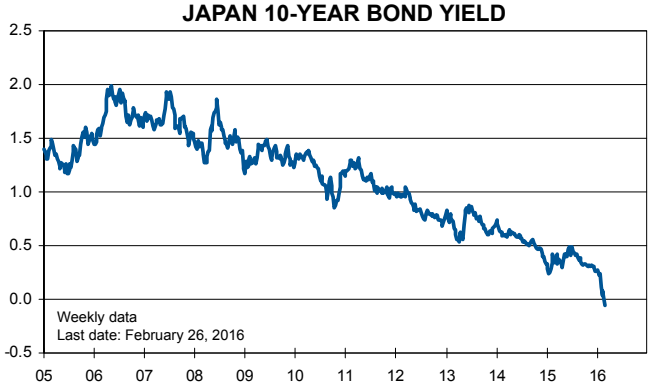
Source: Thomson Reuters Datastream

UK 10-YEAR BOND YIELD



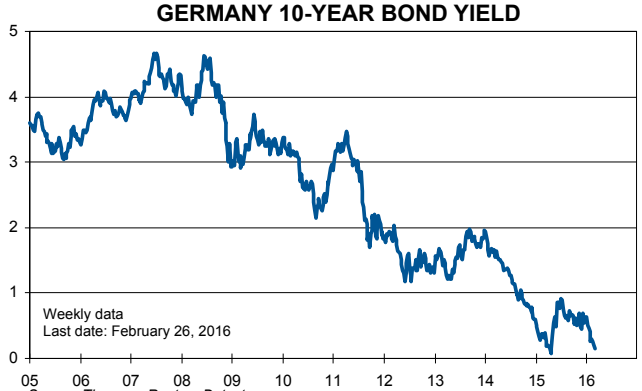
Source: Thomson Reuters Datastream

JAPAN 10-YEAR BOND YIELD



Source: Thomson Reuters Datastream

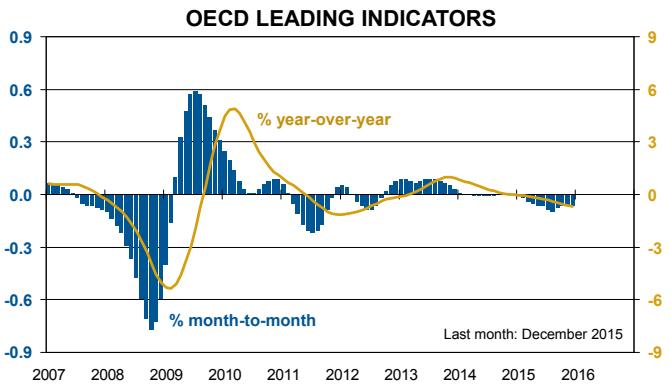
GERMANY 10-YEAR BOND YIELD

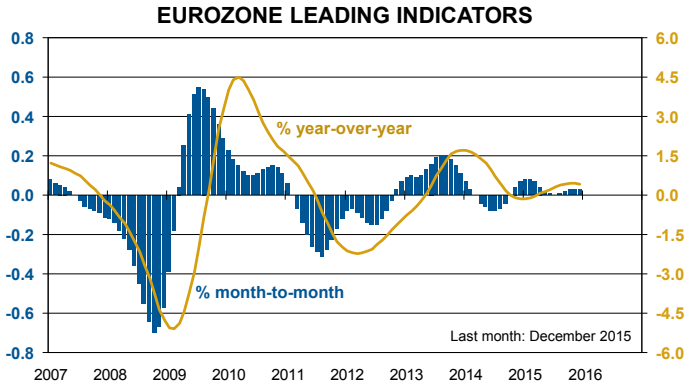


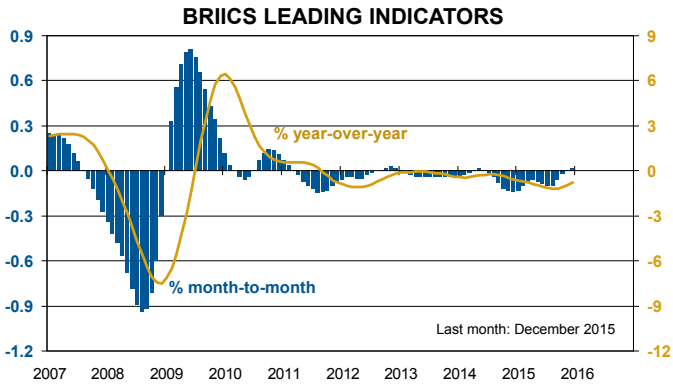
Source: Thomson Reuters Datastream

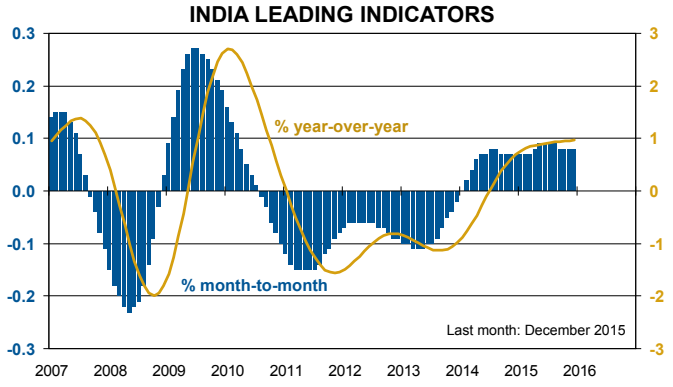
MONTHLY REVIEW ►
INTERNATIONAL – LEADING INDICATORS

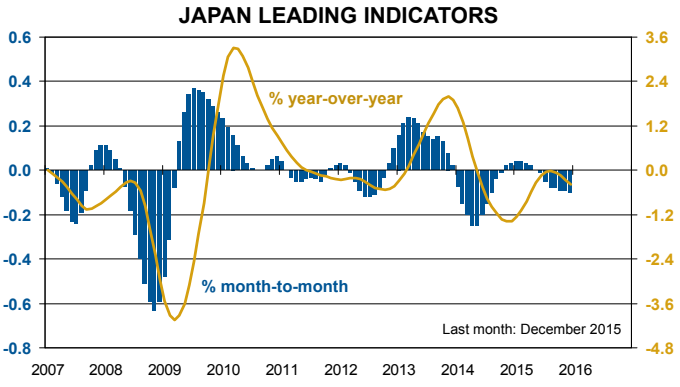
Good news: China's leading indicator was positive month-over-month in both December and January!

