DOLLARS & SENSE
TD Economics

August 15, 2013

AROUND THE WORLD IN 1000 WORDS

Highlights

- The focus in the U.S. over the last month has remained on the upcoming tapering of the Federal Reserve's bond buying program. The macroeconomic picture is perhaps not quite as strong as the Fed would have hoped, but the sustained nature of the recovery should be sufficient to justify the taper to begin in September.
- Broadly speaking, there have not been any major surprises on the global macro front since our last update that would call for a change in our forecasts. The Eurozone recently ended its 6-quarter long recession, but a subdued pace of growth and inflation should keep the ECB on the sidelines in the near term. Meanwhile, China appears comfortable with a lower, but more stable pace of growth.
- In Canada, the main development since last month was the first interest rate announcement of new Bank of Canada governor Stephen Poloz. As expected, the Bank remains comfortably on the sidelines. Their accommodative stance is likely further cemented by a recent announcement by CMHC to tighten mortgage regulations.

In the U.S., the focus over the last month has remained on the upcoming tapering of the Federal Reserve's bond buying program. Since our last issue of Dollars & Sense, the burning question has been, when? Expectations up to this point have been for a September start. However, the Fed has always stated that the timing and scale of the taper hinges on the evolution of the economic recovery. Consequently, the macroeconomic data is where markets have looked to for signals.

Unfortunately, the picture of economic strength needed for the Fed to definitively commit to tapering in the near term has not materialized. However, there was plenty of evidence that suggested the recovery was being sustained. Real GDP growth for the second quarter of the year was much stronger than markets had anticipated (and will likely be revised further upwards during the next release). The labour market posted a decent gain in July, adding 162,000 net jobs. This was not quite the momentum the Fed would want to see given the 6.5% target for the unemployment rate. However, on a trend basis, the labour market showing consistent strength – the 6-month moving average pace of job gains has hovered around the 200K mark since February.

The main detractor from the U.S. economy continues to be the muted pace of inflation. This was referenced in the accompanying communiqué of the FOMC's August 1 meeting. No new references were made as to when the taper might occur, with the only change in language acknowledging that inflation was below the committee's objective. Given all of these developments, markets have reacted with little fervor. Having already priced in the taper over the course of May and June, equity and bond markets are essentially at the same level they were a month ago.

Outside of the U.S., macroeconomic momentum has improved both in Europe and Japan. In the euro zone, second-quarter GDP expanded 0.3%, ending a 6-quarter long recession. However, this is unlikely to change the ECB's subdued outlook for inflation extending in the medium term, given the remaining

Craig Alexander, SVP & Chief Economist 416-982-8064
Martin Schwerdtfeger, Senior Economist 416-982-2559
Francis Fong, Economist 416-982-8066

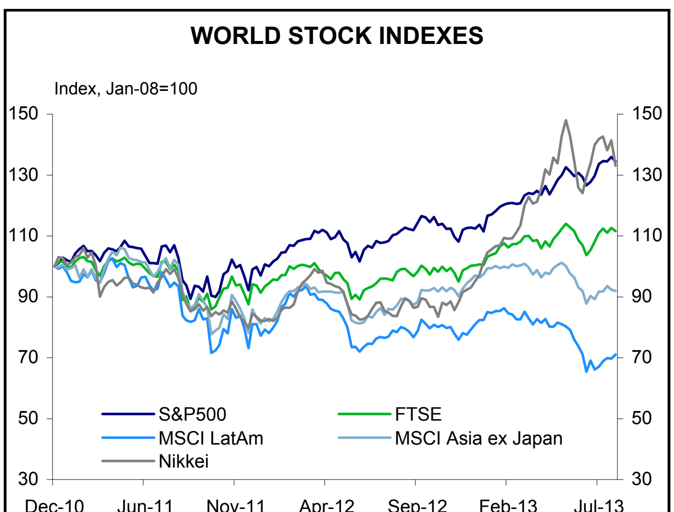
weakness in the economy and subdued monetary dynamics. In line with this assessment, in early August, the ECB reiterated that its key interest rates will remain at present or lower levels for an extended period of time.

The Bank of Japan also left its monetary policy unchanged on August 8, suggesting its Policy Board is confident the aggressive easing measures it implemented in April were doing enough to stimulate the economy and reverse deflation.