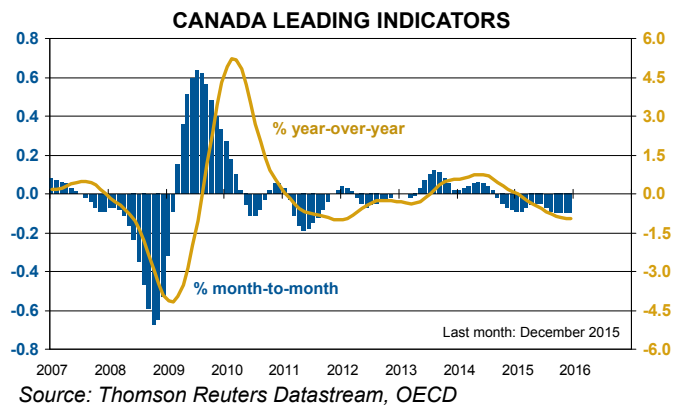


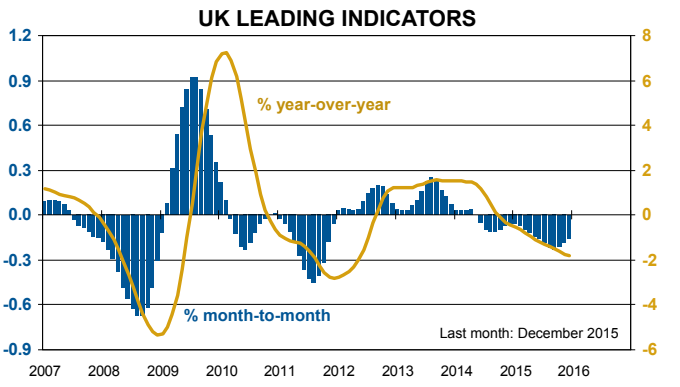










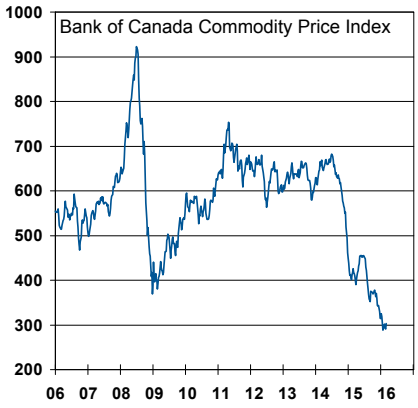


Source: Thomson Reuters Datastream, OECD

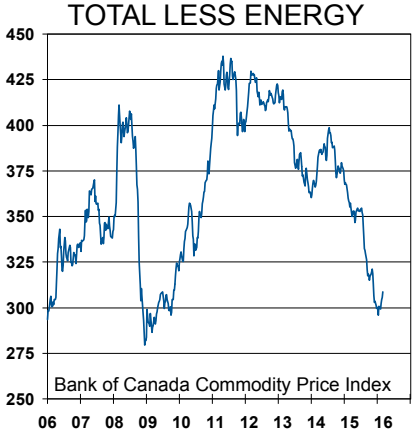
COMMODITY PRICES

1. Bank of Canada Commodity Price Indices (Weekly data to February 26, 2016)

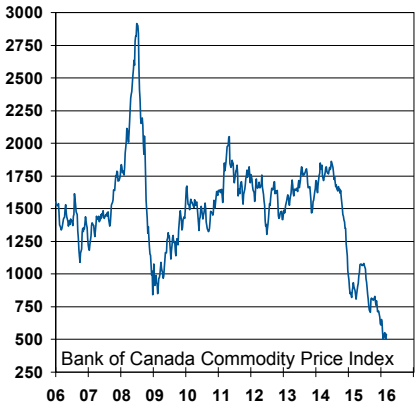
TOTAL COMMODITY



TOTAL LESS ENERGY

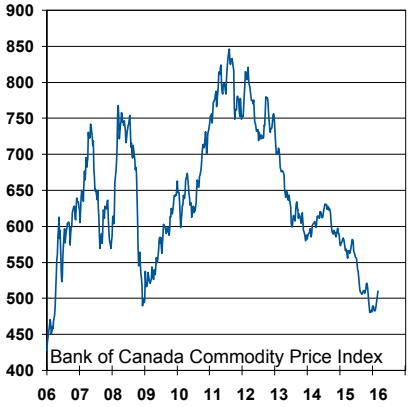


ENERGY



AGRICULTURE

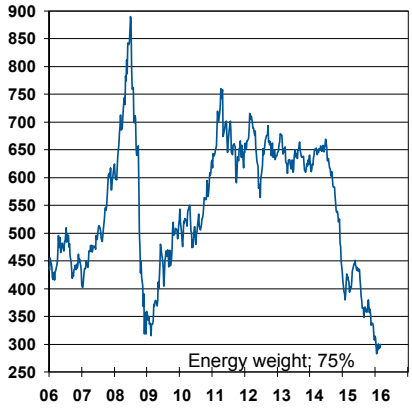
METALS AND MINERALS



Commodity prices increased slightly in February, not least because the US dollar weakened somewhat ...

2. Other Indices (Weekly data to February 26, 2016)

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 February 26, 2016)

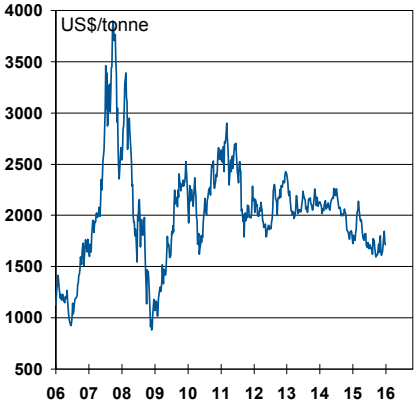
NICKEL

COPPER

ZINC

ALUMINUM

LEAD



GOLD

PLATINUM

SILVER

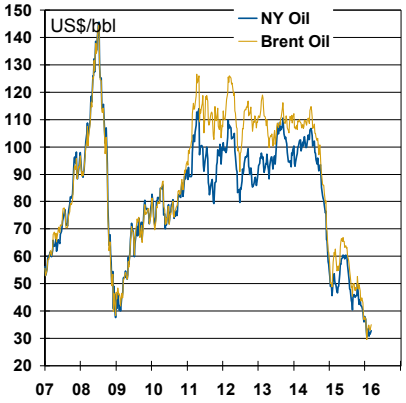
The gold price scored a technical breakout in February (see the *Gold Monitor*).

Sources: LME, LBMA, Wall Street Journal

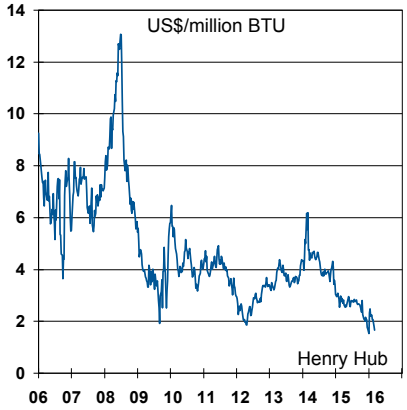
COMMODITY PRICES

4. Energy (Weekly data to February 26, 2016)

SPOT OIL PRICES



NATURAL GAS



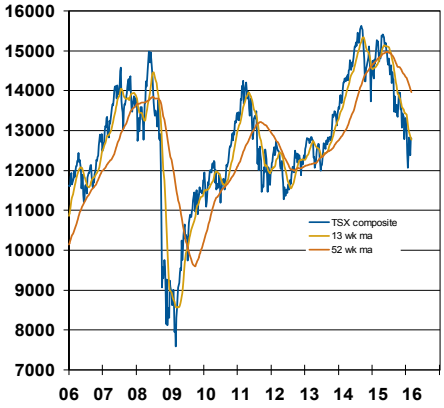
Energy prices remain under pressure although a bottom of sorts may have been reached.

Desperately needed is some agreement on production cutbacks, without which oversupply will remain an ongoing problem.

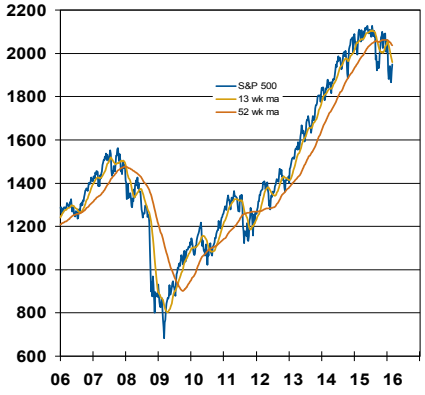
EQUITY MARKETS

5. North America (Weekly data to February 26, 2016)

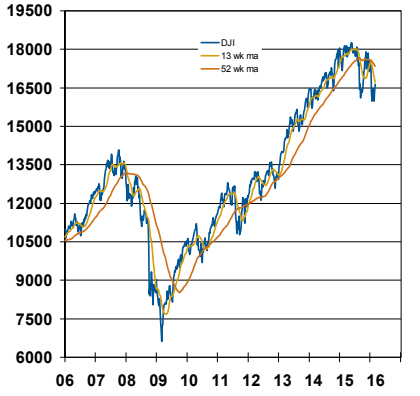
S&P/TSX INDEX



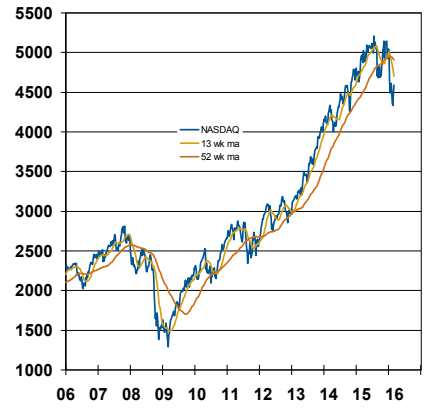
S&P500 INDEX



DOW JONES INDUSTRIALS



NASDAQ INDEX



Equity markets have been very volatile this year to date, on the back of uncertainty about the oil price outlook, the Chinese economy, and global growth.