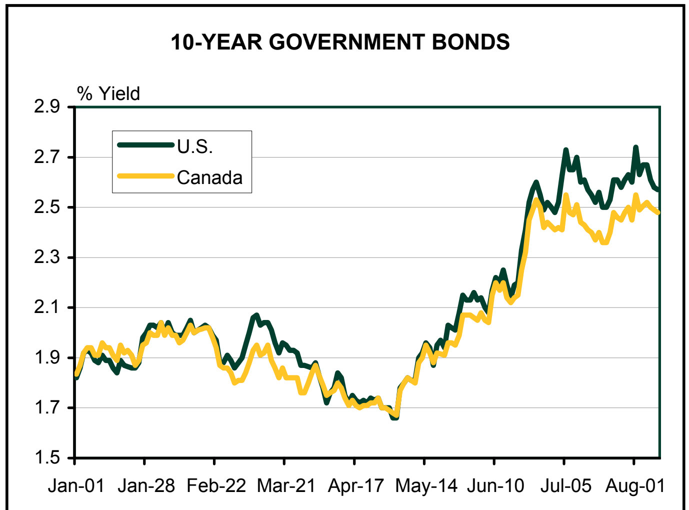
On the other hand, China has not shown an outright deterioration in macroeconomic momentum, but at least more supporting evidence of a slightly weaker economic growth outlook in the second half of this year. The Politburo announced in late July that its key macroeconomic goals were "stable growth, economic restructuring, and economic reform". This suggests authorities will refrain from any stimulatory policies even if the economy is poised to undershoot the official 7.5% economic growth target for this year.

Broadly speaking, there have not been any major surprises on the global macro front since our last Dollars & Sense that would call for a change in our forecasts. Moreover, until the FOMC meets on September 17-18, financial markets will remain primarily focused on upcoming U.S. data that could seal the fate of tapering beginning in the fall.

While not a forgone conclusion, we maintain our view that the tapering will indeed begin in September. The fact that economic momentum appears to be sustained ultimately justifies the Fed moving off the sidelines in the near term. However, it is also worth reiterating one of the Fed's party lines that should the data weaken going forward, the central bank could restart or increase asset purchases. The taper is



Source: Bloomberg, TD Economics



Source: Federal Reserve Board, Bank of Canada

not a one and done deal.

Similar to U.S. financials, the TSX, the Loonie, and Canadian government bond yields have all shown the same inactivity. One of the main developments since last month has been the breakup of Belarusian Potash Company (BPC), a consortium of two potash producers that account for 43% of global potash exports. The dissolution created speculation that potash prices could plummet by as much as 25%, impacting the bottom line of Canada's potash producers. At this point, the financial market impact is difficult to assess, but is likely minimal. Potash represents roughly 2% of Canada's commodity exports and so will likely have minimal impact on the Loonie. Moreover, the 25% price decline assessment needs a few grains of salt since it was put forth by Uralkali, the Russian half that instigated the breakup of BPC. There is even speculation that the partnership will be reinstated in some form over the near term.

The other main development since last month was the first interest rate announcement by new Bank of Canada governor Stephen Poloz. As expected, little was changed with regards to the future path of monetary policy. With household debt growth continuing to slow and economic growth expected to pick up in the latter half of 2013, the central bank remains comfortably on the sidelines in the near term. This is likely further cemented with the recent announcement by CMHC to restrict the amount of mortgage-backed securities the crown corporation guarantees. Combined with the sharp increase in interest rates already recorded over the May and June period, these trends should weigh on housing activity, and thus debt growth, going forward. We continue to look to the end of 2014 for rate hikes to resume.