Source: Thomson Reuters Datastream

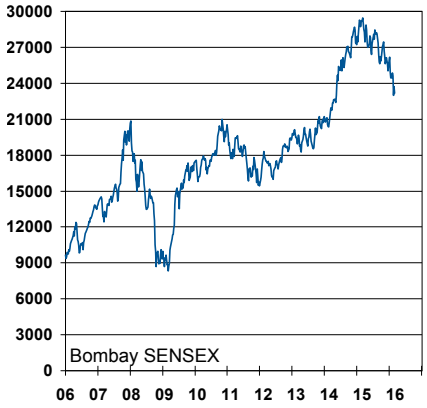
EQUITY MARKETS

6. Around the world (Weekly data through February 26, 2016)

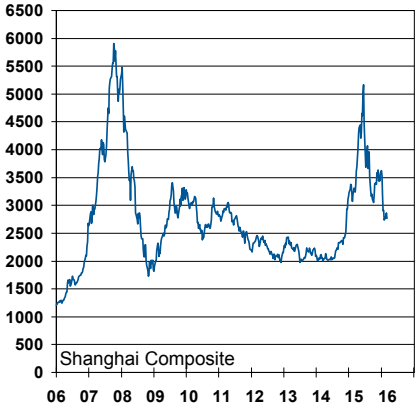
JAPAN

GERMANY

INDIA

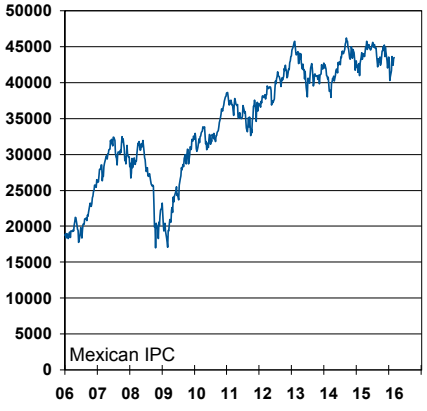


CHINA



RUSSIA

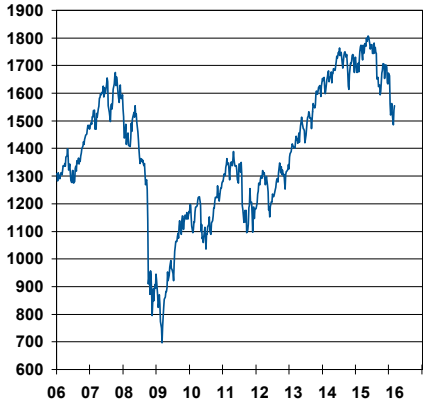
MEXICO



MSCI EAFE INDEX

BRAZIL

MSCI WORLD INDEX



Source: Thomson Reuters Datastream

Exchange Rates - Comparison of Scenarios

	Actual				Projected						
	15-II	15-III	15-IV	1-Mar	Mar	Apr	May	16-II	16-III	16-IV	17-I
US Dollar incl Cdn$											
Scenario A					102.1	105.2	107.5	108.0	110.8	111.3	111.9
Scenario B	***94.68***	***97.26***	***98.50***	***97.82***	***98.45***	***99.09***	***98.75***	***98.64***	***98.03***	***98.30***	***98.11***
Scenario C					95.74	94.42	93.86	93.57	91.82	90.21	88.41
Probability-Weighted					***98.70***	***99.47***	***99.84***	***99.81***	***99.70***	***99.54***	***99.13***
Canadian Dollar											
Scenario A					1.410	1.465	1.505	1.505	1.550	1.540	1.530
Scenario B	***1.229***	***1.310***	***1.335***	***1.341***	***1.365***	***1.380***	***1.380***	***1.385***	***1.395***	***1.400***	***1.390***
Scenario C					1.330	1.315	1.310	1.310	1.295	1.280	1.265
Probability-Weighted					***1.368***	***1.385***	***1.394***	***1.396***	***1.409***	***1.405***	***1.394***
Japanese Yen											
Scenario A					118.5	122.0	124.0	124.0	128.0	129.5	131.0
Scenario B	***121.3***	***122.3***	***121.5***	***114.0***	***114.0***	***115.0***	***115.0***	***115.0***	***115.0***	***115.0***	***115.0***
Scenario C					111.0	110.0	110.0	110.0	108.5	107.0	105.0
Probability-Weighted					***114.4***	***115.5***	***116.0***	***116.0***	***116.6***	***116.6***	***116.5***
British Pound											
Scenario A					133.9	130.8	126.3	123.0	118.2	116.4	114.0