INTEREST RATE OUTLOOK	Spot Rate	2012				2013F				2014F			
	Aug-15	Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
CANADA													
Overnight Target Rate	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.50
3-mth T-Bill Rate	0.99	0.91	0.87	0.97	0.92	0.98	1.02	0.95	0.95	0.95	0.95	1.05	1.40
2-yr Govt. Bond Yield	1.24	1.20	1.03	1.07	1.14	1.00	1.22	1.20	1.25	1.30	1.35	1.55	1.70
5-yr Govt. Bond Yield	1.96	1.57	1.25	1.30	1.38	1.30	1.80	1.75	1.90	2.00	2.10	2.20	2.35
10-yr Govt. Bond Yield	2.70	2.11	1.74	1.73	1.80	1.76	2.44	2.45	2.55	2.70	2.75	2.80	2.85
30-yr Govt. Bond Yield	3.16	2.66	2.33	2.32	2.36	2.50	2.89	2.95	3.05	3.10	3.15	3.20	3.25
10-yr-2-yr Govt Spread	1.46	0.91	0.71	0.66	0.66	0.76	1.22	1.25	1.30	1.40	1.40	1.25	1.15
U.S.													
Fed Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3-mth T-Bill Rate	0.05	0.07	0.09	0.10	0.05	0.07	0.04	0.10	0.20	0.20	0.20	0.20	0.20
2-yr Govt. Bond Yield	0.35	0.33	0.33	0.23	0.25	0.25	0.36	0.30	0.40	0.45	0.55	0.75	0.90
5-yr Govt. Bond Yield	1.55	1.04	0.72	0.62	0.72	0.77	1.41	1.25	1.40	1.50	1.60	1.75	1.90
10-yr Govt. Bond Yield	2.80	2.23	1.67	1.65	1.78	1.87	2.52	2.45	2.60	2.75	2.85	2.95	3.05
30-yr Govt. Bond Yield	3.82	3.35	2.76	2.82	2.95	3.10	3.52	3.65	3.75	3.90	4.00	4.00	4.05
10-yr-2-yr Govt Spread	2.45	1.90	1.34	1.42	1.53	1.62	2.16	2.15	2.20	2.30	2.30	2.20	2.15
CANADA - U.S SPREADS													
Can - U.S. T-Bill Spread	0.94	0.84	0.78	0.87	0.87	0.91	0.98	0.85	0.75	0.75	0.75	0.85	1.20
Can - U.S. 10-Year Bond Spread	-0.10	-0.12	0.07	0.08	0.02	-0.11	-0.08	0.00	-0.05	-0.05	-0.10	-0.15	-0.20

F: Forecast by TD Bank Group as at August 2013; All forecasts are end-of-period; Source: Bloomberg, Bank of Canada, Federal Reserve.

GLOBAL STOCK MARKETS	Aug-15	30-Day % Chg.	YTD % Chg.	52-Week High	52-Week Low
S&P 500	1,685	0.5	18.2	1,710	1,353
S&P/TSX Composite	12,639	1.0	1.7	12,879	11,811
DAX	8,367	2.0	9.9	8,531	6,895
FTSE 100	6,486	-1.1	10.0	6,840	5,606
Nikkei	13,753	-5.8	32.3	15,627	8,534
MSCI AC World Index*	378	1.7	11.1	380	317

* Is a weighted equity index including both developed and emerging markets
Source: Bloomberg.

COMMODITY PRICE FORECASTS	Price	52-Week	52-Week	2012				2013F				2014F				Annual Average		
	Aug-15	High	Low	Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	2012	2013F	2014F
Crude Oil (WTI, $US/bbl)	107	108	84	103	93	92	88	94	94	93	95	95	92	95	95	94	94	94
Natural Gas ($US/MMBtu)	3.36	4.38	2.63	2.45	2.28	2.88	3.40	3.50	4.01	3.85	4.05	3.90	4.00	3.90	4.25	2.75	3.85	4.01
Gold ($US/troy oz.)	1324	1790	1201	1690	1612	1655	1717	1632	1418	1275	1200	1175	1150	1175	1250	1668	1381	1188
Silver (US$/troy oz.)	21.9	35.0	18.5	32.6	29.5	30.0	32.6	30.1	23.3	19.6	17.9	17.8	17.0	18.0	19.3	31.17	22.71	18.00
Copper (cents/lb)	331	379	301	376	357	350	359	360	325	318	335	330	325	320	310	361	335	321
Nickel (US$/lb)	6.76	8.50	6.04	8.91	7.77	7.42	7.70	7.85	6.80	7.50	8.00	8.00	8.60	8.50	8.20	7.95	7.54	8.33
Aluminum (Cents/lb)	86	100	80	99	90	87	91	91	83	90	96	96	96	100	100	92	90	98
Wheat ($US/bu)	8.33	10.39	8.16	9.54	9.36	9.90	10.05	9.32	9.14	9.25	9.30	9.35	9.25	9.00	8.75	9.71	9.25	9.09

F: Forecast by TD Bank Group as at August 2013; All forecasts are period averages; Source: Bloomberg, USDA (Haver).

FOREIGN EXCHANGE OUTLOOK															
Currency	Exchange rate	Spot Price	2012				2013F				2014F				
		Aug-15	Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Exchange rate to U.S. dollar															
Japanese yen	JPY per USD	98.5	82.4	79.8	77.9	86.6	94.2	99.2	100.0	100.0	102.0	102.0	105.0	110.0
Euro	USD per EUR	1.32	1.33	1.27	1.29	1.32	1.28	1.30	1.27	1.24	1.23	1.22	1.22	1.20
U.K. pound	USD per GBP	1.55	1.60	1.57	1.61	1.63	1.52	1.52	1.49	1.48	1.46	1.45	1.49	1.46
Swiss franc	CHF per USD	0.94	0.90	0.95	0.94	0.92	0.95	0.95	0.98	1.02	1.06	1.07	1.07	1.08
Canadian dollar	CAD per USD	1.03	1.00	1.02	0.98	1.00	1.02	1.05	1.06	1.09	1.11	1.11	1.09	1.08
Australian dollar	USD per AUD	0.91	1.04	1.02	1.04	1.04	1.04	0.92	0.90	0.89	0.89	0.88	0.87	0.87
NZ dollar	USD per NZD	0.80	0.82	0.80	0.83	0.83	0.84	0.78	0.78	0.77	0.77	0.77	0.77	0.76
Exchange rate to Euro															
U.S. dollar	USD per EUR	1.32	1.33	1.27	1.29	1.32	1.28	1.30	1.27	1.24	1.23	1.22	1.22	1.20
Japanese yen	JPY per EUR	130	104	103	98	105	122	129	127	124	125	124	128	132
U.K. pound	GBP per EUR	0.85	0.84	0.81	0.79	0.81	0.85	0.85	0.85	0.84	0.84	0.84	0.82	0.82
Swiss franc	CHF per EUR	1.24	1.21	1.20	1.20	1.21	1.23	1.23	1.25	1.27	1.30	1.30	1.30	1.30
Canadian dollar	CAD per EUR	1.37	1.31	1.30	1.25	1.29	1.33	1.34	1.35	1.35	1.37	1.36	1.33	1.29
Australian dollar	AUD per EUR	1.45	1.24	1.27	1.21	1.25	1.27	1.32	1.41	1.39	1.38	1.39	1.40	1.38
NZ dollar	NZD per EUR	1.65	1.60	1.62	1.55	1.58	1.58	1.59	1.63	1.61	1.60	1.58	1.58	1.58
Exchange rate to Japanese yen															
U.S. dollar	JPY per USD	98.5	82.4	79.8	77.9	86.6	94.2	99.2	100.0	100.0	102.0	102.0	105.0	110.0
Euro	JPY per EUR	130	104	103	98	105	122	129	127	124	125	124	128	132
U.K. pound	JPY per GBP	153	125	127	124	131	143	152	149	148	149	148	156	161
Swiss franc	JPY per CHF	105.0	86.2	85.6	81.7	87.3	99.2	104.7	101.6	97.6	96.5	95.7	98.5	101.5
Canadian dollar	JPY per CAD	95.2	79.2	79.3	79.0	82.0	91.5	96.4	94.0	92.0	91.8	91.8	96.6	102.3
Australian dollar	JPY per AUD	89.6	83.7	80.9	81.7	84.5	95.8	97.8	90.0	89.0	90.8	89.8	91.4	95.7
NZ dollar	JPY per NZD	79.1	64.9	63.4	63.6	66.9	77.0	81.0	78.0	77.0	78.5	78.5	80.9	83.6
Exchange rate to Canadian dollar															
U.S. dollar	USD per CAD	0.97	1.00	0.98	1.02	1.00	0.98	0.95	0.94	0.92	0.90	0.90	0.92	0.93
Japanese yen	JPY per CAD	95.2	79.2	79.3	79.0	82.0	91.5	96.4	94.0	92.0	91.8	91.8	96.6	102.3
Euro	CAD per EUR	1.37	1.31	1.30	1.25	1.29	1.33	1.34	1.35	1.35	1.37	1.36	1.33	1.29
U.K. pound	CAD per GBP	1.61	1.57	1.60	1.57	1.59	1.56	1.57	1.59	1.61	1.63	1.61	1.62	1.57
Swiss franc	CHF per CAD	0.91	0.92	0.93	0.97	0.94	0.92	0.92	0.93	0.94	0.95	0.96	0.98	1.01
Australian dollar	AUD per CAD	1.06	0.95	0.98	0.97	0.97	0.96	0.99	1.04	1.03	1.01	1.02	1.06	1.07
NZ dollar	NZD per CAD	1.20	1.22	1.25	1.24	1.23	1.19	1.19	1.20	1.19	1.17	1.17	1.19	1.22

F: Forecast by TD Bank Group as at August 2013; All forecasts are end-of-period: Source: Federal Reserve, Bloomberg, TDBG.