Scenario B	***153.3***	***155.1***	***151.8***	***139.5***	***140.6***	***141.7***	***144.1***	***145.4***	***151.6***	***152.6***	***153.4***
Scenario C					144.0	147.7	150.5	153.2	160.7	164.7	171.2
Probability-Weighted					***139.8***	***140.5***	***141.2***	***141.8***	***145.5***	***146.6***	***148.0***
Euro											
Scenario A					1.050	1.030	1.010	1.000	0.985	0.970	0.950
Scenario B	***1.105***	***1.119***	***1.095***	***1.087***	***1.090***	***1.090***	***1.100***	***1.110***	***1.140***	***1.130***	***1.120***
Scenario C					1.125	1.145	1.158	1.165	1.190	1.220	1.245
Probability-Weighted					***1.089***	***1.089***	***1.087***	***1.091***	***1.114***	***1.113***	***1.109***
Australian Dollar											
Scenario A					70.21	67.24	65.12	65.12	62.58	62.34	62.09
Scenario B	***77.83***	***72.58***	***72.02***	***71.74***	***72.53***	***71.74***	***71.74***	***70.76***	***69.53***	***69.29***	***69.78***
Scenario C					74.81	75.89	76.34	76.34	77.61	79.30	81.03
Probability-Weighted					***72.52***	***71.65***	***71.23***	***70.74***	***69.81***	***70.05***	***70.67***
Chinese Yuan/Rmb											
Scenario A					6.650	6.700	6.750	6.750	6.950	7.000	7.000
Scenario B	***6.120***	***6.264***	***6.389***	***6.552***	***6.550***	***6.570***	***6.590***	***6.580***	***6.600***	***6.600***	***6.600***
Scenario C					6.500	6.480	6.440	6.440	6.400	6.380	6.350
Probability-Weighted					***6.563***	***6.580***	***6.593***	***6.588***	***6.638***	***6.645***	***6.638***
Indian Rupee											
Scenario A					69.50	70.00	70.50	70.50	72.00	73.00	74.00
Scenario B	***63.47***	***64.98***	***65.92***	***67.60***	***68.50***	***68.50***	***68.20***	***68.20***	***67.60***	***67.30***	***67.00***
Scenario C					66.80	66.00	65.50	65.50	64.30	63.70	63.00
Probability-Weighted					***68.33***	***68.25***	***68.10***	***68.10***	***67.88***	***67.83***	***67.75***

Source: WSJ, Thomson Reuters Datastream, Dundee Economics

Interest Rates - Comparison of Scenarios

	Actual				Projected						
	15-II	15-III	15-IV	1-Mar	Mar	Apr	May	16-II	16-III	16-IV	17-I
Canadian Interest Rates											
T-Bills (91-day)											
Scenario A					0.48	0.50	0.54	0.55	0.60	0.86	1.12
Scenario B	***0.63***	***0.41***	***0.44***	***0.46***	***0.45***	***0.43***	***0.41***	***0.42***	***0.40***	***0.40***	***0.40***
Scenario C					0.41	0.17	0.16	0.16	0.10	0.03	0.02
Probability-Weighted					***0.44***	***0.37***	***0.36***	***0.37***	***0.35***	***0.38***	***0.43***
10-year Bonds											
Scenario A					1.62	1.70	1.80	1.80	2.10	2.35	2.60
Scenario B	***1.68***	***1.47***	***1.49***	***1.24***	***1.25***	***1.30***	***1.35***	***1.35***	***1.50***	***1.55***	***1.60***
Scenario C					1.00	0.90	0.80	0.80	0.65	0.55	0.47
Probability-Weighted					***1.25***	***1.26***	***1.28***	***1.28***	***1.37***	***1.41***	***1.46***
Target Overnight Rate											
Scenario A					0.50	0.50	0.50	0.50	0.58	0.83	1.08
Scenario B	***0.75***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***	***0.50***
Scenario C					0.50	0.25	0.25	0.25	0.18	0.05	0.05
Probability-Weighted					***0.50***	***0.43***	***0.43***	***0.43***	***0.42***	***0.43***	***0.48***
US Interest Rates											
T-Bills (90-day)											
Scenario A					0.35	0.55	0.56	0.57	0.82	0.99	1.15
Scenario B	***0.02***	***0.04***	***0.13***	***0.31***	***0.35***	***0.35***	***0.35***	***0.38***	***0.46***	***0.65***	***0.65***
Scenario C					0.28	0.25	0.20	0.19	0.12	0.05	0.03
Probability-Weighted					0.34	0.39	0.38	0.40	0.50	0.63	0.68
10-year Bonds											
Scenario A					2.30	2.40	2.50	2.50	2.85	3.15	3.40
Scenario B	***2.18***	***2.15***	***2.21***	***1.83***	***1.85***	***1.92***	***2.00***	***2.00***	***2.15***	***2.25***	***2.35***
Bonds - Scenario C					1.60	1.50	1.38	1.38	1.25	1.15	1.07
Probability-Weighted					***1.91***	***1.96***	***2.00***	***2.00***	***2.15***	***2.26***	***2.36***
Fed Funds Rate											
Scenario A					0.45	0.65	0.65	0.65	0.90	1.07	1.23
Scenario B	***0.12***	***0.14***	***0.16***	***0.38***	***0.40***	***0.40***	***0.40***	***0.40***	***0.48***	***0.65***	***0.65***
Scenario C					0.36	0.34	0.32	0.32	0.24	0.15	0.13
Probability-Weighted					***0.40***	***0.45***	***0.45***	***0.45***	***0.54***	***0.66***	***0.69***

Source: WSJ, Thomson Reuters Datastream, Dundee Economics

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